Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – June 2017

Launch date	**19.12.13**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (manager) **Sharukh Malik** (analyst)

Aim

The Guinness Asian Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Asia Pacific region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

Performance 31/05/2017

Fund	Guinness Asian Equity Income (X)
Index	MSCI AC Pacific ex Japan Index
Sector	IA Asia Pacific ex Japan

	2014		2015		2016	
	USD	GBP	USD	GBP	USD	GBP
Fund	10.7	17.6	-4.4	1.2	7.5	28.2
Index	1.8	8.1	-9.4	-4.1	7.8	28.6
Sector	3.1	9.5	-8.6	-3.4	5.3	25.7

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	17.1	12.1	24.7	40.5	35.5	71.8
Index	17.4	12.3	26.1	42.2	19.3	51.2
Sector	18.7	13.6	24.8	40.7	20.4	52.6

Annualised % total return from launch

	USD	GBP
Fund	9.2%	17.0%
Index	5.3%	12.7%
Sector	5.5%	13.0%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.6	1.6	4.9	5.8
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.7	0.7
Max drwdn	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	4.0	4.0	5.7	5.7
Volatility	14.9	15.8	13.3	13.9	12.5	14.3
Sharpe ratio	0.1	0.6	0.1	0.7	0.5	1.0

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.

Source: Financial Express, bid to bid, gross total return.

Fund & Market

- The Fund invests in good quality companies, defined as those whose cash flow returns on capital that have been sustained over many years and whose stock prices, in our opinion, undervalue the likely persistence of those returns.

- With this approach, we expect the Fund's performance to capture most, but not all, of the rise in strong market conditions and provide greater downside protection in weak markets. In May, and for the year to date, the Fund's performance has been ahead of expectations.

- Asian markets, as measured by MSCI Pacific ex Japan, rose 2.81% in May in dollar terms, ahead of the S&P 500 Index which rose 1.41% but behind Europe and the UK, whose markets were over 4% higher. In the year so far, Asia (up 17.52%) and Europe up (18.92%) have been the strongest regions.

Events in May

- Chinese policymakers have re-focused on financial deleveraging in banks and non-bank financial institutions by increasing domestic money market rates through open market operations and by more onerous requirements of the banking regulator.

- Risks in the Korean peninsula have diminished. South Korea impeached President Park but her replacement has been widely welcomed. There has also been improvement in relations between China, South Korea and the US over North Korea. While perhaps not a 'meeting of minds', there is evidence of a more coordinated response.

- Technology is a stand-out sector in Asia, driven by renewed product advances in

- smartphones and a cyclical rise in component prices – memory chips and OLED display technology being two key areas.

- Economic growth and pricing power in the region have been better than expected, prompting analysts to upgrade their profit forecasts.

- Regional currencies have strengthened, especially the Korean won, Taiwanese dollar, the Thai baht and most recently the Chinese renminbi.

Outlook & Risks

- Asian markets as measured by MSCI Pacific ex Japan are still trading at a 28% discount to developed markets as measured by the MSCI World Index on an historic Price/Earnings (P/E) multiple basis.

- The Fund is trading at an 8% discount to Asia on a P/E basis while offering a similar forecast earnings growth profile.

- The consensus of analysts' estimates puts profit growth at 8% for the next two years, which, although lower than developed markets, is both better than prior years and is made more attractive, in our opinion, by the lower valuations.

- A key risk to market expectations, but one of which we are well aware, is of slower Chinese growth in coming months. Efforts to rebalance the economy and tackle leverage will exert a drag on growth and China is committed to tackling these issues.

- Slower Chinese growth is likely to be felt in weaker commodities prices, heavy industry and construction – all sectors that require volume growth to make a profit.

We try to mitigate ongoing macro uncertainties by focusing investment in those companies that have achieved profitability without requiring favourable policy or cyclical support.

Discussion

China

China remains a concern to many, but we continue to argue that we think those concerns are excessive. The focus is on the accumulation of debt in China and a fear that this will precipitate financial crisis. Others see stronger growth in China over the last six to nine months and are betting on a cyclical recovery, increasing their exposure to the heavy industrial and materials sectors that have been beaten down in the past few years.

Our view is that China offers some excellent investment opportunities among good companies whose valuations have been depressed by bearish macro views. We caution, however, against buying into companies that are beneficiaries of a perceived cyclical recovery, because there are other forces at work. China is in the process of tackling its debt and excess capacity issues, but these efforts exert a drag on growth. A stronger cyclical recovery provides more headroom to intensify these efforts and hence growth momentum is likely to slow. In short, we believe that the right strategy is to focus on the quality Chinese businesses that supply goods and services that consumers want to buy, rather than those companies which were once used to drive economic growth.

Technology

Technological innovation in Asia is focused primarily on production rather than original design, and in both quantity and quality of production, Asian companies excel. Most smartphones, tablets and PCs are assembled there and their chips, screens and components are made there.

Two big stories in the Asian tech sector are propelling stock prices at present: the smartphone 'super-cycle' which is being driven by Apple, and rising component prices, from memory to screens and even to casings. In smartphones, the anticipated introduction of the new iPhone is significant because its range of product advances and new features have a major impact throughout the supply chain. OLED screens, glass cases, dual high-definition cameras, faster processing and more memory all support average selling prices for the companies that supply. Volume estimates for shipments of the new device are around 210m for 2017, 250m in 2018 and 270m in 2019. The features adopted by the iPhone are likely to be adopted by Samsung and the Chinese manufacturers in due course.

The most important areas of development for component prices are memory chips and OLED screens. Memory capacity has tightened in recent years, which has collided with a significant increase in demand from the smartphone sector and a stabilization in demand from PCs and tablets. In the world of displays, OLED technology has arrived sooner than was expected. These new screens are higher-definition and because they do not require backlighting they can be lighter and more flexible. Smartphone casings have also been given a new lease of life with the introduction of glass (to allow for wireless charging). The frames required to hold such casings together command higher prices and this has been a key reason for the performance of Catcher Technology, which is held in the portfolio.

Momentum in the technology sector seems likely to continue. It should be noted that rising component prices are likely to lead eventually either to compressed margins for suppliers or, if passed on to end customers, lower final demand.

Earnings and valuations

The Asian region, as measured by the MSCI Pacific ex Japan Index, is still trading at a 28% discount to developed markets on a P/E basis. We believe this discount is too wide (and our Fund, even with its portfolio of quality businesses, is cheaper still) and is based on views that are 15 years out of date. First, we believe investors still view the regional economies as overly dependent upon external demand for commodities and exported goods and have failed to take account of the considerable influence now wielded by consumers. The economic cycle is demonstrably less volatile as a consequence. Secondly, although the perception persists that companies in the region are poorly managed or too dependent upon outside factors, we can point to a significant subset of some 500 companies whose profitability and returns on investment have improved and have been sustained since the Asian economic crisis of 20 years ago.

The case for the region – that of better companies in a more diversified operating environment – is given further weight by the improvement in earnings expectations for the next two years. From 2010 to 2015, Asian markets were effectively sidelined by the bull market in the US. This was reasonable, given the lack of earnings growth over the period of 0.5% per annum on average, but also led to valuation compression. Consensus estimates reported by Bloomberg point to profits growth of 14% this year and 8% in 2018 and 2019. The P/E multiples of 13.8x estimated 2017 profits and 12.7x 2018 make the region, in our opinion, more attractive, not less.

Portfolio

The portfolio is made up of 36 stocks which we believe are undervalued by the market relative to the likely persistence of returns on invested capital that the underlying companies can generate. Each stock is equally weighted, making a 'best ideas' portfolio.

The best performing stocks were: Hanon Systems, a Korean company which manufactures climate control systems for conventional and electric vehicle engines and which rose 24%; Relo Group, which provides relocation services for Japanese executives and was up 23%; China Merchants Bank, privately owned and the most retail-focused of China's banks, which rose 16%; and Yangzijiang Shipbuilding, whose recent results and new orders came in ahead of expectations, and Belle International, a Chinese designer and retailer of footwear that is in process of being acquired, which both rose 15%.

The weakest stock by far was AAC Technologies, which fell 27% before being suspended following the issue of a report by a short-seller, Gotham, alleging the company was engaged in dubious accounting practices. The report was, in our opinion, deeply flawed. Following the month-end AAC produced a report of investigations conducted by an independent party that laid these allegations to rest fairly comprehensively. The stock has recommenced trading and made back most of the losses, and Gotham's reputation has taken a dent.
Other weak performers during the month were LPN Development, a Thai property developer; Luk Fook Holdings, a jewellery retailer in Hong Kong and China; JB Hi-Fi of Australia, a discount retailer of electrical goods, which fell 7% following news that Amazon is about to increase its Australian presence; and Largan Precision of Taiwan, a maker of camera lenses for smartphones which fell 5%.

Outlook

Asia has had a very strong start this year, with the MSCI Pacific ex Japan Index up over 8% more than the S&P 500 Index. If we look back to end of the third quarter of 2016 and include Asia's fall in the last 3 months of the year, then the two are almost exactly in line up around 12%. We have therefore seen a bounce and a recovery, but this does not mean that there is no further to go. Asia's valuation discount remains, earnings upgrades are evident and Asian currencies are tending to strengthen still. In the last few weeks that currency strength has also included China's renminbi.
Our belief is that since many investors remain underweight to Asia and with valuations in the US market looking stretched, there are strong arguments for looking at the region. The macro uncertainties and unfamiliarity with the countries and companies can be removed by focusing on what you buy rather than where you buy. Our focus is therefore on companies that can show a long track record of strong financial discipline and performance, and on identifying those whose current market price undervalues those qualities and their persistence.

Edmund Harriss & Mark Hammonds
(portfolio managers)
Sharukh Malik (analyst)

Data sources

Fund performance: *Financial Express, gross total return*

Index and stock data: *Bloomberg*

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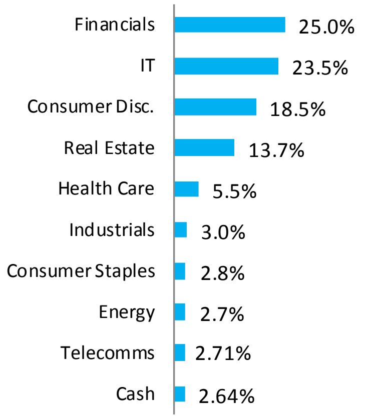
PORTFOLIO

31/05/2017

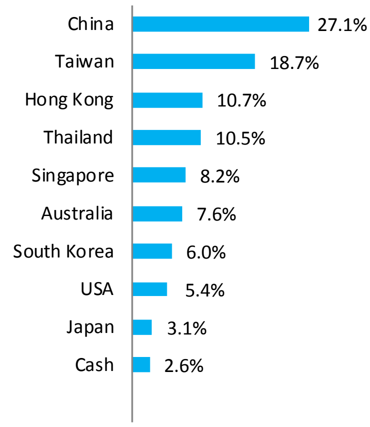
Fund top 10 holdings

Hanon Systems	3.2%
Relo Holdings	3.1%
China Merchants Bank	3.1%
Catcher Technology	3.0%
Yangzijiang Shipbuilding	3.0%
St. Shine Optical Co	2.9%
China Minsheng Banking	2.9%
Tisco Financial Foreign	2.8%
BOC Hong Kong	2.8%
Link REIT	2.8%
% of Fund in top 10	29.6%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

31/05/2017

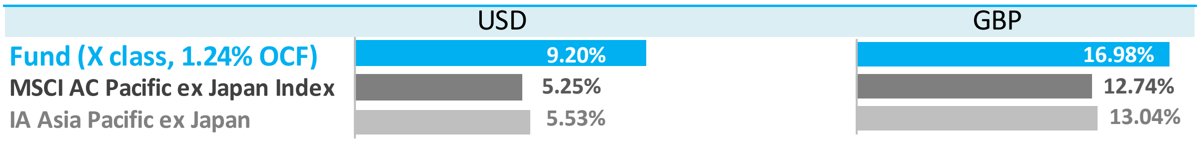
Discrete years % total return

	May '13		May '14		May '15		May '16		May '17	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (X class, 1.24% OCF)	-	-	-	-	19.4	31.2	-13.4	-9.2	24.7	40.5
MSCI AC Pacific ex Japan Index	21.1	22.9	8.7	-1.7	5.2	15.6	-15.9	-11.8	26.1	42.2
IA Asia Pacific ex Japan	22.0	23.9	6.8	-3.5	5.2	15.7	-14.6	-10.5	24.8	40.7

Cumulative % total return

	1 month		Year-to-date		1 year		3 years		From launch	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (X class, 1.24% OCF)	3.1	3.3	17.1	12.1	24.7	40.5	28.9	67.5	35.5	71.8
MSCI AC Pacific ex Japan Index	2.8	3.0	17.4	12.3	26.1	42.2	11.5	44.9	19.3	51.2
IA Asia Pacific ex Japan	3.3	3.6	18.7	13.6	24.8	40.7	12.1	45.7	20.4	52.6

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/05/2017	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.6	1.6	4.9	5.8
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.7	0.7
Maximum drawdown	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
R squared	1.0	1.0	0.9	0.9	0.9	0.9
Sharpe ratio	0.1	0.6	0.1	0.7	0.5	1.0
Tracking error	0.0	0.0	4.0	4.0	5.7	5.7
Volatility	14.9	15.8	13.3	13.9	12.5	14.3

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Source: Financial Express, bid to bid, gross total return. Fund launch date: 19.12.2013.

Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about equities and equity markets invested in by the Guinness Asian Equity Income Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

Risk

The Guinness Asian Equity Income Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment and the income from it can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. The Fund invests only in stocks of companies that are traded on Asian stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. Details on the risk factors are included in the Fund's documentation, available on our website. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Fund. This will have the effect of lowering the capital value of your investment.

Documentation

The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available from the website www.guinnessfunds.com, or free of charge from:-

- the Manager: Capita Financial Managers (Ireland) Limited, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

Residency

In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients. **NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.**

Structure & regulation

The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

Switzerland

The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

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