Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – August 2017

Launch date	**19.12.13**
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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 31/07/2017

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	23.6	15.8	20.4	21.2	43.0	77.5
Index	25.9	18.0	25.3	26.2	28.0	58.9
Sector	25.9	18.0	22.4	23.3	27.7	58.5

Annualised % total return from launch

	USD	GBP
Fund	10.4%	17.2%
Index	7.1%	13.7%
Sector	7.0%	13.6%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.7	1.6	4.8	5.4
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.6	0.6
Max drwdn	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	3.9	3.9	5.7	5.7
Volatility	14.7	15.5	13.2	13.7	12.4	14.1
Sharpe ratio	0.2	0.7	0.3	0.7	0.6	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.

Markets and performance

- Asian markets accelerated in July, rising 5.0% in the month (in USD)
- July was the second strongest month for Asian markets so far this year
- The fund generated a positive return, but lagged the benchmark
- Our expectation is that the fund will not capture all of the upside in very buoyant market conditions

Earnings

- Consensus forecasts currently expect Asia to grow earnings by 31% this year
- Korea is forecast to grow earnings by 56%, driven in part by Samsung Electronics, which is forecast to have a very strong recovery in earnings
- Earnings estimates have been revised up over the course of the year
- The combination of robust growth and positive revisions has led to the impressive rally Asia has experienced

Information Technology

- Information Technology remains the best performing sector in Asia this year and is also the top sector within global developed markets
- The China internet stocks—Tencent, Alibaba and Baidu—as well as Samsung Electronics have been significant contributors to the benchmark's returns
- While these companies do not meet the fund's criteria for inclusion, our holdings in Information Technology have been among the best performers in the portfolio

China

- China’s financial markets have been undergoing a process of liberalisation
- Inclusion of A-shares in the MSCI Emerging Markets Index will have a modest impact initially, but one that could grow meaningfully over time
- The introduction of the Bond Connect programme, which has gone unnoticed by many, marks a significant step towards the opening of China’s markets

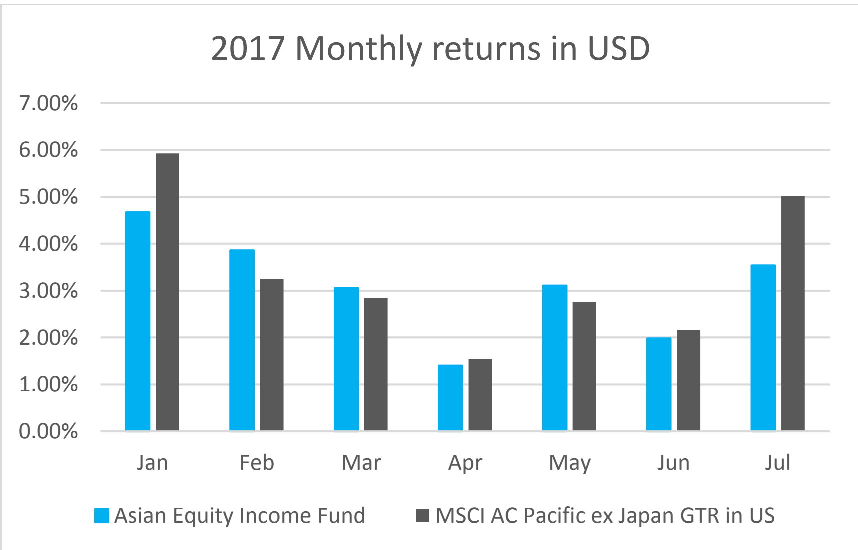
Outlook

- Asia still trades at a sizeable discount to developed markets
- The portfolio – with its bias towards quality – trades at a further discount, and offers an attractive dividend yield
- Investors seem to have set aside their concerns recently, but risks remain, both for developed markets and also for Asia
- In an uncertain environment, we believe it is crucial to focus on quality. We invest in companies that have a track record of generating persistent returns on capital

Monthly review

Markets and performance

Asian markets were very strong in the first half of the year, and that strength accelerated in July. The market gained 5.0% in the month (in USD), making it the second strongest month so far this year. The fund, while still generating a good return, lagged the market in July. For the year to date the fund has returned 23.6%, while the market has returned 25.9%. The following chart shows how this performance has evolved month by month:



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

Our expectation—consistent with the picture above—is that the fund will not capture all of the upside in very buoyant market conditions. Historically, the fund has tended to outperform in falling markets, capturing less of the downside. Nevertheless, the ability of the fund to capture upside in the rising markets this year (and last) has been encouraging.

Earnings

A significant driver of the returns in Asia this year has been an improved outlook for earnings. Consensus forecasts currently expect Asia (as reflected by the MSCI AC Pacific ex Japan Index) to grow its earnings by 31% this year and 9% next year. This performance should be seen in the context of a weak 2016, when earnings fell 13%. This recovery in earnings has been fairly broad-based, with many individual countries also forecast to grow earnings at an impressive rate. Korea, for example, is forecast to grow earnings by 56% (MSCI Korea Index). While Samsung Electronics, discussed below, accounts for a lot of this (the company is expected to grow earnings by 91% and represents more than 30% of the index when preferred shares are included), Korea excluding Samsung is still expected to offer some of the highest earnings growth in the region.

While analysts generally have a habit of starting the year with an optimistic growth forecast, then slowly reducing it over the course of the year, this year we have seen the opposite; earnings revisions have been positive.

It is this combination of robust growth and positive revisions that has led to the impressive rally this year.

Information Technology

The standout sector this year has been Information Technology, which, as the best performing sector within Asia, has risen 47.2%. This trend has also not been confined to the region – it has also been the best performing sector within global developed markets.

We have written about the sector already this year, during its positive run. Looking among Information Technology companies, some of the greatest contribution to the benchmark has come from the 'China internet' stocks: Tencent, Alibaba and Baidu. We don't own these names in the portfolio – their contribution to income is either insufficient or non-existent – but their sizeable weight in the benchmark has a strong influence over its returns.

Another company that has driven the benchmark returns has been Samsung Electronics. While there is plenty to admire about the company and its achievements, Samsung does not qualify for our investment universe as it has not achieved persistently high returns on capital. Some of the industries in which the company operates are highly capital-intensive, such as the manufacture of memory chips. Indeed, it has been a part of the company's strategy to make large capital investments with the aim of eventually dominating the supply of a particular product or component. A recent example of this is the announcement of 20 trillion won ($18bn) of investment in its Pyeongtaek semiconductor manufacturing facility.

Our investment process focusses heavily on the cash returns generated by Asian companies, and the capital investment required to generate them. The requirement for a company to have achieved persistently high returns on capital for eight consecutive years leads us to a universe of around 300 companies, with a number of those in the Information Technology sector.

Of our portfolio of 36 companies, nine are in the Information Technology sector, operating in a range of industries from consumer electronics manufacture and assembly to component manufacture and semiconductor design and fabrication. Several have been among the portfolio's top performers this year, including Catcher Technologies (+66.0%; smartphone casing), Largan Precision (+55.7%; smartphone camera lenses), Hon Hai (+55.3%; product assembly), and AAC (+50.2%; acoustic and vibration components). In contrast, the worst performing Information Technology stock has been Qualcomm (–16.8%; chip designer). Qualcomm's share price has struggled this year with the company's dispute with Apple, its customer, over royalties.

China

China is on a journey to liberalise its financial markets. While the ride is not always smooth, the direction of travel is clear. In recent months, two significant developments have advanced the liberalisation of China's markets, though one seems to have escaped much attention.

In June, MSCI announced its decision to include Chinese A-shares in its Emerging Markets benchmark from next year. Initially, this will be implemented modestly; for the 222 companies that will be admitted, only 5% of the free float market cap will included and the resulting weight in the benchmark of the A-shares will only be about 0.7%. However, if the experience of Korea and Taiwan is anything to go by, this 'inclusion factor' could rise significantly over the coming years, leading to meaningful capital inflows. (We published a detailed discussion of the MSCI decision shortly after it was announced – please contact us if you would like a copy.)

One of the key developments that allowed A-shares to be accepted by MSCI for inclusion has been the Stock Connect programmes linking the Hong Kong and Shanghai and Shenzhen stock markets. The programme has made domestic Chinese shares far more accessible to offshore investors (in addition to adding to demand for Hong Kong listed shares by onshore Chinese investors).

The development in July that many overlooked was the announcement and launch of a similar scheme for the fixed income market, the Bond Connect programme. China has the world's third largest bond market, behind the US and Japan, but foreign ownership of domestic bonds has so far been very low. The Bond Connect will make it easier for foreigners to own bonds, while potentially being a key contributor of capital inflows. Again, if the experience of Korea and Taiwan is anything to go by, the opening up of domestic bond markets represent a significant milestone in financial market liberalisation.

The analogue of the MSCI emerging market indices for bonds are the JP Morgan EMBI indices. A decision to include Chinese onshore bonds within emerging market bond indices would again represent a very important step on China's ongoing journey.

Portfolio

The best performing stocks in July were Yangzijiang Shipbuilding, which rose 20.7%, JB Hi-Fi, an Australian retailer of home consumer products, which rose 15.7%, and Largan Precision, a manufacturer of smartphone camera lenses, which rose 14.1%. Industrial and Commercial Bank of China and China Merchants Bank were also strong performers as they were less affected by the current deleveraging drive within the banking system.

Over the past few years the demand for new ships has fallen significantly as a result of oversupply in the shipping industry and extremely low shipping rates. However, orders for new ships seem to be picking up, and we are seeing demand particularly for new bulk carriers and tankers rather than LNG carriers. Industry data indicates that of the eight orders globally for bulk carriers in July, seven went to Yangzijiang. This is no accident and we maintain our view that Yangzijiang is a quality company. As we have said in the past, it is quite remarkable that in the cyclical shipbuilding industry, Yangzijiang has managed to generate a return on capital above its cost of capital throughout the cycle.

The weakest stock was Sonic Healthcare, a provider of medical diagnostics services in Australia, whose share price fell 4.3%. Other weaker performers were Catcher Technology, a Taiwanese company which manufacturers metal casings for smartphones, which fell 4.1%, and Qualcomm, which fell 3.7% as a result of its legal dispute with Apple.

Outlook

Back in June we noted that the MSCI AC Pacific ex. Japan Index was almost neck-and-neck with the S&P 500 Index from the end of the third quarter to the end of May. Now Asia is 4.5% ahead.

Despite the strong recent performance, Asia still trades at a sizeable discount to developed markets, and the portfolio – with its bias towards quality – trades at a further discount. Partly reflecting this, the portfolio companies offer an attractive dividend yield, diversified across multiple currencies.

As is often the case in a bull market, investors seem to have set aside their concerns, with measures such as the VIX index indicating a high degree of complacency. As the markets hit new highs, valuations in the US in particular look more and more stretched. But while we think Asian valuations are attractive, the region is not without its own risks and difficulties. In part, these represent known problems. We have written many times about the economic transition that China is going through: shifting away from investment towards consumption, restructuring industries with excess capacity and dealing with the build-up of bad debts in these sectors. But there are also problems that are harder to predict; geopolitical interventions, either locally or internationally, can rapidly change the outlook.

Given this uncertain environment, we think the best response is to focus on quality – companies with persistently strong track records. Such businesses have often thrived despite the economic challenges that were thrown at them in the past, and we hope they will continue to do so in future.

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

Data sources

Fund performance: *Financial Express, gross total return*

Index and stock data: *Bloomberg*

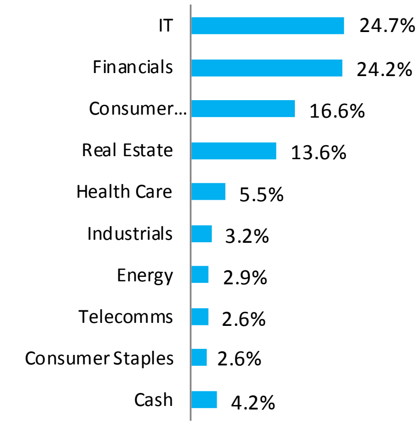
PORTFOLIO

31/07/2017

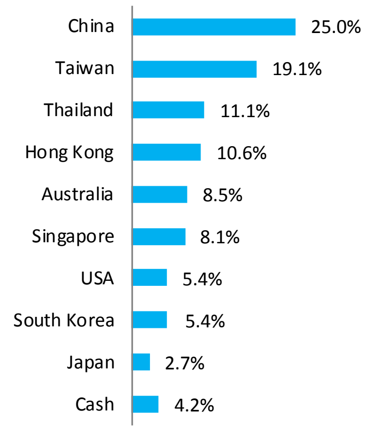
Fund top 10 holdings

JB Hi-fi	3.2%
Yangzijiang Shipbuilding	3.2%
Largan Precision	2.9%
PTT Public Company	2.9%
Delta Electronics	2.8%
Ascendas Real Estate Trust	2.8%
Hanon Systems	2.8%
China Merchants Bank	2.8%
LPN Development	2.8%
Hon Hai Precision Industry	2.8%
% of Fund in top 10	28.9%
Total number of stocks in Fund	35

Sector analysis



Geographic allocation



PERFORMANCE

31/07/2017

Discrete years % total return

	Jul '13		Jul '14		Jul '15		Jul '16		Jul '17	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (X class, 1.24% OCF)	-	-	-	-	3.4	11.9	1.8	19.6	20.4	21.2
MSCI AC Pacific ex Japan Index	8.1	11.7	18.7	6.6	-9.6	-2.2	0.3	17.8	25.3	26.2
IA Asia Pacific ex Japan	9.1	12.8	17.2	5.3	-7.2	0.4	0.3	17.9	22.4	23.3

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)	3.5	2.0	23.6	15.8	20.4	21.2	26.7	62.3	43.0	77.5
MSCI AC Pacific ex Japan Index	5.0	3.5	25.9	18.0	25.3	26.2	13.6	45.5	28.0	58.9
IA Asia Pacific ex Japan	4.5	3.0	25.9	18.0	22.4	23.3	14.0	46.0	27.7	58.5

Annualised % total return from launch

	USD	GBP
Fund (X class, 1.24% OCF)	10.39%	17.18%
MSCI AC Pacific ex Japan Index	7.06%	13.66%
IA Asia Pacific ex Japan	6.99%	13.58%

Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/07/2017	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.7	1.6	4.8	5.4
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.6	0.6
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	0.2	0.7	0.3	0.7	0.6	1.0
Tracking error	0.0	0.0	3.9	3.9	5.7	5.7
Volatility	14.7	15.5	13.2	13.7	12.4	14.1

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 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.

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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.

Singapore

The Fund is not authorised or recognised by the Monetary Authority of Singapore ("MAS") and shares are not allowed to be offered to the retail public. The Fund is registered with the MAS as a Restricted Foreign Scheme. Shares of the Fund may only be offered to institutional and accredited investors (as defined in the Securities and Futures Act (Cap.289)) ('SFA') and this material is limited to the investors in those categories

Telephone calls may be recorded and monitored.