Guinness Best of China Fund

INVESTMENT COMMENTARY – March 2018

Launch date	**15.12.15**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (manager) **Sharukh Malik** (analyst)

Aim

Guinness Best of China Fund is designed to provide investors with exposure to economic expansion and demographic trends in China and Taiwan.

The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle

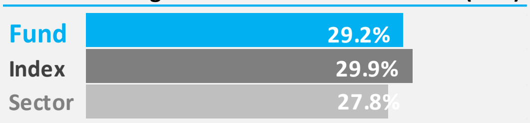
Performance

28.02.2018

Fund	Best of China Fund
Index	MSCI Golden Dragon
Sector	IA China/Greater China

	1 year	3 years	From launch
Fund	25.4	-	76.0
Index	23.2	57.5	78.2
Sector	27.6	59.8	71.9

Annualised % gross total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.2	1.1
Beta	1.0	0.9	0.9
Info ratio	0.0	-0.4	-0.1
Max drwdn	-12.9	-16.8	-14.2
Tracking err	0	5	6
Volatility	18.4	17.9	18.1
Sharpe ratio	1.4	1.3	1.3

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 0.74% OCF.

Fund & Market

- In February the Guinness Best of China Fund rose by 0.4% in GBP terms while the benchmark fell by 2.0%, therefore the fund outperformed by 2.4%.
- Globally, markets sold off in the first week of the month. This was because of better-than-expected economic data in the US, especially stronger wage growth in January, which led to rising expectations of interest rate hikes in the US. The US 10-year treasury yield approached 3%.
- From the peak of the market on 26th January to the trough on 9th February, the fund fell by 6.9% while the benchmark fell by 8.9%. The fund herefore outperformed by 2.0% over this period.
- In February the MSCI China Index fell 3.7%, compared to the Hong Kong and Taiwan indices which fell 0.4% and 1.4% respectively. The S&P 500 Index fell by 0.9% while MSCI Europe fell by 2.7%. Year-to-date, however, China is up 3.2% compared to the US down 0.1% and Europe down 2.6%.
- In China the most defensive sectors were Consumer Staples and Health Care which rose 3.2% and 2.9%. The weakest sectors were Real Estate and Telecoms which fell 8.9% and 8.8%.
- In Taiwan, Information Technology, which makes up more than half of the index, fell 2.3%. Companies in the Apple supply chain guided for weaker-than-expected first quarter results.
- The fund's strongest stock by far was AAC Technologies following several broker upgrades.
- In a month of few results announcements, Hollysys Automation was a bright spot with a long-awaited recovery in railway orders leading to a significant improvement in earnings. On the other hand, Lenovo's results were mixed, with better performance in its data centre business offset by weak volume growth in its smartphone business.

Events in February

- The Communist Party's Central Committee recommended removing the two-term limit for the presidency from China's constitution. This will pave the way for Xi Jinping to stay in power beyond 2022, highlighting how powerful he has become.

- The Chinese insurance regulator took control over management of Anbang Insurance and its founder is being prosecuted for fraud. Anbang's model of funding purchases of trophy assets abroad with short-term insurance products was beginning to become too big a problem for policymakers to ignore. The move is evidence that China is serious about controlling systemic financial risks.

- Trade tensions continued to increase. After imposing import tariffs on washing machines and solar panels from China, the US is planning to introduce tariffs on imported steel. These will hurt firms in Canada, Korea, Mexico and Brazil, which are far bigger exporters of steel to the US than China.

- Geely Automobile's parent company, Zhejiang Geely, bought a $9bn stake in Daimler worth just under 10%. The aim behind the deal is to cooperate on electric vehicles following recent deals signed by Chinese competitors with other foreign carmakers.

- The official Purchasing Managers Index, which is tilted towards state-owned enterprises, was weaker than expected at 50.3. On the other hand, the Caixin PMI index, which is more geared towards small and medium enterprises, came in stronger than expected at 51.6.

February in review

The Communist Party's Central Committee recommended removing the two-term limit for the presidency role from the country's constitution. Of Xi Jinping's three main titles this is the only one with a formal limit. His other two main titles, chairman of the party and head of the Central Military Commission, have no formal limits. Though the timing of the announcement was perhaps a surprise, the move to scrap the limit was virtually confirmed in October 2017 when the new politburo was unveiled with no apparent heir to Xi. The committee is also proposing to engrain "Xi Jinping Thought" into the party's constitution. Hitherto only Mao and Deng Xiaoping have had their ideas named after them. This shows powerful Xi has become, in stark contrast to his immediate two predecessors, Hu Jintao and Jiang Zemin, who governed as "first among equals". His predecessors ruled in accordance with Deng's famous motto "hide your strength, bide your time" but Xi himself apparently aims to govern differently. He seems to want China to become much more prominent in foreign policy; to develop trade and infrastructure links through the Belt and Road Initiative; and to become a leader in technologies such as electric vehicles, aerospace and cybersecurity.

The Chinese insurance regulator took control over the management of Anbang Insurance and its founder, Wu Xiaohui, is being prosecuted for fraud. Wu is the husband of Deng Xiaoping's granddaughter and is politically well connected; the fact that this did not save him from prosecution means China is serious about controlling the risks in its economy. The problem with Anbang was the way it structured its growth. It relied on short-term insurance products to fund purchases of longer-term assets, creating a duration mismatch. This is potentially dangerous as if most of these liabilities are redeemed at the same time it is impossible to sell the long-term assets to match them. Another problem were the long-term assets itself. Anbang bought trophy assets like hotels and real estate in the US, with little relevance to insurance. This is not what the Chinese government intends when it encourages domestic companies to expand abroad.

Trade tensions between the US and China have certainly stepped up a level in 2018. In January the US imposed an import tax on washing machines and solar panels, aimed predominantly at China (and to a lesser extent South Korea). At the end of February the US was planning to impose a 25% tariff on imported steel and a 10% tariff on aluminium. This was done on the grounds of national security, a technicality allowed under World Trade Organisation rules but seldom used. US steelmakers have long complained that the Chinese government subsidises its steelmakers, allowing Chinese companies to become competitive at artificially low prices. However, out of 34.5 million tonnes of steel imports into the US, China accounted for only 0.74m, or 2.1%. In fact, steel producers in Brazil, Canada, Mexico and South Korea, which together account for 48% of imports to the US, are the ones that stand to lose the most. The likelihood is that the affected countries, including the EU, will introduce their own tariffs on US imported products.

February's purchasing managers index (PMI) data was mixed (where a score above 50 means expansion, below 50 signals contraction). The official PMI index, which is tilted towards state-owned enterprises, was weaker than expected at 50.3 – still expanding, but only just. On the other hand, the Caixin PMI index, which is more geared towards small and medium enterprises, came in stronger than expected at 51.6. Non-manufacturing PMI was much brighter at 54.4. In Hong Kong fourth quarter GDP accelerated to 3.4%, meaning overall growth in 2017 was a healthy 3.9%. In Taiwan economic data remains solid, with fourth quarter GDP rising 3.3%. Yang Chin-long was appointed as the new governor of the central bank, replacing Perng Fai-nan who was in place for twenty years.

Company news

AAC Technologies

AAC Technologies was the strongest stock over the period, rising 22.6%. AAC is known for its speakerboxes and haptics in smartphones. The company is now diversifying into new areas such as metal casings for smartphones and hybrid lenses using a proprietary production technique. The share price was weak towards the end of 2017 due to 1) weaker-than-expected sales of the iPhone X, for which AAC is a supplier, and 2) a smartphone inventory correction in China, which affected most firms in the supply chain. We hold AAC because we think it has innovative product development capabilities which give the company an edge; for example, Samsung's new GS9 phone incorporates stereo sound and is 1.4x louder, and AAC is one of two suppliers. China smartphone maker Vivo launched its new concept phone which boast a 98% screen-to-body ratio with hidden in-display speaker system called 'Screen SoundCasting'. The all-screen design will need either a compact speaker grille or an under-display speaker. Either solution will lead to a meaningful average selling price (ASP) increase.

吉利汽车
GEELY AUTO

Geely Automobile's parent company, Zhejiang Geely, bought a $9bn stake in Daimler worth just under 10%. The aim behind the deal is to cooperate on electric vehicles, an area in which Chinese competitors have been signing deals with foreign companies. For example, Daimler also recently announced a deal with BAIC Motor to build a new $1.9bn factory in China with the capability to produce electric vehicles. BMW is in talks with Great Wall Motor to produce electric Minis. Zhejiang has history when it comes to foreign firms; it bought Volvo in 2010 and Geely benefited from the technology acquisition. As a result, Geely sold over a million cars in 2017 for the first time in its history and is aiming to increase volumes by over 50% in 2018.

The Chinese earnings season is in March, so few of our companies have reported. Among those that did we were encouraged to see Hollysys Automation reporting good results. It provides industrial automation units and railway equipment. Railway orders were delayed during 2016 and 2017 but have finally recovered which provided a solid boost to earnings. Lenovo's results were mixed. It is well known for its PC business, where it is losing some market share but is maintaining its margins. It was good to see that the data centre business grew revenue after many quarters of decline and that the segment's losses declined. More worrying is the mobile business, where Lenovo is refocusing its efforts on the US and Latin America to reduce losses, but this will be at the expense of lower volumes.

On a 2018 price/earnings multiple basis, the fund is trading at a 9% discount to the market as measured by the MSCI Golden Dragon Index. This index is in turn trading at a 14% discount to developed markets.

Edmund Harriss and **Mark Hammonds** (portfolio managers)
Sharukh Malik (analyst)

Data sources

Fund performance: *Financial Express, gross total return*

Index and stock data: *Bloomberg*

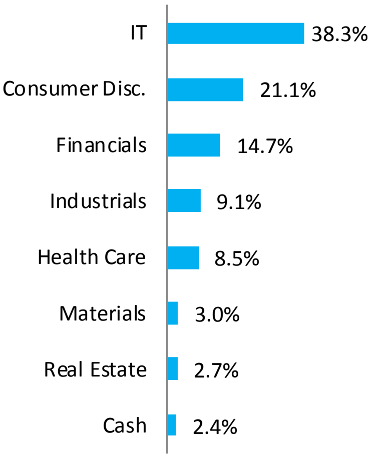
PORTFOLIO

28/02/2018

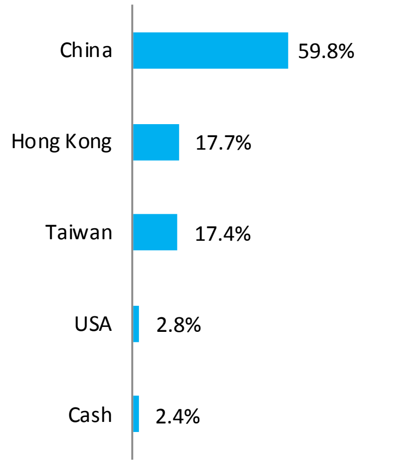
Fund top 10 holdings

Geely Automobile Holdin	3.4%
Haitian International Hol	3.2%
Catcher Technology	3.2%
Elite Material	3.2%
AAC Technologies	3.2%
Li & Fung	3.1%
Lenovo	3.1%
Yangzijiang Shipbuilding	3.1%
New Oriental Education &	3.0%
Anhui Conch Cement	3.0%
% of Fund in top 10	31.6%
Total number of stocks	33

Sector analysis



Geographic allocation



PERFORMANCE

28/02/2018

Annualised % gross total return from launch (GBP)

Fund	29.2%
MSCI Golden Dragon Index	29.9%
IA China/Greater China sector average	27.8%

Discrete years % gross total return (GBP)	Feb '14	Feb '15	Feb '16	Feb '17	Feb '18
Fund	-	-	-	45.5	25.4
MSCI Golden Dragon Index	-6.9	26.8	-12.1	45.5	23.2
IA China/Greater China sector average	-3.3	17.7	-11.2	41.1	27.6

Cumulative % gross total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	0.4	0.8	25.4	-	-	76.0
MSCI Golden Dragon Index	-2.0	2.4	23.2	57.5	86.0	78.2
IA China/Greater China sector average	-2.2	2.3	27.6	59.8	81.8	71.9

RISK ANALYSIS

28/02/2018

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.20	1.09
Beta	1.00	0.94	0.93
Information ratio	0.00	-0.36	-0.12
Maximum drawdown	-12.88	-16.84	-14.20
R squared	1.00	0.94	0.90
Sharpe ratio	1.36	1.28	1.33
Tracking error	0.00	4.59	5.88
Volatility	18.41	17.94	18.09

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 (0.74% OCF). Fund launch date: 15.12.2015.

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 Guinness Best of China 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 Best of China 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. 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 Link Fund Manager Solutions (Ireland) Ltd, 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 will be recorded and monitored.