GUINNESS

Emerging Markets Equity Income

Annual review

2017

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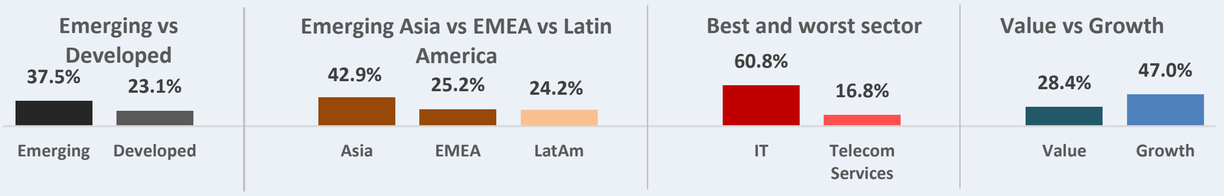
GUINNESS
ASSET MANAGEMENT

2017

Fund size
Start of year $0.2m
End of year $0.3m

What happened in Emerging Markets and the World?

- Donald Trump was inaugurated as 45th President of the United States.
- President Temer of Brazil was accused of discussing bribes with a businessman. He later survived two separate congressional votes for his prosecution.
- Cyril Ramaphosa was elected leader of South Africa's ruling African National Congress, adding to the pressure on President Jacob Zuma.
- India rolled out its new Goods and Services Tax (GST). A recapitalisation of the country's state-owned banks was also announced later in the year.
- South Korea's President Park was impeached. Jae-in Moon was elected President in April.
- The US Federal Reserve raised the target range for interest rates by 0.25% in March, June and December to 1.25-1.50%.
- President Trump announced reforms to personal and corporate income tax and a tax reform bill was finally approved by the House of Representatives in December.
- Moody's upgraded China banks' outlook in July. S&P downgraded China sovereign debt from AA- to A+ in September.
- Tensions over North Korea rose following missile launches in July, September and November.
- New Apple iPhone models were announced in September.
- China's 19th National Congress in October revealed little about the future leadership leading to the assumption Xi Jinping will stay on beyond the expected 10-year tenure.
- Emerging Market currencies mostly strengthened against a weaker dollar. In Asia, the renminbi strengthened 6.7%, while Korean won gained 13% and the Taiwanese dollar strengthened almost 9%. Outside of Asia, the South African rand gained 11% on rising political optimism while the Russian ruble rose 6.6% as the oil price climbed. Brazil was one of the few larger countries in the benchmark to see its currency weaken, as the real fell 1.7%.



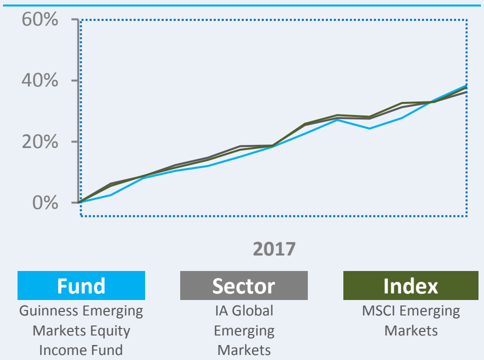
Total return in USD; MSCI World, MSCI Golden Dragon & MSCI Emerging Markets Index; MSCI China & Hong Kong & Taiwan Index; MSCI China Value & Growth Index.

What happened in the Fund?

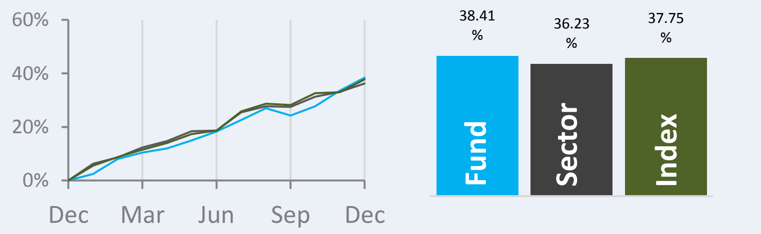
- The Fund had a good year, outperforming in a rising market. The fund rose 38.4% (Z share class, total return in USD) versus the market up 37.8% (MSCI Emerging Markets Index, total return in USD)
- Monthly outperformance was mainly due to individual stock performance. Two of our portfolio companies outperformed after receiving takeover bids. Monthly underperformance was sometimes due to individual stock weakness, but also due to the fund not holding several of the larger stocks in the benchmark that performed well.
- The fund's top three stocks overall were Ping An Insurance, AAC Technologies and Tencent.
- The weakest three stocks were Teva Pharmaceutical, Elite Material Co and Banco Davivienda.
- **Purchases:** China Medical Systems, British American Tobacco, Elite Material.
- **Sales:** Teva Pharmaceutical, Checkpoint Software, Tencent.
- **Other** portfolio changes made on gaining local market access: Purchases – Banco Davivienda, Bajaj Auto, Indiabulls Housing Finance, Tata Consultancy Services. Sales – MSCI India ETF (Lyxor MSCI India UCITS ETF).

Performance (%)

Cumulative since launch



Calendar year 2017



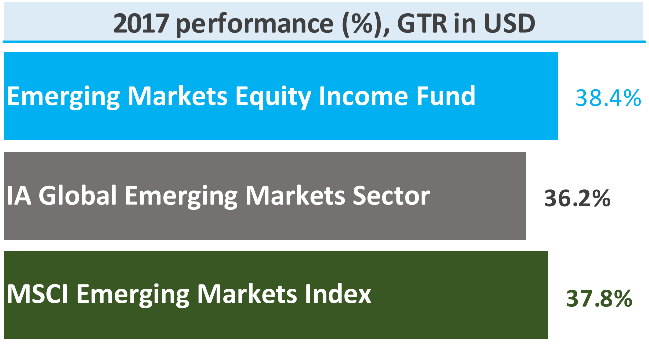
Cumulative % gross total return, in USD.
Source: Financial Express, Z Class (0.74% OCF)

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 fluctuation

2017

Review

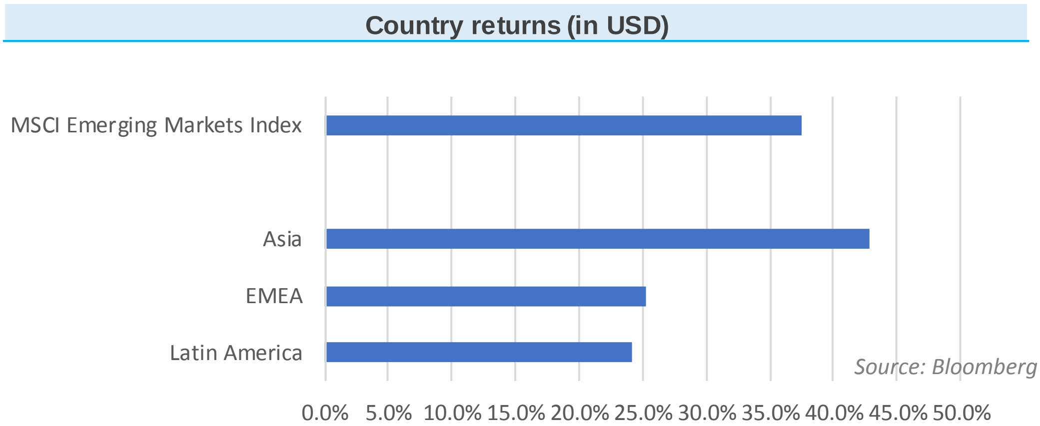
2017 was a strong year for Emerging Markets, with the benchmark finishing up 37.8% (MSCI Emerging Markets Index, total return in USD). The fund outperformed slightly, increasing 38.4% (Z share class, total return in USD). This is better performance than we expect, given the characteristics and nature of the holdings.



Source: Z class (0.74% OCF) to 31.12.2017, Financial Express

As with the Asian Equity Income Fund, which is run along the same principles, we expect the fund to outperform in weak markets and to underperform in stronger markets. We examine the performance of the fund more closely on a quarterly and monthly basis below.

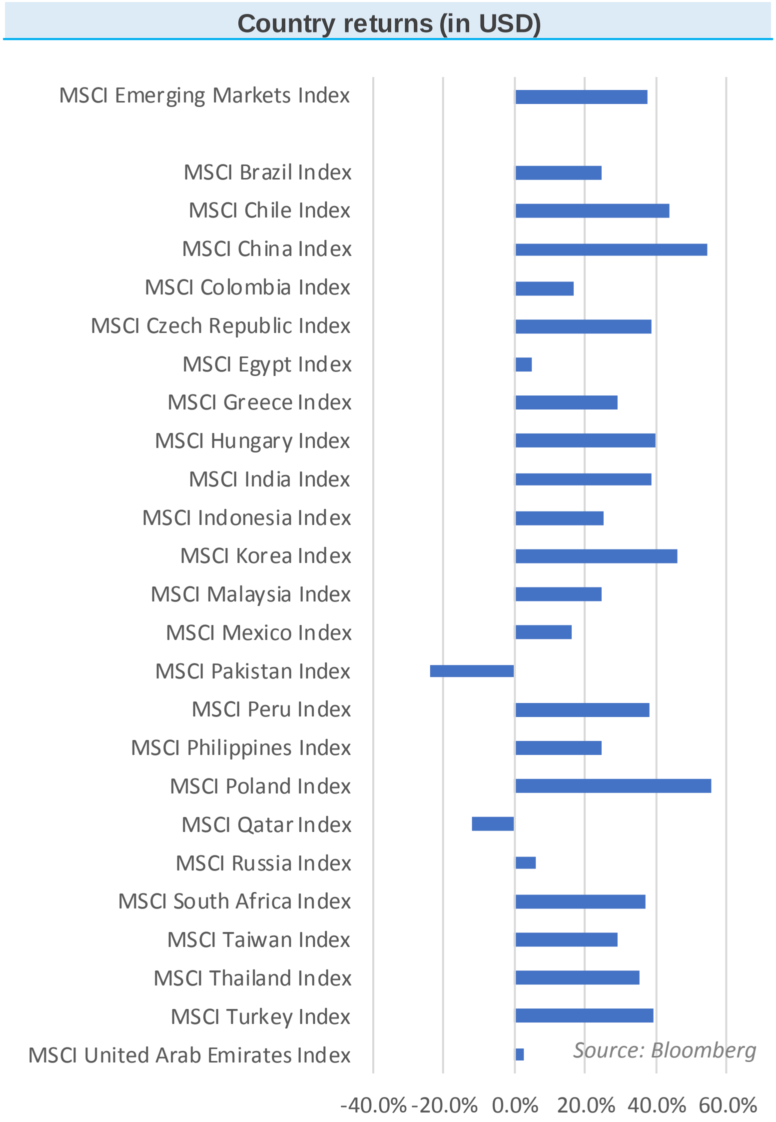
On a regional basis, Asia (accounting for 73% of the index as at the year-end), was the strongest performer, achieving total returns of 42.9% (all regional, country and sector returns as measured by their respective MSCI indices, unless specified). EMEA (Europe, Middle East and Africa) and Latin America performed well, but were some distance behind Asia, rising 25.2% and 24.2% respectively. The sub-indices accounted for 15% and 12% respectively of the MSCI Emerging Markets Index at year-end.



By index weight, the largest countries in the benchmark are: China, South Korea, Taiwan, India, South Africa, Brazil, Russia, Mexico, Malaysia and Thailand. China dominates and, with an index weight of 30%, outstrips all of the EMEA and Latin American countries combined. At present, the index consists of offshore Chinese equities – those listed in Hong Kong or in the US in the form of ADRs. China's index weight will increase further with the inclusion of locally listed 'A-shares'. While the initial inclusion will be modest, we expect the allocation to increase significantly over time.

Among the largest countries listed above, which account for roughly 90% of the index, the best performers in 2017 were China (+54.4%), Korea (+46.0%) and India (+38.9%). The weakest performers were Russia (+6.1%), Mexico (+16.2%) and Brazil (+24.5%).

The following chart shows individual country index returns for the benchmark:



Source: Z class (0.74% OCF), Financial Express

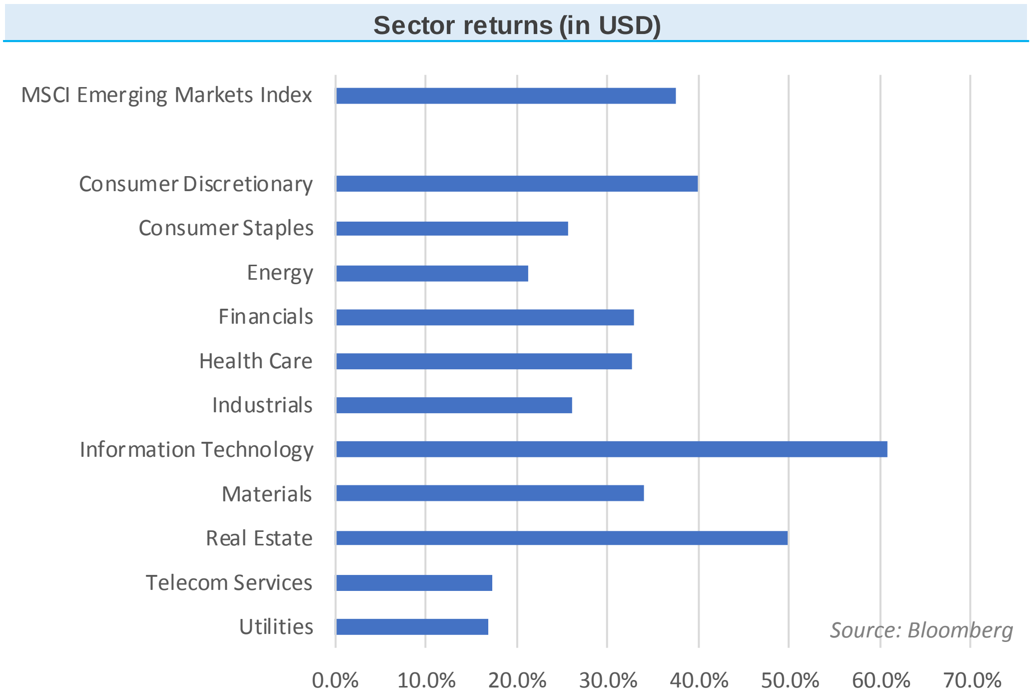
Chinese stocks, as measured by the MSCI China Index, have had their best year since 2009, marking a decisive reversal of the gloomy sentiment that has dominated for so many years. The stock market recovery is as much about what did not happen as what did. The 'near certain' banking sector crisis did not happen. We have long argued that debt servicing capacity, rather than the ratio of debt to GDP, is the most important metric when assessing the burden of debt and gauging financial stability. The recovery in heavy industrial profits and cash flows by 9% in 2016 and by a further 16% for the first 11 months of 2017 has improved matters considerably. According to our analysis of 3,000 listed companies in China the share of debt at risk (where operating profit does not cover a company's annual interest expense) has almost halved from 2015, falling from 30% to 17%. Government efforts to slow debt accumulation appear to be having an effect, according to the International Institute of Finance, with the stock of debt to GDP rising only 2% in 2017, compared to an average rise of 17% per annum between 2010-2016.

Korean stocks did well in 2017 and were led by the technology sector, which experienced strong demand for components (memory chips, displays, etc) from consumer electronics, especially smartphones. There have also been positive moves amongst the shipbuilders. Later in the year, easing tensions with China over North Korea gave a boost to consumer stocks, which had been affected by China's tourist travel bans.

India's stock market strength follows a period of some profound administrative changes. The demonetisation programme in 2016 was disruptive, as was the rollout of the new Goods and Services tax. Economic growth was slower but not derailed. India is now tackling the overhang of non-performing loans in the state-owned banking sector and its decision to recapitalise them has been widely welcomed. The reformist zeal of the current government has set the tone for investor bullishness, but we cannot escape the fact the market looks expensive by historic standards nor that downgrades to forecast earnings have been the most pronounced in Asia.

Among the weaker of the large markets was Russia, whose stock market movements are closely linked to the oil price; Energy has a 47.9% weight in the MSCI Russia Index and Russian national finances are heavily dependent on revenues from oil and especially gas. In the first half of the year the Index fell as the Brent Crude oil price fell from $54 per barrel to $48 and then recovered in the second half as the oil price rose to $66. Mexico is having a challenging time with its well-documented difficulties with President Trump. The debate surrounding 'the Wall' is secondary to the President's stance toward the North American Free Trade Agreement (NAFTA). Earnings revisions in Mexico have stabilised in recent months as fears of significant trade disruption have been deferred.

The following chart shows individual GICS sector index returns for the benchmark:



The best performing sectors were Information Technology (+60.8%), Real Estate (+49.7%) and Consumer Discretionary (+40.0%). The worst performing sectors were Utilities (+16.8%), Telecom Services (+17.4%) and Energy (+21.4%).

Technology has been a big part of the investment story this year. The top four constituents of the Emerging Markets benchmark and five out of the top ten are in the Information Technology sector, and all (Tencent, Samsung Electronics, Alibaba, TSMC and Baidu) are in Asia. Technology in Asia features both in application and in production. These areas show the region at its most innovative. In consumer markets, the race is on for businesses to adapt to changing business methods, to adopt new technologies and to respond rapidly to developing consumer spending patterns. Online retail, e-commerce platforms and e-payments have taken off, which has caused the stock prices of the Chinese internet names especially to surge. On the production side, the launch of the new iPhone has brought with it significant advances in production technology, from phone casings to camera lenses through to facial recognition and screens. The resulting increased performance requirements of handheld devices and the growth in Internet of Things has fed through to an upswing in demand for memory chips. There has been an increase in component prices, lifting profit forecasts throughout the supply chain.

Process and philosophy

At the heart of our process is a focus on the underlying business and the cash flows generated by that business. We have found that companies that persistently generate returns on invested capital above the cost of capital are likely to continue to do so. This gives us the confidence to be able to value the business and hold an investment potentially over many years to allow sufficient time for the returns the business earns on its invested capital to translate into total returns earned by shareholders.

Once we have established that the business is of sufficient quality, we then assess the valuation of its shares. We compare the returns the business is expected to earn versus what the market price is discounting; where the market is undervaluing a company's expected future cashflows, we think there is opportunity.

The company being considered must pay out a meaningful portion of its earnings as income, which should translate into a decent dividend yield at the time of purchase. We look at a company's track record of paying a dividend, and their dividend policy. Both of these factors can indicate a company's willingness to pay a dividend in future, and also management's attitude towards outside minority shareholders. The other factor we consider in relation to the dividend is growth. We target companies that have the ability to grow their dividend over the long term. Companies that are earning attractive real returns on investment should have the ability both to pay distributions to shareholders and to retain capital for reinvestment (and quite often these companies have attractive reinvestment opportunities).

How our approach differs from that of peers is a matter of sequencing. We do not start by going straight to the dividend – looking for companies that pay above market yields. Partly we feel that this approach can lead to poor results: a dividend may turn out not to be sustainable, or these companies can offer weak downside protection in a falling market (despite the presence of the dividend). More philosophically, we believe that the focus should be on the cashflows that underlie a company's dividend payment. It is the quality of the company, its ability to allocate capital, and its ability to maintain its competitive position and fend off external macroeconomic forces that will determine its ability to maintain and grow its dividend in future.

Our approach also contrasts with a top-down allocation approach to Emerging Markets. This method typically assesses country-specific political and economic factors alongside global macro-economic factors such as US dollar interest rates and liquidity, commodity prices and the world economic growth cycle in order to determine allocations to different countries and sectors. Stock selection is then carried out within each country. We, instead, look for 'best ideas' – individual investment opportunities – and our consideration of macro factors is on a company-by-company basis. For each company, our fundamental question is: Will the past returns on capital persist? By assessing the individual business model in the light of macro factors that may impact upon that model, we keep the focus on what we are actually buying, which is a set of cash flows that is undervalued by the market.

The other advantage of focusing on quality is that we believe this is the best way to mitigate risk. Risk, to us, is the potential for permanent loss of capital. A company that has a proven ability to generate returns on capital above the cost of capital over the business cycle, a modest amount of debt (or none), and shares that are attractively valued and pay a dividend, is one, we think, that significantly reduces the risk of permanent loss of capital.

Investment universe

Our investment universe of 360 stocks has distinct characteristics when compared to the MSCI Emerging Markets Index. The dominating feature is quality, which we measure in terms of the return on capital sustained above the cost of capital. The companies in our investment universe have demonstrated their ability to maintain a competitive advantage over their peers and to convert that into superior profitability over time. If sustained for long enough, there is a high probability that these higher returns on capital will persist. In addition, for inclusion in our universe, companies must have moderate borrowings; for non-bank companies we require that the ratio of debt to equity be no greater than 1. Finally, companies must have a minimum market capitalisation of US$500 million.

We identify a Quality company by applying a screen using our preferred metric of Cash Flow Return on Investment. Of those that qualify, roughly two-thirds are in Asia, with the remainder split between EMEA and Latin America, in favour of the former. The ten largest countries by number of qualifying companies are as follows:

Top 10 largest countries in universe (by number of companies)	
India	91
Taiwan	43
China	41
South Africa	22
South Korea	22
Malaysia	18
Brazil	13
Indonesia	13
Mexico	12
Thailand	12

By sector, the largest number of companies are in Financials, followed by Consumer Discretionary, Consumer Staples and Information Technology. Financials is the largest sector in our universe in both EMEA and Latin America, but in Asia it is second by a narrow margin to Consumer Discretionary. The third largest sector in Asia is Information Technology; Asia contains the lion's share of IT companies in our universe.

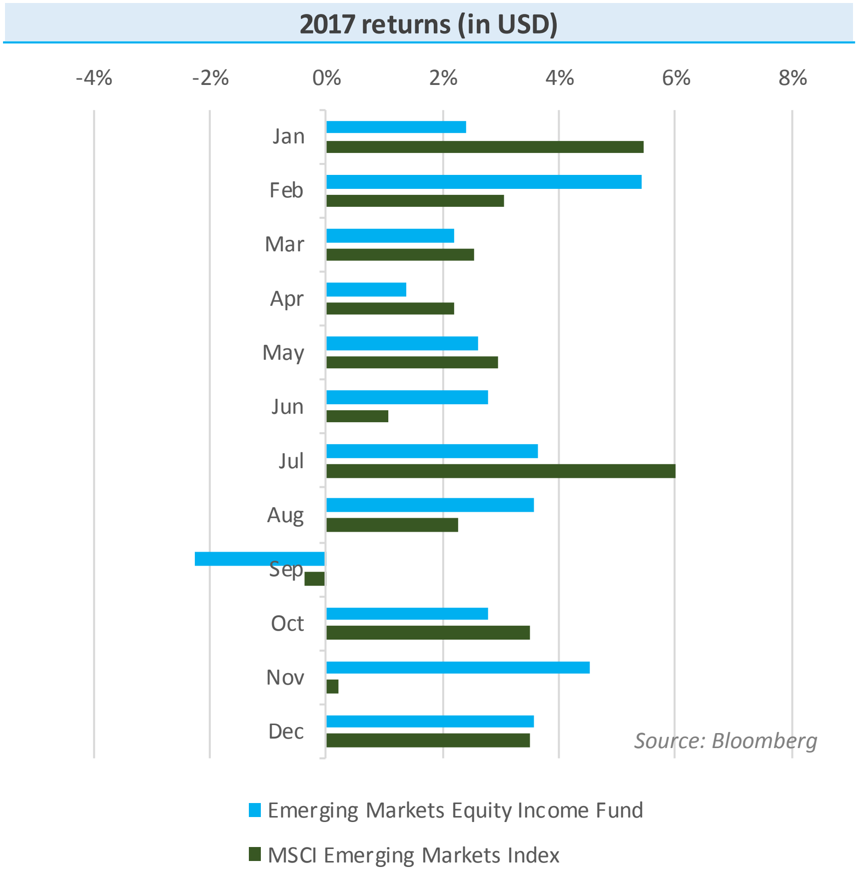
The smallest sectors are Telecommunication Services, Energy, Real Estate and Utilities, with a handful of companies in each. Companies in these sectors tend to earn returns on capital that are either too low (for example because they are in regulated industries) or too volatile (for example because they are linked to commodity prices).

Fund performance review

On a quarterly basis, the Fund broadly kept pace in the first two quarters, underperformed in the third, and then outperformed in the fourth. The market was strong in all periods and gains were relatively consistent – in the best quarter markets rose roughly 11% and 6% in the worst.

In each period it was stock-specific moves rather than regional or country allocations which drove performance. The portfolio's regional exposures relative to the benchmark are 5% underweight to Asia, 2% underweight to EMEA and 1% overweight to Latin America. The balancing position of 5% to 'other' refers to stocks such as British American tobacco, Unilever, Qualcomm and Broadcom, all of which have substantial emerging markets exposure but are listed on developed market exchanges.

We normally expect the Fund to outperform falling markets and to lag a little in strong market conditions. Month-to-month we may expect some variations from this pattern. Performance in 2017 exceeded our expectations as the fund outperformed in a strong market. Below, we review the Fund's performance behaviour through the year and look at the reasons behind deviations from expectations.



In the first month of the year the Fund got off to a sluggish start, underperforming by 3%. We saw some good performance from Chinese internet gaming developer Netease and from Catcher Technology, which makes casings for smartphones. There were contributions also from the Brazil stock exchange and Colombian bank Banco Davivienda. Also in January, however, Qualcomm fell due to legal action from Apple which fundamentally challenged its business model. Jumbo SA is a Greek retailer and wholesaler of toys and baby products with over 50 stores in Greece, nine in each of Bulgaria and Romania and more in Cyprus. The stock was down on weaker sales momentum in Greece. February saw a reversal in fortunes for the Fund which outperformed with contributions from Netease (again) but also from retailers China Lilang (men's clothing) and Grape King (health food in Taiwan), supported by Brazilian insurer Porto Seguro, South African apparel and jewellery retailer Truworths and Mexican bottler Coca Cola Femsa SAB. The combination of underperformance in January followed by outperformance in February and modest underperformance in March left the Fund just 1% behind the index in the first quarter.

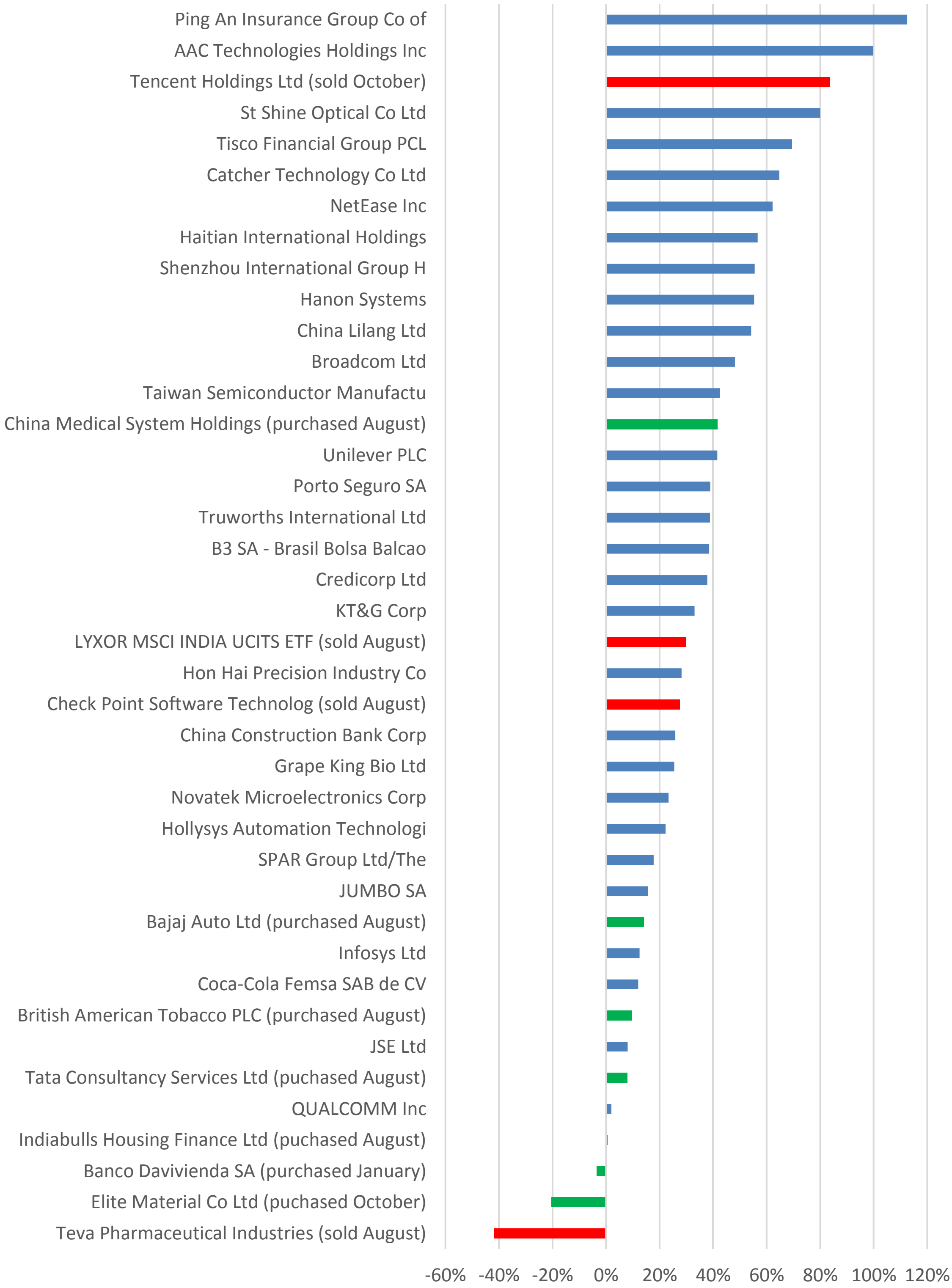
In the second quarter the Fund outperformed, with the most notable contribution coming in June. In that month exactly half the positions outperformed and half underperformed, but on the positive side we saw some significant moves in Haitian (machinery, China) as margins reached historic highs, AAC Technologies (smartphone components, China), Catcher Technology (smartphone casings, Taiwan) and St Shine Optical (Health care, Taiwan). The Brazil stock exchange and Credicorp (Financial services, Peru) were also significant contributors. AAC Technologies rallied after refuting comprehensively claims made by a short-seller that it had manipulated and overstated its reported profitability.

The third quarter looked similar to the first, with underperformance in the first month followed by outperformance in the second. September, however, saw a notable deviation from expectations where we would normally hope to see less downside. Two factors were evident: first, the launch of the Apple iPhone was followed by an ebbing of the excitement as it became apparent that shipments of the iPhone X would be delayed into November, which hit Catcher Technology, Hon Hai Precision and AAC Technologies; second, intensifying political strains in South Africa dragged down the stock prices of the Johannesburg Stock Exchange, Truwoths and Spar as well as the Rand. It is worth noting also that in September, when Greece was the worst performing market, down 13.5% in USD terms compared to the MSCI Emerging Markets Index which fell 0.4%, our one Greek holding, Jumbo SA was an outperformer in the portfolio (just!).

In the fourth quarter the Fund outperformed because of its strong performance in November. Qualcomm (one of the weaker stocks at the start of the year) staged a dramatic recovery when the company was the subject of a takeover bid from Broadcom. Other stocks contributing were St Shine Optical and Netease. KT&G, a Korean tobacco company, was lifted by the successful launch of its new e-cigarette. Spar group in South Africa moved sharply higher following better-than-expected results for the year ending 30 September. Again, the mix of performance drivers – split between China, Taiwan, Korea and South Africa and between Consumer Staples, Health Care, Technology and Financials – demonstrates that stocks, not themes, drive this portfolio.

Stocks performance and commentary

Individual stock performance in 2017 (total return USD)



Source: Bloomberg, Guinness Asset Management

Leaders

Ping An Insurance Group is a financial conglomerate with interests in insurance, banking and asset management. Average consumption of life insurance is relatively low in China compared to developed markets due to lower household incomes. As households become wealthier we expect consumption of life insurance to increase. One of Ping An's competitive advantages is the investments it is making, most of which one would associate with leading tech companies, aimed at improving the efficiency of the business and improving the user experience. For example, Ping An's facial recognition technology is used online in insurance policy applications to reduce identity fraud, cutting the application time significantly. With vehicle insurance, vehicle damage can be photographed and uploaded using the company's mobile app. Ping An's *Jin Guan Jia* app has 120m users and is the world's most used insurance app. We see Ping An entrenching its competitive advantage and making use of the cross-selling opportunities available between its various business lines.

AAC Technologies was our second best performing stock on the back of growth in smartphone sales and in anticipation of the new iPhone launch in September. It had a tumultuous period in the early part of the year; in May, the stock fell 27% before being suspended following the issue of a report by a short-seller, Gotham, who alleged the company was engaged in dubious accounting practices. The report was, in our opinion, deeply flawed and in June AAC produced a report of investigations conducted by an independent party that laid these allegations to rest fairly comprehensively. The stock resumed trading and hit new highs on good results and also on news of new product development in camera motors, sensors and MEMS (micro-electrical mechanical systems).

Tencent has multiple sources of earnings through WeChat, video games and mobile payments. The WeChat platform is now part of daily life in China. It started off as essentially a clone of Whatsapp but over the past few years it has morphed into its own ecosystem. Users can order a taxi through the app, use the Moments feature (similar to Facebook's news feed) and pay for their shopping using WeChat Pay. Tencent does derive advertising revenue on WeChat but has been cautious about showing too many adverts. Revenue per user lags behind peers in the US and so we believe in the long term there is enormous potential for it to grow. Tencent's video games continue to be highly cash generative and the company's return on capital has remained above 20% for over ten years.

St Shine Optical's share price by the end of July had risen only 1.4% compared to the market's rise of 18%. Results reported in March were not inspiring, with lower margins and little volume growth. The company did, however, announce a capacity expansion plan. The picture improved following a positive outlook delivered in May from its main Japanese customer, SEED, but the share price only began to move following St Shine's results announcement in August. The capacity expansion came online in September and was accompanied by increased order flow from existing Japanese customers and the prospect of growing orders from a new US customer. The share price rose 62% in the last five months of the year.

Tisco Financial is an excellent example of a 'good' company, defined by its financial returns over time rather than its glossiness. Its business is consumer finance in Thailand for mass market buyers of cars and scooters. The company reported better-than-expected results (again) marked out by higher profit growth and higher provision coverage (capital reserves set aside in anticipation of future non-performing loans). Growth has been lifted by the acquisition of Standard Chartered (Thailand) Bank's consumer loan book. The stock's dividend has grown 46% over one year, 20% p.a. over three years and 9.5% p.a. over five years.

Laggards

Teva Pharmaceutical had been struggling with a combination of high debt on its balance sheet and the loss of exclusivity for a main drug. When we bought the stock, we saw the company was still generating a decent cash return on its investments and we believed that the price multiple offered compensation for the risks present. The dividend cut announced by the company in August came as a surprise as the operating results in the second quarter did not seem to make it necessary. We took this as a sign of future strain within the business and sold the stock.

Elite Material produces printed circuit boards used in smartphones, servers and the automotive sector. It is the world's largest producer of halogen-free laminates, which are increasingly being adopted due to their environmentally-friendly nature. We think that spending on servers is likely to keep growing at a rapid pace as cloud storage continues to boom. Additionally, consumers are becoming more data-hungry, whether it is through using their mobile phone to watch high quality videos or through streaming on their PCs. As the 5G buildout is likely to begin soon, these trends will only accelerate, placing greater demand on data and therefore the servers behind them. Though Elite is predominantly known for its expertise in smartphones, it has been growing its networking division quickly to gain exposure to the expected increase in demand. While the share price has not performed as well as we would have hoped following the initial purchase, we are confident in the business and the development of its networking and server clients. We think that the sell-off in the shares has been overdone.

Banco Davivienda is a Colombian bank which offers commercial and consumer lending and has a leading market share in mortgage lending. The bank also has a presence in Central America. Economic activity in Colombia has slowed, which has led to a deterioration in the bank's asset quality. Analysts' earnings expectations for the company have been lowered. However, on the positive side, inflation has slowed in Colombia, which has been accompanied by a reduction in the monetary policy rate. The company has made good progress on loan growth, with gross loans in the third quarter growing 9% versus a year previously. We think the company trades on an undemanding valuation.

Indiabulls is an Indian housing finance company that we purchased in August. Partly the stock was handicapped by being purchased towards the end of the year, i.e. not having a full year of performance in the chart above. Prior to purchase, we held an MSCI India ETF as a proxy for India, which generated reasonably strong returns over the first part of the year. The stock was also affected by the Indian government's announcement in October of a $32bn recapitalisation of the banking sector. This move will benefit the company's competitors – state-controlled banks in India – but we are confident that the outlook for Indiabulls remains positive. We discuss the company further below.

Qualcomm has had a torrid year as its dispute with Apple over its royalty model has intensified. The share price came down sharply earlier in the year, leaving the company open to a potential bid, which was eventually made by Broadcom. Qualcomm's chip design business is very diverse, but the heart of its problem lies in the licensing side of its business model which requires the payment of a royalty calculated on the overall price of device that uses its chips, most particularly the modem. Qualcomm argues that without the modem the device would not work and therefore this is an appropriate basis for calculation. Apple argues that while this may have made sense in the past, its devices have moved far beyond being just phones and that Qualcomm is now taking a share of other design and functionality that is more than its due. Our view remains that Qualcomm's products are indeed superior to those of its competitors, that the two companies will ultimately come to an agreement, and that Broadcom's bid at $70/share is too low.

Portfolio activity in 2017

There were several changes to the portfolio in 2017. Some were as a result of gaining local market access to various territories following the launch of the fund. Our purchases of Davivienda and our three Indian stocks are in this category.

BAJAJ Indiabulls

TATA

TATA CONSULTANCY SERVICES

Following gaining access to the local Indian stock market, in August we sold our holding position in an MSCI India ETF (Lyxor MSCI India UCITS ETF), replacing it with Bajaj Auto, Indiabulls Housing Finance and Tata Consultancy Services. Bajaj Auto is a manufacturer of motorbikes and specialises in the premium end of the market. As the motorbike market reaches saturation, the premium end of the market is likely to see higher growth, especially relative to the entry-level market. Indiabulls Housing Finance provides loans for low to mid-income housing in India. There is a push by the government to increase the number of affordable houses in the country, creating a favourable policy environment for Indiabulls. The company has a strong balance sheet, strong provisioning cover and due to sensible lending practices has a non-performing asset ratio of less than one per cent. The company also effectively matches the maturity of its assets and liabilities. As a result, it has managed to sustain very high returns over the past eight years. Tata Consultancy Services is an information technology consultancy with most of its revenues coming from the US and Europe. The industry is facing multiple headwinds: the first is the US administration's attempt to restrict overseas visas for consultants, making them less competitive versus domestic consultants; and revenue growth has slowed as banking and financial customers in turn face slower growth. We argue that the market is implying a low long-term return on capital which, in our view, is very unlikely.

We also made three 'regular' switches which are discussed below.

TEVA

TEVA PHARMACEUTICAL INDUSTRIES LTD.

Teva Pharmaceutical, discussed above, was sold after the announcement that it would cut its dividend. The position was replaced by China Medical System.

China Medical System (CMS) is the largest pharmaceutical contract sales organisation in China. It provides outsourced sales services for pharmaceutical companies, with its customers predominantly being smaller Western pharmaceutical companies who do not have a sales team in China. CMS generates a high cash return on investment as it is a capital-light business. We like the fact that the management of the business have been in place for decades. We also like their strategy which is to sell drugs where there is relatively less competition, reducing the chance of price competition in the market. The healthcare market was disrupted by various new tenders throughout the year and the uncertainty over the implications over the two-invoice system, meaning that CMS was trading at a price we thought was undervaluing the business.

We sold Check Point Software, an Israeli IT security company which provides both software and hardware. Check Point performed well over the holding period, but we felt there was limited further upside with a moderate growth profile fully reflected in the price. It was replaced with a more compelling alternative: British American Tobacco.

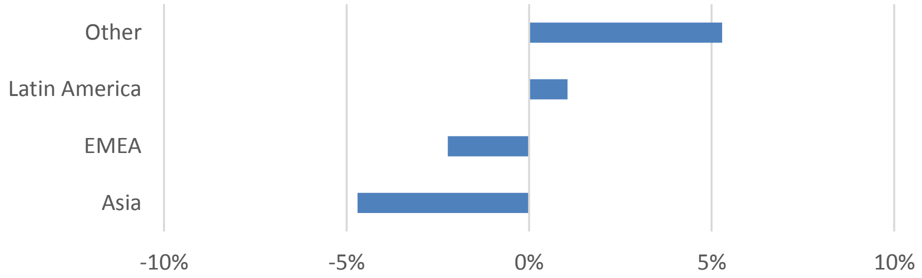
British American Tobacco has a good track record of growing its earnings and dividend over the past 10 years. The stock price weakened on news that the US FDA could seek to regulate nicotine levels in cigarettes, and also on the news that the company was being investigated by the UK Serious Fraud Office over bribery allegations in Africa. We think that the company will be able to navigate both of these challenges, and we took advantage of the lower stock price to initiate a position. While the company's acquisition of Reynolds American will increase exposure to the US, overall the company will retain its majority exposure to emerging markets.

Our final stock switch was to sell our position in Chinese internet company Tencent in October. The stock, which was our third best position over the holding period (see discussion above), was sold on valuation grounds. We replaced the position with Elite Material.

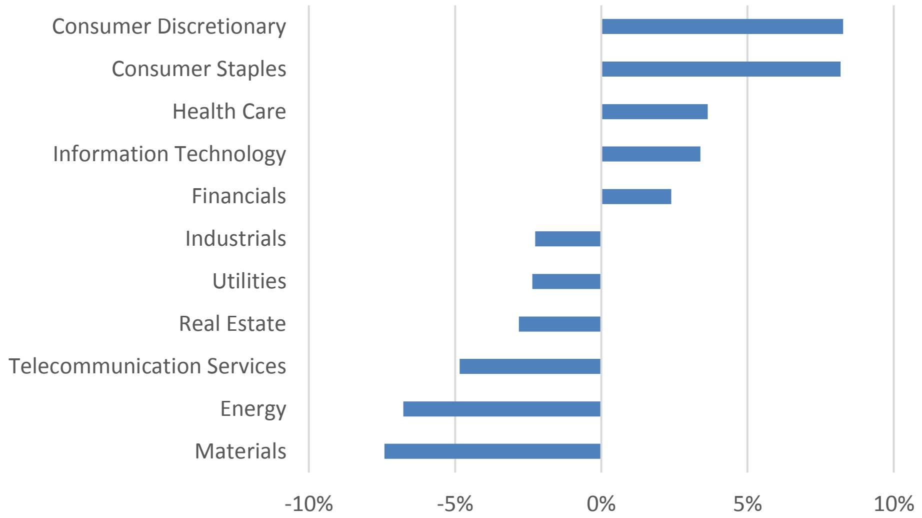
Elite Material is a manufacturer of halogen-free printed circuit board materials and is discussed above.

Portfolio positioning

The following charts show the fund's positioning relative to the benchmark.



On a regional basis, the fund is overweight Latin America and underweight EMEA and Asia. The 'Other' category consists of British American Tobacco and Unilever – two UK-listed companies that both derive more than half of their revenue from Emerging Markets.



On a sector basis, the largest overweights are to the consumer sector – both Consumer Discretionary and Consumer Staples. The fund is also overweight Health Care, Information Technology and Financials. The largest underweights are in Materials and Energy, the constituents of which don't tend to qualify for inclusion in the universe because of the cyclical returns on capital they earn (or sometimes don't earn!).

Outlook

Clearly 2017 was a very strong year, with the market rising 37.5% in US dollar terms (though partly those returns were boosted by dollar weakness). While it wouldn't be impossible to see a repeat of returns at that level next year, it certainly isn't our base case expectation.

Encouraging factors supporting Emerging Markets include the marked improvement in earnings from 2016 that began to feed through into reported earnings in 2017. We expect the effect of this to continue into early 2018 as companies report full year results. Positive earnings revisions (earnings estimates moving higher) have also helped to boost sentiment. In addition, based on long-term valuation metrics, Emerging Markets look attractive.

We outlined the importance of China at the beginning of this review, so it should not be a surprise that much of the outlook depends on the country. China has not witnessed the economic crash that some feared, and the authorities have stepped in to reduce some of the financial excesses that had built up in excessive corporate debt levels. We continue to see banks being the subject of new regulations, with particular emphasis on shadow banking activities.

This market is not without risks. At the moment we think expectations for interest rate rises in the US are fairly modest, so an increase in the speed at which rate rises are applied could destabilise markets. The same applies, of course, to an unexpected and sustained rise in inflation. At the same time, central banks are seeking to reverse the quantitative easing provided as a stimulus in previous years, and this could be a tricky balancing act.

Global growth continues to look reasonably robust and is broadly distributed. Global trade has picked up and is providing a tailwind. A recovery in global capex, which would help to boost domestic demand, could provide the stimulus for the next phase of the business cycle. But as always, there are no guarantees.

In times of uncertainty, we believe our focus on quality, dividend-paying companies priced at attractive valuations is a sensible approach.

For more information

Read more on the Fund

Visit our website for more information on the Fund and to register for regular email updates on its performance and portfolio.

Keeping you updated

Detailed portfolio and performance analysis

White papers

Our thoughts on a range of topics including: the importance of dividends; whether to meet company management; concentrated portfolio; the effectiveness of economic modelling.

To sign up for updates or search the archive, visit guinnessfunds.com

or contact our sales team

Contact our sales team

Our sales team are on hand to explain the Fund and its investment process in more detail and answer any queries you might have.

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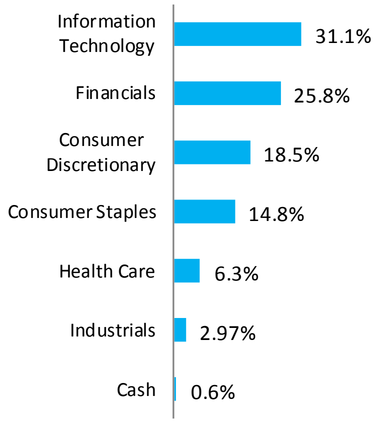
PORTFOLIO

31/12/2017

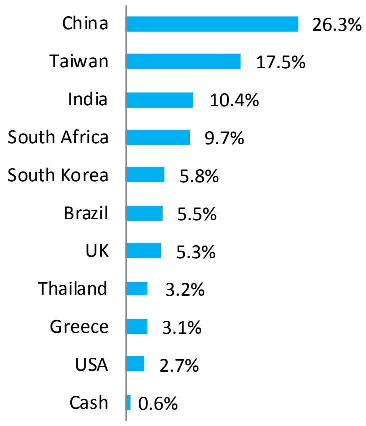
Fund top 10 holdings

JSE Ltd	3.6%
Hanon Systems	3.5%
Ping An Insurance	3.4%
Netease.com	3.4%
Truworths International	3.3%
St. Shine Optical Co	3.2%
Tisco Financial Foreign	3.2%
Jumbo	3.1%
Shenzhou International	3.1%
Coca-Cola Femsa SAB	3.1%
% of Fund in top 10	33.0%
Total number of stocks in Fund	33

Sector analysis



Geographic allocation



PERFORMANCE

31/12/2017

Annualised % gross total return from launch (USD)

Discrete years % gross total return (USD)	Dec '13	Dec '15	Dec '15	Dec '16	Dec '17
Fund	-	-	-	-	38.4
MSCI Emerging Markets Index	-2.3	-1.8	-14.6	11.6	37.8
IA Global Emerging Markets sector average	-2.0	-2.9	-15.1	9.7	36.2

Cumulative % gross total return (USD)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	1.9	38.4	38.4	-	-	39.8
MSCI Emerging Markets Index	1.9	37.8	37.8	31.3	26.0	41.5
IA Global Emerging Markets sector average	2.5	36.2	36.2	26.9	20.7	39.9

RISK ANALYSIS

31/12/2017

Annualised, weekly, from launch on 23.12.16, in USD	Index	Sector	Fund
Alpha	0.00	0.00	6.02
Beta	1.00	1.00	0.92
Information ratio	0.00	0.00	0.56
Maximum drawdown	-3.74	-3.95	-3.57
R squared	1.00	1.00	0.68
Sharpe ratio	3.21	3.13	3.41
Tracking error	0.00	0.00	5.82
Volatility	10.66	10.46	10.24

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, total return (Z class, 0.74% OCF). Fund launch date: 15.12.2015.

Guinness Asset Management

Guinness Asset Management provides a range of long-only actively managed funds to individual and institutional investors. Founded in 2003, Guinness is independent and is wholly owned by its employees.

We believe in in-house research, intelligent screening for prioritisation of research and well-designed investment processes. We manage concentrated, high conviction portfolios, with low turnover and no benchmark constraints. Since our establishment we have developed a variety of specialisms in global growth and dividend funds, global sector funds and Asian regional and country funds. The Guinness equity funds sit within an Irish-listed OEIC. They are managed alongside a range of similar SEC-registered funds offered to US investors by our US sister company, Guinness Atkinson Asset Management Inc. We also offer an Enterprise Investment Scheme (EIS service) investing in UK-based renewable energy projects and AIM-listed companies.

Our Products

Global & Developed Markets	Equity Income	Global Equity Income European Equity Income UK Equity Income
	Growth	Global Innovators Global Equity US Equity Global Money Managers
Asia & Emerging Markets	Equity Income	Asian Equity Income Emerging Markets Equity Income
	Growth	Best of Asia Best of China
Energy	Growth	Global Energy Alternative Energy
Tax efficient services for UK investors	Tax	EIS Service AIM EIS Service Best of AIM Service Sustainable Infrastructure Service
Segregated mandates	Segregated Mandates in the strategies above	

Contact us

Tel	Email	Web

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

This report is primarily designed to inform you about Guinness Emerging Markets 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 Emerging Markets 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. 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