Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – May 2018

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

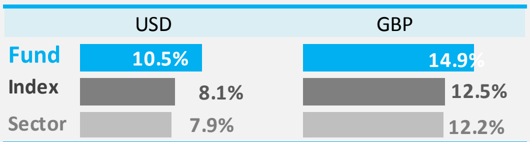
30/04/2018

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

	2015		2016		2017	
	USD	GBP	USD	GBP	USD	GBP
Fund	-4.4	1.2	7.5	28.2	36.5	24.6
Index	-9.4	-4.1	7.8	28.6	37.3	25.4
Sector	-8.6	-3.4	5.3	25.7	37.2	25.3

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	-2.1	-3.9	17.6	10.4	54.6	83.6
Index	0.8	-1.0	21.1	13.8	40.6	67.0
Sector	0.0	-1.8	19.4	12.2	39.2	65.3

Annualised % total return from launch



Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.7	1.3	3.9	4.1
Beta	1	1.0	0.9	0.9	0.8	0.8
Info ratio	0	0.0	-0.1	-0.1	0.4	0.4
Max drwdn	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	3.8	3.8	5.8	5.8
Volatility	14.8	15.3	13.3	13.5	12.4	13.9
Sharpe ratio	0.3	0.6	0.3	0.6	0.5	0.8

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 fell by 1.3% in April (in USD), underperforming the benchmark, which rose 0.8%.
- Asian markets in April underperformed developed markets, which rose 1.2% (MSCI World Index).
- However, for the first four months of the year, Asian markets were still ahead of both developed and US equities (measured by the MSCI World and S&P 500 Indices).
- Within the fund, Information Technology was by far the weakest sector, leading to the underperformance over the month. Financials and Consumer Discretionary stocks offset the weakness in IT and contributed positively to the portfolio.
- IT stocks in the Apple iPhone component supply chain were the main source of weakness, on fears that iPhone sales would disappoint. Post month-end, however, Apple released strong sales figures and provided a better outlook than the market expected. Accordingly, the suppliers we hold in the portfolio began to recover in May.
- The market's enthusiasm towards the component suppliers has varied over time. For example, they enjoyed a considerable period of strength last year in the run-up to the iPhone 8 / iPhone X launch. By equally weighting the portfolio, we can benefit from such swings in sentiment. We expect component suppliers to benefit from improving demand over the second half of the year.
- Positive contributions to the portfolio came from DBS (Financials), the Chinese banks and Luk Fook (Consumer Discretionary).
- Other areas of strength across the wider region were cyclical sectors. Energy rallied with the oil price and Materials was also strong – two sectors where the portfolio is underweight.

Events in April

- Trade tensions between the US and China persisted throughout April. Early in the month, the US announced tariffs affecting $50bn of imports from China, including electronics, machinery and high-tech products. China countered with equivalent tariffs targeting agricultural products and aircraft.
- At the Boao forum, President Xi struck a more conciliatory tone, announcing reforms to continue efforts to liberalise financial markets.
- Later in the month, the US announced a ban on American companies supplying Chinese telecom equipment maker ZTE.
- Economic data in China showed first quarter GDP growth was robust at 6.8%. The NBS manufacturing PMI reading was 51.4 in April, indicating good economic momentum.
- Elsewhere in the region, Singapore is experiencing a period of economic re-acceleration. The PMI reading rose from 52.7 in February to 53 in March, and industrial production grew 5.9% (though slightly slower than the previous month).
- President Trump announced a series of new sanctions against Russia, targeting tycoons with links to President Putin.
- North Korean leader Kim Jong-un met South Korea's President Moon at an historic joint summit in South Korea. A meeting between Donald Trump and Kim Jong-un is due to take place in Singapore in June**.**
- Oil gained over the month due to a combination of stronger demand and the potential for renewed sanctions in Iran. Venezuelan production also continued to be disrupted. Brent crude rose 8% and WTI rose 6% in April.
- Asian currencies were generally weaker, as the US dollar rallied.

Outlook

- The portfolio is trading, on a price/earnings multiple basis, at a 9% discount to the market as measured by the MSCI AC Pacific ex Japan Index. The index is in turn trading at a 14% discount to developed markets.
- Earnings revisions for the region have stabilised after a period of strong upward momentum in 2017, but still reflect expectations that earnings growth will be healthy. Earnings are forecast to grow nearly 9% this year and 10% next year.
- Our approach of investing in companies with a track record of consistent profitability (companies that have generated a return on capital above the cost of capital), combined with attractive valuations and providing a meaningful level of dividend income is, we believe, an attractive one.

Markets and portfolio

Trade tensions continued to dominate the headlines, as the US and China proposed and then countered tariffs of equal proportions (please see last month's update for a full discussion). Later in the month China struck a more conciliatory tone, announcing further efforts to reform and liberalise markets. The US continued to rattle the sabre, instituting a ban on US companies supplying ZTE, the Chinese telecom equipment supplier, which last year pleaded guilty to violating US sanctions against North Korea and Iran. The move looked set to spell the end for ZTE until President Trump tweeted in recent days that efforts should be made to save the company.

China genuinely seems willing to negotiate over trade, and discussions are ongoing. Liu He, China's vice-premier, is due to visit Washington next week for several days of talks. Whether a satisfactory solution can be found is still an open question – the US's formal opening demands in negotiations appear to be completely unrealistic, and unacceptable to China. But President Trump's recent volt-face on ZTE suggests that a pragmatic approach may yet prevail.

Within the portfolio, **IT** stocks suffered, particularly those in the Apple component supply chain, due to market concerns that sales of the iPhone X would disappoint. The main trigger of the worries was TSMC (held within the portfolio), a leading supplier of Apple chips, that guided for weaker smartphone demand. Other smartphone manufacturers, such as Samsung Electronics, also indicated a more challenging market. Chinese smartphone manufacturers had already indicated a weaker demand outlook in the short term, but this was compounded in the case of Huawei (China's leading smartphone maker) on fears that the company could fall foul of US trade sanctions similar to those that had been applied to ZTE.

The market reaction was to lower valuation multiples, as several of the holdings in the portfolio dropped to their ten-year average P/E multiple (based on forward earnings). Interestingly, earnings estimates were – for the most part – unaffected.

Since month end, Apple reported good first quarter results, and provided an outlook that was better than the market expected. The companies in the portfolio with more exposure to Apple have accordingly begun to recover in May.

Looking at the difficulties IT stocks have faced with a longer-term perspective, we see that the pattern is not new. At various stages of the iPhone's development, the market's attitude towards component suppliers has waxed or waned, according to how well the latest model has been received. The run-up to the launch of the iPhone 8 and iPhone X last year was a period of strength for the component suppliers. By running an equally-weighted portfolio, we naturally recycled some of these gains into other stocks. Equivalently, this year we have been adding on market weakness. Our expectation is that the component suppliers will benefit from improving demand over the second half of the year, particularly as the next iPhone model designs are finalised and unveiled towards the end of the year.

By focusing on quality companies with a track record of consistent profitability, we expect the fund to benefit over the long term from the growth in demand for smartphone components and the continual upgrades to phone specifications and features.

Positive contributions to the portfolio came from the Financials and Consumer Discretionary sectors. In Financials, **DBS** recovered after a weaker period in March. At the end of the month, the company released results for the first quarter showing an increase in net profit due to loan growth, higher net interest margin and growth in non-interest income. Return on equity rose to 13% – the highest level in a decade. **Chinese banks** were also an area of strength in the portfolio after clarity was provided on new asset management regulations and a 100 basis point cut in the reserve requirement ratio (RRR) was announced.

In Consumer Discretionary, **Luk Fook** performed well after releasing results that that showed strong sales growth against tough comparatives. The company, a jeweller operating in Hong Kong, Macau, and Mainland China, reported same-store sales growth in both gold and gem-set products led by double-digit growth in those categories in Hong Kong and Macau. Contributing to the growth was an increase in tourists visiting from China.

Portfolio changes

We completed one portfolio switch during the month. We sold our position in Relo Holdings, the one Japanese-listed stock in the portfolio. Held since launch, Relo had been an excellent performer in the fund, but the yield contribution from the stock had fallen to a low level as the stock price had risen, accompanied by an increase in valuation multiples. While we thought the prospects for the company were good, we felt there were more attractive income and valuation opportunities elsewhere.

In Relo's place we purchased Corporate Travel Management (CTM), an Australian company that provides travel management services for corporate clients in Australia, the US, Europe and Asia. In its most recent half year results, the company reported 15% growth in revenue and 32% growth in underlying EBITDA. The dividend was also increased by 25%. We like the client proposition that CTM offers – reducing travel costs for its clients while making it easier to arrange and manage bookings. The founder and Managing Director also owns a significant equity stake in the business. As with Relo, we expect a significant proportion of our total return as shareholders to come from continued earnings growth in the business, leading to growth in the income stream from dividends.

Summary and conclusion

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The portfolio is trading, on a price/earnings multiple basis, at a 9% discount to the market as measured by the MSCI AC Pacific ex Japan Index. The index is in turn trading at a 14% discount to developed markets.

Earnings revisions for the region have stabilised after a period of strong upward momentum in 2017, but still reflect expectations that earnings growth will be healthy. Earnings are forecast to grow 14% this year and nearly 10% next. The broad-based nature of global growth continues to provide a favourable backdrop for Asian and Emerging Market equities.

Our approach of investing in companies with a track record of consistent profitability (companies that have generated a return on capital above the cost of capital), combined with attractive valuations and providing a meaningful level of dividend income is, we believe, an attractive one.

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

Data sources

Fund performance: *Financial Express, gross total return*

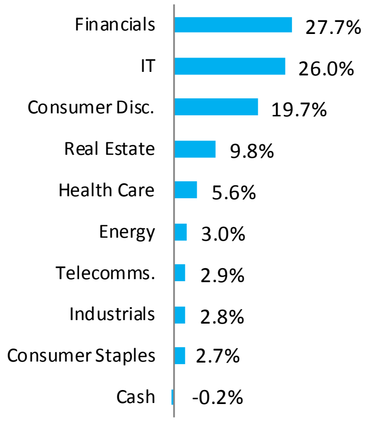
Index and stock data: *Bloomberg*

PORTFOLIO **30/04/2018**

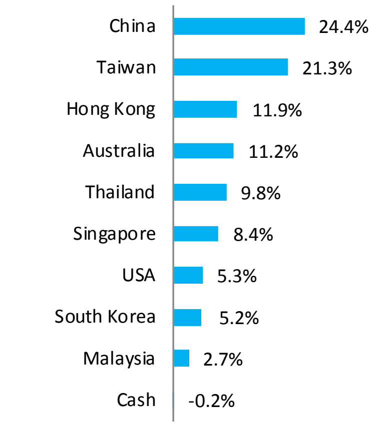
Fund top 10 holdings

Luk Fook Holdings	3.4%
PTT Pcl/Foreign	3.0%
Largan Precision	3.0%
Corporate Travel Management	3.0%
Link REIT	2.9%
DBS Group Holdings	2.9%
BOC Hong Kong	2.9%
China Merchants Bank	2.9%
China Mobile	2.9%
St. Shine Optical Co	2.8%
% of Fund in top 10	29.7%
Total number of stocks in Fund	37

Sector analysis



Geographic allocation



PERFORMANCE

30/04/2018

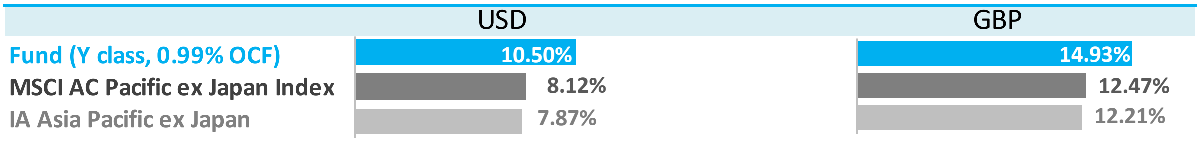
Discrete years % total return

	Apr '14		Apr '15		Apr '16		Apr '17		Apr '18	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Y class, 0.99% OCF)	-	-	-	-	-14.4	-10.2	21.0	37.0	17.6	10.4
MSCI AC Pacific ex Japan Index	1.2	-6.8	11.5	22.5	-16.9	-12.8	20.5	36.4	21.1	13.8
IA Asia Pacific ex Japan	1.1	-6.8	10.0	20.9	-14.6	-10.4	18.9	34.7	19.4	12.2

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 (Y class, 0.99% OCF)	-1.3	0.6	-2.1	-3.9	17.6	10.4	21.7	35.7	54.6	83.6
MSCI AC Pacific ex Japan Index	0.8	2.6	0.8	-1.0	21.1	13.8	21.2	35.3	40.6	67.0
IA Asia Pacific ex Japan	0.9	2.8	0.0	-1.8	19.4	12.2	21.3	35.3	39.2	65.3

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

30/04/2018	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.7	1.3	3.9	4.1
Beta	1.0	1.0	0.9	0.9	0.8	0.8
Information ratio	0.0	0.0	-0.1	-0.1	0.4	0.4
Maximum drawdown	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
R squared	1.0	1.0	0.9	1.0	0.9	0.9
Sharpe ratio	0.3	0.6	0.3	0.6	0.5	0.8
Tracking error	0.0	0.0	3.8	3.8	5.8	5.8
Volatility	14.8	15.3	13.3	13.5	12.4	13.9

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: 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.