Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – June 2018

Launch date	**23.12.16**
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Aim

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

Performance 31/05/2018

Fund	Guinness Emerging Markets Equity Income (Z)
Index	MSCI Emerging Markets Index
Sector	IA Global Emerging Markets

	2015		2016		2017	
	USD	GBP	USD	GBP	USD	GBP
Fund	-	-	-	-	38.4	26.4
Index	-14.6	-9.7	11.6	33.1	37.8	25.8
Sector	-15.1	-10.2	9.7	30.8	36.2	24.4

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	-2.1	-0.5	17.8	14.3	45.3	27.0
Index	-2.5	-0.9	14.4	11.0	43.6	25.5
Sector	-4.3	-2.7	10.1	6.8	40.5	22.7

Annualised % total return from launch

	USD	GBP
Fund	24.4%	17.5%
Index	25.1%	18.2%
Sector	22.6%	15.8%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.3	0.3	3.6	3.6
Beta	1.0	1.0	0.9	0.9	0.8	0.8
Info ratio	0.0	0.0	-0.5	-0.5	0.0	0.0
Max drwdn	-10.3	-10.3	-10.4	-10.4	-10.3	-10.3
Tracking err	0.0	0.0	4.4	4.4	6.3	6.3
Volatility	14.1	14.1	13.0	13.0	13.1	13.1
Sharpe ratio	1.5	1.5	1.4	1.4	1.6	1.6

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: 0.74% OCF, Financial Express, bid to bid, gross total return.

Fund & market

- Emerging Markets continued to trade lower in May and fell 3.5% (in USD), putting the benchmark back at the level it was at in mid-December last year.

- The fund held up relatively well over the month, falling 3.1% (in USD), and thus outperforming the benchmark by 0.4%.

- Volatility returned, with currency weakness a significant driver. The truckers' strike in Brazil (see below) led to a 6% depreciation of the real. The Turkish lira weakened by 10%, forcing the central bank to raise interest rates.

- China was a source of relative strength and stability, with strong industrial profits growth reported.

- Against the benchmark, outperformance in May came mainly from Information Technology and Industrials. In IT we benefited from our holdings Qualcomm and Broadcom. In Industrials, our holding in Haitian International was the main driver of outperformance.

- Offsetting the stronger performers, some of our consumer staples holdings were detractors: Spar Group, Coca-Cola Femsa, Grape King and British American Tobacco.

Events in May

- The Malaysian election yielded a surprise result with the victory of Mahathir Mohamad, the 92-year-old former Prime Minister. He defeated Najib Razak (the incumbent Mahathir had previously selected), who had become embroiled in the 1MDB scandal and accused of corruption. The victory for the opposition party is the first since Malaysian independence in 1957. The election campaign included promises to reintroduce fuel subsidies and to abolish the recently-introduced goods and services tax.

- A ten-day truckers' strike in Brazil over high fuel prices caused significant disruption to the economy and led to food and fuel shortages. As a result,

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economists have lowered expectations for Brazilian growth in 2018. The government, facing an election later this year, ended the protests by offering diesel subsidies which add to the country's fiscal pressures.

- Trade relations continued to simmer. An announcement that America's trade war with China had been put "on hold" initially offered some hope, but the truce did not last long. Facing a backlash from Congress and President Trump's supporter base, the White House subsequently announced that it would push ahead with tariffs on $50bn of imports from China.

- Separately, President Trump announced an investigation into auto imports to determine whether they constitute a threat to US national security. The move was seen as an attempt to put pressure on NAFTA negotiations, which have made little progress. (The fact that limited progress has been achieved in the context of upcoming Mexican elections is unsurprising.)

- Trade tensions escalated further at the end of the month after the US announced that the previously-granted exemptions on steel and aluminium for Mexico, Canada and the EU would come to an end.

Outlook

- We expect earnings growth in Emerging Markets to be stronger than in Developed Markets.

- Economic growth remains supportive. If 1Q18 world growth exceeds 3% on an annualised basis, this will make a run of six straight quarters, which has been achieved on only two other occasions in the last 30 years.

- We appear to be in latter part of mid-cycle rather than late cycle. We do not believe US monetary policy is about to become restrictive, which would lead to a shift down in US corporate investments and earnings growth.

- With expectations still low for a near-term recession, we think that this period of defensive outperformance is unlikely to be sustained and that structural growth themes will reassert themselves.

- We therefore expect Emerging Markets will still do well, although perhaps less than the consensus forecast of 18% earnings growth. Our focus remains, however, on good quality companies with inherent strengths rather than those that require favourable cyclical conditions. Cash-generative companies with low debt, we believe, are the best place to be at this point.

How we invest in Emerging Markets

Our approach to investing in Emerging Markets is different. We do not make top-down allocations to particular countries or sectors. Instead, we make individual stock selections based on fundamentals. We scour our universe of 360 companies to find the best 36 investment opportunities for the portfolio.

We use the same quality framework for defining our investment universe as with the Asian Equity Income Fund. Starting with the roughly 4,000 companies listed in Emerging Markets (or deriving the majority of their business from those countries), we identify those that have achieved a return on capital persistently above the cost of capital. Specifically, we look for companies that have achieved at least an 8% real return on capital – measured in cash flow terms – for each of the past eight years. We therefore require two things:

1. Companies must have a sufficient track record;
2. They must have been consistently profitable over this period.

We rule out companies that are overly indebted (debt to equity must be no greater than one) or too small (market capitalization must be at least $500m). The 360 companies that remain form our investible universe.

From among those, our task is then to identify the most attractively valued stocks that pay a reasonable dividend. From a valuation perspective, we are looking for companies where the market is undervaluing their future cashflows – we think the cashflows from these companies will persist, but the market thinks they will diminish over time. Where the discrepancy exists, this is the valuation anomaly we seek to capture.

Our valuation work consists in asking two questions:

1. How likely is it that the company will continue to generate returns in the future as it has done in the past (i.e. will returns persist)?
2. What is the market expecting in terms of future returns (i.e. what is reflected in the price)?

Companies that have generated high returns are likely to continue to do so over time. If a company has achieved an 8% return for eight consecutive years, there is 90% chance they will do it again the following year. High returns on capital are typically an indication of an underlying competitive advantage – something that shelters the company from the actions of peers. These advantages allow the company to earn profits over the cycle (in good times and in bad) and they increase the chance that it will do so in future. If the market turns temporarily pessimistic on the prospects for one of these companies and discounts its valuation, it can create an opportunity for us to strike.

Dividends play an important role in our investment process. Companies that are earning high returns in cash flow terms should be able to distribute some of their profits to shareholders, but should also have good business opportunities for reinvestment of their cashflows. We want to strike a balance between achieving a reasonable level of income, while reinvesting in order to grow that income over the long term.

The payment of a dividend also plays an important part in the overall capital allocation process. Knowing that they have to allow for a dividend payment each year, management has to carefully consider how the remaining capital will be allocated. Management's willingness to pay a dividend also indicates a degree of alignment with shareholder's interests. In a part of the market where corporate governance can be a challenge (though this is by no means exclusively a problem in Emerging Markets), cold, hard cash in the pockets of shareholders shows that management has considered the interests of the business's owners.

By investing in quality, dividend-paying companies, we seek to achieve a differentiated performance outcome. We expect to capture less of the downside in falling markets, while capturing a significant proportion of the upside in rising markets. With our value bias and more defensive characteristics, we think the fund makes a natural complement to Emerging Markets funds with a growth orientation.

How we think about macro factors

Although we select opportunities based on their individual merits, we cannot avoid considering macroeconomic factors. In Emerging Markets, financial markets can be more volatile, and underlying economies less robust. Exogenous factors, such as the price of oil or other commodities, can have an outsize impact both on fundamentals and on sentiment.

To address this challenge, we consider macro factors in so far as they will affect our individual investments. We distinguish between two effects:

1. How macro factors affect the *prospects* of our companies
2. How macro factors affect *sentiment* towards our companies

Of the two, we are primarily concerned with the former. We consider how different forces may affect the operating results (and thus the financial results) of each company. This assessment helps us to answer the question: "what is the likelihood that the company's returns will persist in future?"

Macro factors may play a greater or lesser role in determining the outcome for a business. Where a company's returns are highly dependent on an outside variable (for example, the oil price), we are likely to have much less confidence in the ability of that company to continue to perform in future. (Companies that are very sensitive to the oil price don't tend to feature in the universe anyway, as their returns are too cyclical to qualify.)

Alternatively, a company's exposure to an external economic variable may be a risk we are willing to bear. For example, banks have meaningful exposure to interest rates, which govern the spread they earn on lending. While we can look at the outlook for interest rates in a particular country, and make a judgement that they are stable, our ability to forecast such a variable is limited.

Instead, our efforts revolve around understanding a company's sensitivity to a particular variable and judging how likely it is to affect future returns. The banks in our universe, while sensitive to interest rates, have nevertheless been able to achieve excellent results over time in different interest rate environments. Banks often have other levers they can pull to offset the potential for lower interest margins. For these reasons, interest rate risk is a risk we are typically willing to accept (and one we mitigate by limiting our individual stock-specific risk and holding a diversified portfolio).

The effect of macro factors on sentiment is much harder to predict, so we naturally spend less time considering this topic. Sentiment can be driven by multiple factors – stock-specific as well as macro-oriented. When a stock price falls merely because the market judges it to be less attractive, but there is no actual impact on the company's operating results, we quite often find an attractive opportunity to enter an investment.

When we purchase a stock, we expect our return to come from three principal areas: valuation/multiple re-rating, earnings growth and dividend income. Over a long enough period of time, it is the earnings power of a business and its ability to reinvest in projects at attractive rates of return which govern the returns to shareholders (i.e. the earnings growth and dividend components are most important; valuations, and thus sentiment, play a much smaller part over the long term).

Currencies represent an additional source of volatility, particularly in Emerging Markets, where they can be affected more by capital flows, interest rates and inflation. In so far as the impact currencies can have on a company's fundamentals, businesses with international exposure are more insulated from movements in the local currency. Having an export orientation provides a natural hedge relative to a company that is more reliant on domestic demand. Similarly, borrowing in a currency that matches the company's revenues is usually much less risky than if there is a currency mismatch (borrowing in a different currency can provide the opportunity to make profits, but it can also inflict pain).

Our approach within the portfolio is not to hedge currencies. Currency hedging is expensive, and notoriously difficult to get even directionally right. We think our investing edge lies in stock selection, so we focus our effort there.

Summary view & outlook

Emerging Market currencies have experienced increased volatility in recent weeks, but expectations for economic growth remain robust.

The portfolio currently trades at a small premium to the benchmark. Given the portfolio's bias towards quality companies, we think this represents attractive value.

We invest in companies that have sustained competitive advantages (reflected in high returns on capital) over their peers. In an uncertain environment, we think that a portfolio of quality, dividend-paying companies is an attractive place to be positioned.

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

Data sources

Fund performance: *Financial Express, gross total return*

Index and stock data: *Bloomberg*

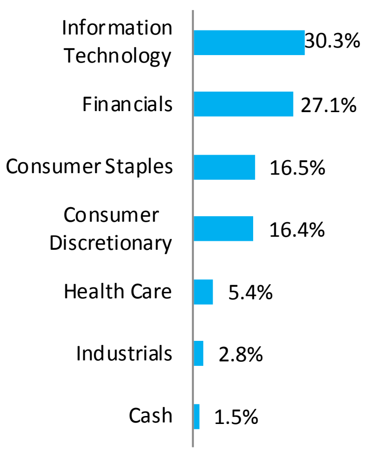
PORTFOLIO

31/05/2018

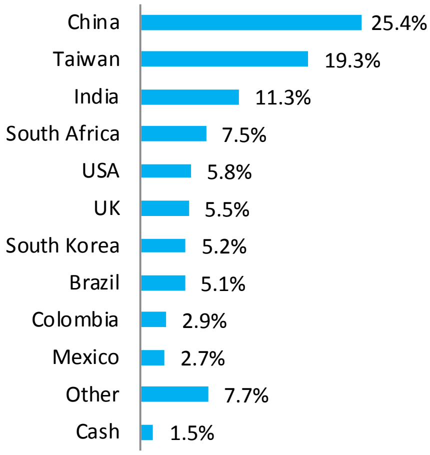
Fund top 10 holdings

China Lilang	3.5%
Grape King Bio	3.0%
Broadcom	3.0%
AAC Technologies	2.9%
Banco Davivienda	2.9%
Taiwan Semiconductor	2.9%
Infosys	2.9%
Indiabulls Housing Finan	2.9%
Ping An Insurance	2.9%
Coca-Cola Femsa SAB	2.8%
% of Fund in top 10	29.7%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

31/05/2018

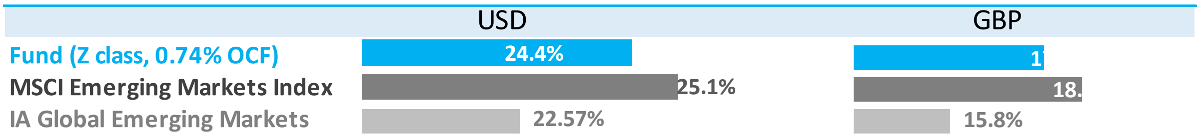
Discrete years % total return

	May '14		May '15		May '16		May '17		May '18	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.74% OCF)	-	-	-	-	-	-	-	-	17.8	14.3
MSCI Emerging Markets	4.6	-5.5	0.3	10.3	-17.3	-13.3	27.9	44.2	14.4	11.0
IA Global Emerging Markets Sector	3.9	-6.1	-2.1	7.6	-16.3	-12.3	26.3	42.4	10.1	6.8

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 (Z class, 0.74% OCF)	-3.1	0.3	-2.1	-0.5	17.8	14.3	-	-	45.3	27.0
MSCI Emerging Markets	-3.5	-0.1	-2.5	-0.9	14.4	11.0	21.0	38.8	43.6	25.5
IA Global Emerging Markets Sector	-3.8	-0.4	-4.3	-2.7	10.1	6.8	16.4	33.4	40.5	22.7

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 23.12.2016

31/05/2018	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.3	0.3	3.6	3.6
Beta	1.0	1.0	0.9	0.9	0.8	0.8
Information ratio	0.0	0.0	-0.5	-0.5	0.0	0.0
Maximum drawdown	-10.3	-10.3	-10.4	-10.4	-10.3	-10.3
R squared	1.0	1.0	0.9	0.9	0.8	0.8
Sharpe ratio	1.5	1.5	1.4	1.4	1.6	1.6
Tracking error	0.0	0.0	4.4	4.4	6.3	6.3
Volatility	14.1	14.1	13.0	13.0	13.1	13.1

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Source: Financial Express, bid to bid, gross total return (0.74% OCF). Fund launch date: 23.12.2016.

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 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

Telephone calls will be recorded and monitored.