Guinness Best of China Fund

INVESTMENT COMMENTARY – August 2018

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

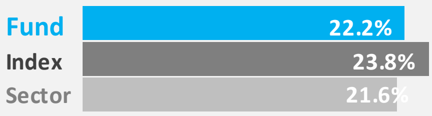
Performance

31.07.18

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

	1 year	3 years	From launch
Fund	7.1	-	69.2
Index	8.1	59.7	75.1
Sector	9.7	57.6	67.2

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	0.0	0.5
Beta	1.0	0.9	0.9
Info ratio	0.0	-0.3	-0.1
Max drwdn	-12.9	-16.8	-14.2
Tracking err	0	5	6
Volatility	18.1	17.6	18.0
Sharpe ratio	1.1	1.0	1.1

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

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

Fund & Market

- The fund (Z class in GBP) fell by 0.5% in July while the MSCI Golden Dragon Index rose by 0.5%.
- MSCI Taiwan was by far the strongest, rising 6.2%. Hong Kong rose by 2.1% while China fell by 1.9%.
- Taiwan's strength was led by a recovery in the Information Technology sector, which rose 8.3%. Companies in the smartphone supply chain, especially those exposed to Apple, reported solid quarterly results. TSMC and Catcher Technology, both of which are held in the fund, were strong.
- In China, Utilities and Materials performed well, with the MSCI indices rising 6.3% and 4.8%. On the other hand, the Consumer Discretionary index fell 8.5%.
- In China the Health Care index fell 7.1% after a vaccine scandal.

Events in July

- US tariffs on $34bn of Chinese goods came into effect, at a rate of 25%.
- The Office of the US Trade Representative (USTR) released a list of products covering a further $200bn of Chinese imports for which a 10% tariff is proposed.
- A series of policies was announced aimed at supporting growth in China. The main policy is a push to accelerate local government bond issuance, which has been relatively weak this year, especially in the second quarter. Weak issuance is one of the main reasons why infrastructure investment, and therefore fixed asset investment, has been growing slowly this year.
- President Trump sparked controversy at a summit with Vladimir Putin in Helsinki by failing to condemn Russia's alleged influence over the 2016 US election.

- Meanwhile, at a meeting with European leaders, China offered conciliatory comments to the US, reinforcing its support for preserving a 'global trading system'.

- Later in the month, President Trump and President of the European Commission Jean-Claude Juncker held talks on trade in Washington. Markets reacted optimistically after an agreement not to impose further tariffs was reached.

- The Yuan continued to weaken over the month, falling 2.8% against the dollar.

Markets and portfolio

The Consumer Discretionary sector was noticeably weak in the month and we saw weakness in **China Lilang** (clothing retailer), **Haier Electronics** (retailer of white good appliances), **Luk Fook** (jewellery retailer) and **Geely Automobile** (car manufacturer). Retail sales growth in the auto industry turned negative in June for the first time since 2015, falling 3.4%. This is partly because last year purchases of smaller vehicles were partly subsidised whereas this year there is no subsidy. In addition, competition is intense with average prices in the industry falling 3.2% so far this year. Nevertheless, Geely put out a positive profit alert and is expecting net profit to increase by c.50% for the first six months of the year.

A vaccine scandal led to weakness in the Healthcare sector after Changsheng Biotechnology was caught falsifying data relating to its rabies vaccine. China has a history of healthcare scandals: in 2008 six babies died and tens of thousands were hospitalised after milk and infant formula was found to be contaminated with melamine, which is used in the production of plastics; and in 2011, 286 people were hospitalised after eating meat which had been injected with a banned steroid. The government has stepped up inspection of healthcare production facilities and it is likely the sector will come under closer scrutiny. Our two healthcare holdings in China, **China Medical System** and **Sino Biopharmaceutical**, were therefore weak.

The government announced plans to accelerate approval of local government bond issuance in order to boost infrastructure investment growth. While the economy is rebalancing towards consumption and so a slowdown in investment growth is expected, we are surprised by how quickly investment growth has slowed down. Cumulative fixed asset investment growth was only 5.5% as of the end of July, compared to 7.2% for 2017 and 8.1% for 2016. Delving deeper into the data shows a stark difference between state-led investment and private sector investment. As of the end of July, state-led investment had only grown by 1%, while private sector investment was up 9%. So, while the headlines may suggest that slower investment growth is a worrying sign, we actually think the opposite is true. The slowdown in investment growth in the state sector is a positive, because the state is much more likely to invest in low-return projects. As a result of the policy change, the materials and industrials sectors were strong. **Anhui Conch Cement** is likely to benefit, although generally the fund has relatively low exposure to companies that rely on infrastructure spending.

Though **Tencent's** share price more than doubled in 2017, it has struggled this year, falling 10%. The company is spending heavily on new areas such as video content which is likely to lead to lower margins in the near term. The company's main generator of cash, its gaming division, is also facing new challenges. The gaming industry is also having to deal with a newly formed regulator which has a large backlog of approvals to go through. Each game in China needs approval to be released, and another approval to be monetised. As gamers are shifting from PC to mobile games and trying new "*battle royale*" style games, Tencent is seeing more of its customers play games which are not monetised at all. Since the Best of China Fund has an equally-weighted portfolio, Tencent has a 3% position in the fund, rather than 9-10% like many China funds. The fund has a disciplined process of investing in undervalued companies and we expect returns to come from a range of companies, not just a few large positions.

Several companies in the portfolio recently announced earnings results or other news.

China Merchants Bank gave an early indication of good results for the first half of 2018, with net profits up 14% year-on-year. Deposit growth returned in the second quarter after being flat in the first, which offset a contraction in net interest margin. Non-interest income also grew at a robust rate, and asset quality improved (reported Non Performing Loan ratio dropped 5 basis points to 1.43%). The results were seen as broadly positive for the sector. The Chinese banks are to report results later in August.

Qualcomm conceded its acquisition of NXP after failing to receive clearance from regulators in China. The company instead announced that it would use its cash for $30bn of share buybacks, to be done in stages. Qualcomm also announced results that were ahead of expectations which include the receipt of interim payments from a licensing customer (Qualcomm is currently in dispute with two of its customers: one is Apple, and the other is believed to be Huawei).

On the negative side, Qualcomm confirmed that Apple will be using a different modem supplier for its newest iPhone cycle. However, this is more a consequence of the dispute with Apple, (which we expect the company to continue to take steps to resolve), and Qualcomm will continue to provide products for previous iPhone models.

Elite Material released results that were broadly in line were expectations, and with much better sales figures for July – indicating a return to growth – the share price had a welcome bounce. After a difficult first half of the year (in common with many smartphone hardware suppliers), we are optimistic that demand for the company's products will recover strongly in the second half.

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

Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

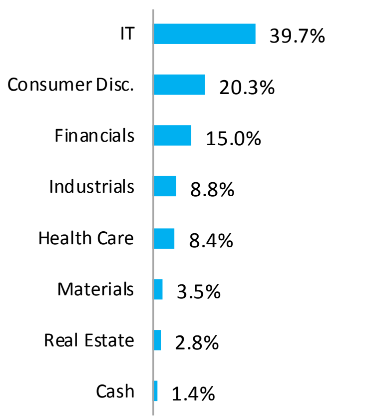
PORTFOLIO

31/07/2018

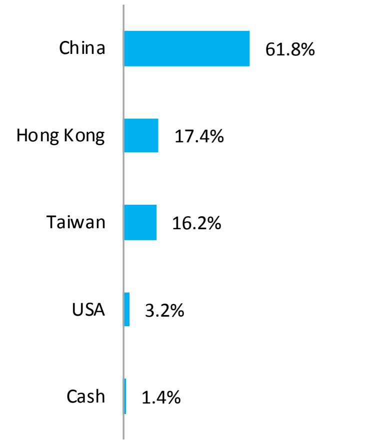
Fund top 10 holdings

Anhui Conch Cement	3.5%
Catcher Technology	3.4%
Elite Material	3.4%
Taiwan Semiconductor	3.3%
Novatek Microelectronics	3.2%
Hollysys Automation Tech	3.2%
China Merchants Bank	3.2%
Noah Holdings	3.2%
Qualcomm	3.2%
Luk Fook Holdings	3.1%
% of Fund in top 10	32.6%
Total number of stocks in Fund	33

Sector analysis



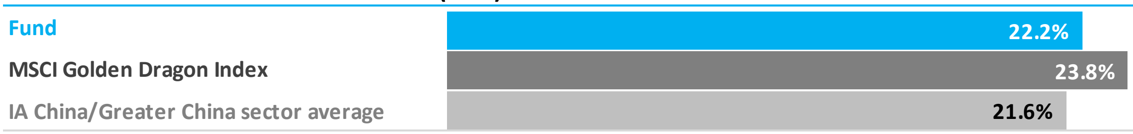
Geographic allocation



PERFORMANCE

31/07/2018

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Jul '14	Jul '15	Jul '16	Jul '17	Jul '18
Fund	-	-	-	36.7	7.1
MSCI Golden Dragon Index	7.5	9.2	11.0	33.2	8.1
IA China/Greater China sector average	6.0	10.1	8.3	32.8	9.7

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	-0.5	-3.1	7.1	-	-	69.2
MSCI Golden Dragon Index	0.5	1.2	8.1	59.7	87.5	75.1
IA China/Greater China sector average	-1.9	-0.5	9.7	57.6	84.0	67.2

RISK ANALYSIS

31/07/2018

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	0.02	0.50
Beta	1.00	0.94	0.94
Information ratio	0.00	-0.27	-0.14
Maximum drawdown	-12.88	-16.84	-14.20
R squared	1.00	0.94	0.90
Sharpe ratio	1.10	1.04	1.05
Tracking error	0.00	4.53	5.81
Volatility	18.10	17.63	17.95

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 (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.