Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – November 2018

Launch date	**19.12.2013**
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

31/10/2018

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

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	-13.5	-8.5	-10.2	-6.6	36.6	74.8
Index	-15.2	-10.2	-12.0	-8.6	17.0	49.9
Sector	-16.5	-11.6	-13.2	-9.8	16.3	48.9

Annualised % total return from launch

	USD	GBP
Fund	6.6%	12.2%
Index	3.3%	8.7%
Sector	3.1%	8.5%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.3	1.0	4.1	4.8
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.6	0.6
Max drwdn	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	3.7	3.7	5.8	5.8
Volatility	14.9	15.3	13.4	13.6	12.7	14.0
Sharpe ratio	0.0	0.3	0.0	0.3	0.2	0.6

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: Financial Express, Y class 0.99%, bid to bid, total return.

Fund & Market

- October was a month to forget with Asia down 8.7% in GBP terms and down 10.5% in USD terms (as measured by MSCI AC Pacific ex Japan net return Index).
- In sector terms, the outperformers were Utilities and Telecom Services, which were down 5%, and Real Estate, Financials and Consumer Staples, which were down 8%-9%. The underperformers were IT, down 14%, and Health Care and Consumer Discretionary, down 13%. Industrials, Energy and Materials moved in line (all in USD terms).
- In country terms, underperformance was confined to north Asia (China, Hong Kong, Korea and Taiwan), which fell 11%-14.5%. South-east Asia and Australia & New Zealand clearly held up.
- The Fund did better than the market during the month. In the portfolio, 20 out of 36 stocks outperformed the market, 12 of which are Chinese, Hong Kong, Taiwanese or Korean companies. Among the top 20 performers are companies in the IT, Consumer Discretionary and Energy sectors as well as Financials and Real Estate.
- Sino-US trade, a strong US dollar, rising bond yields and a steady stream of weaker Chinese macro data combined to drive market sentiment.
- At the end of October, Asian valuations have compressed to 11.8x consensus estimated earnings, back to 2015 lows.

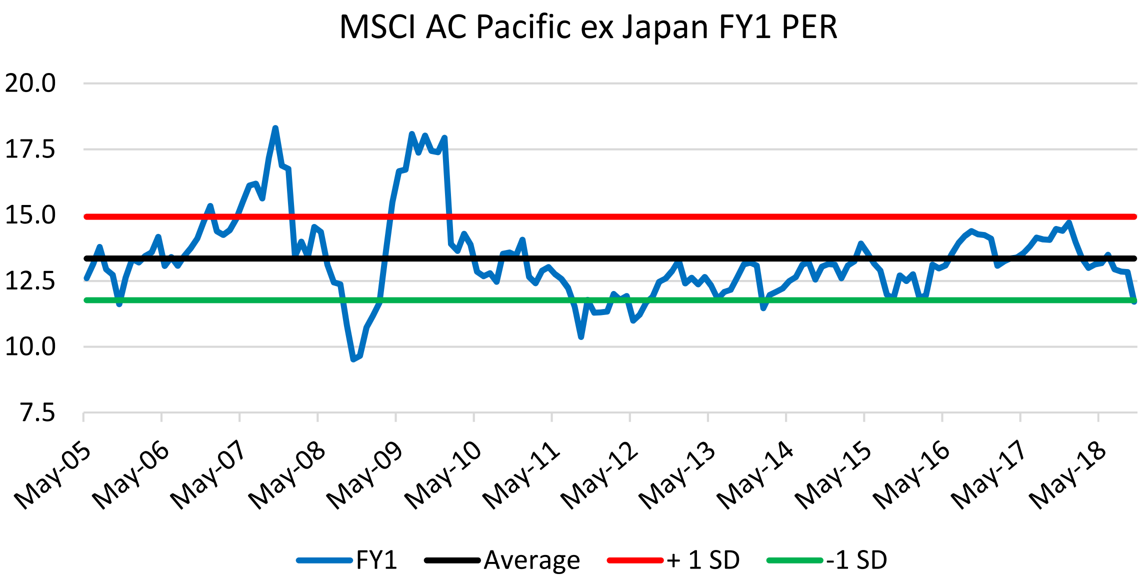
Events in October

- Asian earnings forecasts were revised down by 1.5% over the month to leave forecast earnings growth at 8.4%.
- US and Canada reached an agreement on trade.
- The Italian budget plan was submitted to the EU and was rejected because it fails to meet the requirement for steady deficit reduction. Italian debt was downgraded by Moody's but remains (just) investment grade. Minutes of the Federal Open Markets Committee meeting in September (released in October) suggested the majority were looking to push interest rates into restrictive territory next year. This prompted a spike in bond yields mid-month.
- US-China trade tensions have in fact reduced as threats for the next round of tariffs have diminished and the focus shifts to discussions and a meeting between Trump and Xi in December.
- US did not label China a currency manipulator.
- Although little reported, China doubled its imports of oil from the US in September and cut oil imports from Iran by 34%.
- Jair Bolsonaro was confirmed as Brazil's new president.
- Angela Merkel announced she would not stand again as party leader and that she would not seek re-election as Chancellor of Germany in 2021.

Asian Markets & Macro

Valuations

Asian valuations have now reached the lows of 2015 after a torrid period in markets. The chart below shows the forward Price to Earnings (PER) multiple for consensus expected (FY1) earnings compared to its 10-year average with bands showing +/- 1 standard deviation (for a normal distribution, +/- 1 standard deviation (SD) means that valuations should lie within these bands 68.27% of the time). At the end of October, valuations are at the bottom of this range. This means that Asia has given up all the valuation re-rating that it has achieved since the end of 2015, but in contrast to the period 2010-2015 when Asian earnings contracted 0.5% per annum on average, profits since 2015 have grown 10.1% on an annualised basis (MSCI AC Pacific ex Japan earnings 31 Dec 2015 – 31 Oct 2018).



Source: Bloomberg data, Guinness Asset Management

Asian trade patterns

China has dominated Asian trade since it joined the World Trade Organization in 2000, but in recent years, trade patterns have evolved as other countries' manufacturing capacity has improved. The impetus has been Yuan appreciation (from its pre-2005 pegged level, recent yuan weakness notwithstanding) and rising production and labour costs. These trends have emerged gradually over the last ten years but have now reached a point where changes in behaviour are measurably different. The recent trade dispute between the US and China reinforces the argument for geographical diversification in the supply chain.

In the three years from 2014 to 2017, China's share of total exports from emerging Asia has fallen by 1.2%, while Vietnam has been the clear winner with an increased share of almost 1.5%. The drop in China's share may not seem much, but it is the first fall in ten years. While a degree of caution is required in interpretation, it seems clear that real effective exchange rate appreciation, higher labour costs and higher environmental protection costs have pushed up the cost of doing business, so lower value-added production has shifted. That shift has also been accelerated (some of it deliberately) by government policy support for more 'desirable' long-term industries.

However, it is also true that the rise in manufacturing capabilities in south east Asia is accelerating. Vietnam is picking up both low-cost textile manufacturing and is emerging as a new area for assembly and production in the technology sector. This is true not only for Chinese manufacturers but also for Korea, which has stepped up its offshore production capacity. The industrial story in Thailand is similar, with Taiwanese and Japanese companies setting up production of hard disk drives and power supply systems for the technology sector and auto parts such as clutches.

The shifts that we are seeing are not the product of Trump's trade policies but are a natural process of economic evolution. China's domestic economy is growing wealthier, which means on one hand that it is more expensive to manufacture, thereby pushing China into the production of high-end goods, and on the other, that the wealthier domestic economy will draw in more imported goods as well as create a more extensive services sector and increase both domestic and outbound tourism. This has long-term implications for China's trade and current account surplus, which we would expect to decline over time. Positive environmental outcomes are also likely as a result both of exiting energy intensive manufacturing and of policy explicitly directed toward promoting 'green' industries from electricity generation through to electric vehicles.

For other countries such as Vietnam, Cambodia and Laos, as well as for countries like Thailand and Indonesia, there now opens the prospect of accelerating industrial growth as China vacates the lower-end manufacturing space. Vietnam is rapidly becoming the poster-child of this group, coming as it does from a low base. Its rising export share has been accompanied by increased foreign direct investment and higher trade surpluses. Over time this should point to a structural rise in the value of its currency versus those of its trading partners.

The implications of these trends for the portfolio are incremental, rather than immediate. It does not mean we should immediately seek to increase our exposure to Vietnamese listed securities but rather we should look at those businesses capable of taking advantage of what these trends can offer. For our companies that means the ability to sustain margins and diversify operational risk. Names in the portfolio that immediately come to mind as taking advantage today are Pacific Textiles (China) with its Vietnam operations, Delta Electronics Thailand (which has a Taiwanese parent), Hon Hai Precision (Taiwan) and Li & Fung, whose business model is centred on its ability to source production capacity around the world, but especially across Asia.

Outlook

At present, stock markets are heavily focused on the immediate future. It helps to remember, however, especially in the context of low valuations today, that there are powerful structural trends in Asia which are unlikely to be altered by current policies. The imbalance in trade between China and the rest of the world was already changing before Trump was elected. Asia is still getting wealthier; this process may be a little slower over the next 12 months, but it is likely to continue nevertheless. We therefore reiterate the points we made in the valuation section above that we think Asian markets are cheap and now is therefore a good opportunity to build positions in these structural trends if you can look beyond the current posturing. We think doing so is made easier by our focus on companies that have been profitable dividend-payers over time.

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

Data sources

Fund performance: *Financial Express, total return*

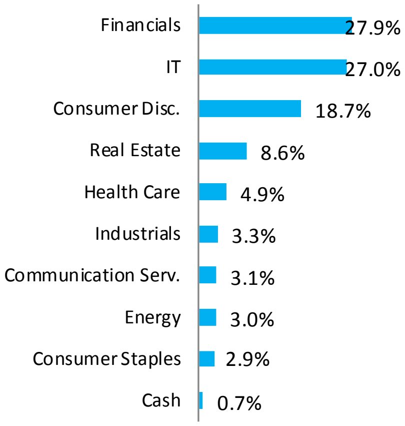
Index and stock data: *Bloomberg*

PORTFOLIO **31/10/2018**

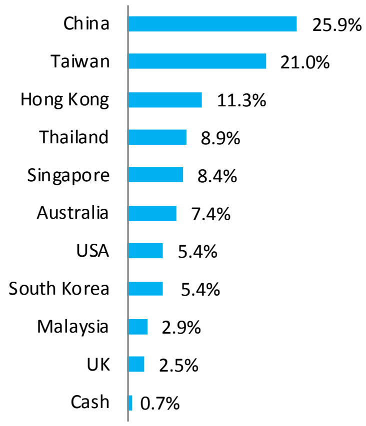
Fund top 10 holdings

Yangzijiang Shipbuilding	3.3%
China Minsheng Banking	3.2%
China Mobile	3.1%
PTT PCL	3.0%
Tisco Financial Foreign	3.0%
Pacific Textiles	3.0%
Capitamall Trust	3.0%
Public Bank Bhd	2.9%
Elite Material	2.9%
China Merchants Bank	2.9%
% of Fund in top 10	30.3%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

31/10/2018

Discrete years % total return

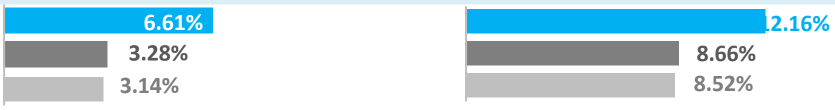
	Oct '14		Oct '15		Oct '16		Oct '17		Oct '18	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Y class, 0.99% OCF)	-	-	-	-	6.1	34.8	27.3	16.3	-10.2	-6.6
MSCI AC Pacific ex Japan Index	2.5	2.9	-10.7	-7.5	8.3	36.9	28.2	17.8	-12.0	-8.6
IA Asia Pacific ex Japan	4.2	4.6	-8.6	-5.3	6.7	34.9	26.5	16.3	-13.2	-9.8

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 (Y class, 0.99% OCF)	-10.1	-8.2	-13.5	-8.5	-10.2	-6.6	21.3	46.5	36.6	74.8
MSCI AC Pacific ex Japan Index	-10.5	-8.7	-15.2	-10.2	-12.0	-8.6	22.1	47.6	17.0	49.9
IA Asia Pacific ex Japan	-10.5	-8.7	-16.5	-11.6	-13.2	-9.8	17.2	41.7	16.3	48.9

Annualised % total return from launch

	USD	GBP
Fund (Y class, 0.99% OCF)	6.61%	12.16%
MSCI AC Pacific ex Japan Index	3.28%	8.66%
IA Asia Pacific ex Japan	3.14%	8.52%



Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/10/2018	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.3	1.0	4.1	4.8
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.6	0.6
Maximum drawdown	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
R squared	1.0	1.0	0.9	1.0	0.9	0.9
Sharpe ratio	0.0	0.3	0.0	0.3	0.2	0.6
Tracking error	0.0	0.0	3.7	3.7	5.8	5.8
Volatility	14.9	15.3	13.4	13.6	12.7	14.0

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. 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.

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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.

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Telephone calls will be recorded and monitored.