Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – November 2018

Launch date	**23.12.2016**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (manager) **Sharukh Malik** (analyst)

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 31/10/2018

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	-10.0	11.6	32.6	37.8	25.4
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	-14.4	-9.3	-7.2	-3.6	31.5	23.6
Index	-15.7	-10.8	-12.5	-9.1	30.1	22.3
Sector	-17.9	-13.1	-14.8	-11.4	25.3	17.8

Annualised % total return from launch

	USD	GBP
Fund	10.2%	7.7%
Index	10.2%	7.7%
Sector	7.8%	5.4%

Risk analysis (annualised, weekly, from launch)

	Index		**Sector**		**Fund**	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.7	3.6	1.8
Beta	1.0	1.0	1.0	0.9	1.0	0.8
Info ratio	0.0	0.0	0.0	-0.4	0.5	0.1
Max drwdn	-24.6	-16.6	-24.6	-16.6	-23.0	-14.8
Tracking err	0.0	0.0	0.0	4.1	6.1	6.4
Volatility	14.6	13.8	13.4	12.3	13.4	13.1
Sharpe ratio	0.3	0.1	0.2	0.0	0.4	0.2

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, total return.

Fund & market

- After a flat month in September, the fund was weak in October, falling 9.2% (Z-class, total return in USD) compared to the MSCI Emerging Markets Net Total Return Index which fell 8.7% (–7.1% and –6.7% respectively in GBP)

- For the year to the end of October, the fund is down 14.5%, outperforming the benchmark which is down 15.7%

- Last month Emerging Asia was the weakest region, declining 10.9%. EMEA was also weak, falling 6.7%.
- Latin America bucked the trend and rose 3.5%. Brazil was the principal driver, following the election of Jair Bolsonaro (see 'Events' below).

- Other than Brazil, all of the ten largest countries declined (as measured by their respective MSCI country indices). North Asia was weak, with China, Korea and Taiwan falling by 11.5%, 14.5% and 12% respectively.

- Mexico was the worst performing of the large countries, declining by 17.4%. One factor that contributed to the weakness was the announcement by the incoming president, 'AMLO', that a new airport in Mexico City would not be going ahead on the original site planned, after a referendum on the project. The move prompted fears that AMLO will be unwilling to push through necessary reforms that are unpopular.

- South Africa was also a laggard, falling 10.8%. We wrote about some of the challenges the South African economy is facing in last month's brief.

- Unsurprisingly given the country returns, our best performing stock in the month was B3, the Brazilian stock exchange, which rose 22.3%. The fund's other best stocks were Credicorp and China Minsheng.

- The weakest stocks were two technology companies: Elite Material (–29.1%) and AAC Technologies (–26.8%). We discuss both below. Information Technology, along with Health Care were the weakest sectors in the Emerging Markets benchmark, both falling 13.6%.

Events in October

- 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) pointed to the majority looking to push interest rates into restrictive territory next year. This prompted a spike in bond yields mid-month.

- US-China trade tensions in fact reduce as threats for the next round of tariffs have diminished and focus shifts to discussions and a meeting between Trump and Xi in December.

- US did not label China a currency manipulator.

- Little reported, but 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. Two of the areas Mr Bolsonaro's administration is expected to tackle are pensions reform and other public expenditure – both areas are seen to be in strong need of reform. He is also expected to lead a clampdown on crime and corruption.

- 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.

Portfolio Review

The volatility we witnessed in emerging markets in October was a useful illustration that political risks/macroeconomic developments are unpredictable and can have an outsized impact on results. As a result, there is considerable merit in focusing on company analysis and stock selection, rather than trying to make top down allocation decisions. Accordingly, we review the outliers in the portfolio – both the outperformers and underperformers – below.

Leaders

B3 – Brasil Bolsa Balcao is the Brazilian stock exchange and financial services group. The company in its current form was established in 2017 following the merger of BM&F Bovespa and Cetip, a services provider in the over-the-counter (OTC) market. The group's divisions operate in derivatives, equities, OTC markets, loans (including vehicles financing) and depository and other services. B3 has an impressive track record of generating high returns on capital over the past ten years.

Stock exchanges are generally an attractive business model to us, as they are relatively 'capital light' businesses and often have limited competition. Stock exchanges generally give investors a higher 'beta' exposure to underlying stock markets – this was particularly apparent in the case of B3 in October, as the Brazilian market rallied after the election. The downside to this is if markets fall then the stock exchanges can be weak (although volatile markets can benefit the exchanges if they reflect increased trading volumes).

Many exchanges have increasingly moved to the provision of market data as a source of revenues in addition to trading. This shift has the advantage that the revenue generated tends to be recurring and thus more 'sticky'. It also moves the business away from a dependence on transaction volumes. Market data currently represents a relatively small proportion of B3's business, but the company has other sources of fee income, and operates in a diverse range of areas.

We like this combination of characteristics that merit B3's inclusion in a diversified portfolio.

Credicorp is the largest banking and financial services company operating in Peru (the stock is listed on the New York Stock Exchange). Credicorp offers universal banking, microfinance, investment banking, wealth management, and insurance and pensions through a range of brand names across South America.

Following month end, the company reported results for the third quarter. Peru's economy has been strong, with 'hard' employment data indicating a resilient formal labour market. Although recently downgraded by the IMF, Peru's GDP is forecast to grow 3.7% in 2018 and 2019. Recent government approval was granted for a second anchovy fishing season, authorising a catch quota of just over 1 million metric tons. Private investment in the country has been recovering, with capital projects being undertaken in the mining sector and a $1.5bn expansion of the Jorge Chavez Airport in Lima. This increase offsets a slowdown in public investment.

The financial results show good progress in loan growth (average daily balances for the first nine months grew 8.7% versus the prior year), which has translated to an increase in net interest income. Expenses have also increased, leading to a small rise in the efficiency ratio. The company's capital ratios remain healthy, and management is guiding return on average equity for 2018 to be around 18%.

China Minsheng, a Chinese bank, was added to the fund at the beginning of the year. Our thesis with this stock has been that the market is overly negative on the company's prospects; reflected in Minsheng trading at 0.6x book value at time of purchase. When the market's pessimism is at such extreme levels, often continuing to generate results that are respectable—rather than spectacular—is enough to warrant a rerating in the stock.

China Minsheng reported a decline in net interest income in the third quarter (compared with the same quarter a year ago), but this was offset by a significant increase in non-interest income from higher trading and investment income. Net profit growth of 8% year-on-year was at higher level than the previous quarter.

At present, we generally expect limited earnings growth from the Chinese banks. Instead we expect our return in these stocks to come partly from the dividend, but mainly from a re-rating of the valuation multiples.

Laggards

Elite Material and **AAC Technologies** both suffered in a month where component manufacturers sold off on concerns over weaker demand for smartphones. Elite Material is a manufacturer of environmentally-friendly circuit board materials and AAC manufactures speaker assemblies, and vibration motors and related components. Both companies have significant exposure to smartphones.

Smartphone sales, in particular the latest iterations of the iPhone, have been disappointing, with overall unit volumes in decline. Demand for the iPhone XR model in particular has fallen short of expectations. These concerns are reflected in Apple's stock price, which at time of writing has fallen 23% from its 52-week high. The members of the supply chain have suffered accordingly.

However, the outlook is not universally bad. Despite the declining volumes, Apple has had success in increasing average selling prices for iPhones: newer models command higher prices than their equivalent previous versions, and customers have shown an appetite to pay up for the prestige of owning the top-of-the range model. This trend benefits the component manufacturers, particularly if they are the market leaders in their segment and can charge a premium price for a differentiated product.

St Shine continued to fall in October following weak monthly revenues. The company's shipments to a US customer, which had been one of the drivers of the strength in the stock price last year, have disappointed relative to consensus expectations. On the positive side, revenues to Japanese clients have grown. Sales overall for the first nine months are up 4% versus the prior year. The stock trades on relatively undemanding price earnings multiples and offers a dividend yield of 4.9%. Over the past five years, the dividend has grown at 7.4% per annum.

Outlook

Emerging markets continue to look cheap. At the end of the October, the MSCI Emerging Markets Index traded on 10.8x 2018 earnings – roughly the level it traded on in early 2016. Although sentiment is very weak (valuation multiples have given up all of the expansion achieved in 2016 and 2017), the fundamental environment now is vastly different. Notable improvements have been made in China's and Brazil's economies, and earnings across the region are forecast to grow at 11% next year.

The fund trades at 11.7x 2018 earnings, and 10.6x 2019. Both figures represent a small premium to the benchmark, but are still in our opinion very modest valuations on an absolute and relative basis. The portfolio yield is around 3.4%.

Uncertainty over trade, softer short-term activity data and a relatively tight US monetary policy are dampening sentiment towards emerging markets. However, for investors with a long-term horizon, we think that being positioned in quality companies that have generated consistent results is a sensible strategy. We will continue to rebalance the portfolio to take advantage of market volatility.

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

Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

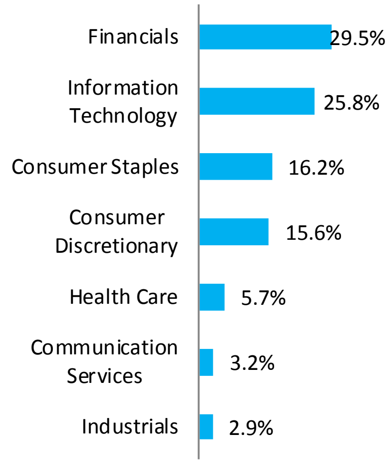
PORTFOLIO

31/10/2018

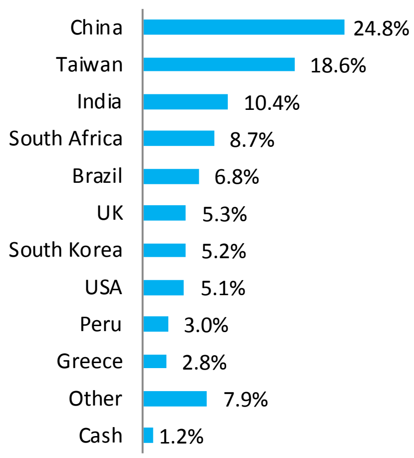
Fund top 10 holdings

B3 SA - Brasil Bolsa Balca	3.8%
Netease.com	3.2%
JSE Ltd	3.2%
St. Shine Optical Co	3.1%
China Minsheng Banking	3.0%
Porto Seguro	3.0%
Credicorp	3.0%
Truworths International	2.9%
Haitian International Hol	2.9%
Elite Material	2.8%
% of Fund in top 10	30.8%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

31/10/2018

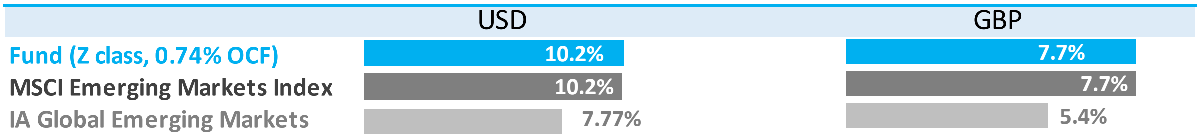
Discrete years % total return

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 (Z class, 0.74% OCF)	-	-	-	-	-	-	-	-	-7.2	-3.6
MSCI Emerging Markets	1.0	1.4	-14.2	-11.1	9.7	38.7	26.9	16.7	-12.2	-8.7
IA Global Emerging Markets Sector	0.1	0.5	-14.5	-11.4	8.4	37.2	24.9	14.9	-14.8	-11.4

Cumulative % total return

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)	-9.0	-7.1	-14.4	-9.3	-7.2	-3.6	-	-	31.5	23.6
MSCI Emerging Markets	-8.7	-6.8	-15.7	-10.8	-12.5	-9.1	20.9	46.1	30.1	22.3
IA Global Emerging Markets Sector	-8.3	-6.4	-17.9	-13.1	-14.8	-11.4	15.4	39.5	25.3	17.8

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 23.12.2016

31/10/2018	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.7	3.6	1.8
Beta	1.0	1.0	1.0	0.9	1.0	0.8
Information ratio	0.0	0.0	0.0	-0.4	0.5	0.1
Maximum drawdown	-24.6	-16.6	-24.6	-16.6	-23.0	-14.8
R squared	1.0	1.0	1.0	0.9	0.8	0.8
Sharpe ratio	0.3	0.1	0.2	0.0	0.4	0.2
Tracking error	0.0	0.0	0.0	4.1	6.1	6.4
Volatility	14.6	13.8	13.4	12.3	13.4	13.1

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 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.