Guinness Best of China Fund

INVESTMENT COMMENTARY – December 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.

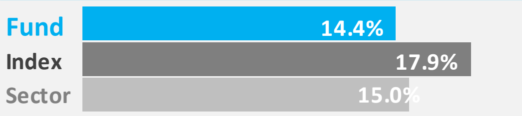
The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle

Performance 30.11.18

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

	1 year	3 years	From launch
Fund	-12.9	-	49.0
Index	-4.1	57.4	62.6
Sector	-7.7	47.0	51.2

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-2.3	-2.2
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.6	-0.5
Max drwdn	-17.8	-21.7	-22.2
Tracking err	0	5	6
Volatility	18.7	18.8	19.0
Sharpe ratio	0.7	0.6	0.5

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. Returns for share classes with a different OCF will vary accordingly

Fund & Market

- In November, the Best of China Fund rose 2.0% (in GBP) while the MSCI Golden Dragon Net Total Return Index rose 5.6%.

- Trump and Xi agreed to meet at the G20 meeting at the end of the month, at which a temporary truce was declared in the trade war. The US will postpone increasing tariffs from 10% to 25% for two months, from January 1st to March 1st. The Chinese agreed to buy some agricultural, industrial and energy products.

- The extra time will give the two sides to negotiate. On December 3rd, the first trading day after the truce was announced, Asian markets were very strong. The Hang Seng Index rose 2.6% while the CSI 300 (mainland shares) rose 2.8%.

- Consequently, MSCI Hong Kong and China were strong, both rising 7.4% in the month. MSCI Taiwan, on the other hand, fell 0.8%. News reports indicate Apple is cutting orders for the iPhone XR. More generally, it is possible that the consensus is Apple will find it difficult to increase the volume of iPhones sold. Companies in the iPhone supply chain were weak as a result. Results from Nvidia suggest a slowdown in demand for GPUs, which led to some weakness for TSMC.

- The fund lagged the index for several reasons. About half of the underperformance came from specific stocks, among which VTech (discussed later), Catcher Technology (in the iPhone supply chain) and Tongda were the greatest laggards.

- The fund holds Tencent but, being equally weighted, it holds less of the stock than the benchmark. The neutral weight of a stock in the fund is 3.0% while Tencent makes up c.8.0% of the benchmark. This cost the fund c.0.9% of relative performance.

- The Fund has a low exposure to real estate because many companies are unable to produce consistently high returns on capital or are heavily indebted. However, this sector did well during the month and this also cost the Fund.

Events in November

- The ruling party in Taiwan, the Democratic Progressive Party (DPP), was the loser in local elections. The President, Tsai Ing-wen, remains in her post but is stepping down as head of the DPP.

- The party's share of the vote fell from 56% in the 2016 election to 39%. The opposition party, the Kuomintang (KMT), saw its share rise from 31% to 49%.

- The DPP lost its seat in Kaohsiung, which had been viewed as a stronghold city and which the DPP had held for 20 years. The DPP now has lost control of Taiwan's largest cities.

- The view is that the DPP lost on domestic issues – including the government's reluctance to increase the minimum wage and proposals to cuts pensions – rather than on relations with China.

Portfolio Update

The fund has only one holding in the Real Estate sector which is China Overseas Land & Investment (COLI). There are few property developers which generate a persistent return on capital and have sensible gearing. The sector was strong in November in both Hong Kong and China. In Hong Kong, since the Hong Kong dollar is fixed to the US dollar, monetary policy must follow that of the US. The Chair of the Federal Reserve in the US, Jay Powell, struck a more dovish tone in November. Since interest rates in Hong Kong follow those in the US, this effectively means interest rates in Hong Kong may not rise as much as markets were expecting, leading to potentially lower funding costs for property developers. In China, the sector was strong because more investors are expecting policymakers to loosen policy to stimulate the housing market. Also, the sector is trading at historically low levels and so is becoming attractive to some. We note more coverage on the leverage that some Chinese developers are taking on and the associated funding costs. China Evergrande Group sold five-year bonds with a 13.75% coupon, the most it has ever paid. Next year many property developers will need to refinance at rates that are much higher than were seen in 2016 and 2017 and there will no doubt be defaults. The companies that are subject to these risks are not the ones this fund aims to invest in.

VTech reported unexpectedly weak results. The company is well known for its toys segment but there are other parts to the business. The company produces phones for the residential and commercial market. It also operates a contract manufacturing service, producing goods such as professional audio equipment and medical health products. It does seem there are a few temporary headwinds the business is facing which explain results. In North America two major customers are clearing inventory in baby monitors and DJ equipment, both of which are fast-growing businesses. In addition, a new series of Voice over Internet Protocol (VoIP) phones was delayed until the second half of the year. In Europe, the toys segment was weak because a new logistics vendor was in the process of moving to a new warehouse, leading to delayed shipments. It was encouraging to see VTech's flexibility with regards to tariffs. Certain products are affected but earlier in the year VTech acquired a facility in Malaysia to which it can shift production.

Last month we spoke about Pacific Textiles and its troubles with its factory in Vietnam, arguing these problems should be in the past. The company reported encouraging interim results with a recovery in revenue and earnings. Higher sales volume is coming through a set of more diversified customers. The Vietnam factory is now running at 40% of capacity and management expect it to be running at pre-suspension levels by March 2019. Management also talked about improving energy and resource efficiency through improving waste water and air treatment, as well as better use of automation. The environmental impact of the textile industry is becoming a bigger issue in the press in Western markets and so garment and textile manufacturers which want to remain competitive need to address these concerns. The fact Pacific Textiles thinks their efforts are paying off is good news.

Noah Holdings is a wealth and asset manager and reported good results. Although volumes were weak, Noah was able to increase its fees, demonstrating pricing power – a characteristic we like to see. The company is notably putting an emphasis on moving away from one-time commissions to recurring fees. We think Noah is doing well in a difficult regulatory environment. Policymakers are cleaning up the wealth management product (WMP) industry through new regulations, making the operating environment quite difficult at the moment. New rules include:

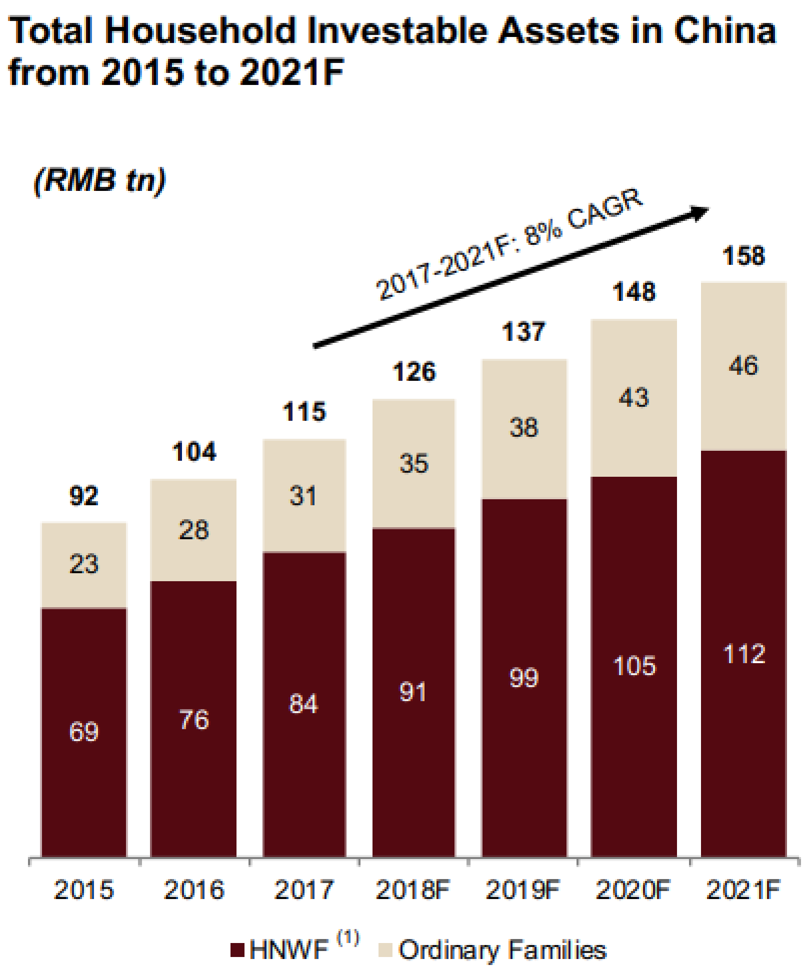
- Implicit guarantees are no longer allowed. In the past, WMPs offered a guaranteed return and to many investors, this was normal. If the WMP did not have the cash flows to support repayment, it would be bailed out. This is no longer allowed.

- Maturity of non-standardised credit assets should be earlier than fund maturity date.

- Limits on leverage on funds.

- Publicly offered funds can only invest in standardised credit assets, listed equities, commodities and derivatives. Privately offered funds can only be sold to qualified investors and can invest in more complex assets.

These new rules mean issuance of WMPs has fallen, which in our opinion is a good thing, though it does mean the market is slow in the short term as clients get used to the idea that investments do in fact involve risk. Noah is running seminars to educate existing and potential clients on how capital markets will work in the new regulatory regime. The long-term story remains absolutely intact. The number of high net worth individuals in China continues to grow and they will have assets to invest – this is Noah's target market.



Source: company presentation

Summary view & outlook

We expect the fund's focus on companies persistently earning a return on capital well above the cost of capital to do well in the long term. The fund now trades on a price to earnings multiple of 10.0x, based on estimated 2019 earnings, while the fund's discount to the benchmark is 12%. China is currently out of favour with many investors and now is the time to be looking at investing in the region, when prices are cheap. The fund invests in a set of quality companies which have persistently generated a return on capital above the cost of capital

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Data sources

Fund performance: *Financial Express, total return 0.74% OCF in GBP*

Index and stock data: *Bloomberg*

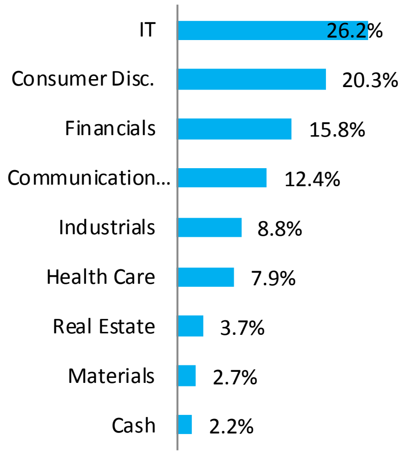
PORTFOLIO

30/11/2018

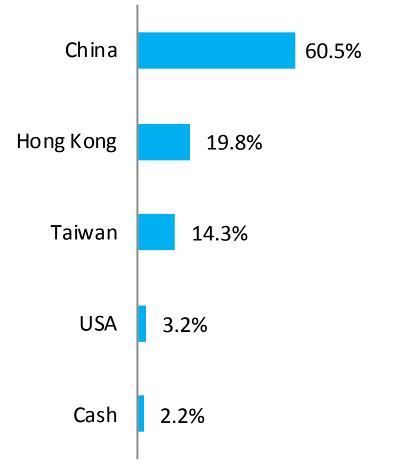
Fund top 10 holdings

China Overseas Land	3.7%
Noah Holdings	3.5%
Tencent Holdings	3.4%
Autohome	3.3%
Pacific Textiles	3.2%
Elite Material	3.2%
Qualcomm	3.2%
China Merchants Bank	3.2%
BOC Hong Kong	3.1%
Hollysys Automation Tech	3.1%
% of Fund in top 10	33.0%
Total number of stocks	33

Sector analysis



Geographic allocation



PERFORMANCE

30/11/2018

Annualised % total return from launch (GBP)

Discrete years % total return (GBP)	Nov '14	Nov '15	Nov '16	Nov '17	Nov '18
Fund	-	-	-	31.8	-12.9
MSCI Golden Dragon Index	12.4	-4.0	31.2	25.2	-4.1
IA China/Greater China sector average	6.8	-0.2	24.7	27.8	-7.7

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	2.0	-14.6	-12.9	-	-	49.0
MSCI Golden Dragon Index	5.6	-6.0	-4.1	57.4	69.9	62.6
IA China/Greater China sector average	6.1	-10.0	-7.7	47.0	56.8	51.2

RISK ANALYSIS

30/11/2018

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-2.30	-2.20
Beta	1.00	0.97	0.96
Information ratio	0.00	-0.59	-0.47
Maximum drawdown	-17.78	-21.67	-22.16
R squared	1.00	0.94	0.90
Sharpe ratio	0.73	0.55	0.54
Tracking error	0.00	4.72	6.05
Volatility	18.72	18.78	19.03

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.