Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – December 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

30/11/2018

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	-12.7	-7.5	-9.6	-4.1	31.5	23.6
Index	-12.2	-7.0	-9.1	-3.6	30.1	22.3
Sector	-14.5	-9.3	-12.4	-7.1	25.3	17.8

Annualised % total return from launch

	USD	GBP
Fund	10.8%	8.5%
Index	12.0%	9.7%
Sector	9.7%	7.5%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.6	3.2	1.4
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Info ratio	0.0	0.0	0.0	-0.4	0.5	0.0
Max drwdn	-24.6	-16.6	-24.6	-16.6	-23.0	-14.8
Tracking err	0.0	0.0	0.0	4.0	6.1	6.4
Volatility	15.1	14.4	13.9	12.7	14.1	13.6
Sharpe ratio	0.4	0.3	0.3	0.2	0.5	0.4

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

- Following a weak month in October, the fund's performance stabilised in November. The fund rose 1.9% (Z-class, total return in USD) compared to the MSCI Emerging Markets Net Total Return Index which rose 4.1% (2.1% and 4.3% respectively in GBP)

- For the year to the end of November, the fund is down 12.7%, underperforming the benchmark which is down 12.2%. However, at time of writing, the fund is again marginally ahead of the benchmark over the year to date.

- After being the weakest region in October, the performance of Emerging Asia turned around as was the leader, rising 5.2% in November. EMEA was also strong, rising 4.5%.

- Again Latin America performed differently to the other regions, this time falling 2.2%. Both Mexico and Brazil fell, triggered to some extent by heightened political concerns over the policies of their new leaders. Mexico fell 4.8% and Brazil fell 2.0%.

- The strongest of the larger countries (as measured by their respective MSCI country indices) was India, which rose 10.5%. Partly this move was due to strength in the currency, and partly because India is a beneficiary of weaker crude oil prices, which continued to fall over the month.

- South Africa rebounded as well, rising 8.4%, though the country has been the weakest of the larger countries in the year to date, declining by around 26%.

- Despite continued rumblings over trade (see below), China also made gains during the month, rising 7.4%.

- Two of our best-performing stocks in the portfolio were South African holdings: Spar Group rose 18.1% and Truworths climbed 15.1%. The other stand-out performer was Taiwanese technology company Elite Material, which rose 18.2%.

- The weakest stock in the portfolio was British American Tobacco, which fell 19% after concerns that the US would ban sales of menthol cigarettes (though any ban would not be likely to be implemented in the near future). Other weak names were Catcher Technology in IT, which declined 14.8% and non-bank Indian financial company Indiabulls, which after rallying in the second half of October gave back its gains in November, falling 8.9%. Indiabulls is facing a challenging liquidity environment after the non-bank financial sector as a whole has run into difficulties. However, management is confident of the company's ability to grow at around 20% over the medium term. We will review all of the best and worst performers in the portfolio over the course of 2018 in our forthcoming annual review.

Events in November

- US-China trade tensions continued to dominate headlines. The Asia-Pacific Economic Cooperation (APEC) forum in Papua New Guinea concluded without agreement on a joint communique.

- The US continued to apply pressure with a report from Trade Representative Robert Lighthizer alleging continued intellectual property theft by China.

- Attention then turned to the G20 talks in Argentina at the end of the month

- US midterm elections resulted in the Democrat party taking control of the House of Representatives.

- Elsewhere, the UK Cabinet backed an agreement covering Britain's exit from the European Union. The deal is yet to be approved by the UK parliament.

- Talks between North Korea and Mike Pompeo on the subject of denuclearization were postponed.

- Central banks in Indonesia, Mexico and the Philippines raised rates, in each case by 25bps.

Outlook for 2019

While we are not in the business of making predictions – for next year or otherwise – it is worth considering the potential tailwinds and headwinds for emerging markets as we approach 2019.

The two strongest factors supporting emerging markets as we move into the new year are expectations for strong earnings growth and lower valuation levels.

Earnings are currently forecast to grow 12% in 2018 and 8% in 2019. It is too early to be certain of the outcome for 2018 (we will only know how this year has turned out for sure towards the end of the first quarter next year as companies begin to report results), so it is certainly right to treat 2019 earnings estimates with caution. Nevertheless, after the volatility we have witnessed in the market this year, and the heightened uncertainty with escalations in trade tensions, earnings expectations have remained remarkably robust.

Analysts' expectations of course may well turn out to be too optimistic, but in emerging markets specifically, there are reasons to be more confident in the outlook. Earnings growth over the past few years has been driven by a combination of sales growth and margin expansion, and both are expected to continue next year. Strength in underlying economies is likely to support sales growth; GDP growth in EM is likely to slow next year as China's growth moderates, but it is likely to maintain a healthy margin over developed markets. Earnings and EBIT margins have been recovering each year since hitting their trough in 2015.

Lower valuations are the second main factor we see supporting emerging markets in 2019. After a period of strength in 2016 and 2017, valuations have corrected, and EM equities are now back at levels below their historic averages on a P/E basis. Not only are they cheap relative to history, they look even more so relative to developed markets – the MSCI Emerging Markets Index relative to the S&P 500 is currently at a discount of around 30%, roughly one standard deviation below the historic average. Last, valuations are cheap on an absolute basis; MSCI Emerging Markets Index trades below 12x forward earnings.

These two tailwinds for emerging markets in 2019 represent two of the three sources of total return we expect from the fund over time (the third being the dividend). We obviously cannot pinpoint the exact returns to come from each of these sources, but the portfolio metrics provide us with a baseline expectation of how each area may contribute over the long term:

- Portfolio trades on 11.8x 2018 earnings and 10.8x 2019 earnings
- Implied earnings growth of 9% (2019 vs 2018)
- Portfolio P/E ratio represents a slight (4%) premium to the benchmark
- Net dividend yield of 3.5% (forward basis)
- Average dividend payout ratio of 51%
- Historic dividend growth over past five years of 14% per annum.

A fourth potential source of total return comes from the currency. EM currencies have struggled this year from a combination of local factors but also a stronger dollar. Recent comments from Jerome Powell, the head of the Federal Reserve, that US interest rates are approaching their neutral level indicate a more dovish outlook over the coming year. Markets reacted accordingly, with a pronounced strengthening in emerging market currencies. If we continue to see a reduction in expectations for US interest rate rises in 2019, it is likely to ease the pressure on EM currencies and could be a source of positive returns (in US dollar terms).

Offsetting these tailwinds are two headwinds:

1. The strength of the US and global economy in general
2. The propensity for trade tensions to escalate further

The first of these is related to the recent moves by the Fed. Slower (or an absence of) further rate rises could also be viewed as a negative for emerging markets if the reason for the change of course is a deterioration in the US economy. The latter part of 2018 has shown us that the particularly strong global growth in 2017 cannot continue indefinitely. Whether slower economic conditions are simply mean reversion (a natural correction of a move that went too far in one direction) or are, more worryingly, indicative of cracks emerging in the global economy, remains to be seen. Emerging markets have taken great strides towards being their own sources of demand (i.e. driving domestic demand instead of being reliant on foreign demand; Asia has made significant improvements in this regard), but they are still dependent on a strong global economic backdrop. This dependence is even more apparent in the case of countries still heavily reliant on commodities to drive economic growth.

The other headwind that has the potential to disrupt emerging markets next year would be an escalation in trade tensions. As we have seen in 2018, the trade conflict between China and the US has raised uncertainty and dented confidence in investors in emerging markets. So far, the impact has mostly been felt in weaker sentiment, rather than actual economic impact, though there are signs that trade has started to slow (after a short-term boost due to demand being brought forwards before higher tariff levels kick in).

The recent G20 meeting at the end of November has given the market renewed optimism that a compromise solution can be worked out and a planned increase in US tariff rates on Chinese goods has been deferred temporarily. It has been our position throughout this year that a negotiated solution is most likely, but as the trade conflict has broadened and dragged in other areas surrounding US-China economic relations, so meeting a growing (and changeable) list of US demands has seemed a more distant prospect. If this pattern continues – or the environment deteriorates – emerging markets are likely to remain in weak territory. On the other hand, a more permanent resolution in the conflict could well bring a significant positive jolt to the market as stocks rapidly reprice.

Our approach

Our approach is unlike many other emerging market managers in that we do not use top-down judgements as the basis for our investment decisions. Rather than trying to weigh regions, countries or sectors against one another, we first identify quality companies (considering macro factors at the individual company level) and then assess their stocks to see which provide the best valuation opportunities.

By focusing on quality, we believe the portfolio can provide refuge during periods when market conditions are stressed. Companies that have been consistently profitable have already demonstrated an ability to withstand tough economic conditions and are highly likely to continue to be profitable.

Businesses that have stable or more predictable business models also give us greater confidence in our assessment of their valuation. As such, market volatility can actually provide us with opportunities to rebalance the portfolio, taking profits from stocks that have outperformed and adding to those that have lagged. Volatility can also throw up opportunities to enter stocks of high-quality companies we have been following but previously considered too expensive.

Edmund Harriss
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Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

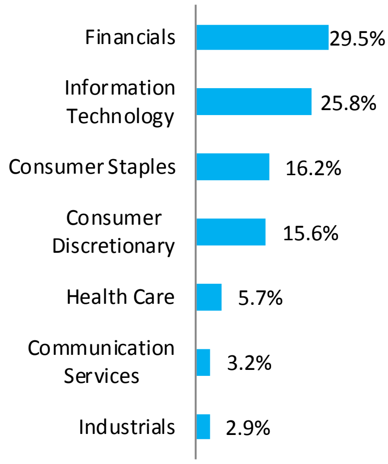
PORTFOLIO

30/11/2018

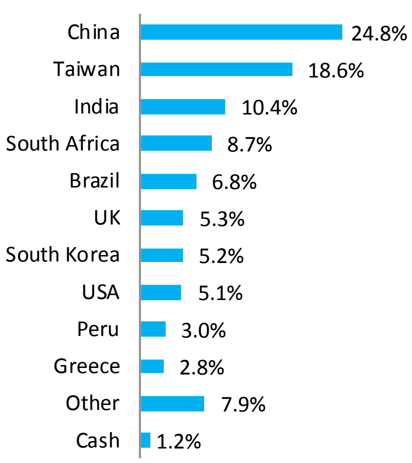
Fund top 10 holdings

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

30/11/2018

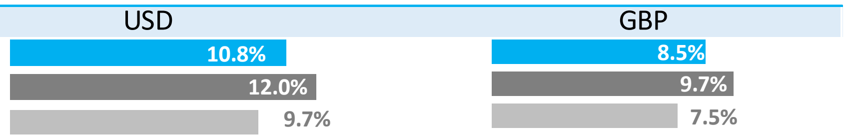
Discrete years % total return

	Nov '14		Nov '15		Nov '16		Nov '17		Nov '18	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.74% OCF)	-	-	-	-	-	-	-	-	-9.6	-4.1
MSCI Emerging Markets	1.4	6.1	-16.7	-13.3	8.9	31.2	33.3	23.0	-8.8	-3.2
IA Global Emerging Markets Sector	1.3	5.9	-16.2	-12.8	5.5	27.1	33.4	23.2	-12.4	-7.1

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)	1.9	2.1	-12.7	-7.5	-9.6	-4.1	-	-	31.5	23.6
MSCI Emerging Markets	4.1	4.3	-12.2	-7.0	-9.1	-3.6	31.0	54.5	30.1	22.3
IA Global Emerging Markets Sector	4.2	4.3	-14.5	-9.3	-12.4	-7.1	23.3	45.4	25.3	17.8

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 23.12.2016

30/11/2018	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.6	3.2	1.4
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Information ratio	0.0	0.0	0.0	-0.4	0.5	0.0
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	0.4	0.3	0.3	0.2	0.5	0.4
Tracking error	0.0	0.0	0.0	4.0	6.1	6.4
Volatility	15.1	14.4	13.9	12.7	14.1	13.6

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, 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.