Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – February 2019

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

31/01/2019

Fund	Guinness Emerging Markets Equity Income (Z)
Index	MSCI Emerging Markets Index
Sector	IA Global Emerging Markets

	2016		2017		2018	
	USD	GBP	USD	GBP	USD	GBP
Fund	-	-	38.4	26.4	-14.8	-9.5
Index	11.6	32.6	37.8	25.4	-14.3	-9.3
Sector	9.7	30.8	36.2	24.4	-16.9	-11.8

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	6.1	2.7	-15.6	-8.7	19.1	14.6
Index	8.8	5.3	-14.2	-7.3	20.4	15.9
Sector	9.0	5.5	-15.9	-9.1	16.2	11.8

Annualised % total return from launch

	USD	GBP
Fund	11.7%	8.0%
Index	14.1%	10.3%
Sector	11.9%	8.2%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.5	2.2	0.3
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Info ratio	0.0	0.0	0.0	-0.4	0.3	-0.1
Max drwdn	-24.6	-16.6	-24.6	-16.6	-23.0	-14.8
Tracking err	0.0	0.0	0.0	3.9	6.1	6.3
Volatility	14.9	14.1	13.8	12.6	14.0	13.6
Sharpe ratio	0.5	0.3	0.5	0.2	0.5	0.3

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

- January saw a sharp recovery in emerging markets, with the benchmark (MSCI Emerging Markets Net Total Return Index) rising 8.8% in USD.
- The fund underperformed in the stronger markets, rising 6.1% (in USD, 0.74% OCF), although this level of upside capture is broadly what we would expect in rising markets.
- Leading sectors were Consumer Discretionary, Energy, Real Estate and Information Technology. Laggards were Materials, Health Care, Consumer Staples and Utilities.
- In January, strong markets were Brazil (+18% in USD), Russia (+14%) and South Africa (+12%). China was up 11%.
- In Brazil, Bolsonaro was inaugurated in January. Local flows have been driving the market, not foreign flows, reflecting optimism in Bolsonaro's policies. Commodities were generally strong, with the Metals Index up 5%.
- Russian strength was due to 1) Crude oil up at least 20% since its lows in December, and 2) the ruble strengthening 6% against the dollar.
- South Africa gained from the rand strengthening 8% against the dollar.
- The weakest markets were India (-1.9%), Malaysia (+1.4%) and Taiwan (+1.4%)
- In India, local returns were flat but the rupee fell 1.9%. India is very sensitive to rising input costs, and higher crude oil during the month weighed on sentiment.

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- In Taiwan, stocks with significant exposure to Apple were weak following the sudden cut in guidance. Stocks with less exposure to Apple held up better.

- Outperformers were Brasil Bolsa Balcao (+25% in USD), Elite Material (21%) and Banco Davivienda (+21%) .

- Weaker names were Indiabulls Housing Finance (-24%), Qualcomm (-13%) and Bajaj Auto (-8%).

Events in January

- The Federal reserve signalled a policy change and a moderation in the pace of interest rate increases.

- The value of the dollar eased on a trade-weighted basis.

- Positive noises from President Trump on trade talks with China raised hopes of progress.

- The People's Bank of China announced a 100-basis point cut in the reserve requirement ratio (RRR) to ease liquidity conditions.

- The US government shut down ended after 35 days.

- The collapse of a dam at one of Vale's iron ore mines in Brazil caused iron ore prices to spike as Vale declared force majeure, potentially reducing production by 40m tonnes.

- Bolsonaro was sworn in as Brazil's president.

Market Commentary

Markets experienced a welcome reprieve in January after suffering sharp losses in December. Partly the strong recovery appears to be a fairly typical reaction to the drawdown at the end of 2018 – as valuations retreated, stocks looked oversold, prompting a bounce – but partly it represented an improvement in the outlook and the expectation of more favourable conditions for emerging market equities in particular.

After a steady stream of negative commentary on US-China trade tensions, positive progress appeared to be being made. While the market oscillates regularly on the perceived state of talks, the overall direction indicates that both sides seem willing to strike a deal.

With all the noise surrounding US-China trade relations, it has been easy to overlook the strong performance of emerging markets on a relative basis (compared with developed markets) since the end of September:

Performance of MSCI Emerging Markets Index relative to MSCI World Index

Source: Bloomberg. Data two years to 14 February 2019.

As the chart shows, the strong relative performance in the fourth quarter follows a period of underperformance over the middle part of last year.

Returning to the recovery witnessed in January, the Fed's change of direction and more dovish tone also contributed positively to performance. Concern over the resilience of global growth seems to have weighed on monetary policymakers, who at the end of the month indicated that the case for further rate rises had weakened. It is interesting to note that the apparent change of direction came not long after Donald Trump piled on the pressure for a looser monetary policy – by reversing course in January, the Fed has been able to accommodate the US President's wishes, without losing face.

Emerging market currencies were also strong, rising 2.8% over the month. The South African rand and the Brazilian real both strengthened significantly. A weaker US dollar and recovering commodity prices were contributing factors.

We have been encouraged to see the operating performance of the Chinese banking sector in recent months as the macro-economic slowdown has become more apparent, because it is in this sector that the 'old' and 'new' Chinese economies meet. The debt built up by the old economy sits in the banks and in order for them to provide a useful function in China's new economy they have to manage the legacy and transform into market-led commercial institutions. The news flow of on-going regulation, bad debt recognition and improved market practice has been evident in 2018 performance, which showed rising net interest margins, solid cost control, accelerated bad debt write-downs and shrinking balance sheets as shadow banking activity reduced.

There are signs too that the technology sector may be beginning to come out of its malaise. Semiconductor stocks in the US have reported an improving outlook which has fed through to the performance of TSMC and Novatek Microelectronics. The smartphone area remains contentious, especially following Apple's warning that the China slowdown was responsible for its sales drop. A closer look reveals a different picture: while volume sales of smartphones fell 10% in the fourth quarter, Apple's sales fell 20%. This begins to look more like an Apple problem than a China problem, especially when we see that local makes Huawei, Oppo and Vivo reported volume growth. Amongst smartphone-related stocks in the portfolio we have seen upgrades to forecasts for both Largan Precision and Elite Material.

Portfolio commentary

Outperformers were Brasil Bolsa Balcao (+25% in USD), Elite Material (+21%) and Banco Davivienda (+21%).

Brasil Bolsa Balcao ('B3'), the Brazilian stock exchange, continued its run of strong performance. The stock has rallied in conjunction with gains in the Brazilian stock market, which has hit record highs this year. Investors are optimistic that Bolsonaro will be able to enact reforms that are positive for the economy, including pension reforms in a bid to improve the country's fiscal situation. We are somewhat more cautious in our appraisal of Bolsonaro's prospects – we often see individual countries rallying after a change in political regimes on the hope that things will improve. Gradually, however, the market realises that change is not so straightforward, and prices contract (South Africa is a good recent example). Nevertheless, reform in many of the areas Bolsonaro has vowed to target would be extremely welcome.

After suffering a weak third quarter, our IT holdings generally had a better January. Elite Material, which manufactures environmentally-friendly printed circuit board materials, rose on expectations that the company's 'substrate-like' PCB products will be included in future iPhone designs. The environment for companies involved in the smartphone supply chain has improved recently, as the introduction of 5G networks in 2019 provides a strong incentive for customers to upgrade their handsets.

Banco Davivienda, a Colombian bank and financial services company, rose strongly in January. Again, this was partly a reversal of a sharp sell-off the stock suffered in December, but also reflected supportive economic conditions. Recent banking data in Colombia has shown a picture of strong and accelerating loan growth, with stable asset quality.

Weaker names were Indiabulls Housing Finance (-24%), Qualcomm (-13%) and Bajaj Auto (-8%).

Indiabulls Housing Finance has continued to be weak this year amid ongoing concerns over the Housing Financial Company sector in India. The sector sold off sharply last year as investor worried about a deterioration in loan quality and a tightening in liquidity. We think these concerns say more about sentiment toward the industry as a whole and less about any specific problems at Indiabulls. In fact, we think the company is well positioned, with appropriate asset-liability matching. The stock trades at a very undemanding valuation, and in our view offers attractive upside from here.

Qualcomm has suffered from a multitude of negative factors over the past year. The stock has been subject to the same pressures arising from the smartphone sector as peers and has been in dispute with its customers (notably Apple) over royalty payments on its intellectual property. A legal challenge by the Federal Trade Commission in the US weighed on the stock in January, but we think the company put forward strong arguments in its defence. Results released at the end of the month and news that the company had struck a new agreement with Huawei (another customer), have helped boost the stock's performance going into February.

Bajaj Auto, an Indian motorcycle manufacturer, is another stock that has recovered in February, to the extent that it has erased its January losses and is now ahead for the year to date. Results released at the end of January were slightly disappointing relative to broker expectations, but management indicated a positive outlook both for the motorcycle industry in general and Bajaj's market share within it.

Outlook

In the short term we expect China-US trade talks to overhang the market as both sides struggle to reach a deal that will satisfy the hawks on both sides. China is facing slowing conditions – trade-related uncertainty has been a headwind, but cyclical factors are also dampening growth. Of course, this comes in the context of a weaker global economy, particularly evident in lower expectations for European growth.

But we do not expect any of this to change the direction of travel for China over the long term. China has been developing its manufacturing expertise over the past thirty years – the fact that this has become a concern to the US in recent years indicates the degree to which China has moved up the value chain. This pattern is something that we think has to be maintained for China's continued prosperity. Weaker demographic trends will force China to move on from its past reliance on cheap labour. This is already happening to a degree; as wages rise in the country, labour-intensive manufacturing is spilling over to elsewhere in the region (with corresponding economic benefits to those countries).

These trends are unlikely to face anything other than short-term disruption. Policy makers will continue to strive for the underlying objectives of Made in China 2025, but do not expect them to trumpet the policy so loudly.

We anticipate these patterns will be experienced more widely across emerging market countries. As incomes increase, so will consumption as people upgrade their lifestyle. Wealth levels will continue to rise as economies develop.

Our approach to investing in emerging markets is unlike many other 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.

Companies 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 considered too expensive previously.

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Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

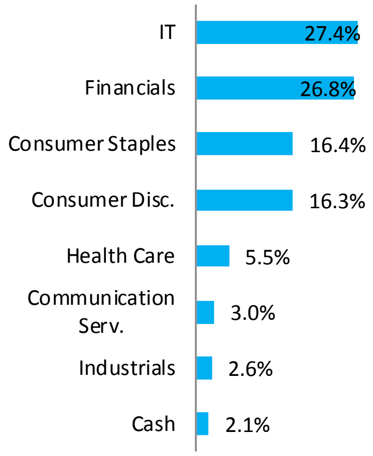
PORTFOLIO

31/01/2019

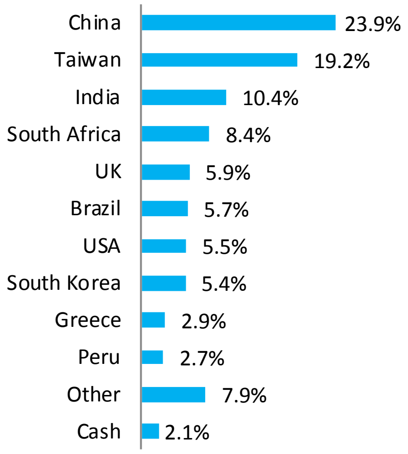
Fund top 10 holdings

Novatek Microelectronics	3.1%
British American Tobacco	3.1%
B3 SA - Brasil Bolsa Balca	3.0%
Netease.com	3.0%
Hanon Systems	3.0%
Infosys	2.9%
Broadcom	2.9%
Spar Group	2.9%
Jumbo	2.9%
Elite Material	2.8%
% of Fund in top 10	29.5%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

31/01/2019

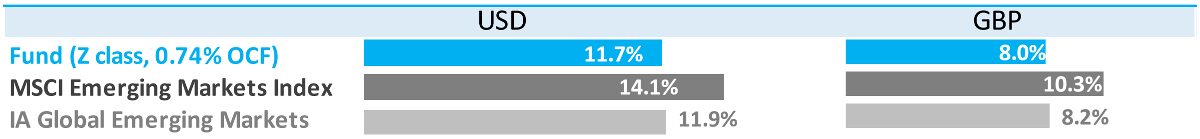
Discrete years % total return

	Jan '15		Jan '16		Jan '17		Jan '18		Jan '19	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.74% OCF)	-	-	-	-	-	-	44.6	27.9	-14.8	-9.5
MSCI Emerging Markets	5.6	15.6	-20.6	-16.0	25.9	41.9	41.5	25.2	-14.6	-9.3
IA Global Emerging Markets Sector	5.8	15.8	-22.5	-18.0	26.5	42.7	37.9	22.0	-16.9	-11.8

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 (Z class, 0.74% OCF)	6.1	2.7	6.1	2.7	-15.6	-8.7	-	-	19.1	14.6
MSCI Emerging Markets	8.8	5.3	8.8	5.3	-14.2	-7.3	51.7	63.5	20.4	15.9
IA Global Emerging Markets Sector	9.0	5.5	9.0	5.5	-15.9	-9.1	46.8	58.3	16.2	11.8

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 23.12.2016

31/01/2019	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.5	2.2	0.3
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Information ratio	0.0	0.0	0.0	-0.4	0.3	-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	0.5	0.3	0.5	0.2	0.5	0.3
Tracking error	0.0	0.0	0.0	3.9	6.1	6.3
Volatility	14.9	14.1	13.8	12.6	14.0	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.