Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – March 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

28/02/2019

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	7.4	2.9	-11.9	-8.8	19.1	14.6
Index	9.0	4.4	-9.9	-6.7	20.4	15.9
Sector	9.7	5.0	-11.5	-8.3	16.2	11.8

Annualised % total return from launch

	USD	GBP
Fund	12.0%	7.8%
Index	13.3%	9.1%
Sector	11.8%	7.6%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.4	2.9	1.2
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Info ratio	0.0	0.0	0.0	-0.4	0.4	0.0
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	14.8	14.0	13.7	12.5	13.9	13.5
Sharpe ratio	0.6	0.4	0.5	0.4	0.6	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

- Emerging markets paused in February after a strong January, with the benchmark (MSCI Emerging Markets Net Total Return Index) rising slightly, up 0.2% in USD.
- The fund outperformed in the flat markets, rising 1.3%.
- Asia was the strongest region, rising 1.7%. EMEA and Latin America were weaker, falling by 3.4% and 3.7% respectively.
- Leading sectors were Consumer Discretionary, Information Technology and Materials. Laggards were Real Estate, Communication Services and Consumer Staples.
- In February, strong markets were Taiwan (+4.7% in USD), China (+3.5%) and Malaysia (+1.8%).
- China benefited as trade tensions abated somewhat during the month (see below)
- The weakest of the larger markets were South Africa (–5.3%), Brazil (–4.5%) and Mexico (–4.2%).
- South Africa fell on rand weakness (returns in local currency were flat) as the struggles of Eskom, the state power company, were highlighted by the announcement of a government bailout.
- Brazil also fell due to currency weakness as GDP figures for the fourth quarter showed a sharp decline in growth.
- Emerging market currencies overall were generally weaker in the month as the dollar

(measured on a trade-weighted basis, including developed markets) strengthened slightly.

- Outperformers were Elite Material (+19.0%), Bajaj Auto (+13.8%) and Ping An Insurance (+8.9%).

- Weaker names were Truworths International (–13.7%), NetEase (–11.4%) and JSE (–6.9%).

Events in February

- US-China trade talks moved forward with a 60-day extension to the tariffs deadline and the potential for a meeting between Presidents Trump and Xi. Hawks remain cautious but it looks like both leaders want a deal.

- The smartphone segment has seen the first phone with a foldable screen. Chinese phone-makers are in hot pursuit.

- Cracks are beginning to appear in the previously unified position against Huawei. 5G technology is coming and Huawei's equipment is regarded equivalent (or better) to that of Nokia and Ericsson and is undoubtedly cheaper.

- Recent economic data from China look more 'glass half-full', with higher input prices reducing deflation fears and new orders picking up. Export orders however still point to tougher external trade – signs, therefore, that China's domestic efforts are beginning to pay off while the external environment remains uncertain.

- The Reserve Bank of India cut interest rates to 6.25% and softened its stance to 'neutral' after a fall in inflation.

- Brazil's President Bolsonaro laid out plans to reform social security, announcing proposed savings of 1.2 trillion real over the next 10 years. The majority of the savings are expected to come from an increase in the minimum retirement age to 65 for men and 62 for women.

Market Commentary

After a strong bounce in January, markets paused for breath in February. Individual country issues and weaker currencies held back Latin America and EMEA; Asia was the bright spot among the regions.
South Africa was notably weak during the month. Returns were dragged down by a decline in the rand over the course of February as the government announced a bailout of Eskom, the state power company. South Africa has been struggling with electricity blackouts owing to old coal-fired power plants that have been poorly maintained. Eskom has suffered from mis-management and is facing escalating costs. The finance minister underlined the need for reform when he announced the bailout, saying: "Pouring money directly into Eskom in its current form is like pouring water into a sieve." The government's battle with the problems faced by Eskom illustrates the difficulties Ramaphosa faces more broadly in enacting reforms in the South African economy. The election in May is expected to provide a welcome boost insofar as it is likely to give Ramaphosa a stronger mandate for change.

Minutes from the January FOMC meeting provided some additional insight into the intentions of the US Federal Reserve's policy makers. Though the recent shift in policy was a remarkable about-face, the next move in interest rates is still expected to be higher. However, any raise is contingent on US economic growth remaining intact and inflation reaching target levels. A pause from the Fed (expressed in the coded language of Fed policy makers as 'patience') should ease the pressure on emerging market currencies from a rising dollar (EM currencies in February were weaker, but we expect the broader trend to be positive for emerging markets).

China has continued its targeted policy support and recent data suggest grounds for optimism that this is having an effect. Domestic services have picked up and manufacturing input prices have risen a little, reducing the prospect of renewed deflation. The outlook for exports, however, looks weaker.

The tempo of China-US trade discussions has also changed. While US trade negotiators remain hawkish, emphasising how much further there is to go on resolving issues relating to intellectual property and China's state support for industry, there is a growing sense that President Trump wants a deal. Although he abruptly cut short talks with North Koreans, that was easier for him to do. The trade issue is more pressing, as there is mounting evidence that China's retaliatory tariffs are having a greater impact on the US than previously thought. A study by the Institute of International Finance shows a collapse in many of the 900 categories US products targeted by China. In July to November, the value of lost exports is estimated to have hit $17 billion, an annualised rate of $40 billion or one third of US exports to China. In this context, China's offer to increase imports of US goods, while not enough for the hawks, looks very attractive politically, especially when we remember that next year is an election year.

Despite the strong performance so far this year, the portfolio valuation remains very reasonable, trading at 11.9x 2019 earnings. This multiple represents a small discount to the benchmark (MSCI Emerging Markets), which trades on 12.1x. The portfolio has an in-built bias towards quality, featuring companies that have achieved persistently high return on capital over the past eight years. Strong earnings growth is also forecast – earnings are expected to grow 11% in 2020 over 2019.

Portfolio commentary

Several of the companies in the portfolio reported results during the month.

Novatek Microelectronics issued full-year results and reported both stronger results (full year profit up 27%) and more upbeat guidance than was expected. The company designs and ships Display Driver ICs (DDI), the chips that control displays on anything from TVs to smartphones. In recent years the company's returns have been fine, but unspectacular. However, it appears that stars are aligning for Novatek in both TVs and smartphones, which is beginning to be reflected in higher volumes and higher selling prices. Their new Touch controller with DDI integration for the smartphone segment has value not only in function but also in form factor. The value is how these elements are integrated, allowing easier smartphone assembly and slimmer smartphone bodies.

Netease reported results which broadly met expectations. Gaming revenue grew, with mobile driving growth. Following the release of expansion packs for older titles, PC gaming grew by more than expected. Since gaming approvals resumed at the end of December, Netease has had one game approved and has many waiting for approval. Throughout 2019, as more games are approved, we expect Netease's revenue growth from this segment to accelerate. The e-commerce business continues to grow but is still operating at a loss. We are willing to give Netease time to grow this business – at a market share of 25%, it is now the second-largest firm in China's e-commerce market for imported goods, only behind Alibaba's Tmall, with a market share of 37%. We note reports that Amazon and Netease are considering merging their e-commerce businesses in China. If this were to go through, the benefit of economies of scale should help the combined business become more competitive against Tmall.

Coca Cola Femsa reported good results for the fourth quarter 2018. On a comparable basis (excluding M&A and foreign exchange translation effects, and adjusting subsidiaries operating in hyperinflationary economies, i.e. Venezuela and Argentina), revenues were up 7.8% and operating profit increased 4.3%. Revenues in Mexico were up 4.1%, but Brazil and Colombia grew more strongly, with comparable revenues for the South American region up 12%. For the full year, comparable revenues were up 5.9% and operating income rose 0.9%. Management noted that the Mexican consumer market was resilient, recording positive volumes in January. The dividend increased 5.7% from the prior year.

British American Tobacco (BATS) reported mixed results for 2018 – the company beat on earnings, but volumes were below expectations. For the full year, adjusted volumes were down 4.6%, but pricing and mix more than offset this resulting in positive 3.5% organic revenue growth. Reported revenues benefited from the full inclusion of Reynolds American. A focus by the FDA in the US on menthol cigarettes and the prospect of a ban has weighed on the stock in recent months, but management note they have a long history of managing changes in the regulatory environment. The dividend was increased by 4%. BATS trades at a very undemanding 10x forecast earnings.

JSE, Johannesburg Stock Exchange, reported earnings for 2018 that disappointed relative to expectations. Muted market activity caused revenue to fall 1% for the year. Margins were a more positive area, and earnings also benefited from a tax credit, leading to headline EPS rising 6%. The dividend increased in line with earnings, also rising 6%. Immediate market reaction to the results was sanguine; however, the company was one of the worst performers for the month overall as South African equities in general were weaker.

In the smartphone supply chain, **AAC Technologies** put out a profit warning. It is well known that the smartphone market in China is currently weak and this is feeding through to suppliers. That being said, we are looking further out to the future and we believe the market is undervaluing the returns these sorts of businesses are likely to generate. AAC should benefit from selling more advanced acoustics and haptics components as phones are upgraded. If prices were to fall further from what we believe are depressed valuations, we will continue to add to the stock to take advantage of this pricing anomaly.

Outlook

After a strong start to the year in January, emerging markets made more measured gains in February. However, we still think the backdrop for emerging market equities is very favourable. We cite again the valuation metrics of the portfolio – trading on only 11.9x 2019 earnings. Despite the emphasis on quality (holdings have consistently sustained a real return on capital above 8%), the portfolio is at a slight discount to the market, which trades at 12.1x earnings.

Supporting the valuation case, the portfolio also has strong forecast earnings growth of 11.2% (2020 versus 2019) and offers an attractive source of income.

Taking a broader view, economic conditions are supportive of emerging markets continuing to outperform developed markets. Emerging markets trade at a significant discount to developed markets. But earnings growth is forecast to be higher, and the gap between emerging and developed market growth forecasts (the 'spread' in GDP growth) remains resilient.

In the short term, on-going talks between China and the US will continue to dominate sentiment, as the two sides appear to alternate between being closer to making a deal and then that prospect seeming further away. Accompanying this uncertainty, we have also seen conditions in China slow, with a knock-on effect on other countries around the world. Recently announced fiscal stimulus measures in China, particularly tax cuts, are expected to offset this weakness to some extent.

However, these are factors mostly affecting China in the short term. In the long term, we expect to see China continue to develop by deepening and enhancing its manufacturing capabilities. The ability to move up the value chain and to develop world-leading technology in a host of areas will determine China's success.

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 each other, 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 considered too expensive previously.

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Data sources
Fund performance: *Financial Express, total return*
Index and stock data: *Bloomberg*

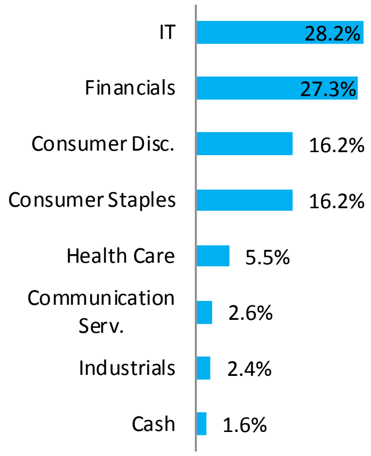
PORTFOLIO

28/02/2019

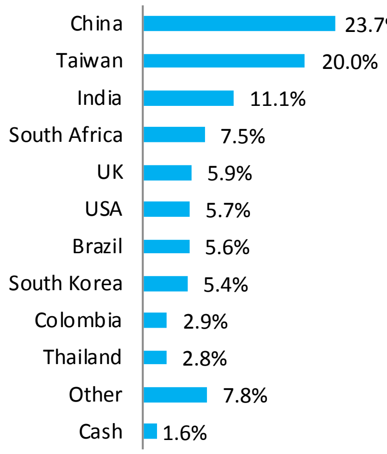
Fund top 10 holdings

Elite Material	3.3%
Novatek Microelectronics	3.3%
British American Tobacco	3.2%
B3 SA - Brasil Bolsa Balca	3.0%
Broadcom	2.9%
Shenzhou International	2.9%
Infosys	2.9%
Banco Davivienda	2.9%
Indiabulls Housing Finan	2.9%
Qualcomm	2.8%
% of Fund in top 10	30.0%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

28/02/2019

Discrete years % total return

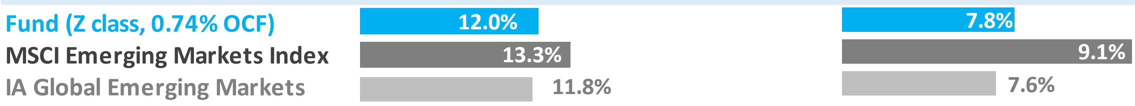
	Feb '15		Feb '16		Feb '17		Feb '18		Feb '19	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.74% OCF)	-	-	-	-	-	-	33.1	20.2	-14.8	-9.5
MSCI Emerging Markets	5.4	14.3	-23.1	-14.8	29.9	45.5	31.0	18.3	-14.6	-9.3
IA Global Emerging Markets Sector	4.0	12.8	-22.8	-14.4	26.8	42.0	29.1	16.6	-16.9	-11.8

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)	1.3	0.2	7.4	2.9	-11.9	-8.8	-	-	19.1	14.6
MSCI Emerging Markets	0.2	-0.9	9.0	4.4	-9.9	-6.7	52.3	59.5	20.4	15.9
IA Global Emerging Markets Sector	0.7	-0.5	9.7	5.0	-11.5	-8.3	44.9	51.9	16.2	11.8

Annualised % total return from launch

USD GBP



Risk analysis - Annualised, weekly, from launch on 23.12.2016

28/02/2019	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.4	2.9	1.2
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Information ratio	0.0	0.0	0.0	-0.4	0.4	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	0.6	0.4	0.5	0.4	0.6	0.4
Tracking error	0.0	0.0	0.0	3.9	6.1	6.3
Volatility	14.8	14.0	13.7	12.5	13.9	13.5

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). 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.