Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – April 2019

Launch date	**23.12.2016**
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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

31/03/2019

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	10.6	8.1	-9.4	-2.4	26.3	17.7
Index	9.9	7.4	-7.4	-0.3	31.0	22.0
Sector	10.6	8.1	-8.5	-1.5	26.6	18.0

Annualised % total return from launch

	USD	GBP
Fund	12.9%	9.9%
Index	13.2%	10.1%
Sector	11.7%	8.7%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.1	3.2	1.8
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Info ratio	0.0	0.0	0.0	-0.3	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	3.9	6.0	6.3
Volatility	14.7	13.8	13.7	12.3	13.7	13.4
Sharpe ratio	0.6	0.4	0.5	0.4	0.7	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: 0.74% OCF, Financial Express, bid to bid, total return.

Fund & market

- Emerging markets made further gains in March, rising 0.8% in USD.
- The Fund finished the month 2.2% ahead of the benchmark.
- For the first quarter of the year, the Fund ended ahead of the benchmark by 0.7%.
- Asia led the regions in March, up 1.8%. EMEA and Latin America both declined, falling by 1.4% and 2.5% respectively.
- Of the largest countries in the benchmark, the best-performing were India (+9.2%), China (+2.4%) and Taiwan (+2.3%).
- The weakest were Brazil (–3.8%), Korea (–3.1%) and Malaysia (–2.8%).
- Outperformance in March relative to the benchmark came mainly from the Fund's IT holdings (principally Novatek, Elite, Broadcom and Qualcomm). Consumer Staples and Consumer Discretionary holdings were also strong.
- Detractors were the Fund's lack of exposure to Real Estate and Energy (the Fund has no holdings in these sectors).
- On an individual stock basis, the best performers during the month were Indiabulls Housing Finance (+33.8%), which regained all its losses earlier in the year, China Lilang (+17.7%), and Novatek Microelectronics (+15.5%). China Lilang and Novatek are two of the best-performing stocks in the portfolio this year.

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- Indiabulls bounced strongly ahead of full-year results due out in April (the company has a March year end). Management recently indicated a positive outlook for achieving 20% loan growth in financial year 2020 (though short-term loan growth is likely to be subdued). Despite the recovery in the share price, at month end, the stock remained cheap on a price to earnings basis relative to the historic average.

- The weakest stocks were JSE (–15.6% in USD terms; –13.5% in ZAR), Hanon Systems (–9.8% in USD) and China Medical System Holdings (–7.9% in USD).

- For the year to date, the best-performing stocks are Elite Material (+60.4%), Novatek Microelectronics (+38.0%) and China Lilang (+33.9%).

- The worst performers are the Fund's three South African holdings: Truworths (–18.7%), JSE (–15.8%) and Spar Group (–7.8%) (figures in USD; not materially different in ZAR).

Events in March

- India was the best-performing market as opinion polls showed greater support for the incumbent party, the BJP. The rise in support follows a period of greater geopolitical tensions with India's neighbour Pakistan. Elections are taking place in April and May.

- China trade talks with the US continued. A deal is yet to be reached, though discussions appear to be making progress.

- China announced significant fiscal stimulus in the form of tax cuts. VAT rates for manufacturers will be reduced from 16% to 13%.

- The Federal Reserve confirmed its change of course on interest rates saying interest rates could be on hold for "some time" as its focus shifted to global risks. The Fed has also decided to slow the pace of drawing down its bond holdings.

- Weakness in Europe, as seen by the drop in German industrial activity, is weighing on Korea and Taiwan's trade in both technology and machinery. Both countries report slowing industrial production.

- Commodity prices rose with alumina, iron ore and oil up 3%-5% in March.

- The ECB announced further monetary easing with the launch of further long-term refinancing operations (LTROs).

Portfolio commentary

With many of the companies in the portfolio having reported results during the month, we again devote much of this update to reviewing these.

Several of our portfolio holdings operate in the smartphone supply chain. **Elite Material** has had a strong recovery this year as it has become more likely the company will re-enter the iPhone supply chain. It produces copper-clad laminates used for printed circuit board and specialises in halogen-free laminates which are environmentally friendly. Its Korean customers are likely to increase adoption of the newest laminate, while the Chinese are expected to follow suit later this year.

AAC Technologies is going through a tough patch as at the end of February it released a profit warning. It is facing more intense competition than we expected in the acoustics and haptics segments. The weakness in the smartphone market is causing pricing pressure down the supply chain and AAC is not immune to this. We continue to hold because we think that AAC is well positioned for the replacement cycle. As consumers buy newer phones, they will be buying products with more advanced speakers where AAC is at an advantage.

Catcher Technology released weak results for the fourth quarter and indicated weaker profits in Jan/Feb this year. The market is divided on its prospects, but we think Catcher only has one serious competitor in the mass production of casings for Apple, Casetek, which is less cost-competitive and has less production scale. Hon Hai is another potential competitor, but Apple has been trying to reduce reliance here. The dividend was maintained.

Hon Hai Precision reported results on the last day of the month which beat expectations. The primary driver was cost-cutting, but there were more positive signs too with additional smartphone orders coming through. Margins were also helped by lower prices for memory chips. The market has been looking for cost controls to deliver meaningful margin expansion and this appears to have come through in the last quarter of 2018 with gross margin 1% higher at 7% and operating margins back up to 3.6%. In recent news we hear that Foxconn Technology, a subsidiary of Hon Hai, is to trial production of the new iPhone in India at its facility outside Chennai. Apple is not a major player in the Indian smartphone market but has been facing increased pressure in China. India has 500 million smartphone users and 140 million devices were sold in 2018, many of them Chinese brands; only 1.7 million were iPhones.

In other sectors, **Chinese banks** mostly issued preliminary results in the earlier part of the year. More detail has since come out which make us happy to continue holding them. In short, net profit was slightly lower than expectations but balance sheet quality improved. The key metrics that we focus on are profits before provisions, which grew 10%, to assess profits from operations; and on the balance sheet side we focus on non-performing loan (NPL) recognition and write offs. A tightening on the balance sheet side should be reflected in higher provisioning costs in the income side which will mean lower net profits, which grew 5%. However, if operating profits are strong enough at the pre-provision level then the banks can afford to address the bad debt issues more aggressively, which is what they have been doing. Reported non-performing loans are still around 1.5%, not much changed from the level in 2013, but adjusted for those the banks have disposed of or written off, the figure is 6%. Over the last five years banks have increased their clean-up efforts and year by year the NPL level adjusted for disposals and write-offs has risen by around 1% per annum.

This is in line with the argument we have made over the last five years that the China bank clean-up is a 10-year project, not a two-year one; that the write-downs will progress as profitability allows and that stability can be maintained because of the domestic nature of both debt and bank funding sources. The low valuations of Chinese banks, in our opinion, have represented a wider misunderstanding of China's domestic debt dynamics and have presented us with an opportunity.

Our investment case for holding shares in China Construction Bank and China Minsheng Bank is that we believe them to be undervalued because of concerns about balance sheet strength and doubts about the ability and willingness of managements to address it. In the recent results we have seen faster loan write-offs and tighter non-performing loan recognition, which should be supportive of our valuation argument. The net profit number is therefore more a function of how aggressive the banks are willing to be in provisioning. The steady growth of pre-provision operating profit lies behind the 5%-8% dividend growth seen from the big banks and strong growth in cash dividend (as opposed to shares) delivered by Minsheng Bank. We do not expect to see much net profit growth while this is underway and thus the total return thesis is based upon valuation expansion and modest dividend growth.

Shenzhou International, an integrated textiles and garment manufacturing company, reported solid results, with sales up 16% year-on-year. The strongest segment was sportswear, with growth coming mainly from China and the US. Casualwear also performed well, with growth from the same countries. Data ahead of the results indicated that they were likely to be positive – China sales data showed strong growth in clothing, shoes and accessories, both offline and online. Online sales of these categories reported growth of 21% in the first 11 months of 2018. Western brands including Nike and Adidas have proved extremely popular in China and Shenzhou is a supplier to both.

As labour costs have increased in China, companies in the textile industry have adapted by moving production offshore and by moving up the value chain. Shenzhou has exemplified these trends, expanding its production capacity in Vietnam and improving efficiency in order to fulfil higher volumes. Future expansion is planned for Vietnam and Cambodia which will help to mitigate the impact of potential tariffs. Management indicated that the current environment is already creating uncertainty around exports.
Management also discussed an interesting shift in the role of their Chinese manufacturing capacity. Increasingly, factories in China are playing an important role in training workers, developing best practices, being used for research and development or developing factory automation. These innovations are first trialled in China before being rolled out to overseas factories.

Shenzhou announced a 21% increase in the dividend: the total dividend of HK$1.75 represents a pay-out ratio of roughly 50%.

Haitian International manufactures plastic injection moulding machines which are subject to tariffs in the US. Despite this headwind, operating income only fell 3%. Sales of the company's main series fell, but this was mitigated by the fact that more customers are instead buying the company's electric machines. Haitian saw greater demand from Europe and emerging markets including Brazil and Russia. It has also just launched the latest generation of its products targeting the mid-to-high end of the market. The stock has outperformed this year as US-China trade discussion have progressed.

China Medical Systems acts as a pharmaceutical distributor to doctors and hospitals for both branded and generic drugs. The regulatory structure in China is changing as the government, as with governments everywhere, seeks to reduce health care costs. The changes have introduced significant new competition where alternative offerings are available, resulting in substantial price cuts in certain cases. China Medical Systems has seen a significant drop in its share price that we believe significantly exceeds its exposure to these changes. In addition, the company has tied up with companies in the US, UK, France, Switzerland and Israel to secure rights to sell formulations to treat strokes, brain cancer and respiratory disease, down to onychomycosis (toenail fungus, which we needn't dwell on). The recent 2018 results delivered the consistency we look for: gross profit, operating profit, net profit and dividend growth all moving in line up 10.5%-12.5% and an unchanged dividend pay-out of 40% of earnings.

China Lilang, which sells men's casualwear, reported strong profit growth. It launched a new smart casual collection targeting the younger range of its 20-45-year-old target demographic. The range is to be rolled out into the wealthier Tier 1 and Tier 2 cities in China, alongside the core range; while at the same time the core range is to expand into the so-called Tier 3 and Tier 4 cities. The new range is being distributed on a consignment rather than wholesale basis, meaning that distributors do not have to buy stock first but can place orders as they need and can return unsold stock. This is sensible since it lowers the risk to distributors of the new range and limits the potential for inventory build-up.

Banco Davivienda released good results for financial year 2018. Net income was up 9% versus 2017, driven by growth in gross loans of 12.3% (of which currency devaluation contributed roughly 2%). The ratio of Past Due Loans (loans more than 90 days overdue), though up significantly on prior year, was stable over the previous quarter at 3.93% and well covered (total reserves coverage ratio of 125%).

Macroeconomic data for Colombia indicates the economy grew at 2.7% in 2018, up from 1.4% in 2017. Momentum has slowed, however, with the PMI dipping below 50 (indicating contraction), although the most recent data point was improved. A rising oil price should bolster the country's exchange rate, and the fiscal deficit has also improved, moving from –4.1% in 2016 to –3.1% in 2018.

Macroeconomic data for Central America shows slowing growth, but inflation is under control. Management cited the political demonstrations in Nicaragua as having a dampening effect on regional growth, as trade and the transport of goods has been disrupted.

The bank reported rapid progress in its digital initiative. The number of digital customers increased 22% over the year to 6.5m, which is 70% of the bank's total customers. Digital sales (which includes sales both fully from the digital channel and those assisted by the digital channel) increased from a low base to reach 16% of total sales. Mobile savings accounts and unsecured personal mobile loans were the drivers behind this increase.

Ping An Insurance (Group) reported good results for 2018, with operating profit up 18.9% and net profit up 20.6%. Operating return on equity was flat at 21.9%. The growth in operating profit came from retail business, which constitutes 87% of the total. Retail customers were up 11% and operating profit per customer rose 18.1%. Ping An has benefited from improved cross-selling – the proportion of customers with more than a single contract increased from 28.5% to 34.6%.

In the life insurance business, growth in New Business Value reached 24% year-on-year for the fourth quarter, with the full-year figure up 7.3%. Margins also improved due to the product mix. The banking business saw 7% growth in net profit, helped by strong growth in retail loans. Asset quality has improved significantly over the past couple of years. In the Fintech & 'Healthtech' division, operating profit after tax grew 25%. A highlight during the year was the completion of a series C financing for Lufaxm – following the postponement of a planned IPO – which values the company at $39bn. Lufax is an online wealth management and lending platform in China and is 41% owned by Ping An.

Ping An's management highlight the company's excellent track record since its IPO in 2004. Over that period, earnings per share (EPS) have grown at a compound rate of 24.5%. The dividend has followed suit, growing at a compound rate of 25.7%. The dividend increased by less in 2018, rising by 14.7% from the previous year, though it is still up by a factor of 4.8 since 2014 (these figures exclude the payment of an additional special dividend in the first quarter of 2018 marking the company's 30th anniversary). This combination of a growing earnings stream that supports the payment of a growing dividend, coupled with a long-term commitment from management to paying that dividend, typifies some of the main attributes we look for in our portfolio companies.

Outlook

Emerging markets have had a good start to the year after a tough end to 2018, but it is worth reflecting on some of the areas of uncertainty facing investors and understanding how we deal with these in the fund.

Several emerging market countries are in the midst of elections or are due to face them later this year, including India, Indonesia and South Africa. The uncertainty in the run-up to elections and changing polling data can cause significant swings in individual country indices, as the strong movements in Indian equities in March reflect. Coupled with this short-term noise, there is often a window in the run-up to elections when incumbent leaders neglect to tackle difficult areas such as structural reforms, particularly where these are unpopular with the electorate. Sentiment often swings back in the other direction once the outlook is more certain.

Political uncertainty can take other forms, such as the trade conflict between US and China. Chinese stocks and emerging market stocks more widely have been volatile over the past months as the prospect of a negotiated agreement seems either closer or more distant. Recently, the mood has been more positive, as signs of compromise are emerging. The perceived progress has boosted sentiment (from very low levels), allowing valuation multiples to recover.

Emerging markets are also subject to external factors such as movements in commodity prices, which can cause equity markets and currency markets in particular to be volatile. This is obviously more pronounced for those countries with a dependence on oil, either as producers (such as Colombia) or as importers (such as India).

These uncertainties naturally make forecasting the performance of economies extremely difficult, let alone that of equity markets. It's one of the main reasons why we don't attempt to make top-down allocations within the portfolio or macroeconomic 'bets'. Our approach is to start with individual companies, assessing their quality – i.e. their ability to generate economic profits, and the likelihood that those profits will continue into the future. This ability is often dependent on the company's competitive positioning but may also be affected by the macroeconomic environment.

From a valuation perspective, we look for situations where the market undervalues the likelihood of a company continuing to generate strong performance. When doing our valuation work we consider this valuation discrepancy given different scenarios the company may face, and when our assessment suggests there is the potential for greater risk, we can adjust the discount rate to take that into account.

Despite the strong performance since the start of the year, valuations continue to look attractive with the portfolio trading on 12.3x estimated 2019 earnings, a 3% discount to the benchmark. Coupled with these valuations, the prospects for earnings growth, both at the fund and regional level, look good. Macroeconomic data for emerging markets – China in particular – have pointed to recent strength. Trade between China and the US has slowed, but fiscal stimulus measures are helping. The 'set-up' for emerging markets looks promising.

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

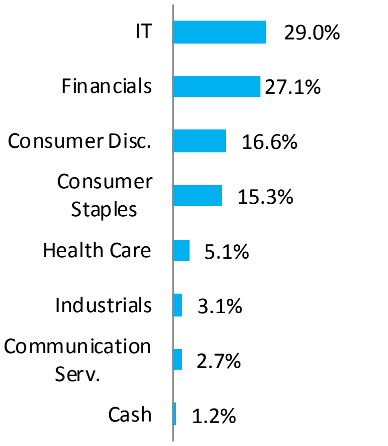
PORTFOLIO

31/03/2019

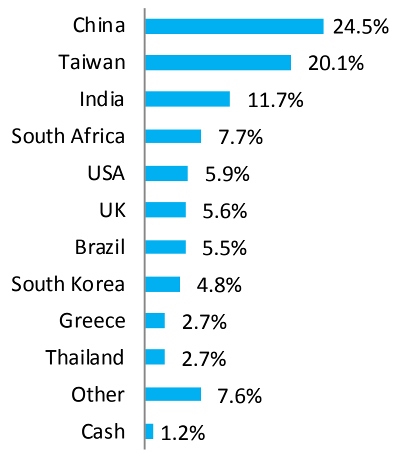
Fund top 10 holdings

Indiabulls Housing Finan	3.7%
Novatek Microelectronics	3.6%
Elite Material	3.5%
Haitian International Hol	3.1%
China Lilang	3.0%
Broadcom	3.0%
Shenzhou International	3.0%
Qualcomm	2.9%
Unilever	2.8%
Truworths International	2.8%
% of Fund in top 10	31.5%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

31/03/2019

Discrete years % total return

	Mar '15		Mar '16		Mar '17		Mar '18		Mar '19	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.74% OCF)	-	-	-	-	-	-	30.3	16.1	-14.8	-9.5
MSCI Emerging Markets	0.8	13.2	-11.7	-8.8	17.7	35.2	25.4	11.8	-14.6	-9.3
IA Global Emerging Markets Sector	0.0	12.3	-12.1	-9.2	17.7	35.3	21.7	8.5	-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)	3.0	5.1	10.6	8.1	-9.4	-2.4	-	-	31.8	23.9
MSCI Emerging Markets	0.8	2.9	9.9	7.4	-7.4	-0.3	35.6	49.6	32.4	24.5
IA Global Emerging Markets Sector	0.7	2.8	10.6	8.1	-8.5	-1.5	31.0	44.5	28.5	20.9

Annualised % total return from launch

	USD	GBP
Fund (Z class, 0.74% OCF)	12.9%	9.9%
MSCI Emerging Markets Index	13.2%	10.1%
IA Global Emerging Markets	11.7%	8.7%

Risk analysis - Annualised, weekly, from launch on 23.12.2016

31/03/2019	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-0.1	3.2	1.8
Beta	1.0	1.0	1.0	0.9	1.0	0.9
Information ratio	0.0	0.0	0.0	-0.3	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	0.6	0.4	0.5	0.4	0.7	0.5
Tracking error	0.0	0.0	0.0	3.9	6.0	6.3
Volatility	14.7	13.8	13.7	12.3	13.7	13.4

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: 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.

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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.