Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – May 2019

Launch date	**19.12.2013**
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Aim

The Guinness Asian Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Asia Pacific region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

Performance

30/04/2019

Fund	Guinness Asian Equity Income (Y)
Index	MSCI AC Pacific ex Japan Index
Sector	IA Asia Pacific ex Japan

	2016		2017		2018	
	USD	GBP	USD	GBP	USD	GBP
Fund	7.5	28.2	36.5	24.6	-15.5	-10.3
Index	7.8	28.6	37.3	25.4	-14.5	-9.2
Sector	5.3	25.7	37.2	25.3	-15.1	-9.8

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	16.0	13.3	0.2	5.8	54.8	94.3
Index	14.0	11.4	-3.2	2.2	34.4	68.7
Sector	14.4	11.8	-2.8	2.7	35.2	69.7

Annualised % total return from launch

	USD	GBP
Fund	8.5%	13.2%
Index	5.7%	10.2%
Sector	5.8%	10.4%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.7	1.3	4.0	4.4
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.5	0.5
Max drwdn	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	3.6	3.6	5.8	5.8
Volatility	14.8	15.1	13.5	13.5	12.7	13.9
Sharpe ratio	0.1	0.5	0.2	0.5	0.4	0.7

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, Y class 0.99%, bid to bid, total return.

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Fund & Market

- Asian markets rose in April by 1.9% in GBP terms (1.9% in EUR and USD) as measured by MSCI AC Pacific ex Japan Net Return Index.
- This was a strong performance in a global context until the end of the month when growing concerns about Chinese stimulus and a strong dollar caused markets to pull back in the last five trading days.
- Qualcomm was a significant driver of fund performance during the month following Apple's withdrawal from its long legal suit against the company. Qualcomm's stock price surged over 50%.
- Other strong performers were Hon Hai Group (also known as Foxconn), DBS Group in Singapore, BOC Hong Kong, AAC Technologies, Hanon Systems in Korea and Luk Fook, a retailer of jewellery in Hong Kong - which all rose between 6% and 18% over the month.
- Our weakest stock was Li & Fung, which was down 8%, followed by Elite Material, China Mobile, Pacific Textile and China Lilang, which were down between 4% and 7%.
- Leading regional markets in the month were Singapore, Taiwan, China and Thailand. Leading sectors were Consumer Discretionary, Communication Services, IT and Financials.
- Lagging markets were Indonesia, Hong Kong, Korea and Malaysia. Lagging sectors were Utilities, Energy, Materials, Industrials and Real Estate.

Events in April

- On the trade talks: Xi Jinping's speech at the recent Belt & Road Initiative forum dwelt on steps China will take on intellectual property, market opening, fair competition, effectively addressing and giving his seal of approval for the concessions required to get a deal done.

- Reports indicate Chinese policymakers are considering stimulating demand for automobiles. Proposals include subsidising the replacement of older, dirtier machines with new electric vehicles and removing the vehicle tax for rural car owners who replace their vehicles with an engine size below 1.6L. Auto makers in China and Europe rose on the news.

- DBS reports that it plans to stop financing coal-fired power stations in the region once existing commitments are complete in 2021.

- Korean company Coway reported that sales of air purifiers in China were weaker in the first quarter, citing lower air pollution in Chinese cities as one of the reasons for reduced demand.

- Chinese economic growth of 6.4% in the first quarter was higher than expected. The data followed improved manufacturing output and trade figures in recent months.

- China's onshore bonds began to be included into the Bloomberg Barclays Global Aggregate Bond Index, a process that will continue until the end of 2020.

Market & Thematic Comments

The resolution of the dispute between **Qualcomm** and Apple has received more coverage than we need to add to, but as holders of Qualcomm we have of course taken a keen interest. The dramatic decision by Apple on the second day of this defining court case allows us, I think, to draw some important conclusions:

1. Qualcomm does indeed have a competitive advantage in chip design for mobile modems;

2. Intel's withdrawal from that business shows it does not have a competitive edge in this market, despite confident assertions to the contrary only recently;

3. 5G, with its high data volumes, requires a high-quality solution that is not easily replicable;

4. Apple's service revenues are not yet a substitute for handset sales - the risk of a delay to the new 5G handset presents too great a business risk to Apple;

5. Apple is under intense competitive pressures. Samsung has been joined by Huawei in the top-end handset space and Apple's brand price premium is no longer secure as evidenced by falling device sales and the comparatively weak response to the recent XR model.

Chinese banks reported results of the first quarter. The sector overall reported strong revenue growth and accelerating pre-provision operating profit growth of 16% which was better than market expectations. The banks we hold did better still, with China Construction Bank (CCB) and ICBC both reporting net interest margins of c.2.3% compared to their peer average of 2.1%, and China Merchants Bank (CMB) reporting a 2.7% margin versus the China private sector bank average of 2.4%. Fee income was also strong, mostly attributed to wealth management product (WMP) fees. This is an area we might be concerned about, but we have high conviction that the Big Four banks in China and China Merchants are applying the tighter WMP requirements imposed by the regulator and the central bank.

Net profit growth was more muted, at c.5% for the sector (11% for CMB). The slower growth was due to higher provisioning. Reported non-performing loans remained little changed, with CCB at 1.46% of total loans, ICBC at 1.51%, CMB at 1.35% and Minsheng Bank at 1.75%, but the provision coverage increased. This brings us to why we hold these banks. Many of our peers are scared off by the China debt story and a lack of confidence in the banks' asset quality. The decision we have to make is whether, after taking into account the likelihood that there are more bad debts in the system, we think that banks have the capacity and willingness to address these issues while maintaining overall stability. Our argument is that Chinese banks overly discount the risks and under-price the prospects for stability. In short, they are too gloomy, and this presents an opportunity for us which has delivered outperformance in four of the last five years.

China's financial reform effort has been characterised by many, including us, as a deleveraging programme, and in part that is true. There are on-going efforts to reduce debt, and the ratio of corporate debt to GDP is coming down. Banks are also writing off bad debts more actively and the higher provisioning charges just discussed are directly related to that. But perhaps it would be more accurate to view China's financial reforms in terms of making the system safer and more stable. There are daily open market operations to manage the supply and price of credit; the degree to which banks can lend to one another has been limited; assets have been brought out of the shadow banking arena back into the formal banking sector; capital adequacy and risk weighting requirements have been raised. 2018 was the first year in a decade where shadow banking assets declined (down 6.5% to $9.1 trillion or 23.5% of China's banking industry assets, according to Moody's).

The results have been promising. Linked to this new stability and safety comes the opening of **China's bond markets**. Most comments have focused on the opportunity offered by a 'new' bond asset class that is deep and liquid as well as having a lower correlation to global benchmarks (the same is true of Chinese A-share equities). This is certainly interesting for Global and EM bond managers, even though the addition of these bonds to the Bloomberg Barclays Global Aggregate Bond Index will not be complete until 2020. However, in our opinion it also speaks to growing confidence amongst Chinese financial policy makers.

Opening the government bond market is a big step which can have a significant impact on monetary policy management because of the introductions of portfolio flows which can often be far greater in bond markets than they are in equities. There are estimates that the combination of stock and bond market opening could generate portfolio flows of $200 billion a year on average. Even for a market of China's size such flows would be significant especially when we also remember that flows can move out as well as in. This suggests that the central bank, after years of maintaining barricades around the financial system, is now confident in its robustness. That is not to say that the risks have disappeared, but this is a step change that we believe has huge implications for how we should think about Asia over the next 10 years.

Portfolio update

JB Hi-Fi in Australia reported sales growth in the first three months of this year of 2.6%, but in difficult trading conditions in Australia this is a good performance. The market has been negative on the sector and so this news following on from better-than-expected news from the previos quarter, though modest, has kept the share price moving. The continued turnaround in the homeware business, The Good Guys, is especially welcome.

DBS in Singapore continues to report strong results with the first quarter 2019 reporting record revenues, pre-provision operating profit and net profit. We were especially struck by the bank's commitment to cease new lending to fund coal-fired power stations.

Janus Henderson offered a very mixed picture in its quarterly results: fund performance has improved sequentially but fund outflows continue and will take time to turn. The loss of an emerging markets equity team (whose fund performance somewhat lags our own EM income fund) is also likely to trigger redemptions.

Hanon Systems has completed the acquisition of the fluid pressure and control unit of Magna International which makes it a leading supplier of automotive thermal and energy management systems. These improve the efficiency of both conventional and electrified power efficiency and so is applicable to internal combustion engine, hybrid and pure electric vehicles. The unit employs 4,100 people across nine manufacturing and engineering facilities in Europe, Asia and America.

Elite Material continues its recovery. The stock is one of our best performers this year after suffering a torrid 18 months prior, due to slowing revenues and loss of orders. Digitimes in Taiwan reports that the company will replace Panasonic as a major supplier of copper-clad laminates for Apple's 2019 iPhone and has in fact secured as much as 70% of the orders for laminates used in substrate-like Printed Circuit Boards (PCBs). The importance of this is twofold – first, the material helps the process of miniaturisation of the PCB, giving a key benefit for the manufacture and design of the overall device, and second, being harder to produce, the product sells at a higher margin.

Aflac reported results for the first quarter that were uneventful. Operating earnings up 7% on last year, which is exactly what we want from this bolt-on healthcare insurer. The main operation in Japan (around 70% of the total business) saw premium income fall 2% but delivered strong investment income growth of 4%. The US business (around 30%) saw premium growth up 2.4%, and investment income also rose by 1.1%, but operating expenses weighed. We are confident that expenses in the US can be managed, while in Japan, we think that premium growth will be helped by the recent tie-up with Japan Post (office), which adds to distribution.

Outlook

Our view on the prospects for the Fund and for Asia is little changed. The companies we hold have reported in line with our expectations and there have been no surprises. The sharp rally in Qualcomm has been a long time coming but based on our fundamental view of its competitive advantage was not a shock. The outlook for China is also little changed. We inch closer to a trade deal but as we have seen from recent comments from President Trump, a deal cannot be taken as granted. There are plenty of signs that the slow-down in the domestic economy has now moderated. The dollar has been strong for a while and we do not expect it to move sharply higher given the interest rate outlook. In any case, Asia's sensitivity to this is not what it was; dollar debt as a proportion of the whole is well below Asian crisis levels and with most countries running current account surpluses and well-capitalized banking sectors, the region does not look vulnerable from this direction.

In the medium term, the China risk remains. High debt levels are an overhang but given the source of that debt funding is predominantly domestic we would have to look domestically for the source of a crisis. This could take the form of an economic slowdown brought about by a policy misstep, perhaps, combining with rapid monetary tightening in response to an inflationary or exogenous shock. There are no signs of these kinds of pressures in any of the data we are looking at.

So this brings us back to working out what returns on capital our portfolio holdings are capable of generating and how much of that is priced in by the market. The Fund is trading at a 16% discount to the market (as measured by the MSCI AC Pacific ex Japan Index); if we exclude the deep value names the discount narrows to around 3%, but importantly, is still there, attached to a group of companies whose operating performances have been well above the average for many years.

Edmund Harriss
Mark Hammonds (portfolio managers)
Sharukh Malik (analyst)

Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

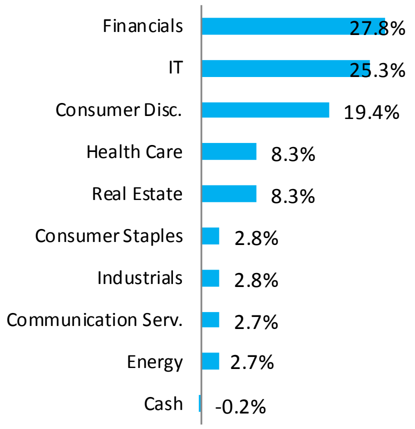
PORTFOLIO

30/04/2019

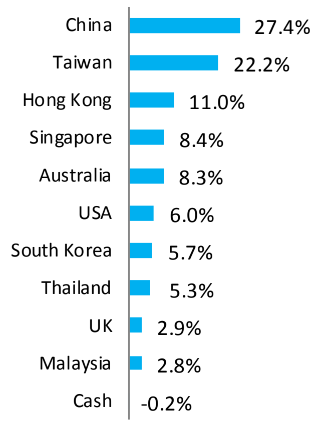
Fund top 10 holdings

Aflac	3.0%
Qualcomm	3.0%
Hon Hai Precision Industry	2.9%
Hanon Systems	2.9%
Asustek Computer	2.9%
DBS Group Holdings	2.9%
Janus Henderson	2.9%
Corporate Travel Management	2.9%
China Medical System	2.8%
Public Bank Bhd	2.8%
% of Fund in top 10	29.0%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

30/04/2019

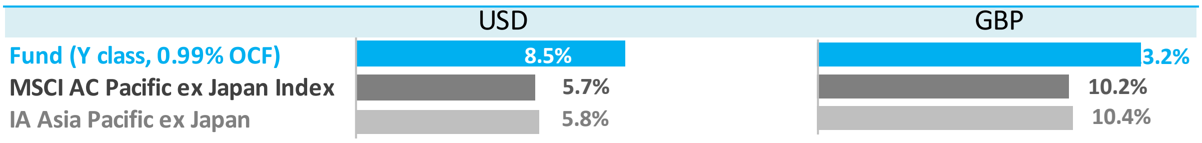
Discrete years % total return

	Apr '15		Apr '16		Apr '17		Apr '18		Apr '19	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Y class, 0.99% OCF)	23.1	35.2	-14.4	-10.2	21.0	37.0	17.6	10.4	0.2	5.8
MSCI AC Pacific ex Japan Index	11.2	22.2	-17.1	-13.1	20.1	36.0	20.8	13.4	-3.2	2.2
IA Asia Pacific ex Japan	10.0	20.9	-14.6	-10.4	18.9	34.7	19.4	12.2	-2.8	2.7

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 (Y class, 0.99% OCF)	2.8	2.8	16.0	13.3	0.2	5.8	42.5	60.1	54.8	94.3
MSCI AC Pacific ex Japan Index	1.9	1.9	14.0	11.4	-3.2	2.2	40.4	57.8	34.4	68.7
IA Asia Pacific ex Japan	2.4	2.4	14.4	11.8	-2.8	2.7	38.0	55.1	35.2	69.7

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

30/04/2019	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.7	1.3	4.0	4.4
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.5	0.5
Maximum drawdown	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
R squared	1.0	1.0	0.9	1.0	0.9	0.9
Sharpe ratio	0.1	0.5	0.2	0.5	0.4	0.7
Tracking error	0.0	0.0	3.6	3.6	5.8	5.8
Volatility	14.8	15.1	13.5	13.5	12.7	13.9

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Source: Financial Express, bid to bid, total return. Fund launch date: 19.12.2013.

Important information

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This report is primarily designed to inform you about equities and equity markets invested in by the Guinness Asian 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 Asian 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. The Fund invests only in stocks of companies that are traded on Asian stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. 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.