Guinness Best of China Fund

INVESTMENT COMMENTARY – May 2019

Launch date	**15.12.15**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (analyst) **Sharukh Malik** (analyst)

Aim

Guinness Best of China Fund is designed to provide investors with exposure to economic expansion and demographic trends in China and Taiwan.

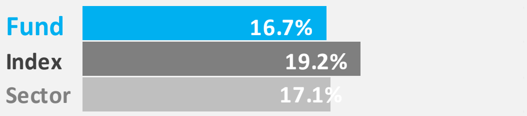
The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle.

Performance 30.04.19

Fund	Best of China Fund
Index	MSCI Golden Dragon
Sector	IA China/Greater China

	1 year	3 years	From launch
Fund	-0.4	72.4	68.6
Index	4.7	75.1	80.7
Sector	2.0	70.9	70.3

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-1.7	-1.6
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.5	-0.3
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	18.1	18.3	18.8
Sharpe ratio	0.8	0.7	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, bid to bid, total return 0.74% OCF. Returns for share classes with a different OCF will vary accordingly

Fund & Market

- In April, the Best of China Fund rose 4.1% (in GBP, Z class) while the MSCI Golden Dragon Net Total Return Index rose 2.0%.
- MSCI Taiwan (net total return of +3.6%) was the strongest market compared to 1.8% for China and 0.8% for Hong Kong.
- In Taiwan, the Information Technology sector, which makes up more than half of the MSCI Taiwan Index, rose by 3.4%. There is an expectation that the build-up of inventory in semiconductors will clear by the second half of the year, leading to rising orders, and the sector has rallied so far this year.
- In China, the strongest sectors were Communication Services, Financials and Information Technology, while the weakest were Industrials and Energy.
- The leading contributors to Fund performance in April were stock-specific, led by Qualcomm (modem and chip development), Netease (online gaming and e-commerce), Noah (wealth management) and Haitian International (injection moulding machines).

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 and 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 auto demand.

Proposals include subsidising the replacement of older, dirtier vehicles with new electric vehicles (NEVs); incentivising local governments to speed up the upgrade of their bus fleet with NEVs; and exempting from vehicle tax rural residents who replace their vehicles with new ones with engines below 1.6 litres in displacement.

- The National Development and Reform Commission is proposing to loosen hukou requirements to encourage mobility of workers. The hukou system links entitlement to services such as education and healthcare to a particular area, meaning many migrants who move to larger cities are not entitled to them. The new proposals call for cities with a population between one and three million people to lift all restrictions, while slightly larger cities are being pushed to gradually ease requirements. The aim is to encourage migration to these smaller cities rather than the larger tier one and two cities, some of which have become too large and are aiming to downsize.

- The Politburo met and stated that “efforts on structural deleveraging should be maintained" and "prudent monetary policy should be kept neither too tight nor too loose". This acts as a reminder that policymakers have a careful balancing act with managing growth while ensuring the financial risks in the system do not grow.

- Bloomberg began including Chinese government bonds and policy bank securities in its Bloomberg Barclays Global Aggregate Index.

- African swine fever (ASF) is likely to lead to China's pig population, which is the largest in the world, to fall by a third. The Ministry of Agriculture expects pork prices to rise by at least 70% year-on-year in the second half of the year and this is likely to put upward pressure on inflation.

Market Update

Most comments on the gradual opening of China’s bond market 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 and 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

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 obviously taken a keen interest. The dramatic decision by Apple on the second day of the defining court case in this dispute allows us, I think, to draw some important conclusions:

- Qualcomm does indeed have a competitive advantage in chip design for mobile modems.
- 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.
- 5G, with its high data volumes, requires a high-quality solution that is not easily replicable.
- 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.
- 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.

As part of the settlement the two companies agreed a six-year licensing deal and Apple payed Qualcomm the dues which have been held back for the past two years. Qualcomm's share price subsequently increased by 50.5% in April. Intel immediately announced it would withdraw from the 5G modem business and this reaffirms our view that Qualcomm does make the best modems. Apple is under pressure following the relative failure of the iPhone X; the risk of missing the next phone cycle is greater than the benefit (perhaps) of winning against Qualcomm.

China Merchants Bank reported solid results. The bank's deposit base is biased towards retail deposits and so is relatively low-cost, allowing the net interest margin to increase. Pre-provisioning operating profit grew 13% while the non-performing loan coverage ratio rose to 363%. The bank is also making good use of its apps, with 59% of its wealth management products being sold through this channel.

New Oriental Education reported strong results. Student enrolments grew 40-45% while the hourly average selling price grew 5%. Margins rose due to better utilisation of classrooms and cost control. A subsidiary, Koolearn, which provides the online learning courses that New Oriental Education uses to complement its classroom-based teaching, was listed on the Hong Kong Stock Exchange.

Anhui Conch Cement saw strong growth in earnings driven by both volume and margins. It is likely strong profit growth could continue as cement prices in key areas are higher compared to last year. There is some concern the government will start an anti-monopoly probe, but management seem comfortable with this risk (though there is a possibility further price increases become more moderated). Infrastructure and property construction should sustain the business in the near term.

Elite Material continues its recovery. The stock is one of our best performers this year after suffering a torrid 18 months prior, on 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, a key benefit for the manufacture and design of the overall device, and second, being harder to produce it earns a higher margin.

Summary view & outlook

Our view on the prospects for the Fund is little changed. The sharp rally in Qualcomm has been a long time coming but based on our fundamental view of its competitive advantage it 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 is 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.

The portfolio has a strong China domestic bias. Average earnings growth for the next two years is 12.5% per annum based on current consensus estimates. This is better than the 11.8% per annum forecast for the market (as measured by the benchmark MSCI Golden Dragon Index). This is made more attractive still when we consider valuations. The Fund's price-earnings multiple of 11.3x 2019 and 10.1x 2020 estimated earnings put it at a 16% discount to the market at the end of quarter. We have all seen the improvement in the Chinese outlook this year with global markets responding very positively. We believe that there remain plenty of uncertainties out there and that our focus on higher-quality companies, evidenced by their ability to sustain profitability over time, is fully justified.

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

Data sources

Fund performance: *Financial Express, total return 0.74% OCF in GBP*

Index and stock data: *Bloomberg*

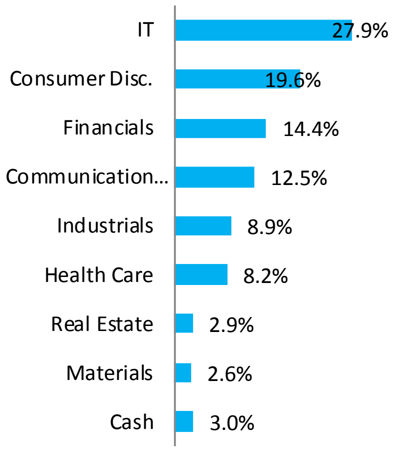
PORTFOLIO

30/04/2019

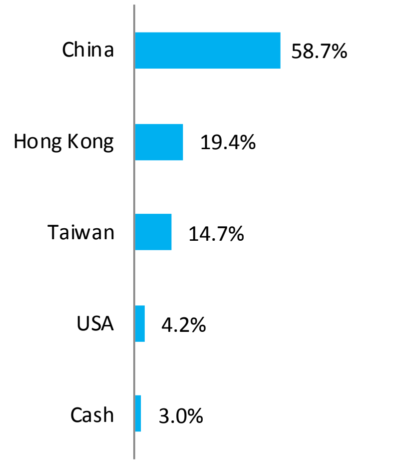
Fund top 10 holdings

Qualcomm	4.2%
Autohome	3.8%
Hollysys Automation Tech	3.6%
Noah Holdings	3.2%
China Lesso Group	3.2%
Netease.com	3.2%
Novatek Microelectronics	3.1%
Taiwan Semiconductor	3.1%
Luk Fook Holdings	3.0%
Ping An Insurance	3.0%
% of Fund in top 10	33.5%
Total number of stocks	33

Sector analysis



Geographic allocation



PERFORMANCE

30/04/2019

Annualised % total return from launch (GBP)

Fund	16.7%
MSCI Golden Dragon Index	19.2%
IA China/Greater China sector average	17.1%

Discrete years % total return (GBP)	Apr '15	Apr '16	Apr '17	Apr '18	Apr '19
Fund	-	-	47.3	17.5	-0.4
MSCI Golden Dragon Index	45.6	-20.0	41.0	18.6	4.7
IA China/Greater China sector average	47.4	-21.3	37.1	22.2	2.0

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	4.06	21.13	-0.37	72.37	-	68.62
MSCI Golden Dragon Index	2.33	15.39	4.65	75.05	103.92	80.66
IA China/Greater China sector average	2.68	18.08	2.02	70.90	98.20	70.29

RISK ANALYSIS

30/04/2019

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-1.71	-1.55
Beta	1.00	0.98	0.98
Information ratio	0.00	-0.47	-0.33
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.90
Sharpe ratio	0.84	0.69	0.69
Tracking error	0.00	4.58	6.06
Volatility	18.10	18.29	18.82

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: 15.12.2015.

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 Best of China 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 Best of China 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.