Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – June 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

31/05/2019

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	6.2	7.3	-7.3	-2.1	41.7	83.9
Index	5.3	6.4	-10.1	-5.1	24.2	61.2
Sector	6.6	7.7	-8.9	-3.8	26.0	63.6

Annualised % total return from launch

	USD	GBP
Fund	6.6%	11.8%
Index	4.1%	9.2%
Sector	4.3%	9.5%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.7	1.3	3.3	3.9
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.1	0.1	0.5	0.4
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	14.9	15.0	13.6	13.5	12.9	13.9
Sharpe ratio	0.0	0.4	0.1	0.4	0.3	0.6

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

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Fund & Market

- After a strong first four months markets turned in May. The story was all about trade.
- Asian markets, as measured by the MSCI AC Pacific ex Japan NR Index, fell -4.5% in GBP terms (-7.2%/-7.6% in EUR/USD terms) making it the weakest region in May.
- Unsurprisingly, China was the weakest market followed by Korea. Australia, Philippines, and Malaysia were the most defensive.
- On a sector basis Consumer Discretionary, Communication Services and Information Technology here hardest hit, closely followed by Energy.
- The weakest stocks over the month were concentrated in the technology area together with Corporate Travel, Janus Henderson, China Lilang and banks DBS, BOC Hong Kong and China Construction Bank.
- We should remember that the first four months went well and that on a year to date basis we still have Technology, Financials, Consumer Discretionary, Health Care and Real Estate names in Australia, China, Hong Kong, Singapore, Taiwan and Thailand among the top performers.
- This past month has been about markets adjusting to the idea that the mercurial 'Trump factor' is ever present and trying to work out an appropriate valuation level (or discount rate) to apply.

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Events in May

- It all began, of course, with a Tweet: US-China trade negotiations were not going well.

- Additional US tariffs would be applied to Chinese goods; China retaliated with higher tariffs on US goods. Huawei was blacklisted and discussions were put on hold until the G20 meeting in Osaka, in June.

- Mexico came into the firing line (immigration and the Wall) and once again trade tariffs were the weapon of choice – a 5% rate rising in 5% increments per month up to 25%.

- Preparation for US-EU trade talks began. The US requires agriculture to be part of any agreement; a centrepiece of the EU has been, and remains, the protection of farmers. EU member countries gave their negotiator permission to begin but “strictly focused on industrial goods, excluding agricultural products”. After the ‘gilets jaunes’ upheavals this year we would not expect the French to compromise on this point.

- China is accelerating the roll-out of 5G networks, with Huawei at the centre.

- India’s election results showed a decisive victory for Modi.

- The political scene in Thailand is notoriously fragmented and the military looms large in this young democracy. May brought greater stability with a new government being formed and was further cemented by the King’s coronation.

- As an aside, Thailand moved up five places to number 25 in a World Competitiveness ranking due to improved economic performance, government efficiency and infrastructure. Singapore took the number one spot, knocking the US back to third with Hong Kong holding on to second.

Tariffs and Trade

If we didn’t know before, we do now: the US election is underway. The three main elements of President Trump’s 2016 election campaign were Jobs, Trade and Immigration. The first has not been a notable success. Tax cuts of $1.5 trillion in 2018 were supposed to provide ‘rocket fuel’ to the US economy by stimulating greater corporate investment (in turn leading to job creation), but companies have been unwilling to do so. But Jobs remain the focus through the connection to Trade and Immigration, which are the two hot-button issues that play well to President Trump’s core support.

We have argued before that the trade ‘deal’ the US made with the world over 40 years ago was one which exchanged access to the US consumer market in return for global reach. This was a deal born out of Cold War realities. The mechanism originated through the granting of Most-Favoured-Nation status under the General Agreement on Tariffs and Trade (GATT), to which the US signed up in 1948. However, the granting of Permanent Normal Trading Relations to China in 2000 just prior to its entry to GATT’s successor, the World Trade Organisation (WTO) changed things dramatically. In an article, “A Tariff for a

Tariff: Trump's crusade against China, two decades in the making" for the University of Florida International Review, Spring 2018, Gregory Barber describes what happened next: three years after China's entry into the WTO, the US had a bilateral trade deficit with China of $130 billion (for comparison, the second largest deficit was $50 billion with Japan).

At the same time, there were significant changes to US manufacturing employment. Barber, citing US Bureau of Labor figures, shows that between 2000 and 2004 manufacturing jobs decreased from 12,400,080 to 10,128,200, a drop of 2,271,880 employees or 18.3%. The loss of manufacturing jobs over the 20 years prior to China's WTO entry was 12%.

The impact of China's arrival on the global scene has been profound. The socio-economic impact in the form of factory closures is easy to see; the benefits are not so readily visible, but they are there. In a staff report from the Federal Reserve Bank of New York June 2017 (Revised July 2018), Amiti et al. studied the impact on US prices in the same period (2000 to 2006) following China's WTO entry. Their conclusion was that the 290% growth of China's exports to the US, by value, had the effect of lowering prices of US manufactured goods by 7.6%. WTO entry brought down Chinese tariffs on intermediate goods which was passed through to the prices of finished goods bought by US consumers. This forced other countries exporting to the US to cut their own prices, or exit. The paper shows that the "key mechanism underlying the China WTO effect on US prices is China lowering its own tariffs on intermediate inputs… [which] not only directly reduced Chinese firms' costs but also increased the value and range of its firms' imports of intermediate inputs, boosting their productivity."

However, the arguments surrounding China trade and industrial policies are intensely political and carry wide support across the political spectrum. The impact on the US labour market and its political importance is made clear in Barber's paper (we should note that 270 electoral college votes out of a total of 538 are required to secure the Presidency):

"Using employment data from the National Association of Manufacturers (the nation's largest manufacturing trade association) the five states with the highest share of manufacturing employees as a percentage of the national total were Indiana (17.3%), Wisconsin (16.4%), Michigan (13.8%), Iowa (13.8%), and Alabama (13.2%). Together, these states are home to 74.3% of manufacturing employees (National Association of Manufacturers). In the 2012 U.S. presidential election, two of these states – Indiana and Alabama – gave their twenty electoral votes to Mitt Romney, and the remaining three states – Wisconsin, Michigan, and Iowa – gave their thirty-two electoral votes to Barack Obama. In the 2016 election, all five states gave their combined fifty-two electoral votes to Donald Trump (Federal Elections Commission). These manufacturing states were drawn to one of then-candidate Trump's many controversial campaign pillars: restricting trade with China."

It is hard to gauge just how far President Trump wants to push this dispute. Tariffs, and the threat of them, gives him powerful leverage in the short term but it is clear this comes at an economic cost. Tariffs provide protection for producers at the cost of higher prices to consumers. Will companies use the protection afforded to invest and make themselves more competitive? History says not, and the absence of renewed investment that the recent tax cuts might have afforded suggests this time will be no different.

Recent calculations of the impact of tariffs on households do not make for happy reading. Research from the New York Federal Reserve estimates the current tariffs cost the average household an extra $831 (in higher import taxes and through 'deadweight' efficiency losses that push up prices); the Urban-Brookings Tax Policy Center estimates middle earners received $930 in tax breaks following the 2017 tax overhaul, so tariffs have wiped out all but $99 of the gain. If tariffs are imposed on another $300 billion of Chinese goods, that will lift the household cost from $831 to $2,294 (for a family of four) according to a business group coalition "Tariffs hurt the Heartland". Finally, Gary Hofbauer at the Peterson Institute for International Economics calculates that if 25% tariffs are reached on Mexican goods, then households will bear an incremental $1,700 cost. If all this plays out and if these numbers are correct (and that's an 'If…') then US households could find themselves $930 better off in taxes and $3,994 worse off in indirect costs through tariffs - net $3,014 worse off. That, or anything approximating it, is not an election winner.

Will Trump make a deal? Or will he overplay his hand? The US economy is already looking less buoyant and the Federal Reserve appears to be leaning toward an interest rate cut. Markets may yet force the issue.

Impact on Asia and the Portfolio

The reversal in China-US trade talks and the subsequent blacklisting of Huawei has re-injected macro uncertainty into the region but valuations, even after the strong run in the first part of the year had not become significantly stretched. On a forward Price/Earnings (P/E) multiple basis the region is trading on 13.3x consensus estimated earnings, which is in line with the average since 2005. Earnings estimates for the region have also had to come down. May saw the aggregate forecast drop 1.9%, led by technology. Consensus estimates are for profits to grow 4.6% in 2019 and by 12.2% in 2020.

The impact on stocks was heaviest on those with most China-related exposure, especially in the Consumer Discretionary, Communication Services and Information Technology sectors. On a country basis, China and Korea were the most affected, but so too was Singapore. The immediate thought is to look at those most exposed to trade, but the widening use of tariffs as a diplomatic weapon soon begins to be felt on a global basis as trade, then investment plans and then wage growth all begin to slow. This effect is what the stock market is trying to quantify, and the unpredictability of the key player brings a low level of confidence to macro forecasting and any portfolio positioning based upon any such analysis (which, fortunately, we avoid).

The stocks in our portfolio have also seen their fair share of earnings downgrades, predominantly in the technology segment, but the overall picture for them has not deteriorated by much. Largan Precision, Hon Hai Precision and Elite Material have all seen earnings forecasts come down by 3%-4% but even after that are still expected to post 2019 growth of 12%-30%. Novatek Microelectronics, which recently fell 10% following a company statement that management was looking more cautiously at the second half of 2019 (hardly a surprise), has seen its earnings estimates rise 9% in May. For balance, we should note that both AAC Technologies and Catcher Technology are expected to see at least 20% earnings contraction in 2019: these forecasts have been in the market for months and are more closely tied to Apple. Overall, we have a sense that macro surprise and its effect on sentiment, rather than earnings gloom, has been the main driver of performance.

Even the blacklisting of Huawei does not spell disaster. As a supplier of smartphone handsets, it is not the only game in town: OnePlus, Vivo, Oppo, Xiaomi are all building a presence inside and outside China. (The first three are all owned by BBK Electronics, a Chinese multi-national that rivals Huawei in Android handsets.) The OnePlus 7 Pro was recently ranked in the UK's Guardian newspaper as the best super-phone. OnePlus has developed its customised version of Android, OxygenOS; the phone uses the latest Qualcomm Snapdragon 855 processor; has a refresh rate of 90Hz (versus 60Hz from competitors); has 6GB of RAM, 128GB of storage, and so on. China technology is not going to stop. The blacklisting of Huawei will just spur China to move faster in developing its own solutions and cut dependence on foreign companies – something of which Google, for example, is acutely aware.

The overarching point is that the stocks we hold in the technology area (Catcher, Elite Material, Hon Hai, Largan, Novatek, TSMC, Qualcomm) have a diversified range of customers that serve growing markets in both the developed and emerging world. These businesses have all displayed superior skills in product development and management ability which mean these disruptions should be transitory. Superior quality electronic devices will continue to be sought and it is Asian companies that will make them.

Outlook

In the short term, market sentiment will be dominated by US-China relations. Treasury secretary Mnuchin recently had discussions with Yi Gang of China central bank which he described as "candid" and "constructive". He held out the prospect of a resolution to the Huawei issue as part of a trade deal. At the time of writing President Trump has just reiterated that point. So we expect markets will continue to be pushed and pulled. Our view remains that a focus on strong businesses rather than macro positioning is the way forward.

We feel confident enough to look through recent events. Without wishing to sound glib or complacent, Asia is still a growing manufacturing centre with labour, capital, infrastructure and supply networks all in place that suggest this is not going to knock Asia off course. There may be disruptions and supply chains within the region may have to be reorganised, which will take time but will happen. We believe that domestic consumption growth in the region may be slower than it would otherwise be, but it will still probably grow faster than in developed markets.

At time of writing, the portfolio trades on a valuation of 10.6x 2019 earnings and 9.8x 2020 earnings. The portfolio forecast 2019 dividend yield is 3.9%. All are at levels that we feel are very attractive.

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

Data sources

Fund performance: *Financial Express, total return*

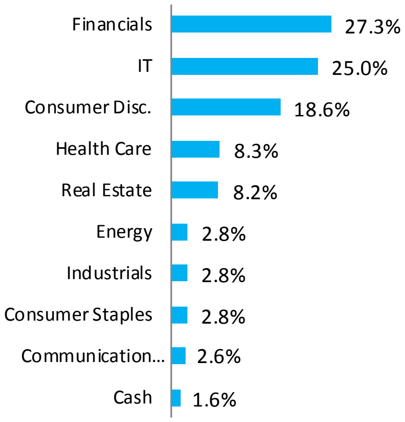
Index and stock data: *Bloomberg*

PORTFOLIO 31/05/2019

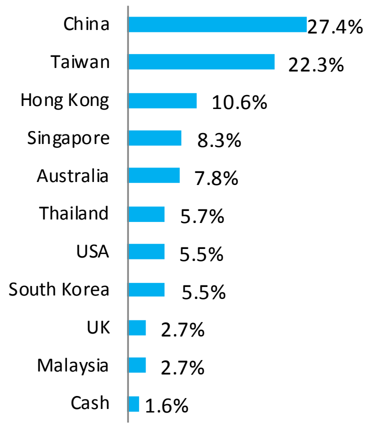
Fund top 10 holdings

China Medical System	2.9%
Hon Hai Precision Industry	2.9%
St. Shine Optical Co	2.8%
Tisco Financial Foreign	2.8%
PTT PCL	2.8%
China Merchants Bank	2.8%
AAC Technologies	2.8%
China Minsheng Banking	2.8%
Capitamall Trust	2.8%
Taiwan Semiconductor	2.8%
% of Fund in top 10	28.4%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

31/05/2019

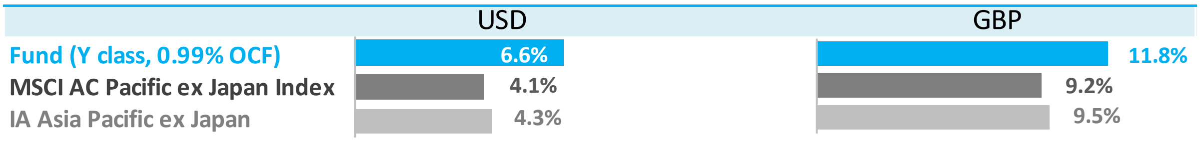
Discrete years % total return

	May '15		May '16		May '17		May '18		May '19	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Y class, 0.99% OCF)	19.4	31.2	-13.4	-9.2	24.7	40.6	12.8	9.4	-7.3	-2.1
MSCI AC Pacific ex Japan Index	4.9	15.3	-16.1	-12.1	25.7	41.8	16.9	13.4	-10.1	-5.1
IA Asia Pacific ex Japan	5.2	15.7	-14.6	-10.5	24.8	40.7	14.8	11.4	-8.9	-3.8

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 (Y class, 0.99% OCF)	-8.5	-5.3	6.2	7.3	-7.3	-2.1	30.4	50.5	41.7	83.9
MSCI AC Pacific ex Japan Index	-7.6	-4.5	5.3	6.4	-10.1	-5.1	32.1	52.5	24.2	61.2
IA Asia Pacific ex Japan	-6.8	-3.6	6.6	7.7	-8.9	-3.8	30.6	50.8	26.0	63.6

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/05/2019	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.7	1.3	3.3	3.9
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.1	0.1	0.5	0.4
Maximum drawdown	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
R squared	1.0	1.0	1.0	1.0	0.9	0.9
Sharpe ratio	0.0	0.4	0.1	0.4	0.3	0.6
Tracking error	0.0	0.0	3.6	3.6	5.8	5.8
Volatility	14.9	15.0	13.6	13.5	12.9	13.9

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. Fund launch date: 19.12.2013.

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 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.

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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.

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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.