

Guinness Best of China Fund

INVESTMENT COMMENTARY – November 2019

Launch date 15.12.15

Team
Edmund Harriss (manager)
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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 31.10.19

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

	2016	2017	2018
Fund	22.7	38.2	-20.3
Index	25.7	31.3	-9.5
Sector	18.5	35.9	-14.2

	1 year	3 years	From launch
Fund	11.6	21.1	63.1
Index	14.0	24.5	75.5
Sector	17.5	26.5	67.4

Annualised % total return from launch (GBP)

Fund	13.4%
Index	15.6%
Sector	14.2%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-1.2	-1.7
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.4	-0.3
Max drwn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.7	17.9	18.6
Sharpe ratio	0.7	0.5	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: Financial Express, bid to bid, total return 0.74% OCF. Returns for share classes with a different OCF will vary accordingly

Fund & Market

- In October, the Best of China Fund rose 1.7% (in GBP, Z class) while the MSCI Golden Dragon Net Total Return Index fell 0.2%. For the year to 31st October the Fund is up 17.2%, ahead of the benchmark which is up by 12.1%.
- MSCI Taiwan was the strongest region, rising 2.7%. The Information Technology Index, which makes up more than half of the Taiwanese index, rose 5.0%. TSMC (held), Hon Hai and Mediatek (both not held) were strong performers, driven by a combination of rising expectations over 5G, better iPhone sales, and optimism over semiconductors (especially memory).
- MSCI China fell 1.2%, driven by Communication Services (-6.4%), Materials (-5.6%) and Industrials (-2.7%). On the other hand, Health Care (+8.7%) and Real Estate (+7.9%) were bright spots.
- Despite the disturbances in Hong Kong, MSCI Hong Kong fell only 0.5%. The two largest sectors, Financials and Real Estate, were down 0.4% and 3.7%.
- The Fund's Information Technology holdings were contributors to outperformance, with the likes of AAC Technologies, Tongda Group and Catcher Technology performing well on expectations of rising 5G smartphone sales and better sales of the iPhone than expected. The Fund's Health Care stocks were also strong as they continue to operate better than expected in a changing regulatory and pricing environment.

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Economic Data

- GDP growth in China continues to decelerate, falling from 6.2% in the second quarter to 6.0% in the third quarter.
- The NBS PMI, which is more geared towards state-owned enterprises, fell 0.5 percentage points to 49.3 in October, driven by falling output. On the other hand, the Caixin PMI, which is more geared towards private enterprises, rose 0.3 to 51.7, driven by higher exports.
- Industrial data was generally weak. On the one hand, industrial production rose 5.8%, but on the other hand, profitability fell 5.3% as producer prices dropped 1.2%.
- Headline CPI was 3.0% but much of this was down to higher pork prices. Due to African Swine Fever, China's stock of pigs may have fallen by as much 40-50% this year. Retail pork prices were higher by c.73% in October. Core inflation, however, is stable at 1.5% vs 1.8% at the beginning of the year.
- Total social financing, the broadest measure of credit growth, increased 11.0% in September vs 10.7% in August. The shadow banking sector continues to decline, offset by rising bank loan growth. Governor of the People's Bank of China Yi Gang said he is "not in a rush" to use monetary stimulus to boost the economy.
- As the protests have continued in Hong Kong, its economy entered a recession as GDP fell 0.5% in the second quarter and 3.2% in the third quarter.

Events in October

- The US and China are aiming to sign 'Phase 1' of a trade agreement, with which reports indicate an agreement will be made over China's purchases of US agricultural products and opening up of China's financial sector to foreign firms. However, there seems to be some disagreement as to whether the US will roll back some existing tariffs and so a deal is not yet guaranteed.
- Trade is, however, only one aspect of the relationship between the two countries. Even if a deal is reached, there are likely to be other points of contention. For instance, the US Department of the Interior has stopped using all its drones made in China or made with Chinese parts unless used for emergencies. As with Huawei, the fear is over Chinese firms spying in the US.
- Paypal bought a majority stake in Gopay, a Chinese payment company. This makes Paypal the only foreign company with a license for domestic and cross border payments in China.
- The Chinese Securities Regulatory Commission announced it would drop limits on ownership of financial companies. Foreign companies will be allowed to own futures companies and asset management companies from January 2020 and April 2020 respectively. Barriers to entry such

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as a requirement of 30 years of business operations will also be dropped for foreign insurance companies.

- Meanwhile, Europe and China continue to talk about an investment treaty, but this is not likely to be a priority for the Chinese. So far the Europeans have not had much success in further opening up Chinese markets to European companies.

Portfolio Update

TSMC is planning to increase its capital expenditure by \$4bn to \$14-15 bn in 2019/2020, which will be the highest it has been since 2010. Demand has increased due to the ongoing launch of 5G across the world and TSMC upgraded its forecasts for adoption of 5G. Its High Performance Computing segment could see higher demand from gaming hardware, 5G infrastructure and datacentres. Last year we noted that GlobalFoundries dropped plans to develop the most cutting-edge processes, leaving Samsung as the only real competitor in the most advanced spectrum of the market. TSMC is now planning on developing new generation processes which reaffirms our view that it is a leader in its field.

In addition to rising expectations over 5G phones, better-than-expected sales of the latest iPhone meant some good performance for our companies in the smartphone supply chain, including AAC Technologies, Tongda Group, Novatek Microelectronics and Catcher Technology. The Fund's Chinese healthcare holdings were also strong, partly due to a recovery in prices after a sell-off in September, and partly as markets look forward to what should be a good set of third quarter results.

We sold our position in VTech. The business is facing headwinds in the legacy parts of its telecommunications business which newer parts of the business cannot offset. In its place, we initiated a position in Alibaba, China's largest e-commerce company and one of the largest of its kind in the world. Despite a slowing economy, e-commerce is a bright spot and has its own secular growth drivers; while retail sales grew 7.8% in September, online goods sales increased 18%. Alibaba's offerings are integral in most Chinese consumers' lives - Tmall and Taobao (two of its most popular platforms) are among the top 10 most visited sites in the world. At least 600 million people actively use Alibaba's payment app, Alipay. Alibaba owns several other e-commerce sites including Kaola (cross border e-commerce in China) and Lazada (leading e-commerce site in South East Asia) and a small stake in Tokopedia (Indonesian e-commerce). The addition of Alibaba usefully gives the Fund exposure to e-commerce, and at a more reasonable price than has been offered in the past. Relative to its competition, Alibaba is, in our view, much higher quality given the persistence of its return on capital.

Summary view & outlook

We argue that the Fund looks attractive relative to its benchmark index because of its greater level of diversification and its discount. The top three positions in the Index, Alibaba, TSMC and Tencent, had a combined weight of 24.6% at the end of October. As the Fund is equally weighted, these three positions made up 9.0% of the portfolio (assuming a neutral weight of 3.0%). The diversification of the Fund should protect it should there be any stock-specific issues with these three companies. The portfolio trades at 12.2x 2029 and 10.9x 2020 estimated earnings, putting it at a 12-13% discount to the market,

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Guinness Best of China Fund

even though the companies in the Fund are expected to grow, in aggregate, at approximately the same rate as the broader market (11-12% a year for the next two years). Over time, we expect this valuation gap to close, and the Fund should benefit as the market recognises the undervalued companies it holds.

Edmund Harriss (portfolio manager)

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Data sources

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

Index and stock data: *Bloomberg*

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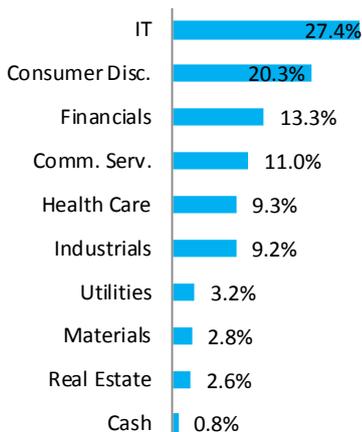
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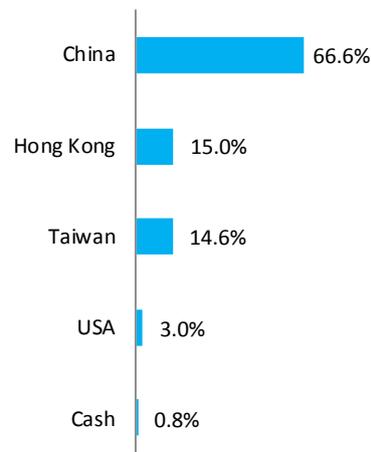
Fund top 10 holdings

China Medical System	3.5%
AAC Technologies	3.5%
Haitian International Hol	3.3%
Sino Biopharmaceutical	3.2%
China Resources Gas Gro	3.2%
China Lesso Group	3.2%
Catcher Technology	3.2%
Taiwan Semiconductor	3.1%
TravelSky Technology	3.1%
Netease.com	3.0%
% of Fund in top 10	32.4%
Total number of stocks	34

Sector analysis



Geographic allocation



PERFORMANCE

31/10/2019

Annualised % total return from launch (GBP)

Fund	13.4%
MSCI Golden Dragon Index	15.6%
IA China/Greater China sector average	14.2%

Discrete years % total return (GBP)

	Oct '15	Oct '16	Oct '17	Oct '18	Oct '19
Fund	-	-	25.2	-13.4	11.6
MSCI Golden Dragon Index	0.2	35.3	21.8	-10.3	14.0
IA China/Greater China sector average	2.3	29.7	23.8	-13.0	17.5

Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	1.7	17.2	11.6	21.1	-	63.1
MSCI Golden Dragon Index	0.1	12.1	14.0	24.5	68.7	75.5
IA China/Greater China sector average	-0.2	16.1	17.5	26.5	67.9	67.4

RISK ANALYSIS

31/10/2019

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-1.22	-1.65
Beta	1.00	0.98	0.99
Information ratio	0.00	-0.35	-0.32
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.93	0.89
Sharpe ratio	0.65	0.54	0.50
Tracking error	0.00	4.60	6.08
Volatility	17.73	17.93	18.63

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Source: Financial Express, bid to bid, total return (0.74% OCF). Fund launch date: 15.12.2015.

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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, 18 Smith Square, London SW1P 3HZ.

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'Île, 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.

GUINNESS

ASSET MANAGEMENT

Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

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