Guinness Best of China Fund

INVESTMENT COMMENTARY – December 2019

Launch date	**15.12.15**
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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

30.11.19

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	10.7	27.0	64.9
Index	9.2	31.0	77.6
Sector	11.4	31.4	68.5

Annualised % total return from launch (GBP)

Fund	13.5%
Index	15.6%
Sector	14.1%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-1.3	-1.7
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.4	-0.3
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.8	17.9	18.7
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 November, the Best of China Fund rose 1.1% (in GBP, Class Z) while the MSCI Golden Dragon Net Total Return Index rose 1.2%. For the year to date the Fund is up 18.5%, ahead of the benchmark which is up by 13.4%.

- MSCI China and MSCI Taiwan led the way, rising 1.8% and 1.6%, respectively. Hong Kong lagged, falling 1.4%.

- In China, the strongest sectors were Consumer Discretionary (+7.6%), Materials (+5.5%) and Communication Services (+2.5%) while the weakest were Health Care (-5.3%), Utilities (-5.1%) and Energy (-3.7%).

- In Taiwan, the Information Technology Index, which makes up more than half of the Taiwanese index, rose 2.6%.

- In Hong Kong, the Financials and Real Estate sectors, which are by far the largest parts of the local index, were down 0.1% and 3.3%.

- The Fund's gains were led by its Communication Services companies (Baidu and Netease) as well as certain companies in the Information Technology sector (Novatek Microelectronics and AAC Technologies).

- On the other hand, we saw weakness in Autohome and Sino Biopharmaceutical.

Economic Data

- The Caixin Manufacturing PMI, which is geared towards private firms, increased slightly to 51.8 in November. The NBS Manufacturing PMI, which is more geared towards SOEs, was above 50 for the first time since April, indicating expanding activity. Both measures showed an uptick in domestic and foreign demand.

- Industrial profits fell 9.9% year-on-year in October compared to a 5.3% fall in September. Year to date, profits have fallen 2.9%. Producer prices fell 1.6% in October vs a fall of 1.2% in September.

- Consumer prices rose 3.8% year-on-year in October but 2.4% of this increase came from pork prices, which rose 101.3% year-on-year. Stocks of pork have plummeted due to African Swine Fever, but inventory of breeding sows (which produce piglets) rose 0.6% month-on-month in October, the first increase since April 2018, indicating some pricing relief could be on the way.

- Total credit grew 10.7% in October vs 10.8% in September. The PBoC cut rates on the one-year Medium Term Lending Facility by 0.05% to 3.25%, the first cut since the facility was introduced in 2016. This was followed by a 0.05% cut in the 7-day repo rate, to 2.50%.

- In Taiwan, the manufacturing PMI was flat at 49.8 in November vs the average of 48.7 in the third quarter and 47.4 in the second quarter. This still indicates marginally contracting activity but is the second-highest reading of PMI since September 2018. Taiwan's exposure to exports means it is, to a degree, dependent on global economic activity and here the data is still weak as Taiwan's exports fell 2% in in October.

- In Hong Kong, the ongoing protests are leading to very weak economic data. Arrivals from China fell 46% in October. Retail sales, by value, fell 24% in October, meaning retail sales have fallen for four months in a row and this is very likely to continue in the November numbers.

Events in November

- The US and China remain engaged in trade negotiations. It seems China is pushing the US to remove some existing tariffs in order for a 'Phase One' deal to be reached. President Trump surprised everyone by saying he likes the 'idea of waiting until after the election for the China deal'. Given his history of making off-the-cuff comments it is debatable as to whether this was intended to increase pressure on the Chinese to reach a deal, or, is a reflection of his actual thoughts.

- MSCI increased the inclusion factor of A-shares from 15% to 20%, which means MSCI will now include 20% of A-shares' free float market capitalisation in its calculations. MSCI also added 189 A-share mid-caps to its China index. It is estimated that as a result of these decisions, c.$43bn of passive flows is likely to be invested A-shares. However, MSCI will not increase the inclusion factor further until access to hedging instruments is improved and progress is made over the short settlement cycle and mismatch between onshore and Stock Connect holidays.

- The Power of Siberia pipeline, linking Eastern Siberia to northern China, started operating. The pipeline helps China diversify its gas supplies and boosts connectivity to the industrial north of the country. The pipeline benefits Russia in the face of sanctions from the West and is another sign of the two countries moving politically closer together. Chinese policymakers are aiming to gradually increase the country's consumption of gas and this should help drive volumes China Resources Gas, which the Fund holds.

- Huawei's latest phones show it is quickly reducing its reliance on American suppliers, following the USA's move to put the company on its Entity List, severely restricting what American companies can export to Huawei. Huawei claims its 5G base stations now do not use any American components and is planning on rapidly increase production of these products. Looking at its latest smartphones reveals that Huawei is diversifying its suppliers, with American firms losing market share to Taiwanese, Japanese and Dutch firms in key components. It is also noticeable that Huawei's own chip unit, HiSilicon, is producing most key components for its smartphones.

Portfolio Update

Baidu reported results which showed it is successfully reining in costs in a challenging operating environment. At the beginning of the year, the company was hit by more ad inventory entering the market. Bytedance, operator of TikTok/Douyin and news aggregator app Jinri Toutiao, has gained significant market share in the digital ad market and given the additional supply entering the market, ad prices have fallen. In order to attract more users towards its platforms, Baidu significantly ramped up its spending on marketing and traffic acquisition, meaning margins fell considerably in the first quarter. Since then, the growth in costs has slowed considerably as the company has ensured marketing met "stringent ROI criteria". The focus shifted more towards in-app monetisation and several encouraging examples were given. For example, a well-known e-commerce company used Baidu's Smart Mini Programs to give away coupons and saw its conversion improve 2.5x compared to its HTML page. A leading after-school tutoring company used these Mini programs to allow users who saw its ads to automatically complete sales leads forms, which improved the tutoring company's marketing ROI by 30% compared to HTML 5 sites. Management believe the demand for ads is stabilising and though we think the business faces challenges, we think the share price is being overly pessimistic.

Novatek Microelectronic's results came in line with expectations. Inventory of TV drivers is likely to continue falling for the next six months and so demand is likely to be weak. Novatek is, however, making good progress with its Touch & Display Driver Integration (TDDI) product and we expect rising adoption by smartphones. Management also point to rising OLED driver demand and expect shipments in the first half of 2020 to be greater than all of 2019.

Netease's gaming division was strong, despite not releasing any new major titles last quarter, with mobile gaming revenue growth accelerating. The pipeline for 2020 looks strong and includes foreign brands such as *Harry Potter: Magic Awakened*, *Marvel Super War* and *Pokemon Quest.* The other parts of the business are also interesting. Netease listed its online education business, *Youdao*, in October. Following the sale of the popular cross border e-commerce business *Kaola*, Netease announced a special dividend, taking its dividend yield to above 2%. The Cloud Music business continues to grow strongly and received an investment from Alibaba. Earnings estimates have consequently risen sharply for the business.

Noah's latest update revealed that after the Camsing incident, it is stepping away from distribution of single counterparty credit products i.e. where the funds are lent to a single entity. This meant operating income halved in its wealth management business as total transaction value in private credit products fell 93%. This is important in the context of the central bank's new rules aimed at reducing risks with wealth management products (WMPs). Many of these WMPs used to offer an implicit or even explicit guarantee that the investor would not incur losses, with the understanding that the financial entity issuing the product would bail out investors. Many investors did not understand the concept of risk in their investments. Last year the central bank finalised most of the regulations to put a stop to this practice and new rules come into effect in 2020 (note Noah will not bail out investors in the affected fund). Public offered funds now can only invest in standardised products, which amongst other things, must be entrusted to an independent custodian and can be transacted in approved exchanges. Financial products must regularly disclose their net asset value (NAV), moving China's fund industry closer to developed market practices. Sophisticated investors are already moving into standardised bond products and mutual funds. Noah's asset management subsidiary, Gopher, is doing well with success in private equity and real estate. Noah argues new know-your-customer (KYC) requirements mean smaller general partners are finding it difficult to raise funds in the private equity space, whereas larger firms such as Noah have largely been unaffected. We believe the market has priced in the changes to Noah's business model and in the next few quarters, we expect the business to start growing earnings again.

The National Healthcare Security Administration (NHSA) revealed the latest National Reimbursement Drug List (NDRL), which lists the drugs the state will pay for. Over the past two years, the government has started requesting aggressive price cuts in exchange for greater volumes for those drugs that make the list. Two of Sino Biopharmaceutical's products, raltitrexed (used to treat bowel cancer) and lidocaine cataplasm (used to treat postherpetic neuralgia, a complication of shingles) made it onto the list with price cuts of 55% and 79% respectively. China Medical System's Xinhuosu (used to treat breathing difficulties) remained on the list with a lower price cut of 23%.

Autohome's results showed a slowdown in growth in a weak automobile market. For the first nine months of the year, sales of new passenger vehicles fell 11% in China. In that context, Autohome's revenue growth of 15% is very good, but it was the outlook for the fourth quarter, in which revenue growth is expected to slow sharply, that the market did not like. We still think Autohome is the leading platform for dealers and its position is secure but growth is likely to be low in the short term. As China's economy continues to grow, we expect the automobile market to grow with it, and so we are confident the company has a long pathway to growth. We liked the fact that the company is going to start paying a dividend for the first time, which will reduce the amount of excess cash on the balance sheet.

Summary view & outlook

We argue that the Fund looks attractive relative to its benchmark because of its greater level of diversification and its price/earnings discount. The top three positions in the benchmark, Alibaba, TSMC and Tencent, made up 26.3% at the end of October. As the Fund is equally weighted, these three positions typically make up around 9% of the portfolio (assuming a neutral weight of 3%). The diversification of the Fund should help protect it should there be any stock-specific issues with these three companies. The portfolio trades at 12.0x 2019 and 10.8x 2020 estimated earnings, putting it at a 13% discount to the market. This is despite the fact that the companies in the Fund are expected to grow, in aggregate, at approximately the same rate as the broader market, which is 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)
Mark Hammonds (analyst)
Sharukh Malik (analyst)

Data sources

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

Index and stock data: *Bloomberg*

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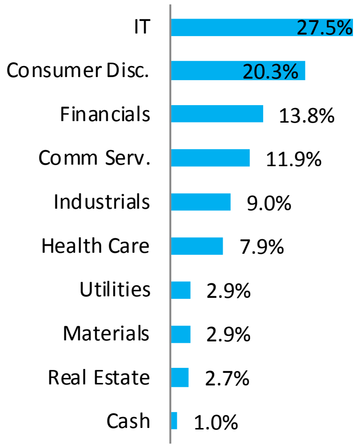
PORTFOLIO

30/11/2019

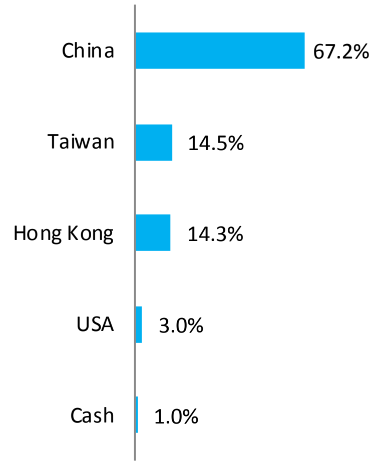
Fund top 10 holdings

AAC Technologies	3.7%
Alibaba Group	3.3%
Netease.com	3.3%
TravelSky Technology	3.2%
China Lesso Group	3.2%
Novatek Microelectronics	3.1%
Taiwan Semiconductor	3.1%
Luk Fook Holdings	3.0%
Haitian International Hol	3.0%
Catcher Technology	3.0%
% of Fund in top 10	31.9%
Total number of stocks	34

Sector analysis



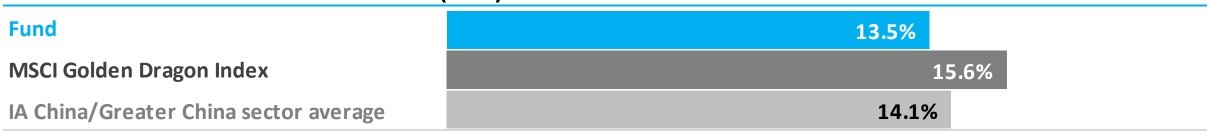
Geographic allocation



PERFORMANCE

30/11/2019

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Nov '15	Nov '16	Nov '17	Nov '18	Nov '19
Fund	-	-	31.8	-12.9	10.7
MSCI Golden Dragon Index	-4.0	31.2	25.2	-4.1	9.2
IA China/Greater China sector average	-0.2	24.7	27.8	-7.7	11.4

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	1.1	18.5	10.7	27.0	-	64.9
MSCI Golden Dragon Index	1.2	13.4	9.2	31.0	65.0	77.6
IA China/Greater China sector average	0.6	16.8	11.4	31.4	63.6	68.5

RISK ANALYSIS

30/11/2019

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-1.30	-1.65
Beta	1.00	0.98	1.00
Information ratio	0.00	-0.37	-0.31
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.90
Sharpe ratio	0.65	0.54	0.51
Tracking error	0.00	4.56	6.04
Volatility	17.76	17.92	18.68

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, 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'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.