Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – March 2020

Launch date	**19.12.2013**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (manager) **Sharukh Malik** (analyst)

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

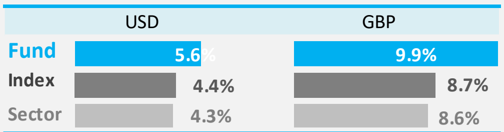
29/02/2020

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

	2017		2018		2019	
	USD	GBP	USD	GBP	USD	GBP
Fund	36.5	24.6	-15.5	-10.3	19.0	14.4
Index	37.3	25.4	-14.5	-9.2	20.3	15.7
Sector	37.2	25.3	-15.1	-9.8	20.4	15.8

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	-11.9	-8.7	-5.8	-1.9	39.9	79.1
Index	-7.8	-4.3	0.1	4.2	30.8	67.6
Sector	-8.8	-5.4	-0.3	3.9	29.8	66.3

Annualised % total return from launch



Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.3	0.8	1.9	2.3
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.2	0.2
Max drwdn	-29.3	-26.4	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	3.5	3.5	5.7	5.7
Volatility	15.0	15.1	13.8	13.6	13.2	14.2
Sharpe ratio	0.1	0.3	0.1	0.4	0.2	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, Y class 0.99%, bid to bid, total return.

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Fund & Market

- The Fund has fallen by more than the market in February – but while share prices of portfolio companies have fallen, their forecast earnings for 2020 and 2021 have held up well.

- Consensus earnings estimates for the portfolio are for average annual earnings growth over the 2019-21 period of 5.3%, down from a 6.3% growth rate estimated at the beginning of the year. The reduction is the result of a cut to 2019 estimated growth from 3.4% to 2.1% and in 2020 from 6.6% to 4.6%. Estimated growth for 2021 of 9% remains unchanged.

- Share price weakness in the portfolio was spread across geographies and sectors. Anything involved in consumer manufacturing and distribution of physical goods as well as those exposed to consumer finance saw share prices fall.

- That said, there were stocks that outperformed, including our Hong Kong and Chinese banks and our shipbuilding companies, and half of our technology manufacturing names did better than the index.

- It is hard to generalise about stock performance beyond saying that much market action has been driven by fear. The companies in the portfolio have low debt and ample cash on hand to deal with current business disruption. They have inherent product, customer and management strength to reassure on long-term profitability and dividend streams. This leads us to believe that recent portfolio declines, while painful today, are likely to reverse sooner rather than later.

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Events in February

- The rate of new virus cases decelerated in China but accelerated in the rest of the world. In absolute terms, the bulk of the cases are in China and the majority of deaths are amongst those with pre-existing medical conditions.

- The virus outbreak in Italy showed what might happen, and therefore market focus has been on the possible extent and duration of containment measures in assessing likely economic damage.

- Economic data from China have reflected the economic shutdown after the Chinese New Year holidays.

- Finance minister from the G20 met in Riyadh. The IMF downgraded forecast Chinese economic growth to 5.4% implying a 0.1% hit to global GDP. The median consensus forecast for 2020 GDP growth is now 2.9% versus 3.1% in January.

- Malaysia's Prime Minister resigned. The reasons are murky but it is likely the result of a power struggle that seeks to exclude Anwar Ibrahim from the succeeding to the office.

- President Trump was acquitted of all impeachment charges. Meanwhile, Bernie Sanders took the lead in the race to become the Democrat nominee for President.

- India removed foreign investment limits of certain sovereign bonds as it seeks inclusion in global bond indices. This is relevant given India's deteriorating public finances and weakening asset quality in the banking sector.

Market Update

The public news flow on the Coronavirus as governments seeks to show they are 'doing something' and news outlets compete for attention has created a climate of fear which finally took hold in financial markets in February. There is great enthusiasm for creating and lingering over worst-case scenarios. However, it is also evident by a look at the data, rather than the myriad opinions of what might be, that the spread is coming under control. In China the rate of new infections continues to slow and is now at a daily rate of 0.1%. Net of recoveries, infections were down 37% week-on-week. China appears to have passed the high water mark.

In Korea, as of 4th March the daily growth in infections has slowed from 35% five days ago to 15% over the past three days and was up 11%. Korea has been one of the best at releasing data (twice a day) on testing and infections. Korea's Centre for Disease Control and Prevention reported last week that the virus barely mutates and shows the same behaviour when transmitting form one person to another. The journal Scientist also published an article saying the genetic sequences among patients around the world are similar and that any mutations are likely of little consequence.

Why is this important? It means that the virus is likely to behave similarly worldwide, so studies of the spread, risks and treatments will be similar. It means also that potential vaccines should be widely effective. A key concern has been the potential for mutation and that the virus will be unstoppable. This fear is not supported by evidence.

From an investment standpoint, this aligns with comments from the Governor of the Bank of England, who described this as a significant economic shock but ultimately temporary. Economic shocks such as the financial crisis of 2008 or the oil price shock in the 1970s had long-term structural implications. Unless this leads to a global economic shutdown for an extended period, which would then have financial solvency implications, we expect this to manifest in economic terms with a significant curtailment of economic growth in the first quarter followed by a sharp rebound in activity in the second quarter. JP Morgan now expects China's economy to contract this quarter compared to the final quarter of 2019, followed by a significant rebound.

How does this happen? We expect it to be driven by a combination of manufacturing output accelerating with first quarter output pushed into the second with increased work shifts. We expect to see incentives to boost consumption and efforts to reinvigorate the real estate and construction market. China's growth rate for 2020 may end up closer to 5% (some forecasts say less, though we probably won't see a published figure of less than 5%) but there is no doubt there will be maximum effort made to restart activity.

The path of equity markets will follow shifts in expectations. A 'V' shaped recovery profile is predicated on a synchronised pattern of disruption and resumption of growth. The return to work in Asia is happening but perhaps more slowly than was expected in early February. Nevertheless, Hon Hai Precision, which is the largest assembler of iPhones, has stated that its operations will be in full production by the end of March. The new challenge is the impact of the spread in the rest of the world and efforts to contain it. This may lead to a 'W' shaped recovery in stock markets as expectations are adjusted.

The sharp falls we have seen in share prices around the world have been some of the steepest 10% drops from a market peak ever. This perhaps has more to do with run-up in markets over recent months in which earnings revisions have played almost no part. This has been a period of valuation expansion on growth expectations, followed by compression.

Portfolio

To be sure, there have been earnings downgrades in Asia; the consensus has cut 2020 profit estimates for the market, as measured by MSCI Asia Pacific ex Japan Index, by 2.9% and 2021 estimates by 2.4% in past month. Over the same period, earnings for the portfolio have been revised down 2.2% for 2020 and 1.9% for 2021. Out of the 36 names in the portfolio, ten have had their 2020 earnings forecasts cut by more than the market, nine have changed by less than 1%, and four have seen their forecasts raised. The remaining 11 have seen cuts to forecasts by more than 1% but all still better than the market.

Among the weakest ten stocks in February we can see that six of them (Corporate Travel, Sonic Healthcare, CapitaLand Mall Trust, KT&G, PTT and Public Bank) saw earnings downgrades of 4% or more. Of the remaining four, Janus Henderson and Luk Fook saw earnings upgrades while forecasts for Godrej Consumer Products and Aflac moved down by 0.5% and 0.1% respectively. This group of ten stocks fell between 11% and 24% in February, with only Corporate Travel moving in line with earnings forecasts. Since earnings expectations have not moved to anything like the same extent as stock prices, we are left with valuation compression as the primary driver. This then leads us to consider whether underperformance over the month was attributable to overvaluation. Have we been buying into and paying up for growth or do we think the price moves are knee-jerk reactions and overdone?

In the case of Corporate Travel, whose profit forecasts were cut by 26% and 16% for 2020 and 2021, we must recognise this as the most vulnerable company in the portfolio to a shock of this nature. Our thesis for the investment depends upon the notion that business travel will resume and that the business model remains sound in the long term. We think the share price reflects the impact for the current year but undervalues the business over our rolling three-year horizon.

We look at valuations in the first instance on a long-term cash flow basis. We consider the value of the cash flows that come from existing asset plus the value of those generated by from a long-term and sustainable rate of reinvestment of profits, which in turn is considered in light of the cash available to reinvest and that required to match the dividend pay-out policy. The degree to which the share price is above or below this valuation indicates how much, if anything, we are paying for growth. We think that the portfolio overall is in line with base valuation level; in other words, at the portfolio level we do not think we are paying anything for growth.

At the individual stock level, there is more of a spread. One of our valuation warning flags is triggered when the growth element of the valuation exceeds 40% of the total. The only stock that exceeds this is Godrej Consumer Products, which trades expensively, as does the rest of the Indian Consumer Staples sector. We have accepted this for Godrej, having considered it in the light of the sector valuation history, its own history and the return on capital profile of the business. It is the only one that exceeds this level. The next most expensive on this metric are Largan Precision, Sonic Healthcare, St Shine Optical and Corporate Travel for whom 30%-40% of the valuation is attributable to growth. All these businesses are characterised by a high and stable return on capital historic profile. In the case of Corporate Travel, the share price move is linked, we believe, to the short-term outlook, and the long-term growth expectation is little changed.

In light of the economic disruption we are seeing we have also reviewed the balance sheet strength of our companies. At the portfolio level, excluding our six banks, total debt to equity is at 38.3% and on a net debt basis the portfolio is 3% net cash. When looking at individual companies on a net debt basis, the most highly indebted is Qualcomm, at 74.8% following its substantial return of cash to shareholders after its planned acquisition of NXP failed to gain regulatory clearance. The debt level has dropped quickly since then. The next two most indebted are Ascendas REIT and CapitaLand Mall Trust at 63% and 43% respectively. After that, the gearing ratios in the portfolio come down quickly. We measure bank leverage by comparing total assets to total equity. We would consider assets that are 20x the size of equity to be the maximum we would accept for a bank and for an emerging markets bank with their more highly concentrated loan books we think we should be looking at 12-13x. China Merchants Bank is the most leveraged at 13.2x and Tisco Financial the least at 7.9x.

Eleven companies reported annual results for the year ending December 2019. DBS and Hanon Systems were ahead of consensus expectations while PTT, KT&G and Yangzijiang Shipbuilding were behind. The rest were in line with expectations. In terms of dividend growth, the strongest were Novatek Microelectronics +25%, Ping An Insurance +19% (+7% if we include last year's special dividend), Largan Precision +18%, KT&G +10% and JB Hi Fi +9%. Public Bank, Aflac, Sonic Healthcare and DBS follow a progressive dividend policy, growing 2.5%-5% a year in recent years, and 2019 has been consistent with that. PTT, Janus Henderson and Corporate Travel dividends were unchanged. There were no dividend cuts.

Outlook

The following comments may well be overtaken by events, but at present we are looking for China and Asia to begin a return to work. Hon Hai Precision targets full production by the end of March. Restrictions on movement are being lifted in measured fashion and policy efforts are directed toward macro-economic support. There is clearly some reluctance in China to deploy a massive stimulus package as we saw in 2009, the legacy of which is still with us. We see the greatest focus needs to be on the provision of liquidity and fiscal flexibility to allow companies to manage their working capital.

The recent US interest rate cut of 0.5% has divided opinion. In our view, while attention-grabbing, it does not really address the problems businesses will face if economic disruption is extended. The issue will be one of access to credit rather than the pricing of it, in our opinion. While it seems to us the high-water mark has passed in Asia, the unknowable piece is the extent of the spread in the rest of the world, the measures taken to contain it and the resultant impact on demand. We proceed on the basis that this is a significant but ultimately temporary economic shock.

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

Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

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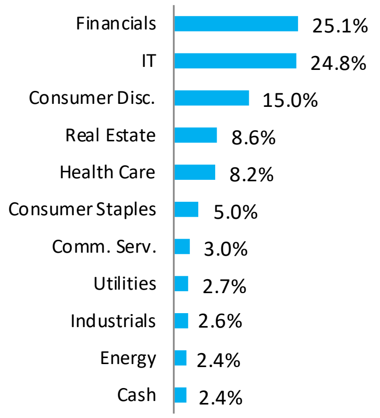
PORTFOLIO

29/02/2020

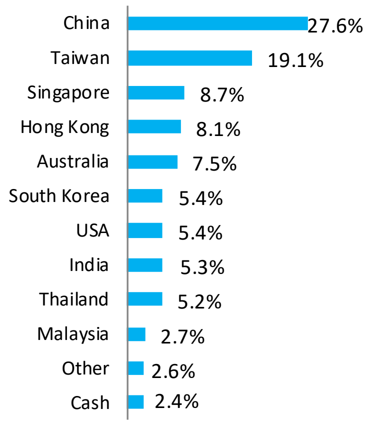
Fund top 10 holdings

BOC Hong Kong	3.0%
China Mobile	3.0%
Ascendas Real Estate Trust	3.0%
Tech Mahindra	3.0%
Sonic Healthcare	3.0%
DBS Group Holdings	2.9%
China Construction Bank	2.9%
Link REIT	2.9%
Elite Material	2.9%
China Merchants Bank	2.9%
% of Fund in top 10	29.3%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

29/02/2020

Discrete years % total return

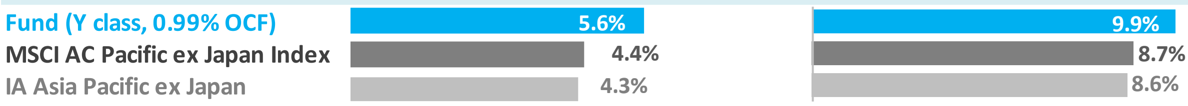
	Feb '16		Feb '17		Feb '18		Feb '19		Feb '20	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Y class, 0.99% OCF)	-11.8	-2.2	23.7	38.6	27.2	14.8	-7.1	-3.8	-5.8	-1.9
MSCI AC Pacific ex Japan Index	-20.5	-11.9	28.1	43.4	27.9	15.5	-7.2	-3.8	0.1	4.2
IA Asia Pacific ex Japan	-18.8	-10.0	24.0	38.9	27.4	15.1	-7.4	-4.1	-0.3	3.9

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)	-7.4	-4.4	-11.9	-8.7	-5.8	-1.9	11.2	8.3	39.9	79.1
MSCI AC Pacific ex Japan Index	-3.9	-0.9	-7.8	-4.3	0.1	4.2	18.8	15.7	30.8	67.6
IA Asia Pacific ex Japan	-5.3	-2.3	-8.8	-5.4	-0.3	3.9	17.6	14.6	29.8	66.3

Annualised % total return from launch

USD GBP



Risk analysis - Annualised, weekly, from launch on 19.12.2013

29/02/2020	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.3	0.8	1.9	2.3
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.2	0.2
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	0.1	0.3	0.1	0.4	0.2	0.5
Tracking error	0.0	0.0	3.5	3.5	5.7	5.7
Volatility	15.0	15.1	13.8	13.6	13.2	14.2

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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.

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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, 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.**

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Telephone calls will be recorded and monitored.