Guinness Best of China Fund

INVESTMENT COMMENTARY – April 2020

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.

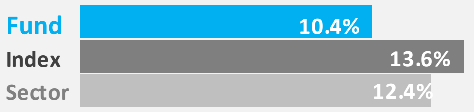
Performance 31.03.2020

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

	2017	2018	2019
Fund	38.2	-20.3	26.0
Index	31.3	-9.5	19.0
Sector	35.9	-14.2	22.2

	1 year	3 years	From launch
Fund	-5.8	4.4	52.7
Index	-2.1	17.7	72.8
Sector	-0.2	19.9	65.5

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.9	-2.8
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.3	-0.5
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	18.0	18.1	19.3
Sharpe ratio	0.5	0.5	0.3

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 March, the Best of China Fund fell 10.9% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index fell 8.9%.
- In the first quarter, the Best of China Fund fell 18.6% while the MSCI Golden Dragon Net Total Return Index fell 13.2%.
- The companies in the portfolio in aggregate reported earnings in 2019 that were 1.0% lower than in 2018.
- In March, MSCI China fell 6.6%, MSCI Taiwan fell 13.4% while MSCI Hong Kong fell 12.2%. The Shenzhen Component Index fell 10.4% while the Shanghai Stock Exchange Composite Index fell 5.7%.
- In MSCI China, the strongest sectors were Consumer Staples (total return of +1.7%), Communication Services (-4.0%) and Financials (-5.5%) while the weakest were Information Technology (-15.9%), Energy (-12.2%) and Materials (-10.6%).
- In Taiwan, the Information Technology Index, which makes up more than half of the Taiwanese index, fell 12.4%.
- In Hong Kong, the Financials and Real Estate sectors, which are by far the largest parts of the local index, fell 9.2% and 10.8% respectively.

Events in March

- Xi Jinping visited Wuhan, signalling that the leadership thinks it has control over the spread of coronavirus. Life seems to be getting back to normal in China, but the rest of the world has entered lockdown. Many factories are now in a position to manufacture goods but have seen foreign demand disappear.

- In a sign that China is not completely out of the woods, after partially reopening, cinemas were shut down again. Some provinces have also shut down tourist attractions.

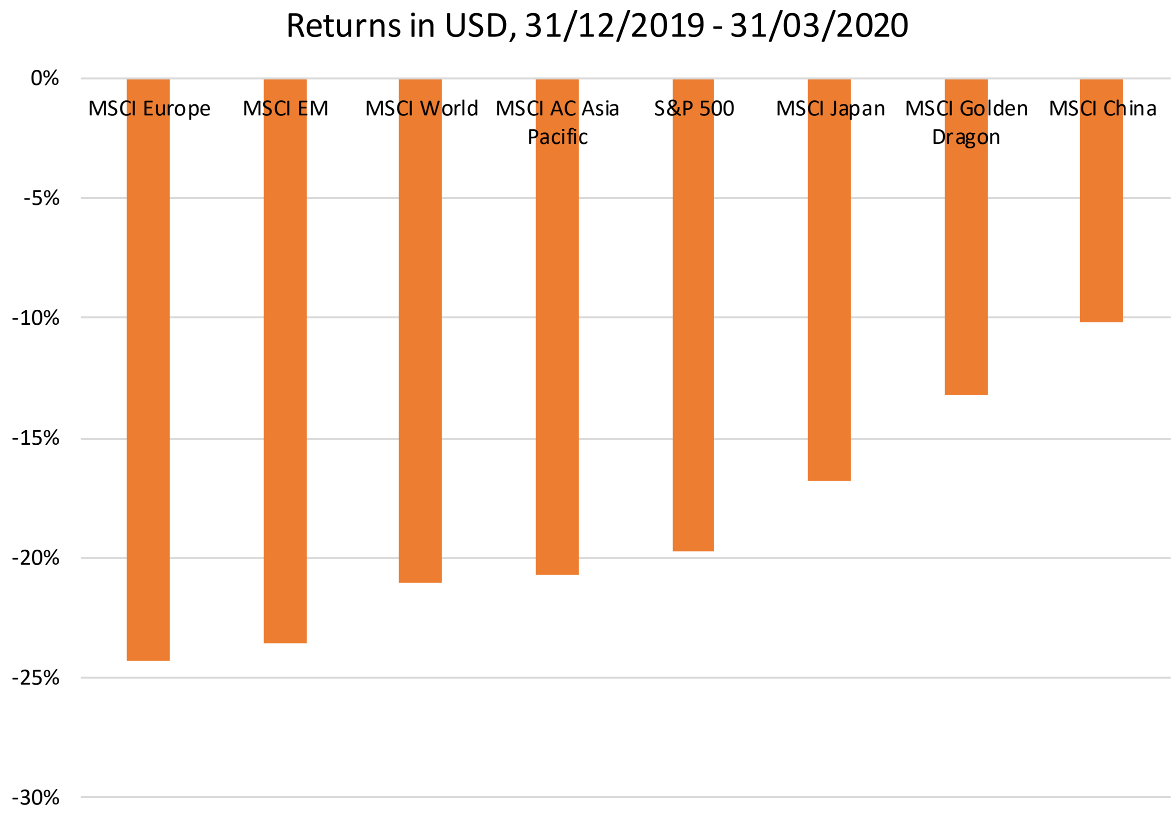
Recent measures by the government to stimulate growth include:

- The PBOC cut the reverse repurchase rate by 0.2% to 2.2% to lower the cost of borrowing. It is likely further cuts will follow.
- The PBOC cut the required reserve ratio (RRR) by 1% for smaller banks, which will be split into one 0.5% cut in April and another in May. The interest rate on excess reserves was lowered from 0.72% to 0.35%. Both measures intend to release liquidity to small and medium sized enterprises (SMEs).
- The PBOC initially set aside CNY 300bn in refinancing funds to alleviate liquidity pressure for SMEs. This was increased to RMB 1trn.
- Price subsidies for those on low incomes are to be doubled until June. The unemployed will be also be eligible for the scheme.
- Subsidies and tax exceptions for new energy vehicles are to be extended for two years.
- In numerous provinces, state-owned enterprises are waiving rental income for several months.
- Local governments can now issue special bonds to fund a greater range of activities, including refurbishments of old residential areas and renovations of shanty towns.

Market Update

High-frequency data shows the Chinese economy is gradually recovering, with some data points showing a better picture than others. Coal consumption of six major power generators is now c.16% below the historical average, compared to the 60% level seen just after Chinese New Year. Housing sales are 4.5% below their historical average. On the other hand, average retail sales of passenger vehicles are 52% of the long-term average. Though traffic congestion is down 7%, volumes in the subways of six major cities is still down 34%. February was a very weak month, with the Purchasing Managers' Index falling to a historic low of 35.7, before recovering to 52.0 in March.

It seems China is coping better with the virus than Europe and the US, and so China was a source of outperformance in the first quarter:



Portfolio Update

The companies in the portfolio in aggregate reported earnings in 2019 that were 1.0% lower than in 2018. Two smartphone component manufacturers, Catcher Technology and AAC Technologies, had the weakest results. Catcher makes metal casings for smartphones and has suffered from greater competition. Operating leverage has worked against it as Apple has diversified orders among its main suppliers, meaning Catcher no longer dominates production of phone casings. Though fourth quarter results were undoubtedly weak, we feel the current price significantly undervalues the company as the business was at one point trading at less than book value. Management bought back 25 million shares in March, worth 3.2% of shares outstanding, a sign that they think the company's shares are undervalued.

AAC Technologies is facing greater competition in its older acoustics and haptics products. It is planning on launching newer versions of these products but it will take time for these new products to meaningfully reverse the decline. The optics business is growing quickly but is still a small part of the business and the impact on profitability is marginal. Management surprised us by not paying a final dividend, in order to preserve liquidity in the current climate.

In the first quarter, 86% of the Fund's underperformance was attributable to the Fund's holdings in the Information Technology sector. These stocks can broadly be classed as component suppliers for smartphones, which in addition to Catcher and AAC, includes Elite Material (base materials for printed circuit boards), Qualcomm (modems and chipsets) and Novatek Microelectronics (display drivers). Initially the fear was that these businesses were facing a supply shock as well as a demand shock, as most factories were closed during the lockdown. Now, most factories are operating but demand from

China and abroad is lower. We do think demand in 2020 will be weak, but assuming the effects of the virus are controlled, over the medium term, the demand outlook remains strong. 5G phones are becoming more popular and, broadly speaking, require slightly more complex components which should lead to both volume and pricing improvements for our suppliers.

After a weak 2018, Elite bounced back in 2019. It regained the contract to supply copper-clad laminates, the base material for printed circuit boards, for the iPhone. Net income and dividends reached an all-time high, boosted by a possible corporate reorganisation which reduced the tax rate from the historical range of 28-31% to 22%. Half of the business is exposed to smartphones and like AAC and Catcher, the short-term outlook is likely to be weak. However, the size of its product within the iPhone could increase by 10-15%, which should help manage revenue growth. Elite also has exposure to servers and here the firm is capturing market share. The demand outlook for servers is more visible and is likely to hold up relatively better compared to smartphones.

In a tough automobile market, Geely's results are understandable. Car sales in China fell 8% in 2019 while Geely's sales fell 9%. The company sold 1.36m cars in 2019 and despite coronavirus is aiming to grow this by 4% in 2020. Six new models will be launched over the course of the year, supported by research and development that is industry-leading when measured relative to revenue. Geely is now in preliminary discussions to acquire Volvo from its parent company, expanding its global reach. While this is likely to be another weak year for the business, we still think Geely can become a leading Chinese carmaker. The long-term picture remains the same. Per-capita vehicle ownership in China is well behind developed markets, given China's lower GDP per capita. We expect, that as China's economy grows over the medium-term, vehicle ownership to grow. As a leading company in the space we think Geely is well placed to take advantage of this trend.

Sino Biopharmaceutical's second-half results missed expectations. Sales of *entecavir*, a previous blockbuster drug used to treat hepatitis, fell on pricing pressure. Management is now shifting sales towards the over-the-counter channel to alleviate some of this pricing pressure. On the other hand, oncology sales increased 70% and *anlotinib*, used to treat lung cancer, is now a blockbuster drug. Sino Biopharm has received approval to sell 11 generic products, some of which could drive significant sales growth, such as *budesonide* (used to treat asthma) and *sitagliptin* (used to treat diabetes). There is also a pipeline of innovative drugs developed by Sino Biopharm itself, which could begin to be sold from 2021 onwards.

Netease grew earnings by more than 100% in 2019, driven by the sale of the cross-border e-commerce business *Kaola* to Alibaba. Net income from continuing operations still grew by 56%, however. Revenue from online games increased by 16%. An expansion pack of the *Fantasy Westward* series, *Fantasy Westward Journey 3D*, was launched and now ranks within the top five grossing games on Apple's App Store. The outbreak of coronavirus led to higher demand for online gaming, benefiting Netease's top-line growth. The online education service *Youdao* was growing quickly before coronavirus and demand has since surged in the first quarter. *Cloud Music* is beginning to make a larger contribution to the business and doubled membership revenues in the fourth quarter.

China Lesso's net profit increased 21%, which was slightly higher than expected. The company sees multiple avenues for further growth. The ongoing shift in energy away from coal and towards gas should drive demand for pipes. New pipes for water supply, drainage, irrigation and heating supply will be required to meet the governments targets. Lesso is now building manufacturing plants in Indonesia and Cambodia, to capture sales in ASEAN.

Portfolio Switches

We sold Li & Fung and Tongda Group. Li & Fung has struggled in a world where its role as a sourcing agent, connecting retailers with suppliers, is becoming less relevant. We gave the business time to show signs of a turnaround, but this looks unlikely, and so we sold the position. Similarly, we have given time to Tongda to show whether its shift to 'glastic' casings can generate the same level of profitability as the traditional metal casings. This was not the case in the most recent update and Tongda is now facing pricing pressure in its waterproof components business.

We bought Zhejiang Supor, a manufacturer of small kitchen appliances. It marks our first purchase of an A-share. Supor has strong brand loyalty and benefits from cooperation with its French parent company, Groupe SEB; e.g. Supor can use its parent's Tefal brand in its products. Supor has leading market share in woks, frying pans, pots and steamers. It ranks second in the market for small domestic appliances such as electric rice cookers, slow cookers, garment steamers and dust cleaners. The business has maintained a high return on capital over an extended period of time. It is one of the few A-share companies to list clearly the criteria used to determine management's compensation, and we feel we can trust management to grow the company in the future.

We are in the process of acquiring another position which will be revealed in next month's update.

Summary view & outlook

We believe we own a set of companies that can navigate the upcoming slowdown in the global economy. Debt/equity for the portfolio, excluding the three banks, is 38%; i.e. the Fund is not highly geared. If we look at net debt/equity, which subtracts cash from debt, the figure is -20%; i.e. our companies could in theory pay back all of their debt with cash. 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 12.0x and BOC Hong Kong the least at 9.8x.

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*

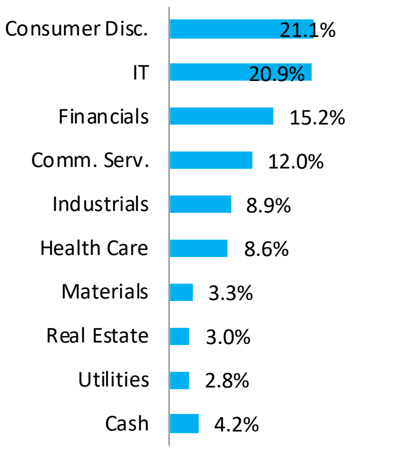
PORTFOLIO

31/03/2020

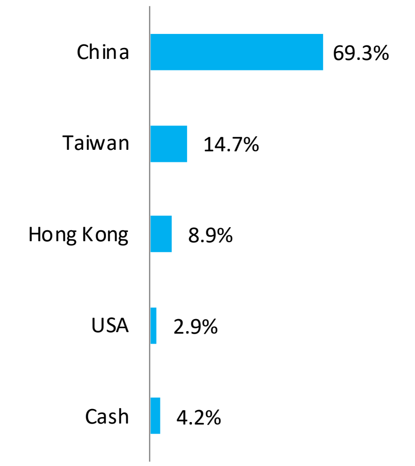
Fund top 10 holdings

Zhejiang Supor	3.5%
Noah Holdings	3.4%
Anhui Conch Cement	3.3%
Tencent Holdings	3.2%
Netease.com	3.2%
Novatek Microelectronics	3.2%
Hollysys Automation Tecl	3.1%
Haitian International Hol	3.1%
China Construction Bank	3.1%
Haier Electronics	3.1%
% of Fund in top 10	32.3%
Total number of stocks	32

Sector analysis



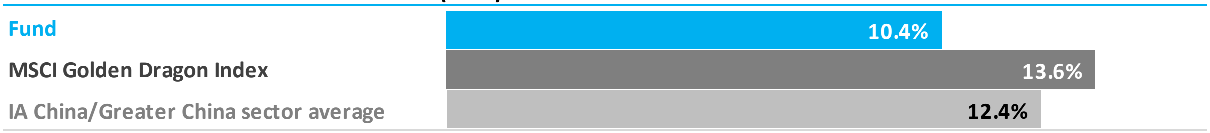
Geographic allocation



PERFORMANCE

31/03/2020

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Mar '20	Mar '19	Mar '18	Mar '17	Mar '16
Fund	-5.8	-4.2	15.6	22.7	-
MSCI Golden Dragon Index	-2.1	3.7	16.0	37.7	-10.9
IA China/Greater China sector average	-0.2	0.9	19.1	36.0	-11.5

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	-8.1	-12.9	-5.8	4.4	-	52.7
MSCI Golden Dragon Index	-6.1	-7.3	-2.1	17.7	44.4	72.8
IA China/Greater China sector average	-5.0	-6.1	-0.2	19.9	44.5	65.5

RISK ANALYSIS

31/03/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.91	-2.76
Beta	1.00	0.98	1.02
Information ratio	0.00	-0.28	-0.45
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.90
Sharpe ratio	0.53	0.45	0.33
Tracking error	0.00	4.60	6.21
Volatility	17.99	18.14	19.30

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

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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.