Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – April 2020

Launch date	**23.12.2016**
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Aim

The Guinness Emerging Markets Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in Emerging Markets world-wide. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

Performance

31/03/2020

Fund	Guinness Emerging Markets Equity Income (Z)
Index	MSCI Emerging Markets Index
Sector	IA Global Emerging Markets

	2017		2018		2019	
	USD	GBP	USD	GBP	USD	GBP
Fund	38.4	26.4	-14.8	-9.5	19.2	14.6
Index	37.8	25.4	-14.3	-9.3	18.9	13.9
Sector	36.2	24.4	-16.9	-11.8	20.6	16.0

	YTD		1 year		From launch	
	USD	GBP	USD	GBP	USD	GBP
Fund	-25.1	-20.0	-19.4	-15.2	6.3	5.0
Index	-23.6	-18.4	-17.7	-13.5	8.9	7.7
Sector	-26.3	-21.2	-19.5	-15.4	3.4	2.2

Annualised % total return from launch

	USD	GBP
Fund	1.0%	0.7%
Index	2.7%	2.3%
Sector	1.9%	1.5%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-1.1	1.9	-0.1
Beta	1.0	1.0	1.0	0.9	0.9	0.9
Info ratio	0.0	0.0	0.0	-0.3	0.3	-0.1
Max drwdn	-33.5	-22.3	-34.8	-24.0	-32.8	-22.9
Tracking err	0.0	0.0	0.0	3.8	5.9	6.0
Volatility	17.4	15.0	17.2	14.1	16.4	14.5
Sharpe ratio	0.0	0.0	0.0	0.0	0.0	0.0

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: 0.74% OCF, Financial Express, bid to bid, total return.

Fund & market

- Emerging markets fell sharply in March as the coronavirus spread around the world. For the month, the MSCI Emerging Markets Net Total Return Index fell 15.4% (all figures in USD unless stated otherwise).
- The fund underperformed slightly, falling 15.6% for the month.
- Asia was the best-performing region, falling 11.7%. EMEA (Europe, Middle East and Africa) followed, down 21.1%. The worst-performing region was Latin America, which fell 34.5%.
- Of the largest countries in the benchmark, the best-performing in the month were China, (−6.6%), Korea (−11.6%) and Taiwan (−13.4%).
- The worst-performing countries were Brazil (−38.2%), Mexico (−29.3%) and India (−25.1%).
- The strongest performers in the portfolio were China Construction Bank (+1.2%), NetEase (+1.1%) and Spar Group (−2.0%).
- The weakest performers were Truworths (−47.9%), Porto Seguro (−36.4%) and Banco Davivienda (−35.6%).
- Emerging market currencies fell by 7.6% during the month.

Events in March

- The coronavirus continued to spread across the world, with Italy and Spain particularly badly affected by the health crisis.
- Major lockdowns were announced in multiple countries, bringing widespread and severe economic disruption.

- The Fed cut interest rates by 100 basis points to zero (at the lower end of the range) on 15 March (a Sunday). A range of supportive measures was introduced, including $700bn in additional asset purchases and dollar swap lines with foreign central banks.

- Further policy measures were announced by the Fed on 23 March which included a pledge to buy corporate bonds for the first time. The package removed the existing cap on asset purchases.

- Congress approved a $2tn package to support the economy, with a combination of spending, business lending and loan guarantees.

- By the end of the month, the US surpassed China as the country with the largest number of confirmed coronavirus cases.

- The oil price fell dramatically after a breakdown in relations between Saudi Arabia and Russia, and a failure to agree production cuts. The WTI benchmark oil price declined 54%.

Review of the quarter

In the first quarter the fund fell by 25.1%, underperforming the benchmark, the MSCI Emerging Markets Net Total Return Index, which fell 23.6%. The market weakness was driven by the coronavirus outbreak, which started in China before spreading to elsewhere in Asia, Europe, the US and rest of the world.

The fund's underperformance against the benchmark came partly in two of the more positive phases of the market: the rally at the beginning of the year, just before the US-China trade agreement was signed, and the recovery in early February after the initial outbreak of coronavirus in China. Markets then entered a sharp drawdown phase towards the end of February and for most of March.

From a market perspective, Latin America was the worst-performing region, followed by EMEA (Europe Middle East and Africa). Asia was the best-performing region. Despite the coronavirus outbreak originating there, China was the best-performing country for the quarter as a whole. Other Asian countries that performed relatively well were Taiwan, Malaysia and Korea. At the other end of the scale, Colombia and Brazil in Latin America, and South Africa and Greece in EMEA, were notably weak.

From a sector perspective, cyclical sectors were the underperformers, notably Energy, but also Financials, Materials and Industrials. Stronger sectors were Healthcare and Communication Services. Information Technology and the two Consumer sectors were also relatively strong.

From a fund perspective, we had a positive contribution on a relative basis from not owning Energy or Materials stocks. In the first quarter, these sectors suffered a combination of oil weakness, caused by the breakdown in relations between Saudi Arabia and Russia, and the deterioration in the economy caused by the coronavirus outbreak. The bias in the portfolio away from these sectors is typically a consequence of our screening process, which looks for consistent returns on capital over time – Energy and Materials companies don't tend to pass this screen as their returns are too cyclical.

This bias gives us a differentiated allocation in certain countries whose indices have significant weightings to these sectors. For example, within Latin America, our Brazilian exposure was a source of relative strength, as we avoided some of the areas in the benchmark that were hardest hit, including Energy. Brazilian banks also suffered poor performance. While we have Financials exposure in the country, our two stocks are both outside the banking sector – Porto Seguro (an auto insurer), and B3, the stock exchange.

The best-performing stock in the portfolio was NetEase, a Chinese video gaming company, which saw a rise in users over the extended Chinese New Year holiday. Grape King, a manufacturer and distributor of health drinks and other products, also performed relatively well after seeing strong demand for its products.

Weaker stocks included those within the Information Technology sector, particularly some of the smartphone component suppliers such as AAC Technologies, Elite Material and Largan Precision.

Consumer Discretionary also had negative impact, with Truworths International, a clothing retailer, being the worst-performing stock in the portfolio. The company also accounts for the weakness attributed to South Africa. Truworths has been hit by the wider negative sentiment affecting South Africa since prior to the coronavirus sell-off and the company now trades at extremely depressed valuations. We saw better relative performance from some of our other South African holdings in the quarter, which we think raises the chances will see a re-rating for Truworths in due course. Bajaj Auto, a motorcycle manufacturer in India, also contributed to the weakness in the Consumer Discretionary sector.

In the Consumer Staples sector, negative contribution came across our holdings, particularly Coca-cola Femsa, (Mexico, Central and South America bottler), Spar Group (convenience retail with exposure to South Africa and also to Europe) and KT&G (Korean Tobacco), which reported disappointing results for the fourth quarter of 2019. Negative contribution also came from stocks in the benchmark not held, for example some Chinese staples stocks which performed relatively well.

Investment Process

The investment process for the fund has not changed; we remain focussed on companies that offer sustained and growing levels of profitability and which have strong balance sheets. In the current environment, clearly more focus is placed on the latter characteristic.

Activity in most industries is likely to decline as a result of the coronavirus shutdowns. Some businesses will see zero activity for a period, and many will see levels depressed for a length of time. Thus it is important to determine that companies can survive much weaker conditions which potentially may persist for some time. (While it is difficult to say exactly how great the extent of the disruption will be and how long it will persist, it is vital to assess the ability of our companies to survive it.)

We have reviewed the portfolio, focusing on debt and liquidity metrics. Across the fund (excluding the banks), gross debt to total equity averages 46%, well below our cut-off of 100%. On a net debt basis, the portfolio is actually in a net cash position.

Looking at liquidity, we have reviewed short-term obligations falling due, comprising short-term borrowing, the current portion of long-term borrowing and lease costs, comparing the total with cash.

This measure is designed to assess whether companies can cover their existing obligations falling due, should access to debt financing be halted (a scenario that is unlikely). For only two of the companies in the portfolio does this figure exceed cash (i.e. the obligations are not covered by cash), and for neither of these companies do we consider it problematic.
Interest coverage is also not a problem – we have EBITDA to interest expense as the metric to assess this. (Generally we want this ratio to be above five times.) On this metric, there are only three companies with coverage below 10, and one that has coverage below five (in this case there are circumstances specific to the company).

Dividends are well covered, with the average coverage for the portfolio just under two times.

Portfolio update

We made no changes in the portfolio in the first quarter but carried out rebalancing of the portfolio in line with our process in response to the volatile market conditions.

Many of the companies in the portfolio have commented to varying degrees on the impact of the coronavirus on their business. A selection of these comments follows.

Coca-Cola Femsa saw its credit rating downgraded by S&P, but this was a direct consequence of the downgrade to Mexico's sovereign rating. S&P noted the company is "well positioned to absorb negative shocks related to the pandemic caused by the Covid-19 outbreak." Further, S&P highlighted the company's "safe and sound finances, strong business position, manageable leverage, robust cash position and geographic diversification."

AAC Technologies, a company operating in the smartphone supply chain in China, commented on an earnings call that it had resumed 80% of operations at the beginning of March and had almost reached 100% of normalized production. This mirrors reports from Huawei, another company operating in the smartphone industry (though private, and not held in the fund), which recently commented that it was back up to full production. Clearly this bodes well for conditions on the ground and the ability of the technology sector to recover quickly. AAC commented that the emphasis now shifts to demand and whether we will see this decline in future. Our current expectation is that in this industry, demand will continue to hold up relatively well.

British American Tobacco highlighted that it had experienced some supply chain disruption in China in February, though again, normal operations had resumed from March. BAT also announced that one of its divisions is working on the development of a vaccine – while a positive outcome in this area would be wonderful, success in this area doesn't form any part of the investment case.

Truworths, a clothing retailer in South Africa, commented in February that the supply chain in China had experienced some disruption. A key period for the company comes in the transition to its summer collection in July and August (ahead of summer in the southern hemisphere). We have seen other companies in similar sectors in China comment positively on recent business developments, so we would not expect significant ongoing supply chain issues for the company.

Outlook

Clearly the coronavirus has introduced a new and significant source of uncertainty into markets, but the question is: how much has been factored into stock prices? Earnings forecasts have been revised downwards, with a 1% contraction for the fund and 2% growth for the benchmark forecast for 2020. These figures will undoubtedly change over the course of the second quarter as companies report more on the specific impact they are facing.

We note that emerging market valuations did not appear excessive going into the start of the year, which could bode well for investors if earnings can recover within a reasonable period. At present, earnings are forecast to rebound in 2021, with 12% growth for the fund and 17% growth for the benchmark forecast. Again, these figures are subject to ongoing revisions.

China's experience can be helpful when considering the process of restarting the economy. Restrictions in China that have been in place since the Chinese New Year are gradually being lifted. People are returning to work, but this is a process that takes time. Manufacturing is coming back relatively quickly, while some of the service industries are taking longer. In Beijing, for example, shops are opening up, although they may have restrictions on the number of people that are allowed inside.

In the rest of Asia, we can highlight several countries that appear to be handling the outbreak well, including South Korea, which has controlled several outbreaks, and Taiwan, Hong Kong and Singapore, which have managed to limit case numbers. Measures applied by these countries are various but include aggressive testing, active contract tracing and regular temperature checks. These tactics in combination appear to be working. Other countries in Asia are at different stages of the outbreak (India for example went into lockdown relatively recently), and we will monitor them closely.

Looking at the rest of emerging markets, Latin America and EMEA have generally been the last areas to report outbreaks. Brazil is notable among this group as having a large number of cases, though growth in new cases appears to have slowed recently. South Africa has reported far fewer cases so far, but we will also monitor developments here closely.

We do think there will be a wider beneficial effect over time for emerging markets from the sheer extent of resources and know-how that are currently being allocated to tackling the health emergency in Europe and the US. While a vaccine may be some way off, better technology for testing, better treatments for patients, and a better understanding of the disease and how the spread of the virus can be monitored and controlled are all areas where we could see a benefit.

In terms of the underlying economic impact, it will affect both the supply side and the demand side. In China, supply chains appear to be getting back to normal, although our companies could encounter further disruptions, particularly if they are dependent on parts from outside the country, as this could delay production of the final good. From a demand perspective, we think that several Asian countries will emerge from this early, which could act as a source of strength for emerging markets.

Our current expectation is that demand will be deferred to some extent to later in the year, and we would expect a relatively strong economic rebound in this case. We think this will be most apparent in those industries producing tangible products, rather than in services, where demand has been lost.

Our approach remains unchanged: we are focused on companies with both resilient business models, that can withstand tough economic circumstances, and with strong financial positions, i.e. with balance sheets that can carry the company through difficult times.

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

Data sources
Fund performance: *Financial Express, total return*
Index and stock data: *Bloomberg*

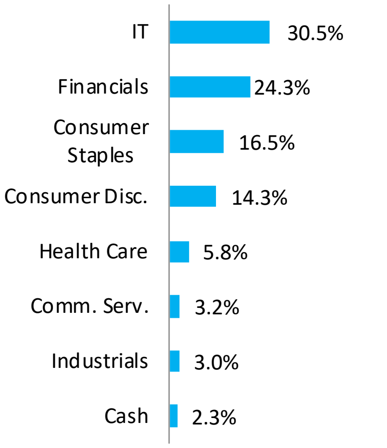
PORTFOLIO

31/03/2020

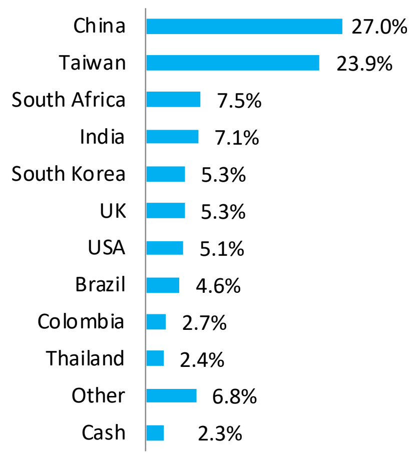
Fund top 10 holdings

China Construction Bank	3.6%
Grape King Bio	3.3%
Netease.com	3.2%
Largan Precision	3.2%
Elite Material	3.1%
Ping An Insurance	3.1%
Hon Hai Precision Indust	3.0%
Haitian International Hol	3.0%
China Medical System	3.0%
China Merchants Bank	3.0%
% of Fund in top 10	31.5%
Total number of stocks	36

Sector analysis



Geographic allocation



PERFORMANCE

31/03/2020

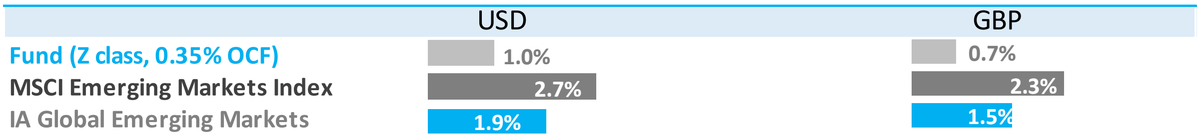
Discrete years % total return

	Mar '20		Mar '19		Mar '18		Mar '17		Mar '16	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (Z class, 0.35% OCF)	-19.4	-15.2	-9.4	-2.4	30.3	16.1	-	-	-	-
MSCI Emerging Markets	-17.7	-13.5	-7.1	0.1	25.4	11.8	17.7	35.2	-11.7	-8.8
IA Global Emerging Markets Sector	-19.5	-15.4	-8.5	-1.5	21.7	8.5	17.7	35.3	-12.1	-9.2

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 (Z class, 0.35% OCF)	-15.6	-13.1	-25.1	-20.0	-19.4	-15.2	-	-	6.3	5.0
MSCI Emerging Markets	-15.4	-12.9	-23.6	-18.4	-17.7	-13.5	-4.8	-4.0	8.9	7.7
IA Global Emerging Markets Sector	-17.6	-15.1	-26.3	-21.2	-19.5	-15.4	-10.4	-9.6	3.4	2.2

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 23.12.2016

31/03/2020	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.0	-1.1	1.9	-0.1
Beta	1.0	1.0	1.0	0.9	0.9	0.9
Information ratio	0.0	0.0	0.0	-0.3	0.3	-0.1
Maximum drawdown	-33.5	-22.3	-34.8	-24.0	-32.8	-22.9
R squared	1.0	1.0	1.0	0.9	0.9	0.8
Sharpe ratio	0.0	0.0	0.0	0.0	0.0	0.0
Tracking error	0.0	0.0	0.0	3.8	5.9	6.0
Volatility	17.4	15.0	17.2	14.1	16.4	14.5

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 (0.35% OCF). Fund launch date: 23.12.2016.

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 Emerging Markets 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.

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 Emerging Markets 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. 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.