Guinness Best of China Fund

INVESTMENT COMMENTARY – May 2020

Launch date	**15.12.15**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (analyst) **Sharukh Malik** (analyst)

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

30.04.2020

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	-2.8	13.7	63.9
Index	1.5	26.1	83.5
Sector	4.7	30.5	78.2

Annualised % total return from launch (GBP)

Fund	11.9%
Index	14.9%
Sector	14.1%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.7	-2.8
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.2	-0.5
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.9	18.1	19.2
Sharpe ratio	0.6	0.5	0.4

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 April, the Guinness Best of China Fund rose 8.9% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index rose 8.0% (in USD).
- In April, MSCI China rose 6.6% in USD, MSCI Taiwan rose 14.1%, and MSCI Hong Kong rose 7.3%. The Shenzhen Component Index rose 8.0% while the Shanghai Stock Exchange Composite Index rose 4.3%.
- In MSCI China, the strongest sectors were Health Care (total return of +14.1%), Materials (+8.9%) and Communication Services (+8.6%), while the weakest were Financials (+2.5%), Energy (+2.6%) and Real Estate (+4.7%).
- In Taiwan, the Information Technology Index, which makes up more than half of the Taiwanese index, rose 14.4%.
- In Hong Kong, the Financials and Real Estate sectors, which are by far the largest parts of the local index, rose 4.2% and 7.7%.

Events in April

- Life is gradually coming back to normal in China and an important milestone was reached when the lockdown in Wuhan was ended. But there was a reminder that a second wave of coronavirus cases is a possibility as there was a spike of cases in Harbin, the capital of Heilongjiang province in the north east. The province has banned non-residents from entering the region and so far it seems the outbreak has been contained.
- China's GDP fell 6.8% in the first quarter due to the effects of coronavirus lockdown from. That being said, there are clear signs of recovery in the economy. Industrial production increased

37% month-on-month in March. Retail sales surged 84% month-on-month in March but were still down 16% year-on-year.

- The official unemployment rate, based on surveys by the National Bureau of Statistics (NBS), increased from 5.3% in January to 5.9% in March. However, this rate likely understates the true level of unemployment. Migrant workers who were fired and then returned to their home provinces are not included in the survey. In addition, some state-owned enterprises (SOEs) have not fired workers but have instead reduced their wages and hours. According to the NBS, in March 18.3% of urban workers were still employed but did not actually work.

- The one-year loan prime rate (LPR), used increasingly to price loans, was lowered by 0.2% to 3.85%. The five-year rate was lowered by 0.1% to 4.65%.

- Over the past few years, the government has tried to channel more credit to small and medium enterprises (SMEs), and the fallout from coronavirus has made this task more difficult. So far this year, SMEs have been attracting nearly all funds in the bond markets and from banks. To this end, the Ministry of Finance (MOF) now requires local government-backed lending facilities to aim for 80% exposure towards SMEs.

- In Beijing, the household income threshold to be eligible for housing rent subsidy was lowered from CNY 4,200 a month to CNY 2,400 a month.

- Local governments are loosening measures that were put in place over the past few years to cool down the property market. In Lanzhou, the capital of Gansu province, the down-payment rate for commercial real estate was lowered from 70% to 50%, which is about average for China.

- The Chinese government will push infrastructure to stimulate growth. While this will include traditional investments into roads, bridges and railways, the government has specified a list of what it considers ‘new infrastructure’. This includes 5G base stations, data centres, ultra-high voltage networks, artificial intelligence and the industrial Internet of Things (IoT).

- Special bonds can now account for 25% of funding for these infrastructure investments, up from 20%.

- In Hong Kong, no new local cases of coronavirus have been reported since mid-April. Most public services were resumed on May 4th.

- The government’s stimulus measured announced on April 8th are worth c.4.8% of GDP and include wage subsidies and financing guarantees for SMEs. This was needed given first quarter GDP fell 8.9%.

- In Taiwan, total coronavirus cases are 440, with only six deaths. However, the economy is highly dependent on foreign demand and so in April the Purchasing Managers Index fell to 42.2.

Market Update

According to calculations by Goldman Sachs, aggregate demand in China is tracking at 81% of 2019 demand, as of April 24th. On the positive side, we see the property and construction markets picking up. In the consumer discretionary market, a noticeable improvement is seen in the auto, restaurant and sportwear markets. On the other hand, weakness is clear in the travel, gaming and box office sectors. In the first three days of the Golden Week holiday at the beginning of May, there were 85m domestic tourists spending CNY 35.1bn. This marks a 42% year-on-year decline in tourists and a 60% decline in spending. Though this is clearly weak, this is an improvement compared to the 61% decline in tourists and 81% decline in spending in the Qingming holiday at the beginning of April.

Measure (as % of last year)	Feb	March 27th	April 24th
Utilisation hours of excavators	40%	75%	90%
Property sales	31%	67%	85%
Auto sales (mass market)	22%	60%	93%
Selected restaurant sales	18%	58%	74%
Selected sportwear sales	21%	61%	73%

Portfolio Update

In April, most of the Fund's outperformance was driven by its holdings in Information Technology, covering Elite Material, Catcher Technology, Qualcomm and Hollysys. This was encouraging to see given that in the first quarter, the Fund's exposure to Information Technology contributed to 86% of its underperformance. The Fund's overweight position in Health Care also contributed to positive performance.

Elite Material reported first-quarter revenue that increased 17% year-on-year (yoy) while earnings per share (EPS) rose 54%. Its high-speed laminates, which are used to make denser printed circuit boards, could be a future driver of growth. These products have low signal loss which makes them ideal in cases where high data transmission is needed, such as in AI and telecom infrastructure. In the smartphone segment, upstream vendors like Qualcomm and Mediatek are maintaining their target shipments for 5G in 2020, of 155-225m and 170-200m respectively. 5G phones use more expensive PCBs and are higher-margin products, so the medium-term outlook looks promising for Elite. The company has net cash on its balance sheet and so can weather a period of volatility.

Catcher Technology's first-quarter revenue increased 12% yoy while operating income increased 17%. Margins and earnings beat consensus due to better cost control and foreign exchange (FX) gains. As many more people are now working from home, demand for notebooks and tablets has increased and so the demand for Catcher's metal casings increased 30% quarter-on-quarter. Earnings estimates have consequently increased since the end of March.

TSMC's revenue and EPS increased 2% and 1% quarter-on-quarter, respectively. Though TSMC is not immune to weakness in the broader economy, it does have exposure to secular growth industries such as High Performance Computing and 5G which can help reduce any upcoming declines in orders. Like

Catcher, TSMC benefited from the short-term boost from more people working from home as well as the growth industries just mentioned.

Supor's revenue fell 35% yoy while EPS fell 40%. The company faced a supply shortage until the middle of March and so was unable to make shipments even though online demand was growing. The long-term story remains the same; in the overall consumer appliances industry, small appliances have market share of 19% in China versus 29% in Japan and 37% in Korea. While 93% of consumers have a rice cooker and 84% have a kettle, only 35% have a slow cooker and 13% have a food processor. There is much room for the cookerware and small appliances industry to grow and Supor should be able to take advantage of this opportunity.

New Oriental Education, a provider of tuition services, reported revenue that grew 16% and EPS that grew 40%. This dropout rates for the company's courses have improved from the spike in February as classes moved out of physical platforms to New Oriental's online platform. Promotions for summer courses are starting and management is sticking to last year's strategy, which is to charge higher prices and focus on converting students to become full-time customers. This means New Oriental will charge about twice what it did last year, and four to 10 times what it charged in 2018. The company is one of the most well-known tuition companies in China, which allows it to charge premium prices. Management is guiding for revenue to be flat, which marks a deceleration in topline growth, but we think this is entirely understandable in these circumstances. The balance sheet is strong enough to weather a slowdown in growth while many smaller peers are unlikely to survive a period of weakness. We think there is a strong chance that New Oriental increases its market share as a result.

China Merchants bank had a strong set of results which beat expectations. It achieved 11% pre-provision operating profit growth in first quarter though a deterioration in asset quality is expected in the second quarter. China Construction Bank also had good results, with pre-provisioning operating profit up 6%. The net interest margin is expected to fall over the coming quarters.

Portfolio Switches

We sold AAC Technologies after it announced a negative profit warning. The returns of the business have been falling for some time and the decline in profit in the first quarter was unexpectedly high.

We are now in the process of moving the fund from 33 positions to 30 positions. There are few alternative companies in the offshore market that 1) meet our quality threshold of achieving an 8% return on capital over eight years, and 2) offer attractive valuations over the medium term. The onshore universe offers more than 100 new companies and we are looking to increase our exposure. However, there are risks in the market that we must manage. One that is increasingly becoming apparent is the popularity of pledged shares by main shareholders. If these main shareholders come into difficulty, these pledged shares can be sold by debtors, which would have implications for share prices and management of these companies. As a result of the lack of compelling alternative ideas in the universe, we would rather increase exposure to the existing positions in the fund which we consider to be best in class.

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 45%; the Fund is not highly geared. If we look at net debt/equity, which subtracts cash from debt, the figure is -17%; our companies could in theory pay back all 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 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 10.0x.

Edmund Harriss (portfolio manager)
Mark Hammonds, CFA (analyst)
Sharukh Malik, CFA (analyst)

Data sources

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

Index and stock data: *Bloomberg*

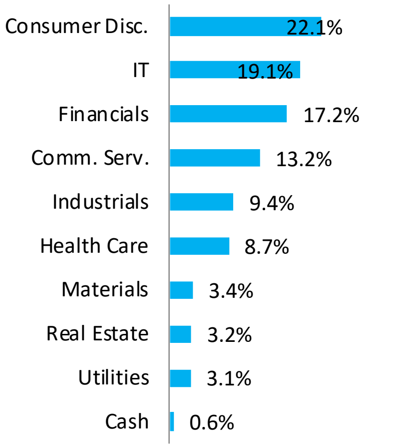
PORTFOLIO

30/04/2020

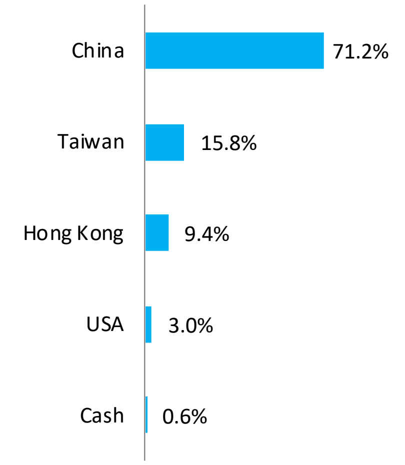
Fund top 10 holdings

Noah Holdings	3.8%
Autohome	3.6%
Elite Material	3.6%
China Merchants Bank	3.5%
Geely Automobile Holding	3.5%
Haier Electronics	3.4%
Anhui Conch Cement	3.4%
Ping An Insurance	3.4%
Baidu	3.3%
China Construction Bank	3.3%
% of Fund in top 10	35.0%
Total number of stocks	31

Sector analysis



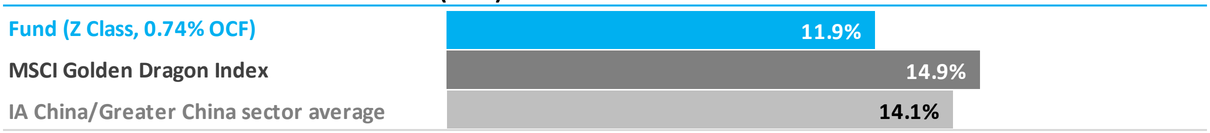
Geographic allocation



PERFORMANCE

30/04/2020

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Apr '20	Apr '19	Apr '18	Apr '17	Apr '16
Fund (Z Class, 0.74% OCF)	-2.8	-0.4	17.5	22.7	-
MSCI Golden Dragon Index	1.5	4.7	18.6	41.0	-20.0
IA China/Greater China sector average	4.7	2.0	22.2	37.1	-21.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	7.3	-6.6	-2.8	13.7	-	63.9
MSCI Golden Dragon Index	6.2	-1.5	1.5	26.1	42.2	83.5
IA China/Greater China sector average	7.7	1.2	4.7	30.5	40.7	78.2

RISK ANALYSIS

30/04/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.72	-2.77
Beta	1.00	0.97	1.01
Information ratio	0.00	-0.24	-0.45
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.90
Sharpe ratio	0.59	0.52	0.39
Tracking error	0.00	4.58	6.18
Volatility	17.92	18.05	19.19

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.