Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – June 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.

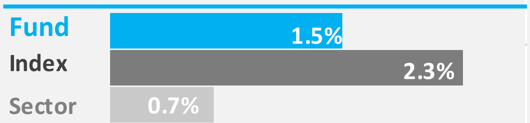
Performance 31/05/2020

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

	2019	2018	2017
Fund	14.6	-9.5	26.4
Index	13.9	-9.3	25.4
Sector	16.0	- 11.8	24.4

	YTD	1 Yr	3 Yrs	Launch
Fund	- 11.8	-6.2	5.1	15.9
Index	- 10.0	-2.5	4.0	18.8
Sector	- 12.3	-5.1	-1.4	13.9

Annualised % total return from launch



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.9	0.3
Beta	1.0	0.9	0.9
Info ratio	0.0	-0.3	0.0
Max drwdn	-22.6	-25.1	-23.1
Tracking err	0.0	3.8	6.0
Volatility	15.0	14.2	14.5
Sharpe ratio	0.1	0.0	0.1

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, Z class (0.35% OCF), bid to bid, total return.

ELITE RADAR on our watchlist: FundCalibre.com

Fund & market

- Emerging markets continued to recover in May, though at a slower pace than April. For the month of May, the MSCI Emerging Markets Net Total Return Index rose 2.8% (in GBP)
- The fund outperformed, rising 4.2% (in GBP) for the month.
- Reversing the trend seen so far this year, Latin America was the best performing region, rising 8.7%. EMEA (Europe, Middle East and Africa) followed, up 6.0%. The worst performing region was Asia, which rose 1.8%.
- Of the largest countries in the benchmark, the best performing in the month were Russia (+10.9%), Brazil (+10.9%) and Mexico (+8.8%).
- The worst performing countries were India (–0.7%), Taiwan (–0.4%) and China (+1.6%).
- The strongest performers in the portfolio were JSE (+24.7%), B3 (+21.9%) and Haitian (+18.6%).
- The weakest performers were Banco Davivienda (–7.5%), China Lilang (–6.0%) and Largan Precision (–5.6%).
- Emerging market currencies rose by 2.6% during the month.

Events in May

- Geopolitical tensions rose as US-China relations deteriorated. China's handling of the coronavirus outbreak was heavily criticised by President Trump; China accused the US of seeking to deflect blame.

- Later in the month, further restrictions on Chinese company Huawei were announced, limiting the company's access to products incorporating US technology.
- China's National People's Congress approved changes to Hong Kong's security laws.
- Coronavirus restrictions began to be eased in certain developed countries.
- Oil recovered strongly, with WTI rising by 88% to close at $35/barrel.
- India announced a Rs20tn economic stimulus package, equating to 10% of GDP. However, the actual fiscal impact of the measures could be much lower, according to some economists. Support measures included assistance for the hard-hit agricultural economy.

In this update we review a recent change to the portfolio before taking a sweep of recent company results from our holdings.

Portfolio changes

So far in the second quarter, we have made one change in the portfolio, selling AAC Technologies and replacing it with LG Household & Health Care.

We sold AAC after the company omitted its final dividend. For a business that should be experiencing reasonably good levels of demand (operating in the smartphone components sector) and that recently reported a recovery to an almost full level of utilization, we take the suspension of the dividend as a warning sign. For that reason we chose to exit the position. Fortunately our experience so far across the portfolio has been much better, with most companies at least holding their dividends, and many of them opting to raise the payment.

LG Household is a producer of cosmetics, household products and soft drinks. In cosmetics, the business earns very strong rates of return, but recent trading has been somewhat impacted by the coronavirus, with duty free sales weak in particular due to reduced travel. Our expectation is that this will to some extent be offset by sales in other channels, while travel comes back gradually over time.

In the soft drinks business, the company has the Coca-Cola bottling business for South Korea. This is lower-margin than the rest of the group, but still we think an attractive operation that offers robust economics.

With LG, we have the ability to purchase the preference share line, which carries essentially the same economic rights as the ordinary, but has the attraction of being available at a roughly 50% discount. This effectively halves the valuation we are paying for the business and doubles the applicable yield.

Portfolio review

Banco Davivienda reported results for the first quarter. The Colombian bank saw a sharp decline in revenue, falling 42% year-on-year. Net interest margin fell 28bps year on year, but remained at an elevated level (when compared to global NIMs) of 6.28%. Costs were kept under control, with only a 1 basis point increase year-on-year in the cost-to-income ratio. Gross loans increased by 23% when compared with the same period last year.

The macro backdrop in Colombia has worsened, with GDP in the first quarter falling from 2.9% to 1.1%, though still in positive territory (so far). The decline in oil prices seen over the last six months has negatively impacted economic prospects, though we expect prices to stabilise over time.

One of the bank's strengths is its positioning in the digital area. As might be expected, numbers of digital customers continued to increase sharply, rising 31% year-on-year.

Credicorp, our Peruvian bank holding, also reported an acceleration in digital users, with numbers increasing over the first four months of 2020 by 580,000, a 30% rise.

Total loans across the company increased 9.6% in the month of March (compared with February) in order to provide support to customers. Offsetting growth in net interest income, the bank reported a cost of risk of 445bps, an increase of 268bps from the previous quarter.

Peru has implemented strict measures in the wake of coronavirus, though Credicorp notes that there is still wide uncertainty about the economic impact. Economic forecasts for the country's GDP show a significant contraction in 2020 followed by a strong rebound in 2021. Credicorp's own forecast is for a 7% to 13% contraction in 2020 followed by a 4% to 8% gain in 2021.

Spar Group, listed in South Africa, reported results for the six months ended 31 March. As with many other food retailers, the company has taken steps to protect customers and employees during the coronavirus outbreak, employing masks and social distancing in stores. The company has 2,402 stores in Southern Africa, but also includes three other major territories: Ireland (1,387 stores), Switzerland (345 stores) and Poland (219 stores).

The Polish business – recently acquired – affected results in the first half, with losses leading to a decline in group earnings of 13%. Excluding the Poland business, earnings on the company's headline metric rose 8.5%. Group turnover over the period increased by 10%. Management took a conservative approach to the dividend, declaring an interim dividend of 200 cents, down from 284 cents in the prior year. However, a portion of this decline stems from lower earnings – had dividend cover (the inverse of payout ratio) remained consistent with prior year, the dividend would have been 243 cents.

Spar also saw a boost to purchasing in the first half, ahead of lockdown measures. This is likely to be reversed in the second half, through we expect to see more normalised levels of purchasing once lockdown restrictions are eased. Although, the lockdown measures implemented in South Africa will reduce alcohol sales in the TOPS business.

Bajaj Auto reported earnings for the fourth quarter (with a March year-end). Earnings came in ahead of estimates after the company achieved strong margins. The export side of the business contributed significantly to the overall result, offsetting a 33% fall in volumes year-on-year in the domestic business.

Management cautioned that profitability levels were unlikely to be fully sustained into the new financial year. The transition to the new BS6 emissions standards has negatively impacted costs.

Recent indications show improvement in activity levels in the domestic business as restrictions are eased. However, the numbers are recovering from a very low base, as the business was hit hard by the lockdown in India. We will have a better idea how much of this demand can be recouped subsequently over the coming quarters.

NetEase reported results for the first quarter. Revenue from online games rose from RMB 11.9bn in Q1 2019 to RMB 13.5bn in Q1 2020. Slightly more than two-thirds of online games revenues are from mobile games (the remainder is PC games). The business is very profitable, with a gross margin of 64% achieved during the quarter.

Netease both develops its own games in-house and licenses titles produced by other companies such World of Warcraft, licensed from Activision Blizzard. Netease also generates revenue from online education, cloud music streaming and private label e-commerce, though these are all smaller businesses in comparison to the gaming division.

In addition to paying dividends of $131m ($1.16 per share) in the quarter, the company also spent $342m on share buybacks, effectively increasing the return to shareholders.

B3 (Brasil, Bolsa, Balcao, the Brazilian stock exchange) benefited from the high volatility in markets during the first quarter. The company reported revenues for the period of BRL 2.1bn, up 39% on the previous year. Average Daily Traded Volume grew 72% in the quarter, reflecting the heightened market activity. Management illustrated the extraordinary volumes they had been witnessing in the earnings call held in mid-May:

> *"Until the beginning of February, the peak number of trades was about 6 million per day, and the average was about 5 million. During the Carnival holiday, international markets started to react more strongly to coronavirus news. When markets reopened in Brazil after Carnival, we reached 10 million trades per day, a 66% increase when compared to the previous peak. This level became the new normal. And in March, we reached 12 million trades per day, a 100% increase. This has never happened before."*

Continuing with the challenges that many companies were facing:

> *"At the same time that the volatility and the number of trades were the highest in our history, 90% of the company has to start working remotely. These three factors combined, extreme volatility [record number of circuit breakers in March], peak number of trades and remote working meant the biggest operational and resiliency stress test ever faced by the company. Fortunately, everything worked out quite well."*

Despite the disruption, expenses were well controlled, leading to a 62% increase in 'Recurring EBITDA'. The magnitude of this change illustrates the degree of operating leverage that can exist in this type of business. It is also worth noting that the strong growth in revenue was achieved during a market decline, rather than a market gain.

We obviously cannot expect revenues to stay at these elevated levels. As well as a trend towards more stable markets, management caution that the appetite for capital raising will be negatively impacted by the economic conditions and decline in investors' risk appetite.

Even so, the company has been very cash generative, paying out a BRL 650m special dividend related to 2019 results.

Porto Seguro, our other Brazilian holding, reported first-quarter results. The company's preferred measure of premiums increased 2.3% versus the year before. A decline of 2.8% in the main auto insurance business, resulting from greater competition, offset significant increases in the health and life parts of the business. Auto insurance represented 45% of the total earnings in in the first quarter, and other insurance contributed a further 40%. The remaining 15% consists of non-insurance financial business, services and the holding company.

Over a longer timeframe of four years, the company has consistently increased revenues at a compound annual growth rate of 4.2%.

Profitability in the insurance business, measured by the combined ratio, improved by 1.1 percentage point to reach 94.1%. The business generates excellent returns, achieving overall adjusted return on average equity of 19.4% in the quarter, a small decline from 21.0% in the previous year.

Hon Hai, the contract manufacturer and assembler, reported quarterly results. Revenue declined by 12% compared with the prior period, but this was achieved despite a 20% reduction in total hours worked following the impact of the coronavirus. Gross profit margin declined to 4.50% from 5.53% the year before (and 6.47% in Q4 2019). Costs and working capital are being carefully controlled by management, with the latter showing a two-day improvement in the cash cycle on better inventory control.

Hon Hai reported in mid-May that all its major factories in mainland China had resumed operations. Vietnam was also operating normally, but other facilities were facing varying degrees of disruption. This situation led management to guide for a single-digit decline in revenue in the second quarter (versus prior year) as it copes with the restrictions. Management confirmed their commitment to payout 40% of net profit as dividends.

Novatek Microelectronics has continued to see strong revenue growth for its products, achieving growth of 12% in March and 19% in April, reaching a record high for the month. For the first four months of the year, revenue grew by 15% versus the prior year. Revenues exceeded the guidance given by management in mid-February this year.

The company produces display driver chips and has seen an increase in orders for its products recently. More people working from home has led to higher demand for laptops, monitors and tablets, which use Novatek chips. Novatek has also seen growth in demand for its System-on-Chip TV products from Samsung, its largest customer.

Tech Mahindra reported results for the fourth quarter (March year-end). Reflecting the way that many global businesses have been required to adapt, the IT services company reported that 93% of offshore IT associates (located outside India) were working from home, with provisions made to ensure data security and privacy. Tech Mahindra also took steps to ensure employee wellbeing, including holding virtual dance classes, meditation session and happy hours.

Revenue growth for the full year came in at 5.6% in constant currency. COVID had an impact mainly on the final month of the financial year, with management attributing half of the 3.3% sequential decline in quarterly revenues to the outbreak. The impact also continued into April, but management commented that they expect businesses to adjust over time. Some clients have deferred network spending in the short term, but this is expected to be temporary as providers' ultimate appetite for installing 5G is unchanged. Over the year, manufacturing has been weaker, led by the auto sector, while communications did relatively well.

If the trend for greater working from home establishes itself, it should represent an opportunity for Tech Mahindra, which enjoys relationships with the top telecommunication companies.

Margins declined by 2.2%, partly due to expected credit losses on receivables due to higher provisioning levels. Nevertheless, by focussing on collections of receivables, free cash flow came in at a record $175m. Costs have also been controlled by reducing subcontractor cost.

The final dividend of INR 5 per share brings the total for the year to INR 15, versus INR 14 for the prior year.

Unilever provided a trading update in mid-April, outlining the ways it is responding to coronavirus. One initiative has led the company to partner with Heineken in Brazil to produce hand sanitizer – the alcohol used is a by-product from the production of Heineken Zero. The finished product was distributed to 210 favela areas around Sao Paulo.

Consumer behaviours have changed, at least temporarily, with more purchases of hygiene products and food for in-home consumption. The decline in out-of-home consumption at restaurants and tourist destinations to led to a weaker performance in the Food Solutions business and a decline in ice cream sales.

Management expects consumers to begin to trade down towards value brands within the range, due to the economic difficulties many will be facing.

The overall effect on the first quarter is that the business has clearly slowed. Underlying sales growth was flat, with a slight (0.2%) increase in volumes offsetting a decline in price of the same magnitude. Disruption caused by the virus, including a significant slowdown in China, dragged on growth, but was offset to a degree by household stocking in developed markets in particular. The effect of the disruption in the first quarter amounted to a roughly 1% drag on growth, while the offset from household stocking contributed +2% at the group level.

The company also provided an update on the balance sheet. Cash and undrawn facilities at the end of 2019 covered the amount of debt maturing in 2020 by a factor of 2.8x. The company also took advantage of the heightened activity in the corporate debt market – after its planned issuance of EUR 1bn was 'very significantly oversubscribed', management increase the size to EUR 2bn.

The quarterly dividend was unchanged.

Last, it is worth noting management's comment on cash control, which is interesting for what they say about the wider economy, on the assumption that many other businesses are following similar steps:

> *"Even though our cash position is strong, uncertainty demands that we put rigorous focus on managing our resources and uses of cash, and that we are super disciplined in controlling operational costs. First of all, we've managed and focused on managing our receivables. We're also re-evaluating all spend to ensure its relevant and appropriate in this situation, including operational costs, capex and restricting investment.*
>
> *Some costs have declined quite naturally, such as travel and in person market research. We've introduced a worldwide hiring freeze. We have a freeze on all nonessential spending, such as things like consultancy, etc. Other savings are readily accessible because advertising production has stopped and media rates have declined so that we can increase our advertising reach for the same level of spend. Nevertheless, we are still reviewing all discretionary marketing spend to ensure it's both effective and appropriate, and above all, we're dynamically reallocating our BMI [brand and marketing investment] in response to the crisis. For example, we're shifting BMI that might have been spend on outdoor advertising and supporting out-of-home campaigns, and dialing up investment behind areas of the highest return on investment, for example, in skin cleansing, home and hygiene brands."*

Coca-Cola FEMSA in Mexico reported results for the first quarter. Volumes were flat, as stronger performance in Colombia, Argentina and Central America was offset by weaker performance in Brazil and Uruguay. Mexico performance was stable. Currency weakness led to an overall 1.9% decline in revenues. (Excluding the currency effect, the top line would have risen 3.6%.)

Operating income for the quarter was flat, but again would have shown growth of 6.3% on a comparable basis.

Echoing the trends faced by Unilever, Femsa had a decline in the on-premise channel. However, most of the company's volume is distributed through the traditional trade channel – mainly mom-and-pop stores – which proved more resilient.

Volumes have slowed more significantly in April as the impact of the shutdowns is felt more acutely, therefore second quarter results will be affected accordingly. However, underscoring management's confidence in its ability to navigate the pandemic and the strong cash generation within the business, a 37% increase in the dividend was approved at the shareholders' meeting in March.

Outlook

Performance in May bucked the trend, but for the year to date emerging markets are split along regional lines, both in equity performance and experience with the coronavirus. Asia, mostly represented by China, has come through the epidemic relatively well – businesses are reopening and people are getting back to work. But the experience across Asia is not universal – India is still in the midst of combatting the virus.

In EMEA, our fund has most exposure to South Africa. Here, the experience with coronavirus has been relatively good, following the imposition of very strict lockdown conditions. The challenge faced by South Africa is more the economic weakness the country was contending with prior to the arrival of coronavirus. The result of the lockdown is likely to further compound the economic weakness. Nevertheless, this is to some degree priced in by the market – South African equities look very cheap relative to past experience and the long-term prospects for a better economic future are good.

In Latin America, many countries are still feeling the full force of the virus's impact. Brazil has been particularly hard hit, with high numbers of new cases being reported. The country ranks fourth globally by number of coronavirus deaths. While the macro and economic backdrop is very challenging, we nevertheless fell that we have good exposure to the country, with holdings in an auto insurer and the stock exchange/diversified financial services.

Valuations to us still look undemanding. The reliability and usefulness of the market's P/E ratio will depend on the experience over the rest of the year as the path for earnings estimates for 2020 becomes clearer. When considering an individual company, we will accordingly usually consider a normalised level of earning power.

Earnings estimates for 2020 have already been revised down significantly, with a reduction of 22% over the past three months, and we would not be surprised to see further revisions. (This figure compares with a 28% reduction over the same time period for world equities.) How robust earnings forecasts turn out to be will obviously depend on the degree to which we see a rebound in the second half of the year. We should also get an indication of the speed and path of the economic recovery by looking at 2021 earnings estimates – these have been revised down for emerging markets over the past three months by a more modest 13%.

Dividends across the portfolio for 2019 have held up very well, with minimal cuts/omissions across the portfolio. The result for 2020 may be more mixed, but many of the dividends won't be declared until companies report results in early 2021. Our positioning within the portfolio should, we believe, help in this regard as we invest in companies with:

- consistent profitability and high levels of returns on capital

- strong balance sheets; restricting investment to companies with low levels of gearing and currently achieving close to a cash neutral position across the portfolio (i.e. zero net debt/cash).

- track record of dividend history indicating management's continued willingness to pay a dividend

On the whole, we expect the companies within our portfolio that reduce the dividend to do it largely in line with a reduction in earnings (i.e. by keeping the payout ratio constant). Over the long term, we expect the portfolio companies to grow their dividend. Sustained reinvestment of earnings at attractive incremental rates of return will lead to earnings growth, which should lead to dividend growth over time.

Much will depend on how quickly global markets can recover and return to more normal levels of economic activity. Stock markets have continued to rally strongly and appear to be discounting a relatively short period of interruption and a strong and swift rebound (we are cautious about the likelihood of this!).

At the same time, companies are still in the reporting period (second quarter) which is most likely to see the biggest impact of the disruption caused by the virus. Many companies won't officially report these results until August, although the reporting of first-quarter results has given us insight into the challenges companies are facing and how they are dealing with them.

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*

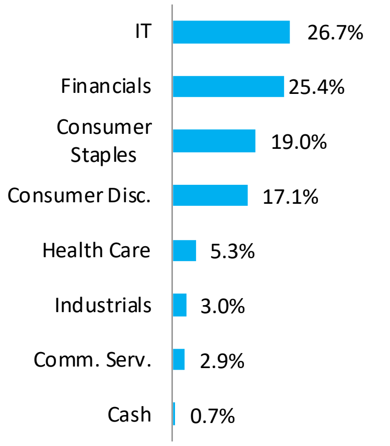
PORTFOLIO

31/05/2020

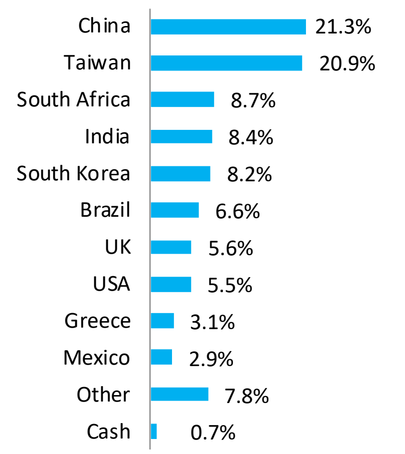
Fund top 10 holdings

B3 SA - Brasil Bolsa Balca	3.3%
Porto Seguro	3.2%
Jumbo	3.1%
JSE Ltd	3.1%
Haitian International Hol	3.0%
Truworths International	3.0%
Bajaj Auto	3.0%
Coca-Cola Femsa	2.9%
Netease.com	2.9%
Tisco Financial Foreign	2.9%
% of Fund in top 10	30.5%
Total number of stocks	36

Sector analysis



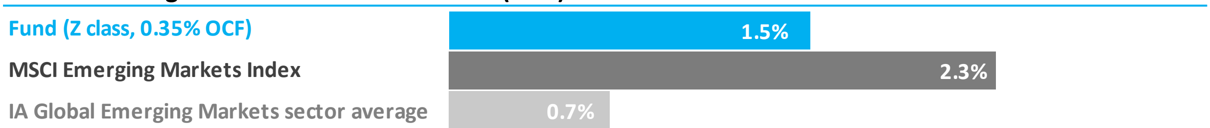
Geographic allocation



PERFORMANCE

31/05/2020

Annualised % gross total return from launch (GBP)



Discrete years % gross total return (GBP)	May '20	May '19	May '18	May '17	May '16
Fund (Z class, 0.35% OCF)	-6.2	-1.9	14.3	-	-
MSCI Emerging Markets Index	-2.2	-3.2	11.0	44.2	-13.3
IA Global Emerging Markets sector average	-5.2	-2.7	6.8	42.4	-12.3

Cumulative % gross total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z class, 0.35% OCF)	4.2	-11.8	-6.2	5.1	-	15.9
MSCI Emerging Markets Index	2.8	-10.0	-2.5	4.0	4.1	18.8
IA Global Emerging Markets sector average	2.5	-12.3	-5.1	-1.4	3.5	13.9

RISK ANALYSIS

31/05/2020

Annualised, weekly, from launch on 23.12.16, in GBP	Index	Sector	Fund
Alpha	1.00	0.92	0.89
Beta	0.00	-0.32	-0.04
Information ratio	-22.63	-25.14	-23.11
Maximum drawdown	1.00	0.94	0.84
R squared	0.07	0.00	0.06
Sharpe ratio	0.00	3.83	6.03
Tracking error	14.19	14.19	14.53
Volatility	0.00	-0.89	0.31

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.

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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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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.