Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – July 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 (in GBP)

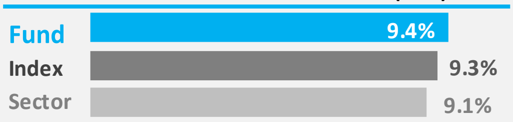
30/06/2020

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

	2019	2018	2017
Fund	14.4	-10.3	24.6
Index	15.7	-9.2	25.1
Sector	15.8	-9.8	25.3

	YTD	1 year	From launch
Fund	-8.4	-6.6	79.7
Index	1.8	4.4	78.3
Sector	0.6	2.6	76.9

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	0.7	1.3
Beta	1	0.9	0.9
Info ratio	0	-0.1	0.0
Max drwdn	-26.4	-24.5	-24.8
Tracking err	0	3.6	5.9
Volatility	15.4	14.2	14.7
Sharpe ratio	0.4	0.4	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. Returns for share classes with a different OCF will vary accordingly.

Source: Financial Express, Y class 0.99%, bid to bid, total return.

ELITE RATED by FundCalibre.com ™

Fund & Market

- In the second quarter the Fund rose 15.5% (Y share class, in GBP) and captured 84% of the market which rose 18.4%, as measured by MSCI AC Pacific ex Japan Net Total return Index.

- Healthcare, materials, communication services, consumer discretionary and technology led the way.

- Australia, New Zealand, Thailand, Indonesia, Taiwan, India, the Philippines and Korea all outperformed the regional index; China, Hong Kong, Malaysia and Singapore lagged.

- The leading contributors to performance over the quarter were JB Hi-Fi, Elite Material, Janus Henderson, Sonic Healthcare, Qualcomm, Novatek Microelectronics, NetEase, PTT, Hon Hai Precision and Corporate Travel Management.

- Detractors from relative performance were China Mobile, Tech Mahindra, Link REIT, China Resources Gas, China Construction Bank, China Lilang, China Merchants Bank, Hanon Systems, Ping An Insurance, Public Bank, Aflac and KT&G.

- Changes made to the portfolio during and just after the quarter include the addition of three domestic-focused China A shares.

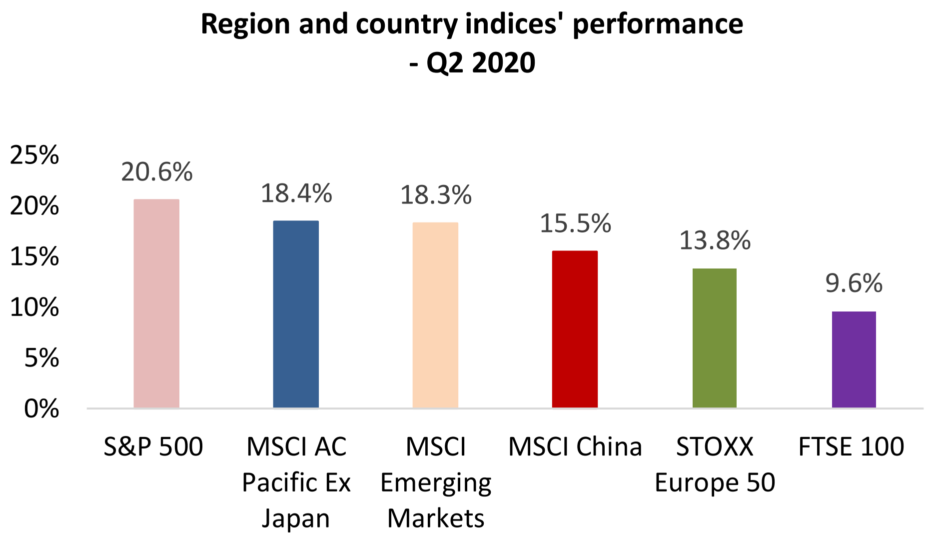
Events in June

- The Chinese government announced its intention to impose a National Security Law on Hong Kong.
- China's domestic economy recovered to record economic growth of 3.2% in the second quarter, compared to the same period last year.
- The US tightened restrictions on the supply of high-end semiconductors and semi-conductor equipment to Huawei, which in addition is facing exclusionary pressures on the supply of 5G telecom equipment.
- Messages on overall US-China trade remain mixed, but the overall impression given by the US Administration is that the Phase 1 deal is holding together.
- Reports circulate of a resurgence of COVID-19 cases in Hong Kong, Korea, Australia and New Zealand, but it should be noted they number fewer than 200 in each instance. India and Indonesia are the worst affected.
- OPEC's (tentative) agreement to control oil supply lifted oil prices by 11% in June. Industrial metals (Iron ore, Copper) have also been rallying.
- Asia's technology supply chain has been lifted by the strong sell-through of the new iPhone SE. Chip demand from datacentres/cloud computing is also supporting the likes of TSMC.
- Clashes on the India-China border were followed by efforts to de-escalate tensions.

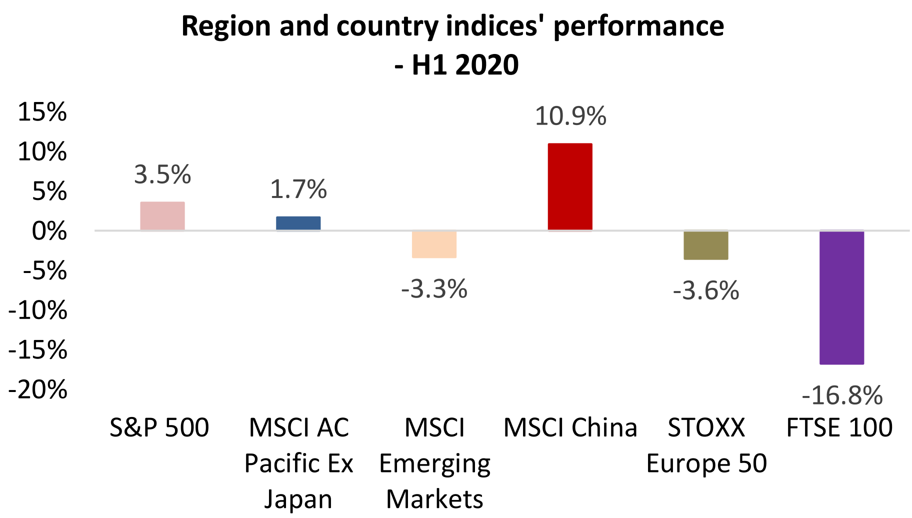
Market review

In the second quarter, the Fund rose 15.5% (Y share class, in GBP) compared to the market which rose 18.4%, as measured by the MSCI AC Pacific ex Japan net total return Index. Over the period, the Fund outperformed in April, moved in line in May and underperformed in the second half of June. Overall, the fund captured a little over 80% of the market rally which is what we would expect to see. This does not mean that we underplay the significance of the Fund's underperformance in the first quarter, which was not what we would have expected to see and which we will discuss later.

Asian markets performed well over the quarter compared to the rest of the world and the performance of China, as measured by the MSCI China Index which has had a big say in that, particularly through the performances of both Alibaba and Tencent, which together account for 33% of that index. The charts below show a comparison of market performances over the quarter:



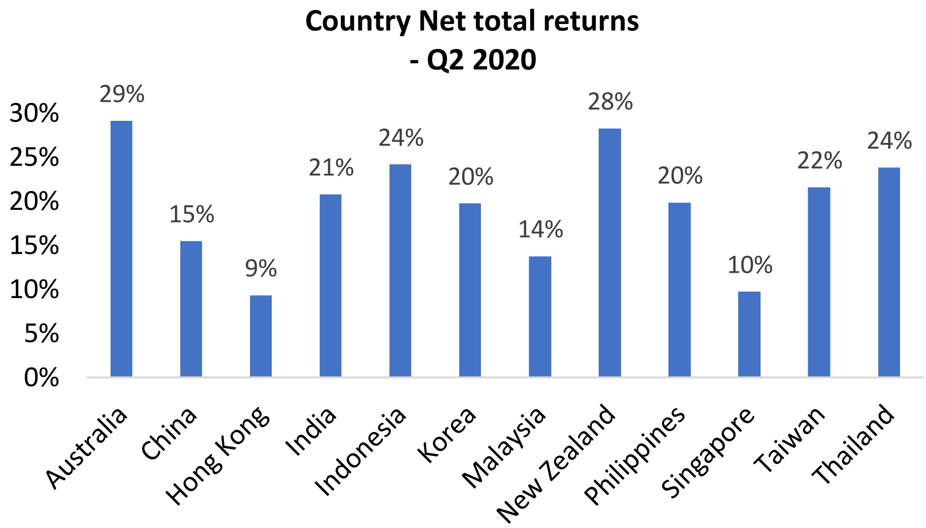
And over the year to date:



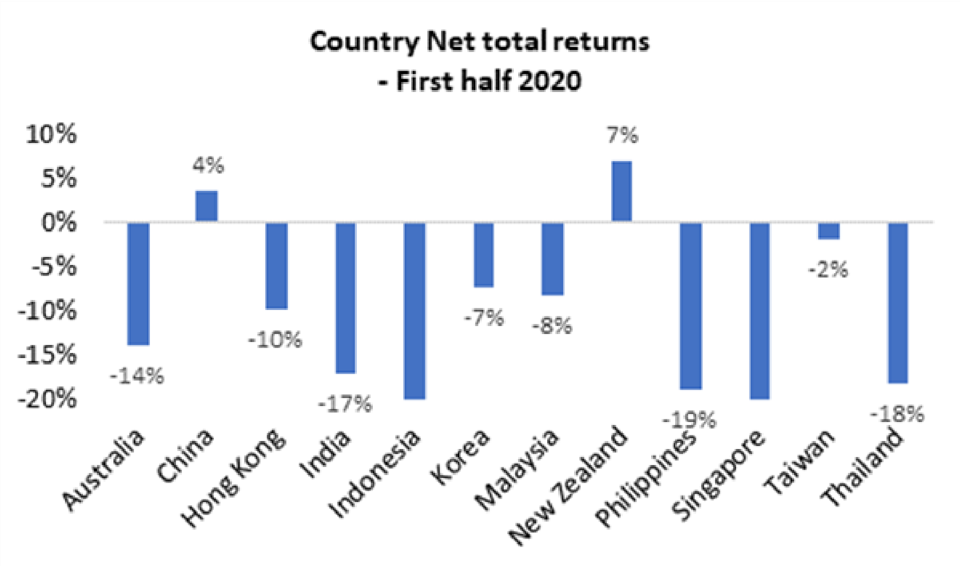
Source: Bloomberg, Net total returns in GBP

Stock market performance in the region, along with the rest of the world, has been heavily influenced by the spread/containment/resurgence of COVID-19 cases and by the unprecedented level of support coming from governments and central banks. Expectations are now for interest rates in developed markets to remain low for the foreseeable future. Quantitative easing and targeted interest rates prevail, and even in cases such as India and Indonesia, we are seeing central banks buying debt directly from the government (previously heavily frowned-upon). In Asia, all countries are implementing some kind of centralised support of up to 15% of GDP, although India, Indonesia and the Philippines are most financially constrained.

The performance of the region by country for the second quarter:



And for the year to date:

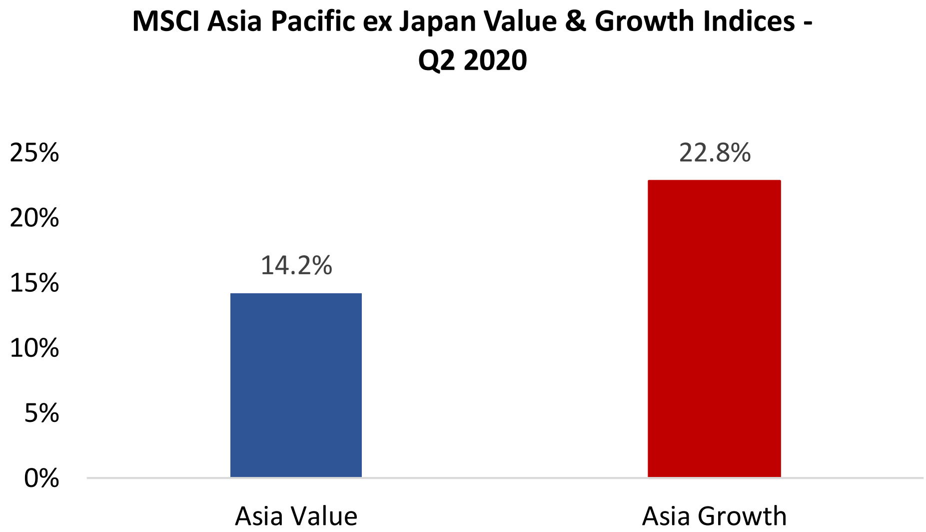


Source: Bloomberg, Net total returns in GBP

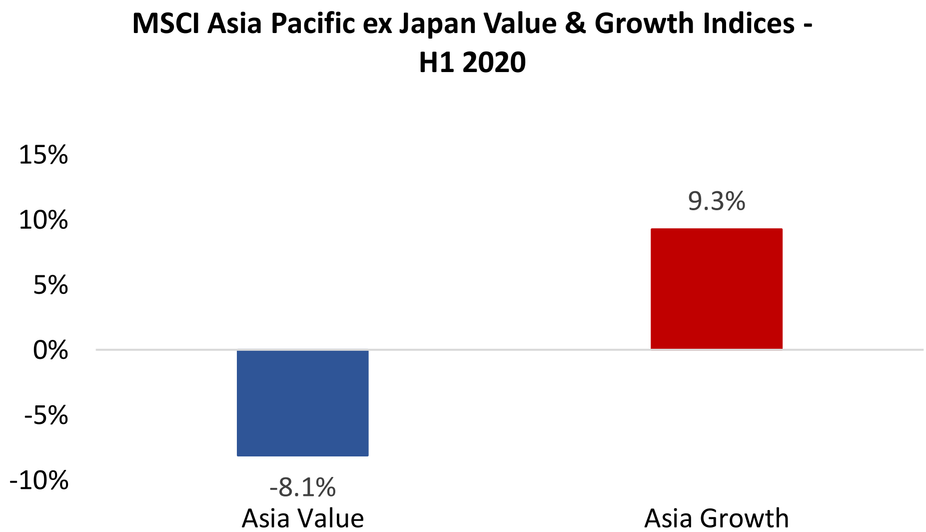
Geopolitics continues to raise its head: a new national Security law in Hong Kong; border clashes between China and India; North Korea coming under increasing sanctions pressure; China trade issues with the US, EU and UK. All these add to the mix. However, life in the region is gradually returning to normal. Mask wearing, social distancing and track & trace appears to be effective and as a result, local economies are opening up. In the most recent news, cinemas in China are now re-opening. International travel, however, remains limited.

High frequency indicators such as electricity consumption, traffic levels, oil demand and air quality point to a resumption of industrial output. Retail sales are still stronger through online channels as compared to offline, but consumer confidence overall appears to be on the rise. This is not to say that COVID-19 is behind us in Asia, but for the most part activity levels are now higher and downturn shallower in Asia than it was in developed markets. While some worry about the effect of ongoing weakness in developed market demand on Asian manufacturing, it does appear that Asia's domestic markets are picking up more of the slack than might have been expected.

The Fund's investment approach – focussing on cash-generative, income-producing stocks that have the capacity to deliver dividend growth and which we believe are undervalued – puts it closer toward the value end rather than the growth end of the market. We would characterise the growth end as being dominated by businesses with high returns on capital and high re-investment of profits leaving little or nothing for dividends. These stocks, because of their low or no dividend pay-out, are ones to which we have low exposure. It is in this context that we show in the charts below the divergence between growth and value styles over the quarter:



And for the year to date:



Source: Bloomberg, Net total returns in GBP

Revisions to forecast market earnings for 2020 have come down almost 20% since the beginning of the year and by around 11% during the second quarter. Earnings estimates for the Fund, however, have come down by around half, and it is that greater resilience which we believe will lead to outperformance over time when the differentiation between company operating results becomes clearer. Markets have been rallying on the back of printed money rather than cash flows, and we prefer to focus on the latter. Dividend estimates for the market have also been declining, not least because dividend policies in Asia are predominantly based on a proportion of earnings rather than an absolute figure. Nevertheless, our experience in the portfolio has been for core dividends (i.e. excluding special dividends) to remain robust.

Portfolio view

In the first quarter of the year there were very few stocks that were working for us. Only a selection of Chinese names together with a couple of Taiwanese technology companies and Ascendas REIT were ahead of the benchmark at the end of March. We attribute this to the economic sensitivity of our names in the provision and distribution of goods and services, which the breadth of economic closures have disrupted. We emphasised the financial strength of our companies because with the extent and unknown duration of lockdowns, we want to be confident that our businesses can not only survive but also emerge in a stronger position relative to peers. We believe that when economies are operating, these businesses have superior attributes that should deliver superior operating cash flows and dividends.

In the second quarter, however, portfolio performance looks much improved. Companies such as JB Hi-Fi, Elite Material, Qualcomm, Novatek and NetEase all reported strong growth in sales. Stocks such as Janus Henderson and PTT were each beneficiaries of rising stock markets and a recovery in the oil price respectively. At the lower end of the table, the Chinese names were more resilient in the first quarter but were always less likely to capture the early stages of a market rally. However, underlying conditions in China have continued to improve and these names have picked up into July.

Our focus is on those names which are still significantly down on the year, because if we are to make good on the underperformance in the first quarter, it is this group which must rise. In the cases of **DBS, Public Bank** and **China Medical Systems** they are now well off their lows, supported by stable cash flows and dividends. Asset quality amongst the banks remains a continued concern, globally, but these banks are well-capitalised and importantly they are also well-provisioned, having adopted a proactive approach to setting aside capital during the good times. **Tech Mahindra, Aflac, China Lilang, Tisco** and **CapitaLand Mall Trust** remain the laggards. However, all have minimal debt and robust business models such that when they are allowed to resume business again, we are confident in their ability to rebound. In the meantime, we track results and company commentary.

In the case of **Tech Mahindra** for example, we note that since our last report the company has been winning new orders and has increased its dividend by 7%. The stock price has been weak because current invoicing has been depressed while people are not able to work onsite. However, in recent weeks this is changing and Tech Mahindra's share price has been moving briskly higher in July. In the case of **China Lilang**, the company recently announced a profit warning that net profit at the interim stage would be down 30%-35%. Since most of its sales are offline, a decline was expected, but with sales in the first quarter down closer to 50%, there are signs that the second quarter has seen an improvement. This company has a good reputation for both quality in design and production and in inventory management. **Corporate Travel Management** remains the weakest performer in the portfolio in the year to date. But we see the basis for a sharp recovery from here; the timing is difficult to predict, but the critical point is that time is on their side with a strong cash position and tight cost management.

The table below shows the performance of stocks in the portfolio in GBP terms for the second quarter and for the half year to the end of June

Name	Sector	Q2 2020 Total Return	H1 Total Return
JB HI-FI LTD	Consumer Discretionary	73.8%	24.3%
ELITE MATERIAL CO LTD	Information Technology	54.2%	26.2%
JANUS HENDERSON GROUP-CDI	Financials	42.9%	-4.0%
SONIC HEALTHCARE LTD	Health Care	41.4%	12.6%
QUALCOMM INC	Information Technology	36.1%	12.5%
NOVATEK MICROELECTRONICS COR	Information Technology	35.9%	12.9%
NETEASE INC-ADR	Communication Services	34.4%	51.0%
PTT PCL	Energy	30.4%	-9.3%
HON HAI PRECISION INDUSTRY	Information Technology	26.5%	3.0%
CORPORATE TRAVEL MANAGEMENT	Consumer Discretionary	25.7%	-49.4%
YANGZIJIANG SHIPBUILDING	Industrials	20.0%	-10.2%
DBS GROUP HOLDINGS LTD	Financials	18.5%	-14.1%
TAIWAN SEMICONDUCTOR MANUFAC	Information Technology	18.0%	4.4%
TISCO FINANCIAL GROUP PCL	Financials	17.2%	-20.3%
CATCHER TECHNOLOGY CO LTD	Information Technology	16.4%	6.0%
ST SHINE OPTICAL CO LTD	Health Care	16.3%	-15.8%
BOC HONG KONG HOLDINGS LTD	Financials	15.1%	-1.9%
SHENZHOU INTERNATIONAL GROUP	Consumer Discretionary	14.7%	-10.8%
ASCENDAS REAL ESTATE INV TRT	Real Estate	14.6%	11.5%
CAPITALAND MALL TRUST	Real Estate	12.5%	-16.3%
CHINA MEDICAL SYSTEM HOLDING	Health Care	10.7%	-11.1%
LARGAN PRECISION CO LTD	Information Technology	9.3%	-11.4%
KT&G CORP	Consumer Staples	6.4%	-14.9%
AFLAC INC	Financials	6.3%	-26.0%
ZHEJIANG SUPOR CO LTD -A	Consumer Discretionary	5.1%	-0.5%
PUBLIC BANK BERHAD	Financials	4.7%	-11.1%
PING AN INSURANCE GROUP CO-H	Financials	3.8%	-7.8%
HANON SYSTEMS	Consumer Discretionary	3.8%	-16.4%
CHINA MERCHANTS BANK-H	Financials	2.0%	-4.2%
CHINA LILANG LTD	Consumer Discretionary	-0.3%	-24.5%
CHINA CONSTRUCTION BANK-H	Financials	-0.9%	0.3%
CHINA RESOURCES GAS GROUP LT	Utilities	-1.3%	-3.3%
LINK REIT	Real Estate	-1.3%	-15.5%
TECH MAHINDRA LTD	Information Technology	-4.0%	-27.0%
CHINA MOBILE LTD	Communication Services	-6.2%	-11.3%

Portfolio changes

This year we have made five changes in the portfolio. We sold **AAC Technologies, Godrej Consumer Products, Luk Fook, Janus Henderson** and **Yangzijiang Shipbuilding** (the latter two just after the quarter-end). We have replaced these with **Shenzhou International, NetEase, Zhejiang Supor, Nien Made Enterprise, Suofeiya Home Collection** and **Inner Mongolia Yili Industrial**. The overall effect has been to increase the emphasis on dividend growth (the historic 5-year dividend growth for the portfolio was 14% compared to 11% before the changes) and to increase exposure to domestic spending. Another point to note is that three of these are domestic China A shares.

- **Sales**

AAC Technologies and **Godrej Consumer Products** were both sold following their decision to omit a dividend (a final for AAC and a quarterly dividend from Godrej). Neither company needed to do so but a commitment by management to the dividend is a cornerstone of this strategy. We sold **Luk Fook** as the situation in Hong Kong continues to deteriorate. The company generates most of its revenues from mainland Chinese visitors to its Hong Kong stores and a resumption of Chinese tourist arrivals looks increasingly distant. We sold **Janus Henderson** following its bounce in the second quarter. In so doing we have locked in some underperformance, but we are not confident that the business model is resilient enough to deliver the dividend growth we seek. **Yangzijiang Shipbuilding** was also sold following a bounce in the stock price. Its ability to win new orders in this environment has been very impressive but again, it is hard to construct an argument for dividend growth over the next few years.

- **Purchases**

Shenzhou International is a textile and clothing manufacturer with a diverse and high-quality customer base and whose recent dividend was 8.75% higher than last year's. We have been watching this company for a while and bought it in the depths of the COVID-19 crisis. **NetEase** is a stock we have followed for a long time in our Asia growth and China strategies, but it has made it into this fund following its decision to pay quarterly dividends. **Zhejiang Supor, Suofeiya Home Collection** and **Inner Mongolia Yili Industrial** are all China A shares with historic dividend yields of 2% to 2.4% and all with track records of strong dividend growth. Zhejiang Supor makes kitchenware and kitchen appliances; Suofeiya makes home furnishings including cupboards, sofas and mattresses; Inner Mongolia Yili produces fresh and powdered milk along with other dairy products. **Nien Made Enterprise** is a Taiwanese company with operations in China and in Mexico, which supplies shutters and blinds to the US, UK, Belgium, Australia and Japan. The company is a beneficiary of both home improvement spending as well as homebuilding.

Outlook

The portfolio consists of companies that we believe are financially robust with solid business models. We have been encouraged by management comments in what have been challenging operating conditions and by the overall willingness to sustain and grow dividend payments. The next few months are going to be more revealing, because it is in the next reporting season that we will have a clearer picture of the impact of lockdowns and the progress made toward their lifting.

So far, as we have discussed, we have seen dividend omissions by two companies which we have sold. Hanon Systems has reduced its dividend this year in line with lower profits and we expect Corporate Travel will need to do the same. CapitaLand Mall Trust has deferred dividend distributions from the first half of this year; they have been permitted to do so by the regulators in Singapore, but income has been earned and therefore must be distributed in due course – and in any case before June 2021 – in order to enable them to continue to qualify as a REIT. We do not anticipate this to be a problem and we still hold the position. Our expectations for dividends in the second half are therefore subject to earnings; we expect special dividends (of which there were a few last year) will not be repeated this year, and there may be some deferrals. However, the financial strength of our businesses and the evidence of domestic stability and/or recovery in their markets gives us grounds for optimism.

At a macro-level, we think that North Asia will continue to be the stronger area, and there are reasons – beyond the cyclical – to believe that China's domestic recovery will continue for the next twelve months. Next year is the centenary of the founding of the Chinese Communist Party in July 1921, in Shanghai. This is a big date in the government calendar and much of China's foreign and domestic policy is likely to be geared to showcasing a new economically and politically assertive China. As we have seen, this has resulted in rising frictions with the rest of the world which is likely to lead to further efforts to bolster domestic self-sufficiency and growth of national champions. Efforts are likely to continue to prevent excesses building or bubbles forming, but the direction of travel is likely to continue to be supportive of growth.

Edmund Harriss (Portfolio Manager)
Mark Hammonds (Portfolio Manager)
Sharukh Malik (Analyst)

Data sources

Fund performance: *Financial Express, total return*

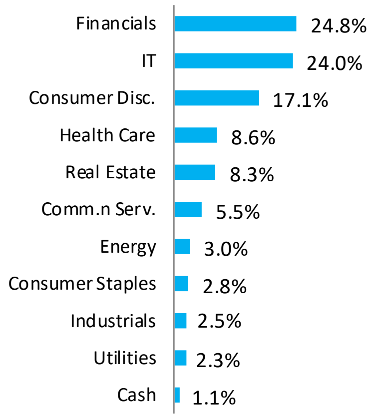
Index and stock data: *Bloomberg*

PORTFOLIO **30/06/2020**

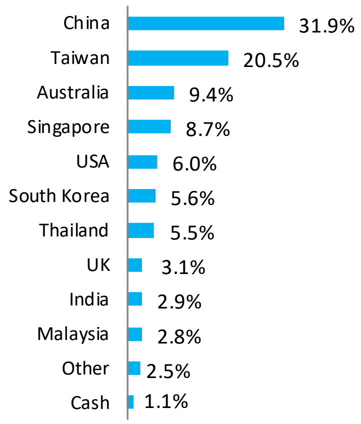
Fund top 10 holdings

JB Hi-fi	3.5%
Sonic Healthcare	3.4%
Elite Material	3.2%
Qualcomm	3.2%
Hon Hai Precision Industry	3.2%
Novatek Microelectronics	3.2%
Janus Henderson	3.1%
Netease.com	3.1%
PTT PCL	3.0%
Taiwan Semiconductor	3.0%
% of Fund in top 10	32.0%
Total number of stocks in Fund	35

Sector analysis



Geographic allocation



PERFORMANCE

30/06/2020

Discrete years % total return (GBP)	Jun '20	Jun '19	Jun '18	Jun '17	Jun '16
Fund (Y class, 0.99% OCF)	-6.6	5.3	5.0	25.7	8.2
MSCI AC Pacific ex Japan Index	4.4	3.9	8.1	29.3	5.2
IA Asia Pacific ex Japan	2.6	4.3	7.5	28.8	5.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	From launch
Fund (Y class, 0.99% OCF)	4.2	-8.4	-6.6	3.3	79.7
MSCI AC Pacific ex Japan Index	8.4	1.8	4.4	17.3	78.3
IA Asia Pacific ex Japan	8.6	0.6	2.6	14.9	76.9

Annualised % total return from launch (GBP)

Risk analysis - Annualised, weekly, from launch on 19.12.2013, in GBP

30/06/2020	Index	Sector	Fund
Alpha	0	0.65	1.28
Beta	1	0.89	0.88
Information ratio	0	-0.07	0.03
Maximum drawdown	-26.36	-24.54	-24.84
R squared	1	0.95	0.86
Sharpe ratio	0.37	0.39	0.41
Tracking error	0	3.57	5.86
Volatility	15.43	14.15	14.74

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 (Y Class, 0.99% OCF). Fund launch date: 19.12.2013. Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly.

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 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.

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 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.**

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

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Telephone calls will be recorded and monitored.