Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – August 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)

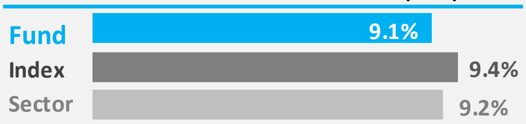
31/07/2020

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	-9.5	-11.1	77.4
Index	3.2	2.8	80.7
Sector	1.6	0.5	78.7

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	0.7	0.9
Beta	1	0.9	0.9
Info ratio	0	0.0	0.0
Max drwdn	-26.4	-24.5	-24.8
Tracking err	0	3.6	5.9
Volatility	15.4	14.1	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.

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Fund & Market

- In July, the Fund fell 1.2% in GBP as measured by the Y share class, compared to the market's rise of 1.8% as measured by MSCI AC Pacific ex Japan Net Total return Index.

- Since then the story is much more upbeat. Markets and stock prices are moving our way: second quarter company results have generally been ahead of expectations and market focus has shifted away from 'China/growth' towards the quality value names we hold.

- In July, Taiwan, India, China and Malaysia were the leading markets. Sector performance was dominated by Technology (all driven by semiconductors), followed by Consumer Discretionary, Materials and Staples.

- Leading contributions to performance over the month came from Taiwan Semiconductor, Novatek Microelectronics, Tech Mahindra, Zhejiang Supor, Inner Mongolia Yili, Nien Made Enterprise and Ascendas REIT.

- Detractors from relative performance came from St Shine Optical, BOC Hong Kong, Tisco Financial, Corporate Travel, Largan Precision, Link REIT, China Construction Bank and Hon Hai Precision.

Events in July

- COVID cases increased again in Asia, especially China, Hong Kong, Japan, Philippines, India and Australia. Local authorities have moved quickly to try to contain the outbreaks.

- The 'Oxford' vaccine reported promising results from early human trials.

- The US revoked Hong Kong's special status; the Chinese consulate in Houston was ordered to close, a move against which Beijing retaliated by ordering the closure of the US consulate in Chengdu.

- An EU stimulus programme of €750 billion was agreed.

- Singapore held a general election which was won by the People's Action Party, again.

- Apple signalled a few weeks' delay for the launch of the new iPhones.

- China reported exceptional flooding with 443 rivers nationwide flooded and 33 of them rising to the highest levels recorded. Extensive damage to property and agricultural output has been reported.

- In Thailand, four cabinet ministers have resigned as protests against the military-led government have increased. These protests have now extended beyond the government to the King himself.

Market and Stocks review

In July, growth stocks outperformed value, as they have for much of the year. The Fund fell 1.2% in GBP terms, as measured by the Y share class. Since the month-end however, value stocks have been outperforming and this has been reflected in Fund performance in August.

The Technology sector was by far the best-performing area in July and this was led by Taiwanese semiconductor businesses, as opposed to the smartphone component manufacturers. Our two semiconductors names, TSMC and Novatek Microelectronics, were the Fund's two best performers. TSMC received a major boost when Intel announced a further delay to its next-generation chip manufacturing. This leaves TSMC as the undisputed leader in chip foundry and therefore the key beneficiary of outsourcing. Semiconductor stocks were also lifted by good results from Qualcomm which suggested an improving outlook for 5G smartphones.

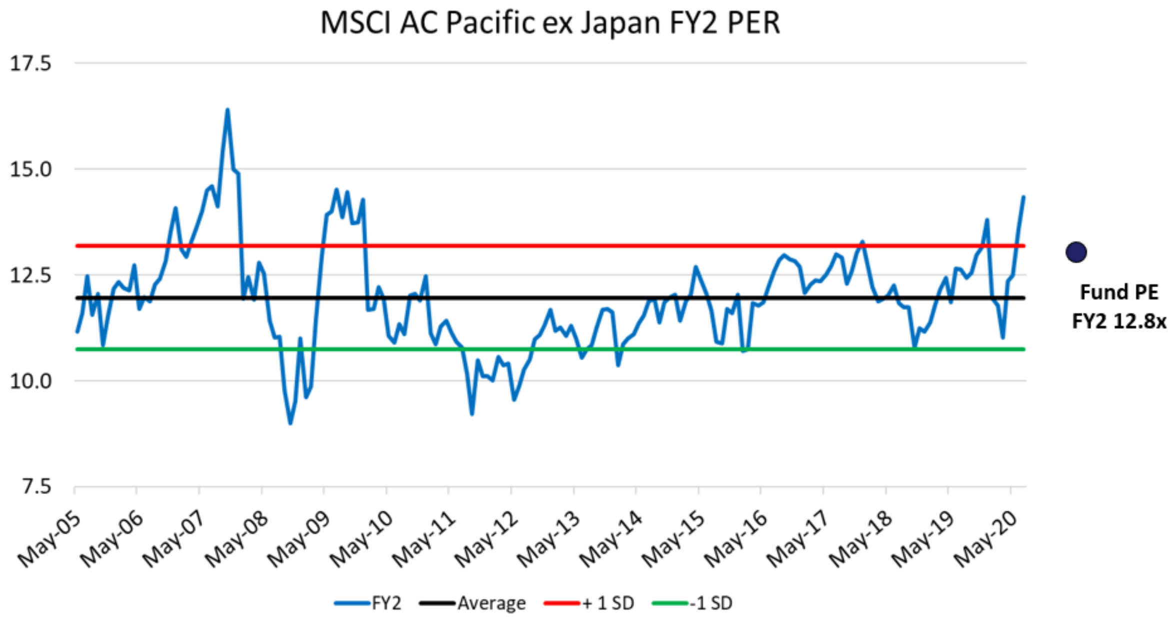
Markets

Relations between the US and China are increasingly being defined by the US electoral cycle, in our opinion. Allegations of espionage and the closure of the Chinese consulate in Houston was a significant escalation. Most recently we have seen sanctions imposed on individuals associated with the imposition of the national security law in Hong Kong and proposals to ban WeChat and TikTok. But it is notable that while the language and posturing have been fiery, the US side has made sure they have stayed away from anyone closely associated with Xi Jinping. China has retaliated but again, they have been vague in the details of their response and stayed away from President Trump's inner circle. Even when we look at the technology ban on Huawei, it is notable that the US Treasury has granted certain American businesses exemptions from technology exchanges to ensure they are not left behind in the development of 5G telephony standards.

However, there are material changes underway. We can see that China is turning inward in a quest to develop self-sufficiency and new national champions. Local suppliers are being preferred over foreign suppliers and China's economy leads the way in economic recovery. Industrial activity and state spending are rising while the focus remains on long-term strategic leadership in areas such as electric vehicles, 5G telephony, industrial automation and alternative energy. It is also leading the way in the development of a digital currency, presently being examined by upwards of forty central banks, by being the first to launch a pilot scheme. These themes along with diversification of supply chains will increasingly shape our portfolio composition.

According to consensus estimates, earnings for the markets (as measured by the MSCI AC Pacific ex Japan Index) are expected to contract 5% in 2020 and grow by 22% in 2021. The Fund, by comparison, is expected to see earnings contract 7% in 2020 and to grow 12% in 2021, based on consensus estimates. In our view, the Fund's earnings profile looks both reasonable and attainable; a view which has become stronger over the course of the most recent results season. The portfolio's Price/Earnings (P/E) discount of 23% and 15% to the market's valuation over the next couple of years looks substantial in this context. When we consider the estimates for market earnings and valuations we need to bear in mind the top-heavy nature of the benchmark, which is dominated by names like Alibaba and Tencent (as well as other Chinese internet and e-commerce names) that are forecast to grow 27% per annum in 2020 and 2021. We also need to remember the forecast contributions from more cyclical areas such as Materials and Energy as well as from certain areas incorporated in the Consumer Discretionary and Industrials sectors which, in our view, still look quite uncertain. Encouraging interim results reported by our portfolio companies, some of which are discussed below, give us greater confidence in the outlook.

The chart below shows the valuation of the region as measured by the Price/Earnings ratio (PER) for next year's earnings (FY2) based on consensus estimates of earnings for the following year. The graph shows how the PER has changed over the last 15 years and also shows the long-run average plus or minus one standard deviation (1SD). *(The standard deviation "SD" expresses the degree to which data points diverge from the long run average. 1SD shows the deviation that captures 68% of normally distributed occurrences, meaning that the remaining 32% of all occurrences have diverged from the average by a greater amount.)*



We have seen stock markets around the world rally strongly on the back of government support measures and low interest rates. We have also seen the rallies driven by a comparatively narrow group of stocks. The PER is quite a volatile number since it incorporates earnings for a single year which, in this extraordinary environment, are moving around significantly. We have chosen to look at the PER for next year rather than estimates for this year to reduce that effect. However, we maintain that longer-term measures of value are much better suited to stock market investing.

Our focus is on the quantity of cash flow that our companies are capable of producing over time, based on existing assets and future growth in assets with sustainable rates of reinvestment of earnings, while also maintaining dividends. We then look to apply a suitable discount rate to those longer-term cash flows to arrive at a present value (i.e. work out what those current and future expected cash flows are worth to us today) to help us form a view whether those stocks offer value.

We consider market aggregate valuations in a similar manner. On that basis we believe the mainland China A-share markets to be expensive overall but that there are areas (outside of technology and healthcare) which still offer value. Outside domestic China, high valuations (in other words, areas where investors are being asked to pay up for growth) appear evident in the Communication Services and Consumer Discretionary sectors. This is where many of the internet service and e-commerce names are to be found. We believe it is possible to navigate around some of these inflated areas and still find growth, albeit more moderate, at substantially lower valuations.

Stocks

Encouragingly, there has been a steady stream of positive news for the Fund surrounding the interim results reason. **TSMC** reported strong results, announced its intention to increase capital expenditure and benefitted from stronger read-through from US tech names. Qualcomm's stronger results were accompanied by the resolution of two legal overhangs: one being the dispute over royalties from Huawei and the second being the favourable resolution of an anti-trust suit in the US. As one of the prime beneficiaries of 5G telephony, these resolutions plus the improving 5G outlook provide Qualcomm with a decent tailwind.

Novatek Microelectronics reported another record set of results in the second quarter and provided strong guidance for the third quarter. The company is a chip designer, rather than a maker, and while it has a substantial and growing presence in smartphones, it is the non-smartphone area that is really driving growth. Its System-on Chip (SoC) designs are increasingly being used in TVs, notebooks and tablets as well as in smartphones. The upgrading of display manufacturing by Chinese producers could benefit the company further.

Tech Mahindra is a stock we have mentioned a few times this year as the disconnect between operational prospects and share price performance widened. In July the gap has narrowed (favourably!). The company reported first quarter (April-June) results reporting 5% revenue growth and new order wins worth $300 million. The share price is now about 50% above its March lows and the market appears now to be focusing on the conversion of new contract wins into revenue generation.

The **Link REIT** in Hong Kong reported results that were in line with expectations. Clearly, tenants in its retail properties are under pressure; the company is providing support for them, but it is also becoming increasingly diversified. Property development forms a material part of the business and it is broadening its reach. The company recently announced a $500 million property purchase in London's Docklands area (25 Cabot Street, Canary Wharf) and it is also expanding in business scope to include residential rental properties alongside the existing office and retail portfolio.

Largan Precision reported an 11% drop in sales for the second quarter which caused the stock to wobble. However, order visibility for the stock is always quite limited. Sales for July showed sequential (month-on-month) growth and momentum appears to have continued into August. This, accompanied by better high-end smartphone sales numbers, has pushed the stock back up. We have also received the annual dividend which was 16% higher than last year.

Elite Material reported second-quarter net profit growth of 28% compared to the same period last year. Growth was driven by the perfect combination of revenue growth and margin expansion. As in the case of Novatek, even though the smartphone business is a major driver, non-smartphone related business also made an important contribution. This segment includes Copper Clad Laminates (CCL), which is the base material for printed circuit boards suitable for high-end computer infrastructure. For example, Intel's new server configuration Ice Lake, built on the Whitley platform, was cited by Elite's management as a source of growth in the infrastructure segment. The company also reported 90%-95% capacity utilisation currently and further capacity expansion to come online later this year to bring total output up from 3.25m units to 3.55m.

Outlook

The recent results season has provided us with a view on how companies in Asia have fared during the pandemic and we think we have a better view of what the rest of the year holds. The Chinese economy has returned to growth driven primarily by investment spending related to property and infrastructure. Exports have also been better than expected, and we can see this not only from China's own figures but also from container shipping rates over the last few months and the positive guidance most recently from Maersk. China retail is still a mixed picture, with online recording markedly better growth than offline. Car sales to end-users have yet to pick up.

In Taiwan and Korea, the technology sector has been making the running while domestic activity remains subdued. This looks likely to remain the case in coming months. Demand for semiconductors driven by computer infrastructure, notebook PCs and smartphones, continues to grow. Smartphone volumes are looking encouraging, although lower than forecasts made a year ago. The launch of the new Apple iPhones is to be delayed for a few weeks, but this has not had a meaningful impact on the supply chain. In South-East Asia the worst of the pandemic seems past, but the path to recovery is slower. Thailand is facing the additional problem of protests against the military-dominated government.

International relations, specifically between China and the US, remain an ongoing issue. China is now noticeably turning inward in terms of developing self-sufficiency in supply chains, preferring local producers and building national champions. As pressures mount in the technology space, there is further emphasis on core industries such as electric vehicles, alternative energy and industrial automation. There is also a focus on maintaining domestic economic momentum while, interestingly, still keeping a hawkish eye on debt management. In recent days the central bank has called on banks to tighten up on bad debt recognition and debt write-offs.

Dividends from a number of companies (CapitaLand Mall Trust, Ascendas REIT, China Lilang, Corporate Travel, DBS, St Shine Optical) are likely to drop this year but others such as JB HiFi, Sonic Healthcare, China Mobile, Aflac, Qualcomm, China Medical Systems, Public Bank have all reported increases in their latest results. We are very encouraged by the recent results season and by the tone of managements' discussions.

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Data sources

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

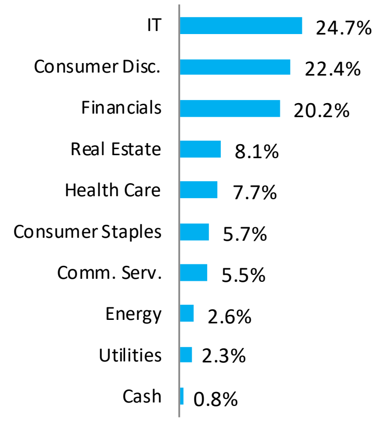
PORTFOLIO

31/07/2020

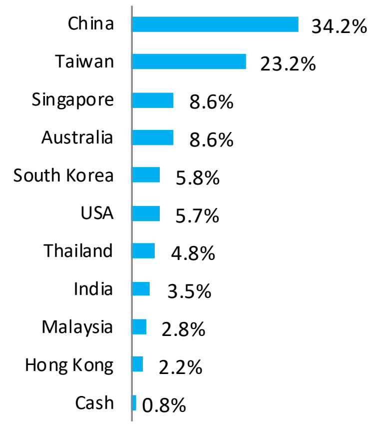
Fund top 10 holdings

Novatek Microelectronics	3.6%
Tech Mahindra	3.5%
Taiwan Semiconductor	3.5%
Elite Material	3.5%
Zhejiang Supor	3.4%
Netease.com	3.2%
Ascendas Real Estate Trust	3.2%
JB Hi-fi	3.1%
Qualcomm	3.0%
Hanon Systems	3.0%
% of Fund in top 10	32.8%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

31/07/2020

Discrete years % total return (GBP)	Jul '20	Jul '19	Jul '18	Jul '17	Jul '16
Fund (Y class, 0.99% OCF)	-11.1	4.7	7.4	21.2	19.6
MSCI AC Pacific ex Japan Index	2.8	5.7	5.9	25.8	17.5
IA Asia Pacific ex Japan	0.5	6.8	5.1	23.3	17.9

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	From launch
Fund (Y class, 0.99% OCF)	-1.2	-9.5	-11.1	0.0	77.4
MSCI AC Pacific ex Japan Index	1.4	3.2	2.8	15.0	80.7
IA Asia Pacific ex Japan	1.1	1.6	0.5	12.8	78.7

Annualised % total return from launch (GBP)

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

31/07/2020	Index	Sector	Fund
Alpha	0	0.73	0.90
Beta	1	0.89	0.88
Information ratio	0	-0.04	-0.03
Maximum drawdown	-26.36	-24.54	-24.84
R squared	1	0.95	0.85
Sharpe ratio	0.38	0.40	0.38
Tracking error	0	3.56	5.91
Volatility	15.38	14.10	14.70

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

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.