Guinness Best of China Fund

INVESTMENT COMMENTARY – August 2020

Launch date	**15.12.15**
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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.

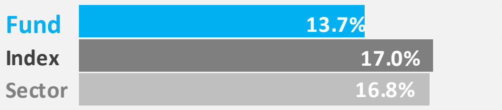
Performance (in GBP) 31.07.2020

Fund	Best of China Fund (Z Cls, 0.74% OCF)
Index	MSCI Golden Dragon
Sector	IA China/Greater China

	2019	2018	2017
Fund	26.0	-20.3	38.2
Index	19.0	-9.5	31.3
Sector	22.2	-14.2	35.9

	1 year	3 years	From launch
Fund	10.1	14.8	81.3
Index	12.6	27.6	106.7
Sector	17.9	34.6	105.1

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.2	-2.8
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.1	-0.5
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.9	18.1	19.1
Sharpe ratio	0.7	0.7	0.5

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.

Source: Financial Express, bid to bid, total return 0.74% OCF. Returns for share classes with a different OCF will vary accordingly

Fund & Market

- In July, the Best of China Fund rose 10.7% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index rose 9.6%.
- MSCI China rose 9.4%, MSCI Hong Kong fell 0.7% and MSCI Taiwan rose 16.3%. The Shenzhen Component Index rose 15.4% while the Shanghai Stock Exchange Composite Index rose 13.4%.
- Chinese markets were the strongest versus other major markets. The S&P 500 rose 5.6%, MSCI Europe rose 3.8% and MSCI Japan fell 1.6%.
- In MSCI China, the strongest sectors were Materials (total return +22.0%), Consumer Staples (+15.8%) and Consumer Discretionary (+14.4%) while the weakest were Energy (+0.7%), Financials (+3.8%) and Real Estate (+5.2%).
- In MSCI Hong Kong, the Real Estate and Financials indexes rose 0.5% and fell 6.0% respectively.
- In Taiwan, the Information Technology Index, which makes up more than half of the Taiwanese index, rose 24.8%.
- In the Fund, positive contribution came from Industrials companies China Lesso and Haitian International, Materials companies Oriental Yuhong and Anhui Conch Cement, Consumer Discretionary firms Geely, Supor and Haier Electronics, and the wealth manager Noah Holdings.

- In the second quarter, the Best of China Fund rose 13.7% while the MSCI Golden Dragon Net Total Return Index rose 15.7%.

- MSCI China rose 15.3%, MSCI Hong Kong rose 9.2% and MSCI Taiwan rose 21.4%. The Shenzhen Component Index rose 21.6% while the Shanghai Stock Exchange Composite Index rose 10.0%.

- In MSCI China, the strongest sectors were Health Care (total return of +37.0%), Information Technology (+32.0%) and Communication Services (+24.2%) while the weakest were Energy (-0.5%), Financials (+0.3%) and Utilities (+1.1%).

- In MSCI Hong Kong, the Real Estate and Financials indexes rose 4.4% and 12.4% respectively.

- In Taiwan, the Information Technology Index, which makes up more than half of the Taiwanese index, rose 23.1%.

- In the Fund, the underweight positions in Tencent, Alibaba and TSMC contributed to 1.7%, 1.0% and 0.3% of underperformance respectively. The Fund's zero allocation to Meituan Dianping and Hong Kong Exchanges & Clearing contributed to a further 0.6% and 0.5% of underperformance. Weakness from Luk Fook led to an additional 0.3% of underperformance.

- Most of the Fund's year-to-date underperformance can be attributed to its holdings in the Information Technology and Consumer Discretionary sectors. In the Information Technology sector, approximately 2.0% of the Fund's 7.8% underperformance is attributable to Tongda Group and 1.6% from AAC Technologies, both of which have since been sold. In the Consumer Discretionary sector, 1.2% of the Fund's 7.8% underperformance is attributable to Luk Fook (which has been sold), 1.0% from China Lilang and 0.7% from Li & Fung (which has also been sold). An additional 1.8% of underperformance is attributable to the Fund's underweight in Tencent.

- On the other hand, we saw good performance from Elite Material (contributed to 0.7% of outperformance), Sino Biopharmaceutical (0.9%) and Netease (0.8%).

Events in July

- Second-quarter GDP grew 3.2%, a marked improvement from the 6.8% fall in the first quarter.

- Industrial production grew 4.8% year-on-year (yoy) in July which was in line with June's growth. Fixed asset investment (FAI) year-to-date remains 1.6% lower but it is clear spending has increased in the past few months as FAI grew 6.1% yoy in July and 4.1% in June.

- On the other hand, retail sales continue to lag, falling 1.1% yoy in July and 1.8% in June.

- CPI was 2.7% in July while producer price inflation (PPI) fell 2.4%. Food inflation was 13.2% and this was likely affected by flooding in Southern China e.g. fresh vegetable prices increased 7.9% in July. Non-food inflation was 0.0% in July as fuel costs remain depressed.

- Total social financing (TSF), a broad measure of credit, rose 12.3% month-on-month/12.9% year-on-year. Policymakers remain focused on providing credit to the economy but are trying to make sure bubbles do not form. The aim is to channel credit to small and medium enterprises.

Portfolio News

Intel announced delays in its plans to develop 7nm nodes, leaving **TSMC** and Samsung as the only realistic suppliers at this level of production. (The 7nm node refers to the process whereby the image of a Central Processing Unit chip is etched onto a piece of silicon. The ability to do so at smaller nodes allows for an increased number of transistors which individually use less power, generate less heat and so enable more calculations.) We think this is further evidence of TSMC's competitive advantage, as billions of dollars in research are needed along with manufacturing know-how to remain at the cutting edge. In order to remain competitive, Intel will need to use 7nm nodes for its products, so there is a good chance that Intel could turn to TSMC for this if it cannot resolve its own problems.

China Lilang, a bricks-and-mortar retailer of casual menswear, has had weak share price performance. In its trading update it revealed retail sales in the first half of the year fell 30-35% year-on-year. However, the decline narrowed from a 40-45% decline in the first quarter to a 15-20% decline in the second quarter. We continue to hold the stock in the anticipation of greater footfall in Chinese shopping malls. The company has also increased its online presence, is actively managing its physical distribution network, and is keeping a cap on inventory. The company has said it expects to see growth resume in the second half of this year. We feel Lilang's share price implies a zero per cent return on capital which is very unlikely, in our opinion.

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 manufacturer and while it has a substantial and growing presence in smartphones, the non-smartphone area is really driving growth. Its System-on Chip (SoC) designs are increasingly being used in TVs, notebooks, tablets as well as smartphones and the upgrading of display manufacturing by Chinese producers could benefit the company further.

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, the non-smartphone related business also made an important contribution. For example, Intel's new server configuration Ice Lake, which is 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 is to come online later this year.

Portfolio Switches

The changes we have made to the Fund this year are summarised below.

Sells		Buys	
Name	**Sector**	**Name**	**Sector**
Travelsky	Information Technology	Zhejiang Supor	Consumer Discretionary
Li & Fung	Consumer Discretionary	JD.com	Consumer Discretionary
Tongda Group	Information Technology	Oriental Yuhong	Materials
AAC Technologies	Information Technology	Yili	Consumer Staples
Luk Fook	Consumer Discretionary	Suofeiya	Consumer Discretionary
St Shine	Health Care	Venustech	Information Technology
Qualcomm	Information Technology	CSPC Pharmaceutical	Healthcare
Yangzijiang	Industrials		
BOC HK	Financials		
China Construction Bank	Financials		

Sells

TravelSky supplies data for China's aviation industry. Its services include real-time flight reservation information and ticket prices, inventory control and airport passenger processing. The number of people travelling in China had fallen significantly as a result of COVID-19 and we felt the fall in the share price did not reflect this, and so sold the position. So far this has proven to be a good decision as the share has significantly lagged the benchmark.

Li & Fung has struggled in a world where its role as a sourcing agent, connecting retailers with suppliers, is becoming less relevant. We gave the business time to show signs of a turnaround but this looked unlikely and so we sold the position. Similarly, we had given time to **Tongda** to show whether its shift to 'glastic' casings could generate the same level of profitability as the traditional metal casings. This was not the case in its update in February as Tongda additionally began to face pricing pressure in its waterproof components business.

We sold **AAC Technologies** after it announced a negative profit warning and significantly, in our opinion, omitted its final dividend. We also sold **St Shine** as its returns on capital have fallen over time and the prospects for growth over the next few years seem weak. **Luk Fook** was sold as the situation in Hong Kong, which is a large contributor to profit, continues to deteriorate after the national security law was passed.

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.

Qualcomm was sold as its share price recovered from its recent declines. While the company is likely to benefit from the rollout of 5G, we think there are several threats on the horizon that the market is not paying attention to. China's determination to achieve self-sufficiency could lead to import substitution, negatively affecting Qualcomm. Greater tensions with the US may mean the Chinese government retaliates against American companies like Qualcomm and we felt this risk was too high.

Yangzijiang's return on capital has been poor for some time, and in the current climate, we think it is unlikely many new orders will be coming in. In the present low interest rate environment, we think **BOC HK** is likely to find it difficult to grow earnings. Growth headwinds for the big banks in China also led to the sale of **China Construction Bank**.

Buys

We bought **Zhejiang Supor**, a manufacturer of small kitchen appliances. It marked our first purchase of a domestic A-share. Supor has strong brand loyalty and benefits from cooperation with its French parent company, Groupe SEB; for example, Supor can use its parent's Tefal brand in its products. Supor has leading market share in woks, frying pans, pots and steamers. It ranks second in the market for small domestic appliances such as electric rice cookers, slow cookers, garment steamers and dust cleaners. It is one of the few A-share companies to clearly list the criteria used to determine management's compensation, and we feel we can trust management to grow the company in the future.

JD.com is one of China's largest e-commerce companies. JD is different to Alibaba in that it has built its own logistics platform, so it has more control over the quality of its service and the amount of inventory it holds. This means that during the worst of the lockdown, JD was better stocked than its peers and its delivery services were less interrupted. JD was initially known for selling electronics but has branched out into apparel and more recently groceries, so it has seen very strong demand this year. In the first quarter, JD's revenue grew 20%, while overall online retail consumption fell 1% according to the National Bureau of Statistics of China, highlighting its strong position. The purchase of JD.com gives the Fund more exposure to e-commerce, which is likely to see even more adoption this year as coronavirus changes consumer habits.

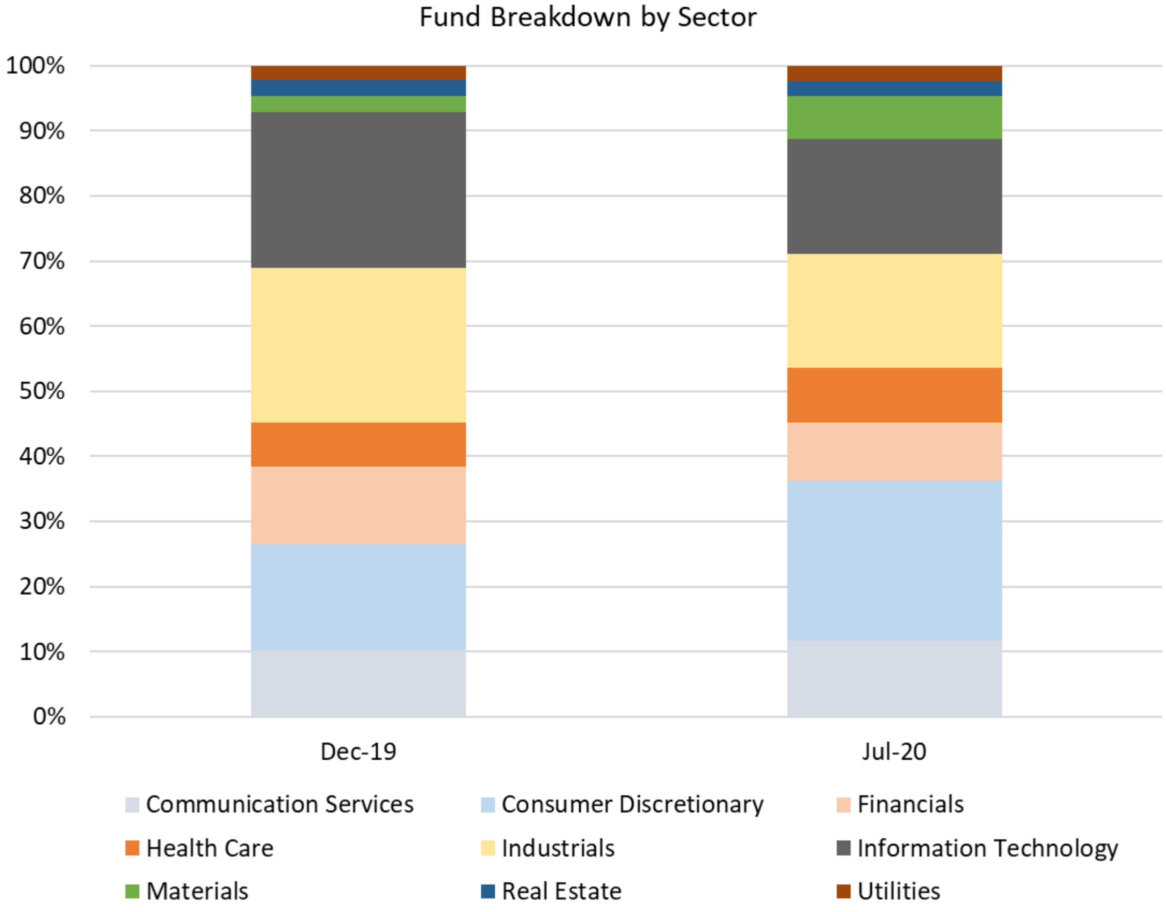
Beijing Oriental Yuhong (Yuhong) is China's largest manufacturer of waterproofing materials. Its products are used for various types of construction and we believe that Yuhong is likely to benefit from China's infrastructure stimulus. Yuhong's focus on quality and its large scale has meant it is by far the most preferred brand by developers.

In June, we significantly increased the Fund's exposure to the A-share market by buying three positions. **Yili** is China's largest dairy company and should benefit as dairy consumption rises with economic growth. Yili also is the largest domestic infant formula provider. **Suofeiya** is a designer and manufacturer of furniture and kitchen cabinets. It is one of the more well-known brands in the industry and is expanding through partnerships with developers to take advantage of the rising trend of furnished apartments in China. Suofeiya has generated a high return on capital for many years and we feel the share price is undervaluing this persistence in the business. **Venustech** is one of China's largest software security providers. Its main customers are various government departments, telecoms companies and financial institutions. Recently cybersecurity standards were strengthened and firms in critical sectors will need to conduct more stringent cybersecurity tests, which should expand the addressable market for Venustech.

CSPC Pharmaceutical is in the process of shifting its business away from generics towards more innovative drugs. It has a well diversified portfolio and has several new drugs in the pipeline. CSPC has rapidly increased its spending on research and development (R&D) and in 2019 spent 9% of its revenue on R&D. This is close to what Sino Biopharmaceutical, an existing holding in the Fund, spends. CSPC plans on increasing its R&D spend to 10-15% revenue in the coming years which should further push the business away from low-margin generics.

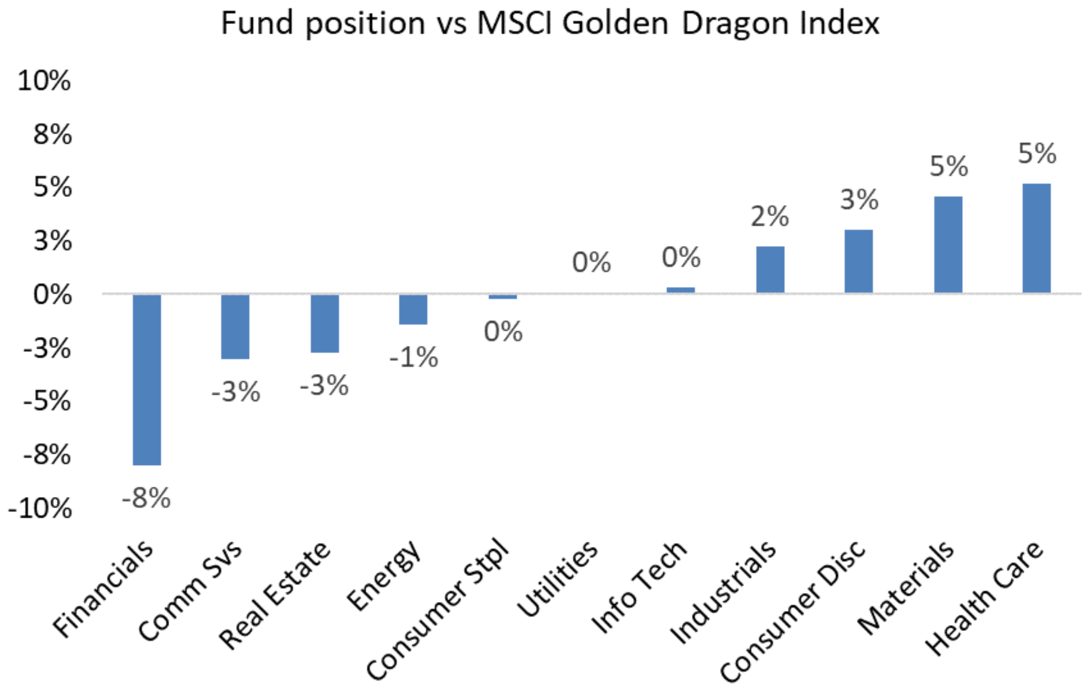
Portfolio Positioning

As a result of the changes made this year, the Fund's allocations to Information Technology and Financials have fallen by 9.3% and 4.3% respectively. The allocations to Consumer Discretionary and Materials have risen by 7.2% and 4.2% respectively.



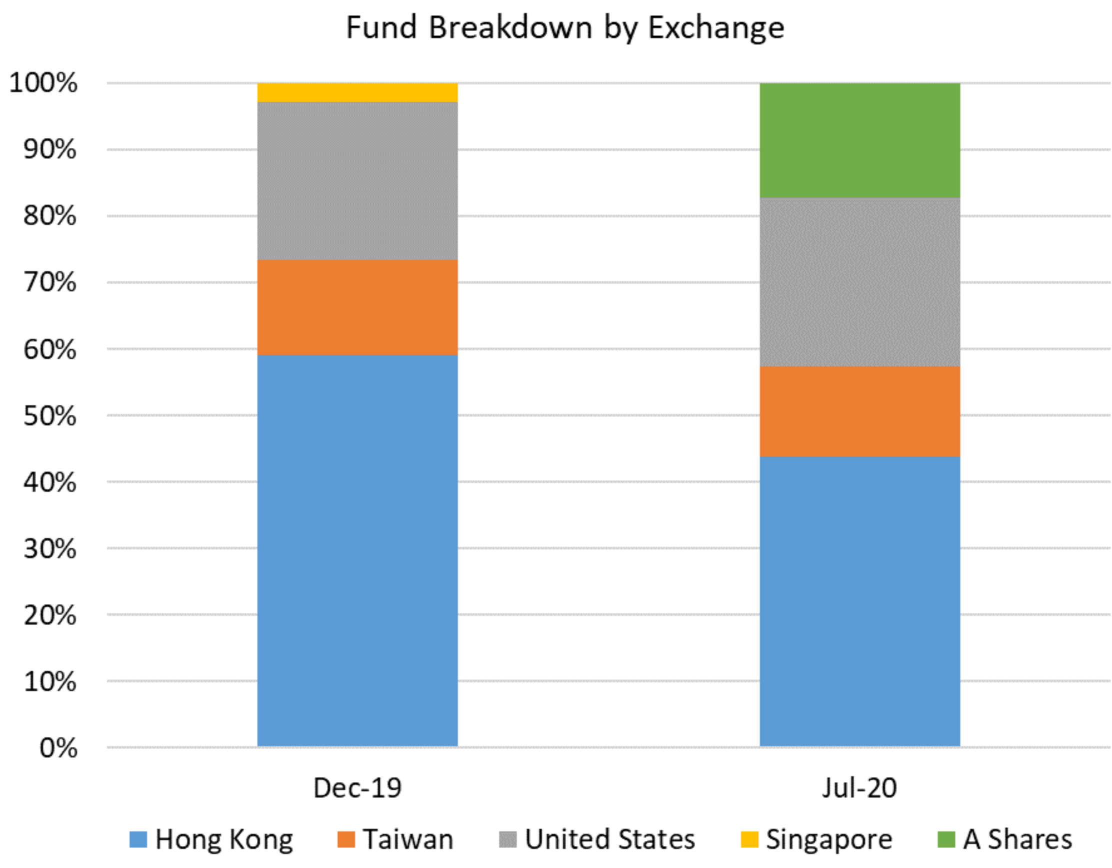
Source: Bloomberg, Guinness AM, Data as of 31 July, 2020

The Fund is most overweight in Health Care, Materials and Consumer Discretionary. The Fund is most underweight in Financials, Communication Services and Real Estate.



Source: Bloomberg, Guinness AM, Data as of 31 July, 2020

The Fund has increased its allocation to the domestic A-share market by 17.3% this year, while the allocation to Hong Kong has fallen by 15.0%.



Source: Bloomberg, Guinness AM, Data as of 31 July, 2020

Summary view & outlook

The focus this year has been selling companies where either the competitive advantage has been lost or the prospect of earnings growth is unlikely. The replacements, we feel, all have a definable competitive advantage, have managed to grow their earnings in the past (pre-COVID) and are likely to do so in the current environment. The Fund has significantly increased its allocation to the A-share market which we expect should give it exposure to any rallies in mainland China. We believe the Fund is now better placed to capture the growth opportunities present in China. The upcoming results season should reveal how our companies have coped now that life in China has some resemblance of normality.

At a macro level, we think there are reasons beyond the cyclical to believe that China's domestic recovery will continue for the next 12 months. Next year is the centenary of the founding of the Chinese Communist Party. 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 are 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. Infrastructure stimulus is likely to promote another area of growth and here we have several interesting ideas on our watchlist in the A-share market.

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*

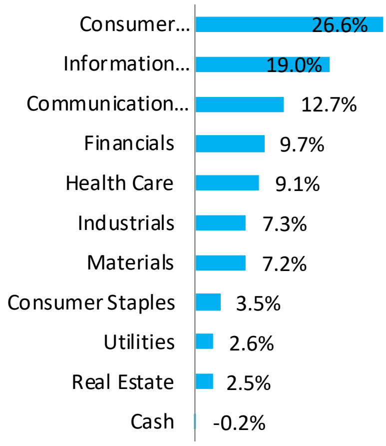
PORTFOLIO

31/07/2020

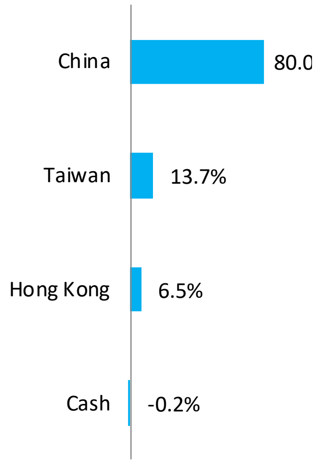
Fund top 10 holdings

Beijing Oriental Yuhong	4.1%
Geely Automobile Holding	4.0%
China Lesso Group	3.9%
Taiwan Semiconductor	3.8%
Zhejiang Supor	3.8%
Elite Material	3.5%
Inner Mongolia Yili Indus	3.5%
Novatek Microelectronics	3.4%
Haier Electronics	3.4%
Alibaba Group	3.4%
% of Fund in top 10	36.8%
Total number of stocks	31

Sector analysis



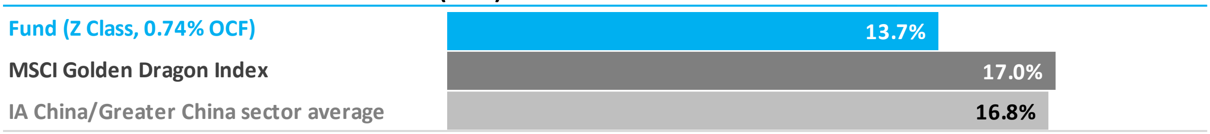
Geographic allocation



PERFORMANCE

31/07/2020

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Jul '20	Jul '19	Jul '18	Jul '17	Jul '16
Fund (Z Class, 0.74% OCF)	10.1	-2.6	7.1	22.7	-
MSCI Golden Dragon Index	12.6	4.8	8.1	33.2	11.0
IA China/Greater China sector average	17.9	4.1	9.7	32.8	8.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	4.3	3.4	10.1	14.8	-	81.3
MSCI Golden Dragon Index	3.1	10.9	12.6	27.6	88.6	106.7
IA China/Greater China sector average	3.1	16.4	17.9	34.6	93.5	105.1

RISK ANALYSIS

31/07/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.15	-2.84
Beta	1.00	0.98	1.01
Information ratio	0.00	-0.12	-0.46
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.89
Sharpe ratio	0.73	0.69	0.51
Tracking error	0.00	4.57	6.27
Volatility	17.85	18.08	19.13

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, 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.