# Guinness Emerging Markets Equity Income Fund

## INVESTMENT COMMENTARY – August 2020

| | |
|---|---|
| **Launch date** | **23.12.2016** |
| **Team** | **Edmund Harriss** (manager)<br>**Mark Hammonds** (manager)<br>**Sharukh Malik** (analyst) |

### 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

31/07/2020

| | |
|---|---|
| **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** | -9.3 | - 10.1 | 3.5 | 19.1 |
| **Index** | -0.8 | - 0.6 | 9.3 | 30.9 |
| **Sector** | -3.5 | - 4.0 | 4.6 | 25.3 |

**Annualised % total return from launch**


**Risk analysis** (annualised, weekly, from launch)

| | Index | Sector | Fund |
|---|---|---|---|
| **Alpha** | 0.0 | -0.7 | -1.3 |
| **Beta** | 1.0 | 0.9 | 0.9 |
| **Info ratio** | 0.0 | -0.3 | -0.3 |
| **Max drwdn** | -22.6 | -25.1 | -23.1 |
| **Tracking err** | 0.0 | 3.8 | 6.2 |
| **Volatility** | 15.0 | 14.3 | 14.6 |
| **Sharpe ratio** | 0.3 | 0.2 | 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 recovered in July. For the month, the MSCI Emerging Markets Net Total Return Index rose 2.6% (all performance figures in GBP unless stated otherwise).
- The fund underperformed, declining 1.6% for the month.
- Latin America was the best-performing region, rising 4.8%. Asia was next, up 3.6%. The worst-performing region was EMEA (Europe, Middle East and Africa), which fell 2.5%.
- Of the largest countries in the benchmark, the best-performing in the month were Taiwan (+9.9%), Brazil (+8.0%), and India (+4.3%).
- The worst-performing countries were Thailand (–8.2%), Saudi Arabia (–3.9%) and Russia (–3.0%).
- The strongest performers in the portfolio were TSMC (+29.3%), Novatek Microelectronics (+25.6%), and Tech Mahindra (+20.5%).
- The weakest performers were British American Tobacco (–17.2%), St Shine (–16.5%) and Tisco Financial (–12.7%).
- Emerging market currencies continued to rise, gaining 1.7%, against a weaker dollar, which fell 4.2% during the month.

## Events in July

- COVID cases increased again in Asia, especially China, Hong Kong, Japan, Philippines and India. Local authorities have moved quickly to try and 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 closed, to which Beijing retaliated by ordering the closure of the US consulate in Chengdu.
- An EU stimulus programme of €750 billion was agreed.
- 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.
- Reforms in Brazil continued, with the government presenting an outline of its tax reform plan to Congress.

This month we review a couple of recent changes to the portfolio before then discussing company results from our holdings.

## Portfolio changes

In July we made two changes to the portfolio, selling Qualcomm and Truworths and replacing them with Suofeiya Home and Zhejiang Supor, both domestically listed China A-shares.[1]

Suofeiya Home is a manufacturer of furniture and kitchen cabinets, with a focus on customised/made-to-measure products. The company is one the leading players in the sector, and its brands have a good reputation. This is important since the products are sold through franchise operators, and therefore the franchisee's 'buy-in' must be sought and maintained.

Suofeiya also operates very efficiently with short lead times, benefitting the customer from a service perspective and the company by negating excess levels of working capital. Margins are also attractive, with high levels of automation being employed in the company's factory to produce customised products to a high standard, and quickly. In turn, this capital investment acts as a barrier to entry (as competitors find it harder to achieve the same scale and operating efficiency, and harder to make the same capital investment).

Another attractive feature of the investment are high levels of insider ownership – two co-founders hold roughly 40% of the shares between them, helping to ensure incentives are aligned.

Zhejiang Supor is a maker of kitchen products including cookware and small appliances, such as rice cookers and soy milk makers. We like the company's robust cash flow generation profile and its competitive positioning in the market, and we believe it will continue to see strong demand for its products in future.

[1] We access the A-share market through Hong Kong via the Stock Connect programme.

The company is majority owned by French parent SEB, owner of the Tefal brand. As well as trade with the parent, Supor and SEB share intellectual property and both can benefit from each other's innovations.

## Performance review

**Hon Hai** reported results which were ahead of consensus, though down 9% for the month of June due to the coronavirus. The rollout of 5G is having a positive effect across the smartphone supply chain – we expect consumers will want to upgrade their handsets once network coverage is established. Apple is due to launch a 5G iPhone later this year and the Chinese handset manufactures are continuing to release more 5G-enabled models.

**TSMC** has also benefited from the 5G upgrade cycle, releasing a good set of results for the second quarter. The High Performance Computing (HPC) division was also a strong contributor. TSMC's strong competitive positioning was also further highlighted when Intel announced delays to its next-generation chip manufacturing.

**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 smartphones and 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.

**Tata Consultancy Services** reported results for the first quarter (March year-end) that were below expectations, although management maintained guidance for the full financial year. A strong order book has partly resulted from increased demand for cloud infrastructure and cyber security products (as working practices have been disrupted and adjusted in the pandemic). Across industries, retail was the most impacted during the quarter, with airline, travel and hospitality clients facing extremely stressed business conditions. The company also announced it is planning for 75% of its employees to work from home by 2025; it will be interesting to see whether this is achieved and whether it is replicated more widely by other companies.

**Bajaj Auto** reported first quarter results that beat expectations, helped by strong exports and favourable foreign exchange. The domestic market for motorcycles in India slowed as a result of the shutdowns, but a demand recovery is expected over the rest of the year, with a strong start to July reported.

**Coca-Cola Femsa** in Mexico is another company reporting signs of a recovery. Second quarter results were weak, though demand has grown in direct response to home markets. The company is also adapting with the introduction of a WhatsApp for Business system to support customer transactions (an 'automated chatbot-enabled order taking platform').

**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 smartphone business is a major driver, non-smartphone related business also made an important contribution. This latter segment consists of Copper Clad Laminates (CCL), 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.

**British American Tobacco** reported results for the first half of the year, maintaining guidance of 1-3% organic revenue growth and mid-single-digit EPS growth on a constant currency basis. In combustibles, volume declines of -6.3% were offset by price/mix gains of 8.5%. The division also made gains in market share. The New Categories segment (vaping and heat-not-burn products) grew by 12.7% on a constant currency basis.

## Outlook

Emerging markets continues to be a story of separate regions – split according to the impact of the coronavirus and the approach taken to tackling it. Asia has emerged relatively well after suffering the impact earliest – China in particular is seeing a good recovery. Latin America continues to struggle, with multiple countries still battling the health crisis and a slow economic recovery after the shutdowns.

Not all businesses are weaker amidst the pandemic, of course, and some are doing relatively well. Our Brazilian exposure, for example – an auto insurer and the stock exchange company – has been performing well. In the case of the auto insurer, the benefit of lockdowns is far fewer car thefts and robberies, resulting in lower claims. In the case of the stock exchange, record trading volumes partly driven by volatile markets has been a boost to business. NetEase, the Chinese online gaming company, has seen strong growth across its gaming franchise and further demand for its Cloud Music service as its customers seek online entertainment.

The valuation of the portfolio still looks attractive to us, with the fund trading in August at 14.1x 2020 earnings, a 21% discount to the benchmark. Though 2021 earnings are far less certain and likely to be subject to change, a discount to the benchmark of 8% exists there as well. The portfolio yields around 3.4% on a forecast basis, and the payout ratio is 58%. Over time, our portfolio companies have a strong track record of growing the dividend with *annual* growth rates over the past five years of 16.8% (though obviously this should not be blindly extrapolated into the future).

Results so far have been generally positive and encouraging given our expectations going into the half year reporting window. We continue to monitor company guidance to understand what the second half of the year will look like – whether there is a strong recovery in certain sectors as markets are beginning to expect.

It is important to remember that we are investing in individual companies (companies we think have favourable competitive positioning and that generate attractive economics). These companies and our portfolio are distinct from market indices (both in scope/spread and in the individual weights and stock concentrations). Market indices are also further distinct from underlying economies – this is one of the explanations for the diverging performance in the US between certain areas of the stock market driving overall indices to new all-time highs, despite the clearly very difficult broader economic situation. Specific indices, therefore, don't necessarily reflect the wider economy accurately.

Whatever the truth of this argument, it is somewhat academic given our focus on specific investments. Animal spirits bolstered by large scale financial stimulus may be pushing up markets, or investors may be correctly pricing in a strong recovery. Time will tell!

Meanwhile, we think that a portfolio of companies that have demonstrated impressive track records, that earn high returns on capital, and are available at reasonable valuations is an appropriate place to be positioned. We want to invest in companies that can cope with economic challenges, be they cyclical, caused by exogenous events or driven by longer-term structural shifts, and emerge strongly on the other side.

**Edmund Harriss**
**Mark Hammonds** (portfolio managers)
**Sharukh Malik** (analyst)

**Data sources**
Fund performance: *Financial Express, total return*
Index and stock data: *Bloomberg*

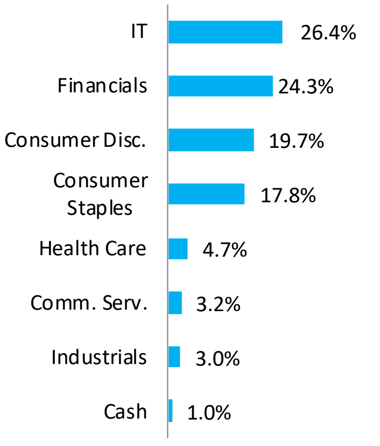
## PORTFOLIO

31/07/2020

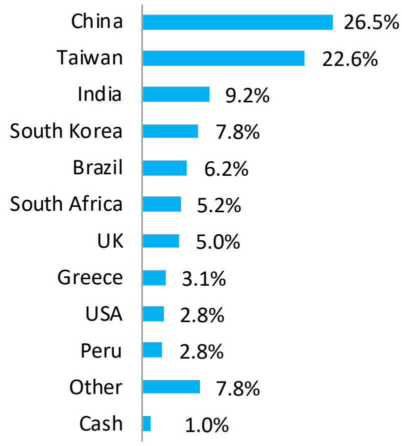
### Fund top 10 holdings

| | |
|---|---|
| Novatek Microelectronics | 3.7% |
| Taiwan Semiconductor | 3.5% |
| B3 SA - Brasil Bolsa Balca | 3.4% |
| Tech Mahindra | 3.2% |
| Elite Material | 3.2% |
| Netease.com | 3.2% |
| Zhejiang Supor | 3.1% |
| Jumbo | 3.1% |
| Bajaj Auto | 3.0% |
| Haitian International Hol | 3.0% |
| % of Fund in top 10 | 32.3% |
| Total number of stocks | 36 |

### Sector analysis




### Geographic allocation




## PERFORMANCE

31/07/2020

### Annualised % gross total return from launch (GBP)

| | |
|---|---|
| Fund (Z class, 0.35% OCF) | 5.6% |
| MSCI Emerging Markets Index | 7.2% |
| IA Global Emerging Markets sector average | 6.0% |

| Discrete years % gross total return (GBP) | Jul '20 | Jul '19 | Jul '18 | Jul '17 | Jul '16 |
|---|---|---|---|---|---|
| **Fund (Z class, 0.35% OCF)** | -10.1 | 4.6 | 10.0 | - | - |
| MSCI Emerging Markets Index | -0.3 | 5.2 | 5.3 | 26.2 | 17.1 |
| IA Global Emerging Markets sector average | -4.0 | 6.6 | 2.1 | 23.9 | 17.1 |

| Cumulative % gross total return (GBP) | 1 month | Year-to-date | 1 year | 3 years | 5 years | From launch |
|---|---|---|---|---|---|---|
| **Fund (Z class, 0.35% OCF)** | -1.6 | -9.3 | -10.1 | 3.5 | - | 19.1 |
| MSCI Emerging Markets Index | 2.6 | -0.8 | -0.6 | 9.3 | 5.2 | 30.9 |
| IA Global Emerging Markets sector average | 2.0 | -3.5 | -4.0 | 4.6 | 4.4 | 25.3 |

## RISK ANALYSIS

31/07/2020

| 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 | -0.34 |
| Information ratio | -22.63 | -25.14 | -23.11 |
| Maximum drawdown | 1.00 | 0.94 | 0.83 |
| R squared | 0.25 | 0.17 | 0.10 |
| Sharpe ratio | 0.00 | 3.79 | 6.22 |
| Tracking error | 14.28 | 14.28 | 14.62 |
| Volatility | 0.00 | -0.68 | -1.30 |

**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.

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 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

This is an advertising document. The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque  Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

## 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.