Guinness Best of China Fund

INVESTMENT COMMENTARY – September 2020

Launch date	**15.12.15**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (analyst) **Sharukh Malik** (analyst)

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.

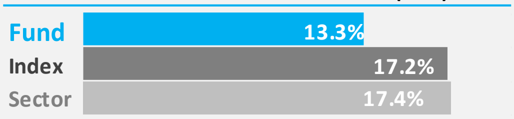
Performance (in GBP) 31.08.2020

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	12.3	7.3	79.9
Index	20.0	23.8	111.4
Sector	25.8	32.8	112.9

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.1	-3.5
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.1	-0.6
Max drwdn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.7	18.0	19.0
Sharpe ratio	0.8	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 August, the Best of China Fund rose 1.4% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index rose 4.3%.
- MSCI China rose 5.7%, MSCI Hong Kong rose 7.9% and MSCI Taiwan fell 1.8%. The Shenzhen Component Index rose 2.9% while the Shanghai Stock Exchange Composite Index rose 4.6%.
- After outperforming in July, Chinese markets were more measured in August. The S&P 500 rose 7.1%, MSCI Europe rose 4.1% and MSCI Japan rose 7.6%.
- In MSCI China, the strongest sectors were Consumer Discretionary (total return of +14.6%), Consumer Staples (+6.5%) and Information Technology (+5.2%) while the weakest were Utilities (-4.7%), Financials (-0.4%) and Real Estate (-0.3%).
- In MSCI Hong Kong, the Real Estate and Financials indices rose 6.1% and fell 9.7% respectively.
- In Taiwan, the Information Technology Index, which makes up more than half of the local index, fell 2.5%.
- Of the Fund's 2.9% underperformance, 1.3% can be attributed to the underweight position in Alibaba, 0.8% to not holding Meituan Dianping, 0.6% and 0.4% from IT holdings Novatek Microelectronics and Hollysys respectively. On the other hand, the Fund benefited from strong performance from JD, Suofeiya and Yili.

Events in August

- The US added 38 companies linked to Huawei to its Entity List, barring any companies using US hardware or software from dealing with them.

- The Hang Seng Index included Alibaba for the first time, along with Xiaomi and Wuxi Biologics. Meanwhile, companies listed on the mainland STAR Market, which hosts innovative "new economy" stocks will be included in the Shanghai Composite Index.

- The ChiNext board began to allow IPOs based on the registration-based system rather than the approval-based system. This should reduce waiting times to list from several months to weeks. After the first five days of trading, daily price changes have had their limit increased from 10% to 20%. This moves the ChiNext exchange in line with the STAR Board which was launched last year.

- The Caixin Purchasing Managers' Index (PMI) reached 53.1 in August, the highest since February 2011, showing strength in new orders and export orders. Industrial production rose 0.7% month-on-month in July, affected by heavy flooding in Southern China. Fixed asset investment rose by 8.3% year-on-year in July, driven by infrastructure and real estate.

- On the other hand, retail sales fell 1.1% year-on-year in July which was a negative surprise.

- In Hong Kong, daily new cases of COVID-19 peaked in late July at 149 and fell to 9 by the end of August. Consequently, some social distancing measures were relaxed.

Portfolio News

JD.com reported strong results. More than 90% of new users came from low tier cities, which are driving growth in e-commerce. Its supermarket business has now become the largest component of revenue and has the potential to grow given the low penetration of online grocery shopping. Management believe that the supermarket business can become larger than the original electronics and home appliances business, sales of which rebounded strongly after moderate growth in the first quarter. Management still aim to increase margins over time, and given the long room for growth we believe the company has, it is our view that the company is undervalued despite its strong share price performance.

Alibaba also reported good results, with all categories growing at least as fast as they did in Q4 of 2019. As was the case with JD.com, Alibaba benefited from a strong recovery in electronics sales as well as fast moving consumer goods (FMCG). The company is experimenting with sales through live streams in response to competition from Bytedance – yet another exciting way in which e-commerce in China differs from that seen in western countries. Alibaba's fintech affiliate, Ant Group, filed its prospectus and plans to list in Hong Kong and Shanghai. It revealed it earned $17bn of revenue in 2019, facilitated $16 trillion of payments on Alipay and lent $290 billion to individuals and small businesses.

Though **Suofeiya's** revenue fell 9% in Q2, it managed to increase gross margins by increasing prices and selling more higher margin products. The company is capitalising well on the trend of more furnished homes being sold in China, and so sales to developers grew 30-40% year-on-year. Management note strong order growth so far in Q3 and expect this to translate to strong profit growth in the second half of the year. We believe that the market is pricing in a return on capital that is far too pessimistic for a business that has historically generated a high and stable return on capital.

Yili reported a strong recovery which came as a positive surprise. The surprise was driven by management's decision to shift attention away from yogurt to milk, allowing Yili to increase its market share in UHT milk by 0.8% to 38.8%. Infant milk formula sales also grew strongly, while newer segments like ice cream and cheese continued to do well. It is increasingly likely that Yili can grow recurring earnings by 9% in 2020, which will mean management become eligible for stock grants as part of the new incentive scheme.

Sino Biopharmaceutical (SBP) reported second quarter results which saw a recovery in operations. Revenue grew 2%, with a 52% increase from oncology sales offset by a 32% reduction in hepatitis sales due to government price cuts. The company's focus is now on future drugs to be launched and here SBP has a pipeline of drugs which should provide a catalyst for continued growth. **CSPC Pharmaceutical** reported revenue growth of 14% with contributions from products across the cardiovascular and oncology franchises. CSPC is planning on increasing its R&D spend by 50% to RMB 3.0 billion in 2020 which should place it as one of the highest spenders on R&D relative to peers in China. In contrast to SBP and CSPC, **China Medical System (CMS)** sells drugs on behalf of other firms, as well some of its own drugs it has acquired licenses for. Despite the focus on generics which have been more exposed to price cuts, CMS grew revenue in the first half with contributions from the digestive and cardiovascular segments. CMS has acquired rights to 18 "innovative drugs" which have greater pricing power compared to generics, and we expect the launch of these products to lead to a rerating for the stock.

Yuhong grew revenue and earnings by 21% and core profits (excluding subsidies) by 85% in the second quarter. Margins grew as a result of lower oil and bitumen prices. Management think they can grow revenue by 20% for the full year despite the headwinds from COVID-19, pointing towards several growth drivers which should be in play in both the short and medium term. Future growth drivers include market share gains, rising renovation demand from existing housing and greater contributions from new segments like paint and insulation.

Hollysys replaced former CEO and Chairman Baiqing Shao with Chit Nim (Colin) Sung as CEO and Li Qiao as Chairman. The new management team immediately wrote off the goodwill associated with the overseas Bond business, which focuses on Mechanical and Electrical (M&E) solutions in Malaysia (e.g. installation of fire protection systems and water systems). Bond had been a drag on the business before COVID-19 and given the slowdown in economic activity over the past six months, the goodwill in the business was written off. This means Hollysys has now written off virtually all of the goodwill from its overseas acquisitions, Bond and Concord (which also focuses on M&E but in the Middle East). We continue to hold the position because we think the stock looks very cheap; on a forward-looking price/earnings ratio, the stock is trading at depressed levels last seen in 2011 when the Wenzhou train crash occurred. To us, this seems far too pessimistic given that the core IA and railway businesses have recovered from the first quarter. Management expect revenue to grow 6-8% in the next financial year with 10% growth from the industrial automation segment and 3-5% growth from the rail transportation business.

Autohome's results came in line with expectations, with flat sales and a small increase in net income. A decline in ad revenue was offset by a large increase in data products sales, which sellers use to better optimise their sales. Management expect passenger vehicle sales to at best grow by single digits in the second half of the year. Autohome is launching new data products which should help support growth in the future.

Catcher's return on capital has dipped over time as competition in the casings business for smartphones has intensified. Catcher recently announced plans to sell its facilities geared towards smartphones to Lens Tech for $1.4bn. This follows Pegatron's acquisition of its affiliate Casektek for $0.5bn and we see competition in this space intensifying as Chinese competitors have plans to expand into the space. We now wait to hear what management plan to do with the proceeds of the sale.

Portfolio Switches

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

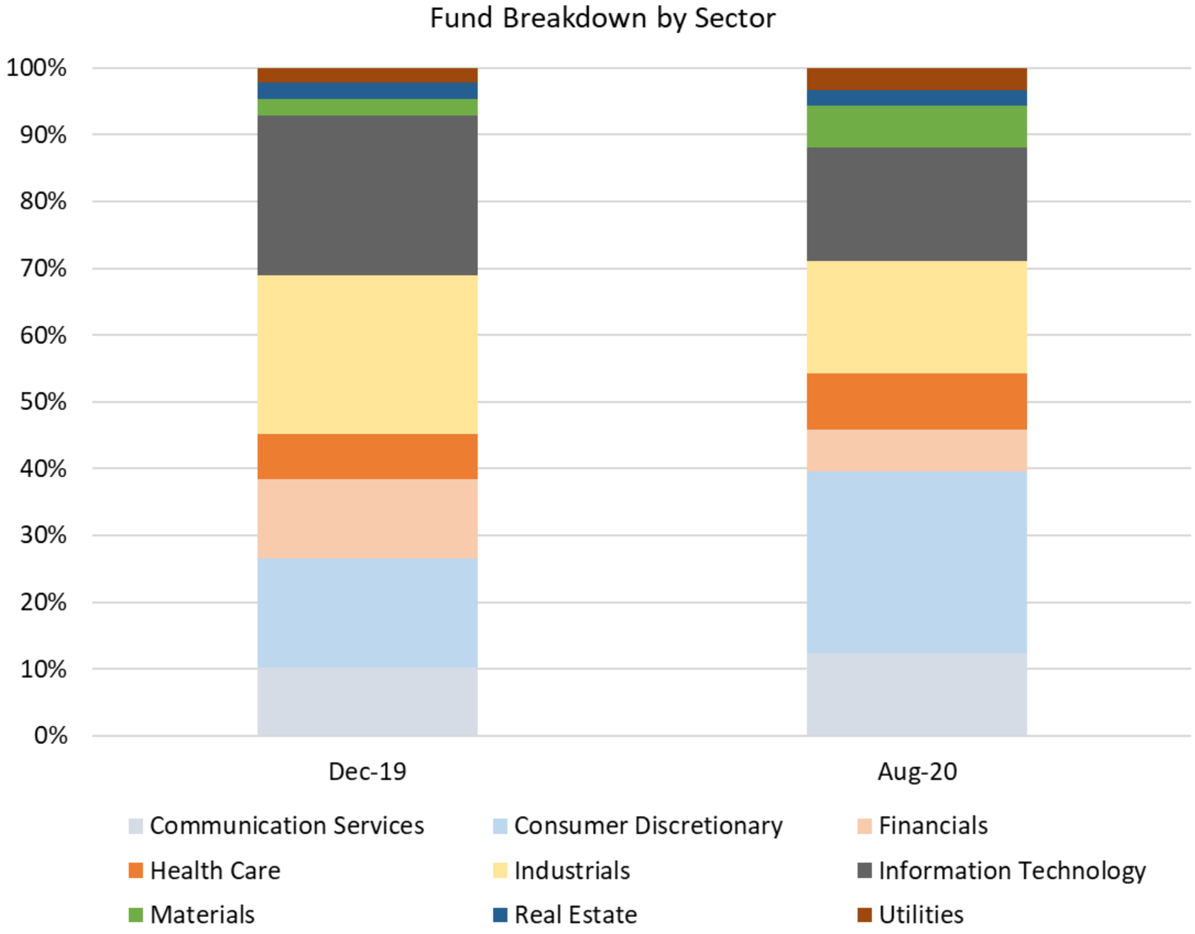
Sells	
Name	**Sector**
Travelsky	Information Technology
Li & Fung	Consumer Discretionary
Tongda Group	Information Technology
AAC Technologies	Information Technology
Luk Fook	Consumer Discretionary
St Shine	Health Care
Qualcomm	Information Technology
Yangzijiang	Industrials
BOC HK	Financials
China Construction Bank	Financials
Noah	Financials

Buys	
Name	**Sector**
Zhejiang Supor	Consumer Discretionary
JD.com	Consumer Discretionary
Oriental Yuhong	Materials
Yili	Consumer Staples
Suofeiya	Consumer Discretionary
Venustech	Information Technology
CSPC Pharmaceutical	Healthcare
Sany Heavy Industry	Industrials

In August we sold Noah, a wealth and asset management business. The company is still feeling the effects related to a credit fund which was in default. The issues have dragged on for a year and combined with the business' ongoing shift in distribution, we felt **Sany Heavy Industry** was a better stock to be in. Sany is China's largest manufacturer of excavators and concrete machinery. We think the company can benefit from infrastructure stimulus and that the downside risk is minimal at current valuations.

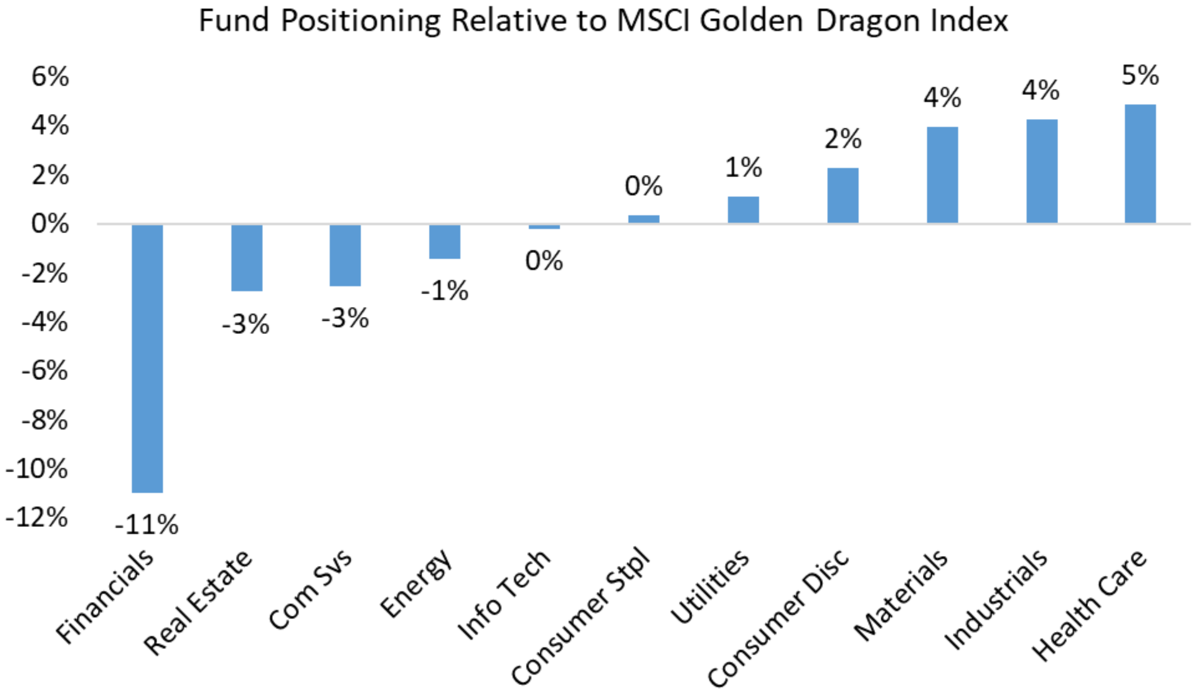
Portfolio Positioning

As a result of the changes made this year, the Fund's allocations to Information Technology and Financials have fallen by 10.8% and 7.6% respectively, compared to December 2019. Consequently, the allocations to Consumer Discretionary and Consumer Staples have risen by 8.7% and 4.1% respectively.



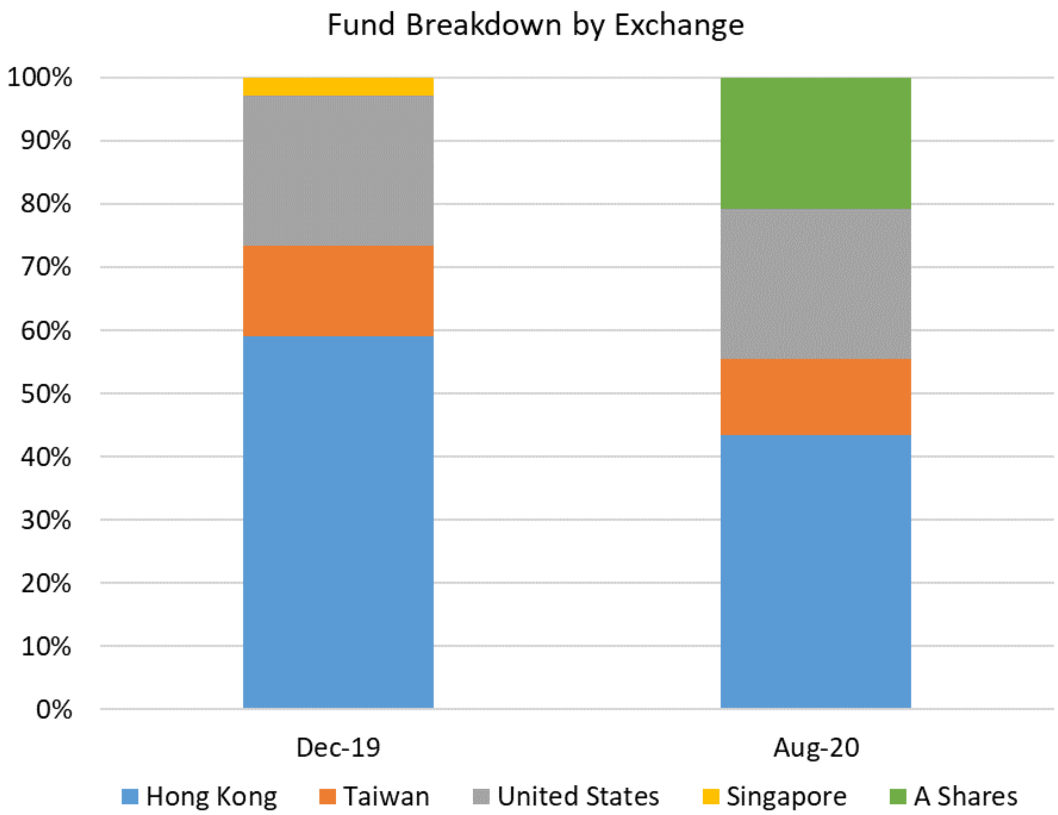
Source: Bloomberg, Guinness AM, Data as of 31 August, 2020

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



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

The Fund has increased its allocation to the domestic A share market by 20.5% this year, while the allocation to Hong Kong has fallen by 15.9%.



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

Summary view & outlook

The focus this year has been on 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 the mainland. We believe the Fund is now better placed to capture the growth opportunities present in China. These growth opportunities lie in structural growth areas such as e-commerce (JD.com), infrastructure stimulus (Yuhong and Sany), cybersecurity (Venustech) and consumption upgrades (Supor and Suofeiya).

Edmund Harriss (portfolio manager)
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Data sources

Fund performance: *Financial Express, total return 0.74% OCF in GBP*

Index and stock data: *Bloomberg*

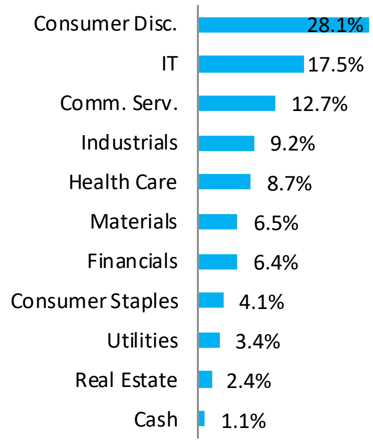
PORTFOLIO

31/08/2020

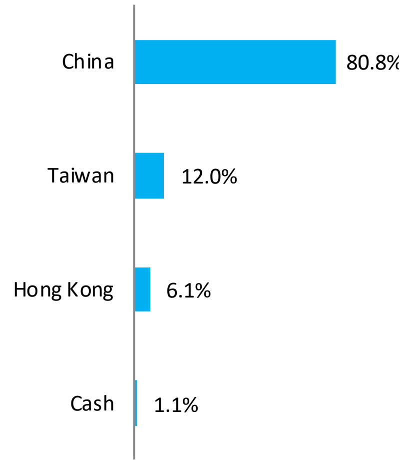
Fund top 10 holdings

Inner Mongolia Yili Indus	4.1%
JD.com	3.8%
Alibaba Group	3.8%
Suofeiya Home Collection	3.6%
Beijing Oriental Yuhong	3.5%
New Oriental Education &	3.5%
China Resources Gas Gro	3.4%
Netease.com	3.4%
China Lilang	3.4%
Elite Material	3.4%
% of Fund in top 10	35.9%
Total number of stocks	31

Sector analysis



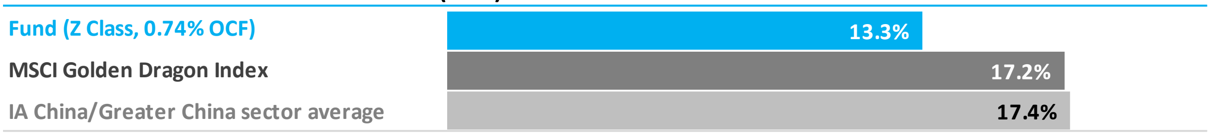
Geographic allocation



PERFORMANCE

31/08/2020

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Aug '20	Aug '19	Aug '18	Aug '17	Aug '16
Fund (Z Class, 0.74% OCF)	12.3	-1.5	-3.0	22.7	-
MSCI Golden Dragon Index	20.0	2.2	0.9	32.5	30.3
IA China/Greater China sector average	25.8	4.8	0.7	30.8	28.5

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	-0.8	2.6	12.3	7.3	-	79.9
MSCI Golden Dragon Index	2.3	13.5	20.0	23.8	113.6	111.4
IA China/Greater China sector average	3.8	20.8	25.8	32.8	123.3	112.9

RISK ANALYSIS

31/08/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.05	-3.51
Beta	1.00	0.98	1.01
Information ratio	0.00	-0.09	-0.56
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.89
Sharpe ratio	0.78	0.74	0.51
Tracking error	0.00	4.55	6.30
Volatility	17.73	17.98	19.00

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.