Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – October 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)

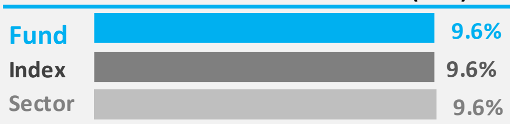
30/09/2020

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	-5.4	-4.6	85.6
Index	6.0	9.5	85.7
Sector	5.8	8.1	86.1

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	0.9	1.3
Beta	1	0.9	0.9
Info ratio	0	0.0	0.0
Max drwdn	-26.4	-24.5	-24.8
Tracking err	0	3.5	5.9
Volatility	15.3	14.0	14.6
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 Q3, the Fund rose 3.3% (Class Y, in GBP) compared to the market which rose 4.5% as measured by MSCI AC Pacific ex Japan Net Total return Index.

- In July, the Fund underperformed the market as growth continued to outperform value. The Fund then outperformed the market in August and September as our portfolio companies reported results.

- We made three changes to the portfolio during the quarter: we bought Nien Made Enterprise in Taiwan and two mainland China-listed A-shares Suofeiya Home Collection and Inner Mongolia Yili Industrial. These replaced Luk Fook Jewellery, sold in June, Janus Henderson and Yangzijiang Shipbuilding.

- The best-performing stocks in the quarter were Corporate Travel Management, Tech Mahindra, Taiwan Semiconductor Manufacturing, Shenzhou International and Hanon Systems.

- The weakest stocks over the period were China Construction Bank, Largan Precision, St Shine Optical, Catcher Technology and BOC Hong Kong.

- The best-performing markets during the quarter were China, India, Korea and Taiwan; Thailand and Indonesia were the weakest markets, while Australia and south-east Asian markets also under-performed.

- Market sentiment, as reflected by changes in revisions to forecast earnings estimates in the benchmark index, turned more positive over the quarter and particularly in September. Increased estimates were apparent in the communications, consumer and industrials sectors and were especially marked in materials.

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Events in the quarter

- China economic growth in the third quarter was reported to have been 4.9%. This was a little below expectations, but does not change the market's expectation for ~2% growth for the full year.

- Thailand is experiencing another bout of political unrest with protests this time focusing on the King. In addition, the Thai Finance minister resigned after only one month, citing ill-health.

- Ongoing US-China tensions were evident over the forced sale of Tik Tok's US operation and President Trump's expressed intention to penalise US companies that create jobs overseas or block those doing business in China from winning federal contracts.

- The US Federal reserve indicated that interest rates may stay lower for longer.

- The Chinese Yuan appreciated against the dollar to reach levels not seen since April 2019. This reflects the higher interest rates in China, compared to the US, as well as the growth in Chinese exports that has resulted in an increased trade surplus this year.

Market Review

The Asia Pacific region, as measured by the MSCI AC Pacific ex Japan Net Return Index, rose 4.5% in GBP terms (9.0% in USD terms) over the third quarter, which followed an 18.4% rise in GBP terms (18.3% in USD terms) in the second quarter. Growth stocks (as measured by MSCI Asia Pacific ex Japan Growth Index) outperformed Value over the quarter although the differential between the two narrowed in August and September. Given the fund has a value bias, and that our portfolio stocks pay out higher dividends than the market, the relative performances of value and growth are relevant to understanding how the Fund itself behaves.

Market performance was led once again by outperformance from China, which accounts for approximately 40% of the benchmark, accompanied by Korea, Taiwan and India. China's outperformance reflects its economic performance, with economists from the international Monetary Fund (IMF) forecasting China to be the only major economy expected to grow this year. While the news flow on China-US tensions remains poor, there is much else about which to be positive. Industrial profits have been growing since April and are now down only 4% over the first 8 months of 2020 compared to the same period last year. Retail sales and car sales are picking up while China's share of world trade has increased over last year. The trade surplus this year could reach as much as $700 billion (almost 5% of GDP) if the current run rate is maintained. These factors, we believe, lie behind China's recent equity market strength and have also helped drive the appreciation in China's currency against both the dollar and against a trade-weighted basket of currencies.

Taiwan and Korea also recorded strong performances over the quarter and once again trade – especially technology-related – has been an important driver. Technology accounts for over 70% of the MSCI Taiwan country index and strong performance here, especially from TSMC, has been a significant factor. Growth in technology manufacturing is not simply confined to smartphones. The growth in cloud computing has lifted infrastructure spending for datacentres which require upgrades to processors, storage, switches and power management to the benefit of many parts of the supply chain. Home office requirements have lifted demand for PCs, which has been weaker in recent years. The growth in 5G telephony with its own requirements from network construction through to end-user devices has provided the supply chain with another driver. Electric

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vehicle requirements and moves toward autonomous vehicles are still in the relatively early stage but many companies we see, from component manufactures to assemblers, are looking to this area to become more significant over the next five years.

On a sector basis, it was the consumer discretionary group that drove market performance during the quarter, followed by technology and then materials. Consumer discretionary and materials names saw strong moves in China, India and Korea. In the technology sector it was Indian and Taiwanese companies that saw the strongest moves.

Portfolio Review

August was the big month for company results reports, and this was also the best month in terms of fund performance during the quarter. 22 of the Fund's 37 holdings reported results. 12 of these companies distribute interim dividends, the rest make annual distributions. 7 companies maintained or increased their dividends: China Medical Systems, China Mobile, China Resources Gas, JB Hi-Fi, Ping An Insurance, Shenzhou International and Sonic Healthcare. Dividends fell for five companies: BOC Hong Kong, China Lilang, Corporate Travel Management, DBS and Public Bank.

The best-performing stocks in the portfolio during the quarter were primarily amongst the consumer discretionary and technology sectors, along with a couple from consumer staples and health care. The fund does not have exposure to materials, which tend to be more cyclical in nature, and do not present the more stable return on capital profile we seek.

By far the best performer was Corporate Travel Management. The business has been disrupted significantly by COVID-19, but the flexibility of the business model and its strong balance sheet has allowed it to adapt and scale back operations. As a result, it is left as one of the strongest businesses in its sector. The company announced at the end of the quarter that it will acquire US-based Travel and Transport (T&T) Inc, headquartered in Omaha, for US$200 million. The company complements Corporate Travel's existing geographical coverage by expanding operations in the US, Germany, UK and France. T&T also owns Radius Travel, a network of corporate travel agencies in 100 countries and a hotel program that covers 44,000 hotels in 160 countries.

We have also been pleased to see strong stock performances coming through from Tech Mahindra in India and Hanon Systems in Korea. We added Tech Mahindra last year on the strength of its telecom consulting business, in anticipation of demand growth prompted by the adoption of 5G telephony. Tech Mahindra's telecom consulting division has experience minimal growth over the last 5 years which had contributed to the company's lower stock market valuation compared to its peers. Activities in the earlier part of the year were curtailed by COVID-19 and thus revenues were depressed; nevertheless, the company was winning new contracts. As the year has gone on, day-to-day business has picked up, new contracts continue to be awarded, and prospects for the telecom side are picking up.

The story for Hanon Systems is broadly similar. Business disruption has been acute in the auto sector with depressed auto sales and auto parts makers have been similarly affected. Consequently, current revenues and profits are at low levels and Hanon reduced its dividend by 15% this year. However, at the second quarter results stage the company reported a significantly improved outlook for the business and – while this is yet to be confirmed – looks set to reinstate its dividend at the prior level. The positive outlook is based on the company's selection as the main parts supplier for four major automakers' electric vehicle platforms, and as

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their production ramps up, so too will the high margin element of Hanon's business. To remind, the company is involved in climate control systems designed to improve energy efficiency; their parts include coolers, compressors, valves and pumps. Production is expected to begin in 2021 and to ramp up through 2025.

We have made three changes to the portfolio this quarter (details of which are described below) thereby bringing the total number of changes this year to six. This is a higher number than recent years but is still in line with our long run average of 2-3 names a year. These changes have been made with a longer view in mind, rather than as a sharp response to COVID-19. Our aim has been to exchange positions which might be regarded as deeper value names for those that have more growth associated with them. The return from a deeper value name would be expected to come from a higher yield plus an expansion in the valuation as the market decides the stock is 'too cheap'. We think that the market is less likely to reward a stock with a higher stock market valuation unless there is a robust revenue growth and dividend growth argument to support it. We are happy to report that five of the six names added this year outperformed during the quarter (including the three recent additions) and all of them have outperformed since purchase.

Amongst the weaker performers, Largan Precision has experienced valuation compression during the quarter because of a more cautious short-term outlook. The company designs and manufactures high-end camera lenses for smartphones and is the leader in its industry. The cautious outlook is due to smartphone manufacturers focusing more on the final cost of their devices, and while they have made significant steps forward in processors screen and the adoption of 5G, this has come at the expense of camera upgrades which were a major selling point over the last 2-3 years. We do not expect this to represent a sea change for Largan and so during this period of stock price decline we have chosen to add to the position while accepting the news flow may not turn significantly more positive until the second half of 2021.

China Construction Bank and BOC Hong Kong both had a weaker quarter on lower interest rates and expectations of higher non-performing loans, both of which will have an impact on their net interest revenues. The two banks are good dividend-payers and both are well capitalised. We are not blind to the risks of rising bad debt in China and the ongoing likelihood of under-reporting. An interesting paper looking at this issue by comparing changes in reported interest income to reported earning assets provides us with another useful analytical tool. We have taken account of these risks by reducing our Chinese bank exposure in 2019 and we are left with those we regard as dynamic consumer banking businesses (Ping An and China Merchants) along with China Construction Bank which we regard as the most robust of the big four. BOC Hong Kong is a Hong Kong-based business where we regard the non-performing loan disclosure problem to be less of an issue, and we like it because of its clearing bank role in international renminbi (Chinese currency) business.

Portfolio Changes

During the quarter we sold positions in Janus Henderson and Yangzijiang Shipbuilding. We purchased replacement positions in Nien Made Enterprise, Suofeiya Home Collection and Inner Mongolia Yili Industrial. The changes return the total number of holdings to 37.

We sold Janus Henderson following its bounce in the second quarter. In so doing we locked in some underperformance but we were 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 was hard to construct an argument for dividend growth over the next few years.

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Suofeiya Home Collection and Inner Mongolia Yili Industrial are China A-shares with more moderate dividend yields but with track records of strong dividend growth. 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 recent earnings reports from our portfolio companies have shown that their operations during this very trying period have remained robust, and that balance sheets, which were strong going into the pandemic, remain so. Some companies still have a little way to go before they are in a position to report a turnaround, especially in the retail space. That said, we can see that Singapore is reporting stronger retail sales growth and we have also seen that a travel corridor is set to be established with Hong Kong. This bodes well for CapitaLand Mall Trust which has significant prime retail exposure in Singapore.

China Lilang is a designer and distributor of men's apparel and saw a significant drop in its business in the first quarter. At the time of their half-year results they reported some improvement in the second quarter and that growth would resume in the third quarter. The interim dividend fell in line with profits – by about 30%. Most recently however, China Lilang has confirmed the expected pick-up in their quarter did happen and even more encouragingly, reported 40% growth in sales during the October golden week holiday. The stock is our best performer so far in October.

We believe that our companies overall have exhibited the financial strength and operational qualities during this period that prompted us buy them in the first place. We believe that the relative strength in both cashflows and dividends has been overlooked, and that over the next three years this will become apparent. The market has shown a preference for high growth in internet and in healthcare, and as a consequence, a significant valuation gap has opened in our opinion. The portfolio trades at a valuation discount to the market, as measured by MSCI AC Pacific Ex Japan Index, of over 20% for 2020 and 14% for 2021.

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

Data sources

Fund performance: *Financial Express, total return, in GBP*

Index and stock data: *Bloomberg*

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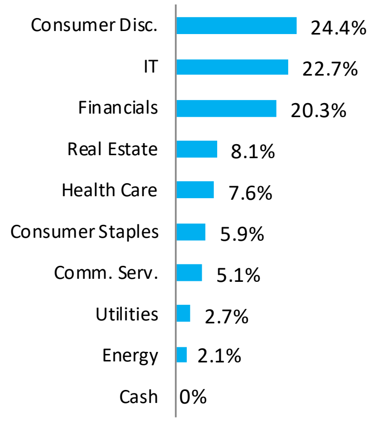
PORTFOLIO **30/09/2020**

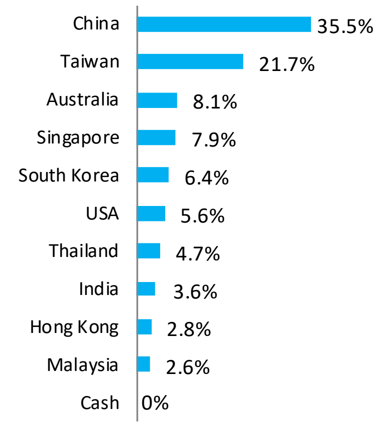
Fund top 10 holdings

Shenzhou International	3.7%
Hanon Systems	3.6%
Tech Mahindra	3.6%
Zhejiang Supor	3.1%
Inner Mongolia Yili Industrial	3.1%
Qualcomm	3.0%
Suofeiya Home Collection	3.0%
Nien Made Enterprise	2.9%
Link REIT	2.8%
KT&G Corporation	2.8%
% of Fund in top 10	31.6%
Total number of stocks in Fund	37

Sector analysis



Geographic allocation



PERFORMANCE

30/09/2020

Discrete years % total return (GBP)	Sep '20	Sep '19	Sep '18	Sep '17	Sep '16
Fund (Y class, 0.99% OCF)	-4.6	2.1	6.7	15.6	35.3
MSCI AC Pacific ex Japan Index	9.5	3.4	5.0	17.4	38.8
IA Asia Pacific ex Japan	8.1	5.6	3.8	15.7	36.8

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	From launch
Fund (Y class, 0.99% OCF)	1.1	-5.4	-4.6	3.9	85.6
MSCI AC Pacific ex Japan Index	1.0	6.0	9.5	18.8	85.7
IA Asia Pacific ex Japan	0.9	5.8	8.1	18.6	86.1

Annualised % total return from launch (GBP)

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

30/09/2020	Index	Sector	Fund
Alpha	0	0.87	1.29
Beta	1	0.90	0.88
Information ratio	0	-0.01	0.03
Maximum drawdown	-26.36	-24.54	-24.84
R squared	1	0.95	0.85
Sharpe ratio	0.39	0.42	0.42
Tracking error	0	3.54	5.93
Volatility	15.28	14.04	14.62

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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.

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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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