

# Guinness Best of China Fund

INVESTMENT COMMENTARY – October 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)** 30.09.2020

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

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

	1 year	3 years	From launch
<b>Fund</b>	13.9	14.1	82.7
<b>Index</b>	22.3	31.0	114.4
<b>Sector</b>	26.8	36.6	112.9

## Annualised % total return from launch (GBP)

<b>Fund</b>	13.4%
<b>Index</b>	17.2%
<b>Sector</b>	17.1%

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

	Index	Sector	Fund
<b>Alpha</b>	0.0	-0.1	-3.1
<b>Beta</b>	1.0	1.0	1.0
<b>Info ratio</b>	0.0	-0.1	-0.5
<b>Max drwn</b>	-17.8	-21.7	-25.7
<b>Tracking err</b>	0	5	6
<b>Volatility</b>	17.7	17.9	18.9
<b>Sharpe ratio</b>	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 September, the Best of China Fund fell 2.0% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index fell 2.1%. In the third quarter, the Fund rose 9.6% while the benchmark rose 11.9%. The fund therefore underperformed by 2.3%.
- In September, MSCI China fell 2.7%, MSCI Hong Kong fell 5.1% and MSCI Taiwan rose 2.0%. The Shenzhen Component Index fell 5.4% while the Shanghai Stock Exchange Composite Index fell 4.4%.
- This compared to the S&P falling 3.8%, MSCI Europe falling 3.3% and MSCI Japan rising 1.0%.
- In MSCI China, the strongest sectors were Consumer Discretionary (total return of +1.0%), Utilities (-2.0%) and Real Estate (-2.9%) while the weakest were Energy (-9.4%), Consumer Staples (-6.6%) and Information Technology (-5.9%).
- In MSCI Hong Kong, the Real Estate and Financials indexes fell 4.3% and 5.4% respectively.
- In Taiwan, the Information Technology Index, which makes up more than half of the local index, rose 3.6%.

## Events in September

- Oracle agreed to invest in TikTok, which President Trump threatens to ban unless it is sold by its parent company. Oracle and Walmart have agreed to invest 20% in a newly formed TikTok Global business, where TikTok will become the new business' cloud provider. There is, however, confusion over who will control the business. Oracle says American groups will control the company

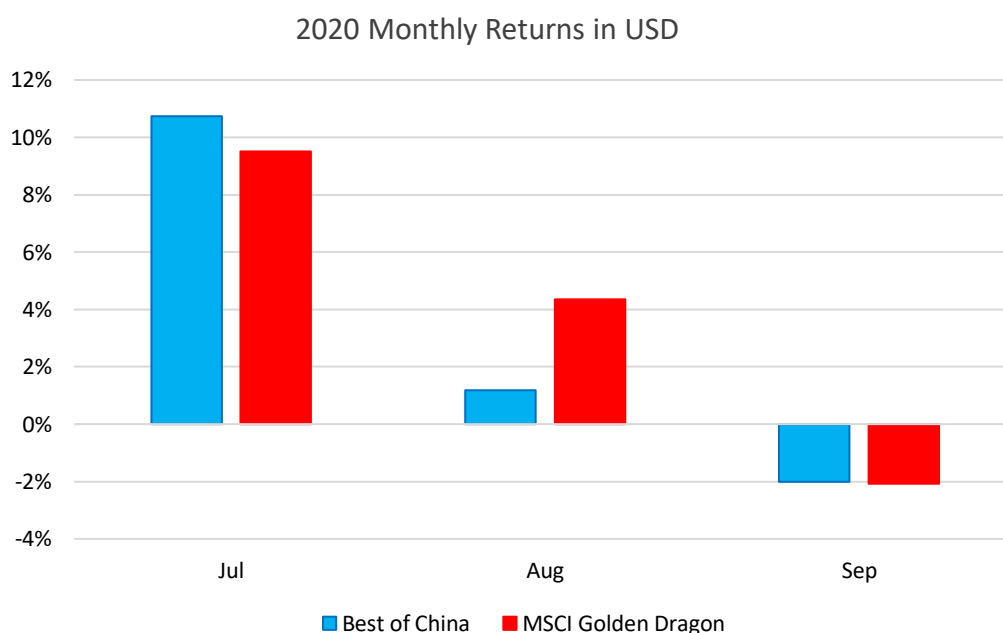
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## Guinness Best of China Fund

whereas Bytedance, the current owner of Tiktok, says it will control the new entity. Furthermore, US courts are due to decide if Trump can even ban Tiktok in the first place, while the Chinese government may ban the deal.

- Semiconductor Manufacturing International Corporation (SMIC), China's largest foundry, had restrictions imposed on it by the US government. The US argues SMIC produces chips for the Chinese military, which acts as justification for the controls.
- HSBC was alleged to have allowed money launderers to move millions which led to weakness in its share price. The Global Times, a state-run newspaper, said HSBC could go on China's first "unreliable entities" list which will contain foreign companies judged to be operating against national interests.
- Industrial production rose 5.6% year-on-year (yoy) in August while industrial profit grew 19.1% yoy. Fixed assets investment increased 9.3%, driven by a 5.0% increase in manufacturing investment.
- Retail sales grew 0.5% yoy in August, an acceleration from the previous month. Offline consumption showed a notable rebound.

## Portfolio Performance



Source: Financial Express, bid to bid, total return. Data as of 30<sup>th</sup> September, 2020

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## Guinness Best of China Fund

The Fund's outperformance in July and September was offset by underperformance in August. The table below shows the biggest contributors and detractors relative to the benchmark in each month and for the third quarter overall:

July		August	
Top 5 Contributors	Top 5 Detractors	Top 5 Contributors	Top 5 Detractors
China Lesso (+1.3%)	Underweight in Alibaba (-1.3%)	Yili (0.4%)	Underweight in Alibaba (-1.4%)
Oriental Yuhong (1.2%)	Underweight in TSMC (-0.5%)	JD.com (+0.4%)	Not holding Meituan Dianping (-0.9%)
Geely (+1.2%)	Underweight in Tencent (-0.4%)	Oriental Yuhong (+0.3%)	Novatek (-0.5%)
Novatek (+1.1%)	Venustech (-0.4%)	Netease (+0.2%)	Hollysys (-0.5%)
Supor (+0.7%)	Hollysys (-0.3%)	Lilang (+0.2%)	Not holding AIA (-0.4%)

September		Q3	
Top 5 Contributors	Top 5 Detractors	Top 5 Contributors	Top 5 Detractors
Sany Heavy (+0.4%)	CSPC Pharmaceutical (-0.3%)	Oriental Yuhong (+1.2%)	Underweight in Alibaba (-3.0%)
Underweight in Tencent (+0.4%)	Elite Material (-0.3%)	China Lesso (1.2%)	Not holding Meituan Dianping (-0.8%)
Autohome (+0.4%)	China Overseas Land & Investment (-0.3%)	Geely (+1.0%)	Venustech (-0.7%)
Suofeiya (+0.3%)	Venustech (-0.3%)	Novatek (+0.8%)	Hollysys (-0.6%)
Not holding Meituan Dianping (+0.3%)	Netease (0.3%)	Autohome (+0.8%)	Underweight in TSMC (-0.5%)

*Attribution relative to a portfolio holding the weighted average of the iShares MSCI China ETF, iShares MSCI Hong Kong ETF and iShares MSCI Taiwan ETF. Source: Bloomberg, Guinness AM*

In **July**, the Fund outperformed by 0.8% despite the underweight in the mega-cap stocks Alibaba, TSMC and Tencent, which were all strong. The Fund benefited from strong performance by a range of stocks, led by China Lesso and Oriental Yuhong which should benefit from infrastructure stimulus.

In **August**, the Fund did not keep up in very strong markets, rising 1.4% while the market rose 4.4%. Of the Fund's 3.0% underperformance, 1.4% can be attributed to the underweight position in Alibaba and 0.8% to not holding Meituan Dianping. The fund saw moderate contributions from Yili, JD.com and Oriental Yuhong.

In **September**, the Fund outperformed in falling markets but gave back its gains in the last week as markets recovered, meaning the Fund outperformed by 0.1% in the month. The underweight position in Tencent contributed to 0.4% of outperformance while not holding Meituan Dianping added a further 0.3% of relative performance. On the other hand, there were moderate losses from CSPC Pharmaceutical, Elite Material and China Overseas Land & Investment.

Overall, of the Fund's 2.3% underperformance in the third quarter, the underweight position in Alibaba and TSMC contributed to 3.0% and 0.5% of underperformance, respectively. Not holding Meituan Dianping contributed to a further 0.8% of underperformance. Weakness from Venustech and Hollysys contributed to 0.7% and 0.6% of underperformance. On the other hand, Industrials companies China Lesso and Haitian contributed to 1.2% and 0.5% of outperformance. Oriental Yuhong, Autohome and Yili further contributed to 1.2%, 0.8% and 0.6% of outperformance.

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## Portfolio Switches

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

Sells		Buys	
Name	Sector	Name	Sector
Travelsky	Information Technology	Supor	Consumer Discretionary
Li & Fung	Consumer Discretionary	JD.com	Consumer Discretionary
Tongda Group	Information Technology	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	Sany Heavy Industry	Industrials
BOC HK	Financials		
China Construction Bank	Financials		
Noah	Financials		

Five changes were made in the quarter. With the exception of Qualcomm, the focus was predominantly on selling businesses which have lost their competitive advantage and where we feel the prospect for earnings growth is poor.

**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 impacting 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**.

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

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conduct more stringent cybersecurity tests, which should expand the addressable market for the company.

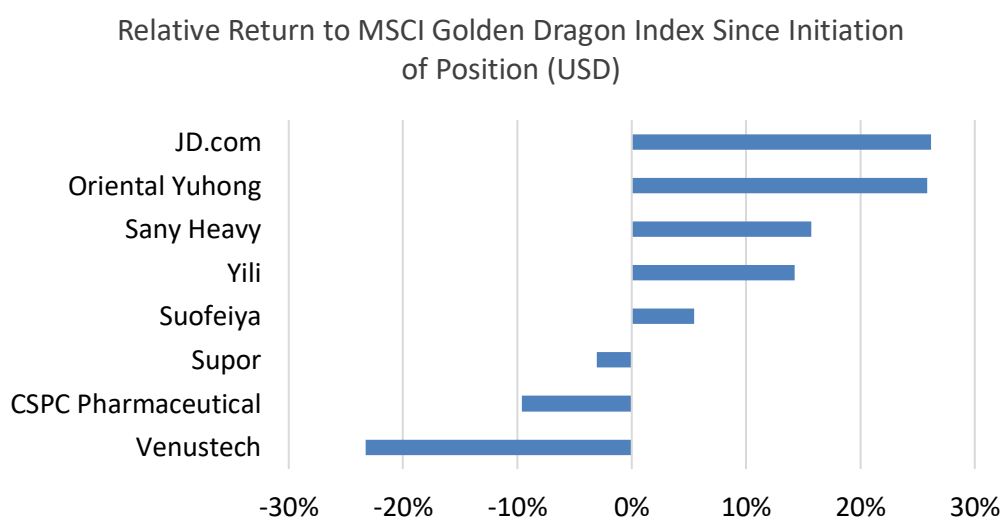
In July we bought **CSPC Pharmaceutical** which is in the process of shifting its business away from generics towards more innovative drugs. It has a well diversified portfolio and has several new drugs in the pipeline. CSPC has rapidly increased its spending on research and development (R&D) and in 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.

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 the downside risk is minimal at current valuations.

So far, the changes we have made this year have, for the most part, outperformed the benchmark. We have seen particularly strong outperformance from Oriental Yuhong and JD.com. Both have shown strong earnings growth along with positive earnings revisions this year, boosting momentum. Yili and Sany Heavy have also added to performance. Yili’s results recovered after a weak first quarter while Sany Heavy’s results were also positive.

On the other hand, CSPC Pharmaceutical and Venustech have lagged. CSPC’s interim results were good as it 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 revenue in China. Despite good results, the healthcare sector has lagged as more cyclical sectors have rallied.

In the case of Venustech, we have taken advantage of weakness in the share price to add to the position. The position gives the Fund exposure to cybersecurity which we have identified as an industry with much potential to grow, and we expect the second half of the year, where the bulk of revenue and earnings come through, to show strong earnings growth for the company.

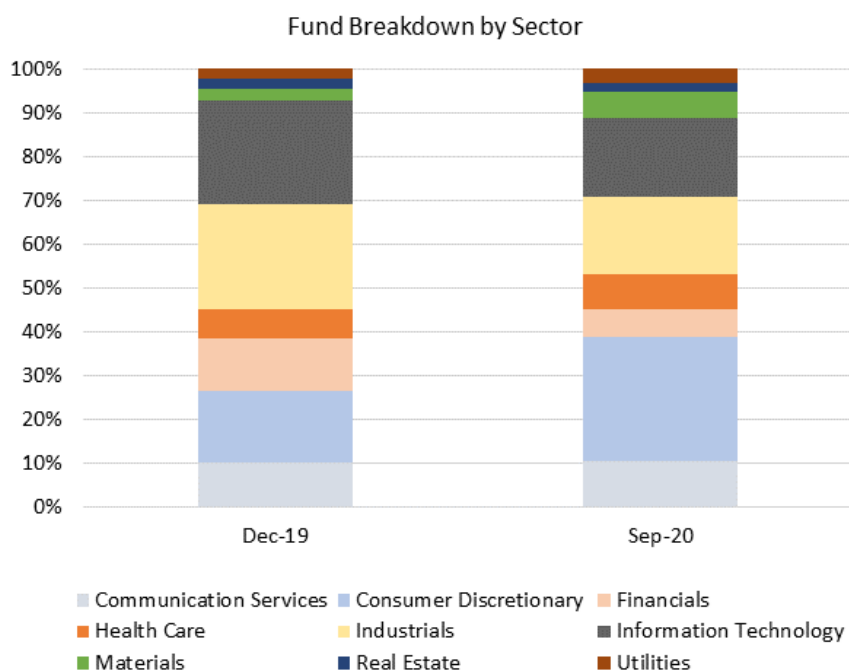


Source: Bloomberg, Guinness AM, Data as of 30<sup>th</sup> September, 2020

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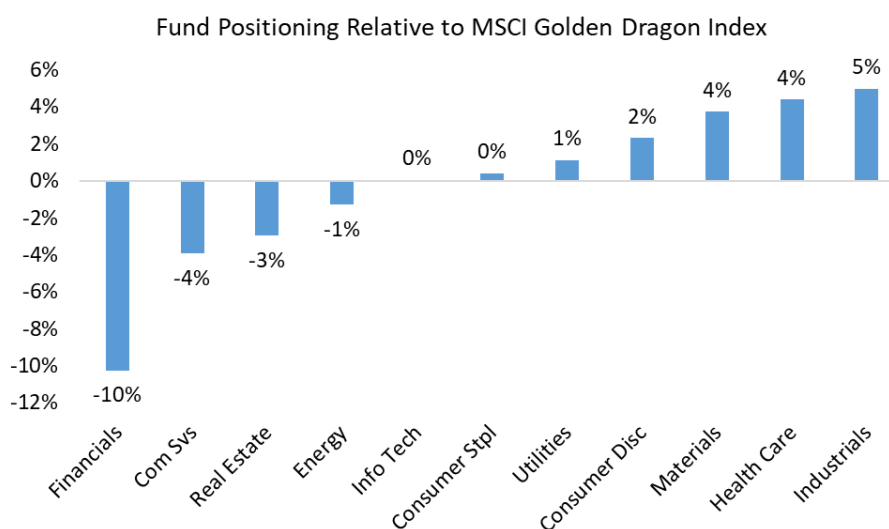
## Portfolio Positioning

As a result of the changes made this year, the Fund’s allocations to Information Technology and Financials have fallen by 10.0% and 7.5% respectively, compared to December 2019. Consequently, the allocations to Consumer Discretionary and Consumer Staples have risen by 9.5% and 3.9% respectively.



Source: Bloomberg, Guinness AM, Data as of 30<sup>th</sup> September, 2020

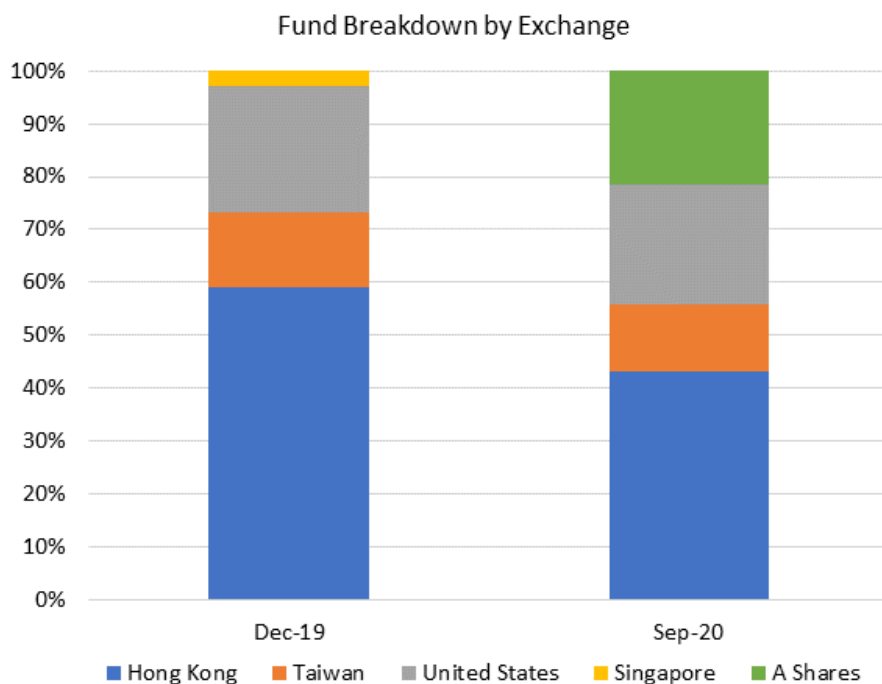
The Fund is most overweight in Industrials, Healthcare and Materials. The Fund is most underweight in Financials and Communication Services.



Source: Bloomberg, Guinness AM, Data as of 30<sup>th</sup> September, 2020

The Fund has increased its allocation to the domestic A share market by 21.2% this year, while the allocation to Hong Kong has fallen by 16.3%.

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Source: Bloomberg, Guinness AM, Data as of 30<sup>th</sup> September, 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 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).

Though we have made many switches this year, our aim is to continue to shift the Fund towards sectors which have structural growth as the main driver. The opportunity set includes industries such as electric vehicles, renewable energy, consumer lending and import substitution. We expect to make more changes over the course of the rest of the year to move the fund to some of these structural growth areas.

**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*

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## Guinness Best of China Fund

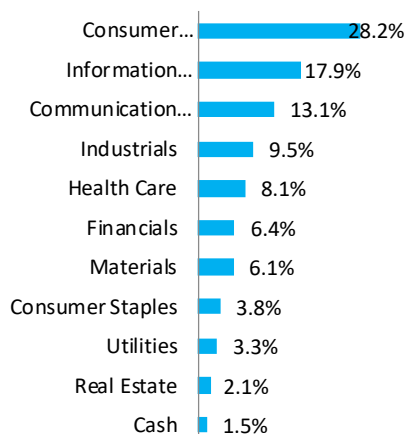
### PORTFOLIO

30/09/2020

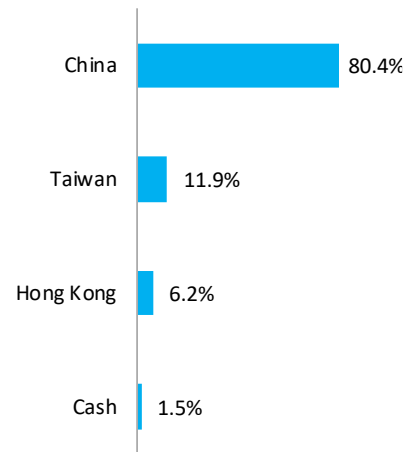
#### Fund top 10 holdings

Alibaba Group	4.0%
JD.com	3.8%
Inner Mongolia Yili Indus	3.8%
Sany Heavy Industry	3.7%
Suofeiya Home Collection	3.6%
New Oriental Education &	3.6%
Haier Electronics	3.5%
Autohome	3.5%
Baidu	3.4%
China Merchants Bank	3.3%
% of Fund in top 10	36.4%
Total number of stocks	31

#### Sector analysis



#### Geographic allocation



### PERFORMANCE

30/09/2020

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

Fund (Z Class, 0.74% OCF)	13.4%
MSCI Golden Dragon Index	17.2%
IA China/Greater China sector average	17.1%

#### Discrete years % total return (GBP)

	Sep '20	Sep '19	Sep '18	Sep '17	Sep '16
Fund (Z Class, 0.74% OCF)	13.9	-0.0	0.1	22.7	-
MSCI Golden Dragon Index	22.3	2.9	4.2	22.4	36.0
IA China/Greater China sector average	26.8	4.8	2.7	23.1	33.6

#### Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	1.5	4.2	13.9	14.1	-	82.7
MSCI Golden Dragon Index	1.4	15.1	22.3	31.0	118.1	114.4
IA China/Greater China sector average	0.0	20.8	26.8	36.6	124.6	112.9

### RISK ANALYSIS

30/09/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.09	-3.06
Beta	1.00	0.98	1.01
Information ratio	0.00	-0.10	-0.49
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.89
Sharpe ratio	0.75	0.71	0.50
Tracking error	0.00	4.56	6.35
Volatility	17.65	17.90	18.90

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Source: Financial Express, bid to bid, total return (0.74% OCF). Fund launch date: 15.12.2015.

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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 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](http://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](http://www.carnegie-fund-services.ch). The paying agent is Banque Cantonale de Genève, 17 Quai de l'Île, 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.

**GUINNESS**

ASSET MANAGEMENT

Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

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