

Guinness Best of China Fund

INVESTMENT COMMENTARY – November 2020

Launch date 15.12.15

Team
Edmund Harriss (manager)
Mark Hammonds (analyst)
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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) 31.10.2020

Fund	Best of China Fund (Z CIs, 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	14.1	10.3	86.1
Index	26.7	29.6	122.4
Sector	32.1	35.0	121.2

Annualised % total return from launch (GBP)

Fund	13.6%
Index	17.8%
Sector	17.7%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	-0.1	-3.6
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.1	-0.6
Max drwn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	17.5	17.8	18.8
Sharpe ratio	0.8	0.8	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 October, the Best of China Fund rose 2.1% (in USD, Z class) while the MSCI Golden Dragon Net Total Return Index rose 3.7%.
- MSCI China rose 5.3%, MSCI Hong Kong fell 1.2% and MSCI Taiwan rose 1.3%. The Shenzhen Component Index rose 4.1%, while the Shanghai Stock Exchange Composite Index rose 1.7%.
- Meanwhile the S&P 500 fell 2.7%, MSCI Europe fell 5.6% and MSCI Japan fell 1.6%.
- In MSCI China, the strongest sectors were Communication Services (total return of +10.4%), Consumer Discretionary (+6.5%) and Information Technology (+5.1%) while the weakest were Real Estate (-3.8%), Energy (-3.6%) and Industrials (-0.6%).
- In MSCI Hong Kong, the Real Estate and Financials indexes fell 2.9% and 1.1% respectively.
- In Taiwan, the Information Technology Index, which makes up more than half of the local index, rose 2.0%.

Events in October

- Third quarter GDP growth was 4.9%, higher than the second quarter rate of 3.2%. The GDP data implies softness came from slower investment growth which seems at odds with the investment data below, which show fixed asset investment (FAI) growth seems robust. Analysis from Goldman Sachs argues FAI is difficult to measure and so instead they use their own investment tracker to suggest machinery sales have decelerated, which is likely captured well by GDP data but not so much by FAI.

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Guinness Best of China Fund

- Industrial production grew 6.9% year-on-year (yoy) in September compared to 5.6% in August. Fixed asset investment (FAI) grew 7.5% yoy in September. Manufacturing investment growth decelerated from 6.6% yoy in August to 2.7% in September while infrastructure investment grew from 7.5% yoy growth in August to 7.5% in September.
- Retail sales grew 3.3% yoy in September, an improvement from 0.5% in August. Automobile sales grew 11.2%.
- The Communist Party of China (CPC) released some details of its next Five-Year Plan. The summary communique did not mention a target goal for GDP growth and instead emphasised higher quality growth, innovation, market reform, domestic demand and final liberalisation. The NDRC will submit a detailed draft in March 2021, when we should see more concrete proposals.
- The Caixin Purchasing Managers' Index (PMI) rose from 53.0 in September to 53.6 in October. The improvement in the reading was broad based as the production, new orders and new export sub-indexes were strong, while the finished goods inventory index fell, suggesting strong demand in October.
- Reports indicate the PBoC is to suspend the countercyclical factor used to fix the USDCNY rate. The factor was introduced in 2017 to reduce the pressure on the Renminbi but this year we have instead seen strength, with the USDCNY rate moving from 7.1671 in May to 6.6915 in October. This means the Renminbi appreciated by 7.1% against the dollar in the period. The removal of the factor suggests policymakers want to reduce the upward pressure on the currency.

Portfolio Performance

In October, the top and bottom five contributors to performance are shown below:

Top 5 Contributors	Top 5 Detractors
China Lilang (+0.5%)	Underweight in Tencent (-1.0%)
Lead Intelligent (+0.4%)	Not holding Meituan Dianping (-0.5%)
Suofeiya Home Collection (+0.3%)	CSPC Pharmaceutical (-0.4%)
China Merchants Bank (+0.3%)	Underweight in Alibaba (-0.4%)
New Oriental Education (+0.2%)	China Lesso (-0.3%)

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.

China Lilang, a retailer of men's casualwear, reported retail sales that grew 5-10% yoy in the third quarter. This marked the first time Lilang has managed to grow sales this year, as in the first half retail sales fell 30-35%. This positive news led to a rerating in the share price.

Suofeiya is a manufacturer of custom furniture and kitchen cabinets. It reported third quarter sales and net income that grew 17% and 8% yoy. Suofeiya is converting its backlog built up in the first half of the year into revenue and is additionally seeing growing contribution from property developers. For 2020 as a whole, management are expecting sales from the property channel to grow 50% which is key if the company is to take advantage of the growing popularity of furnished homes. Suofeiya also established a

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joint venture with Shengdu Decoration in Hangzhou, a leading furnishing company. The joint venture will be used to further diversify sales across sales channels, which management deem as increasingly important as their customers' purchasing patterns change.

China Merchants Bank (CMB)'s pre provisioning profits grew 3% yoy while net profit after provisions was flat. Profit growth was driven by net interest margins which grew 0.07% quarter-on-quarter, as higher margin retail loans were extended while corporate loan growth were flat. The wealth management business was also strong as fees from fund distribution rose 159% yoy. Overall, management have a positive outlook given China's relatively stable economic conditions.

New Oriental Education, a leading provider of tuition services, saw revenue fall 8% in its most recent quarter. Revenue in the K-12 business grew 9% yoy as enrolments increased 21%. It was the overseas test prep business which was the source of weakness as sales fell 51% yoy, for obvious reasons. The company is using a combination of online and offline classes to attract students and the approach seems to work particularly well in smaller satellite cities. One of the reasons for this may be because large online courses are typically priced at a 20-30% discount to offline classes, which should be attractive in smaller cities where household incomes are likely lower than larger cities. Management now expect group earnings to start growing going forward which implies they think K-12 revenue growth can accelerate.

The Best of China Fund is run on an equally weighted basis and so each stock, at its neutral position, has a weight of 3.2%. As of October 30th 2020, **Alibaba** and **Tencent** had a weight of 14.0% and 10.7% in the index. During October, the two stocks increased 3.6% and 15.5% which contributed to 0.4% and 1.0% of relative underperformance for the Fund.

CSPC Pharmaceutical and **China Lesso** were weak but there was no company specific news causing this weakness. We hold CSPC Pharmaceutical because we think it is making good progress in shifting from a generics business towards a more innovative pharmaceutical company. Its spend on R&D, as a percentage of revenue, is likely to be in the same range as its larger, more established peers which we view as a positive signal. China Lesso had been a very strong performer for much of the year and we view the recent weakness as the stock giving back some of its gains. We deployed inflows into the Fund into these two companies as part of the rebalancing process.

Portfolio Switches

We sold **Hollysys** and **Haitian International**. Hollysys has been a serial disappointment and its performance has lagged other industrial automation companies. Though the stock looks cheap, we felt even with a recovery in the multiple the upside was higher in the two new entrants into the Fund. Haitian International has been a good contributor to performance for the Fund over the years. The business has managed to navigate this year's volatility very well but it is difficult to see the long-term structural growth drivers.

We bought **Wuxi Lead Intelligent** and **Nari Technology**. Lead Intelligent is a supplier of battery equipment for electric vehicles. It specialises in the mid stage of the production process, in the winding process used to make cells. Lead Intelligent should benefit from battery manufacturers expansion plans, such as CATL's new €2bn plant in Germany and Northvolt's expansion in Sweden. Nari Technology is a subsidiary of the State Grid Corporation of China and has leading market share in dispatching hardware and software, which transmits real-time information across the grid. We think Nari's valuation is very undemanding for a company which should benefit from increased spending on the grid to support economic growth in China. Further spending on renewable energy should also be supportive to the business. Other growth drivers include China's unique Ultra High Voltage (UHV) and greater adoption of e-IOT smart meters.

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Guinness Best of China Fund

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
Haitian	Industrials
Hollysys	Information Technology

Buys	
Name	Sector
Supor	Consumer Discretionary
JD.com	Consumer Discretionary
Yuhong	Materials
Yili	Consumer Staples
Suofeiya	Consumer Discretionary
Venustech	Information Technology
CSPC Pharmaceutical	Healthcare
Sany Heavy Industry	Industrials
Wuxi Lead Intelligent	Industrials
Nari Technology	Industrials

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), electric vehicles (Wuxi Lead) 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.

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Data sources

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

Index and stock data: *Bloomberg*

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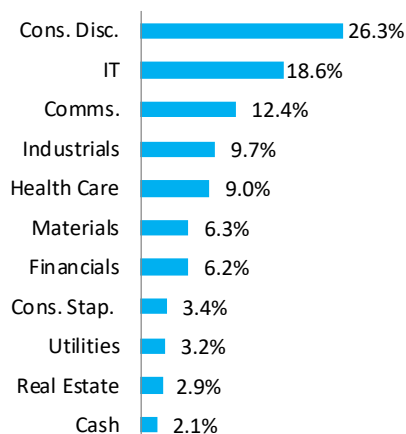
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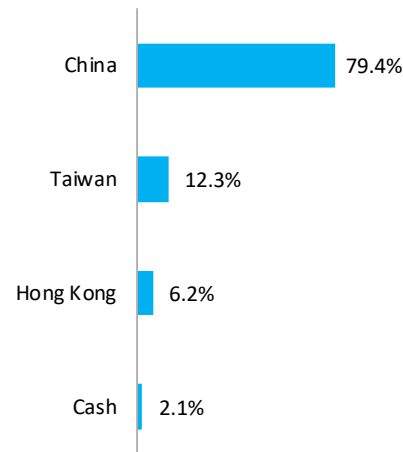
Fund top 10 holdings

WUXI LEAD INTELLIGENT E	3.6%
Alibaba Group	3.5%
JD.com	3.4%
Inner Mongolia Yili Indus	3.4%
Tencent Holdings	3.4%
Suofeiya Home Collection	3.4%
Sany Heavy Industry	3.3%
Zhejiang Supor	3.3%
New Oriental Education &	3.3%
Beijing Oriental Yuhong	3.3%
% of Fund in top 10	33.8%
Total number of stocks	31

Sector analysis



Geographic allocation



PERFORMANCE

31/10/2020

Annualised % total return from launch (GBP)

Fund (Z Class, 0.74% OCF)	13.6%
MSCI Golden Dragon Index	17.8%
IA China/Greater China sector average	17.7%

Discrete years % total return (GBP)

	Oct '20	Oct '19	Oct '18	Oct '17	Oct '16
Fund (Z Class, 0.74% OCF)	14.1	11.6	-13.4	22.7	-
MSCI Golden Dragon Index	26.7	14.0	-10.3	21.8	35.3
IA China/Greater China sector average	32.1	17.5	-13.0	23.8	29.7

Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	1.9	6.1	14.1	10.3	-	86.1
MSCI Golden Dragon Index	3.7	19.4	26.7	29.6	113.5	122.4
IA China/Greater China sector average	3.9	25.5	32.1	35.0	116.8	121.2

RISK ANALYSIS

31/10/2020

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.07	-3.60
Beta	1.00	0.98	1.01
Information ratio	0.00	-0.10	-0.58
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.93	0.89
Sharpe ratio	0.79	0.75	0.51
Tracking error	0.00	4.55	6.32
Volatility	17.54	17.79	18.80

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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, 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'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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