GUINNESS ATKINSON FUNDS

Inflation Managed Dividends brief

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Commentary and Review by co-portfolio managers
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Summary

Recent years' economic volatility and uncertainty has forced asset class correlations to converge, and macro views have been driving returns – the so called "risk on, risk off" strategy. Our investment process is not designed to exploit this idea and goes against our core approach to investing. In fact, we think the idea of cranking up and down the "risk" in a portfolio within short periods of time as closer to speculation than investing.

Manager's Review

The global Macro environment has clearly received a lot of attention since the beginning of the US housing crisis. We have seen large fluctuations in GDP growth, volatile sovereign debt yields, rising unemployment, austerity vs. stimulus debates, Balkanisation of banking activity, the fiscal cliff and unprecedented central bank policies, to name a few. This has led to a widely heard commentary that this economic volatility and uncertainty has forced asset class correlations to converge and therefore macro views have been driving returns – the so called "risk on, risk off" strategy.

Our investment process is not designed to exploit this idea. In fact we think the idea of cranking up and down the "risk" in a portfolio within short periods of time as closer to speculation than investing. The implications of using a "risk on, risk off" strategy goes against our core approach to investing. Here are three reasons why:

1. **Risk on, risk off implies high portfolio turnover and a short time horizon.**
Our portfolio turnover has been low; in 2012 we only sold three positions and bought four. This is a consequence of our investment time horizon. When we are considering investing in a company we do so on the basis that the valuation discrepancy that we are seeking to take advantage of may well take more than two or three years to come good. Market fear and confidence can fluctuate many times over this period, as we have seen over the last five years. Moving in and out of stocks with every lurch in the market would simply create extra trading costs which erode your return over time.

2. **Risk on, risk off implies you believe you are good at market timing.**
Market timing is more luck than anything else. Given the short time horizons implied by the risk on, risk off approach though, market timing is very important for it to succeed. You need to feel confident you know when the inflection points are coming. When we have decided we a like a company's valuation we get on and buy it without trying to pick the perfect moment. In addition, our equally weighted portfolio construction means we don't have to be too precise in choosing our moment to invest. The act of rebalancing the portfolio means we sell down a small proportion of our winners to invest in the companies that have underperformed and therefore have become cheaper. This allows us to improve our average purchase price.

3. **Risk on, risk off implies you are able to make good economic forecasts.**
Statistical studies of expert predictions of future events show that they are not very accurate. Philip Tetlock looked at the predictions of 284 experts over a 20 year period[1]. He analysed the resulting 28,000 predictions and found that these experts' predictions were about as good as a dart throwing monkey. Despite all the hugely confident predictions we hear from economists in the media, in fact, they aren't much better than chance. That isn't to belittle the work of economists; considering different scenarios, the effects of political decisions, shocks, etc. are clearly valuable, but relying on specific predictions can be dangerous. We take the approach of looking at companies from a bottom up perspective and consider how they will perform in different economic environments. If we can find companies that we believe can continue to grow in numerous economic climates then we can be less concerned with predicting the specifics of how the future will turn out.

Our investment approach is to look for companies that consistently generate high returns on capital, and therefore, consistently create shareholder value year on year. This shareholder value creation is independent of what price the market will attribute to its shares at any point in time, but we do receive a proportion of this value creation each year in the form of a dividend from all the companies we invest in thereby locking in some of that value each year.

[1] Source: Tetlock, Philip. *Expert Political Judgment: How Good is it? How Can We Know?* New Jersey: Princeton University Press, 2006.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice.

This information is authorized for use when preceded or accompanied by a prospectus for the Guinness Atkinson Inflation Managed Dividend Fund. The prospectus contains more complete information, including investment objectives, risks, charges and expenses related to an ongoing investment in The Fund. Please read the prospectus carefully before investing.

Mutual fund investing involves risk and loss of principal is possible. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. These risks are greater for emerging markets countries. The Fund also invests in smaller companies, which will involve additional risks such as limited liquidity and greater volatility. The Fund may invest in derivatives which involves risks different from, and in certain cases, greater than the risks presented by traditional investments.

Past performance does not guarantee future results.

Diversification does not assure a profit nor protect against loss in a declining market

Correlation is a statistical measure of how two securities move in relation to each other.

Return on Capital is a return from an investment that is not considered income. The return of capital is when some or all of the money an investor has in an investment is paid back to him or her, thus decreasing the value of the investment.

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