GUINNESS ATKINSON FUNDS

Asia brief

November 2013

Commentary and Review by
Portfolio Manager Edmund Harriss

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Chinese leaders meet this month to map out government policy for the next 10-years, which should address many of the underlying issues that impact economic growth and stability. ASEAN (Association of South East Asian Nations) countries have experienced the same recent volatility affecting many emerging markets this year, and some of the specific factors impacting that area are explored within. Additionally, some recent company results are explored.

This month China's top leaders will meet in Beijing to map out government policy over the next ten years. Far reaching reforms are promised, and they are needed. Everything from financial reform to social change in the form of the one-child policy is said to be up for discussion. What has become abundantly clear to China's leadership, as well as outside observers, is that the investment-led model that has delivered so much is now past its sell-by date. Many of the factors which drove growth have become drags. The changes required will pit reformer against powerful vested interests who have done well over the past thirty years. Shifting drivers of economic growth is inextricably tied up with shifting political power. For the reformers to win out, economic growth cannot be allowed to fall precipitately, and capital flight cannot be allowed to happen. So the process is not going to follow an orthodox pattern, but then little of China's transformation has accorded to standard models.

An insight into the likely areas of debate came from a report issued by the State Council's Development Research Centre. This covered eight areas, including streamlining government approval processes, breaking up monopolies, land reform, financial reform (interest rate liberalization, currency convertibility), social welfare, tax reform, open up to foreign investment and innovation.

Additional insight into government thinking comes from the release of a transcript of a speech given by Premier Li on October 21. The government estimates that every 1% of Gross Domestic Product (GDP) growth creates 1.3-1.5m jobs, and therefore, real economic growth of 7.2% is required to create 10m jobs and maintain the rate of urban unemployment around 4%. Preservation of growth is about preservation of jobs, and for 2013, the baseline for GDP growth is 7.5% and the ceiling for Consumer Price Index (CPI) inflation is 3.5%. He makes clear he regards rising wages as a necessary part of raising living standards. He also acknowledged that China, as a middle income country has moved from a high speed growth era to a so-called mid-high speed period, which he said means 7%-7.5%.

Aggregate monetary policy is unlikely to change much – neither tighten nor loosen. Measures are likely to be more targeted. Premier Li referred to central administration cost cutting with savings diverted to relieving the tax burden on the smallest businesses. There is no desire to see an expansion of the fiscal deficit above the current 2.1% level or to expand the money supply (M2) with M2 now 2x GDP seen as adequate. Other areas about which we shall hear more include railway investment (China has 100,000km vs. the US 250-270,000 km), especially in the middle and western regions; stimulate domestic demand and stabilize export manufacturing which employs 30m people directly or 100m if support industries are factored in.

- **ASEAN**

The ASEAN region has seen some significant volatility over the past few months with the bond markets in particular showing marked weakness as capital pulled back. This has not become a general panic, as conditions now, though more difficult, are nowhere near crisis levels. Indeed, the outflows experienced in recent months reflect what has affected emerging markets more broadly, including India, South Africa, Turkey, Brazil and Mexico.

Indonesia has seen the heaviest outflows, which have resulted in the heaviest bond and currency falls. Here a mixture of weaker external demand, strong internal demand, falling commodity prices and unsustainable fuel subsidies have combined to keep the current account firmly in deficit, inflation high and foreign exchange reserves pushed to uncomfortably (but not critically) low levels. In recent weeks, it appears that foreign exchange reserves have stabilized. However, conditions in Indonesia point to more weakness in local currency and bond markets, further economic downgrades and a higher risk premium.

Thailand has also been on the receiving end of economic downgrades with consensus estimates coming down from around 5.5% to 4.5% in recent months. The main driver of these downgrades has come from expectations for private investment. This is a function of weaker export related demand and there has also been a distorting impact from the ending of the First Car Buyer Scheme*. However, we remain positive on Thailand: private investment has now stabilized, private consumption has been on a rising trend, residential construction appears good and household credit growth has grown almost 13%. Meanwhile, it also appears that the bank of Thailand has ensured that loan quality standards have been maintained.

* An incentive program for first-time car buyers in Thailand that backfired with more than 100,000 indebted consumers defaulting, leaving the big global manufacturers that dominate Southeast Asia's largest auto market struggling to defend their margins. (source: Reuters)

Malaysia faces a series of cyclical and structural issues. Strong demand for petroleum products this year turned Malaysia into an oil importer for the first time since 1995. This is in part due to closure of facilities for maintenance, but in truth, reflects longer term constraints on domestic supply. Oil production has been on a declining trend of 2% a year, and the government has committed to reverse this and grow it by 3% a year on average through to 2020. Another pressing long term problem is the long-term decline in manufacturing competitiveness. In the short term, levels of indebtedness both by government and households that prompted a negative rating watch by Fitch also need to be addressed.

Malaysia's recent 2014 budget marks a start in tackling some of these. On the debt side, the government seeks to bring the fiscal deficit down to 3.5% of GDP in 2014 and keep public debt below a self-imposed level of 55% of GDP. Some measures including an increase in fuel prices and an increase in capital gains taxes on property may help government revenues but more needs to happen. Government revenue looks set to grow less than 2% and government spending growth is likely to fall to below 1%, both rates being the lowest in almost 40 years. A goods and services tax (GST) will be imposed at 6% from April 2015. In the short term it doesn't appear that the budget contains anything that would immediately hit stocks, but over the next few years a fundamental rebalancing to avoid stagnation appears extremely likely.

- **Recent stock results**

The two biggest technology companies in the region, Samsung Electronics and Taiwan Semiconductor (TSMC), have released preliminary results for the third quarter. For Samsung the slowdown in smartphone sales that the market feared over the summer has not played out. Samsung reported strong earnings driven by the success of the new Galaxy handsets. For TSMC current earnings' performance is fine but longer term, there are decisions to be made. Intel is around a year ahead of TSMC in shrinking nodes (working to higher degrees of fineness) and is also further ahead in moving to production of 18" wafers compared to the standard 12" size today. For both companies there is the prospect of heavy capital expenditure, but Intel has the deeper pockets.

In Malaysia, mobile telecom company Digi.com reported good results with much of the capital expenditure associated with its network upgrade complete. This means that free cash flow should now look more substantial and support the continuation of the company's high (90%+) dividend payout ratio.

In China/Hong Kong we saw results from Dongfang Electric and HSBC come in ahead of expectations while Petrochina also surprised with better than expected results from refining and natural gas. Anhui Conch Cement reaped benefits from reduced industry capacity and stronger demand to report higher gross margins and slightly increased tonnage. China Shenhua Energy by contrast reported weaker results on lower coal prices. Yanzhou Coal's results were supported by greater stability in the spot market which allowed them to raise prices and by improved cost controls about which the market had earlier been skeptical. Sohu.com, the US-listed gaming and Internet search stock, delivered a negative surprise as its subsidiary Changyou guided for a significant incremental increase in marketing expenses in coming months. Nevertheless, excluding Changyou, Sohu's advertising and search revenues have been growing strongly. The recent investment by Tencent into Sohu's search engine business is likely to provide a further significant boost to that business.

Market Performance Ending October 31, 2013

	Oct 2013	Year to date	2012	2011	2010	2009
Australia	5.65%	10.99%	22.25%	-10.77%	14.69%	73.87%
China	2.50%	2.39%	22.69%	-18.36%	4.59%	62.06%
Hong Kong	2.07%	9.79%	28.26%	-15.78%	23.28%	60.48%
Indonesia	8.58%	-11.78%	6.11%	5.19%	35.47%	136.12%
Korea	4.05%	2.87%	20.99%	-13.55%	25.84%	74.44%
Malaysia	5.60%	7.88%	14.54%	0.11%	37.67%	51.26%
New Zealand	1.88%	19.45%	31.54%	5.90%	8.73%	49.89%
Philippines	7.87%	11.19%	47.52%	0.04%	35.24%	67.34%
Singapore	3.52%	4.63%	30.98%	-17.54%	22.03%	73.18%
Taiwan	4.24%	9.64%	17.43%	-20.18%	23.14%	80.23%
Thailand	6.17%	1.66%	35.01%	-2.72%	56.67%	76.59%
MSCI AC Far East Free ex Japan	3.88%	4.88%	22.06%	-14.75%	19.41%	68.56%
MSCI AC Pacific ex Japan *	4.33%	6.99%	22.72%	-13.59%	17.95%	71.51%

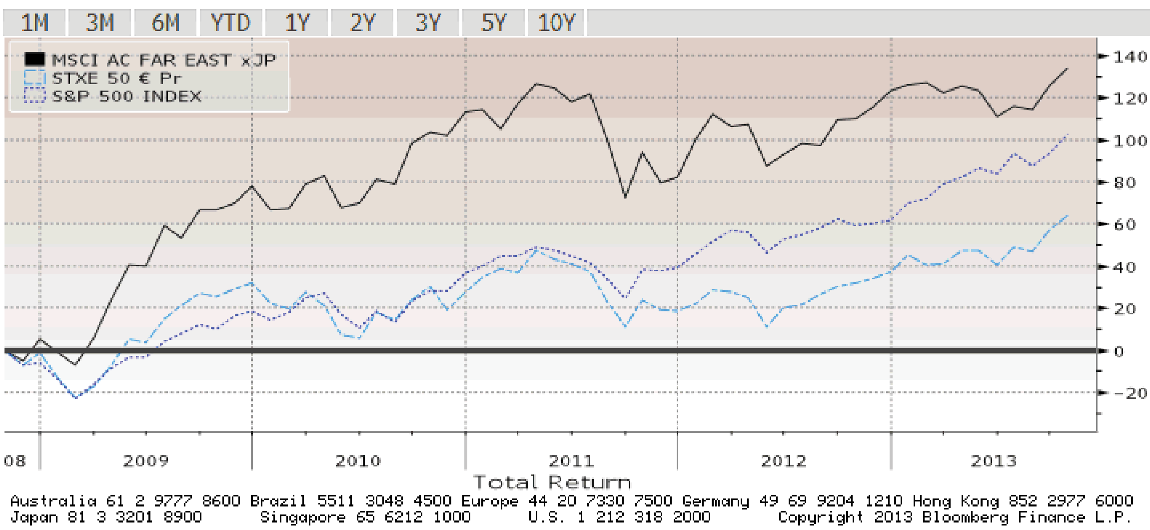
*MSCI AC Pacific includes Australia & New Zealand
(MSCI Indices were used for regional & individual market performance)

Stock market performance was market by improved performances across the region. ASEAN markets enjoyed a relief rally as global concerns abated somewhat and were helped by improving Chinese data. Investors however, seem unconvinced by China following the rally from the lows in the second quarter, while the overall market was subdued by comparison.

Major Indices total returns for the five years ending October 31, 2013

Range 10/31/2008 - 10/31/2013 Period Monthly No. of Period 60 Month(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1.	MXFEJ Index	USD	102.71%	134.09%	70.33%	18.53%
2.	SX5P Index	USD	31.94%	63.76%		10.36%
3.	SPX Index	USD	81.32%	102.48%	38.72%	15.14%



Source: Bloomberg

Commentary for our views on Alternative Energy and Energy markets is available on our website. Please click here to view.

Performance data quoted represents past performance and does not guarantee future results. Index performance is not illustrative of Guinness Atkinson fund performance and an investment cannot be made in an index. For Guinness Atkinson Fund performance, visit gafunds.com.

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. Non-diversified funds concentrate assets in fewer holdings than diversified funds. Therefore, non-diversified funds are more exposed to individual stock volatility than diversified funds. Investments in smaller companies 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. Funds concentrated in a specific sector or geographic region may be subject to more volatility than a more diversified investment. Investments focused in a single geographic region may be exposed to greater risk than investments diversified among various geographies.

The MSCI All Country Far East Free ex-Japan Index (MSCI AC Far East free ex-Japan Index) is a free float-adjusted, capitalization-weighted index that is designed to measure equity market performance in the Asia region excluding Japan. The Index is made up of the stock markets of China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.

The MSCI All Country Pacific Free ex-Japan Index (MSCI AC Pacific Index) is a free float-adjusted, capitalization-weighted index that is designed to measure equity market performance in the Pacific region. The Index is made up of the stock markets of Australia, China, Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan and Thailand.

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general.

The STOXX Europe 50 Index (STXE 50), Europe's leading Blue-chip index, provides a representation of supersector leaders in Europe. The index covers 50 stocks from 18 European countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

One cannot invest directly in an index.

Click for a list of current holdings for the Guinness Atkinson Asia Focus Fund.

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Click for a list of current holdings for the Guinness Atkinson China Hong Kong Fund.

Click for a list of current holdings for the Guinness Atkinson Renminbi Yuan & Bond Fund.

The Price to Earnings multiple reflects the multiple of earnings at which a stock or group of stocks in an index, sells. It is equal to the market capitalization of a stock, or group of stocks in an index, divided by the after tax earnings for that stock or index.

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