GUINNESS ATKINSON FUNDS

Guinness Atkinson
Global Innovators Fund eBrief
April 2015

Overview

The Guinness Atkinson Global Innovators Fund underperformed its benchmark in Q1 2015, which was the first time this occurred since Q3 of 2012. Until the first quarter of this year we have had nine consecutive quarters of outperformance, so arguably we were overdue on one where we underperformed.

In March the Guinness Atkinson Global Innovators fund produced a total return of -2.61%, while over the first quarter the fund was up by 1.12 %. This compares to the MSCI World index which was up 2.47% over the quarter. The fund therefore underperformed the benchmark by 1.35%.

as of 3/31/15	1 YR (annualized)	3 YR (annualized)	5 YR (annualized)	10 YR (annualized)	Since inception annualized (12/15/98)
Global Innovators Fund	1.12%	10.77%	18.90%	14.86%	7.38%
MSCI World Index	2.47%	6.68%	12.95%	10.74%	5.45%

Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 1.26%

Performance data quoted represent past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. For most recent month-end and quarter-end performance, visit http://www.gafunds.com/GIF_performance or call (800) 915-6566.

Holdings Analysis

Our positions in the Industrial sector were a positive contributor to performance, with Boeing and Roper performing particularly well. Our positions in the IT sector were generally a mixed bag with our Asian names in Lenovo, Samsung Electronics and Taiwan Semiconductor Manufacturing all performing well, while our US names such as Intel and Applied Materials underperformed. We had no stock specific issues.

What was noticeable over the quarter was the divergence between the MSCI World Growth and MSCI World Value indices. The market chased high growth companies over the quarter, irrespective of valuation, with the Biotech sector continuing to run higher. While we look to invest in innovative growth companies, our value bias has generally steered us away from the Biotech sector with the exception of our holding in Gilead.

We are not necessarily looking to invest in the most innovative companies with the most exciting story or those that might be the most disruptive. We are looking for the most attractive investments. We believe that innovative companies that are purchased at good valuations have the potential to provide better returns than the most innovative companies at any valuation.

Seeking Innovation and Valuation

Innovative companies can be an extremely exciting group of companies to watch. We can all think of innovative companies that have grown from an idea or invention to become a successful global brand. If we try a bit harder we can probably also remember quite a few companies which were surrounded with great optimism and excitement that eventually flopped.

However, it's the successful companies we tend to remember. The history that surrounds some of these companies has in some cases become almost mythical.

We all love the story of a company being started by a leftfield inventor tinkering in his garage. We remember the story of Apple not as that of two former Atari and Hewlett-Packard employees launching a product, but two likeable mavericks inventing a dream.

The human preference for this kind of creation story has meant that some great companies like Google have perpetuated a "garage" creation story. In reality, the founders of Google began working on their search engine in 1996 while at Stanford. Having secured investment they then moved into a garage in 1998 for just a few months. In 2006 Google bought the garage to secure this creation story!

We believe most entrepreneurs are smart, experienced people, with smart ideas, who surround themselves with more smart people. Those that are going to be successful will also need a bit of luck.

A list of recent and upcoming IPOs (initial public offering) can be a good source from which we can identify innovative companies. Not every company that has recently become a publicly traded company is innovative, of course, but some of them will be. Some of these companies will be seeking a public listing in order to raise the necessary capital to invest to further develop their innovative product, service or business model. It can make sense for a company to go public if they have made a major breakthrough and require capital to scale up their business.

We should also not forget there are other reasons why a company may want to list publicly, most obviously being if it is motivated by private equity investors looking for to exit their investment in the company.

The IPO often coincides with when an innovative company is at its most hyped up and therefore only available at a lofty valuation. Public relations (PR) campaigns are stepped up and growth expectations can rise to levels which are statistically unlikely to ever be met, and we believe unlikely to make you a reasonable return if you do invest.

The IPO of Shake Shack in January this year is a case in point. The company describes itself as "a modern day 'roadside' burger stand". It has the restaurant chain equivalent of the tech company garage origin story in the form of a "street food" stand in Madison Square Park. However, the reality is the chain was founded by serial restaurant entrepreneur Danny Meyer, CEO of Union Square Hospitality Group (USHG).

Its innovation manifests itself in the company's business model, which allows them to charge a premium price for a low cost product, tapping into the "fast casual" restaurant trend. The company

is well established in the US and is now investing to expand globally to monetize the successful formula that they have devised.

There are two main reasons why we would not invest in this company today. One reason is structural and the other is temporal.

Firstly, restaurant chains are somewhat dependent on fashion and trends. The odds of creating a restaurant chain that can maintain its competitive advantage over multiple cycles is low. Shake Shack may beat the odds, but on the other hand, how can the brand continue to maintain its supposed scarcity premium and expand rapidly?

The second reason is the valuation. Restaurants that have scale can be extremely cash generative businesses. Working capital is often negative and therefore a source of funding to grow the business. This is due to the purchasing power they maintain with their suppliers and the fact their customers pay them immediately. These highly cash generative businesses could command a premium valuation if you believe that this cash generation is sustainable.

However, the valuation the market is willing to pay for Shake Shack is extremely high. The market capitalization at the end of March was $1.8 billion[1]. Over the last three years the company has generated an operating income that has averaged less than $5 million, and the consensus of seven Wall Street analysts is that it will not be higher than this in 2015 or 2016. If we are generous and assume that the company's operating profit is equal to their net income, i.e. they don't pay any tax and there are no other exceptional items, then this implies a current and forward looking P/E multiple of at least 360x.

To bring this valuation alive, an alternative way to think about the valuation is to consider the share price per burger sold. The company generated revenue of nearly $120 million last year. If we assume that two-thirds of their revenue came from burgers and on average they cost $8 each, then that suggests they sold 10 million burgers in 2014. With a market cap of $1.8 billion that implied the market is willing to pay $180 per burger sold in 2014.

The idea of paying $180 per burger sold for Shake Shack shares makes our stomachs churn.

Clearly, the market is not looking backwards but is licking its lips about the future. However, to get anything close to considering the current share price as reasonable, the growth assumptions have to be heroic, and would need to be executed perfectly. There is no doubt in our minds that sentiment towards this company is excessively positive.

We prefer cash multiples to burger multiples, and one of our stocks that performed worst last quarter was that perpetual innovator Intel, which generated $20 billion of cash last year and you can buy for 7.5 x cashflow as of 3/31/15.

[1] Source: Bloomberg

Even when investing in innovative growth companies it is worth remembering the sage words of Benjamin Graham:

"The risk of paying too high a price for good quality stocks – while a real one – is not the chief hazard… Observation over many years has taught us that the chief losses to investors come from the purchase of low quality securities at times of favourable business conditions."

Benjamin Graham

Thank you for your continued support.

Matthew Page and Ian Mortimer

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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 medium and 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.

Securities mentioned are not recommendations to buy or sell any security. Current and future portfolio holdings are subject to risk

This information is authorized for use when preceded or accompanied by a prospectus for the Guinness Atkinson Global Innovators 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.

Click here to view the Top 10 Holdings of Guinness Atkinson Global Innovators Fund

Top 10 Holdings of Guinness Atkinson Global Innovators Fund as of 3/31/15:

1. Gannett Co Inc 3.57% 2. Li & Fung Ltd 3.51% 3. Schlumberger Ltd 3.49% 4. Intel Corp 3.46% 5. Roper Industries Inc 3.45% 6. PTC Inc 3.45% 7. QUALCOMM Inc 3.44% 8. Lenovo Group Ltd 3.42% 9. Samsung Electronics Co Ltd - GDR 3.42% 10. Intercontinental Exchange Inc 3.40%

Price to Earnings Ratio (P/E) is a valuation ratio of a company's current share price compared to its per-share earnings. Calculated as: Market Value per Share / Earnings per Share (EPS)

MSCI World Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics across 23 Developed Markets countries.

MSCI World Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries

Forward Looking P/E is a measure of the price-to-earnings ratio (**P**/**E**) using forecasted earnings for the **P**/**E** calculation.

Cash flow is the total amount of money being transferred into and out of a business, especially as affecting liquidity.

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