Guinness Atkinson
Asia Pacific Dividend Builder Fund
Managers Monthly Update – December 2016

Markets

The US presidential election marks a change in direction for domestic economic policy and possibly for trade and diplomatic relationships. Detailed policies from the President-elect are not yet available, but estimates from the Committee for a Responsible Federal Budget based on policy proposals during the election campaign suggest net government borrowing could be more than $5 trillion over the next decade as a result of higher infrastructure spending, higher minimum wages, and tax cuts, among other things. The immediate effect was to push US equities to new highs and for yields on US Treasuries to rise (although in the case of the 10 Year Treasury only to the level it was a year ago).

Although financial markets in the US have moved sharply on expectations of future policies, there are myriad questions on the detail, speed and extent of their implementation as well as how they are funded. The estimate above assumes US real GDP growth grows by 2% per annum. However, deregulation, lower corporate taxes and government spending to spark a new investment cycle could well push that growth rate higher. Faster domestic growth and interest rates back at 2%-3% is a picture we would like to see.

Asia Perspective

- **Interest rate** increases in the US are unlikely to hold many fears for the region. Most countries in Asia are running trade surpluses, foreign debt exposure is not high, banks are well capitalised and inflation is low. There are exceptions, with Indonesia and Philippines looking more exposed than the rest, but overall the picture is stable.

- **Trade agreements** with all the US's trading partners appear to be up for renegotiation and the uncertainty this brings is undoubtedly a risk for Asia. It will also be a risk for the US. Protectionism will impact demand for goods produced in the global supply chain and will inevitably increase costs for US consumers who will no longer be able to find a laptop computer for $400, for example.

- **Diplomatic relations** also appear to be changing, with a clear 'not business as usual' message when Trump spoke to President Tsai. There is a very powerful nationalist element in China which its leadership sometimes struggles to rein in, and which has issued a hyperbolic response matched to some degree by the western media. In truth, it is likely that China has been wrong-footed and its officials are now scratching their heads and trying to work out how to deal with someone prepared to disregard the rules. This too is not necessarily a bad thing, but we hope the advice Trump is getting is informed rather than merely opinionated.

- **Domestic Asia issues** seem to us have greater immediacy than events in the US. Growth momentum in China has risen with the return of pricing power and accompanying profit growth in the heavy industrial sector. This is likely to make debt servicing easier and, if sustained, make room for banks to manage their liabilities better. However, credit growth is still strong and excess production capacity still exerts a drag. These create both inflationary and deflationary pressures, making China's monetary policy setting more of a challenge. The domestic economies of South Korea and Thailand are both affected by political issues: a presidential scandal and impeachment in South Korea and the death of the King in Thailand.

Investment review

The most sensible approach, it seems to us, is to focus on what it is we're actually buying rather than attempt to manage around swirling events and themes. We invest in companies that have long track records of generating returns on invested capital that have exceeded the cost of capital. These companies generally continue to do so and on this basis we regard them as 'quality' businesses. Histories of strong operating performance and the likelihood of their persistence give us greater confidence in identifying those companies that we believe are undervalued by the market. This focus on quality defined in terms of the persistence of strong financial performance coupled with a value discipline delivers what we believe to be a distinctive and attractive risk/return profile.

In the course of 2016 we have seen strong performance from stocks ranging from Australian healthcare (Sonic Healthcare) through Chinese banks (China Construction and China Minsheng) and Hong Kong retail (Luk Fook) to Japanese real estate services (Relo Holdings) and technology companies across the region (AAC Technology in China, Qualcomm in the US, Largan Precision in Taiwan). The common feature for all them is track record of generating above average returns on invested capital and an underestimate by the market of the persistence of those returns.

Clearly, not all stocks are going to move higher at the same time, but we have confidence in all our thirty-six names and those that are currently lagging are added to as we rebalance the portfolio. This year notable laggards have been Li & Fung in Hong Kong (a production outsourcing agent), Chinese retailers Belle International and China Lilang, Bangkok-based property developer LPN Development and Taiwanese technology companies Catcher Technology and Novatek Microelectronics.

In January we shall produce a more detailed review of our companies and their stock performance over the past year. Until then, we send you the season's greetings and wish you all the best for 2017.

Edmund Harriss (portfolio manager)
Mark Hammonds & Sharukh Malik (analysts)

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The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-915-6566 or visiting gafunds.com. Read it carefully before investing.

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. 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 debt securities typically decrease in value when interest rates rise, which can be greater for longer-term debt securities. Investments in derivatives involve risks different from, and in certain cases, greater than the risks presented by traditional investments. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. 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. Investments focused on the energy sector may be exposed to greater risk than an investments diversified among various sectors.

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

Past performance is not indicative of future results.

Top Fund Holdings as of 11/30/16

1	Luk Fook Holdings International Ltd	3.30%
2	Largan Precision Co Ltd	3.30%
3	Hon Hai Precision Industry Co Ltd	3.23%
4	China Construction Bank Corp - H Shares	3.12%
5	DBS Group Holdings	3.07%
6	PTT PCL /Foreign	3.05%
7	Taiwan Semiconductor Manufacturing Co Ltd	3.02%
8	Yangzijiang Shipbuilding Holdings Ltd	2.89%
9	BOC Hong Kong Holdings Ltd	2.88%
10	Tisco Financial Group PCL/Foreign	2.87%

Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

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