Guinness Atkinson
Dividend Builder Fund
Managers Update – January 2018

GUINNESS ATKINSON FUNDS

Review of 2017

"Political noise, market poise" suitably characterizes the year of 2017. Equity markets persistently defied the skeptics, who pointed to political dysfunction, monetary policy uncertainty, and potential geopolitical crises as reasons for woe. Instead the year saw well-diversified global growth, with many equity indices hitting new highs. Every single one of the world's 45 major economies (defined by the OECD) grew in 2017, and is forecasted to grow in 2018. It has been more than a decade since the lift to the world economy was this broad. While risks from politics, central bank policies and military threats have not gone away, investors seem to have recognized that the global economy is not as vulnerable to these influences as perhaps thought of at the start of 2017.

The MSCI World and S&P 500 indices delivered positive returns in every single calendar month of 2017 – the first time this has happened in history. Perhaps more remarkable is that these consistent returns have come with record low volatility. The maximum drawdown for the S&P 500 index was less than 3.3% over the year, and this compares to the index's median average of 18.0%, going back to 1980. The year started with a growing optimism that the new U.S. administration would be beneficial for corporate profitability. Tax reform, deregulation and infrastructure spending initiatives were part of President Trump's initial plans and helped push stock market returns upwards. Positive macroeconomic data releases led the Federal Reserve (FED) to hike interest rates in March, June and December of 2017. This followed a rate hike in December 2016, and although a cumulative rise of 1% in 12 months may not sound significant, previous to these 12 months, there were no rate rises in the last decade. Attempts to disengage from the strictures of unconventional monetary policy, namely zero interest rates and quantitative easing which were introduced in many economies in the aftermath of the financial crisis, are set to continue with forecasts suggesting three to four further rate hikes in 2018. President Trump also announced that Jerome Powell will lead the FED when Janet Yellen steps down as Chair in February 2018. Powell is unlikely to materially alter the likely course of rate rises, but the new FED members to be appointed in the year could potentially shift the path and will warrant close attention. In the final quarter of the year, unemployment fell to the lowest level since 2000, business investment accelerated, and there was also a much-anticipated reduction in the U.S. corporate tax rate to 21%, from 35%. The year finished on a high also in terms of corporate profitability, with third-quarter earnings releases showing a 6% year on year rise.

Despite a good year for the European economy in terms of equity returns and corporate earnings (up 10% year on year in the third quarter), European stocks underperformed several other markets in local currency terms, highlighting the extremely strong returns delivered elsewhere. European equities had a great start to the year, as business surveys picked up and political risk faded with Emmanuel Macron's election win. The strong rally in the Euro in the first three quarters of the year explains much of the subsequent drag (since May) on European equities in local currency terms. Foreign revenues have had to be translated at a less favorable rate. In the fourth quarter, European equities delivered the lowest returns, despite a broadly flat Euro, suggesting they have not experienced the same boost from U.S. tax cuts. Furthermore, politics has given European investors reason to pause for breath. The Catalonian independence disputes have weighed on the relative performance of Spanish equities since August, and the start of October has seen Italian equities also give up a little of their outperformance for the year as investors start to look ahead to the Italian elections in 2018. Turning to look at central bank action, the European Central Bank was encouraged by the overall health of the European economy, perhaps coupled with legal constraints on the amount of German bunds it can buy, to announce in October that it will reduce its monthly quantitative easing purchases down to EUR 30 billion. This lower pace of purchases will start in January and last until at least September 2018.

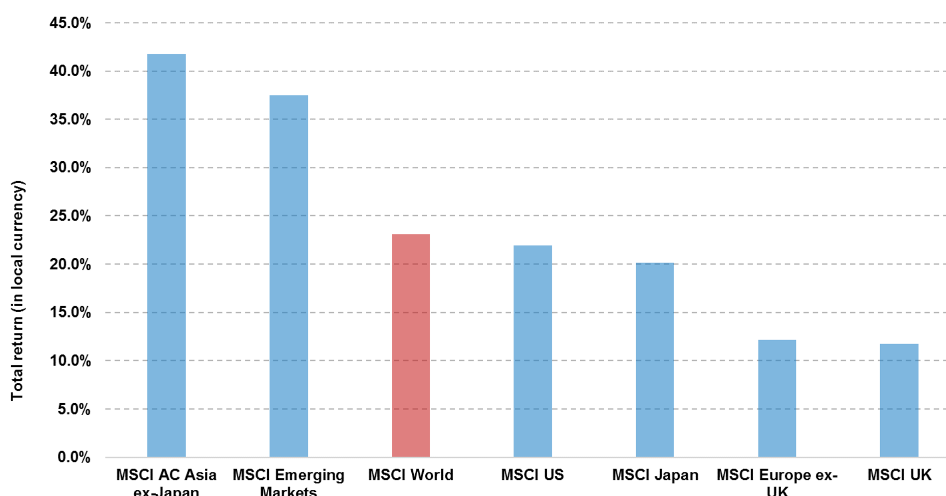
UK equities have had to contend with the strength in Sterling over 2017, weighing on the value of foreign revenues, which make up close to 70% of FTSE 100 sales. The more domestically focused mid-and small-cap stocks have therefore outperformed in 2017, with UK equities overall underperforming most other regions this year. Part of the reason for the rally in the Pound this year has been an increasing probability of a transitional deal on Brexit. The completion of phase one of the Brexit negotiations in December supports the market's assumption that a transitional deal now looks more likely than it did at the start of the year, even though many challenges remain. The deterioration in UK consumer confidence stands in contrast to the buoyant consumer confidence seen in most other regions. The Bank of England increased interest rates in November for the first time since 2007, but noted that any further rate rises are likely to be very gradual and remain highly dependent on the outcome of the Brexit negotiations.

The best-performing equity markets this year have been in Asia and the emerging markets. Several factors have contributed to their strong performance. A weak Dollar has historically been supportive of the relative performance of emerging market equities and this proved to be the case in 2017. EM equities have also benefited from a rebound in earnings off a low base and the rally in technology stocks this year. The MSCI EM Index started the year with Technology making up 25% of the composition. It's also been another year when the China bears have been left disappointed. In the fourth quarter, the 19th National People's conference laid out a plan for reducing financial risks while focusing on delivering slightly lower, but still very substantial, GDP growth.

Following suit, Japanese equities have likewise had a very strong 2017. The major driver of performance this year has been stellar company earnings, which rose by 16% year on year in the third quarter. Earnings were bolstered by strong global growth and a pick-up in global trade. Prime Minister Shinzo Abe comfortably won the election in October, providing political stability and boosting confidence that there should be few changes to his economic policies. Next year, it will be important to watch Bank of Japan (BoJ) policy and whether Kuroda continues as governor after his current term ends in April 2018.

Overall, most equity investors have enjoyed a remarkably smooth and rewarding 2017 as all regions worldwide posted significant gains (figure 1).

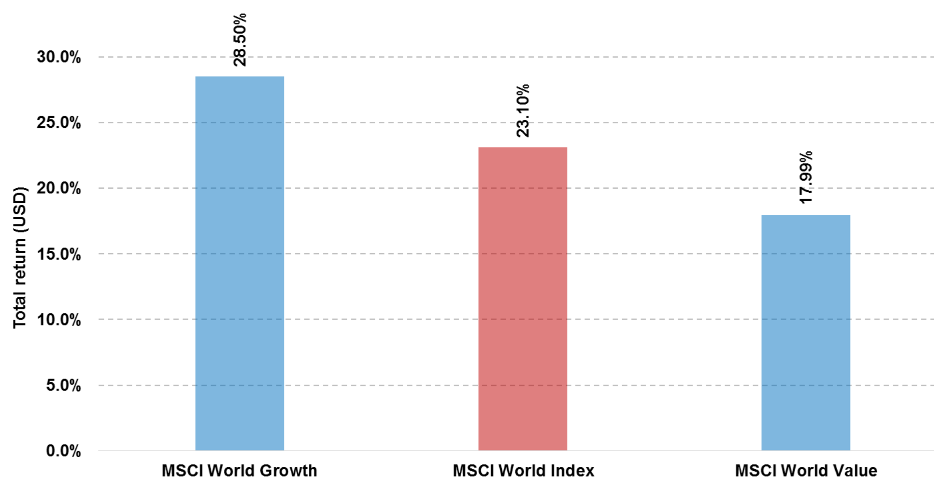
Figure 1: Regional Performance (in local currency). *Source: Bloomberg*



The big question going into 2018 is whether this can continue as new headwinds approach. As ever, rather than trying to pick which way the macro or political winds will blow in the near term, we maintain our focus on companies that can deliver a sustainable, rising income stream alongside capital growth over the long term. Holding good quality companies, that have persistently generated high levels of cashflow return on investment gives us confidence that the fund is well placed to weather different market conditions.

The Guinness Atkinson Dividend Builder Fund tends to outperform in down markets, and is skewed towards quality companies, at attractive valuations. This explains the Fund's slight underperformance this year as we see in the below figure that Growth companies significantly outperformed Value.

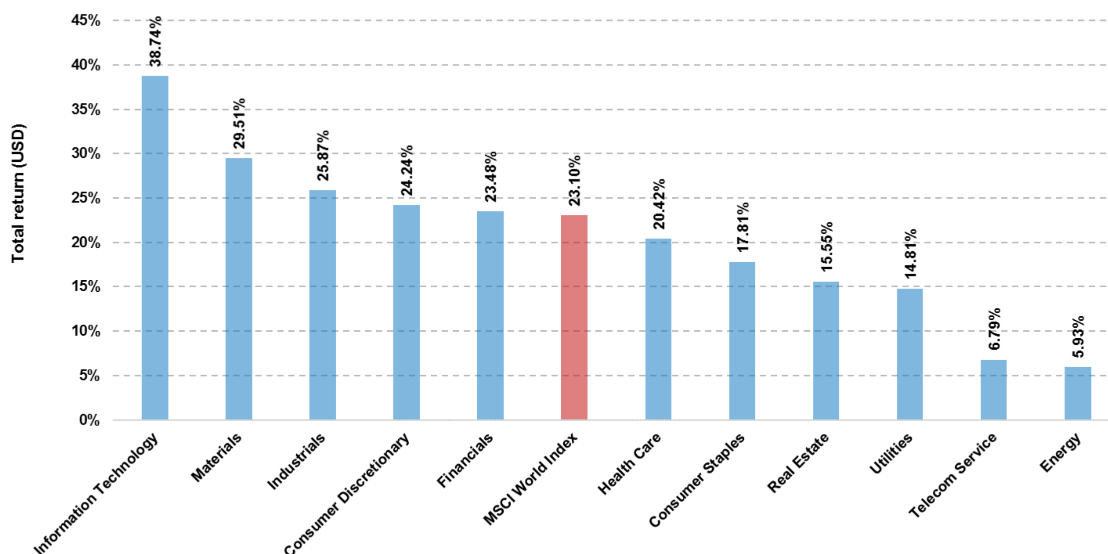
Figure 2: MSCI World style performance in 2017 (in USD) *Source: Bloomberg*



In terms of sectors, technology stocks led the way returning almost 40% (in USD), but the market rally was relatively broad based, with materials, industrials, consumer discretionary, financials and healthcare all returning over 20% (in USD). Defensive "bond-proxy" sectors such as utilities, telecommunications, real estate and consumer staples lagged.

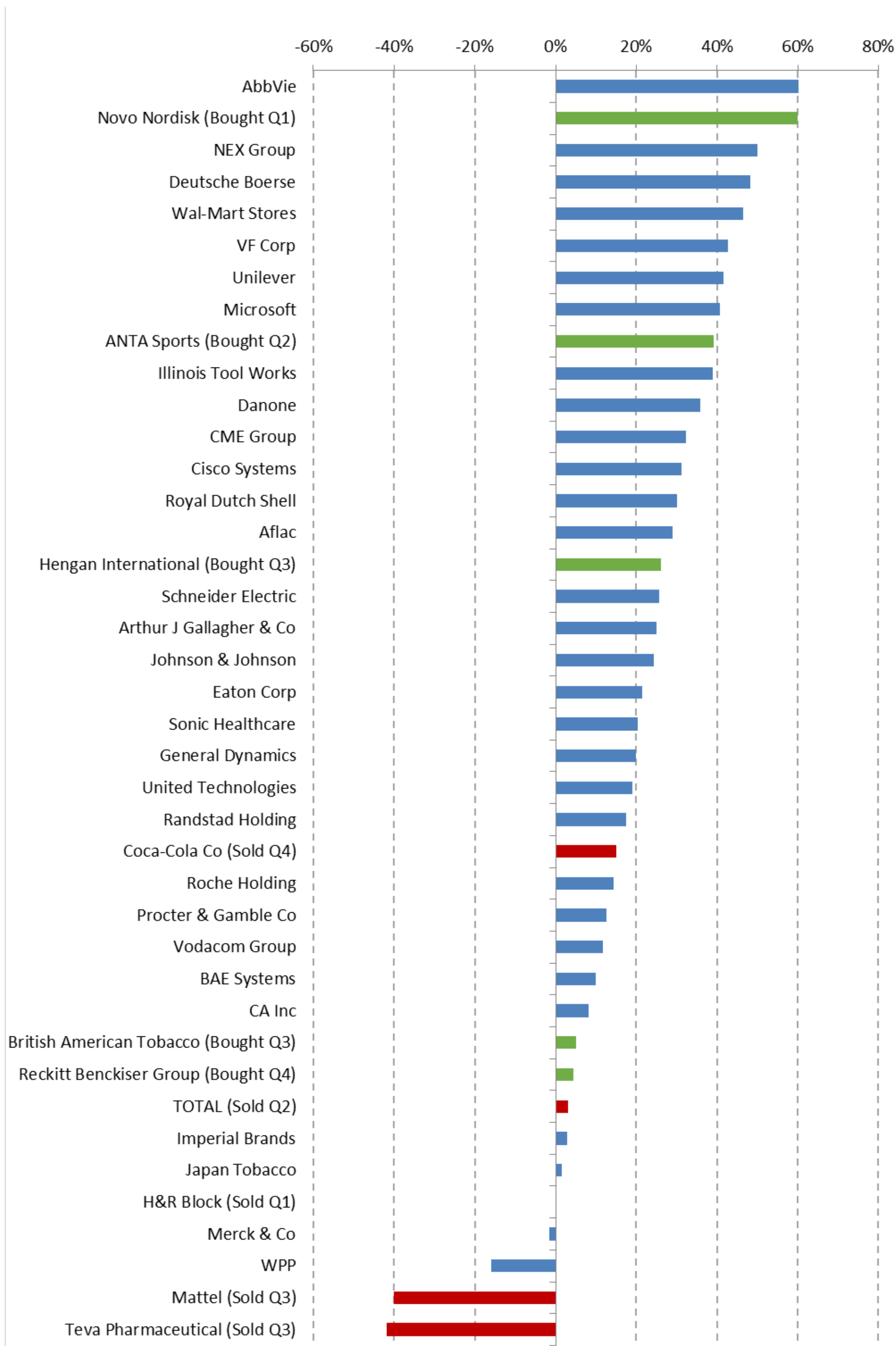
For the fund, overweight healthcare was a small drag on performance from an allocation perspective, but good stock selection (e.g. Novo Nordisk and AbbVie) meant overall allocation to the sector added to performance. This is similar to the case with IT stocks, where underweight to the sector dragged on performance though we saw good returns from individual positions such as Microsoft and Cisco. We also note that although consumer staples underperformed as a sector, good stock selection meant positive contributions. It is particularly pleasing to see many of our newer additions performing well in this sector.

Figure 3: MSCI World sector performance in 2017 (in USD) *Source: Bloomberg*



When we look at how individual companies within the portfolio performed in 2017 we see that out of the top five, we have two healthcare, two financial, and one consumer staples stock (figure 4). This is testament to the bottom-up philosophy of the Guinness Atkinson Dividend Builder Fund focusing on quality companies at attractive valuations. It is also worth noting at this stage that the fund is benchmark and sector agnostic – positions are based on high conviction, bottom-up fundamental analysis.

Figure 4: Individual holdings performance over holding period during 2017 *(total return USD)*



As of 12/31/2017. Holdings are subject to change.

Of the two worst performing stocks, Mattel and Teva Pharmaceutical, we saw significant share price falls in the third quarter. In its earnings release, Teva surprised the market with significant write-downs associated with the Allergan acquisition and a large cut to the dividend, so we decided to sell our position. Mattel had been a long term holding in the fund and performed very well from 2012 to 2015. The company saw falling sales and earnings in more recent years, and it announced a dividend cut in the third quarter, convincing us to sell our position.

Changes to the portfolio

In 2017 we sold five positions and bought five new positions, leaving the portfolio with 35 positions at the end of the year. This was more changes than in 2016, though fewer than in 2015.

Figure 5: Number of changes to the portfolio

	2013	2014	2015	2016	2017
Buys	7	2	7	4	5
Sales	8	3	6	4	5
Total holdings	35	34	35	35	35

In the first quarter, we made one change to the portfolio, whereby we bought Novo Nordisk and sold HR Block.

H&R Block, the US-based tax preparation company, saw some significant changes during our long term holding of the company. Of particular note was the spinning off of its banking arm in 2014, which released the company from the associated regulatory burden and capital requirements associated with that business. This was well received by the market and the company added significantly to the performance of the fund from our first purchase in 2013 to the end of 2015. However, through 2016 the company posted a series of weak quarterly results as it appeared competition in the market place and particularly the 'do-it-yourself' online tax returns model had begun to erode their dominant position. This was reflected by sharp declines in the share price over this period. The quarterly results released in early March surprised to the upside, however, mainly as the market had become too pessimistic rather than results being obviously positive. The subsequent spike upwards in the share price provided us an opportune moment to exit our position. At the time of sale, the valuation of the company was undemanding (around 13.5x 2017 expected earnings) but we felt the quality had deteriorated as debt to equity levels began to rise significantly. We felt our conviction was not high enough to justify holding the stock.

We bought **Novo Nordisk** to replace H&R Block, sticking to our one-in, one-out policy. The Danish pharmaceutical company is a leader in the global insulin market and has maintained a concentrated, yet market leading, portfolio of drugs targeting diabetes – a growing disease especially in less developed countries. We liked the fact that CFROI has been consistently growing over the last 10 years and currently stands at 25%. Dividends per share have also been growing very quickly with a five year dividend growth rate of over 20% per annum. The company has a very strong balance sheet with very little debt compared to its peers and has considerably more cash than debt. The company's shares sold off since mid-2016 after an increase in competitive threats, pricing pressures and uncertainty in the US healthcare reform. However, we believed that the market had been overly pessimistic given Novo Nordisk's growing drugs pipeline, strong balance sheet and significant cash generation, and this gave us an attractive entry point. During the time we have held the stock, the share price has already rallied 60% (in USD).

In the second quarter, we also made one change to the portfolio. We bought ANTA Sports and sold TOTAL.

TOTAL, the global oil and gas company, was one of our two energy sector holdings. We grew increasingly worried at the company's falling cashflow return on investment and this was accompanied by stagnant dividend growth and capital growth. In our opinion, the company's inability to sustain healthy margins put us out of favor with the stock, especially at a time where industry-wide factors were hampering the performance of energy stocks. We believe that the stock was overvalued versus its history, based on its P/E multiple, and with an increasing amount of long-term debt maturing in the next few years, it was deemed a good time for us to sell our entire position in TOTAL.

We bought **ANTA Sports** to replace TOTAL. ANTA Sports is based in China and has a cashflow return on investment over 10%, for its entire 10 years of existence as a public company. The company generates revenue through the manufacture and trading of sporting goods, including footwear, apparel and accessories. Its brand portfolio includes ANTA, ANTA KIDS, FILA, FILA KIDS and NBA, and has joint ventures with new brands too, such as South Korea's Kolon. Looking at the financials, ANTA Sports has very solid margin growth alongside a surge in sales in recent years. The company is well positioned to benefit from the growing wealth in China, recovering economy, and has maintained low debt. It is the official sponsor of the Chinese Olympics team and we have conviction that the stock has potential to maintain its significant earnings growth. Since buying the stock, the company strengthened its multi-brand strategy by acquiring popular kidswear brand, KingKow. During the time we have held the stock, the share price has rallied 39% (in USD).

In the third quarter, we made two changes to the portfolio, whereby we bought British American Tobacco and Hengan International. We sold positions in Teva Pharmaceuticals and Mattel.

British American Tobacco – the global tobacco leader – was on our radar due to its stellar cashflow returns on invested capital, and strong dividend profile. It's increasing market share, sales and earnings, and its successful integration of the mega $65.4bn acquisition of Reynolds American, position the company well for future price and dividend growth. Despite a rising debt, the company has large piles of cash and good interest cover. At the time, we believed that the U.S. Food & Drug Administration's proposal to reduce nicotine in cigarettes had been overly discounted, and coupled with a sell-off following bribery allegations, this provided us an attractive valuation to buy a new position. Integrating the Reynolds American deal and developing the "global drive brands" strategy is the company's focus for the next few years, as synergies from the acquisition are expected to be $400 million. "Global drive brands" continue to boost BAT's market share at higher price points and increased investment in new-generation products will allow longer-term growth.

Hengan International is one of the largest producers of sanitary napkins, diapers and tissue paper in China. Historically the company has captured significant market share in established distribution channels (maternity stores, hypermarkets) and more recently it is seeing growth from online exposure. Management has built up an e-commerce team to take advantage of the channel shift in China, whereby consumers are increasingly purchasing everyday items online. Alongside this there are new brand launches and a revitalized sales strategy to maintain its offline market share. Growing revenues, high and stable margins, year-on-year earnings growth and a well-covered, high dividend are some of the highlights making this a compelling addition to the fund.

We bought **TEVA Pharmaceuticals** in 2013 when the stock was trading at historic low multiples and the market was overly focused on "patent cliffs" – an issue which was associated with healthcare companies in general. Over the following two years the stock price recovered significantly as the expected pessimistic scenarios did not come about. Into 2016, however, the share price weakened as worries mounted regarding drug pricing in the U.S. and the company announced a significant M&A transaction, buying the generic drug business of Allergan for around $40bn. This was an exceptionally large figure for the company and raised questions as to whether TEVA had both over paid and overstretched. In the second half of 2016, the share price continued to fall, although we felt this was more sentiment-driven. However, the second quarter earnings release came as a shock to the market due to the severity of the announcement, which entailed significant write-downs associated with the Allergan business acquisition and a large cut to the dividend, in part to preserve cash to pay down debt and prevent certain covenants being breached. As a consequence of these poor results, and especially in light of the dividend cut, we were quick to sell our full position in TEVA.

Mattel is another company that has been a long term holding in the portfolio, though over the last two years it has had mixed results. Ultimately sales have declined due to strong competition and lack of innovation from the company and the cost of goods sold have not declined in parallel – meaning earnings have been hit. With such an operationally leveraged company it has been of particular disappointment that the management had not been able to tackle costs and arrest the decline in margins. Throughout this period the company did maintain its commitment to the dividend, even as payout ratios increased from what were relatively low levels. After only two years we saw another CEO change announced in February this year, whose background was Google and Groupon, and who had a focus on modernizing their product offering. Through 2017 the company continued to disappoint but the dividend cut announced by the new CEO on the second quarter earnings call further added to market worries, and as a consequence we sold our position in the company.

In the fourth quarter of the year, we made one change. We bought Reckitt Benckiser and sold Coca Cola.

We bought **Coca-Cola** in 2012 and the drinks manufacturer has returned close to 50% (in USD) in total return over the holding period. A sizable proportion of this has come from a large and growing dividend payment over the years, and more recently the stock has seen significant multiple expansion. The company trades at a 10-year peak forward P/E multiple of 23x, and we have seen this as a good opportunity to take profit and sell our position. Although margins have improved, the beverage company has been seeing lower sales growth with earnings increasingly supported by share buybacks. Increased debt to fund these buybacks has left the company more leveraged and reduced our conviction on future growth. Although the dividend yield is still attractive at 3.3%, we believe that there is a higher risk of multiple de-rating if emerging market sales recovery disappoints or is already “priced in”. Regulation on sugary drinks and growing consumer consciousness add to the concerns for Coca-Cola, and this is translating to falling sales growth consecutively for the last 5 years.

We replaced our position in Coca-Cola with **Reckitt Benckiser**, a stock we had previously held between 2012 and 2015. This is a British producer of health, hygiene and home products, with ‘Powerbrands’ – as Reckitt Benckiser likes to call them – such as Nurofen painkillers, Durex condoms and Dettol disinfectant. We see this as a high-quality business that has underperformed the MSCI World Consumer Staples index since mid-2016 due to falling sales growth, particularly in India, Brazil and the Middle East. More recently, in October, the consumer goods firm cut its full-year sales forecast, struggling with a fallout from a cyber-attack, a failed product launch and a safety scandal in South Korea. In turn, we believe the market has been overly-pessimistic and recent acquisitions (e.g. $16bn purchase of baby milk maker Mead Johnson) and business re-organization efforts have not fully been recognized. The stock is currently trading at a forward P/E multiple of 18x, compared to 24x in mid-2016. We see this as an attractive entry point, especially given that dividend growth was 10% in 2017 and earnings are forecasted to grow 6% in 2018.

Portfolio today and outlook

The charts below show the sector and geographic breakdown of the portfolio over the last seven years. The major effect of the changes we made to the portfolio in 2017 was to increase our exposure to consumer staples. In terms of sector weightings, the fund continues to have a zero weighting to utilities, materials, and real estate. The largest overweight positions are to consumer staples, industrials and healthcare.

Figure 6: Portfolio sector breakdown (12.31.17) *Holdings are subject to change.*

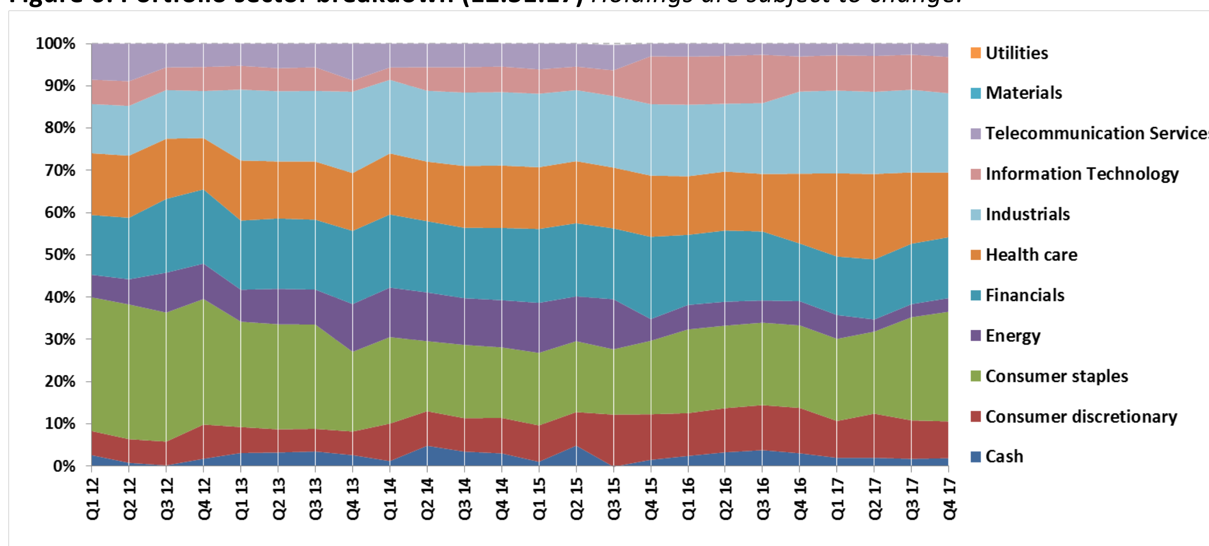
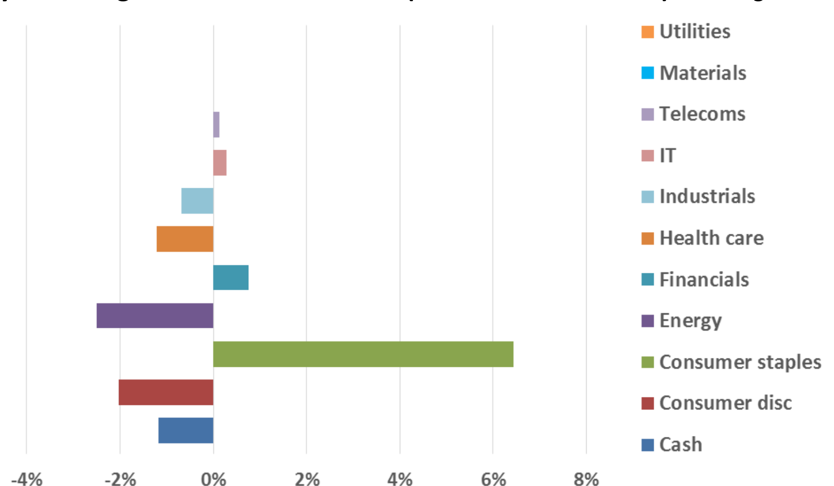


Figure 7: Year on year change in sector breakdown (12.31.17 vs 12.31.16) *Holdings are subject to change.*



In terms of geographic allocation, we reduced our exposure to North America, while increasing our exposure to Asia-Pacific and the UK.

Figure 8: Portfolio geographic breakdown (12.31.17) *Holdings are subject to change.*

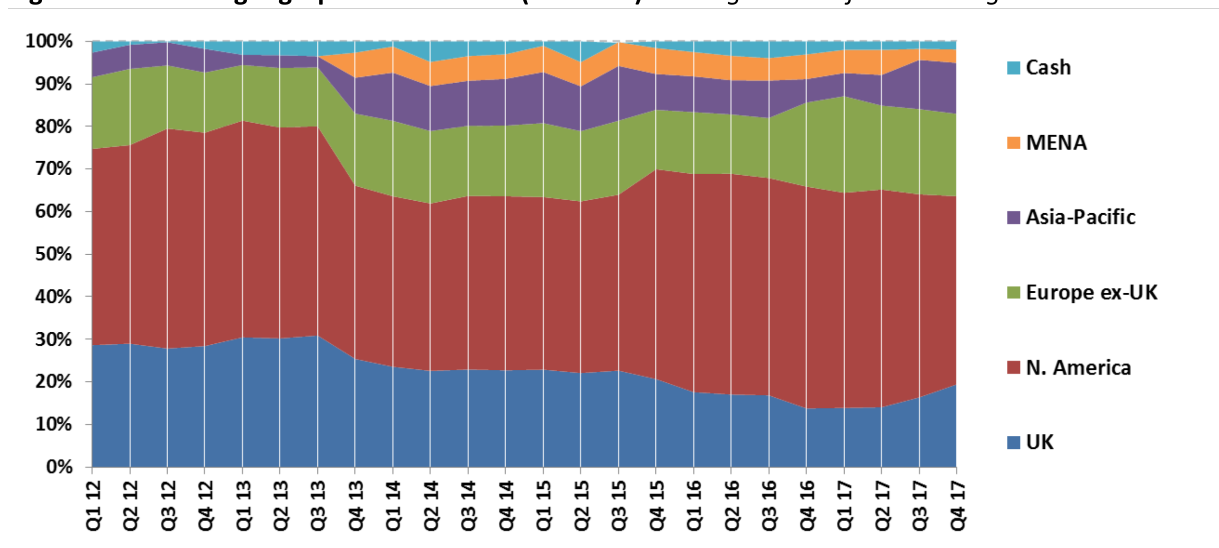
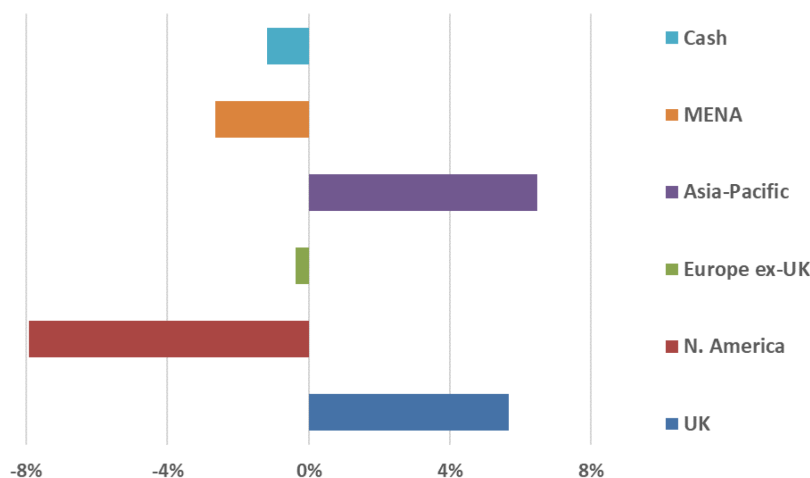


Figure 9: Year on year change in geographic breakdown (12.31.17 vs 12.31.16)
Holdings are subject to change.



The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level to make sure we are providing what we say we will. Based on the measures, holistically, the high-conviction fund has companies which are on average better quality at similar value verses the index.

At the year end, we are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI World Index.

		Fund	MSCI World Index
Quality	Average 10 year CFROI	21%	10%
	Weighted average net debt / equity	54%	67%
Value	PE (2018e)	17.1	17.2
	FCF Yield (LTM)	6.4%	4.5%
Dividend	Dividend Yield (LTM)	2.3%	2.3%
	Weighted average payout ratio	62%	52%
Conviction	Number of stocks	35	1650
	Active share	92%	-

Figure 10: Portfolio metrics versus index. Guinness Atkinson Asset Management, Credit Suisse HOLT, Bloomberg (data as of 12.31.2017)

The fund at the end of the quarter was trading on 17.2x 2018 expected price to earnings; a discount of 0.5% to the broad market. However, on a free cashflow basis, the fund trades at a significant discount to the market. With interest rates set to rise and continuous geopolitical uncertainty around the globe, our perpetual approach of focusing on the quality of the underlying companies we own should stand us in good stead in our search for rising income streams and long-term capital growth.

As ever we would like to thank you for your continued support and we wish you all a prosperous 2018.

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Performance

In 2017 the Guinness Atkinson Dividend Builder Fund produced a total return of 21.34% (TR in USD), compared to the MSCI World Index return of 23.10%. The fund therefore underperformed the Index by 1.76%.

This is reflective of what we saw in equity markets over the last 12 months, with the market preferring growth stocks to value; quality companies and defensive sectors benefitted less from the very strong equity rally.

Standardized Performance

as of 12/31/17	YTD	1 YR	3 YR	5 YR	10 YR	Since inception (3/30/12)
Dividend Builder Fund	21.34%	21.34%	7.71%	11.25%	N/A	10.62%
MSCI World Index	23.10%	23.10%	9.93%	12.31%	N/A	11.43%

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.70% (net); 2.11% (gross)

Performance data quoted represents 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 https://www.gafunds.com/our-funds/dividend-builder-fund/#fund_performance or call (800) 915-6566. Total returns reflect a fee waiver in effect and in the absence of this waiver, the total returns would be lower.

The Advisor has contractually agreed to reduce its fees and/or pay Fund expenses (excluding Acquired Fund Fees and Expenses, interest, taxes, dividends on short positions and extraordinary expenses) in order to limit the Fund's Total Annual Operating Expenses to 0.68% through June 30, 2018. To the extent that the Advisor waives its fees and/or absorbs expenses to satisfy this cap, it may seek repayment of a portion or all of such amounts at any time within three fiscal years after the fiscal year in which such amounts were waives or absorbed, subject to the 0.68% expense cap.

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 Dividend Builder 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.

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Mutual fund investing involves risk and loss of principal is possible. The Fund's strategy of investing in dividend-paying stocks involves the risk that such stocks may fall out of favor with investors and could reduce or eliminate the payment of dividends in the future or the anticipated acceleration of dividends could not occur. The Fund invests in foreign securities which will involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets. Medium- and small-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Top Fund Holdings as of 12/31/2017

1	Wal-Mart Stores Inc	3.36%
2	Illinois Tool Works Inc	3.33%
3	Novo Nordisk A/S	3.30%
4	VF Corp	3.27%
5	Microsoft Corp	3.22%
6	Danone SA	3.16%
7	HengAn International Group Co Ltd	3.01%
8	CME Group Inc	3.01%
9	Cisco Systems Inc	2.97%
10	Aflac Inc	2.97%

Current and future fund holdings and sector allocations are subject to change and risk, and are not recommendations to buy or sell any security.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Dividend yield is calculated by annualizing the last quarterly dividend paid and dividing it by the current share price.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed countries.

Ex-dividend is a classification of trading shares when a declared dividend belongs to the seller rather than the buyer.

One cannot invest directly in an index.

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