Guinness Atkinson

Asia Pacific Dividend Builder Fund

Review of July 2018

Summary Review & Outlook

Market & Fund

- Asian markets recovered in July after a difficult month in June. The MSCI AC Pacific ex Japan Net Total Return Index rose 0.60% in USD terms.
- Our holdings in Information Technology were the principal driver of outperformance, but our Real Estate and Health Care holdings also contributed. Our Consumer Discretionary holdings were detractors.
- Within our IT holdings, several stocks performed well: Largan Precision, Delta Electronics (Thailand), Qualcomm, Novatek, Elite Material and Catcher Technology all contributed to outperformance. The fund also benefited on a relative basis from not holding Tencent (which does not pay a substantial dividend).
- The recovery in IT stocks reverses some of the underperformance the sector experienced in April. Expectations of stronger demand for smartphones in the second half and the low starting valuations that the stocks were trading on, both helped to drive the recovery in share prices.
- Other stocks that performed well include China Merchants Bank, Link REIT and Aflac (see company results, below).
- Weaker stocks were China Lilang (the worst performer over the month, but still the best performer in the fund this year), Luk Fook, and AAC Technologies, which failed to bounce with the other smartphone component suppliers.
- Many of the companies in the portfolio have reported earnings recently and we review these in this update.

Events in July

- US tariffs on $34bn of Chinese goods came into effect, at a rate of 25%.
- The Office of the US Trade Representative (USTR) released a list of products covering a further $200bn of Chinese imports for which a 10% tariff is proposed.
- President Trump sparked controversy at a summit with Vladimir Putin in Helsinki by failing to condemn Russia's alleged influence over the 2016 US election.
- Meanwhile, at a meeting with European leaders, China offered conciliatory comments to the US, reinforcing its support for preserving a 'global trading system'.
- Later in the month, President Trump and President of the European Commission Jean-Claude Juncker held talks on trade in Washington. Markets reacted optimistically after an agreement not to impose further tariffs was reached.
- The Chinese yuan continued to weaken over the month, falling 2.8% against the dollar.

Outlook

- Asian and Emerging Markets still offer attractive earnings growth compared to Developed Markets, while trading at reasonable valuations.

- Over the course of this year, the performance of Developed and Emerging markets has diverged as concerns over trade have weighed more heavily on the latter.
- We think that this makes the opportunity in Asia more attractive – lower valuations imply a higher likelihood of better future returns for investors.
- In a time of uncertainty, we think that holding quality companies that have achieved consistently higher return on capital is a sensible approach.

Asian markets

July saw the continuation of a trend we have experienced for most of the year, as fears over trade wars have been featured in the news on an almost daily basis. The defusing of tensions between the US and the EU following President Trump's meeting with Jean-Claude Juncker in Washington offered some hope, but the optimism has not yet extended to an improvement in relations between the US and China. Worse, threats have escalated recently as President Trump proposed increasing the rate of tariffs applied from 10% to 25% on $200bn of Chinese imports. China responded with a smaller but still significant amount in retaliation. Both sides continue to hold talks, but resolution – which we still fully expect to come from a negotiated agreement – still seems some way away.

Despite the uncertainty, Asian markets overall recovered somewhat in the month. China, however, was weaker. Despite the significant allocation the fund has to China, it nevertheless outperformed; our technology holdings recovered, and individual stock-specific news also drove performance.

As a reminder, the Asia Pacific Dividend Builder Fund is unlike many other Asian funds in that we don't use a top-down or macroeconomic view to guide how the portfolio is allocated. Instead, the portfolio is assembled from analysis at the company level. We select the best 36 opportunities from our universe of approximately 300 companies and hold them in a concentrated portfolio that is periodically rebalanced. We look for those stocks that provide the most attractive potential sources of total return, split into earnings (and dividend) growth, valuation re-rating and dividend income. Company news, and in particular how it is likely to affect those components of total return, is always going to be of more interest to us than short-term noise in the market.

Company news

Several companies in the portfolio recently announced earnings results or other news.

China Merchants Bank gave an early indication of good results for the first half of 2018, with net profits up 14% year-on-year. Deposit growth returned in the second quarter after being flat in the first, which offset a contraction in net interest margin. Non-interest income also grew at a robust rate and asset quality improved (reported Non Performing Loan ratio dropped 0.05% to 1.43%). The results were seen as broadly positive for the sector. The Chinese banks are to report results later in August.

Qualcomm conceded its acquisition of NXP after failing to receive clearance from regulators in China. The company instead announced that it would use its cash for $30bn of share buybacks, to be done in stages. Qualcomm also announced results that were ahead of expectations which include the receipt of interim payments from a licensing customer (Qualcomm is currently in dispute with two of its customers: one is Apple, and the other is believed to be Huawei).

On the negative side, Qualcomm confirmed that Apple will be using a different modem supplier for its newest iPhone cycle. However, this is more a consequence of the dispute with Apple (which we expect the company to continue to take steps to resolve), and Qualcomm will continue to provide products for previous iPhone models.

Aflac released strong results for the first half and revised its outlook for 2018 upwards. A new cancer insurance product in Japan was one of the main drivers behind Aflac Japan's pre-tax profit margins exceeding expectations (in yen terms). The successful product launch was supported by television advertising, a large direct mail campaign and the distribution of the product via over 20,000 Japan Post outlets.

DBS (Singaporean bank) reported record results for the first half in terms of total income (+13% year-on-year), profit before allowances (+14% year-on-year) and net profit (+23% year-on-year). Loan growth and higher net interest margin both contributed to top-line growth and were supported by higher fee income from wealth management and credit cards. The company's cost control was good, with the cost-income ratio maintained at 43%. An improvement in asset quality meant that specific allowances (provisions) halved.

Elite Material released results that were broadly in line were expectations, and with much better sales figures for July – indicating a return to growth – the share price had a welcome bounce. After the company's difficult first half of the year (in common with many smartphone hardware suppliers), we are optimistic that demand for the company's products will recover strongly in the second half.

Janus Henderson (an asset manager) announced broadly positive results for the second quarter. Investment performance of underlying funds is still satisfactory, but the company experienced continued net outflows (for the third consecutive quarter). Positive market performance reduced the overall impact on AUM, which closed the quarter marginally lower. The company's adjusted revenue was 2% higher than the previous quarter, but 1% lower year over year. A share buyback of up to $100m was authorized by the board.

Significant news accompanying the results was the departure of co-CEO Andrew Formica (ex-Henderson) and the appointment of Dick Weil (ex-Janus from Pimco) as sole CEO. Mr Formica was well regarded by the market and his departure was likely viewed as a short-term setback for the company (the shares traded down 8.3% on the day of the announcement and results). However, moving to a single CEO is likely to be beneficial for the company over the long term.

Ascendas REIT announced the acquisition of 12 logistics properties in the UK for about £207m. The properties are distribution centers located close to motorways and include DHL and Amazon as tenants.

Ascendas mentions weaker sterling following the Brexit referendum as a factor supporting the deal. The UK joins Australia as a location of the REIT's properties outside of Singapore.

Delta Electronics, the parent company of Delta Electronics (Thailand), which manufactures electrical power components, announced a tender offer to acquire the remainder of the company at a price of THB 71 (we hold the target in the portfolio).

Summary and conclusion

July was a better month for Asian markets and an even better month for the fund. The overarching narrative surrounding trade was not enough to derail performance, as several companies reported good results and indicated a positive outlook for the rest of the year. This pattern highlights the merit in focusing on individual companies and the danger in making top-down or 'macro' calls – they are liable to be wrong!

Asia and Emerging Markets still offer attractive earnings growth compared to Developed Markets, while trading at reasonable valuations. Over the course of this year, the performance of Developed and Emerging Markets has diverged, as concerns over trade have weighed more heavily on the latter. We think that this makes the opportunity more attractive – lower valuations imply a higher likelihood of better future returns for investors.

In a time of uncertainty, we think that holding quality companies that have achieved consistently higher return on capital is a sensible approach.

Edmund Harriss and **Mark Hammonds** (portfolio managers)
Sharukh Malik (analyst)

Performance

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Despite underperforming the benchmark, the Fund rose by 3.42%. The outperformance in the month was sufficient for the fund to catch up most of its underperformance in the first six months. At the end of July, the fund lagged the benchmark by 0.51% over 2018.

As of 7/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	**-3.56%**	**6.66%**	**9.42%**	**7.94%**	**5.27%**
MSCI AC Pacific ex Japan Index	**-3.05%**	**5.88%**	**10.19%**	**7.69%**	**6.52%**

All returns over 1 year annualized. *Source: Bloomberg, Guinness Atkinson Asset Management*.

Expense Ratio: 1.12% (net); 3.48% (gross)

Performance data quoted represents past performance; past performance 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. Performance data current to the most recent month end may be obtained by calling 800-915-6566 and/or visiting www.gafunds.com. Performance data does not reflect the 2% redemption fee for shares held less than 30 days and, if deducted the fee would reduce the performance notes. Total returns reflect a fee waiver in effect and in the absence of this waiver, total returns would be lower.

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 investments diversified among various sectors.

MSCI AC Pacific Ex-Japan Index is a market capitalization weighted index that monitors the performance of stocks from the Pacific region, excluding Japan consisting of Australia, China, Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan, and Thailand.

One cannot invest directly in an Index.

Price/Earnings Ratio (P/E) is an equity valuation multiple. It is defined as market price per share divided by annual earnings per share.

Payout ratio refers to the proportion of company profits paid out to shareholders as a dividend.

The trade surplus is the difference between the value of a country's exports and imports. The current account surplus adds income and remittances to the trade surplus.

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 07/31/18

1	Delta Electronics Thailand PCL /Foreign	3.17%
2	Catcher Technology Co Ltd	3.17%
3	The Link REIT	3.15%
4	CapitaMall Trust	3.15%
5	Ascendas Real Estate Investment Trust	3.10%
6	JB Hi-Fi Ltd	3.06%
7	Aflac Inc	3.04%
8	Novatek Microelectronics Corp	2.99%
9	Janus Henderson Group PLC	2.97%
10	QUALCOMM Inc	2.97%

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

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