Guinness Atkinson
China & Hong Kong Fund
October 2018

Summary Review & Outlook

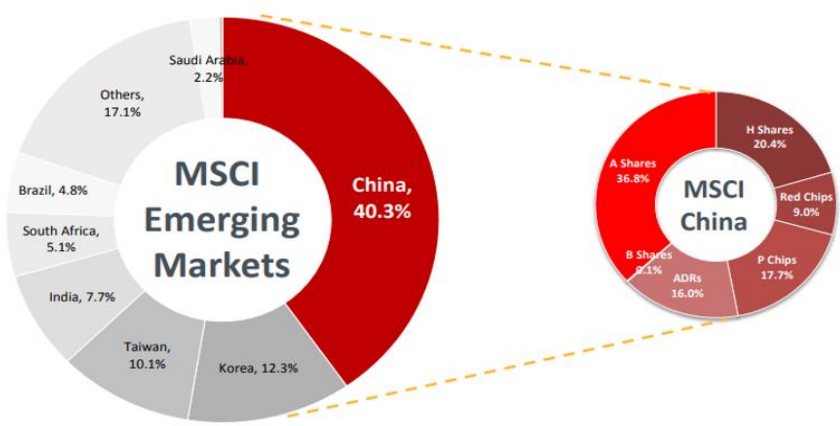
Fund & market

- Regionally, in September MSCI Hong Kong fell 0.9% and China fell 2.0%.
- Given the acceleration in trade tensions between China and the US over the course of the year, it is no surprise that Taiwan has performed relatively better than China, rising 10.0% vs a fall of 5.7% for China.
- In September, the Energy sector was the strongest in China, rising 7.9%. On the other hand, Health Care and Real Estate were weak, falling 10.1% and 7.6%.
- The US introduced a 10% tariff on $200bn of Chinese imports which is due to rise to 25% at the beginning of 2019. The US is becoming increasingly likely to apply tariffs on the remaining $267bn of trade with China. In response, China imposed tariffs of 5-10% on $60bn of goods imported from the US.
- Policymakers in China continue to open up the economy. In June, tariffs were cut on home appliances and cosmetics, and tariffs were completely eliminated on certain imported drugs. China is now planning on reducing tariffs on over 1,500 goods by an average of 2.7 percentage points to 7.8%. Affected products include textiles, metals, and machinery equipment.
- Economic data remains broadly solid. Retail sales grew 9.0% year-on-year in August, slightly higher than the 8.8% growth seen in July. Industrial production rose 6.1% in August while fixed asset investment growth continues to decelerate, with its growth for 2018 of 5.3% (as of August) being the lowest since 1990. As we have highlighted before, the slowdown is coming from state fixed asset investment, which has only grown 1.3% this year. On the other hand, private investment is up 8.7%.

The trade dispute, along with the decision by the US to temporarily shut down ZTE, has highlighted to China just how dependent the country is on the US for its chips. For all the talk of how innovative China is becoming, China currently imports nearly all the advanced chips it uses. Policymakers are now very vocal on the need to shift away from dependence on foreign chips and towards the domestic industry. In the past this was attempted through acquisitions of foreign firms, but many were blocked on national security grounds by the Committee for Foreign Investment into the US (CFIUS), such as Tsinghua's failed bid for Micron Technology, or Canyon Bridge's failed bid for Lattice Semiconductor Corp. It seems policymakers are willing to invest many billions of dollars into nurturing a competitive domestic industry. The government-backed China Integrated Circuit Industry Investment Fund has raised $47bn to invest in advanced chips, but it will take time to invest and build up a competitive domestic industry. For now, we see Chinese firms being most competitive in consumer-facing applications. For example, Huawei uses its own chips for most of its smartphones, rather than using Qualcomm's. In more advanced applications such as the server market, we do not see any Chinese companies threatening Nvidia in the next few years. That being said, we have read that Microsoft is considering using Huawei's chips for its data centres in China.

The Chinese healthcare sector was weak following announcements from the State Medical Insurance Administration. A pilot program will be launched in 11 major cities where prices will be cut for 33 drugs. It is possible that drugs with at least three competitors will face price cuts of 40%, while drugs with fewer competitors will face more lenient cuts. The fund's two Chinese healthcare holdings, Sino Biopharmaceutical (SBP) and China Medical System (CMS), were weak as a result. SBP has six drugs which will be impacted by the trial. CMS has no products on the list but the worry is that two of its major products could be impacted if the pilot program is expanded nationwide. While the price cuts are significant, once a drug wins the tendering process it is very likely to see significant volume increases, which can potentially more than offset the fall in pricing. For example, on SBP's oncology side, a few years ago the price of a competing molecule called Iressa was cut by 51%; volumes in the following year increased by 121%. For now we await more details. Chinese policymakers are aiming to control the costs of healthcare and companies such as SBP are very important to this goal. SBP offers generic products in areas which are becoming increasingly prevalent in China, such as hepatitis and oncology. China cannot afford to pay top-tier prices for drugs from multinational companies and so good-quality domestic companies specializing in generics are vital for keeping healthcare affordable. SBP has generated a cash return on capital around 20% for close to a decade.

FTSE Russell announced that Chinese A shares are to be promoted to Emerging Market status and will be included in its benchmarks from June 2019 onwards. The relevant stocks will be included using 25% of their investable market capitalization and are expected to make up 5.5% of the FTSE Emerging Index. From 2019 onwards, FTSE will look at Asia in three segments: 1) China, 2) Japan and 3) Asia Pacific ex China ex Japan. FTSE's decision follows that of MSCI to add Chinese A shares to its Emerging Market index based on a 5% inclusion factor (where inclusion is 5% of A shares' free float-adjusted market capitalization). MSCI is now proposing to increase the weight of A shares from 5% to 20% and is considering whether to add mid-cap shares. If this were to happen, A shares' weight in the Emerging Market index would increase from the current 0.7% to 3.4% by 2020. If A shares' inclusion factor increased to 100%, China's total weight in the Emerging Market index could increase from 31.3% to 40.3%, as shown below.



Source: MSCI
Forecasting is inherently limited and cannot be relied upon.

Summary view & outlook

We expect the fund's focus on companies persistently earning a return on capital well above the cost of capital to do well in the long term. The fund now trades on a price to earnings multiple of 8.6x, based on estimated 2019 earnings, while the fund's discount to the region (MSCI Zhong Hua) has widened to 18%. We believe that now is a good time to be looking at investing in China as valuations have come down markedly since January. Fears over trade are bringing valuation multiples down, even for companies that actually have little exposure to a trade war. This has been a frustrating period of performance for the Fund but we have high confidence in the continuation of these companies' operating performance. The 'market' may not like them at the moment but we attribute this to sentiment which can change quickly. The drivers of such a change would be positive progress in trade negotiations and/or a Chinese domestic growth response to recent fiscal support efforts (of which we have seen some signs already).

Performance

In September, the Fund rose by 0.13% while the Hang Seng Composite Index fell 0.11%.

As of 9/30/2018	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**-9.60%**	**0.10%**	**13.94%**	**5.82%**	**7.00%**
Hang Seng Composite Index	**-9.47%**	**-2.22%**	**8.96%**	**3.41%**	**4.47%**

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

Expense Ratio: 1.64%

Edmund Harriss & Mark Hammonds (portfolio managers)
Sharukh Malik (analyst)

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 shown is current to the most recent month and quarter end. To obtain performance as of the most recent month end, please visit www.gafunds.com or call 1-800-915-6565. Total returns reflect a fee waiver in effect and in the *absence of this waiver, the total returns would be lower. 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 noted.*

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.

One cannot invest directly in an Index.

Hang Seng Composite Total Return Index is a market capitalization weighted index that monitors the performance of stocks listed in Hong Kong.

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 09/30/18:

1.	CNOOC Ltd	4.83%
2.	Yangzijiang Shipbuilding Holdings Ltd	4.25%
3.	Hollysys Automation Technologies Ltd	3.64%
4.	Ping An Insurance Group Co of China Ltd - H Shares	3.64%
5.	China Merchants Bank Co Ltd - H Shares	3.58%
6.	China Construction Bank Corp - H Shares	3.50%
7.	Anhui Conch Cement Co Ltd - H Shares	3.49%
8.	Baidu Inc	3.37%
9.	Shenzhen Expressway Co Ltd - H Shares	3.32%
10.	CNY Minsheng Banking - H Shares	3.32%

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

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