Guinness Atkinson

Asia Pacific Dividend Builder Fund

Review of September 2018

Summary Review & Outlook

Fund & Market

- September was a turbulent month, but after recovering ground in the latter part of the month the MSCI AC Pacific ex Japan Net Total Return Index ended down -0.65% in USD terms. For the third quarter as a whole, the market was down -1.36% in USD terms.
- The fund was down in September but outperformed the market and ended the quarter in positive territory. After a difficult first half, the Fund is now ahead of its benchmark for the year to date. *(See performance on page 2)*
- The last quarter marked a sharp turnaround from the first half in terms of relative performance. In the first six months, 16 out of the 36 stocks in the portfolio outperformed. In the last three months, 28 stocks out of 36 were outperformers.
- While first half performance was influenced by macro-economic headwinds, it was individual company operating performance that drove the Fund's recovery in third quarter.
- In stock terms our weakest names were Yangzijiang Shipbuilding, Hanon Systems, Elite Material, Delta Electronics Thailand and Qualcomm, which had fallen between 11% and 37% (in USD terms) in the first half but which turned into our leading performers in the third quarter, rising between 13% and 37%.

  We reviewed the Fund's underperformance in the first half through the framework of the total shareholder return. We concluded that underlying operating performance was still good and thus our expectations of earnings growth were maintained; while the growth in cash flows for these companies has been closely aligned with profits growth (this indeed is a measure of their quality) and so we remained confident too in the dividend. (*See performance on page 2)*
- We concluded that the primary driver of weakness was multiple compression and thus an expression of market sentiment rather than fundamental weakness. We therefore held our position and as companies began to report their interim earnings – generally ahead of market expectations but in line with ours – we saw a broad-based recovery in the portfolio

Events in September

- US interest rates were increased 0.25%. The market is looking toward a steady increase over the next 18 months.
- Trade tariffs on a further $200 billion of Chinese goods were announced with China imposing retaliatory tariffs on $60 billion of US goods.
- President Trump upped the ante by threatening to impose tariffs on a further $267bn of Chinese imports.
- The leaders of North and South Korea met for a third time and signed a joint declaration committing to denuclearization of the peninsula.
- In India, Infrastructure Leasing & Financial Services (IL&FS) announced more debt defaults. The government has replaced the board with its own appointees.

- Asian currencies saw only modest downward pressure in September. The Indian rupee and the yen were weakest and down over 2%. The Indonesian Rupiah was 1% lower, but the market has looked favorably on the central bank's proactive response.

Performance

As of 9/30/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	**-4.01%**	**3.50%**	**12.81%**	**7.94%**	**8.47%**
MSCI AC Pacific ex Japan Index	**-5.16%**	**2.05%**	**13.83%**	**5.43%**	**8.17%**

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 noted. Total returns reflect a fee waiver in effect and in the absence of this waiver, 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 1.10% through June 30, 2019. 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 waived or absorbed, subject to the 1.10% expense cap.

Fears reach crescendo

After the market falls in the first half of October we take a look at some of the main factors that we think impact the most on our region. China-US relations are now dominating thoughts and higher energy prices are not far behind. We do not ignore the issues surrounding interest rates, rising bond yields and the stronger dollar but we suspect our readers will find more in-depth analysis elsewhere.

From our narrow fund perspective, we think that the returns on capital our companies generate are high enough to withstand erosion from a higher discount rate and with their low indebtedness are not vulnerable to rising interest expense. Even at a macro level the region is not left especially vulnerable to a strong dollar or weaker local currency due to the preponderance of current account surpluses in Asia and lower levels of US dollar debt than in the past.

China and the United States

If the dispute between China and the US were just a matter of trade surpluses and deficits, it would be relatively straightforward. That was how it was framed initially, and that was what the Chinese thought it was about. However, it rapidly changed into something far more profound. China's economic rise, which used to be seen in the US as a challenge, is now perceived and presented as an existential threat. China has upgraded its industrial base and know-how at a speed with which the US economy cannot keep pace and so the focus is now on the methods China is using to do so. Even in a deeply partisan US political environment this is a unifying issue. China is beginning to recognize this.

In China, there is a pressing need to continue the transformation of its domestic economy to escape the so-called middle-income trap and to deliver the on-going rise in the standard of living that underpins the current political system. The new pillar industries in technology, alternative energy and electric vehicles are the alternative to the debt-funded construction-led growth of the past. Security through self-sufficiency in technology is bound up with this process, which comes under the 'Made in China 2025' banner. The methods of acquiring intellectual property have been transactional (in return for market access), through acquisition, reverse engineering (copying), and 'taking without permission'. Some or all these approaches have been adopted by industrializing countries (UK, US, Germany, Japan, Korea, Taiwan) at one time or another. However, all have recognized that to be sustainable in the long term, they must create. But politically, China cannot be seen to simply roll over.

Progress so far

On the face of it there has been little. The US has imposed tariffs on $250 billion of goods and has threatened to do the same to all other Chinese imports. In addition, through the National Defense Authorization Act (NDAA), which incorporates the Foreign Investment Risk Review Modernization Act (FIRRMA) and the Export Control Reform Act (ECRA), Congress has tightened controls over both inbound investment and outbound sales of 'foundational technologies'. Both can be blocked. In this dispute so far, the US has made all the running.

By contrast, China has been very cautious. Retaliatory tariffs have been placed on fewer goods (inevitably, because the Chinese buy fewer US goods) although they have been targeted. Importantly, however, the level is only 5%-10%, rather than 25%. The Chinese currency has weakened, but only by 6% this year, which is less than the Australian dollar. Devaluation as a weapon has not been employed; indeed, intervention has been directed at preventing weakness, not generating it. Vulnerable industries have been supported with fiscal measures such as the acceleration (but not the increase) of export subsidy payments. China's demeanor appears to suggest a desire to talk, but the US shows little inclination to do so; rather it seeks to emphasize toughness.

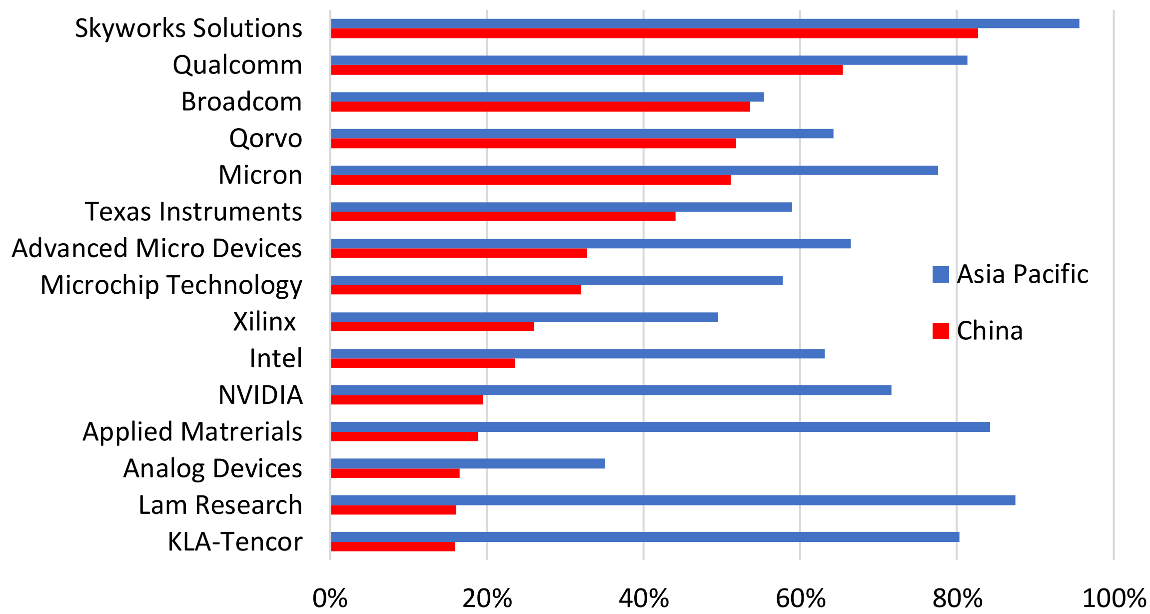
The US approach is in fact Donald Trump's direct and personal approach. The US will be ready to talk when he is ready. It also means that should there be a significant, and from the US perspective, successful resetting of US China economic relations, the credit will be his and could well propel him to a second term.

What's next

Although the US has set the pace, this dispute is not a one-way street. The US stands to be hurt by further escalation and one way to see this is to look at the companies in the S&P 500 Index Semiconductor and Semiconductor Equipment sub-sector.

The fifteen companies in this group have a combined market capitalization of $881 billion. In the last reported fiscal year they generated sales of $211 billion and net profits of $52 billion. This sector therefore has a net profit margin of 24.5%, 2.5 times greater than the average 9.8% net margin for the rest of the S&P 500. The chart below shows where their sales came from in the last reported fiscal year.

S&P 500 Semiconductor and Semiconductor Equipment Index - Source of Revenues in last Fiscal Year



Source: Bloomberg & company data

The sector derives 36.6% of its sales from China and 70% from Asia Pacific as a whole, with Korea, Singapore and Taiwan making up most of the balance. To consider this more broadly, while we can identify direct China sales we can safely assume that a significant share of Asia ex-China sales end up going through the China manufacturing and assembly complex. Aggressive tariffs could have a huge impact on the future of these companies; and what will happen to the many small businesses in the US that supply them?

The dangers are evident and the arguments against such a blunt tool are mounting from both inside and outside the US administration. The negotiations that need to take place are complicated. There are reports that the US has presented China with a list of over a hundred specific demands. We hear that China is willing to move on around a third of these and is open to discussions on a further third. One area of discussion is China's status under WTO rules as a developing nation, which gives it certain rights and exemptions. For Central and Western China this categorization is appropriate, but for its wealthy eastern provinces it clearly is not. The frustration for the Chinese side at the moment is that there is no one mandated to speak for the US administration, but that could be attributable to the US election cycle.

China's recent actions give grounds for optimism, and it should be remembered these come against a political backdrop that is just as fiery as that in the US. The Chinese authorities have maintained their commitment to stabilize and not devalue the currency. They have stood by their commitment to open up market access. In the last few days BMW announced it will increase its stake in its venture with Brilliance Automotive for 50% to 75%, making it the first automaker to take majority control (the irony is that BMW is the largest exporter of vehicles to China from the US, shipping over 100,000 SUVs from its plant in South Carolina per year). In the realm of intellectual property, on the same day as the BMW announcement, the South China Morning Post reported that the UK luxury brand Alfred Dunhill has been awarded damages of RMB10 million (US$1.44m) for trademark infringement in a "ground-breaking decision" by Foshan Intermediate People's Court in Guangdong Province. They have held the individual responsible for the business personally liable.

Photo: Handout

Photo: Zunapress

For illustrative purposes only. Companies shown are not holdings of the fund as of 9/30/18.

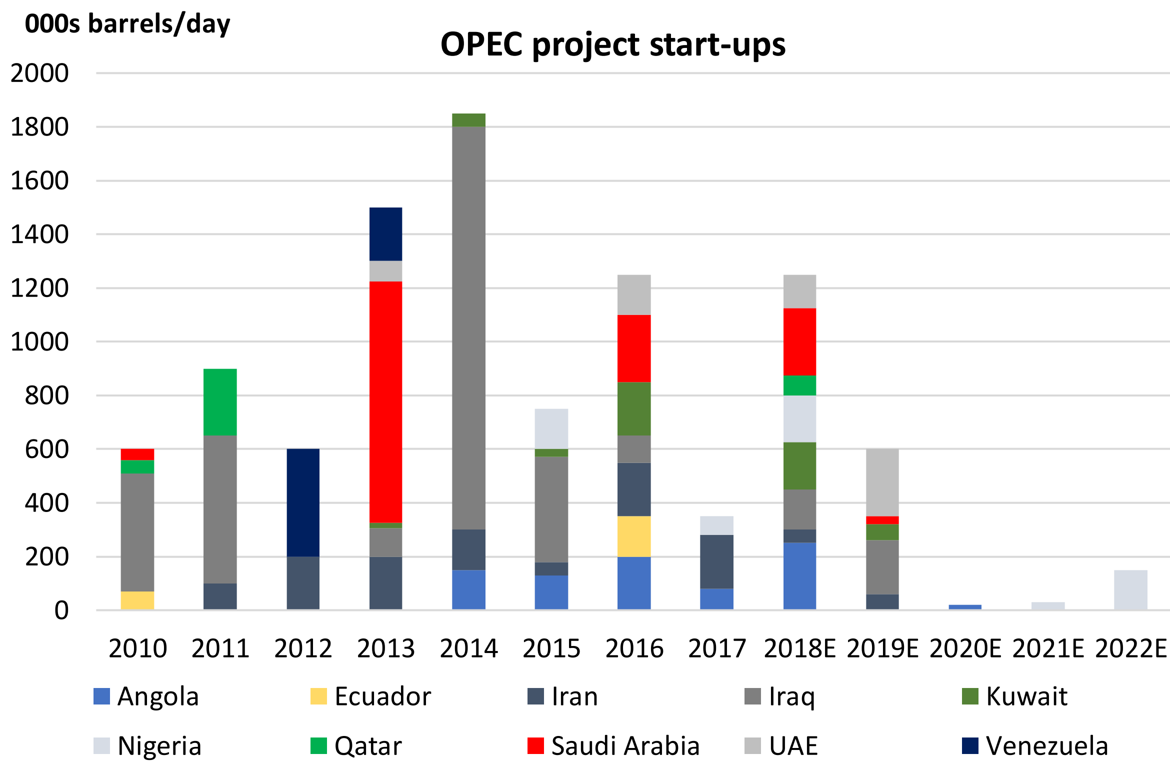
In sum, it is our impression that there is a desire to talk, but short-term imperatives mean the time is not yet right. There has been a view that this dispute is about China containment and that a new Cold War has been declared. However, at the IMF gathering in Bali held October 12-14, there was reportedly a growing view that the US is really after free and fair trade. While complicated to achieve, this points to a much more constructive position.

Energy and Oil

Recent discussions with our Energy colleagues have given us to cause to re-think our views on the oil price. It has been apparent that the immediate cause of higher oil prices has been attributable to supply disruptions especially from Iran and Venezuela. Libya has managed to increase its output but will not increase it further. Brazil's major oil company has been embroiled in scandal. Finally, US shale output has been growing rapidly, but this has not been disruptive, as it was in 2014.

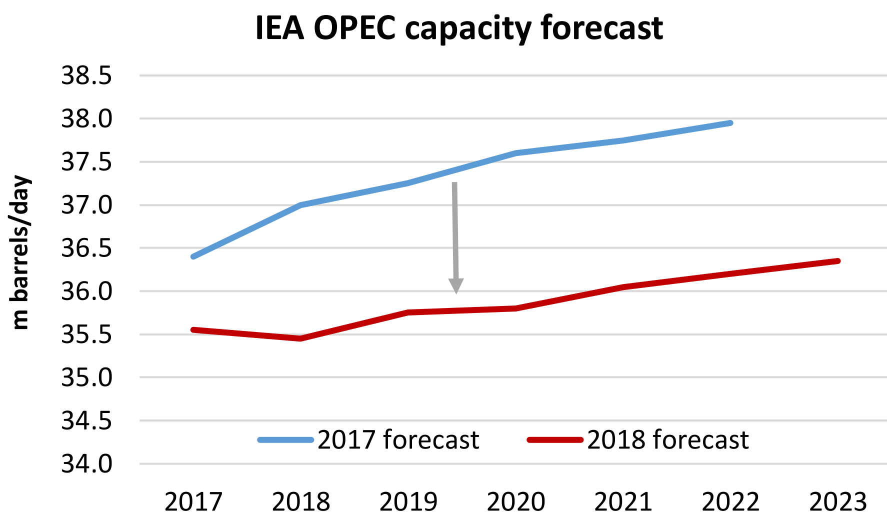
The impact on Asia has been modest so far, suggesting that the region is capable of absorbing prices around this level. Our Energy team has observed that on a global basis between 1970 and 2018 the global oil bill amounted to between 1% and 8% of world GDP (8% during the years of the oil crisis down to 1% when oil fell to $10 per barrel). At a price of $75/barrel the oil bill stands at around 3.5% of GDP and is tolerable; at $100/barrel it reaches 4.5% of GDP and the exerts a drag on growth that erodes demand.

Our change in thinking is that oil prices may well hold around $70-$80 rather than $50 (recession or geopolitical events would alter this in the short term). Temporary disruptions to supply are likely to be replaced by structural tightness based on our team's projections of new investment and thus reserves replacement.



Source: Simmons (Piper Jaffray). Forecasts are inherently limited and cannot be relied upon

New projects fall away dramatically after 2018 and come nowhere close to keeping up with domestic demand growth. OPEC capacity forecasts by the IEA in 2017 have been cut by 1.5 – 1.8 million barrels per day over the next 5 years:



Source: IEA Medium-term Oil Outlook. Forecasts are inherently limited and cannot be relied upon

Given most non-OPEC supply growth looks similarly weak, this now leaves US shale as the main source of additional supply and together with Saudi Arabia a major source of influence over the longer-term oil price.

India is the only economy in the region so far to have been significantly affected. The country is running a current account deficit which stood at 1.9% of GDP at the end of June. This is expected to widen close to 3% of GDP with high oil prices seen as a major contributor. India needs to provide fuel subsidies and recently moved to share that burden with the oil refiners who promptly saw their share prices drop over 10%. In countries like Malaysia and Indonesia, which also have subsidy mechanisms in place, the pain is offset by their own energy exports. For the present, we see oil at current levels as manageable but 'higher for longer' is our expectation.

To read more about Guinness Atkinson's views on Energy please see the [Guinness Global Energy Report] located at [www.gafunds.com/our-funds/global-energy-fund/] or in the white papers section of [www.gafunds.com/resource-insight-center/].

Outlook

Asian markets as measured by MSCI AC Pacific ex Japan Index are now trading on a price/earnings multiple of 11.9x 2018 estimated earnings and 11.1x 2019. On an absolute basis and relative to developed markets, the region looks cheap. We think about our stocks in terms of the total shareholder return (profit, multiple and dividend) and the risks in terms of the discount rate we should apply to assess the value of cash flows from the companies. It is our view that the earnings of our companies and their dividends have held up well (based on the last reporting season) and we expect them to continue to do so. We think that if trade tariffs are heavier than expected then even after building in margin and sales volume compression there is still value in these companies and dividends will still flow. We therefore continue to rebalance the portfolio in line with our process and have made no portfolio changes.

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

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.

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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 09/30/18:

1	Asustek Computer Inc	3.03%
2	Tisco Financial Group PCL/Foreign	3.00%
3	CapitaMall Trust	3.00%
4	BOC Hong Kong Holdings Ltd	2.98%
5	Hanon Systems	2.98%
6	Delta Electronics Thailand PCL /Foreign	2.96%
7	China Mobile Ltd	2.91%
8	The Link REIT	2.91%
9	Yangzijiang Shipbuilding Holdings Ltd	2.91%
10	Pacific Textiles Holdings Ltd	2.90%

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