Guinness Atkinson
China & Hong Kong Fund
November 2018

Summary Review & Outlook

Fund & market

- Markets were weak globally with the S&P 500 falling 4.7% and MSCI Europe falling 5.7%. In the US companies, especially in the Technology sector, are being hit hard if growth is perceived to be slowing.
- Notable outperformers in the fund were Pacific Textiles (apparel manufacturer), Vtech (manufacturer of toys) and China Overseas Land & Investment (real estate).
- Weaker stocks were AAC Technologies (smartphone components), Haier Electronics and New Oriental Education (discussed later).
- Valuations in China are beginning to approach the lows seen between 2012 and 2016. MSCI China is currently trading at 11.1x on 2019 earnings. While MSCI Hong Kong is trading at a relatively higher level of 14.0x, this represents one standard deviation below its historic average.
- The fund now trades on a price to earnings multiple of 8.8x, based on estimated 2019 earnings.

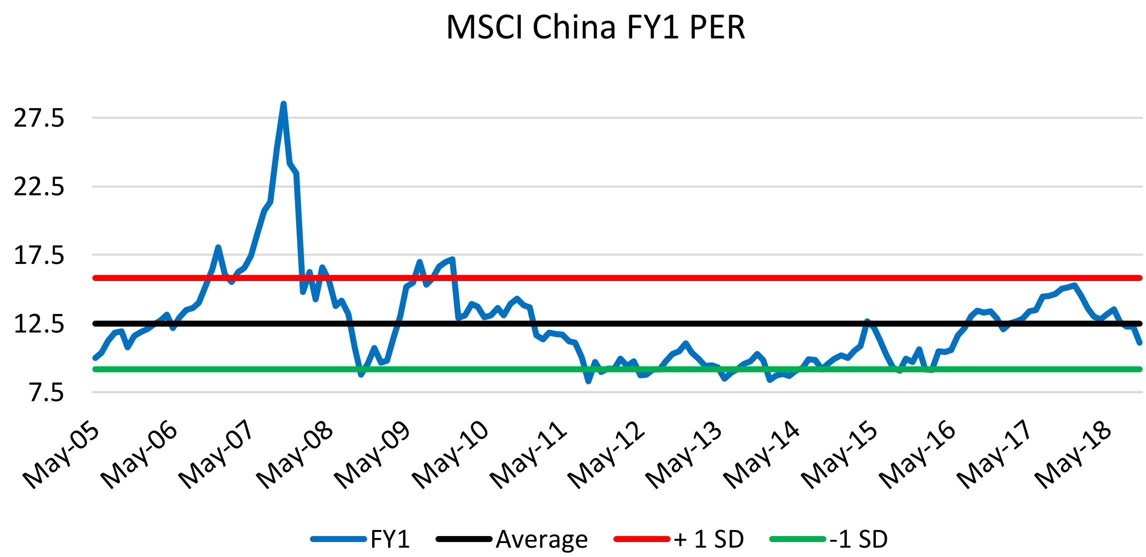
Events in October

- Economic growth for the third quarter slowed to 6.5% compared to 6.8% in the first and 6.7% in the second quarters. Economic data points to a slowdown in some areas. Notably the Politburo explicitly acknowledged the "downward pressure" the economy is facing, and its aim is to ease policy. The tradeoff will be between supporting growth and preventing financial excess building up within the system. Our view is that policymakers know that the risks of debt-fueled investment will undo the past two years of work on deleveraging. The focus will be on loosening policy in some areas but keeping a vigilant eye on speculative bubbles.
- The required reserve ratio was cut by one percentage point, the third time it has been cut this year. Policymakers are trying to channel much of the resulting extra liquidity to small and medium enterprises (SMEs) which drive the bulk of economic growth but generally find it harder to obtain credit. The problem for many of the state-owned banks is that they are used to lending to larger state-owned firms which they know well. These banks often do not have good enough information to rate the credit quality of SMEs and so are reluctant to lend to them.
- The shadow banking system, though in many ways grew out of control in China, was and will continue to be an important source of funding in China. The delicate balancing act is to rein in the more speculative parts of the system (e.g. most of the internet peer-to-peer lending platforms) while allowing enough "sensible" credit to flow to firms who genuinely need it.
- The People's Bank of China launched a credit enhancement facility to support private companies. The aim is to support good businesses which are battling short term headwinds.
- The National People's Congress ruled to ease restrictions on share buybacks. Ping An Insurance announced a share buyback potentially worth $15.8bn. The Chinese Securities Regulatory Commission (CSRC) launched a fund to invest in shares pledged as collateral for loans, aimed at preventing forced liquidation which would further weaken prices.
- Export tax rebates on certain goods are to soon rise by between one and five percentage points, after rebates for other goods were cut in September.

- Reports indicate the vehicle purchase tax, currently at 10%, could be cut to 5%. This would be applicable to cars with engine sizes less than 1.6 liters, a segment which makes up 70% of the market. Note the tax was 5% in 2016 and 7.5% in 2017 before being increased to 10% at the beginning of this year. Therefore, it is not surprising that the auto market has been weak this year.
- Tax rules are being changed to encourage greater consumption. The personal allowance will be increased while tax deductions are to be introduced for the first time. Deductions can be made for education, health care and care for the elderly.
- Relations seemed to be thawing between China and Japan. Shinzo Abe met Xi Jinping in China and a flurry of business deals were agreed. While there are still many unresolved issues between the two, it is clear Japan is hedging its bets given the unpredictability in policy coming out of the White House.
- The Hong Kong-Zhuhai-Macau Bridge opened. It is the world's largest sea bridge. This is one of the many steps China is taking on its path to linking together all of the cities in the Greater Bay Area, a region with a population of 67 million people.

Valuations in the Greater China region are now approaching the lows of 2015 after a torrid period in markets. The chart below shows the forward Price to Earnings (PER) multiple for consensus expected (FY1) earnings compared to its 10-year average with bands showing +/- 1 standard deviation (SD). (For a normal distribution, +/- 1 SD means that valuations should lie within these bands 68.27% of the time). At the end of October, valuations are heading towards the bottom of this range.

But, in contrast to the period 2010-2015 when Chinese earnings rose only 2.0% per annum on average, profits since 2015 have grown 15.4% on an annualized basis (MSCI China earnings December 31, 2015 – November 11, 2018).



Source: Bloomberg data, Guinness Atkinson Asset Management

Pacific Textiles was a notable outlier, rising 18.35% in what was otherwise a very weak month. The company produces apparel for companies including Uniqlo, M&S and Anta Sports. Until recently, the business had been facing problems in Vietnam where production in its factory was suspended. Villagers were blocking the entrance to the industrial park the factory is in, as they were unhappy with their compensation for the land used for construction of the facilities. The problems were resolved in September 2017 and the business now seems to be growing. The importance of the Vietnamese factory cannot be understated – wages in Vietnam are significantly cheaper than in China. For any textile company, the future is no longer in China and is now in countries like Vietnam and Bangladesh.

New Oriental Education runs a tuition business catering to all segments of the market. The industry is very lucrative as deposits are paid before lessons begin, which acts a source of 'float' for the business. Over the past two years there has been a spate of IPOs in the sector (for both tuition and private schools) to take advantage of the potential growth opportunities. However, standards in the sector remain lax and there have been several public outcries in the broader education industry. The government has responded and is introducing several new rules to regulate the industry. For example, regulations now prevent foreign control over private schools. This barely affects New Oriental Education but did lead to sell offs for firms in the sector which operate schools. Approval is now needed to run tuition services over the internet. As a result, compliance costs are rising, while separately marketing and staff costs are rising as the business expands. While earnings growth may perhaps slow in the next year, we are not concerned because the company is keeping a close eye on the rate of expansion. In the past, New Oriental was guilty of expanding too quickly at the expense of margins and return on capital. Management have learnt their lesson and we have every reason to believe that the growth in the business over the next few years will be sustainable.

In the current climate, it is easy to forget that there are structural growth opportunities - like cosmetics. Estee Lauder saw sales in the Asia Pacific region grow 24% which led to better than expected results. The CEO of L'Oreal does not see a slowdown in sales in China and sees "great appetite of Chinese consumers". LG Household & Healthcare, which manufactures the increasingly popular Whoo line, saw sales in China rise 41%. China is an important region for many companies – we have highlighted in the past that for the likes of Nike and Starbucks, China is critical. There is a reason that Starbucks is planning on building 3,000 stores in China over the next five years. The growth of the Chinese consumer is real and though current conditions are slower, one must consider the outlook over the medium term, not just the short term.

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 8.8x, based on estimated 2019 earnings, while the fund's discount to the MSCI Zhong Hua Index is 19%. We believe that now is a good time to be looking at investing in China as valuations have come down markedly since January.

Edmund Harriss & Mark Hammonds (portfolio managers)

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Sharukh Malik (analyst)

Performance

As of 10/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**-17.97%**	**-12.92%**	**6.86%**	**3.34%**	**9.13%**
Hang Seng Composite Index	**-19.47%**	**-15.46%**	**1.99%**	**0.53%**	**5.91%**

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	**-9.41%**	**-2.22%**	**8.96%**	**3.41%**	**4.47%**

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

Expense Ratio: 1.64%

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 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.

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 10/31/18:

1.	CNOOC Ltd	4.67%
2.	Yangzijiang Shipbuilding Holdings Ltd	4.66%
3.	Pacific Textiles Holdings Ltd	3.83%
4.	China Merchants Bank Co Ltd - H Shares	3.80%
5.	Ping An Insurance Group Co of China Ltd - H Shares	3.77%
6.	CNY Minsheng Banking - H Shares	3.67%
7.	Hollysys Automation Technologies Ltd	3.63%
8.	China Overseas Land & Investments Ltd	3.59%
9.	China Construction Bank Corp - H Shares	3.53%
10.	Shenzhen Expressway Co Ltd - H Shares	3.39%

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

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