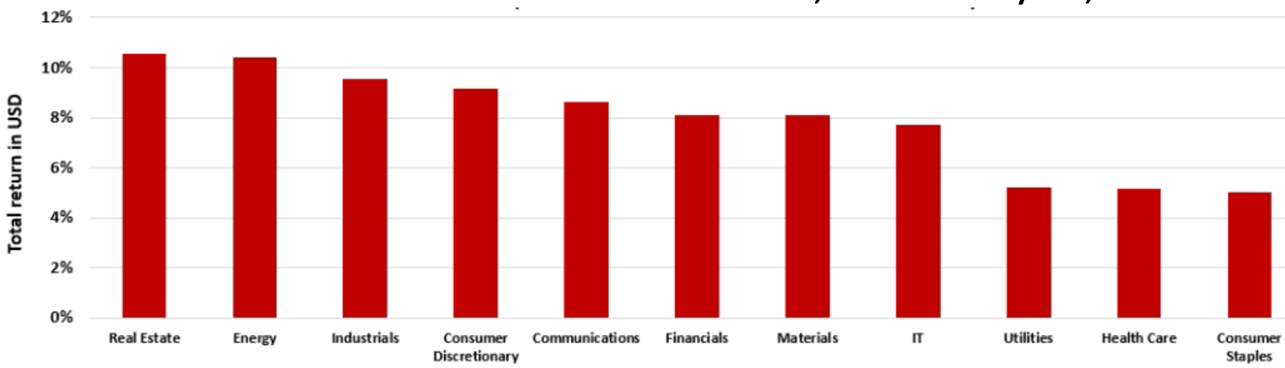
# Guinness Atkinson
# Dividend Builder Fund
Managers Update – February 2019

## Portfolio in Review – January

**MSCI World Sector Indices Performance: December 31, 2018 – January 31st, 2019**




*Source: Bloomberg. As of January 31, 2019*

Over the course of January, performance of the Fund was aided by our overweight allocation to Industrials, after several companies in the sector reported robust earnings results. Companies we own in the sector include BAE Systems, Eaton, United Technologies, Illinois Tool Works, Randstad and Schneider Electric – all of these performed well in the month, with BAE Systems being the stand-out (+15.0% in USD). The company provides some of the world's most advanced defense, aerospace and security solutions, and recently has outperformed after releasing better-than-expected earnings results.

Real Estate and Energy were the best performing sectors in the month and limited exposure here was a small drag on performance. We have no holdings within Real Estate and one holding within Energy: Royal Dutch Shell, which had a strong month after reporting robust earnings. Cashflows came in far ahead of expectations and the company indicated that both upstream (production) and downstream (refining) parts of the business were doing well. The Energy sector also performed well as a whole as the price of WTI Crude oil climbed past US$55 a barrel, reaching its highest level since November last year. Falling OPEC production and speculation that a robust economy would fuel demand spurred the rise – in fact Brent crude oil had its best January since 2005 and West Texas Intermediate oil had its best January on record. Despite recent gains, the low oil price has helped suppress inflation levels and in turn decreased pressure on central banks to raise interest rates to control inflation.

After faring well throughout 2018, Healthcare was one of the underperformers in January. Profit-taking accelerated after the Trump administration proposed banning rebates paid by drug-makers to pharmacy benefit managers (PBMs) and health insurers. These rebates are in exchange for preferred status with those plans' customers. Some of those rebates go toward insurance premiums, while the middlemen keep some for themselves. The pharmaceutical industry has said PBMs prefer higher-priced drugs so they can negotiate bigger rebates and pocket more of the money. The Fund does not have exposure to any US PBMs or insurers so was immune in this respect.

Although drug-makers would not directly be affected by the new proposed legislation, for other reasons, the worst performing stock in the month was AbbVie (-11.8% in USD). The pharmaceutical giant focuses on producing drugs for specialty therapeutic areas such as immunology, chronic kidney disease, hepatitis C, oncology, and neurology. We have owned the company since the end of 2012 and the stock performed very well due to the prominence of its Humira drug, which makes up 60% of total revenue. It has been described as the "world's best-selling drug"; it is an injectable therapy used to treat several autoimmune diseases, predominantly related to arthritis. Recent share price disappointment comes after the company missed earnings and revenue expectations, and also posted a loss due to a $4.1 billion impairment charge associated with the 2016 acquisition of Stemcentrx. AbbVie decided to write-off this costly acquisition after Rova-T repeatedly failed to hit the mark as a later-line lung cancer treatment last year.

After outperforming in the last quarter of 2018, the weakest performing sector in January was Consumer Staples. Given the Fund's overweight position, this was a drag on performance, though it was offset by some good selection. In particular, the Tobacco companies saw a notable revival after analyst upgrades reiterated that investor's concerns may be overly-pessimistic and current valuations possibly reflect the headwinds facing the Tobacco industry. We outlined the issues facing a number of these companies in our annual commentary, released last month.

Our overweight positioning in the Consumer Staples sector is explained by our search for good quality companies that have a strong potential for dividend growth. The philosophy stems from our findings that companies with a strong balance sheet and consistently high returns on capital are better placed to increase their dividends steadily year-on-year.

The Guinness Atkinson Dividend Builder Fund's focus on chasing dividend growth, rather than the highest dividend yields, arises from the disconcerting correlation between high dividend yield and the high risk of a future dividend cut. Companies that cut their dividend tend to perform poorly in anticipation of a dividend cut, as well as once the announcement is made:

If we analyze the companies that cut their regular dividend in 2018 (vs 2017), we begin to see some notable characteristics. Out of the 1632 companies in the MSCI World Index, 64 companies cut their dividend in 2018, i.e. paid a smaller regular dividend per share in 2018 versus 2017. If we compare this group of "Dividend Cutters" versus the Fund, we can draw out some of the aggregate statistics seen below:

### Quality

| | Fund | Dividend Cutters |
|---|---|---|
| Average 10yr Return on Capital | 17% | 6% |
| Average net debt / equity 1st Jan 18 | 54% | 74% |

### Growth & Value

| | Fund | Dividend Cutters |
|---|---|---|
| P/E (2018e) 1st Jan 18 | 17.6 | 19.5 |
| FCF Yield 1st Jan 18 | 6.5% | 4.0% |
| Total Return (2018, in USD) | -5.4% | -15.8% |

### Dividend

| | Fund | Dividend Cutters |
|---|---|---|
| Average dividend yield 1st Jan 18 | 2.9% | 4.0% |
| Average payout ratio 1st Jan 18 | 63% | 111% |
| Average Dividend Growth 31st Dec 18 | 11% | -27% |

*Source: Bloomberg PORT, Guinness Atkinson Asset Management calculations. As of December 31, 2018.*
30-Day SEC Yield: 3.05% (subsidized), 1.70% (unsubsidized). As of January 31, 2019.

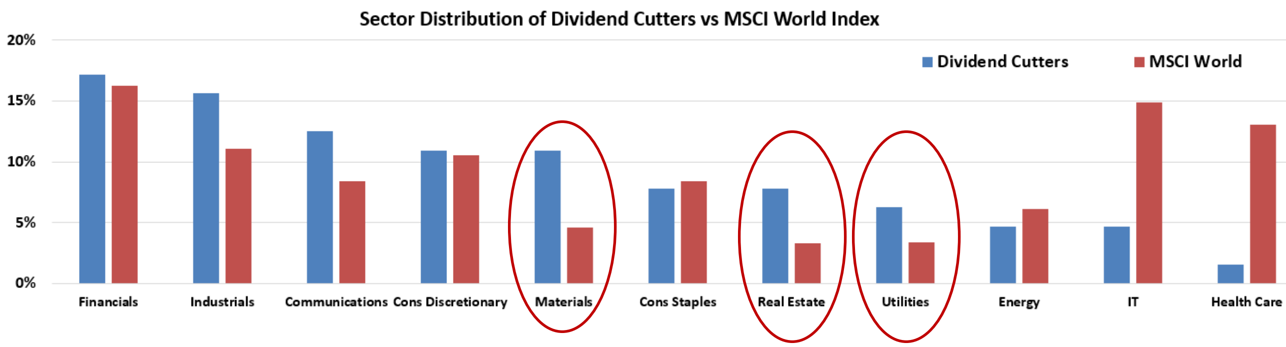
- **Quality** – the Fund has companies that have a much higher and persistent return on capital, while having 20% less net debt to equity.

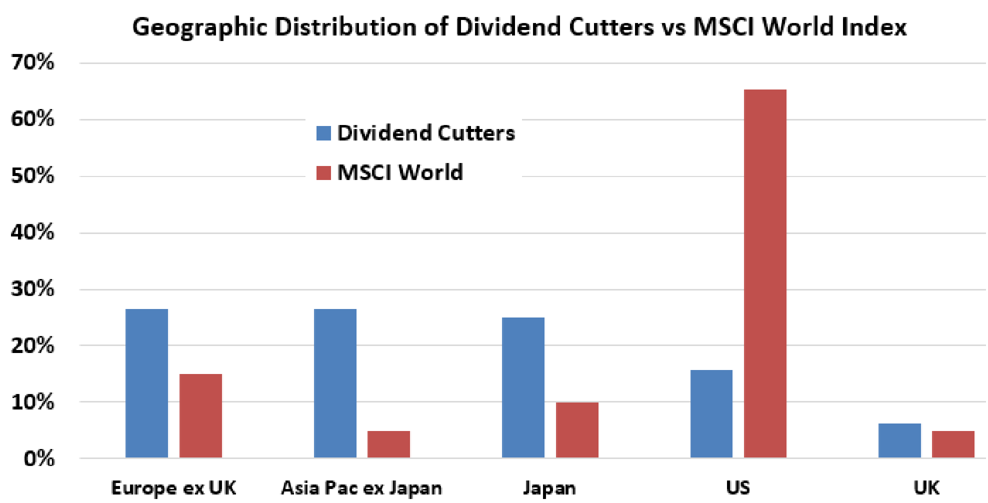
- **Growth & Value** – the Dividend Cutters, on average, were punished by the market. Across 2018, they had a lower total return, and were in fact more expensive on a forward price-to-earnings multiple at the start of the year. Additionally, the group of Dividend Cutters had a lower free-cash-flow yield, indicating a weaker ability to generate sufficient cashflow to meet operating expenses.

- **Dividend** – the Dividend Cutters have a higher dividend yield and significantly higher payout ratio. Naturally, as this becomes unsustainable the company is forced to cut its dividend and is then punished by the market. This then makes its realized yield much lower.

Looking at the individual companies in the "Dividend Cutters" group, we find that based on our initial universe screening, where we look for companies that have above 10% cashflow return on investment for 10 consecutive years, only 8 of the 64 companies would have showed up in our universe. Only 4 companies would remain once we screen out the highly leveraged companies. This shows that our process is designed to somewhat protect against dividend cutters; we stringently screen for quality characteristics in belief that companies which pass the filter are well managed and would not need to cut their dividend.

The figures below show the sector and geographic distribution of the Dividend Cutters.




*Source: MSCI World Index Factsheet, Guinness Atkinson Asset Management. As of December 31, 2018.*

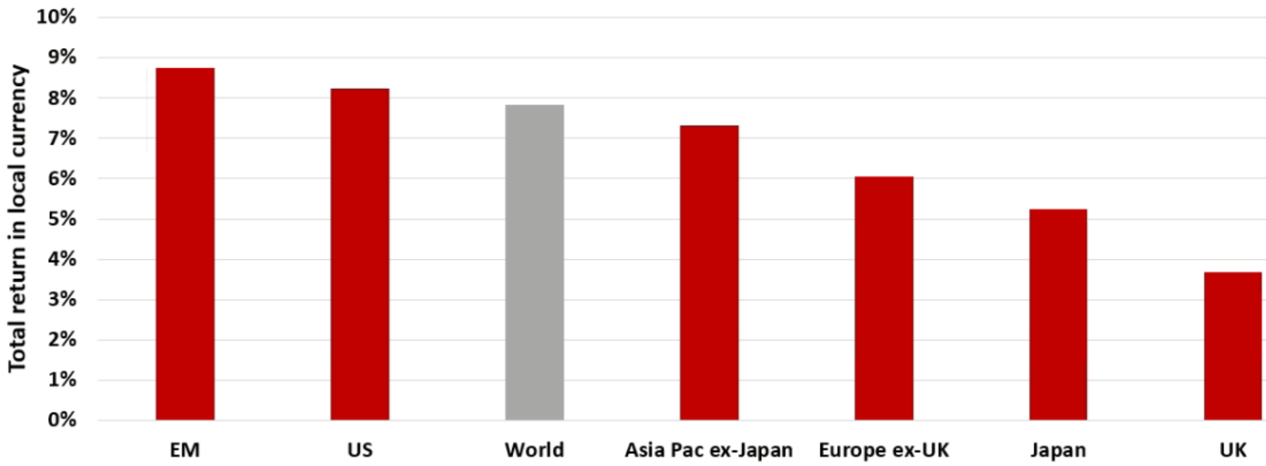
By sector, we see that Materials, Real Estate and Utilities have proportionally the largest number of Dividend Cutters, relative to the size of their weighting in the MSCI World Index. In contrast, Healthcare and IT have the fewest cutters. The Guinness Atkinson Dividend Builder Fund has no exposure to Materials, Real Estate and Utilities since these sectors get largely screened out when looking for companies with consistently high returns on capital. The three sectors tend to be more regulated, and we find that companies tend not to have the persistence in quality that we look for.

Geographically, we see the US as being an anomaly in that it has a large weighting in the MSCI World, however there are proportionally fewer Dividend Cutters. We find that US companies that do pay a dividend tend to have robust balance sheets and a preference for a well-covered progressive dividend policy.

**We made no changes to the portfolio in the month.**

## Market in Review – January

**MSCI World Regional Indices Performance: December 31, 2018 – January 31st, 2019**




*Source: Bloomberg. As of January 31, 2019*

Regionally, Emerging Markets and the US were the best performing in January, though all regions posted substantial gains. In fact, January 2019 marked the second-best monthly performance for global equity markets in over seven years. Stronger than expected corporate earnings results, and some optimism over the US-China trade talks, meant that 2019 got a flying start and somewhat reversed the large sell-off seen in December 2018.

US equity markets were boosted particularly by comments from the US Federal Reserve (Fed) that it would be more patient in increasing interest rates, and more flexible in reducing its balance sheet. The less aggressive statement – and sharp change in rhetoric from the previous month – helped ease fears that policy makers would continue with plans to raise interest rates even as economic data pointed towards a "cooler" economy. The Fed's comments led bond markets to price in no further rate rises over 2019.

Broader concerns about economic growth still remain, including the potential impact on US economic activity from the recent government shutdown. President Trump's desire to build a physical border wall between the US and Mexico can be analogized by the song lyrics bellowed by the Gallagher brothers in 1995:

*I said maybe, you're gonna be the one that saves me*
*And after all, you're my wonderwall*

**Wonderwall song lyrics; written and produced by Oasis in 1995**

"Wonderwall". Though there is no formal definition, scouring the web tells us it is a noun used to describe 'someone you find yourself thinking about all the time; one you are completely infatuated with'. For example, one may be thinking about this wonder during their Presidential campaign promises, or throughout their first two years as US President. Quite fittingly one would also go to many extremes for this infatuation, such as shutting down US Government for 35 days – the longest shutdown in history. The roads to a solution seem to be winding; a lack of Democratic support and a defiant Republican President have led to speculations that a National Emergency to fund the wall may not be an unrealistic possibility. The effect on stock markets has been muted so far, and the biggest victims have perhaps been the US sentiment indicators. The January jobs report may well come out skewed by the shutdown, but the December 2018 jobs report came in fairly strong – wage growth inched up to 3.3% year or year, and the unemployment rate rose 3.9%, though this was largely explained by the increase in labor force participation.

In other regions, EM and Asia benefitted from easing trade tensions between the US and China, as well as the weakening of the US Dollar which accompanied the lower interest rate expectations. China emerged as the best performing market in Asia as the central government revealed plans to stimulate the slowing economy. Full-year 2018 GDP growth came in at 6.6%, versus 6.8% the previous year. 6.6% marks the slowest pace of growth since 1990. Expectations remain high that Chinese authorities will roll out targeted stimulus measures to bolster economic growth throughout 2019 and stabilize the short-term, mixed outlook.

In Europe, economic data pointed to ongoing weakness. GDP figures showed growth of 0.2% quarter-on-quarter in Q4, the same as in Q3. In terms of forward-looking indicators, the flash composite purchasing managers' index fell to 50.7 in January, a 66-month low and compared to 51.1 in December, suggesting that business growth is close to stalling. The unemployment rate remained stable in December at 7.9%; this remains the lowest rate since October 2008. The European Central Bank (ECB) said the risks surrounding eurozone growth have lessened, and the ECB maintained its guidance for interest rates to remain unchanged "at least through the summer of 2019". Italy seems to be worst affected in the region as it slipped into recession with two consecutive quarters of economic contraction.

UK equity markets rose over the course of January, providing the first month of positive returns since the third quarter of 2018. The heightened political tension that has characterized recent months continued into the new year, as the Brexit deadline gets ever closer. In January, the House of Commons voted twice on Prime Minister May's withdrawal agreement. In the first vote, MPs voted-down the bill by a historic margin, however, two weeks later the Prime Minister succeeded in securing MPs backing, subject to material amendments. The market welcomed these political developments, and Sterling enjoyed a three-month high versus the US Dollar over the course of the month. Investors appeared to interpret the developments as supportive of avoiding a 'no deal' exit, as well as a general election.

We thank you for your continued support.

## Performance

In January, the Guinness Atkinson Dividend Builder Fund produced a total return of 5.15% (TR in USD), compared to the MSCI World Net TR Index return of 7.78%. The fund therefore underperformed the Index by 2.63%.

**Standardized Performance**

| as of 01/31/19 | YTD | 1 YR | 3 YR Annualized | 5 YR Annualized | Since inception Annualized (3/30/12) |
|---|---|---|---|---|---|
| **Dividend Builder Fund** | 5.15% | -4.13% | 10.38% | 6.82% | 8.98% |
| **MSCI World Net TR Index** | 7.78% | -6.54% | 11.22% | 6.94% | 8.71% |

| as of 12/31/18 | YTD | 1 YR | 3 YR Annualized | 5 YR Annualized | Since inception Annualized (3/30/12) |
|---|---|---|---|---|---|
| **Dividend Builder Fund** | -4.14% | -4.14% | 7.50% | 4.69% | 8.29% |
| **MSCI World Net TR Index** | -8.71% | -8.71% | 6.30% | 4.56% | 7.63% |

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.68% (net); 2.06% (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 reimburse 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, 2019. To the extent that the Advisor absorbs expenses to satisfy this cap, it may recoup a portion or all of such amounts absorbed at any time within three fiscal years after the fiscal year in which such amounts were absorbed, subject to the expense cap in place at the time recoupment is sought, which cannot exceed the expense cap at the time of the waiver. The expense limitation agreement may be terminated by the Board of the Fund at any time without penalty upon 60 days' notice.

As of November 2018, the MSCI World Index Net Return was used instead of the Gross Return. MSCI World Index Net Return reflects deduction for withholding tax but reflects no deduction for fees and expenses. Net Return is net of local withholding taxes that any investor would typically pay.

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 Funds.***

**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 1/31/2019:

| | | |
|---|---|---|
| 1. | ANTA Sports Products Ltd | 3.30% |
| 2. | Imperial Brands PLC | 3.01% |
| 3. | HengAn International Group Co Ltd | 2.93% |
| 4. | Deutsche Boerse AG | 2.93% |
| 5. | Cisco Systems Inc | 2.90% |
| 6. | VF Corp | 2.90% |
| 7. | Japan Tobacco Inc | 2.89% |
| 8. | Paychex Inc | 2.88% |
| 9. | British American Tobacco PLC | 2.87% |
| 10. | Illinois Tool Works Inc | 2.87% |

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.

Price-Earnings (P/E) ratio is a valuation ratio of a company's current share price compared to its per-share earnings. Forward earnings differ from trailing earnings, which is the figure quoted more often, as they are a projection and not a fact.

Standard deviation is a statistical measure of the volatility of the fund's returns. In general, the higher the standard deviation, the greater the volatility of the return.

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

The 30-Day SEC Yield represents net investment income earned by the Fund over the 30-Day period, expressed as an annual percentage rate based on the Fund's share price at the end of the 30-Day period. The 30-Day unsubsidized SEC Yield does not reflect any fee waivers/reimbursements/limits in effect.

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

*Free cash flow* (FCF) yield represents the cash a company generates after cash outflows to support operations and maintain its capital assets.

One cannot invest directly in an index.

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