Guinness Atkinson

Asia Pacific Dividend Builder Fund

Review of February 2019

GUINNESS ATKINSON FUNDS

Summary Review & Outlook

Fund & Market

- In February, Asian markets moved 2.5% higher in USD as measured by MSCI AC Pacific ex Japan net return Index.
- Leading sectors were Consumer discretionary, Financials, Materials, and Utilities. Laggards were Communication services, Health care, Consumer staples, Real estate and Industrials. Information technology rose in line with the market.
- The best-performing countries were China, Hong Kong Taiwan and Australia/New Zealand. The weakest were the ASEAN countries (Indonesia, Philippines, Thailand, Singapore and Malaysia) and Korea.
- In the fund the outperformers were to be found in IT names (Elite Materials, Largan Precision, Novatek Microelectronics, TSMC, Qualcomm and Hon Hai Precision), in Financials (BOC Hong Kong, China Merchants Bank, Tisco Finance, Aflac, and DBS Group) and in Consumer Discretionary (Luk Fook, Corporate Travel, China Lilang and Pacific Textiles). These companies come from China, Hong Kong, Taiwan, Singapore and Thailand as well as the two US-listed names.
- Underperformers during the month included smartphone-related names (AAC Technologies, Catcher Technology), Consumer discretionary (Hanon Systems, JB Hi-Fi), Financials (China Construction Bank, China Minsheng, ICBC), Healthcare (Sonic Healthcare, St Shine Optical) and from Real estate (Ascendas REIT and CapitaLand Mall Trust).

Events in February

- US-China trade talks moved forward with a 60-day extension to the tariffs deadline and the potential for a meeting between Presidents Trump and Xi. Hawks remain cautious but it looks like both leaders want a deal. However, it's not done yet (see next point).
- Summit between Kim Jong Un and President Trump in Vietnam prompted fears that Trump would be outplayed in his quest for a deal. But talks collapsed when Trump walked away.
- The collapse of the North Korea/US summit was a blow to President Moon of South Korea who has invested substantial political capital in thawing relations. Korean stock markets fell.
- The smartphone segment has seen the first phone with a foldable screen. Chinese phone-makers are in hot pursuit.
- Recent economic data from China look more 'glass half-full' with higher input prices reducing deflation fears and new orders picking up. Export orders however still point to tougher external trade. Signs therefore that China's domestic efforts are beginning to pay off while the external environment remains uncertain.

Steadily improving sentiment toward Asia has lifted market valuations from their three-year lows at the end of December back to their 10-year average. Nevertheless, the Fund remains at 14% valuation discount to that of the MSCI AC Pacific ex Japan Index. The past month has been a good one for the Fund and, combined with January performance, has meant it has made a good start to 2019.

We argued in 2018 that much of the weakness we saw stemmed from valuation compression rather than poor operating performance. Sentiment was weak about the dollar, about China's domestic economy, and about trade. This year we have seen a marked improvement in all these areas. The Federal Reserve abruptly changed its policy on interest rate rises, seemingly shaken by the US stock market's apparent fragility. China has continued its targeted policy support and recent data suggest grounds for optimism that this is having an effect. Domestic services have picked up and manufacturing input prices have risen a little, reducing the prospect of renewed deflation. The outlook for exports however, looks weaker.

The tempo of China-US trade discussions has also changed. While US trade negotiators remain hawkish, emphasizing how much further there is to go on resolving issues relating to intellectual property and China's state support for industry there is a growing sense that President Trump wants a deal. Although he cut short talks abruptly with North Koreans, that was easier for him to do. The trade issue is more pressing as there is mounting evidence that China's retaliatory tariffs are having a greater impact on the US than previously thought. A study by the Institute of International Finance shows a collapse in many of the 900 categories US products targeted by China. In July to November, the value of lost exports is estimated to have hit $17 billion, an annualized rate of $40 billion or one third of US exports to China. In this context, China's offer to increase imports of US goods, while not enough for the hawks, looks very attractive politically especially when we remember that next year is an election year.

Portfolio update

Corporate Travel Management reported strong results that emphasized organic growth. Profit rose 25% and the interim dividend increased 20%. The business in Australia saw a record number of new client wins and it was reported that 80% of transactions are now done online. The Asia business seeks to replicate the Australian strategy following the recent acquisition of Lotus Travel through amalgamation of offices and rolling out Corporate Travel's technology platform to improve efficiency and raise margins. The North American business picture is similar. Only 30% of transactions are online and Corporate Travel continues to spend on implementation of their technology platform in that market. The stock was hit by a report last year that alleged various accounting anomalies ranging from their method of valuing intangible assets to variations in cash flows and also asserted an over-reliance on growth through acquisition. The company issued rebuttals and the stock recovered a bit, but the recent set of results has been widely welcomed pushing the stock back close to previous highs.

Novatek Microelectronics issued full year results and reported both stronger results (full year profit up 27%) and more upbeat guidance than was expected. The company designs and ships Display Driver ICs (DDI) which are chips that control displays on anything from TVs to smartphones. In recent years the company's returns have been fine but unspectacular. However, it appears that stars are aligning for them in both TVs and smartphones which is starting to be reflected in higher volumes and higher selling prices. Their new Touch controller with DDI integration for the smartphone segment has value not only in what they do but also in their form factor. The value is how these elements are integrated allowing easier smartphone assembly and also slimmer smartphone bodies.

PTT in Thailand is an integrated energy business with interests in natural gas supply, exploration and production, petrochemicals and refining and in oil trading. The company reported results for the fourth quarter of 2018 which were in line with expectations but weaker than recent years. The lower oil price in the last few months of 2018 was felt most keenly in the refining business, which accounted for 28% of operating profit and in oil trading, which accounts for 6%. In each case the cause was the same: in a falling oil price environment the price of oil as feedstock is higher than the selling price of the end products because there is a one-month lag between the input price and the final sale price. This of course works in their favor when the oil price rises. Natural gas sales, primarily into the Thailand electricity grid, are protected to some extent against falling prices because their purchase price is linked to Dubai crude prices and their supply contract prices are less variable and linked to the price of Brent crude oil. Profit for the year was down 12% compared to 2017 but the dividend was maintained at the same level.

The **Link REIT** in Hong Kong announced that it has bought Shenzhen Central Walk Mall with the purchase to be funded from recent asset disposals. The company is primarily focused on Hong Kong commercial property but has stated its intention to increase its China exposure. This purchase follows an acquisition in November last year of a shopping mall in Beijing. Their stated strategy for China business is to focus on discretionary retail in the leading Chinese cities (Beijing, Shanghai, Shenzhen and Guangzhou) and to increase exposure to 12.5% to 20% of the overall portfolio. The Link now has five shopping malls in China which together account for 13% of the portfolio up from 9% at the last year end (March 2018).

Janus Henderson is held in the portfolio by virtue of its Australian listing. The results for 2018 were down 16%, after excluding the effects of one-off items but the (progressive) dividend for the year grew 12.5%. Like all asset managers, the ongoing effects of fee pressure continue to weigh. Short term performance of funds in Alternative, Fixed Income and Quantitative strategies has been weak. The equity funds business reported two thirds of the assets under management (AUM) were ahead of the benchmark over one year although over three years only 55% were ahead. The multi asset range appears to have done well over 1. 3 and 5 years. For Janus Henderson, the focus has to be on the average management fee rate across the business which was 0.561% in 2015 and is now 0.53%; on AUM which are driven by both market performance and flows; and on operating expenses which need to be split between compensation and non-compensation costs. In 2018, AUM fell from $370.8bn to $328bn with outflows accounting for $18bn and market movement for $24bn). Compensation was 41.4% of revenue, down from 43.8% in 2017 while other expenses were unchanged from last year.

China Merchants Bank reported preliminary results for 2018 (at the end of January). Profit rose 12.6% for the full year which was welcome, but the market appeared to be more focused on, and pleased by, the evident improvement in balance sheet quality. The non-performing loan ratio was down but this appeared to be associated with more aggressive charge-offs of bad debt, which is something we have been looking for. In the fourth quarter loan growth was down slightly but deposits rose, another sign of strengthening, bringing the loan to deposit ratio down below 90%. A full results release will be available later in March and so we will know more about underlying trends then.

Outlook

Recent news flow on China US trade has taken some of the volatility out of the region and Asian markets have risen strongly, along with global markets. It would be well to remember however, that positive noises coming from Trump and Xi are self-serving and political, especially in the case of the former. At the negotiation level, the issues remain complex and sides far apart. The matters of intellectual property and state industrial policy have not gone away. (The latest talk is that China may look for a 6-year implementation for intellectual property/technology transfer rules. Will the US negotiators accept that? Will president Trump overrule or walk away?). Markets appear to have priced in a significant downgrade of tensions and perhaps a roll-back of current tariffs. This seems to us unlikely, at least at the fullest extent.

The focus therefore remains on companies that can prosper in an uncertain geopolitical environment (reports of renewed activity at North Korean missile sites, following the collapse of the summit) and slower growth evident in China, Europe and perhaps the US. Recent economic data from China suggest that the domestic economy is responding to stimulus efforts, as policy has shifted to downplay deleveraging toward increased domestic credit, while the export outlook remains weaker. Some of these signs have been evident in recent industry sentiment gauges (the Purchasing Managers Indices) but they have also shown up in inflation numbers (headline, non-food and producer prices) that show a sequential rise rather than steady decline.

The technology sector is important for Asia, especially for us in the manufacturing side. Consumer electronics, especially smartphones, have issued mixed signals. The headwinds faced by Apple, for example, only partially reflect the broad market. Offerings from Chinese makes Huawei and Xiaomi are impressive and provide a credible alternative to the iPhone at three quarters of the price or less. Samsung grabbed the headlines for technology innovation with its new folding screen; it may not be widely adopted, ultimately, but it puts them in front in customer perceptions. New cameras, such as the triple camera whose features are being pushed heavily by Huawei, offer a leg up for lens makers. New 5G technology and new form factors coming up later in the year could lift other component makers which are still laboring under weaker numbers in the last three months of 2018 and the first three months of 2019.

Overall, we think there are many cross-currents to navigate and no simple answers on offer from a top down analysis. But our focus at company level and then looking up throws up many reasons to stay positive. The Fund is at a 15% discount to the market valuation and the portfolio shows a return on capital (net profit divided by the capital employed to generate that profit) which is twice that of the market as represented by our benchmark Index. Average earnings growth over the next two years is estimated by the consensus to be 7% per annum, in line with the 10-year average, which we think is an attractive growth rate from a group of companies that pays out on average 55% of their profits as dividends.

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

Performance

As of 2/28/2019	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	11.53%	-7.41%	13.37%	7.93%	13.33%
MSCI AC Pacific ex Japan Net Return Index	10.91%	-7.16%	14.98%	5.22%	12.50%

As of 12/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	-16.42%	-16.42%	7.53%	5.27%	10.60%
MSCI AC Pacific ex Japan Net Return Index	-14.51%	-14.51%	7.95%	2.90%	9.81%

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 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 absorbed.

As of November 2018, the MSCI AC Pacific Ex-Japan Net Return was used instead of the Gross Return. MSCI AC Pacific Ex-Japan 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.

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 Net Return 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. It reflects deductions from reinvested dividends for withholding tax but reflects no deduction for fees and expenses.

One cannot invest directly in an Index.

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

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 02/28/19:

1.	Elite Material Co Ltd	3.44%
2.	Largan Precision Co Ltd	3.03%
3.	Tisco Financial Group PCL/Foreign	2.97%
4.	Corporate Travel Management Ltd	2.96%
5.	Hanon Systems	2.95%
6.	Luk Fook Holdings International Ltd	2.95%
7.	Yangzijiang Shipbuilding Holdings Ltd	2.93%
8.	Lilang China Co	2.89%
9.	Novatek Microelectronics Corp	2.85%
10.	China Merchants Bank Co Ltd - H Shares	2.85%

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

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