Guinness Atkinson
Dividend Builder Fund
Managers Update – September 2019

GUINNESS ATKINSON FUNDS

August in Review

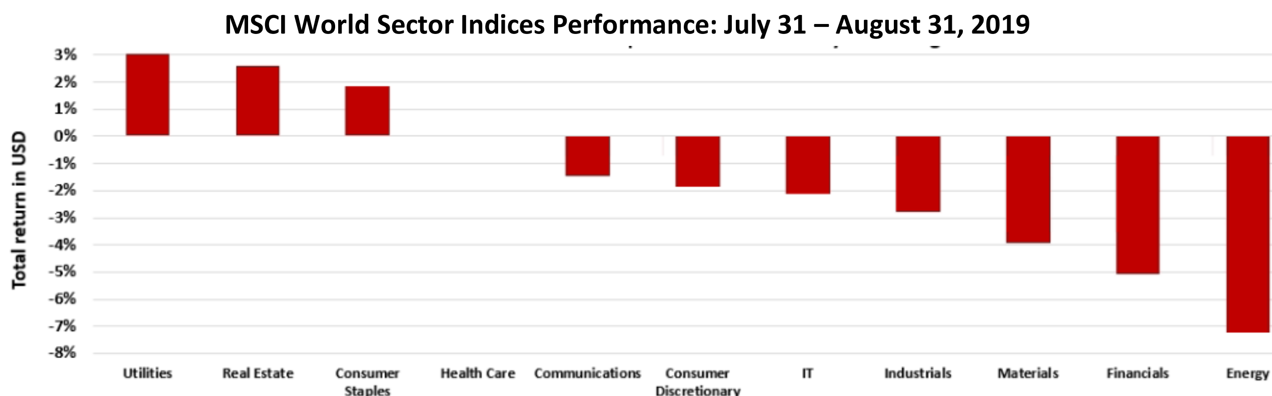
Game theory is the economic discipline that attempts to logically determine the possible outcomes of a given situation. Each competing party seeks the course of action that most benefits them *given* the simultaneous actions of the opposing party. In July, game theorists held the belief that both the US and China had an overarching interest in coming to a face-saving deal, and markets were priced on the assumption that both nations had simply too much to lose by escalating tensions.

It therefore came as a shock when President Trump, at the start of August, announced via tweet that he would impose 10% tariffs on a new set of Chinese imports, worth $300bn, at the beginning of September. That was swiftly followed by China allowing its currency to depreciate below 7 Renminbi-to-the-Dollar – a key historical threshold – and the US declaring that China was a currency manipulator.

The tit-for-tat continued with the White House deferring the imposing tariffs on a range of consumer goods until December 15th to avoid higher US prices pre-Christmas; China increased tariffs on roughly $75bn of US imports; and President Trump then tweeted that all existing and planned US tariff rates would rise by 5%.

With both sides far more committed, and anxious not to lose face, theoreticians were left puzzled and investors became increasingly nervous. By the end of August, markets closed the month in negative territory as the escalating trade war raised concerns about the outlook for economic growth. August also proved to be the most volatile month for equities in the year so far; and led to a flight to safety as investors preferred developed markets and stocks with greater defensive qualities.

This was particularly beneficial to the Fund's performance due to our overweight positioning in Consumer Staples and Healthcare, and our underweight exposure to Energy, Banks and Materials. Regional allocations did not meaningfully add nor subtract from active performance.



Source: Bloomberg, as of August 31, 2019

Utilities and Real Estate were the best performing sectors, and though we hold no positions in these sectors, their relatively small weight in the MSCI World Index meant that this did not have any meaningful impact on our active performance. Our investable universe is characterized by higher quality companies as defined by persistently high returns on capital and strong balance sheets; we see little within the commodity-based and regulated sectors where a company's "destiny" is often influenced by exogenous factors.

We also hold no Banks in the Fund as most are screened out by our "persistency" criteria. Though there are many Banks which have a return on capital greater than the cost of capital, we scarcely find any which have been able to consistently achieve this feat for 10+ years, i.e. through both the Global Financial Crisis and the European Sovereign Debt Crisis.

Recent underperformance of Banks comes as investors are increasingly wary of the global economic outlook. The 0.25% cut in US interest rates on July 31st and expectations that the Fed will cut further in September has supported a rally in bond prices, subsequently depressing bond yields. In fact, on August 14th, the yield spread between two-year and 10-year US Treasury bonds moved below zero for the first time since February 2006. Though it has since widened back to positive territory, the move was significant because such inversions of the yield curve – in which short-maturity yields exceed those for longer-maturity bonds – have preceded nearly all recessions dating back to the 1950s.

Mindful of using the phrase "it's different this time", various pundits have dismissed the yield curves' inversions this time around, citing the unique circumstance around why the curve inverted. The phenomenon of $17 trillion of negative-yielding global debt (Wall Street Journal) is certainly novel and has undoubtedly led to significant safe-haven/higher-yielding purchases of longer-term Treasury securities. As such, unlike most past episodes, the curve inverted this time because long-term yields fell below shorter-term yields (rather than the Fed raising short-term rates above long-term yields). That said, an inverted yield curve, when persistent (and regardless of why/how it inverted), does curb the spread

banks can earn by borrowing short and lending long – typically constraining credit availability, a common precursor to recessions.

Our Financials exposure comes from insurance (Aflac, Arthur J Gallagher), exchanges (CME Group, Deutsche Boerse) and asset management (Blackrock); these boded well for us in August.

CME Group was the best performer in the month (+11.8% in USD), and this coincided with a return of higher volatility, rising from global political instability. Longer term, the exchange is well positioned to integrate the NEX acquisition and offer clients a more holistic solution given its futures, options and data products. The NEX deal should also support CME's international expansion plans, as 50% of NEX's revenue is generated outside of the US. Data and analytics are a key focus area for the company in 2019, with an outlook to expand recurring revenue. CME is also particularly well-placed to benefit from increased interest-rate hedging around FED rate hikes and rising US oil exports thanks to its dominant FED Funds and WTI futures contracts. The company has largely opted to pursue an organic growth strategy, and this has meant low debt-to-equity at 17% with returns on capital increasing every year for the last five.

We made one change in the portfolio during the month, whereby we sold our position in **Vodacom** and bought a new position in **Henkel**.

Vodacom has had a poor year in terms of share price performance (-14.7% in USD and 9.9% in ZAR, South African rand). Sub-Saharan Africa's largest telecom carrier has been battling headwinds facing the entire industry, specifically in the form of price reductions driven by competition and regulation. With around 60% market share in South Africa, the company is highly exposed to any regulatory changes; revenues have started to suffer from government initiatives to make mobile data more accessible via lower and more transparent pricing. Our decision to sell also coincides with the greater risks the company faces from confirmed plans to introduce a Wholesale Open Access Network (WOAN), which reduces Vodacom's access to spectrum and increase costs for Vodacom. Spectrum refers to the radio frequencies available for wireless communication signals to travel over the air. The WOAN would reduce the spectrum available to the private sector and thus bid up prices at auction. Though gross margins have remarkably been increasing year on year for a decade, we see the recent events as threats to the company's margins and believe this is an opportune time to sell our holding.

Henkel manufactures chemical products, used in various industries: laundry and homecare (Persil, All, Pril); cosmetics and toiletries (Schwarzkopf, Dial, Syoss); adhesives (Loctite, Pritt, UniBond). Henkel's business is centered in Europe, with a growing presence in developing economies. The company has had a diversified revenue stream with Adhesive Technologies accounting for around 45% of sales, Laundry and Homecare makes up around 35%, and Beauty Care accounts for about 20%. Dividends have grown at an annualized rate of 9% over the last 5 years; yield at purchase was 2% and the 1-year forward price-to-earnings sat below the 10-year average. Given that the company has low debt, historically high cashflow returns on investment, and is seeking both organic and acquisitive growth, we believe Henkel to be an attractive addition to the portfolio.

Henkel’s recent merger and acquisition (M&A) activity has involved buying up companies to build out its presence in certain markets and boost its product portfolio. Henkel made three acquisitions in 2018. In early 2018 it acquired Unión Técnico Comercial, based in Lima, Peru, strengthening its presence in the maintenance, repair and overhaul adhesives market in Latin America. Later in 2018, Henkel acquired Canada-based JemPak Corporation, strengthening the existing Laundry & Home Care portfolio in North America. Towards the end of the year Henkel acquired Chile-based Aislantes Nacionales, strengthening its presence in the Chilean tile adhesives and building materials market.

With more sensitive markets and many uncertainties, any risks should be considered in the context that global equities continue to yield higher than their fixed income counterparts. Also, we believe that our perpetual approach of focusing on the quality of the underlying companies we own should stand us in good stead in our search for rising income streams and long-term capital growth, despite the direction of any macro or political winds.

We thank you for your continued support.

Performance

In August, the Guinness Atkinson Dividend Builder Fund produced a total return of -0.63% (TR in USD), compared to the MSCI World Net Return Index return of -2.05%. The fund therefore outperformed the Index by 1.42%.

Standardized Performance

as of 08/31/19	YTD	1 YR	3 YR Annualized	5 YR Annualized	Since inception Annualized (3/30/12)
Dividend Builder Fund	14.15%	4.40%	9.14%	6.03%	9.46%
MSCI World NR Index	15.15%	0.26%	9.63%	6.14%	8.98%

as of 06/30/19	YTD	1 YR	3 YR Annualized	5 YR Annualized	Since inception Annualized (3/30/12)
Dividend Builder Fund	14.99%	10.47%	10.87%	6.03%	9.80%
MSCI World NR Index	16.98%	6.33%	11.77%	6.60%	9.43%

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.68% (net); 2.00% (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, 2020. 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.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice.

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 Fund, and it may be obtained by calling 800-915-6566 or visiting gafunds.com. Read it carefully before investing.

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. When inflation rate is greater than expected, that markets may respond differently to changes in the inflation rate than the Advisor expects, or inflation may manifests in such a way that the Fund is unable to provide reasonable protection against inflation.

Top Fund Holdings as of 8/31/2019:

1. ANTA Sports Products Ltd	3.51%
2. CME Group Inc	3.21%
3. Nestle SA	3.15%
4. Taiwan Semiconductor Manufacturing Co Ltd	3.12%
5. Danone SA	3.06%
6. Arthur J Gallagher & Co	3.05%
7. Sonic Healthcare Ltd	3.02%
8. Novo Nordisk A/S	3.00%
9. Deutsche Boerse AG	2.98%
10. Unilever PLC	2.94%

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.

Debt-to-equity is calculated by dividing a company's total liabilities by its shareholder equity. A high debt/equity ratio is often associated with high risk.

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

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

One cannot invest directly in an index.

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