Guinness Atkinson
Dividend Builder Fund
Managers Update – October 2019

GUINNESS ATKINSON FUNDS

Quarter Review

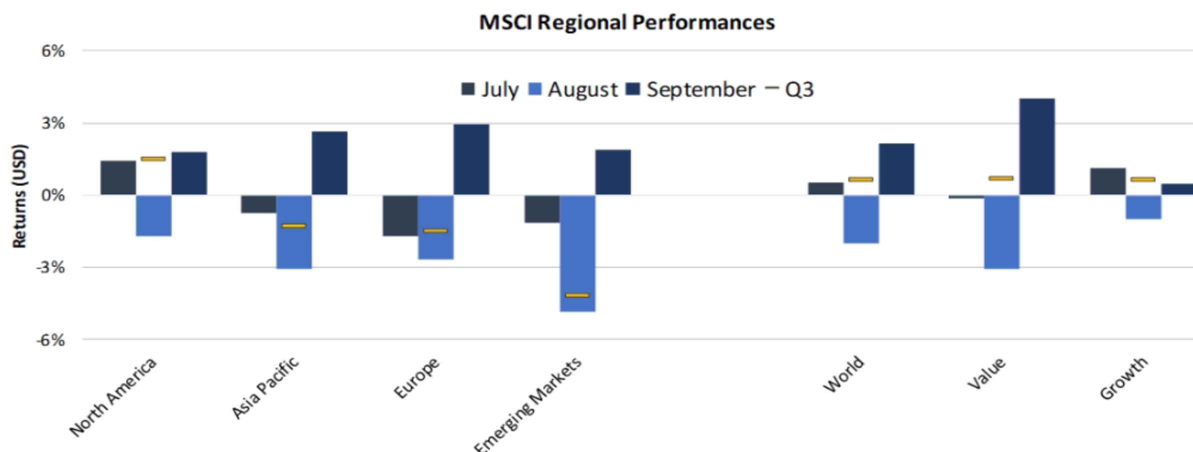
The third quarter of 2019 was characterized with higher bouts of volatility amid continued uncertainties regarding trade and global growth. Central banks took notice, with the US Federal Reserve lowering interest rates for the first time in more than a decade and the European Central Bank also cutting rates and reintroducing quantitative easing. Year-to-date, 46 central banks around the globe have cut interest rates in an attempt to further accommodate the global expansion that started in 2009.

Interestingly, the same news events that dominated the second quarter continued to dominate the third quarter. There were two main themes that kept influencing the markets: hopes of a trade truce between the US and China, and the Federal Reserve's stance with respect to short-term interest rates.

In the US, during the third quarter, investors saw:

- On July 31st, the Federal Reserve cut rates for the first time since 2008;
- On August 5th, the Dow Jones Industrial Average (DJIA) suffered its worst trading day of the year;
- On August 14th, the 30-year Treasury yield hit a record low, and the 10-year vs 2-year yield curve inverted for the first time since prior to the Global Financial Crisis;
- On September 16th, Brent crude oil had its biggest one-day gain after drone attacks on Saudi Arabia's oil infrastructure;
- On September 18th, the Federal Reserve cut rates for the second time this year; and
- On September 30th, both the S&P 500 and DJIA posted their best three-quarter starts to the year since 1997, and the NASDAQ posted its best three-quarter start since 2013.

Two days before the second quarter ended, the Fed formally suggested that no cuts were coming in 2019. Then in July, rates were cut for the first time since 2008 and they were cut again in September. Despite the Fed's stance, the cuts did not come as a surprise to markets. In fact, for most of the month prior to the first cut, the fed funds futures pointed to a 100% chance of monetary policy easing. The corresponding figure for the second cut was 87%. In both months, the cuts spurred on global equity markets, disproportionally contributing to the outperformance of US stocks.



Regional performances in Q3 2019 (all TR in USD)
Source: Bloomberg. Data as of September 30, 2019

All regions posted gains in September, though only the US ended the quarter in positive territory. The S&P 500 Index rose 1.9% (in USD) in a relatively calm September that saw no daily drops of more than 1% for the Index. The gains reversed August's losses and left the Index up a solid 20.6% year to date (in USD) – its best start to a year through September since 1997.

The US economy has remained resilient despite trade uncertainty and political tensions. Consumer confidence remains high (and consumption is the largest contributor (~60%) to US GDP). This is combined with an extremely strong labor market and most recent data points to third quarter economic growth consistent with the trend of the current expansion.

Emerging markets equities matched the S&P 500 return, despite being weighed down by trade uncertainty reflected in lackluster performance from Chinese stocks. Chinese stocks listed on US exchanges were the worst affected after news that the White House was considering restricting US investment in China and forcing US exchanges to delist shares of Chinese companies.

Taiwan, South Korea, and India were among the biggest positive contributors to emerging markets equity gains, with India benefiting from an unexpected corporate tax-cut announcement. Year to date, however, the MSCI EM Index has returned 6.2% (in USD) and lagged the other regions. In the Fund, our exposure to Asia/EM currently comes via 3 stocks: ANTA Sports (China), TSMC (Taiwan) and Hengan (China). The first two were the best performers in the quarter, whilst the latter was one of the worst (discussed later in the commentary).

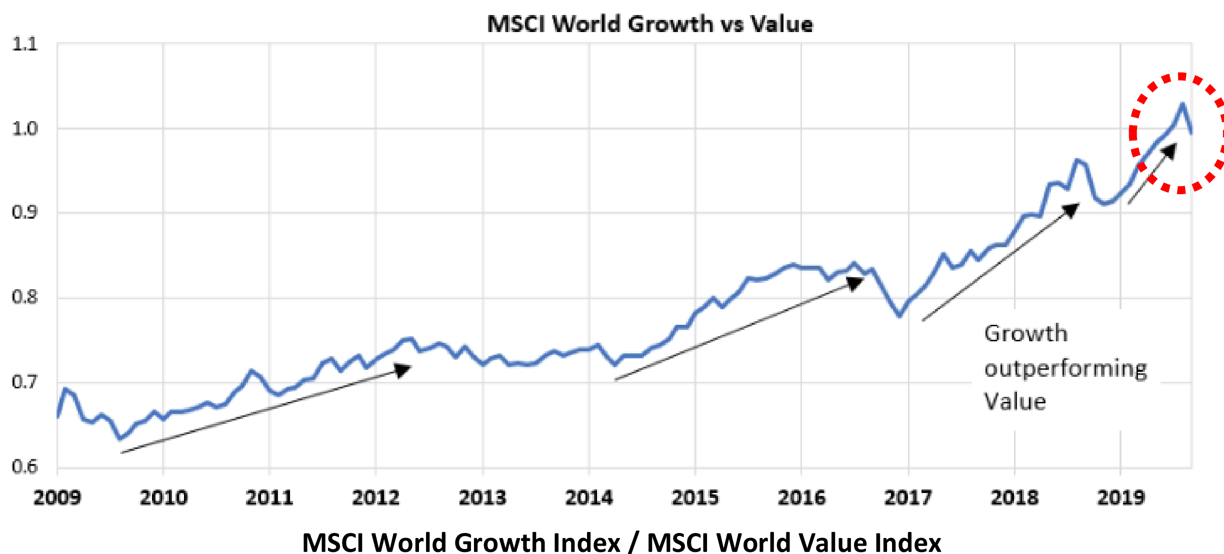
Trade negotiations between the US and China remain uncertain, though officials are set to meet in both October and November, increasing optimism for a mini deal. The start of September also saw encouraging

appetite for a resolution as China exempted certain US agricultural products from additional tariffs, and President Donald Trump delayed a scheduled 5% increase in tariffs from October 1st to October 15th to not coincide with the People's Republic of China's 70th anniversary celebration. Further, with political instability in Hong Kong – where protests continue – and with a formal impeachment inquiry launched by US House Speaker Nancy Pelosi, both the US and Chinese Presidents have arguably more pressing domestic issues to contend with in the short term.

Political issues continue around the globe, with the UK certainly not exempt. Odds against a no-deal Brexit appeared to improve as Parliament passed a bill designed to prevent a no-deal exit from the European Union, and the UK Supreme Court ruled Prime Minister Boris Johnson's suspension of Parliament unlawful. This led to a relief rally in the FTSE 100, though it remains to be seen whether this can be sustained; October will be a more telling month whether a deal can be negotiated or whether the UK will be forced to leave without anything on the table.

Better performance in Europe, in September, can be attributed to the ECB announcing a fresh wave of quantitative easing, encouraging expansionary fiscal policies, and the market's rotation into value stocks. International developed markets are more value oriented and therefore tend to perform better when investors hunt for bargains and shun higher-priced growth stocks.

Last quarter we saw a sharp rotation as economically-sensitive sectors and value stocks gained favor globally:

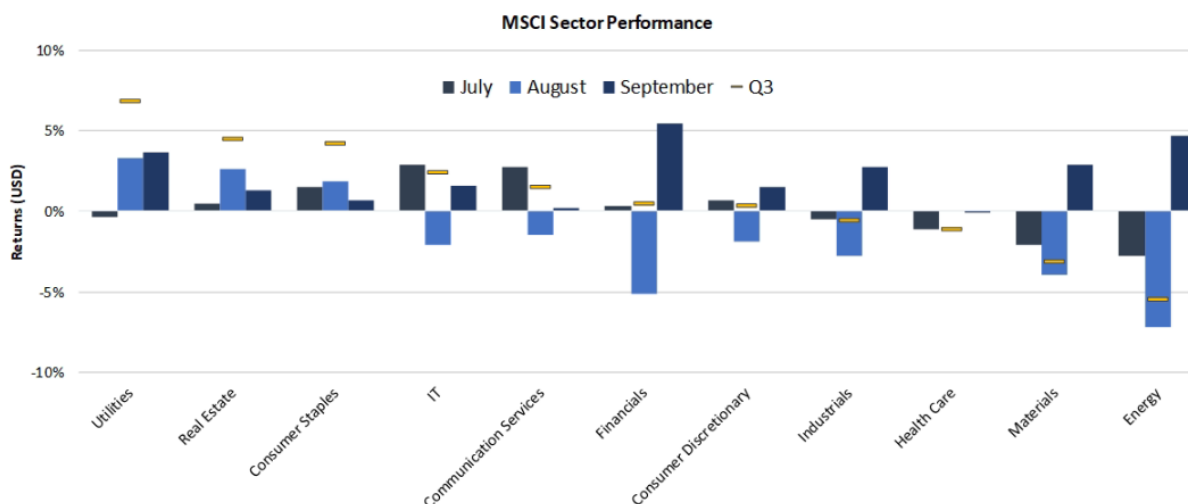


MSCI World Growth Index / MSCI World Value Index

Source: Bloomberg. Data as of September 30, 2019

In September, value stocks outperformed growth in a rising market for the first time since late 2016, and this was particularly pronounced in US and European large caps. While growth stocks still slightly outperformed value stocks over the entire quarter, the move showed how sharply sentiment can shift.

Macroeconomic expectations played a big part in the rotation; bearish sentiment appeared to peak in August and gave way to small doses of good economic news in September. Global manufacturing showed signs of life, as the PMI for August increased after 15 straight months of decline. Bond yields reflected some of this optimism. Since August 14th, when the yield spread between two-year and 10-year US Treasury bonds moved below zero for the first time since February 2006, it has 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 distortion due to prolonged quantitative easing.



Sector performances in Q3 2019 (all TR in USD)

Source: Bloomberg. Data as of September 30, 2019

Utilities and Real Estate were the best performing sectors over the course of the quarter, 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 investible universe is characterized by high 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.

The Fund also holds no positions within Materials, and only one stock in the Energy sector; over the last quarter these were the worst performing sectors and the Fund benefitted from a lack of exposure. The Energy sector has over recent months been negatively impacted by demand concerns, and September's rally was helped by both a rotation into undervalued stocks and the spike in oil prices after a drone attack on oil processing systems in Saudi Arabia wiped out 5% of global supply.

Health care was the only sector to fall over September amid concerns in the US about 2020 Democratic proposals for "Medicare for All". This calls for eliminating private health insurance and replacing it with a universal Medicare plan, which could hinder corporate profits for companies in the space. The Fund holds no US pharmacy benefit managers, and this has been beneficial over the course of this year.

The largest contributor to Fund performance over the quarter was Consumer Staples. This is where the Fund is most overweight versus the benchmark (21% overweight). The sector performed well as investors increasingly turned their attention towards the high-quality, large-cap companies that make up a large proportion of the defensive sector. This rotation coincides well with the change we made in the portfolio over the last three months:

In the quarter, we made one change to our holdings; we replaced our position in Vodacom with a position in Henkel.

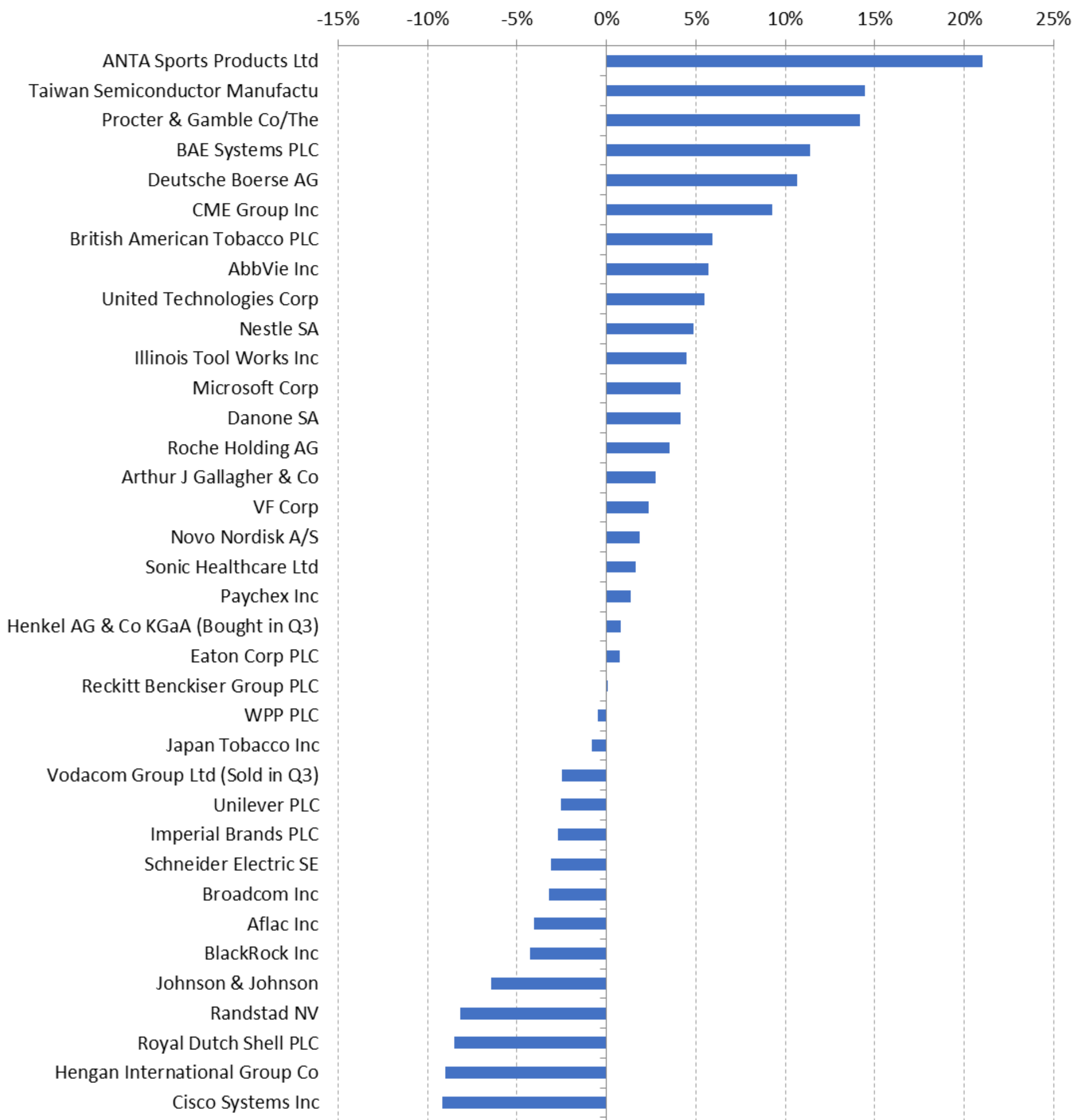
This reduced our Communications – and African – exposure, and increased our Consumer Staples – and European – exposure.

Vodacom has had a poor year in terms of share price performance. 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 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 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, persistently 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 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.

Stock Selection



Source: Bloomberg. As of September 30, 2019

ANTA Sports was the best performing stock in the fund over the quarter (+21.0% in USD). The company generates revenue through the manufacture and trading of sporting goods, including footwear, apparel and accessories. ANTA is poised for greater market share in China as it seeks to woo affluent shoppers with pricier athletic gear. This includes popular brands such as Fila and Descente, as well as Salomon and Arc'teryx – both owned by Amer Sports, who ANTA acquired. Going premium should make up for less-robust gains at its lower-priced namesake brand, which sells at half the price of Nike and Adidas products. ANTA's sales growth is likely to accelerate after the Amer acquisition, yet a profitability boost may not be likely until two years. On the upside the move to acquire a European company gives ANTA Sports scale to expand geographically, as well as launch new products in China. The company's growing product offering could well fuel earnings and revenue growth and the shrewd move into winter sport clothing and equipment comes well-timed ahead of the next Winter Olympics in 2022 in Beijing.

Taiwan Semiconductor Manufacturing Company also performed well (+14.5% in USD). TSMC is a pure-play foundry business and manufactures integrated circuits which are used in computers, communication equipment, consumer electronics, automotives, and industrial equipment. The company has a very low debt to equity ratio of 11%, and an attractive dividend yield of 3.4%. Revenues and gross margins have increased every year for the last 8 years, and cashflow returns on investment have been maintained above 10% for the last 10 years. The recent rally points to optimism regarding future sales and profit growth which are expected to rise as the use of artificial intelligence applications and the emerging adoption of 5G communication standards boost demand for high-end semiconductors. The company's leadership in manufacturing technology, along with Globalfoundries' decision to suspend its 7-nanometer product development, will allow TSMC to solidify its market share in high-performance computing chips and to maintain its industry-leading profit margin.

Cisco (-9.2% in USD) and **Hengan** (-9.0% in USD) were the worst performers in the quarter.

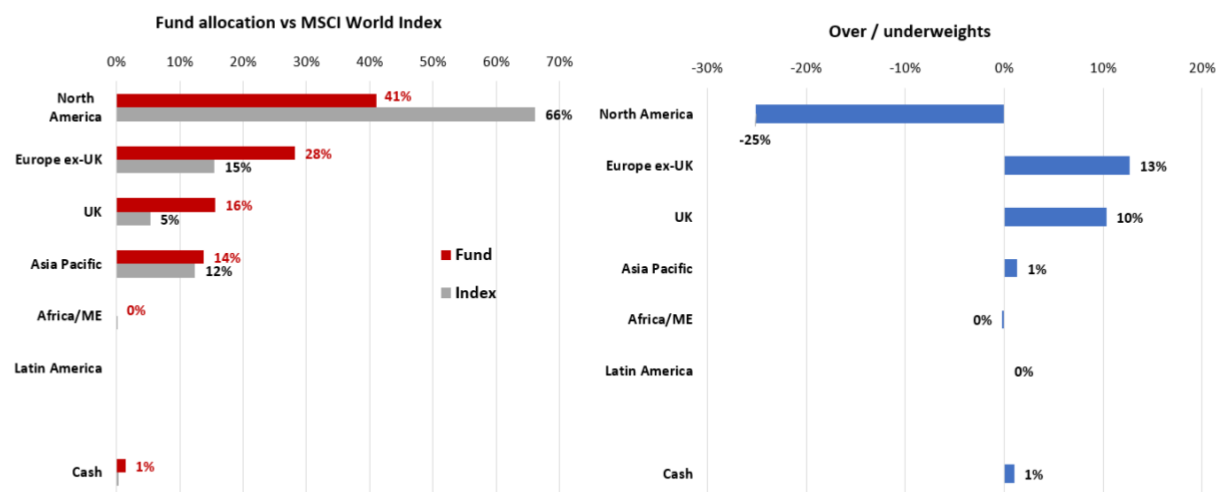
Cisco, the world-leading IT infrastructure equipment vendor, has been making a transition to a balanced revenue mix of hardware and software, with a goal of deriving 50% of sales from software by 2020. Its move to software is best measured by its recurring revenue, which now accounts for around 33% of sales. Further, Cisco's new product sales have been strong – in particular its new line of programmable switches, the Catalyst 9000 series, have been selling well, leading to claims by CEO Chuck Robbins that the 9000 series is the fastest-growing new product in Cisco's history.

The recent weak performance comes as a result of lower enterprise spending due to weakening global economies. Cisco may be more sensitive to macroeconomic dynamics relative to some of its networking peers due to its large exposure to small and midsize enterprise IT spending. Enterprise accounts for about two-thirds of Cisco's sales, with the remainder from telecom service providers and cloud data-center customers. Cisco's fiscal Q4 2019 results showed signs of a potential slowdown, as enterprise orders fell by 2%. China softness and Brexit-related uncertainty were cited as reasons for Q4s order declines.

Hengan International also performed poorly in the quarter. The company is one of the largest producers of sanitary napkins, diapers and tissue paper in China. Historically the company has captured significant market share in established distribution channels (maternity stores, hypermarkets) and more recently it is seeing growth from online exposure. Management has built up an e-commerce team to take advantage of the channel shift in China, where consumers are increasingly purchasing everyday items online. Alongside this there are new brand launches and a revitalized “Amoeba” sales strategy to maintain its offline market share. Growing revenues, high and stable margins, year-on-year earnings growth and a well-covered, high dividend are some of the highlights making this a compelling stock. Its recent weak performance comes due to increasing pulp prices – to which the company is significantly exposed – and also a concern over competition from the likes of Proctor and Gamble and Kimberly Clark, as well as Japan's Unicharm and Kao.

Portfolio Positioning

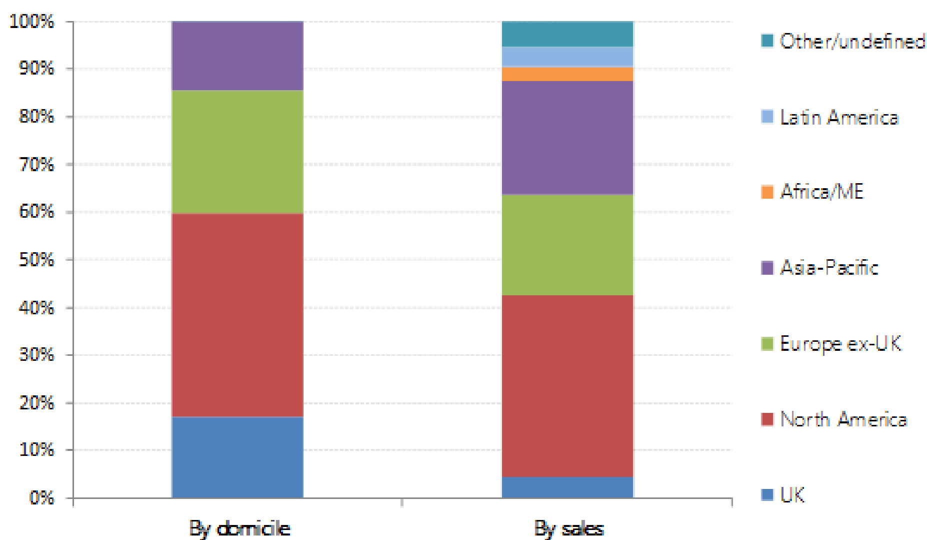
In terms of geographic exposure (chart below), the largest difference between the fund and the benchmark is our exposure to the US (as measured by country of domicile). The fund over the quarter had on average c.41% weighting to North America which compares to the index at c.66%. The largest geographic overweight remains Europe ex-UK and the UK.



Regional breakdown of the fund versus MSCI World Index.

Source: Guinness Atkinson Asset Management, Bloomberg. Data as of September 30, 2019

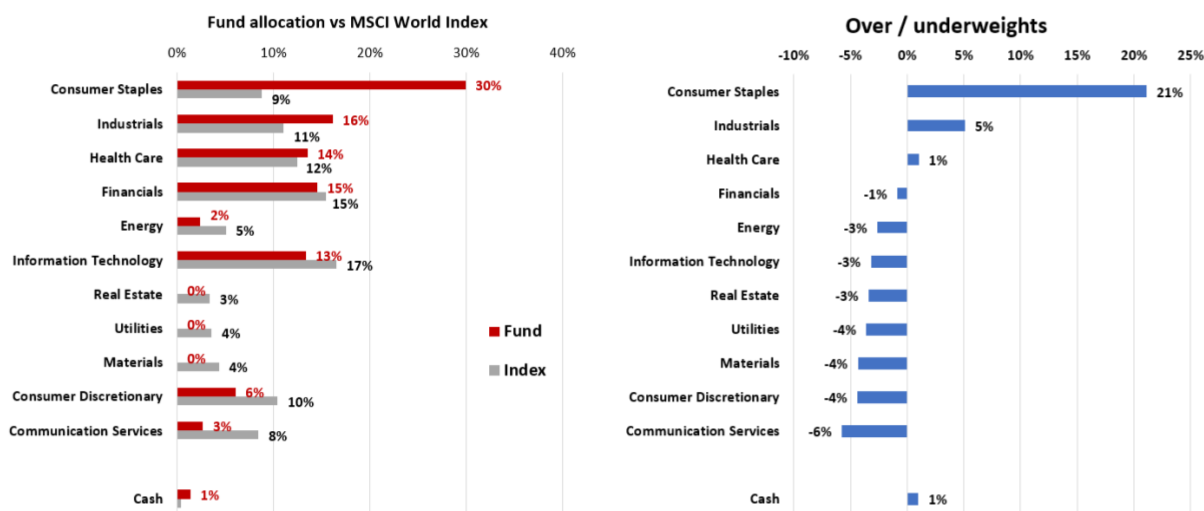
With regards to our UK exposure, we would note two main points, referring to the chart below; (i) the Fund has a lower exposure to the UK when considered in revenues (c.4%) versus by domicile (c.16%). This is because we have favored UK domiciled companies with a more global exposure (such as Unilever and Imperial Brands); and (ii) there is a larger exposure to Asia-Pacific by revenues (c.22%) than the equivalent statistic as measured by domicile (c.14%).



Geographic breakdown of the fund

Source: Guinness Atkinson Asset Management, Bloomberg. Data as of September 30, 2019

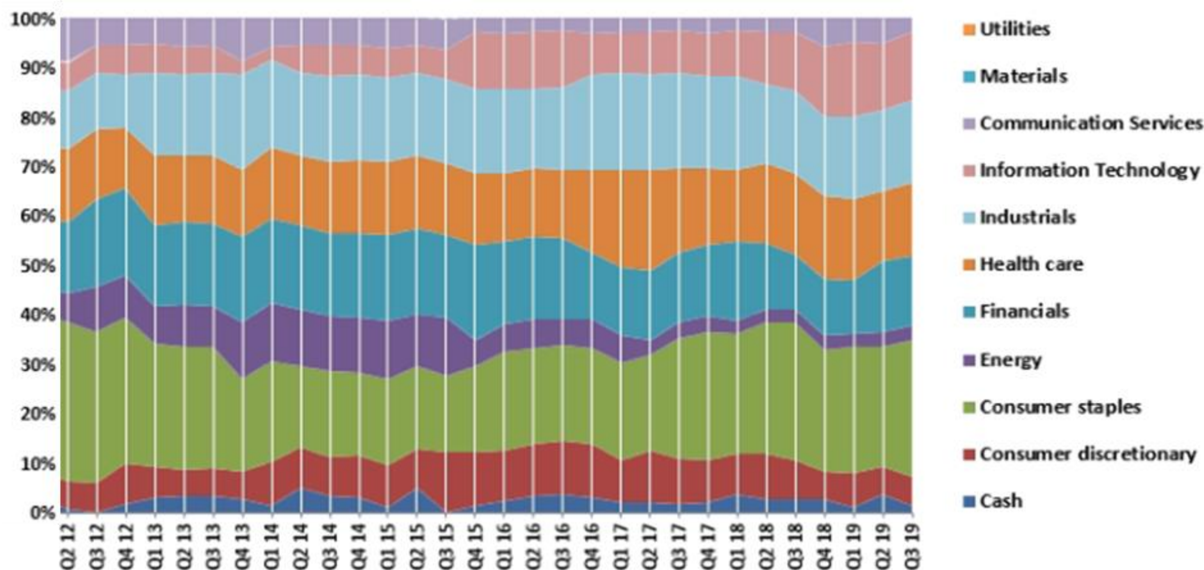
In terms of sectors, the Fund continues to have a zero weighting to Utilities, Materials, and Real Estate, which in the last quarter proved to be a drag for performance. Overweight Consumer Staples benefited the Fund in the last quarter.



Sector breakdown of the fund versus MSCI World Index

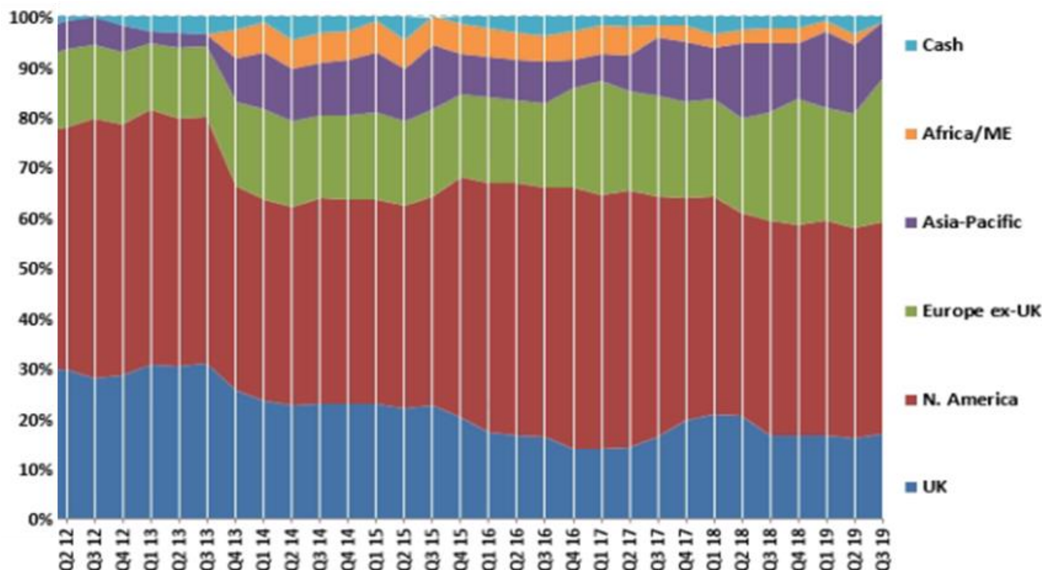
Source: Guinness Atkinson Asset Management, Bloomberg. Data as of September 30, 2019

The below two charts show how the exposure of the fund has evolved since we launched the strategy back in 2010.



Sector breakdown of the fund since launch

Source: Guinness Atkinson Asset Management, Bloomberg. Data as of September 30, 2019



Geographic breakdown of the fund since launch

Source: Guinness Atkinson Asset Management, Bloomberg. Data as of September 30, 2019

Outlook

The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level to make sure we are providing what we say we will. Based on the measures, holistically, the high-conviction fund has companies which are on average better quality at better value verses the index. We are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI World Index.

		Fund	MSCI World Index
Quality	Average 10 year Cashflow Return on Investment	17%	8%
	Weighted average net debt / equity	52%	79%
Value	PE (2019e)	15.7	16.7
	FCF Yield (LTM)	6.0%	4.5%
Dividend	Dividend Yield (LTM)	2.5% (net)	2.5% (gross)
	Weighted average payout ratio	59%	51%
Conviction	Number of stocks	35	1650
	Active share	91%	-

Portfolio metrics versus index

Source: Guinness Atkinson Asset Management, Credit Suisse HOLT, Bloomberg.
Data as of September 30, 2019

The fund at the end of the quarter was trading on 15.7x 2019 expected price to earnings; a discount of 6.2% to the broad market. Additionally, on a free cashflow basis, the fund trades at a 25% discount to the 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 September, the Guinness Atkinson Dividend Builder Fund produced a total return of 2.31% (TR in USD), compared to the MSCI World Net Return Index return of 2.13%. The fund therefore outperformed the Index by 0.18%.

Outperformance in the quarter largely came in August as investors focused their attention on higher quality companies in the more defensive-minded sectors, as a result of the increased trade uncertainty and greater recession fears.

The Fund performed in line with the rising markets seen in July and September, and outperformed the benchmark when markets fell in August. This is reflective of how we would expect the Fund to behave; our stringent focus on picking high quality companies, with strong balance sheets, and the potential for attractive dividend growth (as opposed to simply high dividend yield) may position the Fund to provide some protection when markets are weaker.

Further, the Fund's ability to keep up with rising markets can be attributed to our universe screening criteria. We search for companies with **persistently** high return on capital throughout all periods in a business cycle, and this strays us away from regulated and commodity-based sectors such as Utilities, Materials, Real Estate and Energy. These sectors tend to benefit relatively less when markets are strong, and so by avoiding these, the Fund is also able to partake in rising markets.

Standardized Performance

as of 09/30/19	YTD	1 YR	3 YR Annualized	5 YR Annualized	Since inception Annualized (3/30/12)
Dividend Builder Fund	16.79%	6.64%	9.88%	7.02%	9.68%
MSCI World NR Index	17.61%	1.83%	10.21%	7.18%	9.17%

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

30 Day SEC Yield as of 9/30/19: 2.79% (Subsidized), 1.53% (Unsubsidized)

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.

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 9/30/2019:

1. Taiwan Semiconductor Manufacturing Co Ltd	3.26%
2. Deutsche Boerse AG	3.10%
3. United Technologies	3.02%
4. Arthur J Gallagher & Co	2.96%
5. Danone SA	2.95%
6. The Procter & Gamble Co	2.95%
7. Roche Holding AG	2.95%
8. Illinois Tool Works Inc	2.94%
9. WPP PLC	2.92%
10. Novo Nordisk A/S	2.91%

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.

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.

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.

Active share measures the extent of active management in a portfolio compared to the corresponding benchmark listed.

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.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock.

Forward price/earnings (P/E) differ from trailing earnings, which is the figure quoted more often, as they are a projection and not a fact. Price-to-earnings ratio (P/E) is an equity valuation multiple. It is defined as market price per share divided by annual earnings per share.

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

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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