Guinness Atkinson

China & Hong Kong Fund

Review of 2019

2019 Fund size

Start of year $56.7m

End of year $67.6m

What happened in China?

- Trade talks between the US and China broke down in May as the US raised tariffs on Chinese goods and put Huawei on its entity list.
- In September, the US imposed further tariffs but soon after talks resumed, both countries agreed to delay further tariff rises and in October they agreed the broad outlines for a “Phase 1” agreement, which was signed in January 2020.
- MSCI increased the inclusion factor for domestic China-listed A shares from 5% to 20% in some of their indexes. According to MSCI, this took A shares’ weight to 12.1% and 4.1% in the MSCI China and MSCI Emerging Markets Indexes.
- The Science Technology Innovation Board (STIB) was launched, aiming to make it easier for private companies in innovative sectors to raise capital.
- Bloomberg and JP Morgan added renminbi government debt into their indexes.
- African Swine Fever hit China’s pig farmers whose livestock may have fallen by as much 40-50%, putting upward pressure on inflation.
- Hong Kong was paralyzed by protests over a bill which would allow extraditions of residents to China and Taiwan. The bill was dropped in September, but protests continued, pushing Hong Kong into recession.

What happened in the Fund?

- The Fund rose 30.00% in 2019 compared to the Hang Seng Composite Index which rose 15.36%.
- The MSCI China Net Total Return (NTR) Index rose 23.5% while the MSCI Hong Kong NTR Index rose 10.3%.

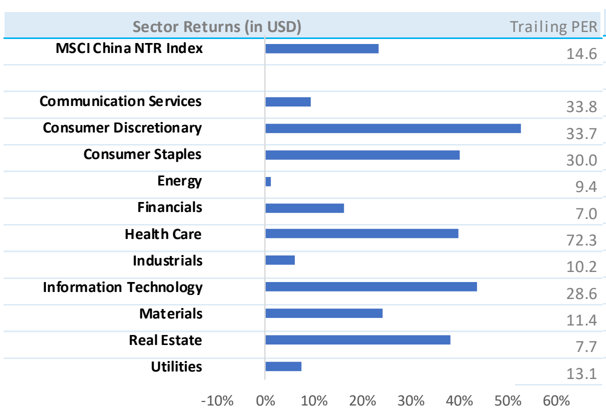
  Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. To obtain performance as of the most recent month end, please visit www.gafunds.com or call 1-800-915-6565.

- The Shenzhen Component Index, which has greater exposure to “New Economy” sectors such as Information Technology, rose 44.3%. The Shanghai Composite Index, which has more exposure to “Old Economy” sectors (Financials, Industrials and Materials) rose 23.8%.
- We sold four positions: Industrial and Commercial Bank of China, China Minsheng Bank, Pacific Textiles and VTech.
- We bought four positions: Haitian International, China Resources Gas, TravelSky and Alibaba.
- The Fund’s top performing stocks were China Lesso, New Oriental Education, Sino Biopharmaceutical, Weichai Power and China Medical System.
- The Fund’s weakest performing stocks were Pacific Textiles, Baidu, Noah, Yangzijiang Shipbuilding and Hollysys Automation.
- The Fund ended the year on a price to earnings ratio (PER) of 12.6x on 2019 and 11.5x on 2020 estimated earnings and a 13% discount to the MSCI Zhong Hua’s 2019 PER and a 18% discount to 2020. Earnings are forecast by the consensus to grow at a compound average annual rate of 8% over the next three years.

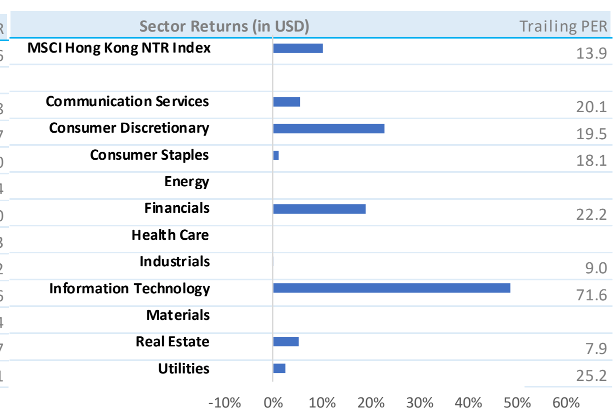
Fund & Market Review

The Fund had a successful year, increasing 30.00%. This was ahead of the benchmark, the Hang Seng Composite Index, which increased 15.36%. Of the 32 holdings in the fund, 27 increased in value over the year, of which three increased by more than 100%.

The charts below the market performance of countries and sectors as measured by relevant MSCI indices:



Source: Bloomberg



Source: Bloomberg

The fourth quarter of 2018 saw sharp falls for many of the Fund’s holdings, most of which we felt were unwarranted. This meant that at the end of 2018 the Fund was valued at 8.3x forward earnings. However, we remained confident in our holdings given their ability to achieve a persistently high return on capital over time and in our belief that they would continue to achieve these returns. Furthermore, more than half of the Fund’s holdings traded on valuations that incorporated minimal expectations for future growth.

Over the course of 2019, the multiple the market was willing to pay for the companies in the Fund increased significantly. The Fund ended the year valued at 11.5x on forward earnings, a 38% increase from the previous year. The sharp recovery in the Fund's valuation is likely linked to the solid earnings profile of the companies it holds, in what is a tougher operating environment in China. The Fund is expected to grow earnings by 4% for 2019, based on consensus earnings estimates. On the other hand, the MSCI Zhong Hua's earnings are expected to contract by 8.8%.

China's economic growth target was lowered from "about 6.5%" in 2018 to 6.0–6.5% in 2019. Policymakers know the pitfalls of unsustainable economic growth, driven by debt accumulation, but are facing a tricky balancing act. Reducing the pace of growth too dramatically could lead to job losses and potential social instability. Reducing the pace of growth insufficiently will lead to further debt creation, some of which is likely to be written off at a significant cost in the long term. The trade war with the US further added pressure to the economy.

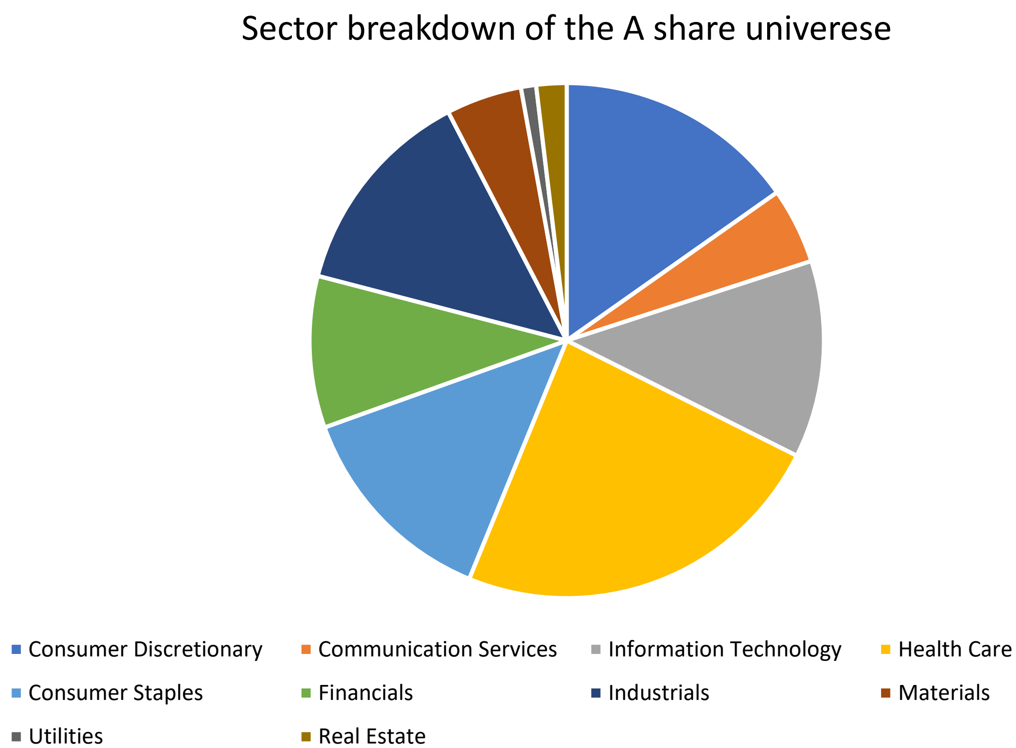
Policymakers shifted the focus away from deleveraging and towards stabilizing growth. The required reserve ratio (commercial bank deposits required to be placed with the central bank) was cut several times in 2019, aiming to boost liquidity. Interest rates were cut moderately in order to lower funding costs. Large state-owned banks historically have not been very effective in lending to smaller and medium-sized businesses and so despite looser monetary policy, we sense they are still finding it hard to obtain credit.

In 2019, the there was an increase in the number of debt defaults in China. The government is much more willing in letting larger firms default, making it clear it will not implicitly guarantee debt. Tewoo Group, a large commodities trader backed by the local government in Tianjin is one such case. This is in fact a welcome development as it reinforces the concept of risk and reduces the dangers from moral hazard. But it has made us reluctant to further increase exposure to affected industries, such as banks and heavy industrials.

There are also a couple of other factors to bear in mind. The US and China have agreed to a "Phase One" deal which has eased fears of further deterioration in relations. Its scope is fairly limited and leaves out important points of contention which will eventually need to be addressed – this is not likely to be a smooth process. Secondly, China's demographic shift toward a shrinking labor force and ageing population has a significant influence over long term industrial, tax and welfare policies. The country's working age population has already peaked while the birth rate continues to fall. This is one of the motivations behind the "Made in 2025" plan, as producing more complex goods will likely generate funds to provide for the country's growing group of pensioners.

Though we have outlined the risks present in China, we must not forget the opportunities present in the country. China's economic growth over the foreseeable future is still likely to be well above that of developed economies. The impact of the trade dispute reinforces the need to develop a higher degree of self-sufficiency in technology. The focus on pillar industries such as electric vehicles and sustainable energy is supported by the weight of demand afforded by its sizeable domestic market. The application of technology to consumer businesses is evident from the growth in online retail and in payment platforms. As investment in these areas continues, we can see a path toward greater improvements in productivity which are essential if China is not to be bogged down in the middle-income trap.

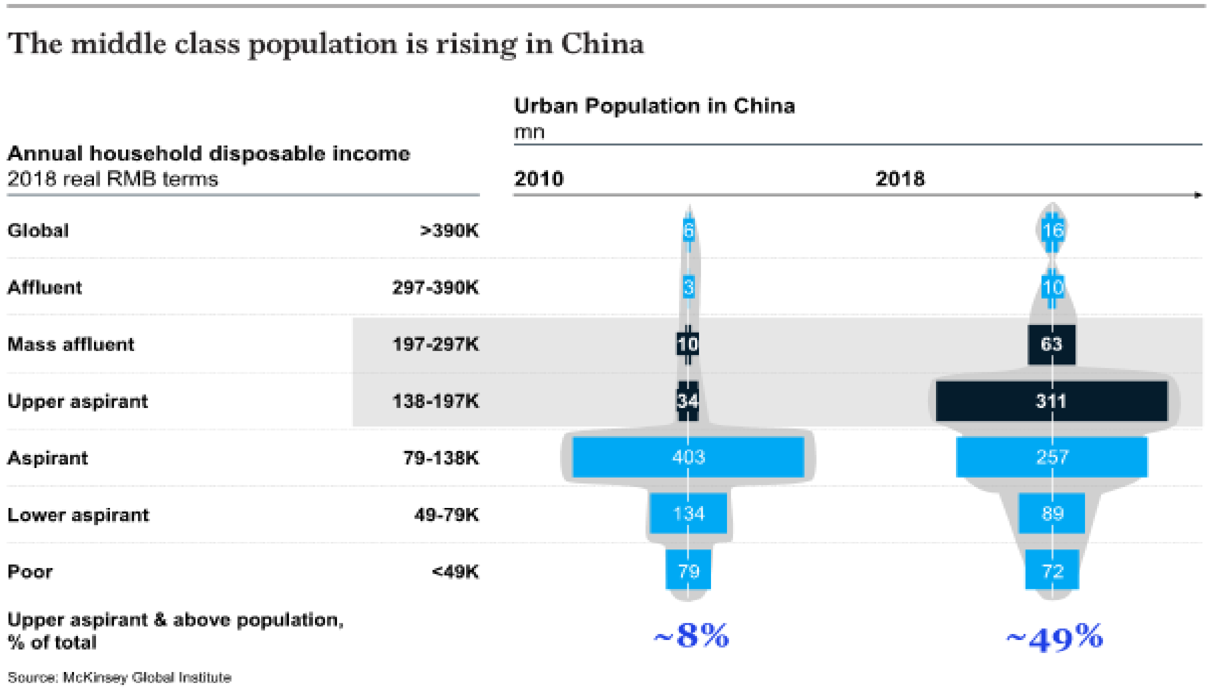
The Fund is set up to invest in A shares, which opens up the universe to interesting ideas that are less prevalent in the offshore market. The companies in the onshore universe are, on average, growing earnings at a faster rate than in the offshore universe which makes them particularly appealing. There are just over 100 A shares which make it into the quality universe, with good diversification between sectors. Financials make up less than 10% of the A share universe compared to 37% of the Shanghai Composite. There is solid representation in our A share universe from the Consumer Discretionary, Consumer Staples, Health Care, Industrials and Information Technology sectors:



The Consumer Discretionary and Consumer Staples sectors are of particular interest to us, offering more companies with exposure to China's rapidly growing set of consumers. China's middle class has grown enormously over the past decade, as the following chart shows. 277 million households that were earning at most $11,000 in 2010 are now earning as much as $20,000. To put things into an even greater context, today there are 26 million households in China that are earning more than the average household in the UK[1]. As it happens, in 2018 there were 27.6 million households in the UK. As more households enter the middle class, they will for the first time buy certain products that are common in developed markets. For example, small appliances only account for 19% of the overall consumer appliances market vs 29% in Japan and 37% in Korea. Many Chinese households will be entering the middle classes and will be buying

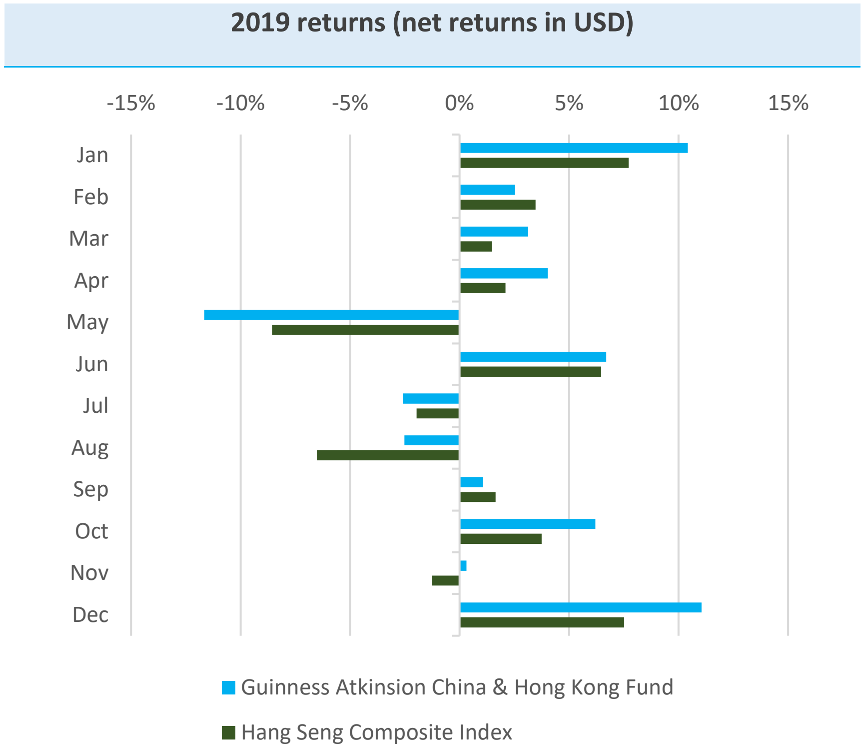
[1] As of 12/31/19, GBPUSD was 1.3257 and USDCNY was 6.9632. According to the UK's Office for National Statistics, the median household disposable income was £29,400 in the financial year ending 2019. According to McKinsey, 26 million households earned at least RMB 297,000 which was equivalent to $42,653 or £32,174.

their first food processor, noodle maker or toaster. This is the consumer story that we believe will play out in China in the coming years.



(Using an exchange rate as of 12/31/19, USDCNY 6.96, annual household disposable income = <$7,040, lower aspirant = $7,040 – $11,351, upper aspirant = $11,351 - $19,828, mass affluent = $19,828 - $28,305, $28,305 - $42,672, affluent = $42,672 – $56,034, global = >$56,034)

The following chart shows the Fund's performance on a monthly basis:



Source: Guinness Atkinson Asset Management, Bloomberg

The first quarter was strong for the Fund, with outperformance in each of the first three months of the year. Trade talks seemed to be progressing well and Chinese markets were strong, outperforming developed markets as well as other emerging markets. The strongest stocks in the first quarter tended to be those where the valuation recovered from sharp falls in the last quarter of 2018, such as New Oriental Education and Sino Biopharmaceutical.

The Fund outperformed in April with Qualcomm the main contributor. Qualcomm settled its dispute with Apple, with the two agreeing a six-year licensing deal and Apple paying Qualcomm its dues which had been held back for the past two years. Intel immediately announced it would withdraw from the 5G modem business and this reaffirmed our view that Qualcomm does indeed make the best modems. In May, trade talks broke down and Chinese markets were underperformers. Huawei was put on the US' Entity List and so the share prices of its suppliers sold off sharply. Exposure to Huawei ranges from 5-15% for the Fund's smartphone component suppliers and we stress that none are a pure play on Huawei's growth. Baidu also reported a weak set of results, which will be discussed in detail later in this review.

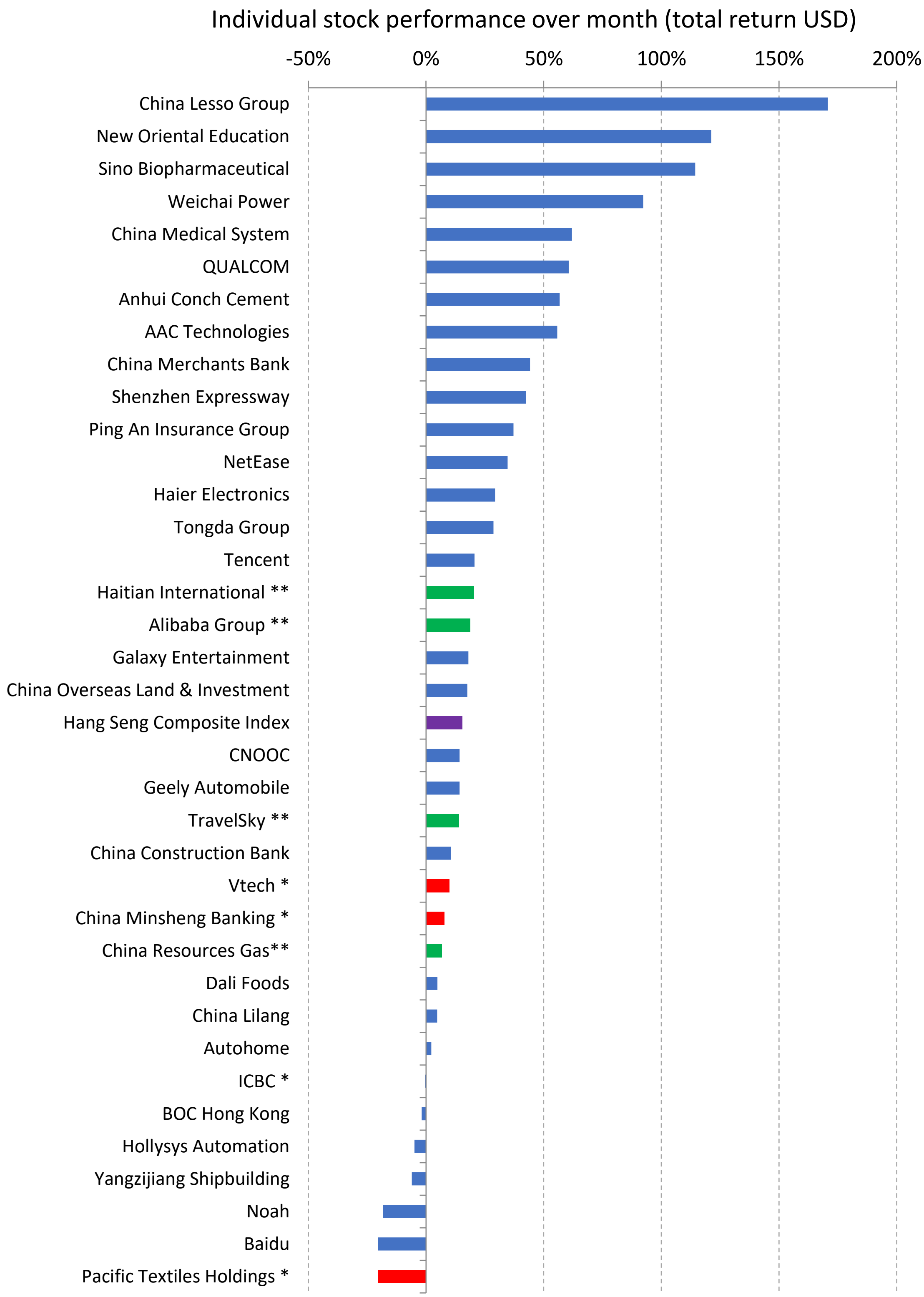
In June we saw a rally in markets and Chinese markets were outperformers. The Fund's Industrial stocks, China Lesso and Yangzijiang Shipbuilding, were strong along with Anhui Conch Cement. In July, the fund underperformed in a rising market due to Noah and the weakness in Consumer Discretionary companies Haier Electronics and Geely. Noah had a bad debt issue with one of its credit products, which will also be discussed in detail further on in this review.

In August trade talks broke down, but the Fund outperformed in a falling market, supported by Chinese healthcare companies which reported better results. Many were worried over the effect of the government's push to cut the cost of drugs. The Fund's two pharmaceutical companies, Sino Biopharmaceutical and China Medical System, deal mostly with unbranded drugs and so particular attention was paid to their results. They both reported good growth in revenue and earnings and overall, their results were better than expected. In August, the benefit of the fund's equal weighting was also apparent as Tencent fell by more than 10% in the month. Tencent accounts for more than 10% of the benchmark while its neutral weight in the Fund is ~3%, protecting the fund on the downside.

In October, the US and China announced plans to sign a "Phase 1" deal. Better than expected sales of the latest iPhone also led to revised estimates of sales, benefiting component suppliers such as AAC Technologies and Tongda. Healthcare stocks also continued to be strong after giving back some of their gains in September.

In December, the US and China agreed to a deal in principle. Chinese markets consequently rallied and we saw a sharp rise in the share price for Tongda Group, a manufacturer of casings for smartphones, in the portfolio. Tongda was an early mover into what it calls "glastic" casings (plastic casings which look like glass) and so in the ramp up of production for these glastic casings, margins suffered. Earnings estimates fell sharply over the year, but a local broker note seems to have reminded the market that Tongda signed up Samsung as a new customer and may well be one of its largest casings suppliers. Tongda has a chance of also broadening its waterproof components business further into Apple's supply chain. AAC Technologies, China Lesso and Noah were also strong performers in the month.

Stock Performance



Source: Guinness Atkinson Asset Management, Bloomberg

* sells, ** buys

Leaders

LESSO

China Lesso is a manufacturer of plastic pipes, pipe fittings and building materials. The forward price/earnings multiple that the market had been assigning to the stock fell from a high of 8.5x in 2017 to just above 4.0 at the end of 2018. The company has consistently grown earnings since we launched the Fund and so to us, it was puzzling that the market was assigning such a low value to the business. Over the course of 2019, the valuation rebounded**.** The business is expected to show rising earnings for 2019 as the government is investing in a number of infrastructure projects to reduce water pollution and is also pushing the country's energy consumption towards gas. Both factors should lead to greater demand for pipes.

新东方 NEW ORIENTAL

New Oriental Education provides tutoring services in China. Like others in the Fund, the company's valuation fell sharply in 2018 and then partly recovered in 2019, along with strong earnings growth. Management is targeting revenue growth of approximately 30% in the next financial year. We think margins should rise over time as the business has pricing power – for example, in the summer promotion, the company doubled its prices compared to 2018 but still managed to grow enrolments by 4%. Secondly, efficiency should increase as learning centers which were opened in the past year or two are beginning to reach the target level of utilization.

中國生物製藥有限公司 SINO BIOPHARMACEUTICAL LIMITED

CMS

Sino Biopharmaceutical and China Medical System were among the Fund's weakest stocks in 2018. The government has been cutting prices for drugs, with greater cuts for unbranded drugs. Both companies, however, have done better than expected in 2019. One of Sino Biopharmaceutical's best-selling products, Runzhong, saw its price cut significantly but sales have only fallen, implying significant growth in volume. Sales of oncology products have accelerated, driven by Anlotinib which was originally approved to treat small cell lung cancer, but is now also approved to treat soft tissue sarcoma, another type of cancer. China Medical System also reported good results and has signed deals with other pharmaceutical companies to sell newer, more innovative drugs.

Weichai Power benefited from earnings upgrades as new “China VI” vehicle emission standards came into effect, starting with richer provinces and rolling out nationwide in 2020. In some instances, these are even stricter than European standards and should drive replacement demand for heavy duty trucks. Favorable natural gas prices also increased demand for Weichai’s natural gas engines.

Laggards

Baidu has been spending a lot on content and traffic acquisition costs to build scale for iQiyi (the Chinese Netflix) and its newer apps, such as Baijiahao (a newsfeed app). This was fine in the past as the core business of advertising was highly cash generative, supporting these growing businesses. However, during the first quarter the ad business unexpectedly slowed down. Management believed advertising inventory in the market increased towards the end of the first quarter, lowering prices. Since then, the growth in costs slowed considerably as the company ensured marketing met “stringent ROI criteria”. The focus shifted more towards in-app monetization and several encouraging examples were given. For example, a well-known e-commerce company used Baidu’s Smart Mini Programs (a stripped-down version of its app accessible within Baidu) to give away coupons. It saw its sales conversion rate improve 2.5x compared to its HTML page. Baidu now thinks demand for advertisements is stabilizing and though the business faces challenges, we think the share price is being overly pessimistic.

Noah announced that one of its credit funds was in default. The fund was worth 2% of Gopher’s (Noah’s asset management business) AUM and there is no indication that Noah itself is responsible reimbursement. Noah is sensibly stepping away from distribution of single counterparty credit products where the funds are lent to a single entity and moving into offering fixed income products with greater underlying diversification. This is in preparation for new rules coming into effect in the coming years which will increase regulation and oversight. Publicly offered funds may only be able to invest in standardized products. The holdings of a fund must be entrusted to an independent custodian and must be transacted on approved exchanges. Financial products may eventually have to regularly disclose their net asset value (NAV), moving China’s fund industry closer to developed market practices.

Yangzijiang Shipbuilding's share price fell when the chairman was linked to a mainland China investigation. Nothing was found and has is now back at the company. In the interim period the company won orders for five new vessels – three of 82,000 dead weight tons (DWT) and two of 325,000 DWT, worth $395 million. The change in emissions rules from the International Maritime Organization (IMO) limiting the permitted sulfur content in shipping fuel has resulted in a surge of enquiries, according to the company, including from Japanese shipping companies.

Hollysys Automation manufactures discrete control systems used in industrial applications, as well as equipment for the railway sector. The industrial economy was weak as producer price inflation was barely positive in the first half of the year and slipped into negative territory in the second half. Industrial profits for the first 11 months of 2019 fell 2.1%. In this environment, we think Hollysys is coping well. It is gaining market share in its Industrial Automation segment and is looking for further growth in the petrochemical market. Its recurring aftersales income now accounts for ~20% of revenue and management is looking to increase this further. Earnings estimates have remained fairly flat and the drop in the valuation was the main cause of the weak share price, so we have been adding to the position in anticipation of a recovery in this valuation.

Portfolio Changes

The Fund sold four positions.

Due to slower economic growth and rising level of defaults, we thought it was likely that ICBC and China Minsheng Bank would have to increase bad debt provisions. This has the effect of reducing earnings growth. Though valuations for both banks looked low relative to their history, we thought this reflected our view that earnings growth would be hard to come by. Stock specific issues were the ultimate trigger for selling both positions. In the case of ICBC, its move to take a large stake in the Bank of Jinzhou was troubling as Jinzhou was facing issues with its credit quality. In the case of China Minsheng Bank, the return on capital had dipped and we thought it was unlikely to return to its previous levels.

Pacific Textiles is a manufacturer of knitted fabrics which started off in China but, like its peers, has diversified into Vietnam to take advantage of lower labor costs. This expansion into Vietnam has not been a success. Problems have plagued the company's factory in the country, ranging from protests over the way the land was acquired, to a shutdown of the factory so new water pipes could be installed to meet tougher environmental regulations. We believed the business would find it difficult to grow revenue in the medium term.

VTech is well known for its toys and electronic learning products but also makes phones and is engaged in contract manufacturing services. Though VTech's Asian business is growing rapidly, we thought persistent weakness elsewhere in the business meant the prospects for earnings growth was remote. The residential phones business is in a long-term structural decline. Logistics issues in Europe and tough market conditions meant sale of Vtech branded toys fell. We felt that there were better opportunities elsewhere in the universe with a much greater likelihood of earnings growth.

The Fund added four positions:

Haitian International is one of the worlds' largest manufacturers of plastic injection molding machines. It serves all part of the market, ranging from mass market machines which produce low cost simple plastic parts, to all-electric machines which serve high-tech markets. Haitian recently launched new generation products which in the past have led to better sales growth relative to its competitors. This made it a compelling company to add to the portfolio at a reasonable valuation.

China Resources Gas (CRG) is one of the few utility companies that make it into our universe. Its focus is on the provision of gas to urban household customers. While other gas businesses in China seek to become involved in the wholesale gas market or expand into rural areas, we like CRG for its focus on domestic urban and industrial customers. There is a long-term drive in China to support wider use of gas in place of coal for electricity production. CRG has benefited on the back of this through the increasing supply of gas nationwide and is tapping into this through the "so-called" last mile connection. It is possible the coming months may see slower growth from its industrials customer base, but we think that there is a structural growth story here and that conditions remain supportive for CRG's margins.

中国航信
TravelSky

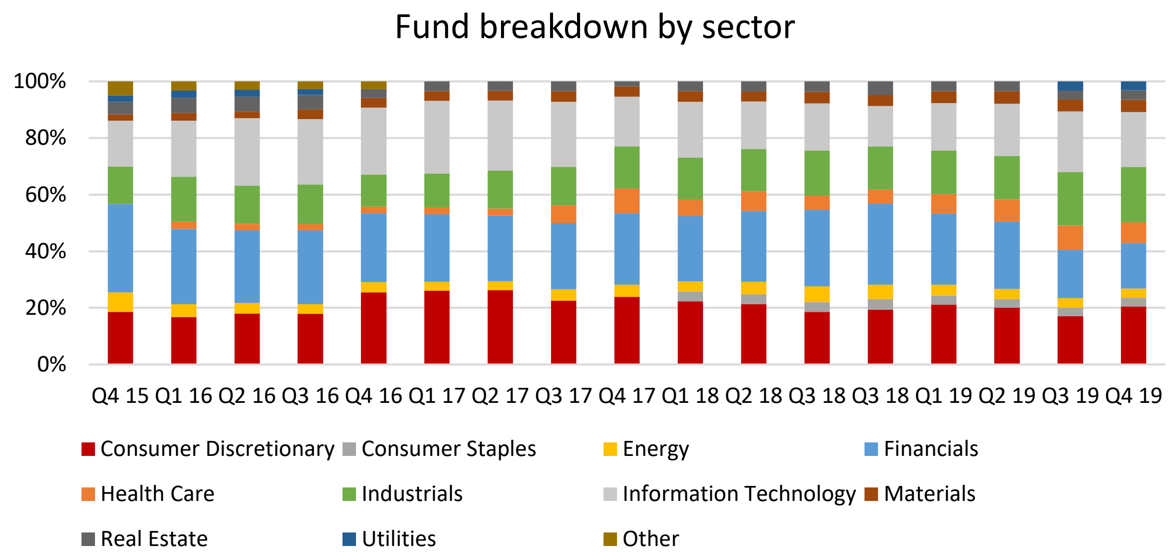
TravelSky supplies data for China's aviation industry. Its services include real time flight reservation information and ticket prices, inventory control, airport passenger processing and Global Distribution Service (GDS). Due to local regulations, it has a monopoly over the GDS market in China and no foreign competitors are allowed to enter this business. In China, less than 10% of people have a passport and as the economy continues to grow, we expect the demand for air travel to accelerate and for Travelsky to likely benefit as a result.

Alibaba Group

Alibaba is China's largest e-commerce company and one of the largest of its kind in the world. Despite a slowing economy, e-commerce is a bright spot and has its own secular growth drivers. Alibaba's offerings are integral in most Chinese consumers' lives - Tmall and Taobao (two of its most popular platforms) are among the top 10 most visited sites in the world. At least 600 million people actively use Alibaba's payment app, Alipay. Alibaba also owns several other e-commerce sites including Kaola (cross border e-commerce in China) and Lazada (leading e-commerce site in South East Asia), while it owns a small stake in Tokopedia (Indonesian e-commerce). The addition of Alibaba gives the Fund exposure to e-commerce, something which was lacking, at a more reasonable price than has been offered in the past. Relative to its competition, Alibaba is, in our view, a higher quality given the persistence of its return on capital.

Portfolio Positioning

Compared to the Hang Seng Composite Index, the Fund is overweight to the Consumer Discretionary, Industrials and Health Care sectors. The fund is underweight in Financials and Real Estate and Communication Services.



Source: Guinness Atkinson Asset Management

Outlook

Consensus earnings estimates for the portfolio indicate a compound average annual growth rate in profits for the three years 2018-2021 of 8%. This is the product of estimated earnings growth for the portfolio's holdings of 4% for full year 2019 followed by 10% for 2020 and 12% for 2021. These estimates are, of course, likely to change significantly in the months ahead.

It is undeniable that China is experiencing downward pressure on economic growth. So, it is important that we remain vigilant on valuations and ensure that especially for potential new entrants into the fund, growth expectations are reasonable, and we do not overpay for growth. A good example is the Consumer Staples sector, where very few offshore companies make it through into our quality universe. In the onshore market, there are more companies which pass the quality test, but valuations are at their highest since 2010 and forecasted returns on capital are well above their long- and short-term averages. Due to the fact the A share market is dominated by retail investors, companies that do not meet expectations can see significant multiple de-ratings and this is something we would like to avoid in the Fund.

On the manufacturing side, the new 5G telecom standard is likely to have a big impact. Initially we should see this amongst the component manufacturers because the new standard requires an upgrade to the whole system from transmission through to reception. However, over time the application of this technology opens up opportunities for commercial and industrial users as well as consumers. We think this process is one that will last for several years (i.e. a secular, rather than cyclical uplift).

Domestic Chinese A shares, are as yet an untapped source for us in the Fund but a large number of companies are of undoubted interest to us. Our approach means that we think we can evolve the focus to incorporate A shares, while maintaining our requirement for quality management as evidenced by above average returns on capital.

Performance

As of 12/31/2019	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**30.00%**	**30.00%**	**15.58%**	**8.00%**	**3.91%**
Hang Seng Composite Index TR	**15.36%**	**15.36%**	**12.00%**	**6.78%**	**4.92%**

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

Expense Ratio: 1.54%

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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. The China and/or Hong Kong stock markets in which the Fund invests may experience periods of volatility and instability. These fluctuations may cause a security to be worth less than it was at the time of purchase. Market risk applies to individual securities, a particular sector or the entire economy. China and/or Hong Kong stocks may fall out of favor with investors, the value of Chinese currencies may decline relative to the U.S. dollar and/or China or Hong Kong stock markets may decline generally. The Fund invests in invest in small-cap or mid-cap, which involve additional risks such as limited liquidity and greater volatility, than investments in larger companies.

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.

The MSCI Zhong Hua Index is a composite index that comprises the MSCI China and MSCI Hong Kong Index. The index captures large and mid-cap representation across all China securities (B shares, H shares, Red Chips, PChips and foreign listed shares) as well as Hong Kong securities.

MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 703 constituents, the index covers about 85% of this China equity universe.

MSCI Hong Kong Index is a capital weighted stock index designed to measure the performance of the large and mid cap segments of the Hong Kong market. It has 48 constituents and covers approximately 85% of the free float-adjusted market capitalization of Hong Kong equity stocks.

MSCI Emerging Markets Index is used to measure equity market performance in global emerging markets.

Shenzen Component Index, also known as SZSE Index, is an index of 500 stocks that are traded at the Shenzhen Stock Exchange (SZSE).

Shanghai Composite Index, also known as SSE Index, is a stock market index of all stocks that are traded at the Shanghai Stock Exchange.

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 12/31/19:

1.	Tongda Group Holdings Ltd	4.53%
2.	China Lesso Group Holdings Ltd	3.93%
3.	Anhui Conch Cement Co Ltd - H Shares	3.71%
4.	Shenzhen Expressway Co Ltd - H Shares	3.50%
5.	AAC Technologies Holdings Inc	3.49%
6.	New Oriental Education & Technology Group Inc	3.48%
7.	Weichai Power Co Ltd - H Shares	3.44%
8.	Alibaba Group Holding Ltd	3.39%
9.	NetEase Inc – ADR	3.30%
10.	China Medical System Holdings Ltd	3.25%

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

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