Guinness Atkinson
China & Hong Kong Fund
Managers' Update – September 2022

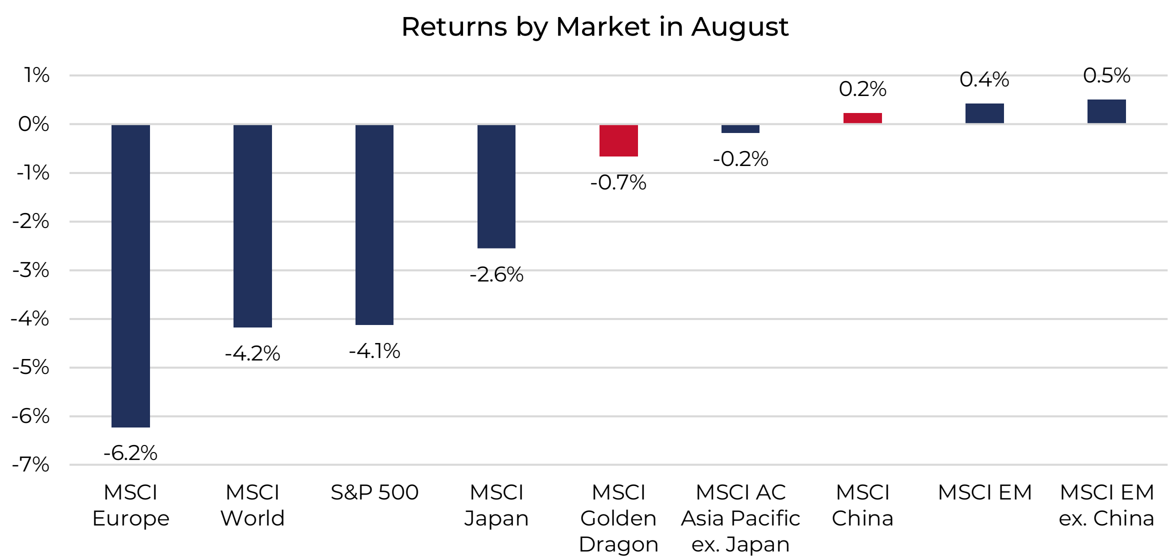
GUINNESS ATKINSON FUNDS

Summary Review & Outlook

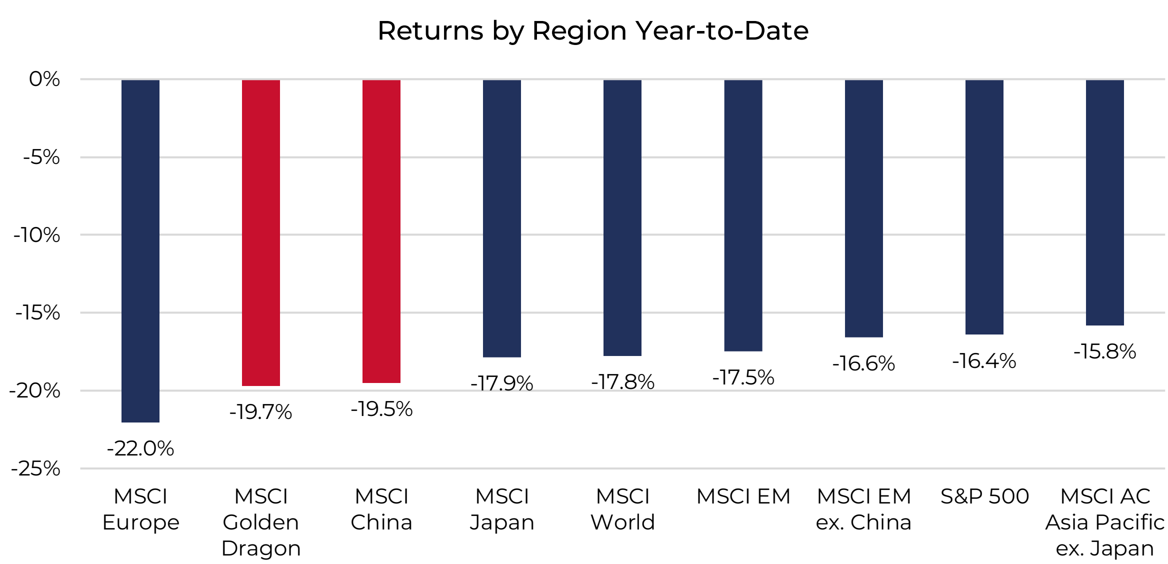
Summary View

- In August, the MSCI China Total Return Index ("MSCI China Index") rose 0.2% (in USD unless otherwise stated).
- The People's Bank of China (PBOC) loosened monetary policy in August. It cut short-term interest rates (the seven-day open market operations rate) by 0.1%. It also cut the Medium Lending Facility (MLF) rate, which is the rate banks borrow from the central bank, by 0.1%. The 5-year Loan Prime Rate (LPR), which is used primarily to price mortgages, was cut by 0.15% to 4.30%. The cut in the LPR is designed to support the weak housing market where sales are down 30-40%.
- In Sichuan province, a record heatwave led to rivers and dams drying up, meaning hydropower could not generate enough energy. At the same time, the demand for air conditioning significantly increased, placing strain on the electricity grid in the province. The local government-initiated power cuts which led to companies stopping production for a week.
- Rising Covid cases led to lockdowns in Tibet, Sichuan, and Shenzhen. As the party is going to hold its five-year congress meeting in October, where Xi will be formally re-elected as leader of the party, a stable political situation is the aim. It is imperative that there are no major outbreaks until the meeting and so lockdowns and movement restrictions are likely to be more vigorously implemented in the next two months.
- The US now requires American chipmakers to obtain a special license to sell high-end AI chips to China. This affects Nvidia whose shares were down 8% on the day the rule was announced. The US justification revolved around the potential military use of such chips, but there are also non-military applications too e.g., data centres and high-performance computing.
- The US and China reached a deal to let the US regulator, the Public Company Accounting Oversight Board (PCAOB), inspect the audit work of Chinese companies listed on American exchanges. It is currently not completely clear how the process will work but the PCAOB will look at audits of selected Chinese companies in Hong Kong. Reports indicate that Fund holdings Alibaba, JD.com, Baidu and Netease will be asked to take part in these audit inspections.
- Rising interest rates in the US and a weak domestic Chinese economy led to some weakness in the Renminbi. The PBOC set the fixing rate for the currency at a higher level (against the dollar) than the average estimate, implying policymakers want to reduce the pressure on the Renminbi. The PBOC also reduced the foreign exchange reserve requirement ratio by 2% to 6%, meaning banks can sell some of their dollars and buy more Renminbi, boosting demand for the currency.

Market Commentary

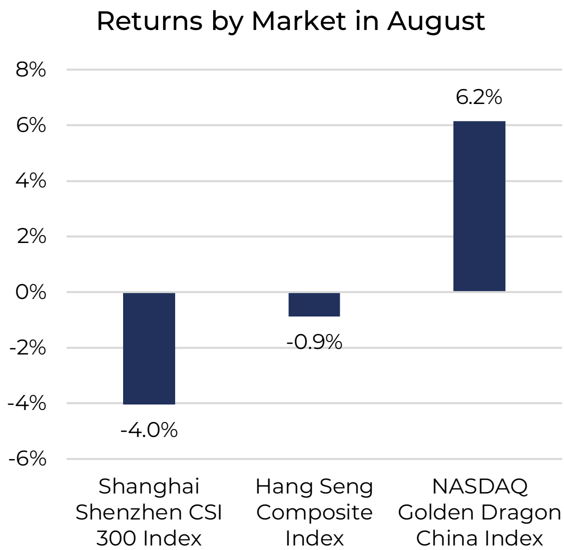


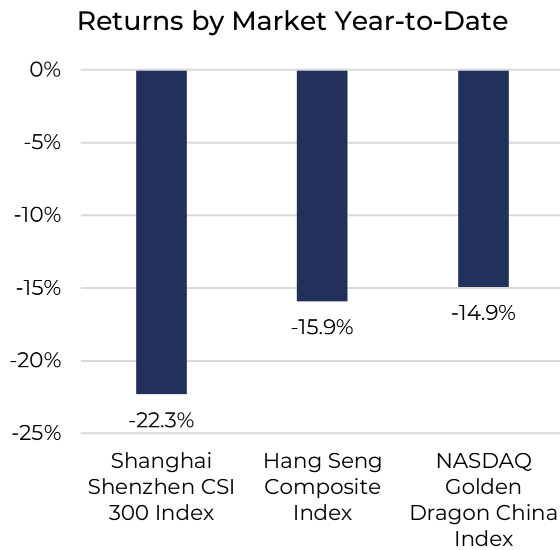
(Data from 07/31/22 to 08/31/22, returns in USD, source: Bloomberg, Guinness Atkinson Asset Management calculations)



(Data from 12/31/21 to 08/31/22, returns in USD, source: Bloomberg, Guinness Atkinson Asset Management calculations)

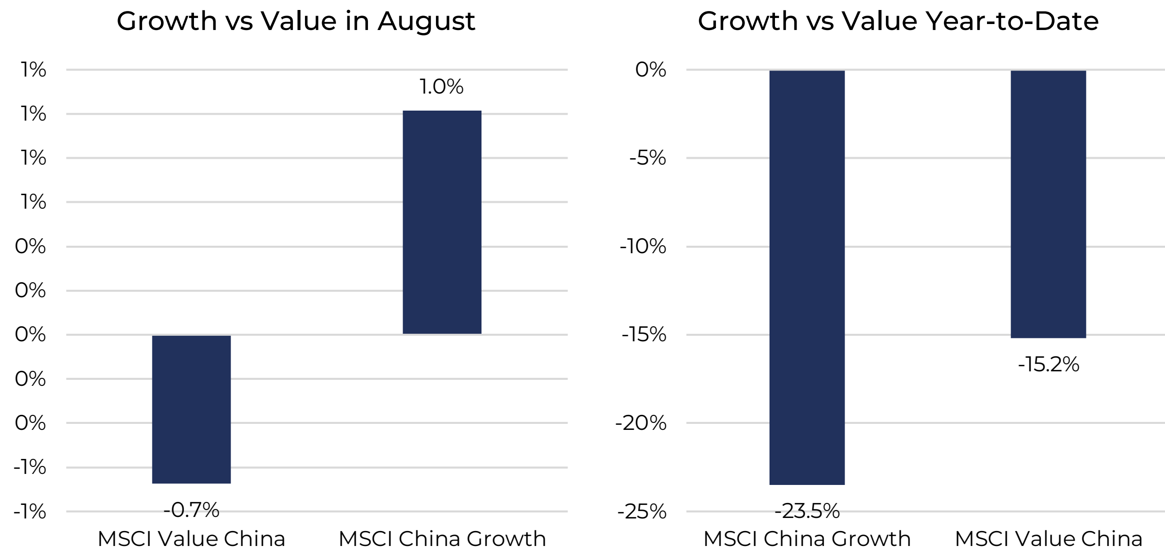
Chinese markets rose by 0.2% (in USD) in August, which made them outperformers relative to other major markets. The S&P 500 fell by 4.1% while MSCI Europe fell by 6.2%. Year-to-date, MSCI China has fallen by 19.5% compared to a 22.0% fall for MSCI Europe and a 16.4% fall for the S&P 500.





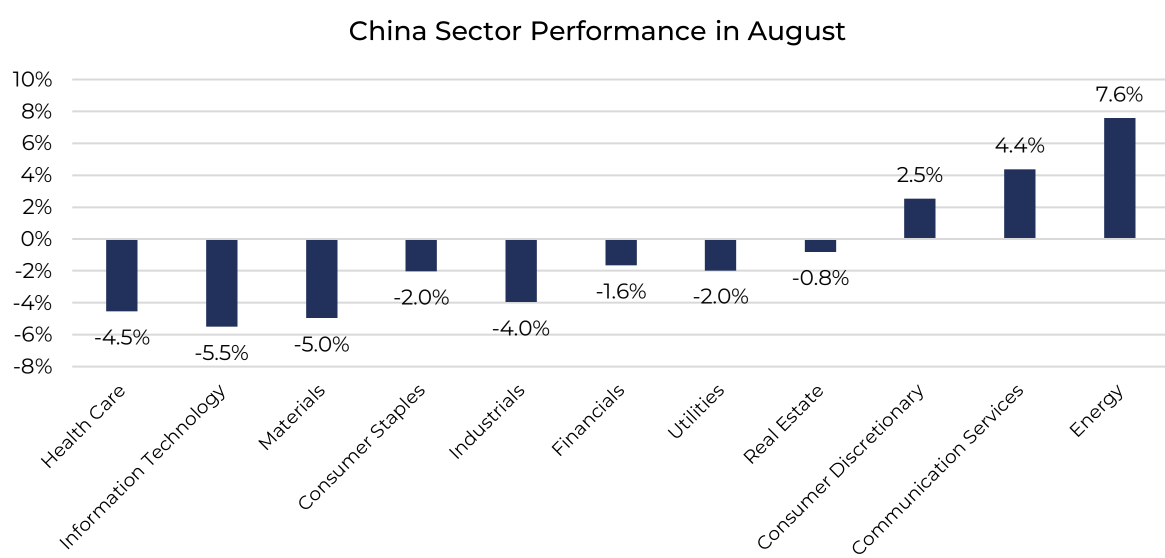
(Left chart: data from 07/31/22 to 08/31/22. Right chart: Data from 12/31/21 to 08/31/22, returns in USD, source: Bloomberg, Guinness Atkinson Asset Management calculations)

In August, the A share market was weakest as the CSI 300 Index fell 4.0%. Meanwhile, offshore markets were better performers as the Hang Seng Composite Index fell 0.9%. The NASDAQ Golden Dragon China Index, which tracks Chinese companies listed in the US, rose 6.2%. This was driven by the strong performance of the tech stocks which rebounded at the end of the month. Positive news related to China stimulus and the deal on audits of Chinese companies, likely led to short covering (buying stocks to cover short sales) but with no significant increase in liquidity. On the day of the positive announcements, Tencent, Alibaba, Meituan, and Pinduoduo were up strongly.



(Left chart: data from 07/31/22 to 08/31/22. Right chart: Data from 12/31/21 to 08/31/22, returns in USD, source: Bloomberg, Guinness Atkinson Asset Management calculations)

As the tech stocks rebounded in the month, Growth did better than Value in August – the MSCI China Growth Index rose 1.0% while the MSCI China Value Index fell 0.7%. Year-to-date however, the Growth Index has fallen 23.5% while the Value Index has fallen by 15.2%.



(Data from 07/31/22 to 08/31/22, returns in USD, source: Bloomberg, Guinness Atkinson Asset Management calculations)

The best performing sectors were Energy, Communication Services and Consumer Discretionary. Rising oil prices and expectations of future higher prices led to strong performance for the Energy sector. The strong performance of the tech stocks led to good performance in Communication Services (containing Tencent and Netease) and Consumer Discretionary (containing Alibaba and Pinduoduo).

The weakest performing sectors were Health Care, Information Technology and Materials.

Company Updates

Most of the Fund's holdings reported their second quarter or interim results in August, where of course lockdowns in the second quarter negatively impacted results. For the companies that report quarterly results, the median increase in revenue and earnings per share (EPS) in the second quarter was 4% and 6% respectively. For the companies which disclose interim results, the median increase in revenue and EPS in the first half of the year was 9% and -3% respectively. Below we highlight noteworthy results for our holdings.

Shengyi Tech reported second-quarter revenue which fell 14% and EPS which fell 48%. Shengyi makes copper clad laminates (CCLs), which are the base material for printed circuit boards (PCBs). Consumer demand has been weak, leading to falling CCL prices, but there has been more stable pricing in the past month. CCL inventories are reaching a more normalized level which may reduce pricing pressure. We expect Shengyi to continue to move up the value chain by focusing on high-end CCL products in the server, telecom, and automobile markets. Shengyi is also expected to benefit from more Chinese customers localizing their production.

Tencent's revenue fell 3% in the second quarter and its net income fell 56%. In its ad business, Tencent did well to capture a bigger share of e-commerce businesses ad spend in the 618-shopping event. This meant the decline in the advertising business was less than expected. News reports also indicated that Tencent is planning on selling its stake in Meituan (the Chinese version of Deliveroo/Uber Eats). Though it unclear whether the whole stake will be sold, this is a continuation of a trend we have seen over the past 12 months. Large tech companies are selling down their stakes in other businesses, most likely at the request of the central government who are reducing monopoly power. For example, late last year Tencent sold most of its stake in JD.com, a Fund holding which is one of the largest e-commerce businesses in China.

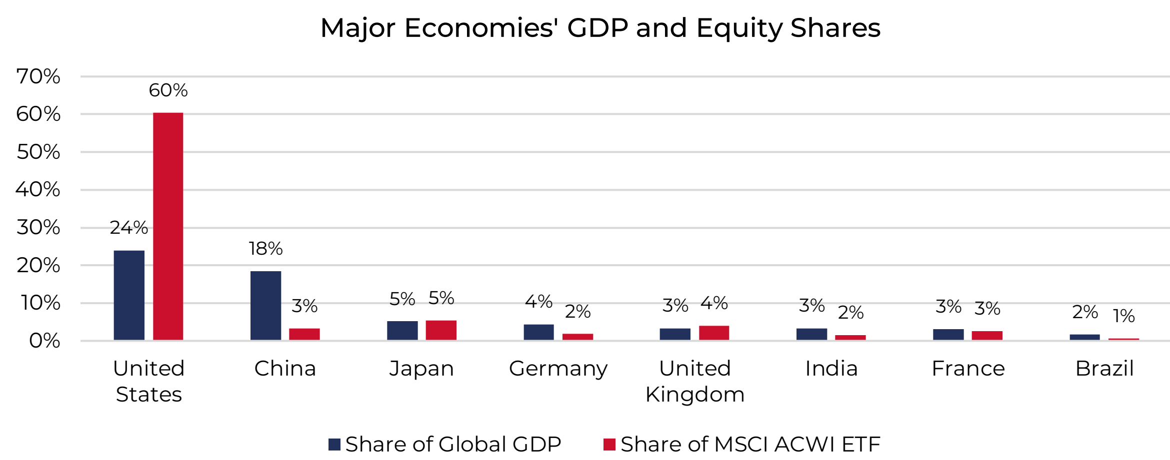
Hong Kong Exchanges & Clearing (HKEX) reported second quarter revenue which fell 8% and EPS which fell 22%. Weak equity markets in Hong Kong and a subdued landscape for new company listings explained the topline contraction. Weak markets also led to low investment income, offsetting the higher income from margin balances which benefited from higher interest rates. Labor costs, which account for two thirds of the cost base, were up 18% due to new hires and higher wages. A positive long-term driver was the announcement of the ETF Connect and Swap Connect, which will allow ETFs and swaps between the mainland and Hong Kong to be traded.

In the first half of the year, Geely's revenue rose 29% but its EPS fell 37%. Volumes fell 3% but higher average selling prices (ASPs) led to an increase in revenue. Despite the rise in revenue, margins fell as battery costs, selling expenses, and R&D costs increased. Tight semiconductor supply is an additional problem but given Geely's size, it has signed agreements with large chip companies to better secure supply. Geely is also making more key components in-house to lower costs and its reliance on tight supply chains. The company's electric vehicle (EV) sales are rapidly increasing, and this is the key focus going forward. Its premium model received more than 10,000 orders in July alone which is a sign of Geely's growing success in the space.

Inovance's second quarter revenue rose 16% and its EPS rose 34%. Management is maintaining guidance from the beginning of the year, aiming to grow revenue 25-50% and net profit 10-30%. The industrial automation business grew 32% with good growth across all segments. The EV component segment grew 93% and Inovance now has top five market share in controllers, power trains and motors. The industrial robots business grew 30% and Inovance now has meaningful market share in its main product line. The elevator business, however, remains weak due to the property slowdown.

China Medical System (CMS) reported interim revenue which grew 16% and EPS which grew 11%. Of the company's main products, Deanxit, an antidepressant, is not going to enter the national Volume Based Procurement (VBP) list, which means most hospitals will no longer off the product. For Deanxit to have made it onto the VBP list, CMS would have to accept a steep price discount in return for the larger volumes, which it rejected. Through the over-the-counter channel CMS can mitigate some of the lost volumes. In response to pricing pressure for generics, CMS has been developing its own innovative drug business which is subject to fewer price cuts.

Outlook



(Source: World Bank, Guinness Atkinson Asset Management calculations. GDP refers to 2021 nominal GDP. MSCI ACWI ETF refers to the weights derived from the iShares MSCI All Country World ETF (ACWI US), as of 07/29/22. Categorizations done based on domicile.)

In the current gloomy outlook for Chinese equities, it is easy to forget the attractive long-term story. Despite China's large share of global GDP its Chinese equity markets are much smaller than one may think. As of July, China only accounted for 3% of the MSCI All Country World Index, much lower than its 18% share of global GDP. As you can see above, the US has very developed financial markets with its share of global equity markets at 60%, well above its 24% share of global GDP. But looking at the other major economies, their equity shares are roughly in line with their GDP shares. China is the clear outlier here, representing an opportunity for investors as we believe China's equity share of global markets is likely to increase over time.

What could drive this increase? One factor is linked to the treatment of China A shares, which are mainland shares listed in Shanghai and Shenzhen. Currently index providers only include a portion of the valuation of these A shares in their indexes. For example, MSCI include A shares with an inclusion factor (IF) of 20%, which means they only include 20% of the relevant A shares' market capitalization in their calculations. We expect over time for this inclusion factor to increase as China opens up the A share market, involving improvements over settlement cycles, hedging instruments and derivatives, as well as access to onshore Renminbi. The expected increase in the inclusion factor is likely to lead to greater demand for A shares, as passive funds are obliged to match the new index weights. The secondary effect is that A shares and so China's overall weight in global benchmarks would increase, making China harder to ignore for asset allocators.

Edmund Harriss (portfolio manager)

Sharukh Malik (portfolio manager)

Performance

As of 08/31/2022	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	-22.29%	-25.61%	-0.24%	-0.86%	4.02%
Hang Seng Composite Index TR	-15.93%	-24.09%	-2.08%	-1.98%	4.48%
MSCI China Net Total Return Index	-19.51%	-28.19%	-2.19%	-2.33%	4.65%

As of 06/30/2022	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	-11.07%	-20.53%	2.57%	3.47%	4.93%
Hang Seng Composite Index TR	-7.67%	-25.24%	-1.87%	1.63%	5.45%
MSCI China Net Total Return Index	-11.26%	-31.79%	-0.57%	2.14%	5.49%

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

Expense Ratio: 1.50%

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 shown is current to the most recent month and quarter end. To obtain performance as of the most recent month end, please visit www.gafunds.com or call 1-800-915-6565. 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.

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.

The Shanghai Shenzhen CSI 300 Index is a market capitalization-weighted stock market index designed to replicate the performance of the top 300 A-share stocks traded in the Shanghai and Shenzhen stock exchanges.

Hang Seng Composite Total Return Index is a market capitalization weighted index that monitors the performance of stocks listed in Hong Kong.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

In China, **the NBS Manufacturing Purchasing Manager Index** measures the performance of the manufacturing sector and is derived from a survey of more large-scale, state-owned companies. The Manufacturing Purchasing Managers Index is based on five individual indexes with the following weights: New Orders (30%), Output (25%), Employment (20%), Suppliers' Delivery Times (15%) and Stock of Items Purchased (10%), with the Delivery Times index inverted so that it moves in a comparable direction.

The Caixin PMI measures the performance of the manufacturing sector and is derived from a survey of more private companies.

MSCI AC Asia Pacific ex Japan Index is free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of countries in the Asia Pacific region.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of European markets.

MSCI EM Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of Emerging markets in Asia, Europe, Middle East, Africa, and Latin America.

MSCI EM ex China is the same as the MSCI Emerging Markets Index but excludes China.

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.

The MSCI China A Index captures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The index covers only those securities that are accessible through "Stock Connect".

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 Golden Dragon is a composite of the MSCI China, Hong Kong and Taiwan Indices which are free float-adjusted market capitalization weighted indices that is designed to measure the equity market performance of the respective markets.

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

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

MSCI China Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics across the Chinese equity markets.

MSCI China Value Index captures large and mid-cap Chinese securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price, and dividend yield.

S&P 500 Index is a market-capitalization-weighted index of leading publicly traded companies in the U.S.

Price/Earnings ratio (P/E) 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 8/31/2022:

1.	JD.com Inc	4.67%
2.	NetEase Inc - ADR	4.47%
3.	China Overseas Land & Investments Ltd	4.30%
4.	NARI Technology Co Ltd	4.23%
5.	Baidu Inc	4.08%
6.	AIA Group Ltd	3.98%
7.	China Medical System Holdings Ltd	3.93%
8.	Shenzhen Inovance Technology Co Ltd.	3.59%
9.	Haier Smart Home Co Ltd	3.59%
10.	Inner Mongolia Yili - A Shares	3.44%

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

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