

Asia Brief
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Welcome to the December 2008 Guinness Atkinson Asia Brief.

In this month's Asia Brief we think that rather than rehearse what is happening in the developed economies of the US and Europe we will confine ourselves to a review of what has been happening in Asia and to give readers an idea of what we think will happen in 2009 and how our funds are positioned.

Turbulent markets

The rapid change in economic conditions in the developed world and particularly the freezing of the credit markets has been reflected in sharp and deep declines in Asian stock markets. It has also been reflected in similar declines across all emerging markets and across all sectors with remarkably uniform declines, with some differentiation where economies are perceived to have specific looming problems.

The point is that regardless of the relative strength of many economies, especially in Asia where there is little evidence of leveraged excess, the stock markets have come down. The primary cause of these declines has been a withdrawal of funds from the 'peripheral' markets back to the core. And this has not only been the case in stock markets. Availability of short term US Dollar funding also reduced sharply in Emerging Markets in October which finally prompted the Federal Reserve to open a \$120 billion line of credit for Singapore, South Korea, Brazil and Mexico in particular.

Tighter credit markets have also been apparent in international trade especially, but not solely, in the dry bulk goods sector. When a Chinese steel producer, for example, wants to secure a shipment of iron ore from Australia or Brazil, payment for the ore is secured in advance by a letter of credit issued by a bank that ensures funds will be transferred on delivery. The unwillingness of banks to issue such letters of credit brought the dry bulk shipping market almost to a standstill.

Asian economies of course are feeling the effects of the global slow down most keenly in the export manufacturing sector. Exports from South Korea, Singapore and Taiwan have all experienced sharp drops. Exports from China continued to grow strongly until November when they contracted 2% compared to the same period last year. At the same time, Asian governments are, by and large, in a relatively strong position to take policy actions to mitigate this.

China is best placed in Asia

We have to recognize that China appears to be facing a significant economic slow down that has happened faster than anyone expected and has been felt in both the external and domestic sectors. The government has also recognized the severity of the problem and it is for this reason that they have moved fast to launch a stimulus package of \$586 billion as well as make a series of policy and monetary adjustments.

It is important to understand that while the export manufacturing sector has suffered in the wake of global events, the domestic slow down is very much a home grown issue and one that is the result of policy decisions made when the economy was growing at 10% or more. The government sought to constrain growth by acting aggressively to reduce excess liquidity in the system which was a by-product of the trade surplus that ballooned after 2004.

In addition, the government also looked to head-off overheating in key sectors by restricting loan growth, enforcing credit quotas and delaying approvals for major new projects. From 2006 attention turned to the property sector where prices showed signs of accelerating and where construction was expanding fast. In this the government was pre-empting the creation of an asset bubble, rather than seeking to burst one that had already formed.

The current climate made it important for China to change course quickly, to boost domestic growth in order to offset the declines in export manufacturing over which it has little or no control. The success of their efforts may hinge on the government program rallying support from banks and companies to increase their investment. In 2007 investment spending in China was financed by bank lending (40%) and retained company profits (29%). As profit growth slows we believe it will be necessary for banks to increase their lending.

Most banks have been unwilling to increase lending at a time when the risk of deteriorating asset quality and default has been rising, as we are seeing in the US and Europe. In China's case, leverage levels have been falling since 2003, loan to deposit ratios are only 65% across the banking sector, balance sheets of banks and companies are relatively strong, the interest rate structure encourages banks to lend and government policy has been adjusted to support increased lending. The latest bank lending figures suggest that banks take a similar view and loan growth has jumped significantly following several quarters of policy-induced declines.

South Korea is struggling

The economic problems faced by Korea look similar to those in the US. The finance minister Kang Man Soo was quoted as saying:

“Apart from exports, everything including investment, consumption, employment and the current account balance is on a trend similar to that seen during the [Asian crisis].”

To some extent, Korea can be seen as a victim of its own success. The export sector is hugely successful, accounting for 40% of GDP. Its leading companies are known to consumers worldwide as suppliers of goods ranging from computer chips to mobile phones to televisions and refrigerators. Korea is also the world's leading shipbuilder with unrivalled skill in building advanced vessels such as liquefied gas carriers. It is also home to the world's largest car plant with its own dedicated deepwater port shipping out 1 million vehicles a year.

The small and medium enterprise sector is also vibrant area playing host to world-leaders in niche markets. The sector employs 88% of the workforce, accounts for 50% of manufacturing output and 32% of exports. These companies are vulnerable not only to the collapse in exports but also to the bursting of a domestic bubble that has its roots in the now-familiar tale of increased home-ownership and asset backed debt. The unwinding of debt, slower external and domestic economic growth and a widely fluctuating currency make for a challenging set of conditions.

The Outlook for Asia

The countries in the region lie between these two extremes. Most lie closer to China in terms of current account and fiscal surpluses which can be used to support domestic growth. Interest rates in the region have been cut and although currencies have weakened most have moved gradually. The Korean Won and Indonesian Rupiah have been the biggest movers.

With domestic growth now at the top of the agenda it means that China is the country to watch. A large stimulus package, earthquake reconstruction and any number of "shovel-ready" projects that have already been approved have been coming together with administrative and monetary policy shifts designed to increase liquidity.

A key element in bringing about a successful domestic boost lies in the ability to kick start the property and construction sector. As discussed earlier, the slower property sector was brought about by policy changes in a high growth era rather than a fall-off in underlying demand. The effect has been to cap prices, reduce sales of finished units and ultimately to slow construction. The impact of this last has been seen clearly in the prices of commodities including iron ore, copper, zinc, nickel and other commodities.

Encouragingly there have been early signs of a recovery in those cities that were first affected by the property downturn. We have also seen stabilization in steel production and some pick up in iron ore shipments.

However, we should remember that many of the policies and packages launched across the world have only come in the last couple of months and it may take time for the effects of these to become visible in economic data. In the meantime we expect that the data may continue to be weak going into the first quarter of next year. At the same time we also expect that analysts will continue to cut back their earnings estimates, especially when the 2008 reporting season gets underway. This of course will not be a purely Asian phenomenon.

For investors, we will be looking for signs that domestic activity is first stabilizing and then starting to pick up. Sustained growth in Chinese bank lending, following on from November's jump could be an important sign that policy is having the desired effect. After that we will be looking for signs of increasing construction and property activity. It seems unlikely that economic data will show much of a recovery before the second half of next year but we think we should see some initial indications before then.

Fund Positioning

The Funds are positioned toward domestic rather than export-related businesses. In regional funds we are looking at companies that should benefit directly and indirectly from renewed domestic growth in China. In the first instance this is likely to be amongst construction related beneficiaries. We are also looking at consumer businesses catering to the mass-market.

Low gearing and high cash-flow businesses are preferable at this point and we are looking at companies that are relatively asset-light. We are also looking carefully at the structure of company debts to assess near-term funding requirements. While we expect that dividends are going to come down we are watching to see if companies are able to maintain the proportion of earnings paid out in dividends.

Market Performance Ending November 30, 2008

	November 2008	2008 YTD	2007	2006
Australia	-7.33%	-52.99%	30.69%	33.22%
China	4.51%	-55.15%	65.90%	81.48%
Hong Kong	0.64%	-52.56%	41.16%	29.79%
Indonesia	-12.13%	-64.93%	54.79%	72.63%
Korea	-13.39%	-63.19%	32.11%	11.17%
Malaysia	-1.92%	-45.13%	47.43%	37.55%
New Zealand	-6.95%	-56.07%	11.26%	18.38%
Philippines	-0.53%	-51.45%	41.46%	58.67%
Singapore	-3.04%	-50.81%	28.78%	46.85%
Taiwan	-10.76%	-48.62%	9.33%	20.03%
Thailand	-4.26%	-59.59%	63.01%	12.07%
MSCI AC Far East Free ex Japan	-5.27%	-55.12%	36.55%	31.33%
MSCI AC Pacific ex Japan*	-5.87%	-54.60%	34.50%	31.83%

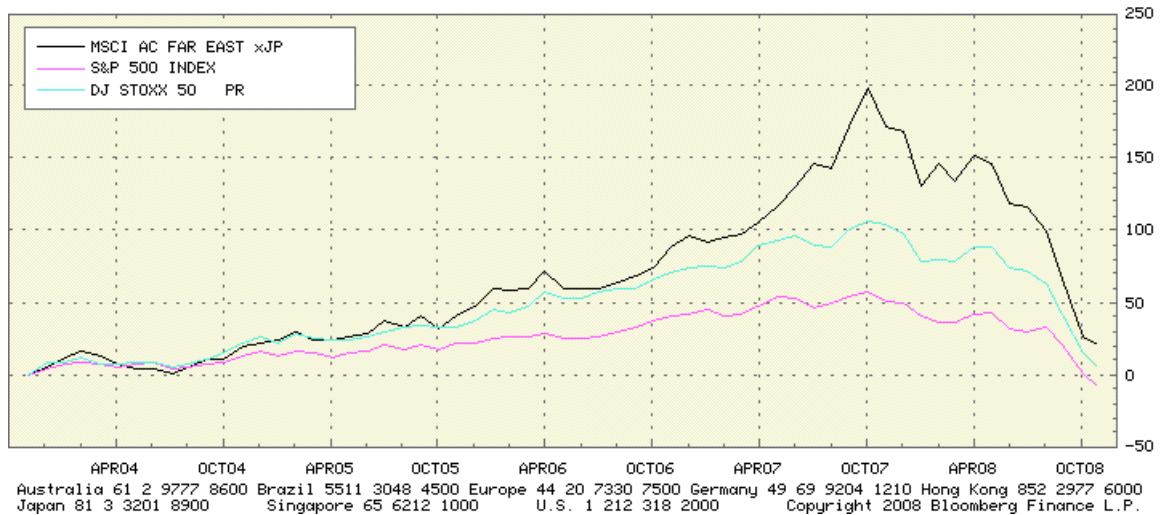
*MSCI AC Pacific includes Australia & New Zealand
(MSCI Indices were used for regional & individual market performance)

The comparative returns over five years for Asia ex Japan versus the U.S. and Europe are shown in the chart below.

COMPARATIVE RETURNS Page 1/ 6

Securities	Range	Crcncy	Prc Appr	Total Ret	Difference	Annual Eq
1 MXFEJ Index	11/28/03 - 11/28/08	USD	5.90 %	20.38 %	27.16 %	3.77 %
2 SPX Index		USD	-15.31 %	-6.78 %		-1.39 %
3 SX5P Index		USD	-10.88 %	6.00 %	12.79 %	1.17 %

(* = No dividends or coupons)



Source: Bloomberg

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Commentary for our views on Alternative Energy and Energy markets is available on our website. Please [click here](#) to view.

Performance data quoted represents past performance and does not guarantee future results. Index performance is not illustrative of Guinness Atkinson fund performance and an investment cannot be made in an index. For Guinness Atkinson Fund performance visit gafunds.com.

Mutual fund investing involves risk and loss of principal is possible. The Fund invests in foreign securities which involves greater volatility, political, economic and currency risks and differences in accounting methods. The Fund is non-diversified meaning it concentrates its assets in fewer holdings than diversified funds. Therefore, this Fund is more exposed to individual stock volatility than diversified funds.

The MSCI All Country Far East Free ex-Japan Index (MSCI AC Far East free ex-Japan Index) is a free float-adjusted, capitalization-weighted index that is designed to measure equity market performance in the Asia region excluding Japan. The Index is made up of the stock markets of China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.

The MSCI All Country Pacific Free ex-Japan Index (MSCI AC Pacific Index) is a free float-adjusted, capitalization-weighted index that is designed to measure equity market performance in the Pacific region. The Index is made up of the stock markets of Australia, China, Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan and Thailand.

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general.

The Dow Jones STOXX 50 Index is a capitalization-weighted index of 50 European blue-chip stocks using free float shares in the index calculation.

One cannot invest directly in an index.

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

This information is authorized for use when preceded or accompanied by a prospectus for the Guinness Atkinson Funds. The prospectus contains more complete information, including investment objectives, risks, fees and expenses related to an ongoing investment in the Funds. Please read the prospectus carefully before investing.

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

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