



**GUINNESS
ATKINSON**
FUNDS

Special
brief



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**Commentary and Review by portfolio manager
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Offshore Renminbi Market View

Within the last month, the offshore Renminbi (CNH) market saw unusually large fluctuations, weakening against the dollar, while the onshore Renminbi rate remained relatively stable. The onshore and offshore Renminbi rates have previously been very close. The recent moves put offshore rate at a discount of over 2% to the onshore rate.

How these markets work:

The onshore rate is tightly managed by the People's Bank of China. On the flip side, the offshore rate moves freely, determined by supply and demand, and while it generally responds closely to the rate prevailing in the mainland, the market is still separate. The moves in the CNH that have happened reflect the independent market dynamics.

Why these movements have taken place:

- The sell-off in CNH was in part driven by sales of underlying securities (RMB-denominated bonds), with the proceeds converted back into USD.
- This move was in line with sell-off across Asian currencies and other emerging market bonds. It appeared to reflect a belief in the dollar as a safe haven in the short term, rather than a belief that the Chinese currency will now depreciate.

This action was exacerbated by two other factors:

1. The immediate upward pressure on the dollar as investors moved away from 'risk' exposed other positions by traders who had gone short-dollar and long-CNH. These needed to be covered.
2. A statement from BOC Hong Kong branch that its quota for the quarter was full and that it would no longer be buying Renminbi at the onshore rate for trade settlement.

This last point needs some explanation:

The Bank of China (BOC) has a quarterly quota of RMB 4 billion allowed to it to Buy and Sell renminbi for trade settlement purposes. The imbalance of cross-border settlement between importer and exporters is a problem at present. Currently 80-90% of the cross-border CNH transactions are done by Chinese importers. International corporations get paid in CNH and sell this CNH to BOC for USD. As BOC's quota gets filled, some of the flow has to go through interbank dealer market. This, unfortunately, met with general squeeze in in the Asian foreign exchange markets.

At the beginning of October the quota for the fourth quarter was expanded from RMB 4 billion to RMB 8 billion to avoid a repeat of this situation.

What to expect going forward:

We believe that the gap between the onshore and offshore rates should close once again, and we expect that it will happen by a strengthening of the offshore rate against the dollar. It seems unlikely to us that China will weaken the onshore rate materially since all the reasons for allowing a stronger currency (inflation, imbalances etc) all remain in place. The process of arbitrage that takes place with Chinese Corporates able to access both rates is also still in place. This does not happen instantaneously because of the controls in place to regulate capital flows between the onshore and offshore markets.

Performance data quoted represents past performance and does not guarantee future results.

Mutual fund investing involves risk and loss of principal is possible. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. Non-diversified funds concentrate assets in fewer holdings than diversified funds. Therefore, non-diversified funds are more exposed to individual stock volatility than diversified funds. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. The funds may invest in derivatives which involve risks different from, and in certain cases, greater than the risks presented by traditional investments.

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