Guinness Atkinson

Asia Pacific Dividend Builder Fund

Managers Monthly Update – February 2018

GUINNESS ATKINSON FUNDS

Summary Review & Outlook

Fund & Market

- The mini-correction we saw between January 26 and February 9 was a useful reminder of this Fund's characteristics.
- The market wobble was triggered by US inflation and interest rate concerns which pushed US government bond yields higher. Financial assets world-wide have done well on ultra-low interest rates and so a reversal is likely to put pressure on share valuations.
- The market consensus expects synchronized global economic growth with all regions (US, Europe and Emerging Markets) contributing for the first time since the financial crisis. Earnings forecasts continue to be positive and have been supported by a solid results-reporting season so far.
- The best performing markets were south-east Asian (Thailand, Malaysia, Singapore and Indonesia) and Australia. China was a notable under-performer. Heath care, consumer staples and utilities were the best performing sectors. Telecoms continued their wretched run, under-performing the market by 2.5%.
- The Fund continued to march to its own beat with outperforming names from China, Taiwan and Hong Kong as well as Singapore and Thailand which operate in the technology, energy, financials, consumer discretionary and health care sectors. We have minimal exposure to consumer staples and no exposure to utilities.
- At the end of the month the Fund was attractively valued at 12.1x 2018 earnings and at a 9.5% discount to the MSCI AC Pacific ex Japan Index Price /earnings multiple of 13.3x 2018 earnings.

Events in February

- We remain of the view that Central Banks in both the US and Europe wish to move toward a 'normalization' of monetary conditions and we believe the US Federal Reserve is at the forefront. The recent testimony by the new chair of the Federal Open Markets Committee (FOMC) gave extra force to that, in our opinion.
- In China, the big political development was the move by Xi Jinping to remove the two term (10 year) Presidential limit. This can be seen as a formalization of the political reality, but it is a major step nonetheless.
- The Winter Olympics in South Korea saw a thawing of relations between the North and South. The US retains its firm stance against North Korea, but it is evident that the South, due to proximity, is much more willing to engage.
- At the beginning of March US President Trump announced a plan to impose tariffs on steel and aluminum on all imports into the US whether from Europe or Asia. This was a surprise to everyone, including the Treasury, the Pentagon, the Republicans, and the Democrat. While the EU suggested a readiness to retaliate, China re-emphasized that it has no desire for a trade war.

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Outlook

- US moves on trade, first on washing machines and solar panels then on steel and aluminum, may be harbingers of more wide-ranging protectionist moves. America First could hit global growth, then hit US growth to affect Federal Reserve forecasts and US interest rates.
- Global and Asian regional economic growth looks positive for the year ahead and this is supportive for the earnings outlook. But there are also factors we need to consider:
- China is expected to step up its efforts to cut debt. The government forecasts 6.5% growth, dropping the "or faster if possible" rider. Money supply growth is forecast to be similar to last year and the fiscal deficit is forecast to narrow to 2.6% of GDP. The combined effect is likely to be slower GDP growth. For investors this means staying away from companies that are sensitive to macro-economic policy and focusing on businesses that stand on their own two feet.
- We expect to see US interest rates move toward normalization. Vulnerable stocks include those higher yielding shares whose dividends are not growing (so-called 'bond-proxies) and high-priced growth stocks whose valuations depend on high growth in the long term.
- The best defenses: focus, as we do, on those companies which can sustain dividend growth and on those companies for whom future growth prospects make up a lower proportion of the valuation (i.e. Growth at Reasonable Price).

Performance

The Fund outperformed by 2.20% the MSCI AC Pacific ex Japan Index market which fell 9.87%.

As of 2/28/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	0.67%	26.77%	11.69%	7.88%	4.91%
MSCI AC Pacific ex Japan Index	2.14%	28.52%	9.79%	7.27%	5.79%

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

Expense Ratio: 1.11% (net); 3.14% (gross)

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 current to the most recent month end may be obtained by calling 800-915-6566 and/or visiting www.gafunds.com. 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 notes. Total returns reflect a fee waiver in effect and in the absence of this waiver, total returns would be lower.*

Discussion

While trade-related issues move higher up the agenda there is better news out of **Korea**. The signs of a rapprochement between North and South Korea at the Olympics has been followed up by a formal meeting between Kim Jong Un and South Korean ministers. At this meeting North Korea held open the possibility that it may be willing to shelve its nuclear ambitions in return for guarantees from the US over its security (and no doubt an easing of sanctions). It is always near impossible to identify exact motives behind North Korea's action, although we can certainly speculate, but the news has been warmly greeted so far.

The stock market in **India** remains challenging. The mood can best be summed up as Buy the hope, Sell the reality. Most top down observers are very excited by the reform moves by Modi and the radical actions (de-monetization, a goods and services tax, a recapitalization of state banks) coupled with some of the best economic growth in the region. The problem is that not everything is moving the same way: the discovery of substantial fraud in one of the state banks, a capital gains tax on stocks, the refusal to share stock exchange pricing data with overseas platforms to enable pricing of derivatives are all reminders that much remains to be done and not everyone is signed up to the plan. The fact that Indian shares are still seeing downgrades to earnings forecasts while also being some of the most expensive in Asia and emerging markets also helps explain its significant under-performance this year.

In **Thailand**, consumer confidence continues to rise and is now at a three-year high. This is positive for our holding in Tisco Finance. The results reported in January included a modest outlook for loan growth following the acquisition of Standard Chartered Bank's Thai consumer business and indicated plenty of positives on loan quality and provisioning. The 45% increase in the dividend on 20% profit growth and a rise in the payout ratio from 40% to 65% puts the shares on a 4% yield. The PTT group performed very strongly in February following news of a share split by the parent, which is held in the Fund. PTT is Thailand's main energy business made up of natural gas supplier PTT, oil exploration business PTT Exploration & Production and a petrochemicals business PTT Global Chemical. We like PTT because of the low volatility in its earnings, primarily due to its long-term gas supply contracts to Thailand's electricity generators and higher oil prices have been a positive contributor. We think PTT's share price discounts $56 oil prices at present. The recent results came in ahead of expectations and included a 25% increase in the dividend.

Last month we spoke positively of **Singapore** and improvements in consumer confidence. In February we have seen continued evidence of this; the manufacturing sector has sustained its upswing not only in technology but also in commodity sensitive areas such as oil services and in general manufacturing. This broadening expansion supports employment and expectations of wage inflation. This in turn sets the scene for some monetary tightening in Singapore which is beneficial to the banks and to the fund's holding in DBS in particular which was the best performing stock in the local market index and the fund's third best performer in February. We also hold two real estate investment trusts (REITs) in Singapore, Ascendas and CapitaMall Trust, which could be seen to be at risk in a rising interest rate environment. These REITs are focused on industrial properties and commercial properties, respectively. We are very conscious that any company that fails to grow its dividend is at risk, treated by the market as a bond proxy whose dividend value will be eroded by rising rates. However, both Ascendas and CapitaMall Trust have shown an ability to grow their dividends over time and we expect them to be better able to preserve the value of the income stream and thus their capital value in this environment.

China had a weak month relative to the region but that followed an exceptionally strong month in January. The big political news was the formalization of Xi Jinping's unassailable leadership position with the removal of the two-term limit on the Presidency. Though the timing of the announcement was perhaps a surprise, the move to scrap the limit was virtually confirmed in October 2017, when the new politburo was unveiled with no apparent heir to Xi. His predecessors ruled in accordance with Deng's famous motto "hide your strength, bide your time" but Xi himself apparently aims to govern differently. He seems to want China to become much more prominent in foreign policy; to develop trade and infrastructure links through the Belt and Road Initiative; and to become a leader in technologies such as electric vehicles, aerospace and cybersecurity.

AAC Technologies was the strongest stock over the period. AAC is known for its speakerboxes and haptics in smartphones. The company is now diversifying into new areas such as metal casings for smartphones and hybrid lenses using a proprietary production technique. The share price was weak towards the end of 2017 on the back of 1) weaker than expected sales of the iPhone X, which AAC is a supplier of, and 2) a smartphone inventory correction in China, which affected most firms in the supply chain. We hold AAC because we think the company is a business with innovative product development capabilities which give the company an edge: Samsung's new GS9 phone incorporates stereo sound and is 1.4x louder - AAC is one of two suppliers. China smartphone maker, Vivo, launched its new concept phone which boasts a 98% screen to body ratio with hidden in-display speaker system called 'Screen SoundCasting'. The all-screen design will need either a compact speaker grille or an under-display speaker. Either solution will lead to meaningful ASP increase.

Weaker stocks in February include China Merchants Bank, Delta Electronics Thailand, China Mobile, LPN Development and JB Hi-Fi. China Merchants Bank has been one of our best performers over the past 18 months and its reversal during the month was related to broader market weakness and tightening rules on deleveraging rather than anything specific to the bank. China Mobile had a weak month on rumors, subsequently confirmed, of plans to cut mobile internet service fees across the sector by the elimination of domestic roaming charges. Delta Electronics Thailand was weak on slower earnings in the last quarter of 2017, but sales are expected to pick up in 2018 especially from the auto parts sector. In the short term, Thai baht strength is a headwind. JB Hi-Fi had a weak month after management guided profit growth over the next six months would be slower than sales growth due to increasing investment, especially in on-line distribution.

Summary and conclusion

The portfolio is trading on a price/earnings multiple basis, at a 9% discount to the market as measured by the MSCI AC Pacific ex Japan Index. This index is in turn trading at a wider discount to developed markets than its ten-year average. A combination of above average companies in our opinion, paying above average dividends and trading on a below-average valuation seems to us to be an attractive one.

Edmund Harriss and **Mark Hammonds** (portfolio managers)
Sharukh Malik (analyst)

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. 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 debt securities typically decrease in value when interest rates rise, which can be greater for longer-term debt securities. Investments in derivatives involve risks different from, and in certain cases, greater than the risks presented by traditional investments. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. Funds concentrated in a specific sector or geographic region may be subject to more volatility than a more diversified investment. Investments focused in a single geographic region may be exposed to greater risk than investments diversified among various geographies. Investments focused on the energy sector may be exposed to greater risk than investments diversified among various sectors.

MSCI AC Pacific Ex-Japan Index is a market capitalization weighted index that monitors the performance of stocks from the Pacific region, excluding Japan consisting of Australia, China, Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan, and Thailand.

One cannot invest directly in an Index.

Price/Earnings Ratio (P/E) is an equity valuation multiple. It is defined as market price per share divided by annual earnings per share.

Payout ratio refers to the proportion of company profits paid out to shareholders as a dividend.

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.

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Top Fund Holdings as of 02/28/18

1	Taiwan Semiconductor Manufacturing Co Ltd	3.17%
2	PTT PCL /Foreign	3.13%
3	Ascendas Real Estate Investment Trust	3.10%
4	Yangzijiang Shipbuilding Holdings Ltd	3.02%
5	Largan Precision Co Ltd	2.98%
6	AAC Technologies Holdings Inc	2.86%
7	Janus Henderson Group PLC	2.83%
8	Aflac Inc	2.82%
9	DBS Group Holdings	2.82%
10	Elite Material Co Ltd	2.80%

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