Guinness Atkinson

China & Hong Kong Fund

Fund Update – Review of June 2021

Summary Review & Outlook

Market

- Chinese markets have been volatile this year after a strong 2020. A strong rally lasted until February, followed by sell-off which ended in May, and then a mild recovery.
- In the first six months of the year, MSCI China increased 1.8% and MSCI Hong Kong increased 10%. The CSI 300 Index increased 2.1%.
- In China, the strongest sectors were Energy (total return of +25.7%), Health Care (+24.4%) and Industrials (+14.3%) while the weakest were Consumer Staples (-5.6%), Information Technology (-4.4%) and Consumer Discretionary (-2.7%).
- In Hong Kong, the Real Estate and Financials indices rose 15.5% and 6.7% respectively.
- In the Fund, strong performers were China Medical System, China Lesso, Yuhong Waterproof, CSPC Pharmaceutical and China Merchants Bank. Weaker stocks were New Oriental Education, Autohome, Ping An Insurance, Supor and Yili.

Events in the Second Quarter

- Producer prices were strong, with Producer Price Inflation (PPI) reaching a peak of 9.0% in May. Rising PPI reflected rising global commodity prices, but the high rates have been boosted by a low base. As the low base rolls over, it is likely PPI should fall. On the other hand, headline Consumer Price Inflation (CPI) remained low at 1.3% in May and 1.1% in June. Weaker pork prices should continue to offset higher oil prices.
- The stock of total social financing (TSF), a broad measure of credit, grew 11.3% in June which was broadly unchanged compared to May. The People's Bank of China (PBOC) announced a surprise cut in the required reserve ratio (RRR), aiming to again boost credit to small businesses. The PBOC said this cut in the RRR was also driven by underutilized government bond issuance, so the injection in funds should help plug this liquidity gap. We think it is too early to call this an easing of monetary policy as the RRR is only one tool the central bank has available. The use of other tools does not suggest a decisive shift to monetary easing.
- Retail sales in May grew 12.4% which was weaker than expected. The two-year annualized growth in retail sales was 4.5%, which is lower than GDP growth. This reflects that much of the government stimulus has been to boost production rather than consumption.
- There was an outbreak of COVID in Guangdong province, leading to delays in the busy Yantian port. This highlights that even though China has done well to contain COVID, the virus will remain a problem until most of the population is vaccinated. As of June 30th, China had given enough doses to have vaccinated about half of its population.
- Census data revealed that China's working age population continued to fall over the past decade. Birth rates continue to fall, prompting the government to allow each family to have three children. But it was only in 2016 that the government allowed all families to have two children, which did

not lead to a sustained increased in birth rates. The government will have to do more to incentivize families to have more children. This will include managing high housing costs in tier one and two cities, as well as improving the general quality of public schooling.

Investment Process

The Fund is designed to give exposure to the seven structural growth themes we have identified in China:

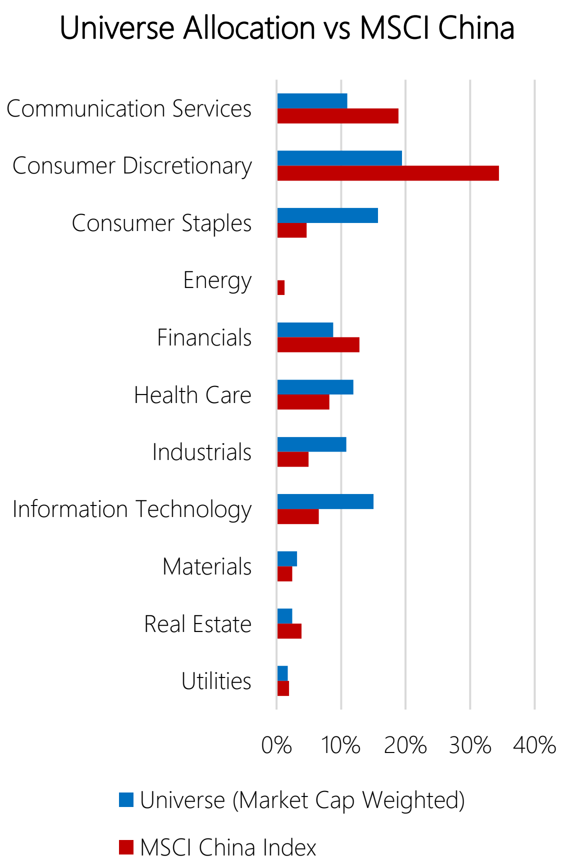
- Rise of the Middle Class
- Sustainability
- Manufacturing Upgrades
- Healthcare
- Cloud Computing & Artificial Intelligence
- Next Gen Consumer
- Financial Services

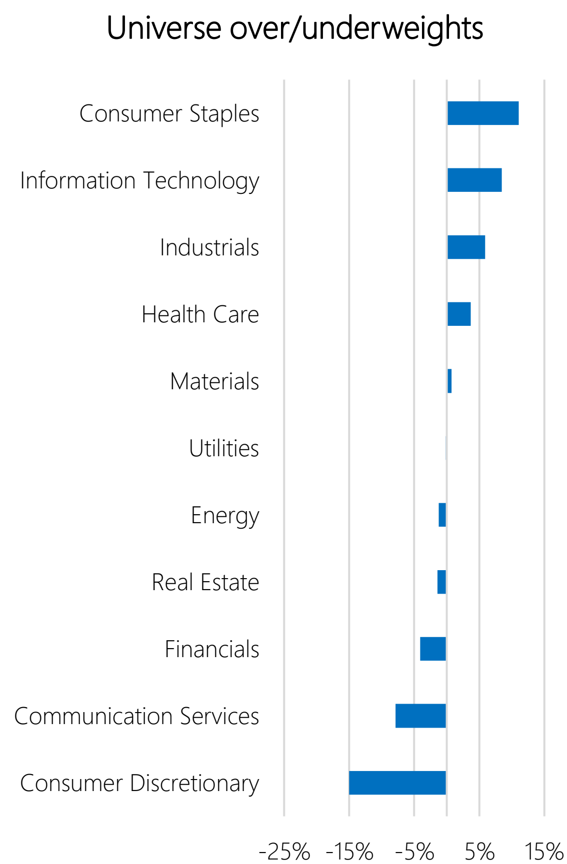
Once we have identified companies which give exposure to these themes, we also apply a set of quantitative filters to identify quality, profitable companies with strong balance sheets. Quality is defined as a return on capital above the cost of capital while a strong balance sheet is defined as debt/equity less than 150%. These filters reduce the universe from an initial ~1,600 companies to ~800 companies, of which we pick 31 to form an equally weighted portfolio.

The chart below shows the universe's exposure to each theme, on an equally weighted basis. The largest exposures are to the Rise of the Middle Class, Manufacturing Upgrades and Healthcare.

Looking at the more conventional GICS sectors, the universe's largest exposures are to the Consumer Discretionary, Information Technology and Consumer Staples sectors. Compared to MSCI China, the largest overweights are in Consumer Staples and Information Technology, while the largest underweights are in Consumer Discretionary and Communication Services.

We are interested in businesses which have a good structural growth theme to take advantage of and can translate this opportunity into earnings and cashflow growth. When looking at a company, we break down the financial statements to understand the evolution of the various types of cashflow. We are looking for businesses that can convert their gross cashflow into operating cashflow (which takes working capital into account). Then we look at the uses of cash and the potential returns on these investments – we are looking for businesses that are making good capital allocation decisions. Another important part of the process is to make sure we are comfortable with the accounting decisions the company has made, and that we trust the information shown to us. The next stage is to look into the history of management, and to ultimately judge whether we trust them to run the company well. The final stage is to consider valuations, where ultimately, we are looking for companies that can grow earnings by enough to offset a potential valuation derating. Alternatively, we are looking for companies that can grow earnings by enough to offset a moderate increase in discount rates.





Source: Guinness Atkinson Asset Management; Bloomberg. As of 06/30/21.

This process results in a final portfolio with the following characteristics: compared to MSCI China, the Fund is invested in higher return on capital companies. The Fund's overall net debt/equity figure is negative, meaning in aggregate, the companies in the fund have enough cash to pay off their debt. The portfolio has, over the past five years, grown sales and earnings by 11% a year. This better than MSCI China, where there has been very little sales growth and no earnings growth over the same period. The market is expecting the Fund and MSCI China to grow earnings at a similar pace in the next two years. The Fund, on a forward-looking price/earnings basis, is 3% cheaper than the market. This is despite being invested in higher return on capital companies which have historically grown earnings by much more than the market.

As the Fund is run on an equally weighted basis, it does not have the same stock concentration as MSCI China or other China funds. As there are 29 positions in the Fund, assuming a 1% cash position, each stock has a neutral weight of 3.4%. This limits the stock specific risk in the Fund. This is in contrast to MSCI China, where, as of June 30th, Tencent had a weight of 13.4% and Alibaba a weight of 13.3%. These two stocks have done well over the past five years but given the government's rising attention to large tech stocks, we think it is risky to have so much exposure to two stocks. The Fund's equally weighted process means it is genuinely different to MSCI China, with an active share of 85%.

Quality

	Fund	MSCI China
CFROI (2021e)	13%	10%
Return-on-Equity	20%	14%
Net debt/equity	-15%	13%

Growth

	Fund	MSCI China
Sales growth (Historic 5 yr annualised)	12%	3%
Earnings growth (Historic 5 yr annualised)	13%	0%
Expected sales growth (2 yr annualised)	19%	32%
Expected earnings growth (2 yr annualised)	18%	17%
PE (2022e)	14.2	14.7

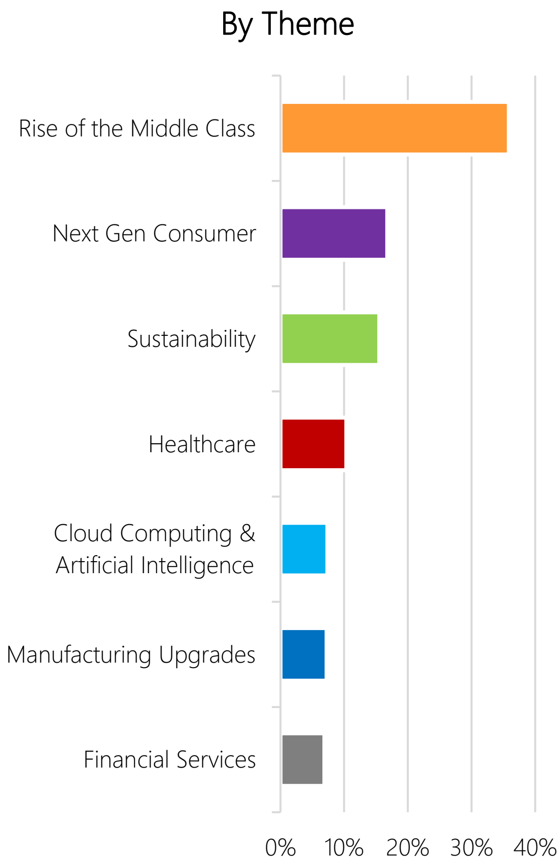
Conviction

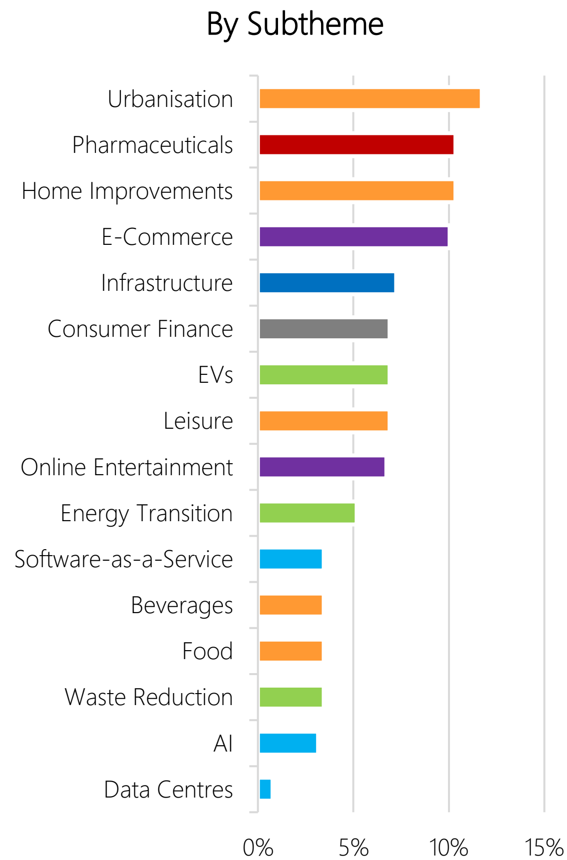
Positions	29
Top 10 %NAV	41%
Bottom 10%NAV	28%
Active share[1]	85%

Source: Guinness Atkinson Asset Management. As of 06/30/21.

1- *Active share relative to iShares MSCI China ETF.*

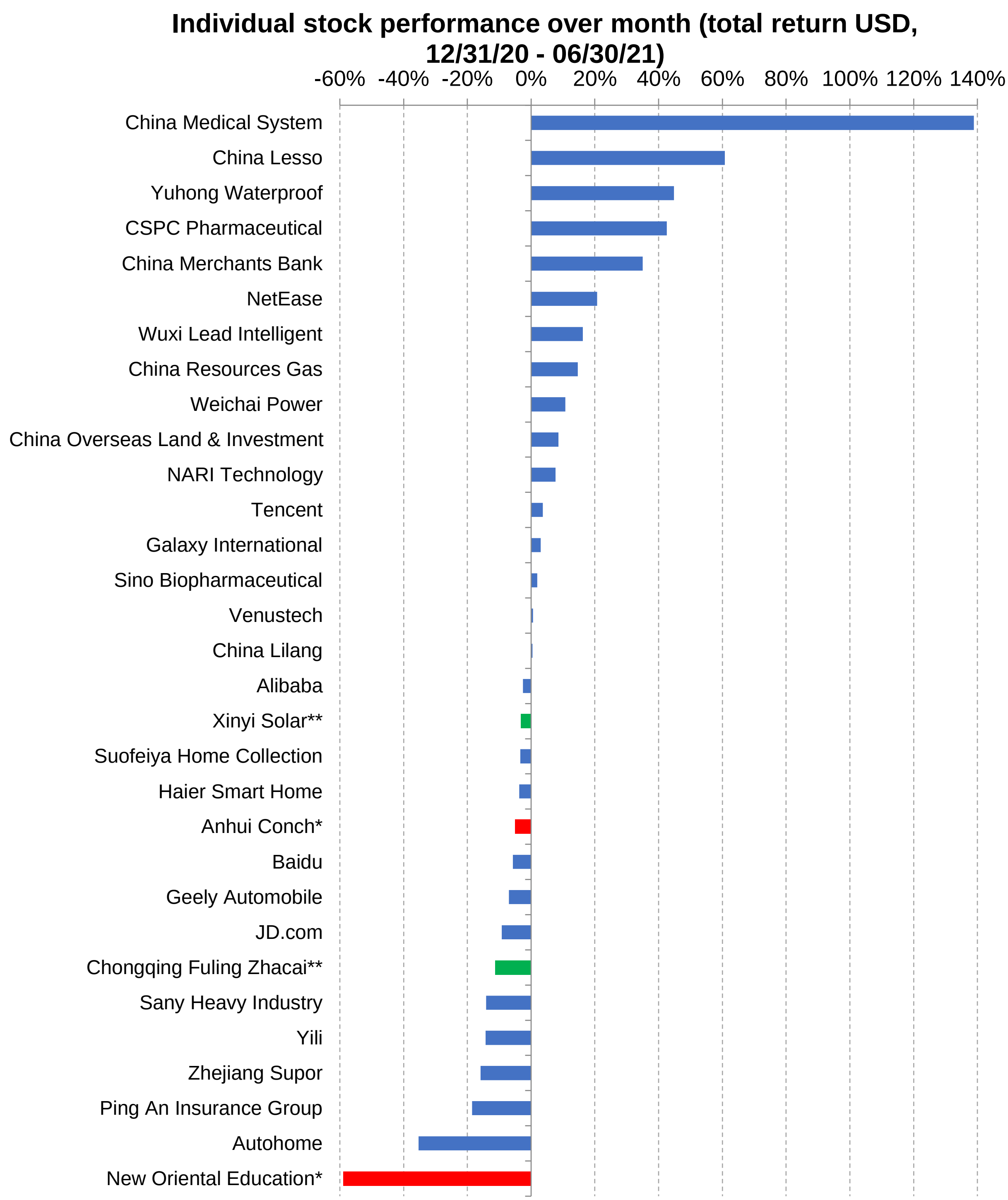
By theme, the Fund's largest exposure is to the Rise of the Middle Class, followed by the Next Gen Consumer and Sustainability. Important subthemes include Pharmaceuticals, Home Improvements, E-Commerce and Urbanization.





Source: Guinness Atkinson Asset Management. As of 06/30/21.

Stock Performance



** sell, * buy

China Medical System was by far the strongest stock in the portfolio, rising 139%. The company was historically a contract sales organization that sold drugs on behalf of foreign companies in China. Its focus was on generics, an area in which the government has initiated significant price cuts to lower overall healthcare costs. As a business dealing exclusively in generics, CMS's share price sold off sharply in 2019 and was weak in 2020. We felt the share price during this period was implying the worst-case scenario so continued to add to the position as part of the Fund's rebalancing process. Over time, CMS has delivered. Price cuts for its generic products have been well below average. The business has signed deals to build its innovative pipeline, where pricing power is much higher compared to generics. In 2020, CMS delivered revenue growth of 14% and earnings per share (EPS) growth of 30%.

Lesso is China's largest manufacturer of plastic pipes. It has benefited from positive earnings revisions and a valuation rerating. Lesso is expanding its plastic pipes business into the agricultural sector, which is a sensible decision, as it is a natural extension of the existing business. Potential applications include irrigation systems and marine aquaculture. Lesso is also expanding its overseas business as it is building a new production base in Indonesia and is planning another for Cambodia.

Yuhong is a manufacturer of waterproofing materials. Like Lesso, it has also benefited from positive earnings revisions and a valuation rerating. Water leakages remain a significant problem in China and building standards should become stricter over time, entrenching Yuhong's strong position.

CSPC Pharmaceutical reported good first quarter results. The company's largest product, NBP which is used to treat strokes, faced significant price cuts to remain on the national reimbursement list. But volume growth has been rapid in the two months after the price cut and there is a chance that sales could be flat in the first year, which would be a good outcome. Looking at the rest of the business, there are signs that CSPC has the ability to find new growth drivers. It recently won approval to sell Amphotericin B, an anti-fungal generic drug, which could be a decent contributor to earnings in the future. CSPC also signed a deal with KeyMed Bioscience to sell CM310, which is used to treat respiratory illnesses like asthma. Overall, for a growing business, we think the valuation for the company is very undemanding.

New Oriental Education was the weakest stock in the portfolio and was sold for reasons explained in the next section.

Autohome is China's largest online platform for car dealerships. The stock was very strong in the rally in the beginning of the year but has since been one of the weaker positions in the portfolio. New car sales growth slowed from 69% in the first quarter, to 12% in April and then turned negative in May. Management attribute this to delays in supply arising from the broader chip shortage. Whether looking at trailing or forward-looking price/earnings ratios, the stock is trading at its lowest valuation since 2016. We think the valuation is too low for a growing, high return on capital business.

Other weaker stocks were **Ping An Insurance**, **Supor** and **Yili**. Earnings revisions for all three have broadly been flat this year and so they have suffered from valuation deratings. But overall, we do not think the investment case for any of the three has changed. All three managed to increase their asset base in 2020 while doing so at a high return on capital, which is value accretive.

Stock Switches

Anhui Conch Cement was sold as it is difficult to argue, with confidence, that earnings will meaningfully increase in the medium term. The long-term growth driver for the cement industry is ultimately driven by real estate and infrastructure and at least in the case of infrastructure, there are better names available such as Yuhong which is held in the fund. Conch Cement is a consolidator but is ultimately a price taker in the cement industry, and so has limited pricing power.

We sold **Shenzhen Expressway** as it was also difficult to identify the long-term structural growth drivers for the business. The company runs toll roads with revenue concentrated in Shenzhen and the broader Guangdong province. Though margins are relatively high, the business is very capital intensive and so asset turnover is low, resulting in a low overall return on capital.

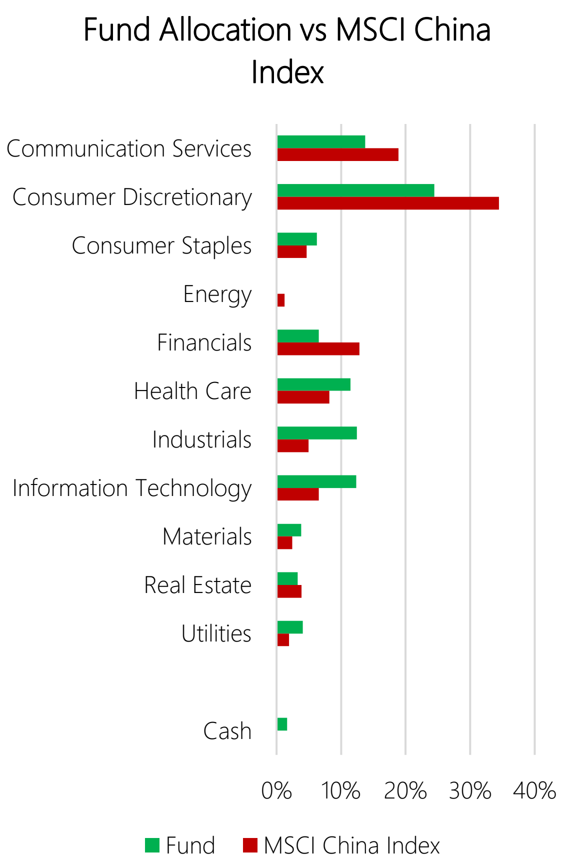
New Oriental Education was sold after it became much likelier that the government would ban weekend and holiday tuition. These periods are significant revenue contributors, and we think that if the ban is to come into effect, there is only so much the company can do. In our view, a limited number of classes can be shifted to weekdays, but the government seems intent on reducing students' workload. Earnings growth over the next few years seemed unlikely and so the position was sold.

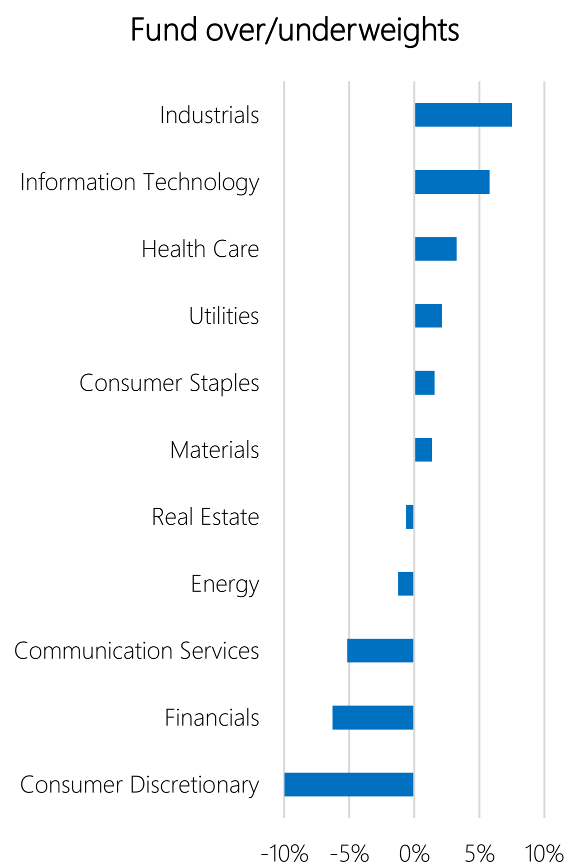
We bought **Xinyi Solar**, which is the world's largest manufacturer of solar glass and so through its economies of scale, benefits as the low-cost producer in the industry. However, its competitive advantage is not solely a function of its scale. The quality of Xinyi's glass is high relative to its peers, so the company is well trusted by its clients. This is very important given the rising popularity of bifacial panels which need thinner and so more durable glass. Tighter emissions standards also raise the cost of production, as well as the barriers to entry, protecting incumbents such as Xinyi. We believe that the company can grow earnings by enough to offset mean reversion in the valuation multiple. Policymakers in all major regions around the world are aiming to significantly increase investment into renewable energy sources which should bode well for Xinyi.

We bought **Fuling Zhacai**, a condiment company focused on the production of zhacai and paocai. Zhacai is made using mustard roots and is commonly eaten with rice and buns. Fuling Zhacai has a long history of manufacturing zhacai and has a market share of 36%. 28% of sales are from the South where the company is based, but there is an even split between the other major regions of China. Fuling Zhacai has been able to pass on cost increases to its customers which is a strong indicator of its pricing power, allowing the company to earn a high return on capital over time.

Portfolio Position

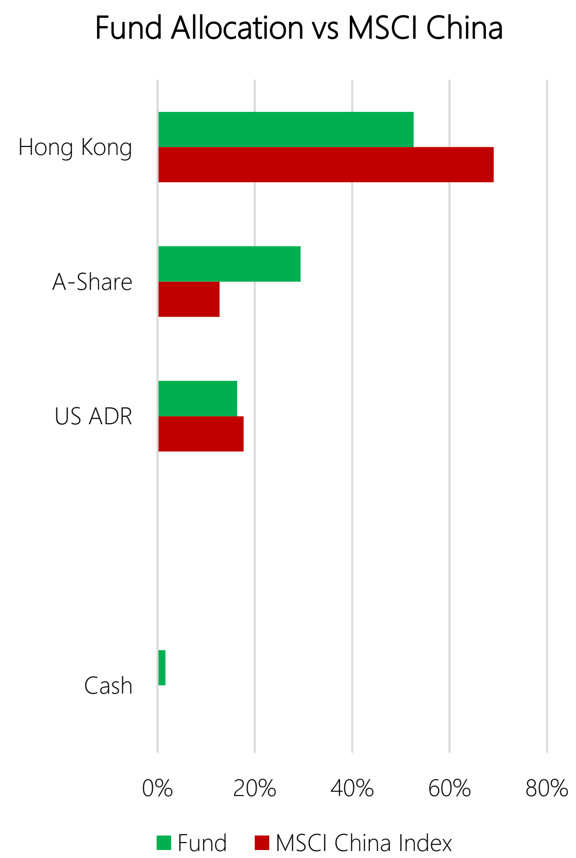
On a sector basis, the Fund's largest exposures are to Consumer Discretionary, Communication Services and Industrials. Relative to MSCI China, the Fund is overweight in Industrials and Information Technology, and underweight in Consumer Discretionary, Financials and Communication Services.

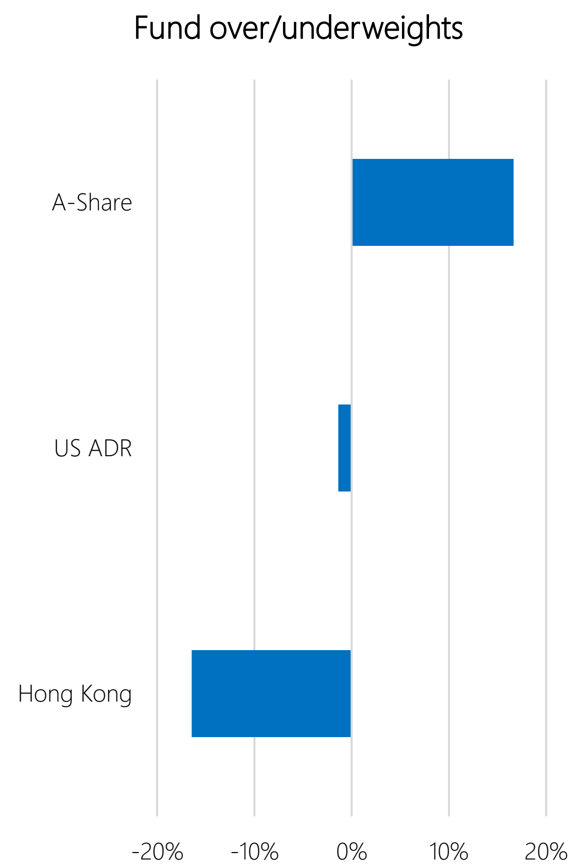




Source: Guinness Atkinson Asset Management, Bloomberg. As of 06/30/21.

On a listing basis, the Fund's largest exposures are to Hong Kong (53%), the domestic A share market (29%) and US ADRs (16%).





Source: Guinness Atkinson Asset Management, Bloomberg. As of 06/30/21.

Outlook

We believe the Fund's equally weighted approach should help limit stock specific risk. This is important given the government's increased attention towards online technology companies' operations. Earlier in the year, Alibaba was fined $2.8bn for promoting "forced exclusivity", which meant vendors on its platform could not sell their goods on other platforms. More generally, the government has been tightening up antitrust measures, which is an important issue globally. In July, Didi, which acquired Uber's China operations, had its app removed from the various app stores days after it listed in the US. The justification from the government was that Didi did not have sufficient control over the personal information of its users. The government is likely concerned about potentially sensitive information flowing through to foreign entities, as Didi is listed in the US. We may be entering a phase where regulations mean the internet tech companies' growth rates significantly slow down.

We argue that the Fund has diversified exposure to the various, long-term structural growth themes present in China. The online technology stocks come under the theme Next Gen consumer, which only accounts for 16% of the Fund. This means 84% of the Fund has exposure to other themes, such as the Rise of the Middle Class, encapsulating Home Improvements, Urbanization, Beverages, Leisure and Food. Another theme is Sustainability, encapsulating Electric Vehicles, Energy Transition and Waste Reduction. Unlike the benchmark, the Fund is not dominated by online technology companies.

In our view, China remains committed to developing and modernizing its economy around consumption and key pillars of industry. Some of these pillars include robotics, electric vehicles, power equipment and medical devices. Even though technology businesses are being forced to adapt to new rules, we still expect them to play a significant role in helping China achieve its goals. The digital economy accounts for 40% of China's GDP according to economists from Goldman Sachs, while China Tech/Internet stocks also account for 40% of the region's market capitalization. This highlights the important role these companies play.

In this evolving environment, our equally weighted approach to portfolio construction helps us deliver meaningful exposure to the online tech stocks but also helps us limit stock specific risk. This stock specific risk is clearly evident in the dominance of a small number of technology stocks in the benchmark index.

Edmund Harriss (portfolio manager)

Sharukh Malik (portfolio manager)

Performance

In the second quarter, the Guinness Atkinson China & Hong Kong Fund fell 1.2% while the Hang Seng Composite Index rose 2.7% and the MSCI China Net Total Return (NTR) Index rose 2.3%.

In the first six months of the year, the Guinness Atkinson China & Hong Kong Fund rose 4.4% while the Hang Seng Composite Index rose 6.3% and the MSCI China Net Total Return (NTR) Index rose 1.8%.

Relative to MSCI China, year-to-date, the biggest contributors to performance to outperformance were:

- Healthcare: driven by both the overweight to the sector as well as stronger than sector performance from China Medical System and CSPC Pharmaceutical.
- Industrials: primarily driven by the overweight to the sector. We saw good performance from China Lesso while Sany Heavy Industry was weak.
- Materials: driven by performance from Yuhong which was the third strongest stock in the portfolio.

As of 06/30/2021	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**4.40%**	**32.00%**	**8.50%**	**14.76%**	**4.74%**
Hang Seng Composite Index TR	**6.33%**	**29.76%**	**7.84%**	**13.24%**	**6.95%**
MSCI China Net Total Return Index	**1.83%**	**27.39%**	**10.34%**	**16.58%**	**7.70%**

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

Expense Ratio: 1.60%

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.

Price-Earnings (P/E) ratio is a valuation ratio of a company's current share price compared to its per-share earnings. Forward earnings differ from trailing earnings, which is the figure quoted more often, as they are a projection and not a fact.

Active Share is the percentage of portfolio holdings in a Fund that differs from the benchmark index.

A cash flow return on investment (CFROI) is a valuation metric that acts as a proxy for a company's economic return.

Return on Equity (ROE) is calculated as net income divided by equity.

Net debt/equity is calculated as (debt – cash and cash equivalents) / equity.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock.

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.

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 06/30/2021:

1.	Wuxi Lead Intelligent Equipment Co Ltd	4.65%
2.	Xinyi Solar Holdings Ltd	4.30%
3.	China Medical System Holdings Ltd	4.27%
4.	NetEase Inc - ADR	4.07%
5.	China Resources Gas Group Ltd	4.05%
6.	China Merchants Bank Co Ltd - H Shares	4.03%
7.	CSPC Pharmaceutical Group Ltd	4.02%
8.	China Lesso Group Holdings Ltd	3.87%
9.	Beijing Oriental Yuhong	3.81%
10.	Geely Automobile Holdings Ltd	3.60%

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

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