GUINNESS ATKINSON FUNDS

Inflation Managed Dividends *brief*

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Commentary and Review by co-portfolio managers Dr. Ian Mortimer, CFA and Matthew Page, CFA

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Manager's Review

This was the second month in a row where we saw strong performance in global equities. Historically the Inflation Managed Dividend Fund has tended to lag in sharp rallies and outperform in sharp down periods. However, so far this year we have seen two months of strong performance for global equities, and rather than underperform the MSCI World Index during this period, the fund has actually kept up with the index. So why have we kept up with the index during the sharp rally at the beginning of this year?

A key contributor is the fact that we have seen strong performance in one of the companies we bought in October. H&R Block is a mid cap ($6.8 billion dollar market cap) so at the smaller end of the market cap spectrum of our investable universe. Its core business is filing tax returns and one in six Americans use their service. Given the need to file a tax return annually we like the steady recurring nature of the company's revenues. Their main competition is mom and pop accountants and their scale gives them pricing power, brand awareness, ease of access, sophisticated software, etc. We like companies that have a diversified rather than concentrated customer base. A business that has 20 million customers each spending $100 every year is more attractive to us than a business that has 100 customers each spending $20 million, and far more attractive than a company with 2 customers each spending $1 billion.

We had sold our position in Pepsi in order to buy H&R Block. Pepsi was trading on 18x projected earnings which made it one of our more expensive holdings, analysts were reducing their earnings estimates, the company had taken on more debt, and while the company remains suitably robust, we couldn't justify continuing to own it when we saw H&R Block trading on 10x earnings, 4.5% dividend yield, and a recent debt refinancing strengthening their balance sheet. The contrarian in us liked that the company was not well covered by the analyst community, (only three analysts were covering the company) and unloved due the threat of tax simplification in any potential budget deal resulting in to avoid the fiscal cliff.

We thought this company had the potential to double in value if we held it for 3-5 years. In fact we have seen strong performance quite quickly. Since we bought the stock it has produced a total return of approximately 48% (in USD), with 34% total return year to date, a useful start to the year.
While our investment process is not thematically driven, one theme which we find interesting is the media/analysts love of using the world cliff, i.e. patent cliff, fiscal cliff. It's a rather emotive word and it potentially creates some attractive buying opportunities if everyone gets scared away from stocks associated with the idea. The idea behind patent cliffs is that pharmaceutical companies were all going to suffer because all their blockbuster drugs were going to come off patent. This would allow other companies to start producing the generic equivalents at lower cost, and the company holding the original patent would no longer be able to maintain their premium pricing, meaning their margins would erode over time.

Many of these companies were really beaten up a couple of years ago and valuations started to look really attractive as the market continued to extrapolate further bad news. We bought a number of Pharma companies back in 2011 when they were beaten up as we felt the valuations had all this bad news baked in and concern had gone too far. In reality the "cliffs" associated with patents when considered at the company level are more like very gentle downward slopes over a prolonged period of time. Large, high quality companies often seem to find a way to deal with these issues. It might take years for any strategies to have any effect but if your holding period is long enough and you buy at the right valuation you could make decent returns. We are no experts on analysing the potential for new drugs, so we aren't going to add any value by trying to understand whether drugs in the development cycle are going to be successful or not. We simply saw these stocks as unloved, beaten up, cheap in absolute terms, and cheap relative to their own valuation histories, and they have performed well over the last couple of years.

At the end of last year everyone was and generally still remains particularly worried about the US fiscal cliff. The issue of the fiscal cliff has been looming for years but the failure of policymakers in the US to avert the automatic budget cuts has brought it into the spotlight. The market is concerned that US government spending on defense is going to be significantly reduced and this is going to have a meaningful effect on the revenues and margins of defense companies. As a consequence defense stocks are now looking cheap on our screens and consequently we are looking at them quite closely. A number of companies in the sector are now looking particularly cheap relative to the range of valuations at which they have traded historically, and relative to other companies in our investable universe, suggesting perhaps this negative sentiment has gone too far and this may provide an opportune entry point.

For the period ending 2/28/13 the Guinness Atkinson Inflation Managed Dividend Fund delivered a one-month total return of 4.78% and a 4.77% total return year to date (YTD). As of 12/31/12, the fund since inception (3/31/12) has returned 4.89%, and as of 02/28/13 the fund since inception has returned 9.89%. Expense Ratio for the Fund is 0.92% (gross), 0.68% (net).

For the period ending 2/28/13 the MSCI World Index delivered a one-month total return of 4.78% and 5.37% total return YTD. As of 12/31/12, the Index since 3/31/12 has returned 4.38%, and as of 02/28/13, the MSCI World Index has returned 9.98% since 3/31/12.

Performance data quoted represent past performance and 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. For most recent month-end and quarter-end performance, visit www.gafunds.com/performance.asp or call (800) 915-6566.

The Fund imposes a 2% redemption fee on shares held for less than 30 days. Performance data does not reflect the redemption fee and, if deducted, the fee would reduce the performance noted.

The Advisor has contractually agreed to reduce its fees and/or pay Fund expenses (excluding Acquired Fund Fees and Expenses, interest, taxes, dividends on short positions and extraordinary expenses) in order to limit the Fund's Total Annual Operating Expenses to 0.68% through March 31, 2015.

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

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

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. These risks are greater for emerging markets countries. The Fund also invests in smaller companies, which will involve additional risks such as limited liquidity and greater volatility. The Fund may invest in derivatives which involves risks different from, and in certain cases, greater than the risks presented by traditional investments.

For a list of current holdings, click here. Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

Diversification does not assure a profit nor protect against loss in a declining market

The MSCI World Index (MXWO) is a capitalization weighted index that monitors the performance of stocks from around the world.

You cannot invest directly in an index.

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