GUINNESS ATKINSON FUNDS

Asia brief


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Commentary and Review by Portfolio Manager Edmund Harriss & Analyst Mark Hammonds

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Asian equity markets had mixed performance in 2014. After a weak start to the year, markets rallied up to the beginning of September, whereupon they promptly reversed and gave up most of the year's gains. Among the markets in our investment universe, Indonesia, Philippines and Thailand were the strongest performers in 2014, while South Korea, Malaysia and Japan were the weakest. Significant falls in the oil price and weak economic data from Europe led to increased equity market volatility in the latter part of the year. However, we believe that the region has excellent opportunities for economic growth, and for investors with a long-term horizon that are prepared to 'ride-out' short-term volatility, the area offers attractive opportunities for investment.

In this month's update, we review the case for investing in Asia, review performance for last year, and look at how the portfolio is positioned at the end of December.

1. Investing in Asia

One of the main reasons often cited for investing in the Asia Pacific region is the favorable outlook for economic growth. The following table shows consensus estimates for real gross domestic product (GDP) growth in selected countries:

Real GDP growth (% year-on-year)		
	2014E	2015E
US	2.2	3.0
Euro	0.8	1.5
Japan	1.0	1.2
Australia	3.0	3.0
New Zealand	3.5	2.9
China	7.3	7.2
Hong Kong	2.5	3.5
Indonesia	5.2	5.6
Korea	3.6	3.8
Malaysia	5.7	5.2
Philippines	6.3	6.5
Singapore	3.3	3.7
Taiwan	3.6	3.6
Thailand	1.5	4.1

Source: JP Morgan

As the forecasts show, China, Indonesia, Malaysia and the Philippines are all expected to grow at more than 5% in 2015. While we do not rely on macroeconomic forecasts such as these, which often turn out to be inaccurate, they do provide an indication of the magnitude of expected growth; for developing countries in the region, a 5% growth rate is attractive on both an absolute basis and a relative basis, when compared with US, Europe and Japan. Furthermore, we believe that many of the developing countries in the Asia Pacific region will experience favorable medium and long term economic growth, as they continue to develop.

Other emerging markets around the world also have favorable growth rates, so it is worth considering why we believe these countries are not as attractive. Many emerging market countries have built their economies around the production of commodities, and those economies can face difficulties when the price of those commodities falls. Two of the countries in the 'BRICs' acronym (Brazil, Russia, India & China), Brazil and Russia, illustrate this danger; Russia in particular has faced difficulties from a falling crude price (now down over 50% from its 2014 high). Russia's problems have also been compounded by international sanctions following its annexation of Ukraine. As a result of these events, the Russian rouble has fallen sharply in recent months.

Many of the countries in the Asia Pacific region, on the other hand, have been able to diversify their economies away from commodity production and related industries. For example, China and Taiwan have developed specialties in technology manufacturing that are unmatched (or at least are uncompetitive) elsewhere in the world. Rather than produce goods that can be supplied by a number of countries, e.g. commodities, the production of goods that have no straightforward substitute from other countries can strengthen an individual economy (assuming, of course, that those products remain in demand).

Economic growth rates are an important factor in investing over the long term, as they contribute to the revenue and earnings growth of companies; however, they do not automatically translate into investment performance. This has typically resulted in investors anticipating strong growth and bidding up the valuations of related companies in advance. We instead take a predominantly bottom-up approach to investing, and while we are mindful of macro factors that can affect an investment, we focus mainly on analysis of individual companies' fundamentals and valuations.

The following table shows the differences in valuations between the regions, aggregated at a country level:

	P/E ratio		Earnings growth (%)	
	2014E	2015E	2014E	2015E
Global*	16.2	14.9	4.6	8.5
US	17.7	16.4	5.2	7.8
Europe	15.3	14.0	2.7	9.2
Asia Pacific	14.1	13.1	10.8	7.4
Japan	15.6	14.0	74.4	8.7
Australia	15.0	15.1	2.3	-0.5
China	10.4	9.4	7.6	9.9
Hong Kong	14.8	14.2	9.1	4.0
Indonesia	15.9	14.3	10.5	10.7
Korea	11.5	9.4	0.6	22.9
Malaysia	15.9	14.9	-1.0	6.1
Philippines	21.5	19.0	5.8	13.2
Singapore	14.3	13.9	9.3	2.4
Taiwan	13.8	12.8	26.1	7.9
Thailand	14.5	13.1	8.4	11.0

Source: I/B/E/S, MSCI, J.P. Morgan estimates.
* MSCI AC World Local Index

While there is a general trend for forecasted economic growth to translate into expected earnings growth that attracts a higher valuation, there are disparities in the data. China is the most notable: the country's economy is expected to grow at around 7-7.5% over the next two years, and earnings are expected to grow by a similar magnitude, but the country's forecast 2015 P/E ratio is only 9.4. Although this inconsistency is partly due to the underlying spread of industries (some sectors are on much higher multiples), we believe that it is in part simply undervaluation. We therefore think that China represents an attractive opportunity for investment, and correspondingly the portfolio has significant exposure.

We have written before about the importance of dividends as part of our investment process. Reinvested dividends can make a significant contribution to total return over the long term, and can provide an element of downside risk mitigation (provided dividend payments are sustainable). Management of Asian companies are increasingly recognizing the attraction of dividends to investors, and as companies mature, have become more willing to provide a regular payment. When considering whether to invest in a company, we consider not only the magnitude and sustainability of dividend payments, but also the potential to grow that dividend. We believe that Asian companies can provide a good balance between paying out dividends at a decent level, and being able to achieve satisfactory dividend growth over the long term.

2. Performance

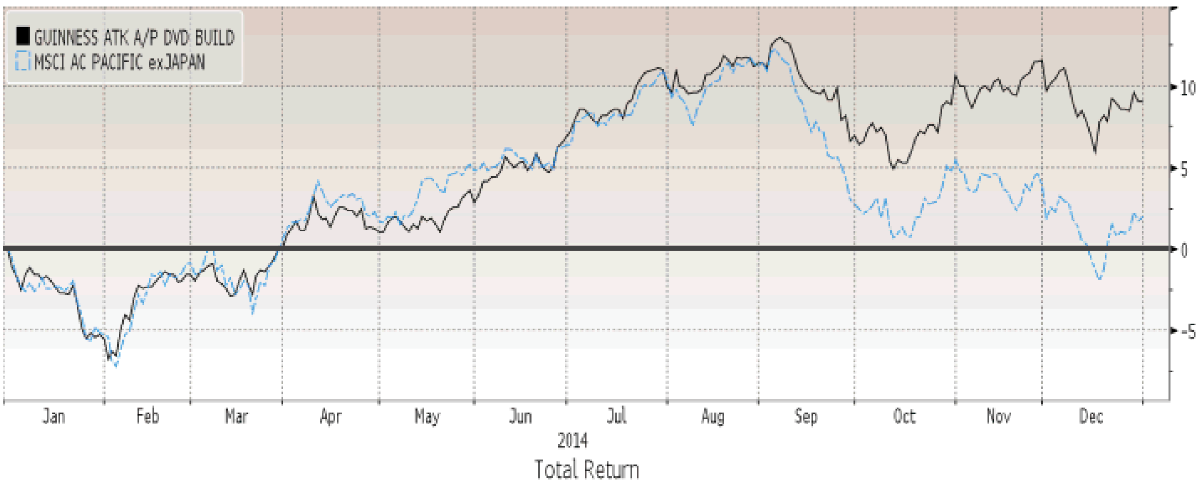
Total Returns (in USD) As of 12/31/14	1 year (Actual)	3 year (Annualized)	5 year (Annualized)	Since launch 3/31/06 (Annualized)
Asia Pacific Dividend Builder Fund	9.03%	9.63%	6.98%	5.19%
Benchmark Index:				
MSCI AC Pacific ex Japan	1.96%	9.46%	6.28%	7.99%

Source: Bloomberg
Expense Ratio: Gross 3.56%; Net 1.98%*

*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 1.98% through June 30, 2015. To the extent that the Advisor waives its fees and/or absorbs expenses to satisfy this cap, it may seek repayment of a portion or all of such amounts at any time within three fiscal years after the fiscal year in which such amounts were waived or absorbed, subject to the 1.98% expense cap.

Performance data quoted represents 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. Performance data current to the most recent month end may be obtained by calling 800-915-6566 and/or visiting www.gafunds.com. Current performance of the Funds may be lower or higher than the performance quoted. Total returns reflect a fee waiver in effect and in the absence of this waiver, the total returns would be lower. 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 quoted.

The fund returned 9.03% in 2014: the first full calendar year since the adoption of our revised investment process at the end of 2013. The benchmark index, MSCI AC Pacific ex Japan, returned 1.96% over the same period, meaning the fund outperformed by 7.07%. Most of this outperformance came from September onwards, as Asian equities fell. The following chart shows this outperformance:



Source: Bloomberg

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

We believe that the fund's exposure to defensive, dividend-paying companies can provide some degree of downside risk mitigation, and we are pleased that this characteristic has been borne out by performance in recent months.

Among the countries in our investment universe, Indonesia, Philippines and Thailand were the strongest performers in 2014, returning 27.53%, 26.42% and 16.95% respectively. South Korea, Malaysia and Japan were the weakest markets, returning -12.39%, -10.63% and -3.37% respectively. (per MSCI Indonesia, Philippines, Thailand, South Korea, Malaysia and Japan country indices total returns, in USD terms)

3. Portfolio Position

The following table shows the country weightings of the fund at the end of December 2014:

Geographic Weight (as of 12/31/14)	Fund
Australia	10.52%
China	12.41%
Hong Kong	32.57%
Indonesia	0.00%
Japan	3.01%
Korea	2.30%
Malaysia	2.81%
New Zealand	0.00%
Philippines	0.00%
Singapore	8.26%
Taiwan	16.22%
Thailand	7.77%
US	2.99%
Cash	1.13%
Total	100.0%

Source: Guinness Atkinson Asset Management

As the table shows, our largest country exposures were to Hong Kong (32.57%), Taiwan (16.22%), China (12.41%) and Australia (10.52%). We generally find that these markets offer a combination of: sufficient number of companies for inclusion in our universe, and favorable fundamental and valuation characteristics. In other countries, for example Indonesia and Philippines, we often find that the companies which meet our screening criteria have valuations that are not sufficiently attractive.

The following table shows the fund's sector weightings:

Sector Weight (as of 12/31/14)	Fund
Consumer Discretionary	18.62%
Consumer Staples	2.30%
Energy	5.20%
Financials	32.24%
Health Care	5.12%
Industrials	2.81%
Information Technology	21.86%
Materials	2.62%
Telecommunication Services	8.10%
Utilities	0.00%
Cash	1.13%
Total	100.0%

Source: Guinness Atkinson Asset Management

The fund's largest sector exposures are to Financials (32.24%), Information Technology (21.86%) and Consumer Discretionary (18.62%). Again we find that these categories are well-represented in our investment universe, and provide attractive valuations. We note that some sectors, for example, Materials, Energy and Utilities have historically had low representation in our universe – materials and energy are highly cyclical industries, while utility companies are often heavily regulated, and achieve lower returns.

4. Outlook

The falls in the oil price towards the end of 2014, which have continued in early 2015, have dominated events in financial markets. Brent crude has fallen from $115 in June 2014 to around $45 at time of writing. Along with these price movements, European economic data has been weak, with deflation again concerning investors. Against this macro backdrop, equity markets have been volatile, and Asia Pacific markets have been no exception.

However, despite short-term market volatility, we think that the Asian Pacific region offers investors excellent long-term prospects. The region has, and can continue to benefit from, favorable demographic characteristics and rising levels of personal wealth. Developing Asian economies are increasingly switching from being driven by investment to becoming more consumption-led. We believe this trend can result in favorable economic growth and attractive investment returns.

We think that the Guinness Atkinson Asia Pacific Dividend Fund stands to benefit from economic growth in the region, while at the same time providing investors with a satisfactory source of income.

Commentary for our views on Global Equity Income, Innovation, 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. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. These risks are greater in emerging markets. 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.

The MSCI China Index is a free-float adjusted market capitalization weighted index that is designed to measure equity market performance of Chinese stocks available into international investors traded in China and Hong Kong. The Index is made up of Chinese stocks listing in Hong Kong and in the B share markets in Shanghai and Shenzhen.

MSCI Indonesia Index is a free-float adjusted market capitalization weighted index designed to track the performance of Indonesian securities listed on the Indonesia Stock Exchange (IDX).

MSCI Philippines Index is a free-float adjusted market capitalization weighted index designed to track the performance of Philippine securities listed on the Philippine Stock Exchange.

MSCI Thailand Index is a free float-adjusted market capitalization weighted index designed to track the performance of Thai securities listed on the Stock Exchange of Thailand and the Market for Alternative Investments.

MSCI Korea Index is designed to measure the performance of the large and mid cap segments of the South Korean market and covers about 85% of the Korean equity universe.

MSCI Malaysia Index is designed to measure the performance of the large and mid cap segments of the Malaysian market and covers about 85% of the Malaysian equity universe.

MSCI Japanese Index is a free float-adjusted, capitalization-weighted index designed to track the performance of Indonesian securities listed on the Indonesia Stock Exchange (IDX).

MSCI AC World Local Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world.

It is not possible to invest in an index.

The Price to Earnings multiple reflects the multiple of earnings at which a stock or group of stocks in an index, sells. It is equal to the market capitalization of a stock, or group of stocks in an index, divided by the after tax earnings for that stock or index.

Earnings growth is the annual rate of growth of earnings from investments.

Earnings growth is not representative of the Fund's future performance.

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

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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