Guinness Atkinson
Asia Pacific Dividend Builder Fund
Managers Monthly Update – April 2017

GUINNESS ATKINSON FUNDS

Summary Review & Outlook

1Q17 Review

- The Fund rose more than we would normally expect in such strong markets rising 11.76% compared to the MSCI AC Pacific ex Japan Index (the Index) which rose 12.55%. This represents over 93% upside capture when in strong markets we would normally expect 75%-85% upside capture, on average.
- Closer analysis shows the greatest market strength was in January when the Index rose 5.92% and the Fund captured 75% of that which is in line with expectations. In February and March, the Index rose less sharply 3.30% and 2.87% and the Fund outperformed by 0.80%.
- Leading stocks in January were technology names, Chinese retail and banks in China, Hong Kong, Singapore and Thailand. Subsequently, we saw stronger individual stock moves post-results which drove outperformance, notably Yangzijiang Shipbuilding and Catcher Technology.
- Overall, Asian markets outperformed developed markets as measured by MSCI World Index in each of the first three months of the year; this rally reverses much of the underperformance in 4Q16 and over 6 months Asian and Developed markets have performed in line.
- Factors driving this recovery in our opinion, include:
    - Improved profitability in Chinese heavy industry and return of producer price inflation to positive territory after 4 ½ years;
    - a recovery in commodities prices;
    - improving asset quality in China's banking sector;
    - reduced political risk associated with future US policies on trade;
    - upward revisions to earnings estimates post-results.

Fund performance

as of 3/31/17	YTD	1 YR	3 YR	5 YR	10 YR
Asia Pacific Dividend Builder Fund	11.76%	17.83%	8.14%	6.34%	4.71%
MSCI AC Pacific ex Japan	12.55%	18.80%	3.97%	5.35%	5.37%

All returns over 1 year annualized. *Source: Bloomberg, Guinness Atkinson Asset Management*
Expense Ratio: 1.10% (net)*; 3.87% (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 noted. Total returns reflect a fee waiver in effect and in the absence of this waiver, total returns would be lower. * 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) to limit the Fund's Total Annual Operating Expenses to 1.10% through June 30, 2018. 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 1.10% expense cap.

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Outlook

- Asian markets still look cheap after this rally trading at a 29% discount on a PE basis to the world and with the Fund trading at further 11% discount to that we think there is real value to be had.
- US relations with China, surely the most important bilateral relationship in the world today, looks to be much more constructive than many feared.
- We expect China's current economic strength and the recently improved profitability of its heavy industrial sector will provide room for China to intensify efforts to resolve its structural issues of debt and excess capacity. Thus, we do not expect growth to accelerate further and in fact it may slow from here.
- The recent results season has prompted analysts to upgrade profit forecasts more broadly across countries in Asia and across sectors. This could provide extra confidence to those looking to allocate more money into the region.
- The latest news from the region centers on North Korea. There are no ready answers but it any solution must involve both of the US and China working together. Beneath the public positions of these two, it appears that both are working closely together following the timely President Trump-President Xi Jinping summit meeting in Florida.

In more detail

Markets

While writers in the likes of the Wall Street Journal and Financial Times continue to focus on the challenges China faces to achieve economic reform, markets appear now to be focusing on more positive developments. In the 12 months to March 31, MSCI China has outperformed Asia Pacific, Emerging Markets and the S&P 500. Consensus profit estimates are forecasting earnings growth of more than 13% and a forward Price/Earnings (P/E) multiple of 11.1 times.

Improved profitability amongst China's heavy industrial companies which began last year is an important reason. A recovery in commodity prices combined with a revival of investment spending in China saw a jump in profits and cash flows. The benefits have spilt over into the banking sector whose most indebted customers have now seen their debt servicing capacity improve and consequently we have seen the banks report slower non-performing loan formation. Earlier estimates of hidden non-performing loans in the system have been scaled back. A recovery in the value of the renminbi this year (up 0.8% against the dollar) from its recent lows at the end of 2016 and by a continued rally in prices of Chinese stocks traded in Hong Kong have added to the optimism.

At the same time, the central bank has been active in managing domestic liquidity through open market operations and has not been afraid to tighten to push forward its de-leveraging agenda. Interest rates in the interbank market have gone up twice this year and liquidity provision has been reduced in recent weeks, all designed to encourage greater prudence. The bank regulator has signalled its intent to tighten up its regular macro-prudential assessment of banks' capital adequacy by including new categories of credit including wealth management products. This will require banks to set aside more capital and thus should act as a restraint on shadow-banking activity. Another area of focus is the housing market where big price rises in the largest cities have caused concern.

Singapore and South Korea also outperformed during the quarter. In Singapore, strong economic growth driven by manufacturing was behind a strong rise in January which carried on into February with upward revisions to 4Q16 GDP growth providing extra impetus. In South Korea, the impeachment of President Park ended a political crisis that has engulfed the country. At the same time, a strong rebound in technology has produced some of Asia largest upgrades to profit forecasts and stock prices followed. In both countries, stronger stock prices in local currency terms have been given a further lift by a stronger exchange rate against the dollar. The leading sectors in the quarter were technology, health care, consumer discretionary and real estate followed by financials. Technology has been the best performing sector this year across developed and emerging market regions with smartphones, memory chips and displays all doing well. Samsung Electronics is investing heavily in new memory chip production capacity and Toshiba is also receiving strong interest for its memory business.

Portfolio news

Yangzijiang Shipbuilding rose 43% after quite a long period of rather more moderate performance. Its results were better than the market had expected and so the deep discount on its share price narrowed. We hold this stock because it has achieved returns above the average cost of capital and this set of results sustains that level. We had been rebalancing into the stock during its prior weakness and so have reaped the full benefit of this recovery allowing us then to rebalance away following the rally. We are now at equal-weight. Half of the top ten performers in the quarter were technology names. Catcher, AAC Technology and Largan Precision are associated with smartphones while Asustek is a PC/tablet producer and Novatek is a chip designer for high definition displays. However, the performance was not just limited to our technology allocation. In addition to Yangzijiang, we also have Tisco Financial (auto financing in Thailand) Luk Fook (China/HK jewellery retail), China Lilang (men's apparel) and Ascendas REIT (industrial property in Singapore) in the mix.

On the weak side, we have Qualcomm (-11%) which is presently facing legal issues from both the Federal Communications Commission (FCC) and from Apple against the perceived unfairness of its licensing model. Nevertheless, it is still a leading chip designer for smartphones and has agreements with all the major Chinese smartphone manufacturers. We have been adding to the position on weakness. JB Hi-Fi is an Australian discount retailer of electrical goods. The 12% underperformance during the quarter follows a 50% rise in 2016, well ahead of the 7.5% rise of broad market. Hanon Systems is a Korean company specialising in climate control systems for the auto sector for both combustion engine and electric vehicles where the temperature control is linked to greater fuel efficiency/battery life. The company is well managed, is diversifying its customer base and has moved to paying a quarterly dividend which itself is unusual for a Korean company. Li & Fung has disappointed for a while. The factory agency business operates with very fine margins and the volumes that Li & Fung needs to put through have remained elusive while global trade growth has been weak. The fifth weakest stock was China Minsheng Bank. It is the weakest of the banks we hold with a greater reliance on wholesale funding, a greater exposure to small and medium-sized companies and is more levered than the group. This is one we are watching closely.

Outlook

Asian markets still look cheap after this rally trading at a 29% PE discount to the world and with the Fund trading at further 11% discount to that we think there is real value to be had. The portfolio offers earnings growth of 6% this year and 8% next year which is not in itself especially eye-catching but the opportunity we believe comes in the higher predictability and stability of that earnings profile which we see as undervalued by the market. Higher earnings growth is available in basic materials and energy which are recovering from lows on the back of a 'reflation trade' which itself is far from certain, in our view.

The arguments supporting Asia are to some in part external, where the US looks expensive and where many are still overweight, and in part internal, where a cyclical recovery in China is now prompting a re-appraisal of the region. In this respect, a recovery in earnings revisions across Korea, China, Thailand and Indonesia as well as across Energy, Materials, Industrials, Consumer Discretionary and Technology all helps. The bulk of revisions are concentrated in Korea and China and in Energy in Materials. Revisions in the rest are more modest, but they are evident.

From our perspective, the reflation story in Asia is one we welcome because it is positive for sentiment and reduces risk premia, allowing for multiple expansion. However, it is not a story we would look to invest in. Improved profitability, cash flows and asset quality in China will likely lead to an intensification of economic re-balancing efforts. Higher pre-provision operating profit for banks will result in more aggressive charge-offs of non-performing loans: good for the economy as a whole but not the fuel for a further rerating of bank shares, for example, which are already up over 40% from their lows. Reflation stories are not just confined to China. Malaysia, Taiwan and Thailand are all embarking on domestic spending programmes.

There are risks all around to this outlook: political risks, US valuation risk, interest rate risk, currency risks, European electoral risks – just about anything you can think of these days. However some of these are subsiding. The recent Sino-US summit was far removed from President Trump's earlier rhetoric. Trade intervention either in the form of border adjustment taxes or imposition of tariffs looks more remote (but has not gone away). Following the Dutch elections, Marine Le Pen in France does not seem to be reaching out beyond her core supporter base. Our focus however, remains on companies that have operated and flourished (in terms of returns on capital over time) in this higher growth region but are not dependent upon that growth.

Edmund Harriss (portfolio manager)
Mark Hammonds & Sharukh Malik (analysts)

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 an investments diversified among various sectors.

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

MSCI AC Pacific Ex-Japan Index is a market capitalization weighted index that monitors the performance of stocks from the Pacific regions, excluding Japan. (You cannot invest directly in an Index.)

The MSCI China Index captures large and mid cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 150 constituents, the index covers about 85% of this China equity universe.

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

Past performance is not indicative of future results.

Top Fund Holdings as of 03/31/17

1	Largan Precision Co Ltd	3.10%
2	DBS Group Holdings	3.05%
3	Delta Electronics Thailand PCL /Foreign	2.95%
4	Ascendas Real Estate Investment Trust	2.95%
5	St Shine Optical Co Ltd	2.90%
6	JB Hi-Fi Ltd	2.87%
7	Sonic Healthcare Ltd	2.85%
8	Luk Fook Holdings International Ltd	2.84%
9	Henderson Group PLC	2.84%
10	Catcher Technology Co Ltd	2.83%

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

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