Guinness Atkinson

Asia Pacific Dividend Builder Fund

Managers Monthly Update – September 2017

Fund & Market

- The Fund performed strongly in August and was ahead of the MSCI AC Pacific ex Japan Index by 3.46%.
- Thailand was up 4.64% in dollar terms (as measured by the MSCI country index) and led the region higher along with China, Hong Kong and Taiwan. South Korea and Southeast Asia were notably weaker. Among the sectors, it was Materials, Energy and Consumer Staples which were the strongest. While these are areas to which the Fund has minimal exposure, this did not hold back Fund performance.
- Market forecasts for company profits were 1% higher in August and have been revised upwards by 3% since June. The biggest earnings upgrades in the region have been seen in China while India has seen profit expectations downgraded by 3%. From a sector perspective, analysts appear to be turning significantly more positive on energy, real estate and materials.

Events in August

- North Korea dominated the headlines with the imposition of sanctions by the United Nations followed by the US placing its own sanctions on Chinese firms for aiding North Korea.
- Samsung Group's *de facto* boss was sentenced to five years in jail for bribery of ex-President Park as the political scandal of last year rumbles on.
- Less of an 'event' but still important: currency movements. The Chinese renminbi strengthened 2% against the US dollar and is 5% stronger than at the beginning of the year. We believe the moves have been driven by a combination of improving domestic conditions in China, US dollar weakness and slower capital outflows as Chinese companies express a lesser desire to hold dollars.

Outlook

- We believe earnings growth will continue to be a significant driver of Asian stock markets.
- China's economic growth may decelerate in coming months, consistent with efforts to reduce leverage in the financial system and to reduce excess capacity in heavy industry.
- The evidence so far suggests that China is achieving these policy aims in an orderly fashion.
- Risks facing Asian markets include a resurgence in inflation, policy missteps in China or renewed talk of trade restrictions by the US administration.
- North Korea remains a wildcard.

Discussion

The Fund's performance in August was stronger than we would normally expect and therefore we undertook a review to see if that performance was driven by sector or thematic concentrations. We aim to keep such concentrations to a minimum. The common theme we identified was that a number of companies reported better results during the interim reporting season but the companies themselves came from a wide range of sectors and countries. We briefly discuss some of them below. (Stock performances are all reported in US dollar terms).

- **AAC Technologies** has completely shaken off the short-sellers report that caused the stock to be suspended at HK$82. Steady profit growth coupled with upbeat assessments of technology improvements (in lenses, acoustics) and moves into new product areas (Android and Chinese makers) pushed the stock to close at HK$142.
- **Li & Fung**, a perennial underperformer, turned following an unexpected 11% growth in operating profits. The company's stated efforts to focus on efficiency and cost control are visibly bearing fruit. The longer-term future depends on its ability to deliver supply chain management services e.g. improving the speed of pre-order processes (Plan, Source, Design, Cost) from 17 weeks down to 3 weeks – and cutting the whole process from pre-order to production and shipping down from 40 weeks to 13 weeks. The stock rose 23% in the month, our second best performer.
- **China Lilang**, a retailer of men's clothing, up 21% after results showing a pick-up in orders, higher prices and progress in re-organizing their business following the decision to close their lower-end/mass-market sub-brand, L2.
- **St Shine Optical**, a maker of contact lenses, up 15% following its results report – reported first half profit in 2017 was below expectation but the outlook is much stronger: both from its Japanese customers' outlook for contact lenses and a new product launch (color contact lenses). The completion of new capacity additions later this year, on schedule, will also remove a bottleneck.
- **China Merchants Bank** up 15% on strong results and bright expectations for its private banking and retail banking model. The focus on retail over corporate business diffuses risks and its adoption of financial technology (retail mobile banking apps for example) allows it to extend reach while controlling costs. This bank is the most aggressive of the Chinese banks in adopting innovative banking processes into its model.
- **Relo Holdings**, a relocation agency for Japanese executives, up 13%. First quarter operating profit was up 12% and the outlook remains favorable. This stock has performed very well since purchase: 2014 +44%, 2015 +69%, 2016 +18%, 2017 YTD +60%. This is a low 1% yield/steady dividend growth (14 years) story. The business is domestic Japanese executive relocation which has now broadened into international Japanese executive relocation and HR services.
- **Hanon Systems** up 12.5%. This car climate control business develops and sells systems for controlling the temperature environment in combustion engines and in electric vehicles. The stock has had a weak year but the price tuned higher in May. Results reported in August were expected

to be poor because of a collapse in Korean car sales in China. The reality was that internal cost restructuring and an improved product mix offset China weakness, and so results were better than expected. The order book looks strong, beyond Hyundai & Ford, with high visibility; a regulatory drive in Europe to promote electric vehicles and a quarterly dividend (payout ratio 60%) are also supportive.

- **Catcher Technology**, a manufacturer of smartphone casings, rose 11% after operating margin of 38.1% beat expectations, again. Increasing sales momentum is coming through. Higher shipments are expected in the second half for the iPhone and these are becoming visible.

Not every stock in the portfolio rose during the month. **JB Hi Fi**, an electrical retailer in Australia fell 9% on concerns surrounding the imminent arrival of Amazon into the Australian market. **Pacific Textiles** fell back 7%, but the recent resolution of a factory dispute in Vietnam coupled with the arrival of Toray (the supply chain manager and close partner of key customer Uniqlo) as the largest shareholder looks very promising. **LPN Development** in Thailand was down 5% after reporting weaker results for the second quarter on lower apartment sales. However, in recent weeks conditions are improving into the third quarter. **Asustek Computer** also fell 5% as the market adjusted expectations for next couple of years as the business re-organizes its business lines into PC, Gaming and Smartphone to bring about faster innovation and cost efficiency. In the meantime, we expect to see slower business momentum but management has committed to maintaining the dividend for the next two years.

Outlook

We remain positive on Asian growth and earnings prospects with all sectors expected to see earnings per share growth. Reported earnings have been ahead of expectations overall and this leaves valuations of MSCI AC Pacific ex Japan still looking attractive on a price/earnings (P/E) multiple of 14.3 times estimated 2017 earnings and 13.1 times 2018 estimates. The Fund's P/E multiple is at a 7% discount to the market for a similar earnings growth (9% in 2018 versus 2017).

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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.

MSCI Thailand Index measures the performance of the large and mid-cap segments of the Thailand market.

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.

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 08/31/17

1	Largan Precision Co Ltd	3.29%
2	Li & Fung Ltd	3.13%
3	Relo Holdings Inc	3.06%
4	China Lilang Co	3.03%
5	Yangzijiang Shipbuilding Holdings Ltd	3.00%
6	China Merchants Bank Co Ltd	2.97%
7	Catcher Technology Co Ltd	2.96%
8	Novatek Microelectronics Corp	2.89%
9	Hanon Systems	2.87%

10	CapitaMall Trust	2.86%

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