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

Outlook

- We believe the Asian markets have further to go following the rally this year based on faster growth than developed markets and strong upward revisions to profit estimates. The consensus estimates the MSCI AC Pacific ex. Japan Index to trade on a Price/Earnings (P/E) multiple of 12.5 times 2018 earnings which are expected grow 15%. The consensus' estimates for 2018 earnings have been revised upwards by 11% this year. (Source: Bloomberg)
- We think that China's economic rebound has sufficient breadth and momentum to continue and is likely to be stronger for this year than the 6.7% last year, we believe. This growth combined with closer regulatory supervision of the banking sector and the progress made toward deleveraging makes China an 'anchor' for Asian and emerging markets performance rather than a source of instability, in our view.
- Asian currencies are 4% stronger against the dollar this year (by our calculations, on a weighted average basis) but fell back following an unexpectedly hawkish statement from the Federal Reserve. We however, believe that aggressive rises in US interest rates are not likely in the near term.
- We expect the Chinese Yuan to remain stable at current levels following the weakness in 2016 and subsequent rally this year. Central bank intervention appears to have reduced now capital outflows have moderated and China's reserves of foreign exchange are rising once again. Chinese companies appear more willing to hold RMB now that China's domestic prospects have improved and the dollar has weakened.
- We think the main risks to Asia stem from the US – aggressive interest rate moves, changes to trade taxes or protectionism we think would cause the US to slow and would be felt more severely in Asia. We do not expect any of these to occur in our base case. North Korea remains a wild card but we expect considerable efforts to be made to avoid a missile launch against the US and thus is also not in our base case(!).

Fund & Market Review

- In the year to date the Fund has captured 92% of the upside in Asia as measured by MSCI AC Pacific ex Japan Index. The Fund was 0.29% behind the index in the third quarter having lagged 1.54% in July, outperformed by 3.46% in August and lagged 2.13% in September
- Underperformance in September was due to weakness in some our technology names related to the iPhone, namely Catcher Technology, AAC Technologies and Hon Hai Precision and to weakness in some of our Chinese names including the banks and Yangzijiang Shipbuilding following a share placement. Over the quarter however, except for Catcher and Hon Hai, these stocks including Chinese banks, have been outperformers.
- In September the MSCI AC Pacific ex Japan Index moved 0.04% and for the quarter was +6.42%.
- Leading sectors in September were Health care, Consumer discretionary and Technology while materials, Telecom and Financials were laggards. Thailand, the Philippines and South Korea (despite the tensions) did the best while Taiwan, Singapore and Australian were the weakest. In the quarter, Technology, Real Estate, Energy and Materials were runaway winners while on a country basis only China and Thailand outperformed.

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Fund performance

as of 9/29/17	3Q 2017	YTD	1 YR	3 YR	5 YR	10 YR
Asia Pacific Dividend Builder Fund	6.13%	26.78%	18.74%	10.28%	8.68%	3.40%
MSCI AC Pacific ex Japan	6.42%	27.79%	21.95%	7.68%	7.45%	3.76%

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

Expense Ratio: 1.11% (net)*; 3.14% (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 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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Why do we own Chinese banks?

Many of our peers adopt a position on the 'high ground' by saying that they do not and would not invest in Chinese banks regarding them and the Chinese economy as too risky. Now that market sentiment, economic data and earnings data are coming around we expect to see some backtracking. But we initiated positions in 2013 when the consensus was firmly against us and we have maintained them since then. We expected, and received, some resistance to this exposure and so we thought we'd review how the stocks have done since we bought them and the decision process behind it. In the next section we look at China's current debt position in the light of the recent downgrade to China's credit rating by Standard & Poor's.

In 2013 we bought four Chinese bank positions: China Construction Bank, Industrial & Commercial Bank of China, China Merchants Bank and China Minsheng Banking. The first two are state owned banks and are two of the so-called Big-Four, the last two are private owned institutions. The table below shows how the stocks have done year by year and over the holding period in US dollars (including dividends) compared to the market as measured by MSCI AC Pacific ex Japan Index in both absolute and relative terms:

	2014		2015		2016		9M 2017		Full Period	
	Absolute	Relative	Absolute	Relative	Absolute	Relative	Absolute	Relative	Absolute	Relative
China Construction Bank Corp	16.2%	14.0%	-12.4%	-3.4%	19.7%	11.6%	13.3%	-14.5%	38.1%	9.8%
China Merchants Bank Co Ltd	23.9%	21.7%	-2.6%	6.4%	4.1%	-4.0%	55.5%	27.7%	95.4%	67.1%
China Minsheng Banking Corp Ltd	45.6%	43.5%	-23.7%	-14.7%	14.0%	6.0%	-10.4%	-38.2%	13.6%	-14.7%
Industrial & Commercial Bank of China Ltd	15.2%	13.1%	-12.9%	-3.9%	5.7%	-2.4%	30.4%	2.7%	38.3%	10.0%
MSCI AC Pacific ex Japan Index	2.2%		-9.0%		8.1%		27.8%		28.3%	

Source: Bloomberg

As the table shows, they did not all contribute all the time but over the period only one of them has detracted from overall Fund performance (China Minsheng) and the weakness has all been this year as central bank efforts to limit banks' risk appetite and leverage are deemed to fall more heavily on China Minsheng causing its valuation to decline.

Our analysis at the time of purchase (and on an ongoing basis) took us through net interest income (the spread between interest income and interest expense), Non-interest income, Costs, Provisioning charges against bad loans, Loan Growth, Asset quality, Provision reserves, Funding/Liability structure and Capital adequacy. We considered off-balance sheet exposures like Wealth Management Products (WMP) and shadow banking activity when making asset quality/provisioning requirements/capital adequacy assumptions. When we value these banks, we look at the current and forecast price to book and back out the levels of nonperforming loans (NPLs) we think are implied in the share price.

Our macro analysis considers the importance of banks to the Chinese economy as a whole; non-financial corporate debt servicing capacity based on reported profitability and cash flows; regulatory scrutiny of bank operations with respect to direction of lending, access to and pricing of wholesale funding, on-going stress testing, requirements to set aside capital against non-standard assets (WMP).

A fundamental difference in Chinese economic management today compared to the past can be seen in the pressure applied to bank managements. In the past when China sought to stimulate growth they eased policy and let the banks operate unconstrained. Risk appetite took off and when it became necessary to tighten the sector was left wallowing in bad debt. The solution was to bail them out in 1995 (to the tune of 20% of GDP) and again in 2005. This time the regulators scrutinizing all aspects of operations. The combination of close regulatory oversight, improved debt servicing capacity and slowing debt accumulation at the macro level (it fell slightly mid-year on a debt/GDP basis) makes these banks look like investment opportunities, at current valuations.

However, we are well aware that that the argument has not concluded. In October, a couple of years after Chinese debt concerns really intensified, S&P downgraded China's sovereign credit rating citing concerns about China debt build up. In the next section we take a closer look.

China's credit rating

China's credit rating was recently downgraded by Standard & Poor's (S&P) from AA- to A+ because of worries over the rapid growth of the country's debt. Not surprisingly China refuted concerns, with the China Ministry of Finance (MOF) saying that "the downgrade is a result of [S&P's] long-standing mode of thinking, and misreading of the Chinese economy based on developed countries' experience." What S&P ignored, MOF says, is the country's distinctive financing structure, the wealth-creating effect of government spending and its support for growth, as well as sound development fundamentals and growth potential.

We must assess ourselves the two key components of credit analysis: the willingness and ability to pay off debt.

It is important to note:

- The downgrade focuses on the sovereign default risk when the problem is corporate debt.
- Over 90% of China's debt is domestically funded meaning no foreign capital flight to precipitate a crisis and no impact on China's future funding costs.

China's total debt to GDP at the end of 2016 stood at 257% of GDP. Government debt was 46%, Household was 44% and Non-financial corporate debt was 166%.

Government debt

S&P's downgrade specifically deals with the creditworthiness of Chinese Government Bonds which, at 46% of GDP equates to approximately $5.25 trillion of debt. The average yield on these bonds is 3.5% meaning annual interest payments of ~$184 billion. Total fiscal revenue received by the government equated to 28% of GDP in 2016 amounting to $3,200 billion. The government can easily service its debt and so that is not the problem.

Corporate debt

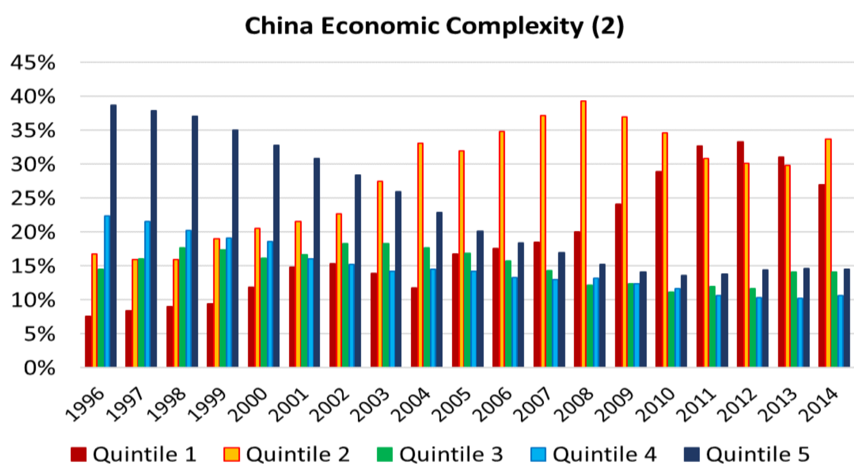
Corporate debt has grown rapidly in recent years and concerns about this are justified. There have been two drivers of this growth - the first was the government effort to boost GDP growth between 2008 and 2011; the second was the subsequent rise in lending by the banking sector, with an excessive risk appetite underpinned by expectations of implicit guarantees which encouraged excessive borrowing.

S&P has assumed that the government is on the hook for every dollar of corporate debt, that debt will continue to grow and that China's ability to repay it now comes into question. The counter-arguments are these:

- The government has already identified debts linked to government policy and is swapping those into municipal bonds – i.e. taking sovereign responsibility.
- Debt run up on private projects by both corporates and local governments are not their responsibility and need to be worked through. We are seeing more bond defaults as a consequence.
- Banks are under intense regulatory pressure to shrink balance sheets and curb risk appetite:
    - Off-balance sheet loans and wealth management products are now included in capital adequacy requirements
    - Wholesale funding rates have increased through central bank tightening to make this funding source more expensive.
- Excess capacity industries (steel, cement, aluminium and real estate) all have limited access to capital as bank lending to these sectors is restricted by the central bank.

Underlying China's debt story is an economy that has transformed from low- to higher-end manufacturing that has brought with it wages to match. An investment program into infrastructure has created the framework for China's productivity to increase over time. Certainly, there has been waste, there are projects that will not pay for themselves but at a macro-level China is becoming wealthier.

The path of economic transformation can be seen through a measure known as Economic Complexity. The measure combines metrics of the diversity of countries and the ubiquity of products to create measures of the relative complexity of a country's exports. By ranking China's overall output in terms of complexity, and dividing into quintiles (quintile 1 being the most complex and quintile 5 the least) we can see the change:



Source: Observatory of Economic Complexity, Guinness Atkinson Asset Management

In China, the increase in the value of goods produced, the greater share in the global supply chain, higher wages, higher tax revenues and greater cash flows all combine to make the economy more productive and therefore capable of servicing more debt. Add to this the efforts to reduce excess capacity in the 'old economy', the visible rise in heavy industrial profitability and we can see that China debt servicing ability is rising not falling.

For our investment strategy we need to understand where the risks lie in the corporate sector and where they are/are not improving:

Through the A-shares market we have a window on some (10%) of the $116 trillion of corporate debt held and so get a sense of the share of. We looked at 2,800 listed Chinese companies (ex-financials) to identify where debt is clustered and how much is at risk i.e. where operating profits defined as Earnings Before Interest and Tax (EBIT) do not cover the annual interest payment:

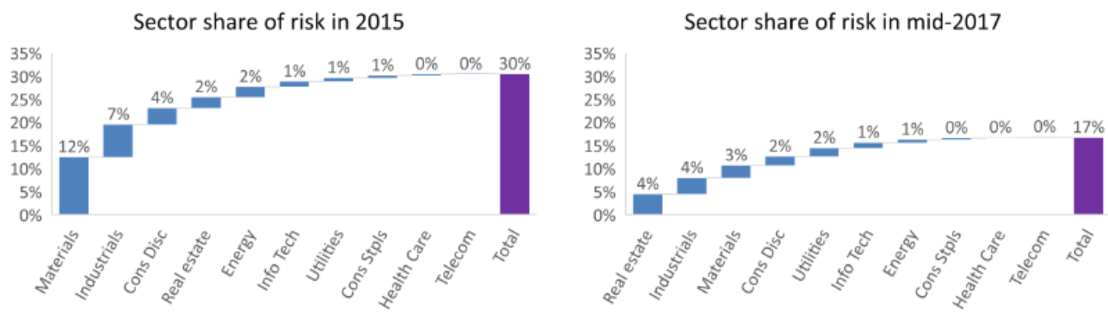
Debt is said to be at risk if a company's EBIT is less than interest expense

	Debt CNY trn		Share of debt		% of debt at risk		Share of risk	
	2015	1H17	2015	1H17	2015	1H17	2015	1H17
Consumer Discretionary	0.99	1.23	10%	11%	37%	19%	4%	2%
Consumer Staples	0.17	0.20	2%	2%	33%	20%	1%	0%
Energy	0.38	0.41	4%	4%	60%	18%	2%	1%
Health Care	0.23	0.30	2%	3%	15%	3%	0%	0%
Industrials	3.11	3.49	31%	30%	23%	12%	7%	4%
Information Technology	0.42	0.59	4%	5%	29%	23%	1%	1%
Materials	1.95	1.93	19%	17%	65%	16%	12%	3%
Real estate	1.62	2.04	16%	18%	15%	25%	2%	4%
Telecommunication Services	0.15	0.17	1%	1%	0%	0%	0%	0%
Utilities	1.14	1.19	11%	10%	7%	18%	1%	2%
Total	10.16	11.55	100%	100%	30%	17%	30%	17%

Source: Bloomberg, Guinness Atkinson Asset Management

In 2015, some 30% of debt was at risk. Today that figure is around 17%. So, the level of debt at risk has reduced and cash flow generation has improved, allowing debt to be paid back with earnings.

Sector share of debt at risk



Source: Bloomberg, Guinness Atkinson Asset Management

The improvement in the overall level of debt seen at risk this year compared to 2015 helps explain the rally in China seen since mid-2016. We know that the Industrials and Materials sectors remain at risk because they are sensitive to Chinese GDP and commodity prices. Real estate is probably the most important area to focus on. As long as property prices and property sales continue to be as buoyant as they are now then debt can be worked through. If property and land prices were to drop then this would be significant in two ways. First, construction activity, which is still an important contributor to growth, will fall. Second, land is a major source of collateral for loans and a fall in collateral values means greater pressure on capital requirements for banks. We do note, however, that the government has space to loosen some of the tightening measures it has introduced for the property market in the past year.

The sovereign sits atop an indebted economy, certainly, but one that that is domestically funded and that continues a 20-year trend of becoming more productive and more cash generative. In sum, we think S&P has missed the mark with its downgrade.

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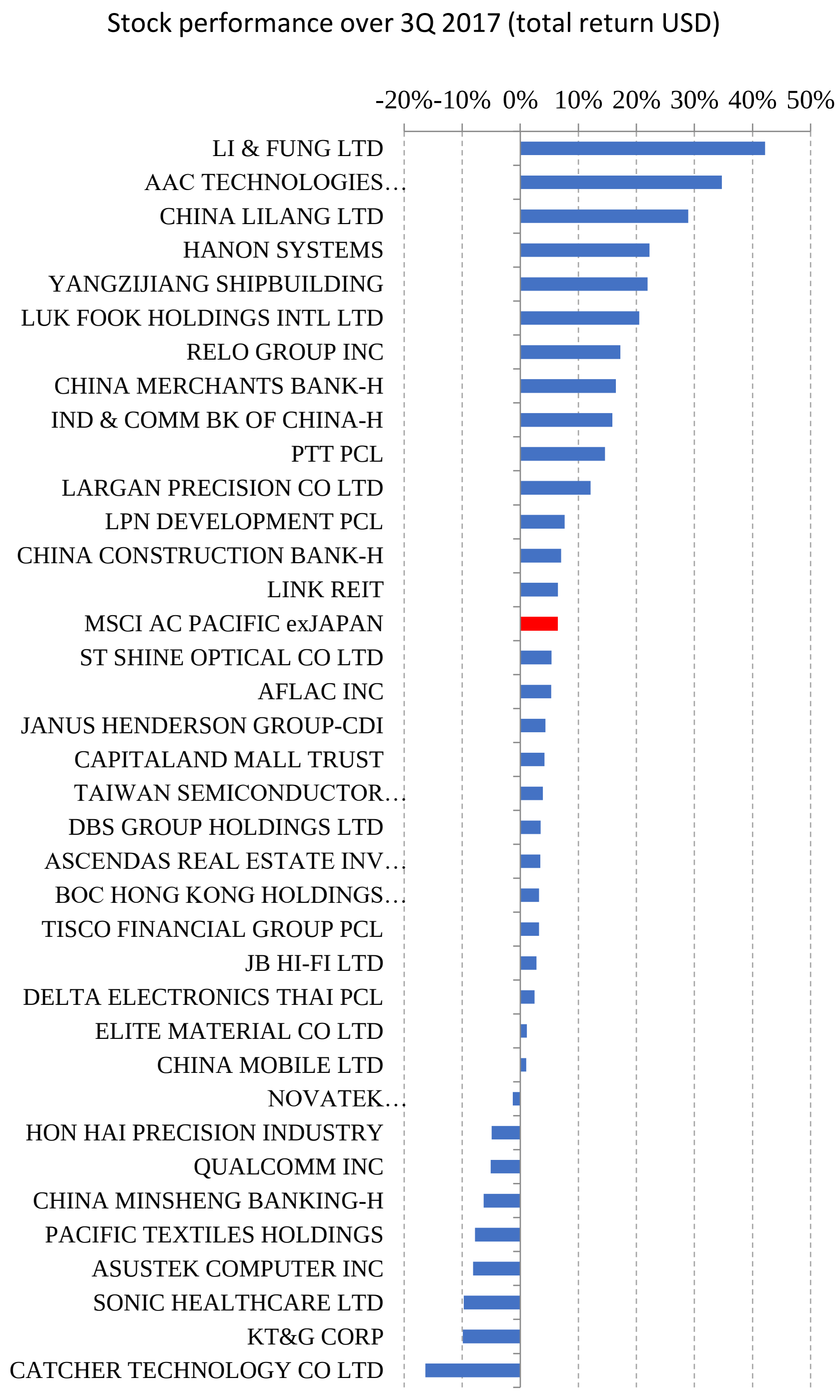
Portfolio news

The chart below shows the performance of the stocks in the portfolio at the end of the third quarter, and that of the benchmark.



- Outperformers in the quarter

In a quarter when the best performing sectors were technology, real estate, energy and materials we find that the best performers in the Fund are, with one exception, all drawn from other sectors.

Li & Fung is a factory agent, serving as an intermediary between factories in the developing world and customers in the US and Europe. The company has been battling cyclical headwinds of slower world trade growth and the structural forces of technological change. However, the company is now turning the corner, controlling costs in the short term and fundamentally developing and augmenting its services in terms of both scope and speed. Stronger than expected profitability reported for the first half of this year made this our best performer this quarter.

AAC Technologies has been a strong performer for a while. The company was subject to a series of allegations made by a short-seller that their margins were overstated and benefitted from undisclosed connected transactions. The subsequent stock price drop reversed dramatically following a detailed company report that comprehensively refuted the allegations. AAC is an important supplier of acoustic components and haptics (motion controls) for smartphones, such as the iPhone and others.

China Lilang (which trades under the LILANZ brand) is a designer and retailer of men's clothing. Over the past few years they have made improvements to designs, to the product range, to the quality of fabrics and to the structure of the distribution network. The chief designer has been hired from Armani; new product lines have been added in shoes, underwear and casual clothing; proprietary fabrics make up a bigger proportion of usage and their quality has improved; the distribution channel has shifted away from department stores to shopping malls. The management has proven itself to be both dynamic and adaptable, reflecting rapidly evolving Chinese consumer patterns. Strong results at the interim stage lifted the stock into our top five performers this quarter.

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. 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 is that internal cost restructuring and improved product mix offset the difficult conditions.

Yangzijiang Shipbuilding is a Chinese shipbuilder specialising in building dry bulk vessels (for carrying industrial materials such coal and iron ore and agricultural commodities such as soy). The shipping sector has had a challenging time following the decline in commodity prices and has seen daily shipping rates plunge from a peak of $10,000/day in 2008 to less than $300 in 2016. Today, daily rates are around $1,400 in line with longer run averages. It has meant that shipbuilders have experienced a significant slowdown in new orders from the heady days of peak in commodity prices but it is still the case that shipping companies need to replace ageing vessels. For example, Vale, one of the world's largest mining companies, is seeking to replace 30 ageing VLOCs (Very Large Ore Carriers). Yangzijiang has benefitted as one of the largest and most efficient dry bulk builders. Better than expected results for 2016 drove the share price at the start of the year; rising new orders and a pick-up in shipping rates has continued to push the share price higher this quarter.

- Under-performers in the quarter

Catcher Technology saw its share price fall following the launch of the Apple iPhone. The company makes metal casings for smartphones and is making the metal frames for the new glass-backed versions. The stock performed well in anticipation of the launch and expectations were perhaps excessive. With that in mind, we were careful to ensure that we locked in gains by cutting back the position to neutral ahead of the launch and after the decline in September we added to take the position back to neutral.

KT&G is Korea's leading tobacco company. In the current market conditions dominated by technology, real estate, materials and energy a consumer staple like this would not be expected to perform especially well. The business has increased its share of the domestic market, it has demonstrated continued pricing power and gross margins have risen to 68%. Overall Korea market volume has fallen by 4% but KT&G has only seen a 2% volume decline. Revenues in the cigarette business are 5% higher in the first 6 months of this year over the same period last year while ginseng product revenues are 9% higher. The business looks fine but the stock is out of favour at the moment.

Sonic Healthcare is an Australian company providing medical diagnostic services both domestically and in Europe (UK, US and Germany). The company has recently won contracts for hospitals in the UK which are expected to contribute annual revenues of GBP 12 million. On the downside however, the report out from the US Center for Medicare and Medicaid Services confirms planned cuts under the protecting Access to Medicare Act will be effective in 2018 and are greater than the industry expected – close to the maximum 10% per annum allowable reduction compared to earlier indications of around 5.5%. A recent report shows that private rates for tests are some 22% lower than Medicare rates suggesting that further cuts lie ahead. Only 4% of group revenue comes from this activity so cuts to forecasts are not massive and there are savings that can be made the potential as well to acquire other labs more significantly affected by this, which could offset the lower rates.

Asustek Computer produces notebook PCs, tablets and smartphones that are sold under the ASUS brand. The company's operations are struggling with intensifying competition and rising component prices in the PC segment while the smartphone division is making losses. Asustek is in the process of restructuring operations to fall back on more profitable areas of the PC market and to reboot its smartphone division. We believe this will take at least a year to show up in margins. In the meantime, management has committed to maintain its cash dividend over the next two years. The fundamental nature of Asustek's challenges however, mean this is one we must keep under closer review.

Pacific Textiles is a Chinese manufacturer with operations not only in China but also in Vietnam. Uniqlo, the Japanese brand, is one of its major customers. The arrival of Toray (the supply chain manager and close partner of key customer Uniqlo) as the largest shareholder looks very promising and tightens the relationship with a key customer. There has been a dispute over pollution issues at one of its factories in Vietnam which has been running for much of this year where local residents have blockaded the facility. The company has shifted orders to China and deliveries have been delayed but no orders have been withdrawn. We look forward to a resolution with the company establishing pollution safeguards and the resumption of full production.

Outlook

We believe that Asia still offers value after its performance this year based on its earnings' prospects and economic growth momentum. We still think that a bottom up approach by identifying what we believe are good businesses in the first instance, rather than building a shape of the world and looking for investments that fit it, is the right way to go.

There is growing talk of a resumption of inflationary pressure as global growth picks up. There are offsetting factors such as slow wage growth that mean the inflation argument is still wide open. But in the event it becomes a concern we believe we are well positioned. The companies in which we invest have strong competitive positions, as demonstrated by their sustained profitability which makes it likely that they have pricing power with customers and bargaining power with suppliers. Their above average returns on invested capital also means that an erosion in the value of these returns caused by inflation will probably have a lower impact on the share price than for a less profitable businesses. Furthermore, our requirement that the companies we buy should have low debt levels means that the effect of sharper interest rate rises will also be more manageable, in our opinion.

Edmund Harriss and **Mark Hammonds** (portfolio managers)
Sharukh Malik (analyst)

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.

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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.

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.

Economic complexity is a measure of the production characteristics of large economic systems, usually whole countries. The goal of is to explain an economic system as a whole rather than the sum of its parts; to explain the knowledge accumulated in a country's population (the networks that people form) and that is expressed in the country's industrial composition. To achieve this goal, the measure combines metrics of the diversity of countries and the ubiquity of products to create measures of the relative complexity of a country's exports.

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 09/29/17

1	Li & Fung Ltd	3.44%
2	China Lilang Co	3.18%
3	Luk Fook Holdings International Ltd	3.14%
4	LPN Development PCL	3.06%
5	Hanon Systems	3.04%
6	Relo Holdings Inc	3.03%
7	Largan Precision Co Ltd	2.95%
8	Yangzijiang Shipbuilding Holdings Ltd	2.83%
9	Industrial & Commercial Bank of China Ltd	2.79%
10	KT&G Corp	2.78%

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