Guinness Atkinson

Asia Pacific Dividend Builder Fund

Managers Monthly Update – November 2017

Fund & Market

- The Fund performed well in October and was a little ahead of the MSCI AC Pacific ex Japan Index which rose 3.79% in USD terms and outperformed the US, UK, Europe and non-Asian Emerging markets, as measured by their respective MSCI indexes.
- This makes Asia comfortably the best performing region this year and yet, as discussed below, valuations are still attractive.
- Technology, Healthcare and Consumer staples were the outperformers over the month while Telecom continued its long-term weakness, followed by Real Estate and Consumer Discretionary. On a country basis, South Korea, Taiwan, Singapore and China were outperformers, as measured by their respective MSCI country indexes.
- Technology stocks which had been weak in September after the iPhone launch recovered in October with more positive noises coming from Apple about likely demand for the iPhone X. This could have been mere 'puff' from the company were it not also for stories in the Taiwanese press that Apple has asked component suppliers to double their shipment volumes for the rest of the year.
- The valuation of the portfolio is still at a discount to the market on a Price/Earnings basis trading on 13.1x 2017 and 12.0x 2018 estimated earnings compared to the MSCI AC Pacific ex Japan Index which is trading on 14.5x and 12.6x respectively.
- Asian markets, as measured by MSCI AC Pacific ex Japan, are still at a 26% discount to MSCI World on a reported earnings basis from a 30% discount at the start of year (as compared to the long run average discount since Jan 1995 of 23%) - but this not much of a reduction in the discount given the level of their outperformance this year. The reason? Reported profits in Asia have been growing faster than in developed markets.

Events in October

- China had its 19th Party Congress; at the end of which, the new leadership line-up was revealed. President Xi Jinping and his deputy Li Keqiang remain in place, as expected, while the five other members of the Standing Committee retired and were replaced. Importantly, all of these need to retire in five years' time and no candidates to succeed President Xi in 2022 were brought forward. Thus, we must conclude it is probable Xi will stay on beyond his 'normal' 10-year term. This is not necessarily a bad thing and investors should most likely welcome it. There are some tough reform decisions ahead with possibly powerful opposition from vested interests. Political strength will be needed if they are to be carried through, and this President Xi undoubtedly possesses.
- Japan's Prime Minister Abe secured a two-thirds majority in the lower house of Parliament in the snap election.
- India announced a significant recapitalization plan for its state-owned banks ($32.4bn/1.3% of GDP) over the next two years in response to the bad debt issues facing the sector.
- South Korea is mending relations with China after a year-long tussle over the country's deployment of THAAD, an anti-missile missile system to counter the threat from North Korea. Trade and business relations have been significantly affected over the past 12 months. The Korean Won was the strongest currency in the region up 2.4% against the dollar.

- **Happening in November:** US President Trump embarks on a twelve-day tour of Asia during which he will meet China's President Xi.

Outlook

- We expect to see interest rates in the US and UK rise only moderately in the coming twelve months.
- The capital expenditure cycle is showing signs of picking up which is supportive for Asia.
- China's economic growth looks likely to come in ahead of market forecasts for this year but in the months ahead we expect intensifying efforts to tackle leverage in the financial system, debt in the corporate sector as well as efforts to take the heat of the real estate market. All will have a depressing effect on economic growth.
- We remain positive because we are focused on companies that do not require policy driven growth to turn a profit and the portfolio is trading at a discount to Asian markets, as measured by the MSCI AC Pacific ex Japan Index.

Stocks news

This has been a good period for company results over the past month and into November. Twenty-one companies have reported quarterly or half-yearly results. Six companies missed their estimates but only one, Elite Material has seen an adverse market reaction. DBS Group, Singapore's largest bank, recorded the widest miss, but this was the result of management's decision to recognize all problem loans in the oil and gas segment of the loan book and set aside additional provisions. The market welcomed the move which was accompanied by pre-provision operating profit growth driven by a widening of the net interest margin and improved cost efficiency.

Elite Material has a 50% share in laminates for rigid printed circuit boards (PCB) used in smartphones. We have been looking for the success in smartphones to be replicated in the server/networking segment and the company is on track to do this with the 24% revenue growth observed in this area in 2016 – it now contributes over a quarter of all revenue. However, in the short term there are concerns about smartphone market share loss as the iPhone migrates to a different technology. We believe that this concern has been overplayed and while the recent quarter's results were below estimates, non-Apple smartphones were bigger contributors than expected. There is still plenty to go for in non-iPhone smartphones, servers as well as the possibility of recouping iPhone share so we have been adding to the position.

We wrote about Asustek at the half year stage as one of our weaker positions. The company is undergoing a re-organization of its operations as the PC business remains under pressure for weaker demand and intensified competition while the smartphone area has yet to reach adequate scale. We were happy to see therefore, that its third quarter results came in ahead of the highest estimates. Gross margin was better than expected and the company has been helped on the PC side both by reduced price competition from HP and also by stronger demand for motherboards and graphics cards. The company still has a way to go to resolve the challenges it faces but we are encouraged to see in these results, the qualities that drew us to this company in the first place.

St Shine Optical is another stock we have written about as optimism around the company has ebbed and flowed over the past three years. The company is enjoying another upswing and the share price has now pushed through the high in 2014. Recent results came in 9% ahead of consensus estimates reflecting the reacceleration in sales growth, which the company reports monthly. Expansion into the US market is the recent positive development driving St Shine's share price. A new online client was added in 2016 and now accounts for 85% of US sales. The belief is that sales in this channel could be more stable than those from Bausch & Lomb in China. Even more encouragingly, the gross profit margin for US sales has now increased to match that of Chinese sales. Margin expansion, increased production capacity as well as new sales areas are combining to make for a strong story.

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.

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.

Guinness Atkinson

Asia Pacific Dividend Builder Fund

Managers Monthly Update – November 2017

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 10/31/17

1	Li & Fung Ltd	3.25%
2	Luk Fook Holdings International Ltd	3.10%
3	Relo Holdings Inc	3.09%
4	LPN Development PCL /Foreign - NVDR	3.06%
5	Hanon Systems	3.02%
6	Largan Precision Co Ltd	3.00%
7	Yangzijiang Shipbuilding Holdings Ltd	2.93%
8	Catcher Technology Co Ltd	2.90%
9	DBS Group Holdings	2.83%
10	St Shine Optical Co Ltd	2.81%

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

Distributed by Foreside Fund Services, LLC.