Guinness Atkinson

Dividend Builder Fund

Managers Update – November 2017

GUINNESS ATKINSON FUNDS

October in Review

I've never been certain whether the moral of the Icarus story should only be, as is generally accepted, 'don't try to fly too high,' or whether it might also be thought of as 'forget the wax and feathers, and do a better job on the wings'. - Stanley Kubrick

In recent months, equity indices across the world have repeatedly reached new highs and October was no different. Prolonged high flying and soaring valuations inevitably bring with it forecasts of imminent doom, and this was heightened this month with the 30-year anniversary of "Black Monday". 19th October 1987 saw the Dow Jones plunge 22.6%, ousting the previous record one-day fall of 12.8% set during the Wall Street Crash on 28th October 1929. Most stock markets in developed countries had been growing at more than 30% a year in the five years up to "Black Monday" – gains that have not been repeated since. This led to worries about a slowing global economy and high stock valuations which led to the biggest crash in living memory. Exacerbated by wide-spread panic and an electronic-trading glitch, stock markets tumbled across the world forcing central bank intervention. Interest rates were cut, and the Federal Reserve encouraged banks to continue lending; the policies worked, and stock markets had recovered in the five years following the crash.

While high stock valuations can contribute to a fall they are not necessarily the catalyst. As Table 1 below illustrates, valuations in the US, Europe and UK are higher now than they were in 1987, yet stock markets continue to hit record highs.

Region	P/E in 1987	P/E in 2017
World	24.9	21.6
US	20.0	23.6
Europe	16.7	21.2
UK	17.0	24.2
Japan	64.0	15.8

Table 1. Price to earnings ratio for MSCI indices. Source: Bloomberg.

"This time is different". Perhaps a dangerous phrase, more so because perhaps every time it is different and the future remains unknowable. However, looking at the world now and 30 years ago, the main disparity stands in the form of government bond yields (Table 2). Back then investors could protect their money and find a healthy return with high bond yields; today, that option is less desirable.

Region	10-year Govt. bond yields in 1987	10-year Govt. bond yields in 2017
US	9.89	2.92
German	7.04	0.48

UK	10.12	1.28
Japan	6.35	0.08

Table 2. 10-year government bond yields. Source: Bloomberg.

Today, we are also seeing a synchronized global recovery, driven higher by positive economic data and strong corporate earnings releases. Developed market equities gained 2.6% in October making the year-to-date return 15.9%. Emerging market equities gained 3.9% in October, giving a year-to-date return of 28.7%.

In Europe, October saw the unemployment rate fall to an eight-year low of 8.9% and the first estimate for Q3 GDP came in at 0.6% quarter on quarter. The big monetary policy event of the month was the European Central Bank's (ECB's) meeting, where Mario Draghi announced an extension of the bank's quantitative easing (QE) program for nine months with monthly purchases of EUR 30 billion from January to September 2018. This was an acknowledgement of the solid growth apparent in the region, but also keeps the door open for a further extension to be announced. Inflation readings in the eurozone will be crucial for the QE outlook, given that it remains low: 1.4% for September's year-on-year figure.

In the U.S. – like Europe – October also saw unemployment fall further, with September's reading dropping to 4.2% – a 16-year low. Industrial production and consumer sentiment statistics were both encouraging, though non-farm payrolls dipped off the back of hurricane season. The generally positive macroeconomic outlook has allowed companies to deliver quarter on quarter earnings growth, with Q3 earnings season proving no different. With two-thirds of the S&P 500 Index having reported by the end of the month, year on year EPS growth was around 7%. S&P 500 price levels responded to positive earnings surprises gaining 2.3% (in USD) over the month, taking the year-to-date rally to 16.9% (in USD). The strong showing increased the expectations of a December interest rate hike and there is also more confident talk from the Republicans in their efforts to push through ambitious tax plans. The White House claims that robust growth would pay for US$1.5 trillion of planned cuts to corporate and personal taxes.

In Asia, equity markets performed strongly in October, with new record highs for several markets. South Korea was the region's best performing market, supported by news that an agreement with China had been reached to normalize relations following the recent fallout over the installation of THAAD (the U.S. anti-missile system). The move could provide a significant boost to Korea's economy, bringing an end to China's boycott of Korean goods as well as the clampdown on Chinese visitors to the country. The most notable development in China was that President Xi Jinping secured his political primacy for the foreseeable future. China's third quarter GDP growth of 6.8% year-on-year was in line with expectations.

In Japan, the elections were a focus for markets. Voters handed a majority to incumbent Japanese Prime Minister Shinzo Abe's Liberal Democratic Party in the snap election. During the campaign,

Prime Minister Abe made several promises about fiscal policy to voters, including using part of the revenue from the upcoming consumption tax hike to increase labor force participation and to invest in improving Japan's human capital. Broadly speaking, the result means continuity for the Japanese economic and political landscape. Japan's TOPIX was the best performing equity index, posting gains of 5.4% in October alone, taking its year-to-date return to 18.6% (in USD).

Market Update

In terms of sectors, so far, it's been the year driven by the technology sector. In the U.S., not only is it the largest sector by far (23.2% of the S&P index with financials next largest at 14.6%) but it has also performed the best (up 26% YTD in USD) by a large margin. According to Bloomberg, of the 14.2% return year to date (in USD) for the S&P 500 Index, technology contributed 5.7% (over 40%) of that. The next largest sector contributor was healthcare at a mere 2.8%. Microsoft, Intel and Alphabet all reported stronger than expected earnings, helping the technology sector reach an all-time high.

Telecommunication was the worst performing in the month, dragged lower by AT&T after the company said that it lost 90,000 video subscribers in the third quarter and that a string of natural disasters would reduce its revenue and earnings in the quarter. The company makes up close to a fifth of the sector. More cyclical sectors, with greater sensitivity to the business cycle, such as financials, materials and industrials, outperformed more defensive areas, and growth continued to outperform value. The industrials sector reported strength in aerospace and construction, and though financial stocks were in positive territory, the rally is fading. Doubts have started to emerge whether the Republican party can pass meaningful tax cuts, and the hurricane season negatively impacted insurers' profits. The fund's underweight positions in IT and Materials were a drag on performance, while overweight Consumer Staples was beneficial. Given valuation is an important part of our investment process it has meant that the portfolio has slightly underperformed the MSCI World index.

Equity valuations have risen globally in the wake of the bull market, and are reaching dearer levels particularly in the U.S. There is perhaps justification given the low interest rate environment and growing revenues and earnings, though we continue to believe that valuation plays a very important role in long-term investing. We can learn from "Black Monday" that asset markets are potentially vulnerable to sharp corrections when – as at present – valuations appear stretched, and that such corrections can occur without a clear "trigger event". Holding good quality companies that have persistently generated high levels of cashflow return on investment gives us confidence that the fund is well placed to weather different market conditions while providing a steady stream of income.

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Portfolio Update

In the fund, in terms of individual holdings in October, the strongest performer in the fund was Wal-Mart (+11.74% in USD). The world's largest retailer reaffirmed its upbeat 2018 guidance and said it expects U.S. e-commerce sales to surge 40% in the next fiscal year. The company has been seen making the right moves to further its online competitiveness against Amazon by expanding its web marketplace, acquiring several internet-based retailers, and expanding its online grocery business. Wal-Mart has been rewarded for recognizing the threat of e-commerce to its traditional retail operations and made an aggressive move to acquire Jet.com for $3.3 billion in August 2016. It quickly installed Jet CEO Marc Lore as head of its e-commerce division. Since then, Lore has spearheaded numerous initiatives that together have taken what was a struggling part of Wal-Mart's business and transformed it into its most exciting growth driver. Wal-Mart's U.S. online sales soared 60% year over year in the latest quarter. The company also announced it will buy back $20 billion in stock in fiscal 2019, where it expects to see 5% growth in EPS (earnings per share).

Microsoft (+11.67% in USD) also performed very well; it was the software maker's cloud transformation that has seen buoyant demand. Azure cloud services, used to store and run customers' applications in Microsoft's data centers, is number two in the cloud sector behind Amazon Web Services, though the market is growing fast enough to lift both companies' revenue. Microsoft's fiscal Q1 results show that the company surpassed its goal of $20 billion in annualized cloud revenue, set by CEO Satya Nadella in 2015, and the higher-margin cloud-product sales do not seem to be slowing. Commercial-cloud gross margin improved 800 bps to 57%, driven by expansion across various cloud assets: Office 365, Dynamics 365 and Azure. This helped total gross margin by 200 bps, which was key to better-than-expected EPS growth (1 year EPS growth is 29.3%). Microsoft has beat consensus EPS estimates for 6 of the last 8 quarters, and 35 of the last 43 quarters (over 10 years). We have held a position in Microsoft since the launch of the fund in 2010.

The worst performing stock in October was Merck (-13.96% in USD). The drug-maker withdrew its European regulatory application for Keytruda, its leading lung cancer drug. The decision was made based on findings from its Keynote-021 trial, which has already demonstrated effectiveness in treating non-small cell lung cancer (NSCLC) based on two measures: overall response rate and progression-free survival. The company announced it was amending its trial of Keytruda with chemotherapy to include overall survival rate, which is a measure that takes longer to evaluate. The market responded negatively to this since Merck may be waiting

a while to bolster its application with additional survival data. This gives competitors such Bristol Myers Squibb and AstraZeneca an opportunity to gather pace in gaining approval for their competing drugs. Keytruda is a highly successful drug that exceeded $1 billion in sales in the most recent quarter for the first time, and has already been approved in the U.S., for use alongside chemotherapy to treat NSCLC. Although the delay in approval poses competitor risks, the cautious approach of Merck in the short run may well prove advantageous in the longer run.

We made no changes to the portfolio in October.

Thank you for your continued support.

Portfolio managers
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Analysts
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Performance

In October, the Dividend Builder Fund produced a total return of 1.05% versus the MSCI World Index return of 1.92%. The fund therefore underperformed the index by 0.87%.

as of 10.31.2017	YTD	1 YR	3 YR (ann.)	5 YR (ann.)	Since inception (3.30.2012) (ann.)
Dividend Builder Fund	15.99%	17.46%	5.73%	10.57%	10.05%
MSCI World Index	18.77%	23.49%	8.78%	12.23%	11.07%
as of 09.30.2017	**YTD**	**1 YR**	**3 YR (ann.)**	**5 YR (ann.)**	**Since inception (3.30.2012) (ann.)**
Dividend Builder Fund	14.79%	12.12%	5.86%	10.38%	10.01%
MSCI World Index	16.53%	18.85%	8.33%	11.65%	10.86%

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.70% (net); 2.11% (gross)

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. Current performance of the Fund may be lower or higher than the performance quoted. For most recent month-end and quarter-end performance, visit https://www.gafunds.com/our-funds/dividend-builder-fund/#fund_performance or call (800) 915-6566. Total returns reflect a fee waiver in effect and in the absence of this waiver, the 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) in order to limit the Fund's Total Annual Operating Expenses to 0.68% 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 waives or absorbed, subject to the 0.68% expense cap.

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

This information is authorized for use when preceded or accompanied by a prospectus for the Guinness Atkinson Dividend Builder Fund. The prospectus contains more complete information, including investment objectives, risks, charges and expenses related to an ongoing investment in the Fund. Please read the prospectus carefully before investing.

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Mutual fund investing involves risk and loss of principal is possible. The Fund's strategy of investing in dividend-paying stocks involves the risk that such stocks may fall out of favor with investors and could reduce or eliminate the payment of dividends in the future or the anticipated acceleration of dividends could not occur. The Fund invests in foreign securities which will involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets. Medium- and small-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Top Fund Holdings as of 10/31/17

1	Microsoft Corp	3.32%	6	Schneider Electric SE	3.23%
2	Illinois Tool Works	3.32%	7	Wal-Mart Stores Inc	3.16%
3	Danone	3.27%	8	Eaton Corp PLC	3.09%
4	VF Corp	3.27%	9	Arthur J Gallagher & Co	3.08%
5	Novo Nordisk A/S	3.24%	10	Johnson & Johnson	3.03%

Current and future fund holdings and sector allocations are subject to change and risk, and are not recommendations to buy or sell any security.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Dividend yield is calculated by annualizing the last quarterly dividend paid and dividing it by the current share price.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed countries.

Quantitative easing is an unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

S&P 500, the abbreviation for the Standard & Poor's 500, is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE (New York Stock Exchange) or the NASDAQ (National Association of Securities Dealers Automated Quotations System). It is designed to measure the equity market performance of the U.S. stock market.

Ex-dividend is a classification of trading shares when a declared dividend belongs to the seller rather than the buyer.

One cannot invest directly in an index.

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