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Asian markets retreat – Guinness Atkinson view

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After such a strong run this year in stock markets around the world, investors are concerned that something nasty is about to happen. Unless there is a strong view about the dollar, interest rates, or a global price shock then the question comes down to valuation. Have markets become too expensive and therefore should we retreat a little before year end?

To me, this looks like a broader move in sentiment to cut back on positions that have done well, *i.e*. a question of valuation and profit-taking. This does not appear to be because of any fundamental change to market earnings or economic conditions.

We think that Asian markets never got expensive. Valuations have come up from multi-year lows (which also depresses the 10-year average, making that comparison lower than it might otherwise be) and are supported by strong earnings growth forecasts which in turn are supported by strong profit growth already reported.

What follows is a quick review of what I think is relevant:

Markets:

1. The stocks selling off today 4% or more in our portfolios include Catcher, Largan, AAC Tec (smartphones), Ping An (Chinese insurance), Geely Auto (Chinese car maker), St Shine Optical (Taiwan Healthcare), Haitian (Chinese machinery maker), Anhui Conch Cement (Chinese cement maker). Those selling down 2%-3%: Hanon Systems (Korea Autoparts), Chinese banks, Delta Electronics Thailand (power systems for Tech hardware).

   This is a broad range of sectors with no common theme running through other than they are in markets (China) or sectors (Technology) or are stock specific which have all done well this year - up 50% or more.

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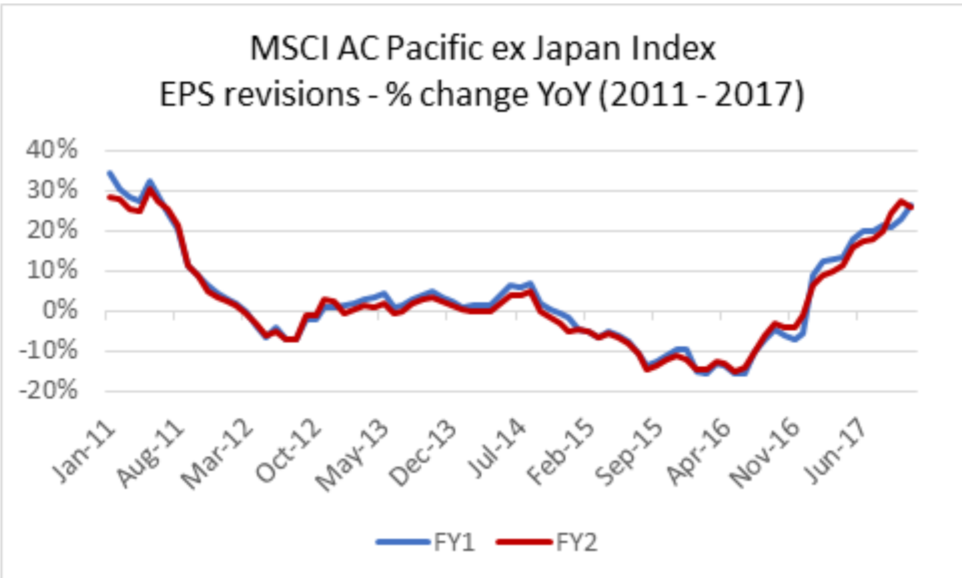
2. Reported earnings growth in Asia is still accelerating

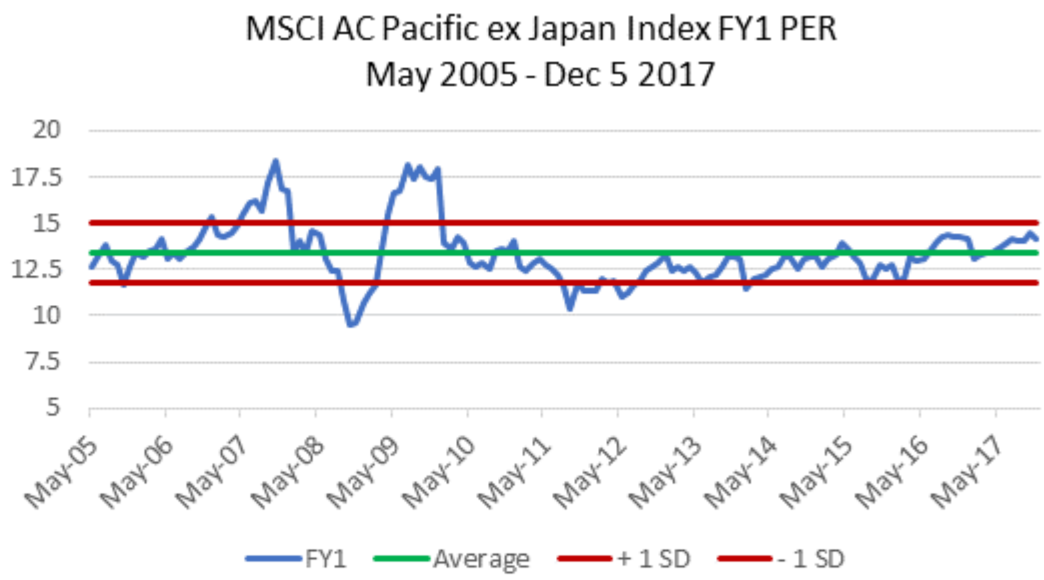
Source: Bloomberg data, Guinness Atkinson calculations. Data through to November 30, 2017.

3. Forecast earnings growth in Asia is also rising strongly – the dip in the red line is a data distortion in Sept/Oct, corrected in November, relating to Samsung Electronics. Take out that 2-month data error and revisions for both this year and next are still accelerating.



Source: Bloomberg data, Guinness Atkinson calculation. Data through to November 30, 2017

4. The market PE valuation has been rising since the latter part of 2016. It never got expensive compared to its 10-year average and recent weakness is pulling it back toward average.



Source: Bloomberg data, Guinness Atkinson calculations

Macro view:

1. At the high level, there are no concerns being expressed about GDP growth. China is expected to slow down from 6.8% toward 6.5% as financial sector reforms continue and deleveraging progresses. The markets appear comfortable with this and we have seen no surprises in retail, industrial output, investment or inflation data.
2. At a sector level, the concern has been raised that the cycle has peaked and that higher component prices mean that either demand will reduce or that prices must fall. Some analysts are forecasting that Q1 2018 will see the peak in iPhone sales growth although the volumes are still likely to remain high.
3. Some analysts have also warned that car sales growth in China will lose momentum in the coming months. Guangzhou Auto (not held) reported weaker sales today and some investors are reading across. But this company produces and sells Honda cars and unless investors were already nervous, the impact of this news would normally be slight.
4. Looking across the economies of Korea, Taiwan, Singapore, Thailand, and Australia we see no changes to conditions from 6 months ago. The outlook for US interest rates has not changed and neither has the outlook for the dollar vs regional currencies.

Our view in sum:

After such a strong run this year in stock markets around the world, investors are concerned that something nasty is about to happen. Unless there is a strong view about the dollar, interest rates or a global price shock then the question comes down to valuation. Have markets become too expensive and therefore should we retreat a little before year end?

Asian markets retreat – Our view

We think that Asian markets never got expensive. Valuations have come up from multi-year lows (which also depresses the 10-year average, making that comparison lower than it might otherwise be) and are supported by strong earnings growth forecasts which in turn are supported by strong profit growth already reported.

On that basis, market weakness looks like a buying opportunity and in the face of weak sentiment we shall be rebalancing our stock positions into that weakness.

December 6, 2017

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

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus and summary prospectus contains this and other important information about the investment company, and it may be obtained by calling 800.951.6566 or visiting www.gafunds.com. Read it carefully before investing.

Mutual fund investing involves risk and loss of principal is possible. 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. The Fund also invests in medium and smaller companies, which will involve additional risks such as limited liquidity and greater volatility. The Fund may invest in derivatives which involves risks different from, and in certain cases, greater than the risks presented by traditional investments.

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.

1 SD means 1 Standard Deviation which is a measure expressing the degree of variation around the mean (*i.e.* by how spread out the numbers in a group are from the average).

ASIA PACIFIC DIVIDEND BUILDER FUND Top 10 HOLDINGS (as of 10/31/2017)	
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%

ASIA FOCUS FUND Top 10 HOLDINGS (as of 10/31/2017)	
1. Sino Biopharmaceutical Ltd	3.64%
2. Geely Automobile Holdings Ltd	3.56%
3. Tencent Holdings Ltd	3.50%
4. Samsung Electronics Co Ltd	3.49%
5. Largan Precision Co Ltd	3.47%
6. Hanon Systems	3.41%
7. Relo Holdings Inc	3.40%
8. Anhui Conch Cement Co Ltd - H Shares	3.23%
9. St Shine Optical Co Ltd	3.20%
10. DBS Group Holdings	3.18%

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