Guinness Atkinson

**Dividend Builder Fund**

Managers Update – April 2018

## Quarter in review

Global equity markets have had an eventful start to 2018. The turn of the year saw equity markets surge ever higher on optimism over the strength of the world economy, big US tax cuts, and upbeat corporate earnings releases. Global growth forecasts for 2018 and 2019 were raised by 0.2%, to 3.9% in both years, and the MSCI World Index enjoyed its best January since 1994. This was, however, followed by the largest ever one-day spike in the CBOE Volatility (VIX) Index; the first 10% market correction since early 2016; and a subsequent 8% rebound (all in USD).

February's sell-off was triggered not by weaker economic data but by an acceleration in wage growth in the US. Average hourly earnings increased 2.5% year-on-year in December 2017 after a similarly strong November number; data released in early February 2018 confirmed an unexpected further pick-up in wage growth during January (2.9%). The updates strengthened the prospect of more aggressive rate hikes and prompted investors to consider the implications for bond markets; 10-year U.S. treasury yields rose to a high of 2.95% in February, raising speculation that the long-term downward trend in yields had been broken.

This was all before March, a month in which the year's early optimism faced increasingly strong headwinds from rising inflationary pressures, Federal Reserve (FED) rate hikes, and protectionist threats. As many anticipated, the FED did indeed raise rates by 25 basis points, to a range of 1.5% to 1.75%. It did not, however, alter its overall rate projection of three hikes for 2018. The announcement quelled some concerns, though just as it appeared that calm had returned to markets, global equities were rocked once again by fears of a global trade war.

The US administration initially announced tariffs on steel and aluminum imports, followed by a 25% tariff on $60 billion worth of Chinese imports. The Chinese, in response, announced increased tariffs on $3 billion worth of US imports. As the tit-for-tat trade stand-off continues it is worth reiterating that the proposed tariffs on Chinese goods amount to only about 0.1% of Chinese GDP while those on US goods are even less significant for US and global growth. That is not to say that risks to the trade outlook do not exist, but market gyrations have largely been due to the unpredictable potential impact on corporate profitability of specific industries. Overall, the S&P 500 has declined -0.76% (in USD) year-to-date.

In the meantime, the quarter has seen US companies report strong Q1 2018 earnings and analysts have been busy revising up their earnings estimates for the full year as companies start to communicate the effect the US tax cuts would have. While fiscal stimulus runs the risk of eventually overheating the economy, it significantly reduces the risk of a recession this year. Key early warning indicators for the economy continue to paint a positive picture of the growth outlook: consumer confidence is elevated, jobless claims remain low, and job openings are the highest on record.

Looking at Europe, equity markets retreated in March for a second consecutive month. Much like the US, February's pullback was set off by rising inflation and interest rate concerns; March's drop was caused by global trade worries. Although there was some relief when the White House declared a temporary exemption for the European Union and other nations on the steel and aluminum levies, this was not enough to fully recover the quarter's losses: the MSCI Europe ex UK Index fell 1.24% (in USD).

Turning to economics, the conditions in the Eurozone remained encouraging over the three months. January figures revealed that GDP growth for Q4 2017 was confirmed at 0.6% quarter-on-quarter and unemployment was stable at 8.6%. However, forward-looking surveys painted a picture of slower future growth. The composite purchasing managers' index (PMI) hit a 14-month low in March, albeit the reading of 55.3 still implies solid growth. Annual inflation was 1.1% in February, below the European Central Bank's (ECB) target, though Chairman, Mario Draghi, reiterated that interest rates would not rise until well past the end of the quantitative easing program.

In the UK, the backdrop of improving wage growth (2.8%) and low unemployment (4.3%), combined with the recent good news that a Brexit transition deal has been agreed, indicated that the Bank of England (BoE) could well raise rates again in May. This is certainly what the market rhetoric suggests. However, with Sterling's rally since the start of the year, UK inflation could also fall quite quickly (currently 2.7%), easing the squeeze on real wages.

Sterling strength has been accompanied with Dollar weakness; it is hence not surprising that emerging market (EM) equities have held up relatively well compared to many other markets, supported by still-strong GDP and corporate earnings growth. Brazil generated the strongest return as former president Luiz Inácio Lula da Silva saw his criminal conviction upheld, increasing the chances that the left-wing candidate is prohibited from participating in October's presidential elections. Despite falling back later in the quarter, Russia recorded a strong gain as the central bank cut interest rates and the country's debt was upgraded to investment grade by ratings agency S&P. Although Chinese equities were volatile towards the end of the quarter, given rising trade tensions with the US, the market recorded a positive return and outperformed. Macroeconomic data remained broadly stable, albeit there were ongoing signs of a gradual slowing in momentum, with official PMI easing to 50.3.

## Performance Drivers

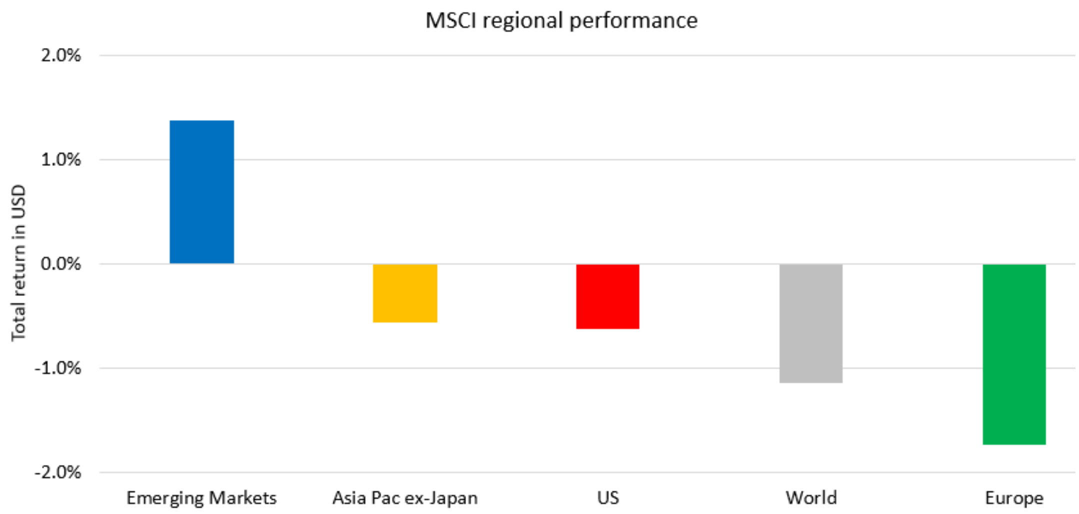



**Chart 1: MSCI World Index geographic total return breakdown for Q1 2018, in USD.** Source: Bloomberg (data from 12/31/2017 to 12/3/2018)

From a sector perspective, cyclical sectors performed more strongly in January and February, when the market was focused on faster rate hikes. In March, the broader decline in risk appetites saw more defensive areas outperform. Over the quarter, the weakest performance was in Telecoms, Energy, Consumer Staples and Materials, although most sectors fell. Despite the strong quarter overall for Technology, March's volatile performance weighed on investor sentiment as the quarter draw to a close. Of note was the privacy-driven regulatory concerns, contributing to the sector's weakness during the latter half of March.

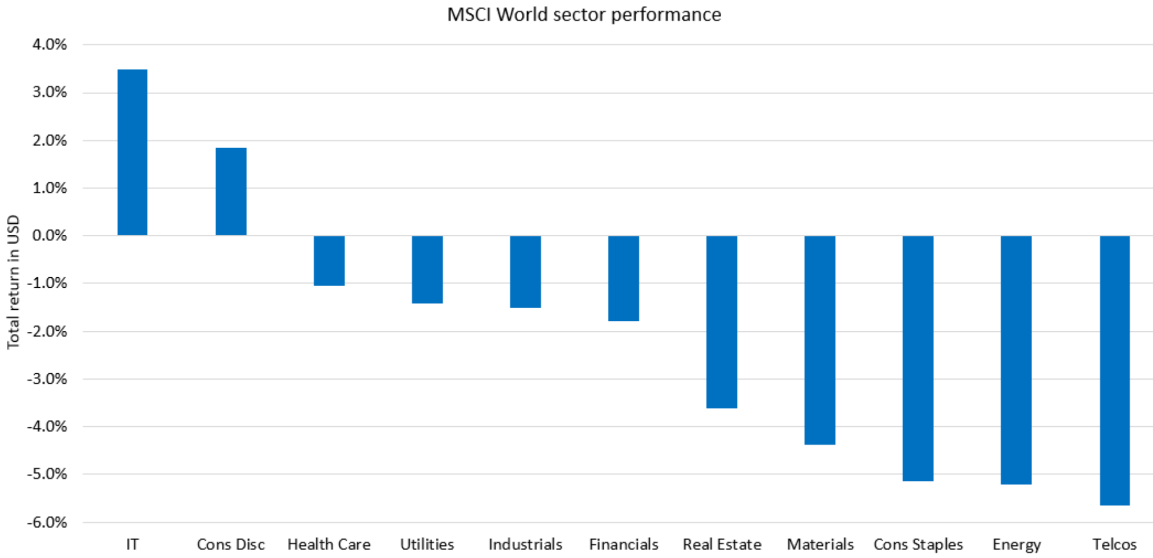
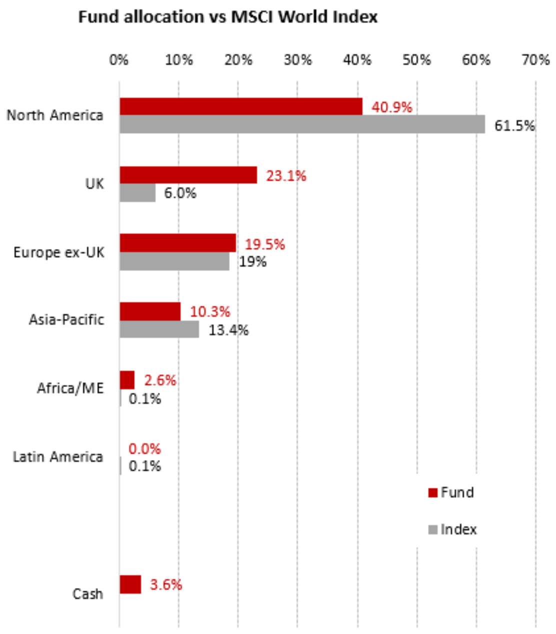



**Chart 2: MSCI World Index sector total return breakdown for Q1 2018, in USD.** Source: Bloomberg (Data from 12/31/2017 to 12/3/2018)

## Positioning

In terms of geographic exposure (chart 3), the largest difference between the fund and the benchmark is our exposure to the U.S. (as measured by country of domicile). The fund over the quarter had on average about 40% weighting to North America which compares to the index at about 60%. The largest geographic overweight remains the UK which had a c.17% larger position than the benchmark over the quarter.



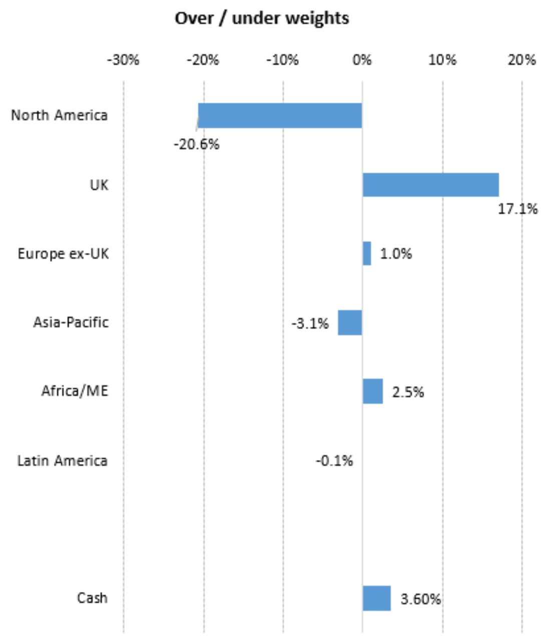




**Chart 3: Regional breakdown of the fund versus MSCI World Index. Guinness Atkinson Asset Management, Bloomberg (data as of 03.31.2018)**

We would however note two main points, referring to chart 4; (i) the fund has a lower exposure to the UK when considered in revenues (c.7%) versus by domicile (c.23%). This is because we have favored UK domiciled companies with a more global exposure (such as Unilever and Imperial Brands); and (ii) there is a larger exposure to Asia and emerging markets by revenues (c.20%) than the equivalent statistic as measured by domicile (c.10%).

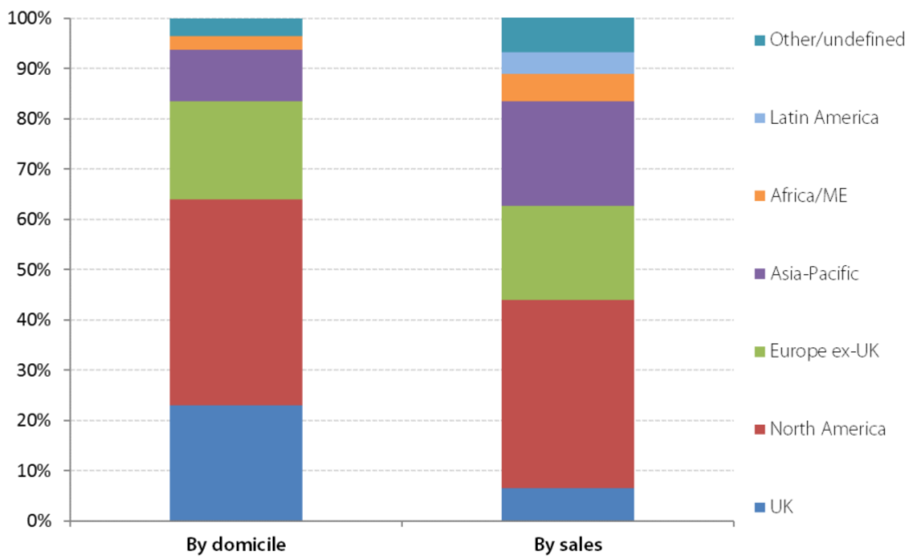
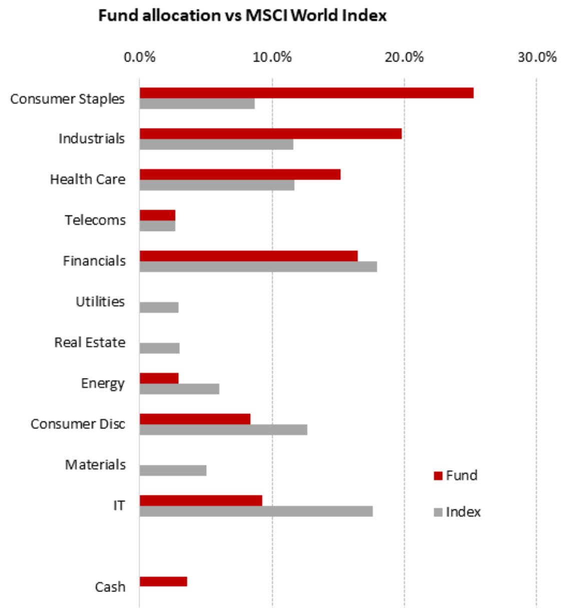



**Chart 4: Geographic breakdown of the fund. Guinness Atkinson Asset Management, Bloomberg (data as of 03.31.2018)**

In terms of sectors, the fund benefitted most from our overweight in Industrials and Healthcare, though underweight IT was still a drag given the sector's positive performance overall. The fund continues to have a zero weighting to utilities, materials, and real estate, and only 1 position in each of Telecoms and Energy – all to the benefit of the fund's performance in the last quarter.



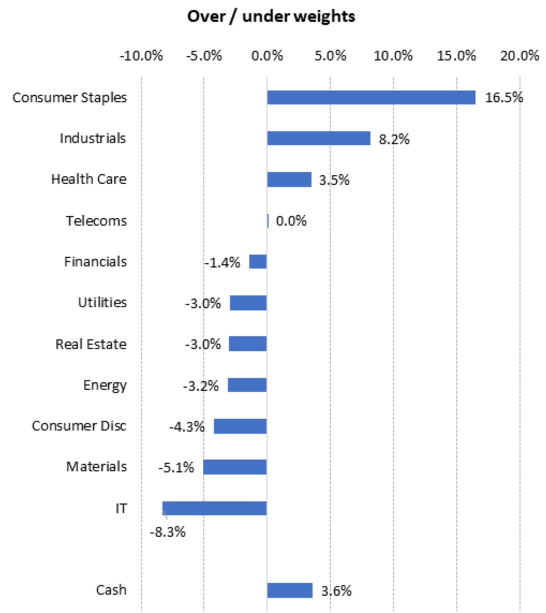




**Chart 5: Sector breakdown of the fund versus MSCI World Index. Guinness Atkinson Asset Management, Bloomberg (data as of 03.31.2018)**

The below two charts show how the exposure of the fund has evolved since we launched the strategy back in 2010.

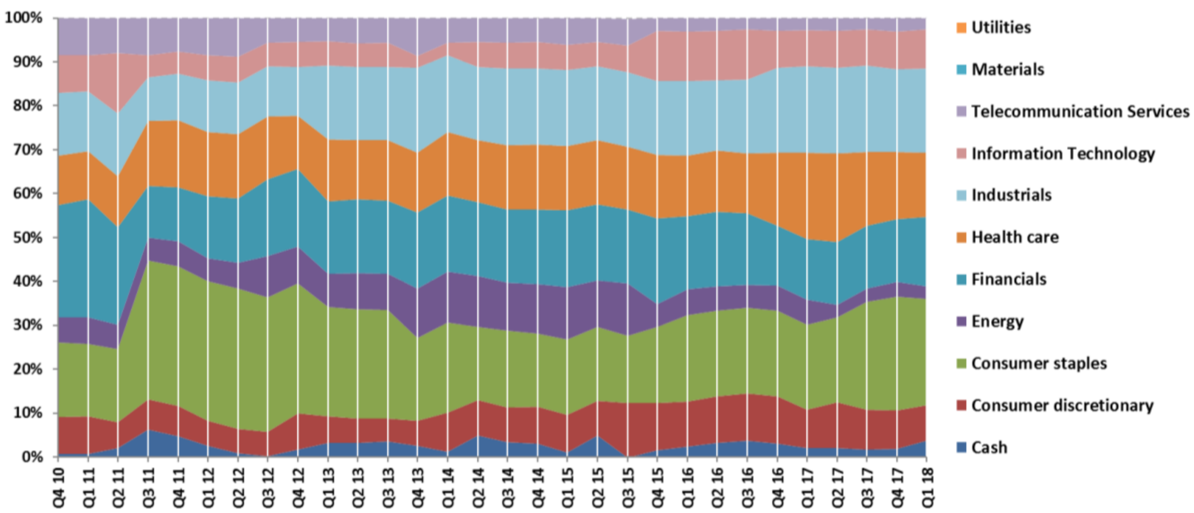



**Chart 6: Sector breakdown of the fund since launch. Guinness Atkinson Asset Management, Bloomberg (data as of 03.31.2018)**

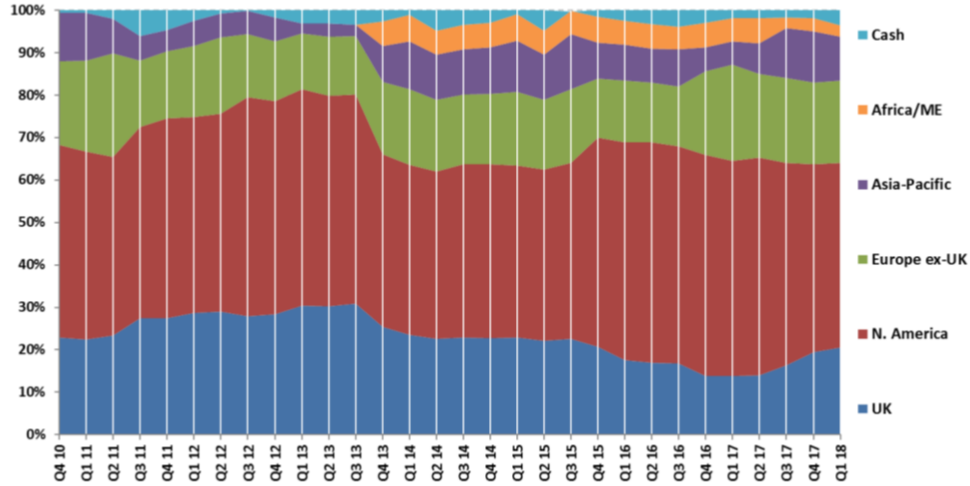
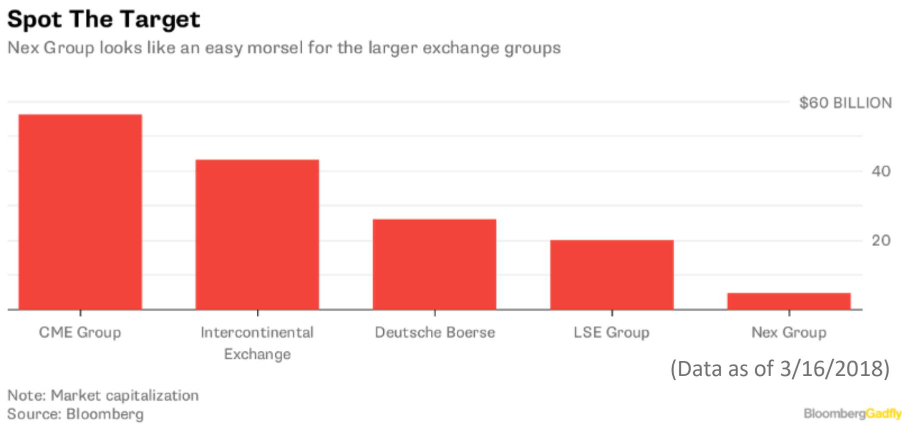



**Chart 7: Geographic breakdown of the fund since launch. Guinness Atkinson Asset Management, Bloomberg (data as of 03.31.2018)**

Individual companies that performed well over Q1 were NEX Group, Deutsche Börse and Cisco. Companies that had weaker performance over Q1 were Imperial Brands and Hengan International.

**NEX Group** (+67.6% in USD) was the best performer in the quarter after a combination of increased market activity and trading volumes was followed by a $5.5 billion takeover approach from CME Group. The financial technology firm, which provides electronic trading platforms, will be CME Group's largest overseas acquisition and its largest since it bought Nymex for $11bn in 2008. CME Group, which owns and operates both the Chicago Board of Trade and the Chicago Mercantile Exchange, will pay 500 pence and 0.0444 in new CME shares for each NEX Group share. The market has seen the latest wave of consolidation in global exchange markets as positive for both companies, with the annual synergy of expenses expected to reach $200 million per year by 2021. We pleasingly also own CME Group in the fund, and the stock is up 11.2% (in USD) over the quarter.




"At a time when market participants are seeking ways to lower trading costs and manage risk more effectively, this acquisition will create significant value and efficiencies for clients globally," said CME Group's CEO, Terry Duffy. "As one organization, we will be able to employ the complementary strengths of each company to serve a wider client base while diversifying our combined businesses across futures, cash and OTC products, and post-trade services."

**Deutsche Börse** (+16.8% in USD) reported a 3% year-on-year increase in net revenue to €639m, beating analyst expectations (€619m). Theodor Weimer, the new CEO of Deutsche Börse, in charge since January, revealed that the German exchange platform is targeting net revenue growth of at least 5% and net income growth of at least 10%. The Company offers listing and trading services and operates the trading platforms Xetra and Frankfurter Wertpapierboerse. It also provides clearing, reporting, settlement and custody services for fixed-income securities, stocks and investment funds. Revenue tailwinds include rising interest rates, greater volatility, and Brexit uncertainty; and the company has also recently benefitted from strict cost controls.

**Cisco** (+12.8% in USD), a world-leading IT infrastructure equipment vendor, has been making a transition to a balanced revenue mix of hardware and software, with a goal of deriving 50% of sales from software by 2020. The company reported a 2.7% increase in its fiscal Q2 revenue and a 5% gain in product orders, suggesting it may be on track to post sustained growth in coming quarters. Its move to software is best measured by its recurring revenue, with 33% of fiscal 2Q18 sales coming from recurring offers. The quarterly gains reflect rising strength in Cisco's new product sales, particularly its new line of programmable switches, the Catalyst 9000 series. These switches are selling well, with CEO Chuck Robbins citing the 9000 as the fastest-growing new product in Cisco's history.

**Imperial Brands** (-18.8% in USD) is a global tobacco manufacturer. Share price weakness has come due to falling cigarette volumes and the increasingly regulatory pressure on tobacco companies. However, the company's fundamentals remain strong and there is an active effort from management to refocus business to key brand franchises. This will inevitably lead to a fall in cigarette volumes in the short run, as a range of tobacco products are disposed, however, the goal is to maximize profitability and cash generation. This is then to be reinvested in faster-growing next-generation products, which would form the basis of future growth. The company's cashflow return on investment trends upwards and the dividend has attractively been grown nine consecutive times by 10%. Currently trading at a 1-year forward P/E multiple of 9.6 and a dividend yield of 6.8%, we believe the market has been overly pessimistic, and continue to favor the company.

**Hengan International** (-16.6% in USD) is one of the largest producers of sanitary napkins, diapers and tissue paper in China. Historically the company has captured significant market share in established distribution channels (maternity stores, hypermarkets) and more recently it is seeing growth from online exposure. Management has built up an e-commerce team to take advantage of the channel shift in China, whereby consumers are increasingly purchasing everyday items online. Alongside this there are new brand launches and a revitalized "Amoeba" sales strategy to maintain its offline market share. Growing revenues, high and stable margins, year-on-year earnings growth and a well-covered, high dividend are some of the highlights making this a compelling stock. Its recent sell-off points to two reasons: firstly, a slowing momentum of sales growth, and secondly the increasing year-on-year price of wood pulp – a major input for Hengan's product. We believe the market has been overly pessimistic considering that slowing sales growth has been explained as voluntary curbing, after some regional offices had already hit their yearly sales targets by December. Furthermore, structurally the company is still in the process of reforming its sales strategy that has shown early signs of success.

In the quarter we made no changes to the portfolio. The average turnover of the fund is 20% annually (~5 positions).

## Key Fund Metrics Today

The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level to make sure we are providing what we say we will. Based on the measures, holistically, the high-conviction fund has companies which are on average better quality at similar value verses the index.

At the quarter end, we are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI World Index.

| | | Fund | MSCI World Index |
|---|---|---|---|
| **Quality** | Average 10 year CFROI | 18% | 8% |
| | Weighted average debt / equity | 45% | 61% |
| **Value** | PE (2018e) | 16.3 | 15.6 |
| | FCF Yield (LTM) | 6.7 | 4.3 |
| **Dividend** | Dividend Yield (LTM) | 2.8% | 2.3% |
| | Weighted average payout ratio | 59% | 52% |
| **Conviction** | Number of stocks | 35 | 1650 |
| | Active share | 92% | - |

**Chart 7: Portfolio metrics versus index. Guinness Atkinson Asset Management, Credit Suisse HOLT, Bloomberg (data as of 03.31.2018)**

Guinness Atkinson
**Dividend Builder Fund**
Managers Update – April 2018

GUINNESS ATKINSON FUNDS

## Outlook

With an increasingly volatile environment perhaps on the horizon, we believe that our approach to finding quality companies at attractive valuations is more important than ever. The Guinness Atkinson Dividend Builder fund currently trades at a reasonable valuation to the MSCI World on a price to earnings basis and has a free cash flow yield 50% higher than the MSCI World (6.7% vs 4.3% respectively). We believe this provides good value to our investors and puts us in good stead in our search for long-term capital growth and a steady, growing income stream.

We thank you for your continued support.

<u>Portfolio Managers</u>
Matthew Page, CFA
Ian Mortimer, CFA

<u>Analysts</u>
Sagar Thanki
Joshua Cole

## Performance

In March, the Guinness Atkinson Dividend Builder Fund produced a total return of -0.49% (TR in USD), compared to the MSCI World Index return of -2.18%. The fund therefore outperformed the Index by 1.69%.

**Performance**

| as of 03/31/18 | YTD | 1 YR | 3 YR | 5 YR | 10 YR | Since inception (3/30/12) |
|---|---|---|---|---|---|---|
| **Dividend Builder Fund** | 1.00% | 15.66% | 8.02% | 9.56% | N/A | 10.34% |
| **MSCI World Index** | -1.15% | 14.21% | 8.60% | 10.35% | N/A | 10.71% |

| as of 12/31/17 | YTD | 1 YR | 3 YR | 5 YR | 10 YR | Since inception (3/30/12) |
|---|---|---|---|---|---|---|
| **Dividend Builder Fund** | 21.34% | 21.34% | 7.70% | 11.24% | N/A | 10.61% |
| **MSCI World Index** | 23.10% | 23.10% | 9.91% | 12.30% | N/A | 11.42% |

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](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.***

**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 03/31/2018

| | | |
|---|---|---|
| 1 | NEX Group PLC | 4.48% |
| 2 | Microsoft Corp | 3.33% |
| 3 | Deutsche Boerse AG | 3.26% |
| 4 | CME Group Inc | 3.23% |
| 5 | Cisco Systems Inc | 3.23% |
| 6 | VF Corp | 3.18% |
| 7 | Arthur J Gallagher & Co | 3.05% |
| 8 | ANTA Sports Products Ltd | 3.04% |
| 9 | Danone SA | 2.96% |
| 10 | Schneider Electric SE | 2.96% |

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.

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.