
Summary Review & Outlook

Fund & Market

- The best performing regions in March were Korea and Malaysia. For the first quarter as a whole the best performing regions were by far Thailand and Malaysia.
- The weakest regions in March and for the quarter were Indonesia, the Philippines and Australia.
- Defensive sectors were strongest in March with Utilities, Health Care and Consumer Staples leading the way. Consumer Discretionary, Financials and Materials were weakest.
- For the first quarter as a whole, Health Care was a bright spot, rising 10.8% compared to a flat market. Telcos were very weak, falling 6.0% in the quarter (all returns in USD, unless stated).
- Over the first quarter, earnings revisions were strongest in China, Korea and Thailand. On the other hand, revisions were noticeably weaker in Australia.
- Donald Trump halted Broadcom's bid for Qualcomm on the grounds of national security.
- China Lilang was by far the strongest stock in March, rising over 30%, after releasing results showing a strong pickup in same-store-sales.

Events in March

- Trade tensions continue to increase. The US announced tariffs on imported steel and aluminum, though exemptions have since been made for several countries. The US also announced plans to introduce tariffs on \$50bn worth of imports from China, targeting specific industries such as aerospace and industrial machinery. Initially China responded cautiously, increasing tariffs on only \$3bn worth of imported goods from the US. But as the scale and scope of tariffs directly targeted at China became clear, the country threatened to respond with its own tariffs on \$50bn of US goods including soybeans and automobiles.
- One of the exemptions to US tariffs was agreed with South Korea. The two countries agreed to revise an existing trade pact that further opens up the Korean market to the US automobile industry. The revised deal also forces Korea to become more transparent with its foreign exchange interventions, which some have criticized for keeping the won at levels that are artificially cheap.
- Following further diplomatic maneuvering, it was announced that a joint summit between North and South Korea will be held on April 27th. The news follows Kim Jong Un's visit to Beijing where he met Xi Jinping. Donald Trump is due to meet Kim Jong Un at the end of May.
- In China, policymakers agreed to target GDP growth of around 6.5%. Noticeably the reference to achieving faster growth "if possible" was dropped.
- Renminbi-denominated debt will be added to the Bloomberg Barclays Global Aggregate Index in April 2019, being phased in over 20 months. The move represents another step in integrating Chinese markets with global markets, following MSCI's decision to include China A-shares in its Emerging Markets index.

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Outlook

- Fears over trade will likely dominate the news over the coming months. While China is currently in the spotlight, we believe the US will also seek to address imbalances with its other trading partners.
- We believe it is not in the interests of the US, China or its other trading partners to start a trade war. The US is reacting to perceived unfair access to Chinese markets, including a requirement to surrender intellectual property. Reforms by China in this area could help to de-escalate tensions.
- Our portfolio of companies is attractively positioned, trading at a 9% discount to the market. The market, in turn, trades at a discount to developed equities.

Performance

The fund fell by 0.72%, outperforming the benchmark which fell 2.24%.

As of 03/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	-0.05%	22.25%	10.87%	8.01%	4.95%
MSCI AC Pacific ex Japan Index	0.01%	22.33%	9.01%	7.18%	6.15%

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 notes. Total returns reflect a fee waiver in effect and in the absence of this waiver, total returns would be lower.

Trade tensions

The escalation we have seen in trade tensions between the US and China in particular represents a return of President Trump's protectionist agenda, which had been somewhat quiet over the course of 2017. Until recently, the biggest step taken by the administration had been to withdraw from the Trans-Pacific Partnership (TPP)¹. That all changed with the announcement of tariffs on steel and aluminum in early March. As we discussed last month, the tariffs were introduced on the grounds of national security and seemed mainly directed at countries other than China. China only accounts for around 2.1% of US steel imports. Countries more prominently in the firing line were Brazil, Canada, Mexico and South Korea, which account for around 48% of steel imports.

In the days after the announcement and as the dust settled, we got a clearer indication of the rationale behind the measures. Aside from appealing directly to Trump's supporters, the announcement seemed to be an act of brinkmanship, with countries one-by-one gradually securing 'exemptions' from the tariffs. In the case of Canada and Mexico, for example, the quid-pro-quo is continuing to renegotiate the provisions of NAFTA. The agreement the US reached with South Korea is particularly notable for the level of concessions the US obtained. In return for not applying the tariffs, American car manufacturers have been granted better access to the Korean market (South Korea has agreed to accept US safety regulations for 50,000 vehicles, up from 25,000 and has extended a tariff exemption on US pickup trucks). South Korea has also agreed to limit exports to a level at 74% of 2017 levels. The US certainly seems to have caught the better end of this bargain!

China's response was measured and targeted. In direct retaliation, China announced tariffs on \$3bn of imports of US steel pipes, fresh fruit, wine and pork. The inclusion of agricultural products is clearly directed to send message to some of Trump's core supporters in rural areas.

The second wave of tariffs by the US was explicitly directed at China and were announced following a review of intellectual property rights of US companies operating in or selling to China. The tariffs are explicitly designed to target Chinese companies operating in high-tech industries – the very same industries that the Chinese government has been promoting as part of its Made in China 2025 policy. Among the 1,333 products affected are: construction machinery, components used in display screens, and industrial robots. China's response to this second wave of tariffs was swift, announcing additional tariffs on 106 products from the US including soybeans, automobiles and chemical products. The targeting of soybeans by the Chinese is interesting because they are a seasonable product. At this time of year, they are mainly imported from South America.² But from the autumn, China imports from the US. If the tariffs are fully implemented as planned, the impact could start to be felt just before the US mid-term elections in November this year.

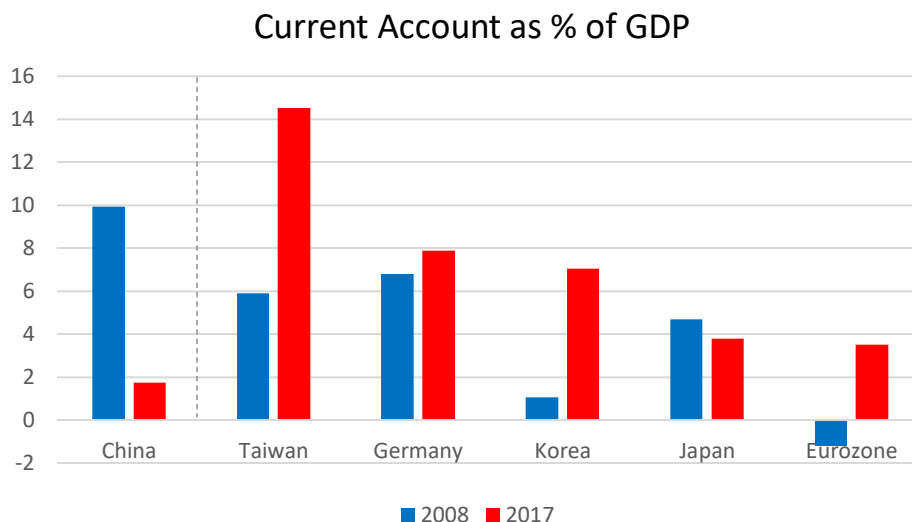
¹ The TPP which was subsequently re-negotiated by the remaining participants—probably contrary to US expectations—and signed as a new agreement: the 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership'. While it seems unlikely at this juncture, it remains an open question whether the US would re-join the trade agreement – President Trump indicated that this was a possibility if a "substantially better deal" for the United States could be agreed.

² As the 'Dim Sums' blog points out, Brazil only emerged as a major soybean exporter as a result of Japan's efforts to diversify its soybean supply. Why did Japan need to do this? It faced an export embargo by the US in the 1970s.

The market response to these developments has been volatility. Equities have swung as optimism that a trade war has been averted has shifted to pessimism as further levies are announced. Such a backdrop offers potentially a difficult climate in which to invest – and a useful reminder of why we don't attempt to make top-down macro allocation decisions. But despite the uncertainty, there are several reasons to be optimistic.

First, we note that while China's response has been robust, it has left the door open for negotiation. The involvement of Liu He in talks with Steven Mnuchin and Robert Lighthizer in Washington at the end of March reflects the importance with which both sides view the issues. Our position has always been that a trade war would not be in either China's or America's interest, and China's 'reluctant' response reflects this. But it may take further saber-rattling by the US before tensions begin to de-escalate. China could help by agreeing to further market reforms. But already we have seen a negative reaction in the US to the trade proposals from both businesses and consumers. Further pressure could force a compromise.

Second, if we look at global trade more broadly, China's trade surplus as a proportion of GDP is much smaller than it was ten years ago. In 2008, China's current account surplus (a broader measure of trade) was 9.9% of GDP. At that time, one could make a convincing argument that China had been unfairly exporting its excess savings to the rest of the world. But that argument is now harder to make. By 2017, the surplus had fallen to only 1.8% of GDP, as the following chart shows:



Source: World Bank, Bloomberg (as of 3/31/18)

In contrast with China, the Eurozone's current account increased from a deficit of 1.2% of GDP in 2008 to a surplus of 3.5% in 2017. Germany by itself has a current account surplus of 7.9%. Donald Trump has previously made his dissatisfaction with Germany's trade position clear, but for now the attention has been focused on China.

Looking across Asia, Taiwan and Korea have much larger surpluses, relative to GDP, than China. Since the financial crisis, China's economy has been less dependent on global trade. As Martin Wolf points out in a recent article,³ after relying for many years on investment to sustain GDP growth, the economy is transitioning to one that is more based on consumption. As we describe below, the development of higher-complexity manufacturing is one factor that has supported wage growth, which in turn has allowed patterns of increased consumption to emerge. Given the progress that China has made in reducing its surplus, we expect a fair amount of attention to shift to other countries with which the US has trade surpluses.

Third, the targeting of China's high-tech industries reveals just how far China has come in developing advanced manufacturing capabilities, and how seriously the US takes the competitive threat. We have written before that China's manufacturing is evolving and moving up the value chain. China is determined to throw its weight behind certain national champions in high-tech industries as the Made in China 2025 plan shows.

It is difficult to see how the US will be able to suppress this trend. While technology transfer can be resisted, and direct foreign investment in the US can be blocked, we think China is fast approaching an inflection point where domestic innovation will be paramount. The development of 5G networking standards is one such example – see comments on Huawei below.

Markets and portfolio

In addition to the de-escalation in tensions over North Korea (see comments above), we note further progress in corporate governance in **South Korea**. The country's Fair Trade Commission has ordered chaebols to simplify their ownership structure without negatively impacting minority shareholders. Hyundai is simplifying its crossholdings across its subsidiaries, by changing its holdings in Mobis (manufacturer of car parts) and Globis (logistics). This is an encouraging sign that the government's efforts to improve governance at the chaebols are moving in the right direction. **Malaysia** defended well in March and has been one of the strongest markets in the region so far in 2018. The outperformance follows a period of much weaker relative performance last year.

In the **Philippines** inflationary pressures continued to build up, with inflation in February coming in at 4.5%. The central bank did not increase interest rates while the required reserve ratio was recently cut, leading to concerns over both inflation and the peso, which is still the weakest currency this year in the region. The fund currently has no exposure to the Philippines. In **Australia**, nearly all sectors were negative in March. Economic data was generally on the weaker side: fourth quarter GDP growth was 0.4% versus 0.7% in the third quarter; private capital expenditure in the fourth quarter of 2017 fell slightly and retail sales were flat in January. Iron ore prices fell 18% in March following lower Chinese steel prices.

³ "The Chinese economy is rebalancing, at last", 3 April 2018. *Financial Times*.

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Broadcom's bid for **Qualcomm** ended with an intervention by President Trump, who blocked the deal on the grounds of national security. The move followed a letter published by the Committee on Foreign Investment in the United States (CFIUS) launching an investigation into the deal. CFIUS highlighted several problems with the proposed takeover, including the possibility that Broadcom would cut R&D spending at Qualcomm. Qualcomm is at the forefront of developing mobile communication standards that will be used in the upcoming shift to 5G, as is China's Huawei. The fear is that if Qualcomm falls behind in 5G, Huawei would play the main role in the global standard-setting process. The US government has long been critical of Huawei, both because of the level of support it receives from the state, and the effect on national security of its links with the Chinese Communist Party.

China Lilang was the standout performer in March, rising by more than 30%. The company is a clothing retailer which targets the casual menswear segment. For more than a decade the business has generated a cash return on investment of around 15% which is impressive for a clothing retailer. Lilang's main brand, LILANZ, was struggling in 2016 but following renovation of a number of stores, same store sales accelerated in the second half of 2017. An important gauge of the company's prospects are its orders at trade fairs for the spring and summer seasons. We were happy to see orders increasing by 31% on a year-on-year basis.

The fund's holdings in hardware manufacturers in the Information Technology sector were weaker in March. There was a general sell-off in IT across Asia and the US, that fed through to **AAC Technologies** (manufacturer of speaker boxes, haptics and wafer lenses) and **Largan Precision** (manufacturer of plastic smartphone lenses). Though the stock moved lower over the month, AAC actually reported good results that met expectations. The company is already seeing progress in its wafer lens business which makes it a competitor in an industry that Largan dominates. **Elite Material**, a manufacturer of halogen-free printed circuit boards used in smartphones and servers, reported margins which were weaker than expected. All three companies are exposed to the Chinese smartphone industry. Chinese shipments fell 4% in the fourth quarter of 2017 and the first quarter of 2018 is likely to see weaker demand from Chinese manufacturers as inventories are reduced.

Summary and conclusion

The portfolio is trading, on a price/earnings multiple basis, at a 9% discount to the market as measured by the MSCI AC Pacific ex Japan Index. The index is in turn trading at a wider discount to developed markets than its ten-year average. A combination of above average companies—in our opinion—paying above average dividends and trading on a below-average valuation seems to us to be an attractive one.

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

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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.

Payout ratio refers to the proportion of company profits paid out to shareholders as a dividend.

The trade surplus is the difference between the value of a country's exports and imports. The current account surplus adds income and remittances to the trade surplus.

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.

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Top Fund Holdings as of 03/31/18

1	Lilang China Co	3.58%
2	Ascendas Real Estate Investment Trust	3.12%
3	China Mobile Ltd	2.93%
4	Luk Fook Holdings International Ltd	2.92%
5	Novatek Microelectronics Corp	2.90%
6	Catcher Technology Co Ltd	2.86%
7	Hanon Systems	2.85%
8	Delta Electronics Thailand PCL /Foreign	2.83%
9	Elite Material Co Ltd	2.81%
10	Largan Precision Co Ltd	2.80%

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

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