At the beginning of July, the US fired its opening salvo and introduced a 25% tariff on $34bn of Chinese imports, with tariffs on another $16bn due to follow. The US is now planning to impose a 10% tariff on $200bn worth of Chinese imports with the potential of more to come. Many are now becoming concerned over the impact of these tariffs on not just the Chinese and US economy but also the impact on global growth.

In 2017, China's exports of goods totaled US$2.3 trillion and its imports were $1.8tn. The largest trade partner in 2017 was the United States, which according to US Census Bureau data received US$506 billion of Chinese exports and in return sold goods to China worth $130bn. While China has an overall trade surplus with the world of $420bn, the US runs a trade deficit of $375bn.

The focus of the trade dispute was initially on the trade imbalance between the US and China which has been above $250bn per year for the past 10 years. The US's complaints were mainly directed at unequal access to China's domestic market and the appropriation of foreign technology along with insufficient protection for intellectual property rights. As the dispute has continued, however, the complaints have extended to China's industrial policy and its level of state involvement – issues which cut to the heart of China's effort to wean itself off debt-fueled state investment and move towards more advanced industrial manufacturing. This makes the task of resolution much harder to achieve.

The question of what the US actually wants is tricky to unpick. Donald Trump was elected President with the promise of a protectionist stance and he knows he must deliver. Mid-term Congressional elections are approaching, which make it even more pressing for him. However, there is more to the matter than just Donald Trump. The harder line against China enjoys bi-partisan support in Congress, something which very few issues achieve. US foreign policy appears to be shifting from one of engagement to containment. There are two powerful themes at work in the US: the free-traders point to the benefits to investment and consumption through globalization and lower prices; the American worker counts the cost of globalization in terms of lost jobs and stagnant wages – not everyone participates equally.

The direct impact on China is likely to be limited because the country is no longer as dependent on exports as it used to be. At their peak, exports of goods and services in 2006 were worth 36% of China's GDP or around $1 trillion. In 2017 China exported $2.3tn, but this represented only 20% of GDP, a much smaller proportion because China's economy is many times larger. The overall impact of the potential upcoming tariffs is a 6.5% increase in overall tariffs on $250bn of exports to the US which it is estimated could reduce exports by 8%-10% and shave 0.2% off GDP growth. Job losses in China as a direct result are estimated to be around one million. The harder part of the analysis comes in trying to assess the wider implications in terms of the effects on business and consumer confidence. Much of this depends on what China's response will be. Will it continue to counter with its own tariffs? On top of the $250 it has already targeted, will the US impose tariffs on the remaining imports from China? If the situation were to escalate,

the impact on China's and the US's growth rates will become more significant, along with a reduction in global growth. It is worth noting that the US administration has not targeted certain sectors at all. Toys, apparel and smartphones have remained unscathed so far because if tariffs were to be imposed, consumers would most likely be affected immediately through higher prices. The US has targeted intermediate goods and household items such furniture and fixtures where it is likely that the burden of the tariff could be shared by both manufacturers and consumers.

There is also the potential for tariffs to inadvertently affect American companies. Data from China's customs department shows 70% of the largest 100 companies exporting to the US are foreign, with Taiwanese and overseas divisions of American companies (including joint ventures) the largest in this group. The case of plastic injection molding machines is a good example to illustrate the effect of collateral damage. Tariffs have already been introduced in this industry and their intended targets are Chinese manufacturers such as Haitian International and Chen Hsong. But Engel, an Austrian company that manufacturers certain ranges of its products in China, is likely to be subject to the tariff. Milacron Holdings is a US company that should benefit but may end up paying more for intermediary components made in China. Given how integrated China is in global supply chains, it is very likely that US firms in the manufacturing sector will face disruption in one way or another. This dynamic represents leverage for the Chinese to negotiate with.

China has the capacity to respond to tariffs, but it is restricted in how it can do so. The US exported $130bn of goods in 2017 to China. Having already introduced tariffs on $50bn, China only has $80bn of US trade to put tariffs on. There are, however, other ways China can respond. China can make life difficult for US companies operating in the country by increasing the amount of red tape businesses face or the amount of time goods are held up at customs. Although in our view it is a measure of last resort, the government can whip up anti-American sentiment and encourage a boycott of American goods, which it did in recent disputes with Japan and South Korea. Large consumer-facing American companies that have significant exposure to China include:

- Apple, which derives 20% of its revenue from the region and manufactures virtually all of its iPhones in Asia
- 27% of Starbucks stores are in the China/Asia Pacific region, which has much faster growth in sales compared to the US
- Nike derives 12% of its revenue and 30% of its earnings from Greater China; much of its manufacturing base is in the region

The business lobby in the US will no doubt be voicing its concerns to the US administration and this will be a factor in determining the next steps forward.

Finally, it is worth comparing the rhetoric over trade with the reality in terms of earnings growth. We are still seeing decent earnings growth for the Asia Pacific ex Japan region, with forecast earnings growth of 10% for 2019. Having traded more than one standard deviation above its historic average on a forward basis, the region is now trading at 13.5x FY1 earnings – in line with the historic average. On a relative basis the region is still looking cheap versus the S&P 500, trading at a 22% discount – nearly one standard deviation below the historic average. The Asia Pacific Dividend Builder Fund is even more attractively valued, trading at a further 7% discount to its benchmark on forecast earnings. In aggregate, the portfolio trades on only 11.9x 2018 earnings and 10.8x 2019 earnings, implying 10% earnings growth. The net yield of the portfolio is significantly higher than both the benchmark and many other regions around the world. Given the compression in valuation multiples, we think now is a great opportunity to be buying into quality companies that are persistent cash generators.

Performance

As of 6/30/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	**-6.75%**	**6.71%**	**6.32%**	**7.12%**	**4.40%**
MSCI AC Pacific ex Japan Index	**-3.70%**	**10.44%**	**7.89%**	**8.06%**	**6.10%**

All returns over 1 year annualized. *Source: Bloomberg, Guinness Atkinson Asset Management.*
Expense Ratio: 1.12% (net); 3.48% (gross)
30-Day SEC Yield: Subsidized 3.08%, Unsubsidized 0.85%

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.

GUINNESS ATKINSON FUNDS

Top 10 Holdings as of 6/30/18:

Holding	Weight
1. Largan Precision Co Ltd	3.30%
2. Corporate Travel Management Ltd	3.18%
3. KT&G Corp	3.14%
4. CapitaMall Trust	3.02%
5. QUALCOMM Inc	3.00%
6. Asustek Computer Inc	2.99%
7. Ascendas Real Estate Investment Trust	2.98%
8. Sonic Healthcare Ltd	2.98%
9. Luk Fook Holdings International Ltd	2.92%
10. The Link REIT	2.91%

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 Asia Pacific Dividend Builder Fund. You can find the prospectus here.

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.

Net yield is the rate of return on an investment after subtracting all expenses.

SEC Yield is a standard yield calculation developed by the U.S. Securities and Exchange Commission (SEC) that allows for fairer comparisons of bond funds. It is based on the most recent 30-day period covered by the fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period after the deduction of the fund's expenses.

Unsubsidized Yield represents what the yield would have been in the absence of temporary expense waivers or reimbursements.

Subsidized Yield represents the yield including temporary expense waivers and reimbursements.

One cannot invest directly in an Index

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