Guinness Atkinson

Asia Pacific Dividend Builder Fund

Review of October 2018

Summary Review & Outlook

Fund & Market

- October was a month to forget with Asia down 10.5% in USD terms (as measured by MSCI AC Pacific ex Japan net return Index).
- In sector terms, the outperformers were Utilities and Telecom Services, which were down 5%, and Real Estate, Financials and Consumer Staples, which were down 8%-9%. The underperformers were IT, down 14%, and Health Care and Consumer Discretionary, down 13%. Industrials, Energy and Materials moved in line (all in USD terms).
- In country terms, underperformance was confined to north Asia (China, Hong Kong, Korea and Taiwan), which fell 11%-14.5%. Southeast Asia and Australia & New Zealand clearly held up.
- In the portfolio, 20 out of 36 stocks outperformed the market, 12 of which are Chinese, Hong Kong, Taiwanese or Korean companies. Among the top 20 performers are companies in the IT, Consumer Discretionary and Energy sectors as well as Financials and Real Estate.
- Sino-US trade, a strong US dollar, rising bond yields and a steady stream of weaker Chinese macro data combined to drive market sentiment.
- At the end of October, Asian valuations have compressed to 11.8x consensus estimated earnings, back to 2015 lows.

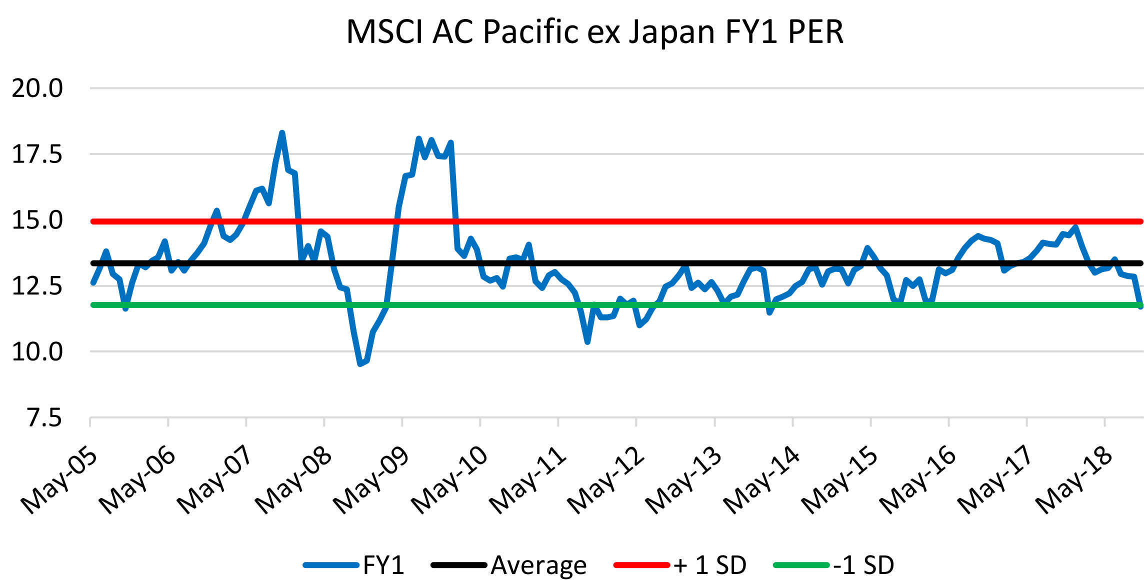
Events in October

- Asian earnings forecasts were revised down by 1.5% over the month to leave forecast earnings growth at 8.4%.
- US and Canada reached an agreement on trade.
- The Italian budget plan was submitted to the EU and was rejected because it fails to meet the requirement for steady deficit reduction. Italian debt was downgraded by Moody's but remains (just) investment grade. Minutes of the Federal Open Markets Committee meeting in September (released in October) suggested the majority were looking to push interest rates into restrictive territory next year. This prompted a spike in bond yields mid-month.
- US-China trade tensions have in fact reduced as threats for the next round of tariffs have diminished and the focus shifts to discussions and a meeting between Trump and Xi in December.
- US did not label China a currency manipulator.
- Although little reported, China doubled its imports of oil from the US in September and cut oil imports from Iran by 34%.
- Jair Bolsonaro was confirmed as Brazil's new president.
- Angela Merkel announced she would not stand again as party leader and that she would not seek re-election as Chancellor of Germany in 2021.

Asian Markets & Macro

Valuations

Asian valuations have now reached the lows of 2015 after a torrid period in markets. The chart below shows the forward Price to Earnings (PER) multiple for consensus expected (FY1) earnings compared to its 10-year average with bands showing +/- 1 standard deviation (for a normal distribution, +/- 1 standard deviation (SD) means that valuations should lie within these bands 68.27% of the time). At the end of October, valuations are at the bottom of this range. This means that Asia has given up all the valuation re-rating that it has achieved since the end of 2015, but in contrast to the period 2010-2015 when Asian earnings contracted 0.5% per annum on average, profits since 2015 have grown 10.1% on an annualized basis (MSCI AC Pacific ex Japan earnings December 31, 2015 – October 31, 2018).



Source: Bloomberg data, Guinness Atkinson Asset Management

Asian trade patterns

China has dominated Asian trade since it joined the World Trade Organization in 2000, but in recent years, trade patterns have evolved as other countries' manufacturing capacity has improved. The impetus has been Yuan appreciation (from its pre-2005 pegged level, recent yuan weakness notwithstanding) and rising production and labor costs. These trends have emerged gradually over the last ten years but have now reached a point where changes in behavior are measurably different. The recent trade dispute between the US and China reinforces the argument for geographical diversification in the supply chain.

In the three years from 2014 to 2017, China's share of total exports from emerging Asia has fallen by 1.2%, while Vietnam has been the clear winner with an increased share of almost 1.5%. The drop in China's share may not seem much, but it is the first fall in ten years. While a degree of caution is required in interpretation, it seems clear that real effective exchange rate appreciation, higher labor costs and higher environmental protection costs have pushed up the cost of doing business, so lower value-added production has shifted. That shift has also been accelerated (some of it deliberately) by government policy support for more 'desirable' long-term industries.

However, it is also true that the rise in manufacturing capabilities in south east Asia is accelerating. Vietnam is picking up both low-cost textile manufacturing and is emerging as a new area for assembly and production in the technology sector. This is true not only for Chinese manufacturers but also for Korea, which has stepped up its offshore production capacity. The industrial story in Thailand is similar, with Taiwanese and Japanese companies setting up production of hard disk drives and power supply systems for the technology sector and auto parts such as clutches.

The shifts that we are seeing are not the product of Trump's trade policies but are a natural process of economic evolution. China's domestic economy is growing wealthier, which means on one hand that it is more expensive to manufacture, thereby pushing China into the production of high-end goods, and on the other, that the wealthier domestic economy will draw in more imported goods as well as create a more extensive services sector and increase both domestic and outbound tourism. This has long-term implications for China's trade and current account surplus, which we would expect to decline over time. Positive environmental outcomes are also likely as a result both of exiting energy intensive manufacturing and of policy explicitly directed toward promoting 'green' industries from electricity generation through to electric vehicles.

For other countries such as Vietnam, Cambodia and Laos, as well as for countries like Thailand and Indonesia, there now opens the prospect of accelerating industrial growth as China vacates the lower-end manufacturing space. Vietnam is rapidly becoming the poster-child of this group, coming as it does from a low base. Its rising export share has been accompanied by increased foreign direct investment and higher trade surpluses. Over time this should point to a structural rise in the value of its currency versus those of its trading partners.

The implications of these trends for the portfolio are incremental, rather than immediate. It does not mean we should immediately seek to increase our exposure to Vietnamese listed securities but rather we should look at those businesses capable of taking advantage of what these trends can offer. For our companies that means the ability to sustain margins and diversify operational risk. Names in the portfolio that immediately come to mind as taking advantage today are Pacific Textiles (China) with its Vietnam operations, Delate Electronics Thailand (which has a Taiwanese parent), Hon Hai Precision (Taiwan) and Li & Fung, whose business model is centered on its ability to source production capacity around the world, but especially across Asia.

Outlook

At present, stock markets are heavily focused on the immediate future. It helps to remember, however, especially in the context of low valuations today, that there are powerful structural trends in Asia which are unlikely to be altered by current policies. The imbalance in trade between China and the rest of the world was already changing before Trump was elected. Asia is still getting wealthier; this process may be a little slower over the next 12 months, but it is likely to continue nevertheless. We therefore reiterate the points we made in the valuation section above that we think Asian markets are cheap and now is therefore a good opportunity to build positions in these structural trends if you can look beyond the current posturing. We think doing so is made easier by our focus on companies that have been profitable dividend-payers over time.

Edmund Harriss and **Mark Hammonds** (portfolio managers)
Sharukh Malik (analyst)

Performance

As of 10/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	-13.82%	-10.41%	6.70%	5.06%	11.32%
MSCI AC Pacific ex Japan Index	-15.16%	-12.04%	6.88%	2.24%	9.98%

As of 9/30/2018	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	-4.01%	3.50%	12.81%	7.94%	8.47%
MSCI AC Pacific ex Japan Index	-5.16%	2.05%	13.83%	5.43%	8.17%

All returns over 1 year annualized. *Source: Bloomberg, Guinness Atkinson Asset Management*.

Expense Ratio: 1.12% (net); 3.48% (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 noted. Total returns reflect a fee waiver in effect and in the absence of this waiver, 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 1.10% through June 30, 2019. To the extent that the Advisor 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 absorbed.

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 Fund, 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. Forward earnings differ from trailing earnings, which is the figure quoted more often, as they are a projection and not a fact.

Standard Deviation is a statistical measure of the volatility of the fund's returns. In general, the higher the standard deviation, the greater the volatility of the return. 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.

Top Fund Holdings as of 10/31/18:

1	China Merchants Bank Co Ltd - H Shares	3.09%
2	Industrial & Commercial Bank of China Ltd - H Shares	3.08%
3	China Construction Bank Corp - H Shares	3.05%
4	Delta Electronics Thailand PCL /Foreign	3.03%
5	CNY Minsheng Banking - H Shares	3.01%
6	PTT PCL /Foreign	2.99%
7	CapitaMall Trust	2.99%
8	China Mobile Ltd	2.96%
9	Luk Fook Holdings International Ltd	2.95%
10	Janus Henderson Group PLC	2.89%

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

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