Guinness Atkinson

China & Hong Kong Fund

Review of January 2019

Summary Review & Outlook

Fund & market

- Chinese stocks were notably strong, with the MSCI China Net Total Return Index rising 11.06% compared to 7.76% for the MSCI Hong Kong Net Total Return Index. Stronger Chinese markets were likely partly driven by continued talks between China and America over the trade dispute. American delegates met with their counterparts in Beijing, which was followed by another meeting in Washington led by Liu He. The two sides have until March 1st to reach a deal otherwise tariffs on $200bn of imports from China will be increased from 10% to 25%.
- The strongest sectors in China were the Consumer Discretionary (+19.31%), Health Care (+14.77%) and Real Estate (+12.41%) indices. Policymakers announced plans to stimulate consumption of white goods by subsidizing purchases of environmentally friendly appliances. New policies were announced for the automobile sector, encouraging replacement of older less fuel-efficient cars, though specific details were missing. The value added tax (VAT) rate applied to transactions was also lowered from 3% to 2%.
- A combination of a more dovish outlook by the Federal Reserve in the US, and stabilizing property prices, helped explain the strong performance of Real Estate in Hong Kong (+13.67%).
- The strongest stocks in the portfolio were New Oriental Education (+40.56%), Tongda Group (+35.64%) and Sino Biopharmaceutical (+27.67%).
- The weakest stocks in the portfolio were Qualcomm (-12.99%), Dali Foods (-7.94%) and Autohome (-7.48%).

Events in January

- Monetary policy was loosened further in China. The required reserve ratio (RRR) was cut by one percentage point. The aim, as ever, is to channel this liquidity towards small and medium enterprises and away from speculative uses.
- In another form of fiscal loosening, the government cut taxes for small businesses; the corporate tax rate for businesses with less than one million yuan in taxable earnings will fall to five percent, and for those with taxable earnings between one and three million, the rate will fall to 10%.
- Financial access to foreign firms continued to increase. S&P became the first foreign company to receive approval to operate a domestic bond business in China. JP Morgan Asset Management received approval to sell two funds in China, through its local joint venture.
- Bloomberg announced it would be adding renminbi government debt into the Bloomberg Barclays Global Aggregate index from April 2019 onwards. The process will be implemented over 20 months and when fully accounted for, Chinese bonds will represent the fourth largest currency in the index.
- The pushback against Huawei continued. American prosecutors charged Huawei with a dozen indictments including fraud, conspiracy, theft of trade secrets and obstruction of justice. Reports indicate more Western economies are considering excluding Huawei from the buildout of 5G.

Portfolio Update

New Oriental Education provides after school tuition services in China. The business has been affected by new regulations, introduced in 2018, covering the entire industry. One of the more important changes meant tuition providers could no longer collect prepayments longer than three months, limiting the float of the business. The rest of the other rules aim to standardize the industry e.g. there are rules on what can and cannot be taught, licensing is required to open a center. In our opinion the regulations were designed to weed out more unsophisticated centers rather than professional and larger entities like New Oriental. Nonetheless, as one of our holdings trading at relatively higher valuations, the combination of tighter regulation and weaker markets meant the earnings multiple fell over the course of 2018. However, it seems New Oriental is coping fine and it reported results which beat expectations on both a revenue and earnings basis. It is one of the faster growing companies in the portfolio, with earnings expected to increase by roughly ~20% over the next few years.

Tongda Group is most known for its metal casings for smartphones, but has diversified into plastic cases that look like metal (“glasstic”). The Chinese smartphone market was weak over the course of 2018 and with Tongda targeting 40% volume growth, the market was questioning whether this was too ambitious. Tongda put out an update confirming it had become a supplier for Samsung in the third quarter of last year. So far, Tongda is supplying glasstic back covers for a low-end model and is looking to supply mid end models. According to Canalys, Samsung shipped 294m phones in 2018 and 317m in 2017, and so if Tongda were to take a reasonable share of these shipments, its volume target looks more reasonable. The company also announced its expansion into base station antenna for 5G, expecting production to commence in the second quarter.

Autohome was weak following its decision to increase prices for lead generation by at least 20%, with some reports indicating leading dealers stopped dealing with Autohome as a result. Management confirmed most clients have already paid for their 2019 services so in the short-term, earnings look relatively unharmed. Dealers are finding it tough in the weak auto environment and understandably a 20% price hike is not helpful – on this front Autohome seems to be flexible. Following a meeting with some of its clients it is considering increasing the number of guaranteed leads and discounting services during Chinese New Year promotional events. We continue to keep an eye on proceedings and expect a compromise to be met. Dealers spend up to half of their marketing budgets online and Autohome will account for a significant portion of this amount. It’s leading position in the industry means it has pricing power and this is why we like the company.

Approvals for gaming monetization resumed at the end of December. Though Netease and Tencent were not included in the first batch of approvals, they were included in the second and this should provide support for earnings over the coming year. Note the two firms are the largest gaming companies in China.

Summary view & outlook

We expect the fund’s focus on companies persistently earning a return on capital well above the cost of capital to do well in the long term. The fund now trades on a price to earnings multiple of 9.4x, based on estimated 2019 earnings, while the fund's discount to the MSCI Zhong Hua Index is 22%. China is currently out of favor with many investors and now is the time to be looking at investing in the region, when prices are cheap. The fund invests in a set of quality companies which have persistently generated a return on capital above the cost of capital.

Edmund Harriss (portfolio manager)

Performance

As of 1/31/2019	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	10.41%	-18.28%	15.07%	5.53%	10.09%
Hang Seng Composite Index	7.66%	-18.18%	11.48%	3.67%	7.19%

As of 12/31/2018	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	-20.21%	-20.21%	6.93%	2.07%	8.08%
Hang Seng Composite Index	-16.81%	-16.81%	4.16%	0.94%	5.59%

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

Expense Ratio: 1.64%

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 shown is current to the most recent month and quarter end. To obtain performance as of the most recent month end, please visit *www.gafunds.com or call 1-800-915-6565. Total returns reflect a fee waiver in effect and in the absence of this waiver, the total returns would be lower. 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.*

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 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 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.

One cannot invest directly in an Index.

Hang Seng Composite Total Return Index is a market capitalization weighted index that monitors the performance of stocks listed in Hong Kong.

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 Value Added Tax, or VAT, in the European Union is a general, broadly based consumption tax assessed on the value added to goods and services.

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 1/31/18:

1.	Tongda Group Holdings Ltd	3.78%
2.	Hollysys Automation Technologies Ltd	3.77%
3.	Ping An Insurance Group Co of China Ltd - H Shares	3.75%
4.	Weichai Power Co Ltd - H Shares	3.73%

5.	Sino Biopharmaceutical Ltd	3.66%
6.	NetEase Inc - ADR	3.49%
7.	New Oriental Education & Technology Group Inc	3.47%
8.	China Merchants Bank Co Ltd - H Shares	3.41%
9.	Anhui Conch Cement Co Ltd - H Shares	3.38%
10.	Yangzijiang Shipbuilding Holdings Ltd	3.37%

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

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