Guinness Atkinson

Asia Pacific Dividend Builder Fund

Review of First six months of 2019

Fund and Market

- Markets rebounded in June following May's sharp sell-off, with Asian markets, developed and emerging markets all moving roughly in line.
- The Fund rose by more than market as measured by MSCI AC Pacific ex Japan NR Index (the benchmark) in the first four months of the year before falling behind in May's sell-off. In June, the Fund closed the gap and at the time of writing (24 July) has moved back ahead over 2019.
- Given market conditions this year we are happy with how the Fund has behaved with the exception of performance in May: the correlation in stock movements in our North Asia exposure clearly tightened even though there is diversification in underlying revenue streams.
- We calculate that estimates of 2019 earnings for the MSCI AC Pacific ex Japan Index have dropped more this year than for the Fund over the same period.
- The key element in performance over the course of the year to date has been the expansion and contraction of the Price/Earnings (P/E) multiple: we calculate that over the first half, the P/E of the Index expanded 26.8% while that of the Fund expanded 16.5%.
- Leading sectors in the benchmark index in the first half were Consumer Discretionary, Real Estate and Materials, while laggards were Communication Services, Utilities, Healthcare, Energy and Industrials. Financials and Information Technology moved in line.
- Leading country performers within the benchmark, as measured by the MSCI Country indices, were Australia/New Zealand, Thailand and Hong Kong. Laggards were Malaysia, Korea, Indonesia and Taiwan. China, Singapore and the Philippines moved in line.

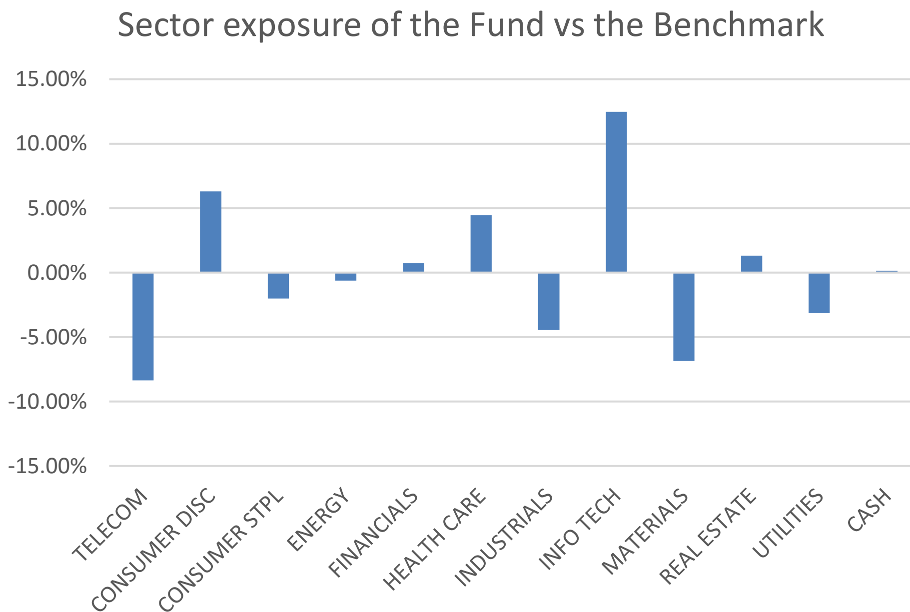
Events in 2019

- Trade tensions reduced in January and then ratcheted back up again in early May before being raised further in late May by the backlisting of Huawei Technologies.
- A fragile stabilization between the two sides was achieved in June at the G20 summit but trust, even if there was little enough to begin with, has been damaged.
- The US Federal Reserve has decisively altered its position on the outlook for interest rates. Cuts, not increases, are now expected with the market divided on whether the next move will be a reduction of 0.25% or 0.5%.
- Modi won the election in India decisively; the Reserve Bank of India has begun to reduce interest rates; Indian economic growth decelerated in the first three months of 2019 to 5.8% year-on-year, the slowest rate in five years. Policy is now focused on this.

- Japan and South Korea are locked in their own trade dispute. Japan is limiting the transfer of key items related to the manufacture of semiconductors. The underlying cause appears to have been a Korean court ruling in relation to compensation for forced labor in the colonial period.
- Elections in Thailand and the coronation of the King have brought about a reduction in the risk premium for Thai equities making the market one the region's best performers this year. The new government will be in place by mid-July.
- In Indonesia the re-election of President Jokowi was affirmed by the Constitutional Court. Interest rates in Indonesia are expected to come down and plans are afoot to cut the corporate tax rate from 25% to 20%.
- Unrest has grown in Hong Kong in July as tensions between citizens and Beijing-backed government boiled over with an attempt to introduce and extradition law. The stock market has not yet been affected but Hong Kong's longer-term outlook points more firmly to China.

Portfolio positioning

Although the fund's benchmark, the MSCI AC Pacific ex Japan Index, plays no part in the construction of the portfolio, we think it might be helpful to show the position of the Fund relative to that of the Index on a sector and geographic basis.



Sources: Guinness Atkinson, MSCI as of 6/30/19

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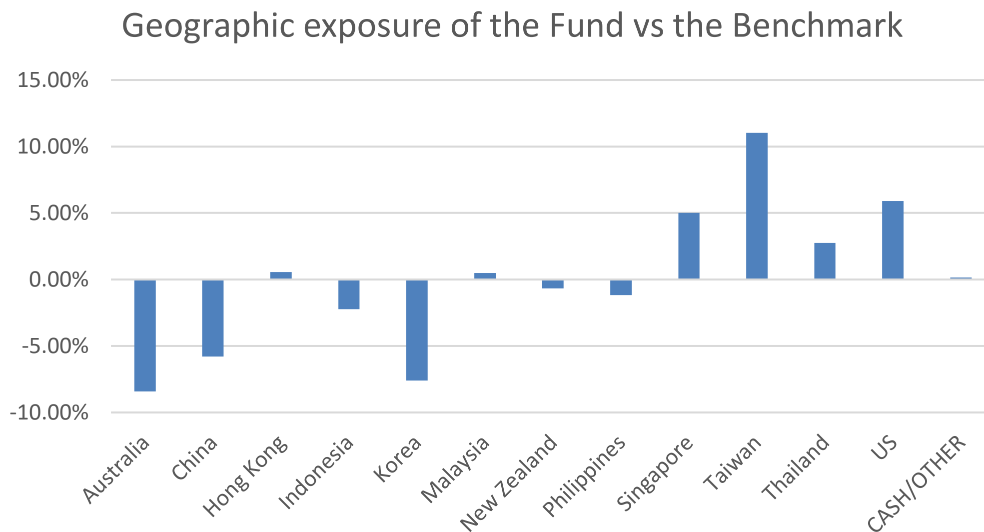
The Fund is overweight in Consumer Discretionary, Health Care and Technology companies and is underweight Energy, Materials and Utilities which, either for cyclical or regulatory reasons, have been unable to sustain our required minimum return on capital.



Sources: Guinness Atkinson, MSCI as of 6/30/19

On a country basis, the Fund is most notably underweight in Australia, China and Korea and overweight in Singapore, Taiwan and Thailand. Our US positions consist of Qualcomm (smartphone chips) and Aflac (health insurer).

The split between emerging and developed markets remains very similar to that at the start of the year, accounting for 63% and 36% respectively (for reference, we count Korea and Taiwan as emerging markets; while the economies are developed the stock markets with their ID requirement for access and restricted currencies keep them in the emerging market category). In terms of market size, stocks below $1 billion market capitalization account for 5% of the portfolio; $1 billion - $10 billion 53% and over $10 billion market capitalization 41%. We had no illiquid or unlisted stocks in the portfolio as of 6/30/19.

Portfolio positioning is driven primarily by individual company considerations where we seek those businesses whose operations have sustained higher returns on capital and which, in our opinion, are likely to continue to do so but whose shares are priced as if they won’t. We do not begin with a framework that leads us toward cyclical versus defensive or growth versus value or indeed to favor one country over another. These elements play a role when we consider the prospects for a particular business model and when we consider how we should value the current and expected future cash flows of the business.

The structural themes that attract investors to Asia include demographics and growing household wealth and disposable income which have arguably reached a critical mass in the region. The evidence that

supports this assertion can be seen in spending patterns and the types and value of consumer products (cars, durables, fashion etc) that are now sold in the region as well as in macro-economic data which indicate lower volatility in economic growth and money supply metrics than ten or fifteen years ago. We aim to capture these themes by identifying good businesses, and through our portfolio construction, try to avoid excessive concentration in themes or product areas. This we do by considering revenue streams by geography, product area and customer group.

The largest exposures we have in headline terms are to China and Taiwan, followed by Hong Kong, Australia and Singapore. On a sector basis, the largest absolute exposures are to Information Technology, Financials and Consumer Discretionary, followed by Real Estate and Health Care. Much of our Information Technology exposure is to be found in Taiwan, where we are focused on hardware manufacturers and designers of processor and controller chips rather than in more cyclical areas such as memory or display panels. These are areas where Asian manufacturing skills have turned companies like Taiwan Semiconductor, Largan Precision and Novatek Microelectronics into world leaders. Our technology exposure also includes materials such as environmentally friendly coatings for printed circuit boards and super-efficient assemblers. These companies have operating facilities across the region and serve multiple customers and product areas; they are not simply China-based suppliers to Huawei, as stock price performances in May appeared to suggest.

Consumer Discretionary exposure is to be found in Australia, China and Korea for the most part. These businesses include electrical retailers, travel services, autoparts, textile makers and fashion and jewelry retailers. While some are domestic businesses such as JB Hi-Fi and China Lilang, others offer regional and global services like Hanon Systems, Corporate Travel Services and Pacific Textiles. A similar story can be seen in our Financials exposure. We invest in commercial banks, finance companies, insurers and asset managers in China, Hong Kong, Malaysia, Singapore, Thailand as well as in Australia and in the US (through which we have exposure to Japan). Demographics is often cited as a reason to be interested in the region and so it is – for the younger populations in the likes of Indonesia and Vietnam but just as interestingly for ageing populations in China, Malaysia, Singapore and most obviously Japan. The needs of the two population profiles are different but both provide a backdrop for investment opportunities.

Real Estate exposure is concentrated in Singapore and Hong Kong. In the portfolio it takes the form of Real Estate Investment Trusts (REITs), which distribute 90% of their income. From an income perspective the dividends from these REITs remain attractive in a world of declining interest rates. We like the yield but we also like the ability of these companies to grow their dividends. In the case of the Singaporean REITs, Ascendas and CapitaLand Mall Trust, the growth drivers come from the refreshing and rebalancing of their portfolios through disposal and acquisition, their headroom to take on further debt up to a modest ceiling to fund expansion and their ability to improve rental yields through asset enhancement. In the case of Ascendas, industrial properties tied into logistics and central distribution sites reflects the changes underway in e-commerce. CapitaMall is exposed to bricks-and-mortar retail and so their advantage is their access to prime space and creation of retail destinations to serve luxury retail and spending. The Link REIT in Hong Kong has an increasingly interesting future. Its forays outside Hong Kong into Cantonese-speaking

China have been successful. China's drive to create a greater Bay area linking Hong Kong and Macau with nine other mainland cities can only increase the possibilities afforded to this business.

Performance Review

As of 6/30/2019	YTD	1 Year	3 Year	5 Year	10 Year
Asia Pacific Dividend Builder Fund (GAADX)	**13.02%**	**1.29%**	**9.64%**	**6.45%**	**8.71%**
MSCI AC Pacific ex Japan Net Return Index	**12.69%**	**0.20%**	**11.45%**	**4.14%**	**8.15%**

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

Expense Ratio: 1.12% (net); 3.27% (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, 2020. 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.

In the first quarter of the year, when markets were up strongly, the Fund rose 13.43% versus the MSCI AC Pacific ex Japan NR Index which rose 11.88%. In the second quarter, when conditions were much choppier, the Fund fell 0.37% compared to the Index which rose 0.72%. For the first half the year, the Fund was up 13.02% and the Index rose 12.69%.

Given market conditions over the past six months, we are happy with where the Fund has ended up this year. However, we like to pay attention to how the Fund behaves in different market conditions and see

where it conforms or deviates from our longer-term expectations. The chart below breaks down the performance of the Fund and its index into monthly returns.

2019 YTD monthly returns (%) in USD

-10.00 -8.00 -6.00 -4.00 -2.00 0.00 2.00 4.00 6.00 8.00 10.00

Jan
Feb
Mar
Apr
May
Jun

Guinness Atkinson Asia Pacific Dividend Builder Fund
MSCI AC Pacific ex Japan Net Total Return USD Index

Source: Bloomberg, Guinness Atkinson Asset Management

The performance over five of the six months conformed with our expectations. Outperformance in February, March and April coincided with the results season, when the Fund tends to do well. In 2019, these company results followed a very weak period in stock markets in the last three months of 2018 when market fears reached a crescendo. Relief as much as positive expectations drove performance, in our opinion. The performance in May, when the Fund unperformed in weak market conditions, is the standout. We would normally expect to see a more defensive profile based upon a stronger earnings profile and diverse revenue streams.

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We have looked at the total returns of our stocks over the first six months of the year and at the contribution to returns from changes in the forward Price/Earnings valuation multiple and the imputed contribution from the combination of earnings and dividends. In the first four months of the year, revisions to consensus forecast earnings for the Fund's holdings were robust, down 3.8% compared to estimates for the market (as measured by our benchmark index) which fell 8.7%. In the portfolio we had three stocks which saw significant downgrades to forecasts (AAC Technologies, Catcher Technology and Li & Fung) and if we exclude those, 2019 earnings forecasts for the portfolio were unchanged. For the 17 stocks which drove the outperformance over the period, earnings estimates increased. This was sufficient to support the recovery in stock prices which was manifest in an expansion in the PE multiple from depressed levels at the end of 2018. There was a reasonable dispersion in stock performance between sectors and countries. Consumer Discretionary, Energy, Financials, Health Care, Information Technology and Real Estate were all represented among both leaders and laggards. The country representations were similarly diverse across the groups.

In May however, we saw a different pattern. The earnings profile of the portfolio barely changed, and performance was almost entirely explained by changes in the PE multiple, a measure of sentiment, which contracted 7.7% for the portfolio. The market PE multiple contracted less, by 5%, even though estimates of market earnings continued to drop. In the portfolio there was an evident concentration in behavior amongst stocks in the technology sector and those with significant North Asia (read China) exposure. The ratcheting up in the trade dispute coupled with the blacklisting of Huawei prompted a sharp move by investors into non-China areas. In this liquidity shift, technology stock and stocks in North Asia tended to move together more closely. The fact that DBS in Singapore is a regional bank with substantial revenues from South and South East was outweighed in terms of sentiment by its Chinese banking business and was as weak as a pure Chinese bank or a Taiwan technology company exposed to Huawei smartphones.

In our analysis of this episode we do not believe that there is a concentration that we have missed. If earnings and dividends hold up and grow, then we would expect valuations to reflect that over time. We can accept that there will be periods when the market moves in a direction that we think is not justified by the fundamentals (i.e. the capacity and prospects for cash generation). The results season in the earlier part of the year justified to us that our faith in these businesses is not simply based on hope. We expect to see a solid results reason for our companies in coming months. (Taiwan Semiconductor has just reported solid mid-year results and added its comment that the demand outlook for the second half is "very, very strong".)

This analysis reminds us that stock behavior at more extreme moments can be unfavorable to stock pickers and we shall continue to maintain vigilance on this aspect. The portfolio is expected, over time, to lag in strong markets and outperform when they are weak. In the short term, exceptions can occur, and it is important we have a view on the reasons for it when they do. We do not see the need for a radical shake-

up of the portfolio, but we believe that spending some time thinking about and discussing this aspect of portfolio construction is important.

The chart below shows the performance of individual stocks through the first half of the year.

Individual stock performance 2019 YTD (total return USD)

-20% -10% 0% 10% 20% 30% 40% 50%

ELITE MATERIAL CO LTD
TISCO FINANCIAL GROUP PCL
QUALCOMM INC
CHINA MERCHANTS BANK-H
YANGZIJIANG SHIPBUILDING
ASCENDAS REAL ESTATE INV TRT
SONIC HEALTHCARE LTD
LINK REIT
JB HI-FI LTD
AFLAC INC
NOVATEK MICROELECTRONICS COR
CAPITALAND MALL TRUST
LARGAN PRECISION CO LTD
PTT PCL
LI & FUNG LTD
DBS GROUP HOLDINGS LTD
CHINA LILANG LTD
MSCI AC PACIFIC ex JP NR
LUK FOOK HOLDINGS INTL LTD
BOC HONG KONG HOLDINGS LTD
ASUSTEK COMPUTER INC
TAIWAN SEMICONDUCTOR MANUFAC
CHINA MINSHENG BANKING COR-H
HON HAI PRECISION INDUSTRY
IND & COMM BK OF CHINA-H
JANUS HENDERSON GROUP-CDI
DELTA ELECTRONICS (THAILAND) - sold March
CORPORATE TRAVEL MANAGEMENT
HANON SYSTEMS
CHINA CONSTRUCTION BANK-H
ST SHINE OPTICAL CO LTD
AAC TECHNOLOGIES HOLDINGS IN
CATCHER TECHNOLOGY CO LTD
CHINA MOBILE LTD
PUBLIC BANK BERHAD
KT&G CORP
PACIFIC TEXTILES HOLDINGS
CHINA MEDICAL SYSTEM HOLDING - Bought...

Source: Bloomberg

Within the top five performers there is a mix of industries: retail, integrated circuit design, energy, travel services and banking. The companies are based in China, Taiwan, Thailand, Australia and Singapore.

Among the weaker names we have a similar mix of industries: shipbuilding, healthcare products, auto components, export services and product sourcing, and integrated circuit materials. Again, a variety of countries is represented: China, Taiwan, Korea and Hong Kong.

Portfolio review

Amongst the leaders we particularly welcome the recovery in Elite Material, which we bought in August 2017. The company produces printed circuit boards used in smartphones, servers and the automotive sector and is the world's largest producer of halogen-free laminates, which are increasingly being adopted due to their environmentally friendly nature. From the latter part of 2017 and through 2018 the share price was weak on slowing sales but in 2019 the business has turned. Our equal weight and rebalancing process means we have added to the stock at lower levels; the position has outperformed the benchmark index by over 10% over the period since purchase.

The performances of Tisco Finance in Thailand, China Merchants Bank and Yangzijiang Shipbuilding have all been driven by better-than-expected results, with solid dividend growth from China Merchants Bank and accelerating dividend growth from the other two. Qualcomm's performance has been closely tied to the outcome of its dispute with Apple. This was suddenly resolved in Qualcomm's favor when Apple concluded that the risks to the launch of its next generation of smartphone were too great. In short, Apple's alternative chip supplier Intel was not able to match Qualcomm in the race to 5G-enabled handsets. The result was the immediate release of previously withheld royalty payments to Qualcomm and a jump in the share price.

Laggards

Amongst the laggards our new purchase, China Medical Systems has been weighed by changes to the operating environment in China. We knew this was still a challenge and that the timing of resolution would be hard to judge, but it looks now that the skies are clearing. We have added on subsequent weakness and remain positive on the outlook. Pacific Textiles has seen its Vietnam operation achieve normal capacity utilization after months of disruption. The business is generating cash and the dividend is generous with little need for extra capital expenditure. Growth from its main customer Uniqlo, however, remains elusive.

KT&G and Public Bank in Malaysia are low-growth but cash-generative businesses with solid local franchises. Their weaker performance in what have been strong markets overall is not a surprise. KT&G's outlook has improved with a turnaround in export sales, which dragged significantly last year. The next set of results should reflect that turnaround and the share price should get a lift. China Mobile has to contend with competition in its current business and a rising capital expenditure burden associated with 5G, which in China is fast becoming a political totem. As with Pacific Textiles, growth rather than cash generation is the issue and the 5G burden makes the prospects for improving returns more distant.

Portfolio changes

We made one change to the portfolio during the first half. The parent company of Delta Electronics (Thailand) made a tender offer for the shares it did not already own and we took up that offer. We replaced it with a position in China Medical Systems.

The company acts as a pharmaceutical distributor to doctors and hospitals for both branded and generic drugs. The regulatory structure in China is changing as the government, as with governments everywhere, seeks to reduce healthcare costs. The changes have introduced significant new competition where alternative offerings are available resulting in substantial price cuts in certain cases. China Medical Systems has seen a significant drop in its share price that we believe significantly exceeds its exposure to these changes. In addition, the company has tied up with companies in the US, UK, France, Switzerland and Israel to secure rights to sell formulations to treat strokes, brain cancer, respiratory distress down to onychomycosis (that's toenail fungus, for anyone interested). The recent 2018 results delivered the

consistency we look for: gross profit, operating profit, net profit and dividend growth all moving in line up and an unchanged dividend payout of 40% of earnings.

Outlook

Opinion in the market is divided on whether we are now at the end of the cycle or whether there is still further to go. The change in direction by the Federal Reserve appears to suggest that they are concerned, and the recent moves by the European Central Bank have only added to that. Monetary easing is the order of the day, with several central banks in the emerging markets cutting interest rates to stay in front of the Federal Reserve.

Investment and consumer demand in Asia are weaker than they were but have certainly not collapsed. China has been reluctant to move aggressively to stimulate the domestic economy and the moves they have made show some signs of effectiveness. This reluctance reflects their ongoing wish to tackle debt, for which we think they should be applauded. The unrest in Hong Kong is a matter of concern. China has been careful not to be seen to crack down in Hong Kong, but the recent siege of the China Liaison office in marks a switch away from protests against the Hong Kong government and toward a more direct challenge to China.

Chinese leaders are about to head off for the summer retreat and significant policy moves are unlikely (but not impossible) until September. Renewed face-to-face trade talks with the US will happen before then, but little concrete is expected given China's demands that the recent tariff increases and the blacklisting of Huawei be lifted.

We think that in this increasingly uncertain environment there are doubts as to whether growth can continue or if the value approach (based upon lower Price/Earnings multiples) is broken due to changing business models. In this context we believe an equity position in good businesses with sustained and growing dividend streams over the long term, whether in Asian, European or Global companies, we think cannot be a bad thing.

Edmund Harriss and **Mark Hammonds** (portfolio managers)

Sharukh Malik (analyst)

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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 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 Net Total Return 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.

Top Fund Holdings as of 06/30/19

1	Elite Material Co Ltd	3.12%
2	Li & Fung Ltd	3.09%
3	PTT PCL /Foreign	3.05%
4	QUALCOMM Inc	3.04%
5	Catcher Technology Co Ltd	3.02%
6	Sonic Healthcare Ltd	2.99%

7	Hon Hai Precision Industry Co Ltd	2.91%
8	China Medical System Holdings Ltd	2.91%
9	Ascendas Real Estate Investment Trust	2.90%
10	DBS Group Holdings	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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