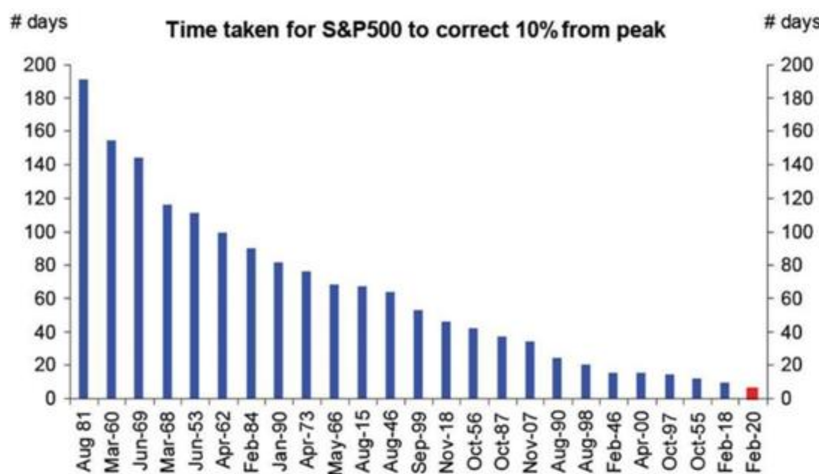
Guinness Atkinson
Dividend Builder Fund
Managers Update – March 2020

GUINNESS ATKINSON FUNDS

Summary Performance

Global equity markets rallied in the first half of February but fell particularly strongly between February 19th and month-end. Looking at the US, the sell-off saw the fastest 10% correction the S&P500 has suffered on record – the Index fell 10% from its recent peak in 6 days.



Source: Bloomberg as of February 28, 2020

The coronavirus outbreak, that originated in China in January has subsequently spread further around the world in February, with South Korea and Italy seeing the largest number of cases. With the hope in January that this was a China-only issue now redundant, market confidence has been knocked and uncertainty has increased. Equity markets sold off particularly hard over the last week of February after rapid growth in the number of cases in South Korea and Italy, and the number of new countries reporting cases increasing each day.

On March 2nd, 2020, the OECD has lowered its growth forecast for the global economy in 2020 from 2.9% to 2.4% but said a "longer lasting and more intensive coronavirus outbreak" could reduce global growth to 1.5% in 2020.

Exogenous shocks such as this are impossible to predict. They are the "unknown, unknowns" or "black swans". They are events which are unpredictable and often unprecedented. We know neither when they will happen or how they will pan out.

There is no real precedent to this coronavirus outbreak. Neither the Spanish flu, SARS, MERs, Ebola, etc. are particularly useful in forecasting what will happen next. Health officials and governments appear to be operating on the basis that this virus will spread further and that all current efforts are focused on minimizing the spread, while efforts are made to develop a vaccine – a process that could take up to a year.

The global economy is therefore facing both a supply side shock due to efforts to contain the virus leading to factories being shut in China (which can have a knock-on effect on supply chains) and a potential demand led shock from concerned consumers and lower corporate spending.

Put simply global growth is a function of Consumption + Investment + Government spending + Trade.

Last year we saw the impact that a trade war between the US and China had on global growth forecasts by dampening the "Trade" part of the equation. Consumption, however, was strong, as collectively consumers continued to increase the amount spent on basic goods (food, etc.) and discretionary goods (smartphones, cars, etc.) offsetting a reduction in Trade.

The way the Coronavirus outbreak is affecting this equation so far is as follows:

1. In an effort to contain the virus, many factories in China were temporarily closed meaning they were unable to manufacture and send their goods to their customers. This has the effect of reducing trade.
2. Many people in China have had restrictions placed on their movements and the fear of the virus spreading has meant people have not been out spending as much money affecting the Consumption part of the equation.

This uncertainty has meant manufacturers don't know when they will receive the components they need and when they will be able to ship goods to their customers. This has led to a downturn in the outlook for Investment from these companies as reflected by the recent Purchasing Managers Index data out of China that was very weak.

Over the last few days major central banks around the world have demonstrated their willingness and readiness to take action by providing liquidity and cutting interest rates. Indeed, some people are projecting a 50bps cut later this month by the US Federal Reserve and potentially another 50bps cut later in the spring. This would be a dramatic fall in interest rates and will help some companies that need to borrow and therefore provide companies with the ability to invest when they might otherwise have been constrained. This would also provide some support to equity markets and make dividend yields even more attractive relative to bonds. However, central bank easing is clearly not going to stop the spread of a virus.

The other element left to support global growth is Government Spending. We will wait to see what fiscal stimulus governments around the world may be willing to implement, but it looks necessary in China and will likely be necessary in other countries if the virus cannot be sufficiently contained.

So, while the last week of February was painful, we now find ourselves at the beginning of March with central banks ready to cut interest rates, governments likely to provide a fiscal stimulus and equities trading at lower valuations. Historically this has been a good environment for equities.

While the outlook for the spread of the virus is still uncertain, governments are ramping up their plans for containment and ensuring clear advice is disseminated to their citizens. No one knows how this will evolve and how long it will last so how can we build a portfolio of equities that can weather an exogenous shock such as this?

This fund was born in the aftermath of the Global Financial Crisis. With the memory of the financial crisis present in our minds we sat down with a blank sheet of paper to consider how we might be able to build a global equity portfolio that could weather storms in the future while also providing upside in rising equity markets. The principles that we developed have served us well and it is worth revisiting those principles in light of the current events.

The first element is to focus solely on high quality companies. We want to own companies that have consistently generated high levels of profitability for a long time. Companies that have generated good margins and are often leaders in their industries commanding pricing power from their customers. They often have lower costs than their peers, recurring revenues, and they have generated a lot of cash that may be paid in the form of a dividend. When times get tough, they appear to be well placed to survive but also take advantage of by taking market share when weak business struggle.

Quality also means we look for companies with strong balance sheets who have not taken on excessive amounts of debt. When exogenous shocks occur, we want companies who have sufficient balance sheet strength that management do not have to worry about capital raising but can focus on their day to day operations.

Portfolio construction is also an important risk influence. We want to have diversification in the portfolio across industries, geographies and currencies. While all the companies we are own are high quality we want to have a balance of companies with steady growth, faster growth, cyclical growth and sometimes no near-term growth but a great valuation. We don’t want to have the entire portfolio exposed just to one country or region, so we own companies all around the world. We also don’t want to take excessive bets on any one sector, so even though the strategy does not include a sector limit, we limit ourselves to a maximum of 30% in any sector.

Position sizing is also a way to mitigate risk. Our process has included equal-weighting all companies in the portfolio which means that each position in our portfolio is currently approximately 3%. This means we do not intend to take excessive bets on individual positions in a company which could be great if they get it right but when shocks occur could leave the portfolio exposed to high levels of stock specific risk.

We also invest at least 80% in companies that pay a dividend. We seek to invest in companies that have had a cash flow return every year for 10 years, even if the share price goes down in any individual year. We also prefer companies that can grow their dividends over time because the business itself is growing.

The final element is to have patience and a long-time horizon. We intend to only buy companies if we can envisage ourselves holding them for 5 years. The chances of their being an exogenous shock during a five-year period is significant and therefore we must believe when we buy a company that it will be able to weather most scenarios.

Looking at the portfolio at the end of February we can see the portfolio continued to have these defensive elements:

When we look at the quality of the companies in the portfolio, we see that:

1. The average Return on Equity of the portfolio was 24% which is approximately double that of the benchmark at 12%. Companies that we own like Unilever, Diageo and Roche have been exceptionally profitable.
2. The balance sheets of our companies have been strong. The average net debt to equity of the companies in the portfolio was 49% compared to the benchmark which was around 80%. Companies we own like Microsoft, Novo Nordisk and Anta Sports even have more cash than debt making them particularly robust.

The portfolio continues to be diversified around the world. We have around 47% invested in US companies, around 45% invested in Europe, while we only have around 10% in Asia-Pacific. Within the Asia-Pacific region we have one company listed in Hong Kong (Anta Sports), one company listed in Taiwan (Taiwan Semiconductor) and one company listed in Australia (Sonic Healthcare). Our Asia-Pacific holdings have been robust. Year to date they have collectively outperformed the MSCI AC Asia-Pacific ex-Japan Index by approximately 3%. Our position in Sonic Healthcare has actually produced a positive return year to date while Anta Sports is our only direct exposure to China and has underperformed by around 3% and while in the short-term the Chinese consumer will be spending less the long-term drivers of this business are not going to be affected by this virus outbreak.

In terms of the types of companies we own we have a fairly even balance between defensive and cyclical/growth companies. We have approximately 50% in quality defensive companies (e.g. consumer staples and health care companies), while we have around 50% in quality cyclical or growth-oriented companies (e.g. Industrials, Financials, Consumer Discretionary, Information Technology, etc.) Within Financials however, we do not own any banks which helps to dampen the cyclicality of our Financials. In fact, two of the financial exchanges that we own, Deutsche Boerse and CME, often perform well on a relative basis in periods of market distress as they benefit from higher trading volumes in periods of volatility. This has been true on this occasion as well, with Deutsche Boerse up around 1% in USD year to date and CME down 1%, compared to the MSCI World index which is down 9% in USD year to date.

We also do not have any exposure to some of the hardest hit areas of the market such as airlines, cruise companies, luxury goods, etc.

All our companies have returned cash to us every year through the form of a dividend, and these dividends are currently well protected. On average they tend to return to us just over half the earnings they generate in the form of a dividend. This gives them plenty of scope to reinvest for growth, or if times are hard to hold on to some extra cash without needing to cut their dividend.

Many of the positions we own in the portfolio have been there for a long time. Around 60% of the names in the portfolio have been there since 2015, while 20% of the names have been held since we launched the fund. Put together, this means we have a portfolio that has historically held up relatively well when markets have fallen and has repeated this pattern in the February correction. Including this correction there have been seven significant drawdowns in global equity markets since we launched the fund, and the Guinness Atkinson Dividend Builder Fund (GAINX) has outperformed the MSCI World Index in all of these drawdowns. Historically buying in these dips has been a good strategy.

As we discussed, Black Swans are unpredictable and unprecedented. We don't know when they will occur and what the outcome will be. They come out of the blue and can affect markets rapidly and therefore we believe our portfolio always needs to be prepared for such an eventuality. However, for the patient investor with a long enough time horizon, this Black Swan may allow you to buy good quality companies a lot cheaper than you could a few weeks ago.

Portfolio changes in February:

We made two changes to the portfolio in February selling our positions in Royal Dutch Shell and WPP and replacing them with Medtronic and PepsiCo. While Royal Dutch Shell and WPP are quality companies they are not as robust as they have been historically. They offer optically cheap valuations which we felt were

attractive at the start of the year where global growth expectations and earnings expectations were improving. However, we had to reassess these positions in light of the current environment and a weak set of results from WPP.

Royal Dutch Shell had been a long-term holding in the fund. Following the long-term shift in oil prices at the end of 2014 as US shale oil production ramped up and expectations of demand from the "BRIC" nations (Brazil, Russia, India, and China) tempered, Royal Dutch Shell, along with the other majors, reset their business models and focused again on returns over growth. During this transition, the reliability of the dividend was questioned along with the sustainability of debt that had accumulated in the previous era of growth. Ultimately Royal Dutch did not cut its dividend, although it did move for a time to scrip payments, as capex and costs were cut, and a significant disposal program was executed. Recent results raised some question marks for the company as the buyback program was reduced and we saw weakness across all areas of the business, including in the downstream which is usually counter cyclical. As oil prices fell once again on demand worries in relation to recent events we took the view that we could potentially see lower oil prices for the medium term which would affect cash flows that are already under pressure leading to the dividend once again becoming questionable, but now from a position where costs have already been cut.

Medtronic is the largest pure-play medical device maker (current market capitalization of $130bn). It has a diversified product base covering chronic diseases and numerous acute care cases in hospitals, and typically holds significant market share in its core products such as heart devices. The company has continuously invested into new, innovative areas through research and development which helped to protect from competition and offered new channels for growth in the future rather than purely relying on established products – which was evident from consistently high and stable returns on capital. The balance sheet is strong, and the company has been paying down debt over recent years. More recently the company has focused on costs which has driven growing operating margins and led to improved earnings growth. With the potential to capitalize on previous investments to further increase revenue growth we see a good runway for steady earnings growth in the medium to long term. The dividend yield is back above 2% following the recent sell off, the dividend growth has averaged 8% over the past 3 years, and the forward PE multiple has fallen back to close to the average over the past 5 years. We see this as good opportunity to buy a consistent and high-quality business at a reasonable price which may provide good earnings growth in a market environment where growth has become more uncertain.

Since 2017, **WPP** has faced a number of headwinds. The global advertising agency has faced a fall in revenues from consumer goods companies, a traditionally large customer base, seeking to cut advertising budgets. This is an issue that has affected the ad agencies as a group and has led to slower growth for these high return businesses. The

threat of Facebook and Google and programmatic advertising taking market share has also weighed on long term sentiment. Long-time CEO Martin Sorrell left WPP somewhat under a cloud in April 2018 with new CEO Mark Read taking over shortly after and implementing a strategy to merge businesses within the group and drive growth. Dividend growth was halted although the dividend itself was not cut and a decision to sell a stake in the Kantar Group Unit was announced in July 2019 which helped alleviate pressure on the balance sheet, another market concern. Performance was positive in 2019 with the stock price up 34% (in GBP) outperforming the FTSE All Share by 15%. However, the latest results in February were weak, and the stock price reacted very negatively falling 16% on the day (in GBP) as the market fell alongside. Organic growth for the quarter was weaker than expected but guidance for 2020 was adjusted downwards to zero growth and did not account for any effects of the coronavirus, which could be meaningful. This led us to conclude that the planned turnaround could well take longer and may also require further investment – which could weigh on operating margins – in an environment where the economic background is less certain, and the long-term competitive headwinds have not yet abated. This uncertainty coupled with the low probability of a return to dividend growth in the near term (and a higher probability of a reduction in the dividend) led to our decision to sell the position.

PepsiCo, the global beverage and snack business often sits #2 to rival Coke in many large markets but its integrated business model can potentially lead to advantages in an environment of quickly changing tastes and differences locally. The company has taken a more data-driven approach to tailor products to customers more specifically, utilizing its agile supply chains, leading to improved returns. Like other established branded consumer goods companies, it has begun to devolve decision making more locally to adapt more quickly and potentially develop new, higher growth, products. Operating margin declines in 2019 were affected by higher investments, which should now be behind the company and lead to incremental improvements in 2020 and beyond. The market expects growth of around 8% in earnings per share over the medium term, which may be affected by the virus short term, but should be relatively well insulated. The dividend yield is almost 3% and has been growing 8% on average over the last 3 years. The stock is back towards the average PE multiple over the past 5 years, but is now expected to grow faster, and is at a small discount to peers. The return on capital has remained solid and has been improving slightly in recent years. Much like Medtronic (above) we see this as a good entry point for a high-quality business at a reasonable price with a strong, growing dividend.

The overall effect of these changes has been to boost our exposure to Consumer Staples and Health Care and reduce our exposure to Energy and Consumer Discretionary. It has boosted our exposure to US companies while reducing our exposure to European companies.

Thanks for your continued support.

Performance

In February, the Guinness Atkinson Dividend Builder Fund produced a total return of -8.44% (TR in USD), compared to the MSCI World Net TR Index return of -8.45%. The Fund therefore outperformed the Index marginally by 0.01%.

Performance

as of 02/29/20	1 YR	3 YR Annualized	5 YR Annualized	Since inception Annualized (3/30/12)
Dividend Builder Fund	6.12%	8.64%	5.86%	8.97%
MSCI World Net TR Index	4.64%	7.24%	5.88%	8.51%

as of 12/31/19	1 YR	3 YR Annualized	5 YR Annualized	Since inception Annualized (3/30/12)
Dividend Builder Fund	26.71%	13.80%	8.70%	10.50%
MSCI World Net TR Index	27.67%	12.56%	8.73%	10.02%

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.68% (net); 2.00% (gross)

Performance data quoted represents past performance and 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. For most recent month-end and quarter-end performance, visit https://www.gafunds.com/our-funds/dividend-builder-fund/#fund_performance or call (800) 915-6566. Total returns reflect a fee waiver in effect and in the absence of this waiver, the total returns would be lower.

The Advisor has contractually agreed to reimburse 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 0.68% through June 30, 2020. To the extent that the Advisor absorbs expenses to satisfy this cap, it may recoup a portion or all of such amounts absorbed at any time

within three fiscal years after the fiscal year in which such amounts were absorbed, subject to the expense cap in place at the time recoupment is sought, which cannot exceed the expense cap at the time of the waiver. The expense limitation agreement may be terminated by the Board of the Fund at any time without penalty upon 60 days' notice.

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 Funds.

Mutual fund investing involves risk and loss of principal is possible. The Fund's strategy of investing in dividend-paying stocks involves the risk that such stocks may fall out of favor with investors and could reduce or eliminate the payment of dividends in the future or the anticipated acceleration of dividends could not occur. The Fund invests in foreign securities which will involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets. The Fund invests in small- or mid-cap companies, which involve additional risks such as limited liquidity and greater volatility than larger companies. When inflation rate is greater than expected, that markets may respond differently to changes in the inflation rate than the Advisor expects, or inflation may manifest in such a way that the Fund is unable to provide reasonable protection against inflation.

Top Fund Holdings as of 2/29/2020:

1.	Deutsche Boerse AG	2.91%
2.	Danone SA	2.89%
3.	Nestle SA	2.87%
4.	Henkel AG & Co KGaA	2.87%
5.	ABB Ltd	2.87%
6.	Novo Nordisk A/S	2.87%
7.	Sonic Healthcare Ltd	2.85%
8.	Roche Holding AG	2.85%
9.	Schneider Electric SE	2.85%
10.	Broadcom Inc	2.85%

Current and future fund holdings and sector allocations are subject to change and risk and are not recommendations to buy or sell any security.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Dividend yield is calculated by annualizing the last quarterly dividend paid and dividing it by the current share price.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed countries.

A cash flow return on investment (CFROI) is a valuation metric that acts as a proxy for a company's economic return.

One cannot invest directly in an index.

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