Guinness Atkinson

China & Hong Kong Fund

Review of August 2020

Summary Review & Outlook

Fund & market

- MSCI China rose 5.7% while MSCI Hong Kong rose 7.9%. The Shenzhen Component Index rose 2.9% while the Shanghai Stock Exchange Composite Index rose 4.6%.
- After outperforming in July, Chinese markets were more measured in August. The S&P 500 rose 7.1%, MSCI Europe rose 4.1% and MSCI Japan rose 7.6%.
- In MSCI China, the strongest sectors Consumer Discretionary (total return of +14.6%), Consumer Staples (+6.5%) and Information Technology (+5.2%) while the weakest were Utilities (-4.7%), Financials (-0.4%) and Real Estate (-0.3%).
- In MSCI Hong Kong, the Real Estate and Financials indexes rose 6.1% and fell 9.7% respectively.
- In the Fund, positive contribution came from e-commerce companies JD.com and Alibaba, interior decoration firm Suofeiya and dairy company Yili.

Events in August

- The US added 38 companies linked to Huawei to its Entity List, barring any companies using US hardware or software from dealing with them.
- The Hang Seng Index included Alibaba for the first time, along with Xiaomi and Wuxi Biologics. Meanwhile, companies listed on the mainland STAR Market, which hosts innovative "new economy" stocks will be included in the Shanghai Composite Index.
- The ChiNext board began to allow IPOs based on the registration-based system rather than the approval-based system. This should reduce waiting times to list from several months to weeks. After the first five days of trading, daily price changes have had their limit increased from 10% to 20%. This moves the ChiNext exchange in line with the STAR Board which was launched last year.
- The Caixin Purchasing Managers' Index (PMI) reached 53.1 in August, the highest since February 2011, showing strength in new orders and export orders. Industrial production rose 0.7% month-on-month in July, affected by heavy flooding in Southern China. Fixed asset investment rose by 8.3% year-on-year (yoy) in July, driven by infrastructure and real estate.
- On the other hand, retail sales fell 1.1% year-on-year in July which was a negative surprise.
- In Hong Kong, daily new cases of COVID-19 peaked in late July at 149 and fell to nine by the end of August. Consequently, some social distancing measures were relaxed.

Portfolio News

JD.com reported strong results. More than 90% of new users came from low tier cities, which are driving growth in e-commerce. Its supermarket business has now become the largest component of revenue and has the potential to grow given the low penetration of online grocery shopping. Ultimately, management think the supermarket business can become larger than the original electronics and home appliances business, sales of which rebounded strongly after moderate growth in the first quarter. Management still aims to increase margins over time and given the long room for growth we believe the company has; we believe the company is undervalued despite its strong share price performance.

Alibaba also reported good results, with all categories growing at least as fast as they did in the fourth quarter of 2019. As was the case with JD.com, Alibaba benefited from a strong recovery in electronics sales as well as fast moving consumer goods (FMCG). The company is experimenting with sales through live streams in response to competition from Bytedance – this is another exciting way in which e-commerce in China is different to that in western countries. Alibaba's fintech affiliate, Ant Group, filed its prospectus and plans to list in Hong Kong and Shanghai. It revealed it earned $17bn of revenue in 2019, facilitated $16 trillion of payments on Alipay and lent $290 billion to individuals and small businesses.

Though **Suofeiya's** revenue fell 9% in the second quarter, it managed to increase gross margins by increasing prices and selling more higher margin products. The company is capitalizing well on the trend of more furnished homes being sold in China, and so sales to developers grew 30-40% yoy. Management note strong order growth so far in the third quarter and expect this to translate to strong profit growth in the second half of the year. We believe that the market is pricing in a return on capital that is far too pessimistic for a business that has historically generated a high and stable return on capital.

Yili reported a strong recovery which came as a positive surprise. The surprise was driven by management's decision to shift attention away from yogurt to milk, allowing Yili to increase its market share in UHT milk by 0.8% to 38.8%. Infant milk formula sales also grew strongly, while newer segments like ice cream and cheese continued to do well. It is increasingly likely that Yili can grow recurring earnings in 2020, which will mean management may become eligible for stock grants as part of the new incentive scheme.

Sino Biopharmaceutical (SBP) reported second quarter results which saw a recovery in operations. Revenue grew 2%, with a 52% increase from oncology sales offset by a 32% reduction in hepatitis sales due to government price cuts. The company's focus is now on future drugs to be launched and here SBP has a pipeline of drugs which should provide a catalyst for continued growth. **CSPC Pharmaceutical** reported revenue growth of 14% with contributions from products across the cardiovascular and oncology franchises. CSPC is planning on increasing its R&D spent by 50% to RMB 3.0 billion in 2020 which should place it as one of the highest spenders on R&D relative to peers in China. In contrast to SBP and CSPC, **China Medical System (CMS)** sells drugs on behalf of other firms, as well some of its own drugs it has acquired licenses for. Despite the focus on generics which have been more exposed to price cuts, CMS grew revenue in the first half with contributions from the digestive and cardiovascular segments. CMS has acquired rights to 18 "innovative drugs" which have greater pricing power compared to generics, and we expect the launch of these products to lead to a rerating for the stock.

Yuhong grew revenue and earnings by 21% and core profits (excluding subsidies) by 85% in the second quarter. Margins grew as a result of lower oil and bitumen prices. Management think they can grow revenue by 20%

for the full year despite the headwinds from COVID-19, pointing towards several growth drivers which should be in play in both the short and medium term. Future growth drivers include market share gains, rising renovation demand from existing housing and greater contributions from new segments like paint and insulation.

Hollysys replaced former CEO and Chairman Baiqing Shao with Chit Nim (Colin) Sung as CEO and Li Qiao as Chairman. The new management team immediately wrote off the goodwill associated with the overseas Bond business, which focuses on Mechanical and Electrical (M&E) solutions in Malaysia e.g. installation of fire protection systems and water systems. Bond had been a drag on the business before COVID-19 and given the slowdown in economic activity over the past six months, the goodwill in the business was written off. This means Hollysys has now written off virtually all of the goodwill from its overseas acquisitions, Bond and Concord (which also focuses on M&E but in the Middle East). We continue to hold the position because we think the stock looks very cheap – on a forward-looking price/earnings ratio, the stock is trading at depressed levels last seen in 2011 when the Wenzhou train crash occurred. To us, this seems far too pessimistic given that the core IA and railway businesses have recovered from the first quarter. Management expect revenue to grow 6-8% in the next financial year with 10% growth from the industrial automation segment and 3-5% growth from the rail transportation business.

Autohome's results came in line with expectations, with flat sales and a small increase in net income. A decline in ad revenue was offset by a large increase in data products sales, which sellers use to better optimize their sales. Management expect passenger vehicle sales to at best grow by single digits in the second half of the year. Autohome is launching new data products which should help support growth in the future.

Portfolio Switches

The changes we have made to the Fund this year are summarized below:

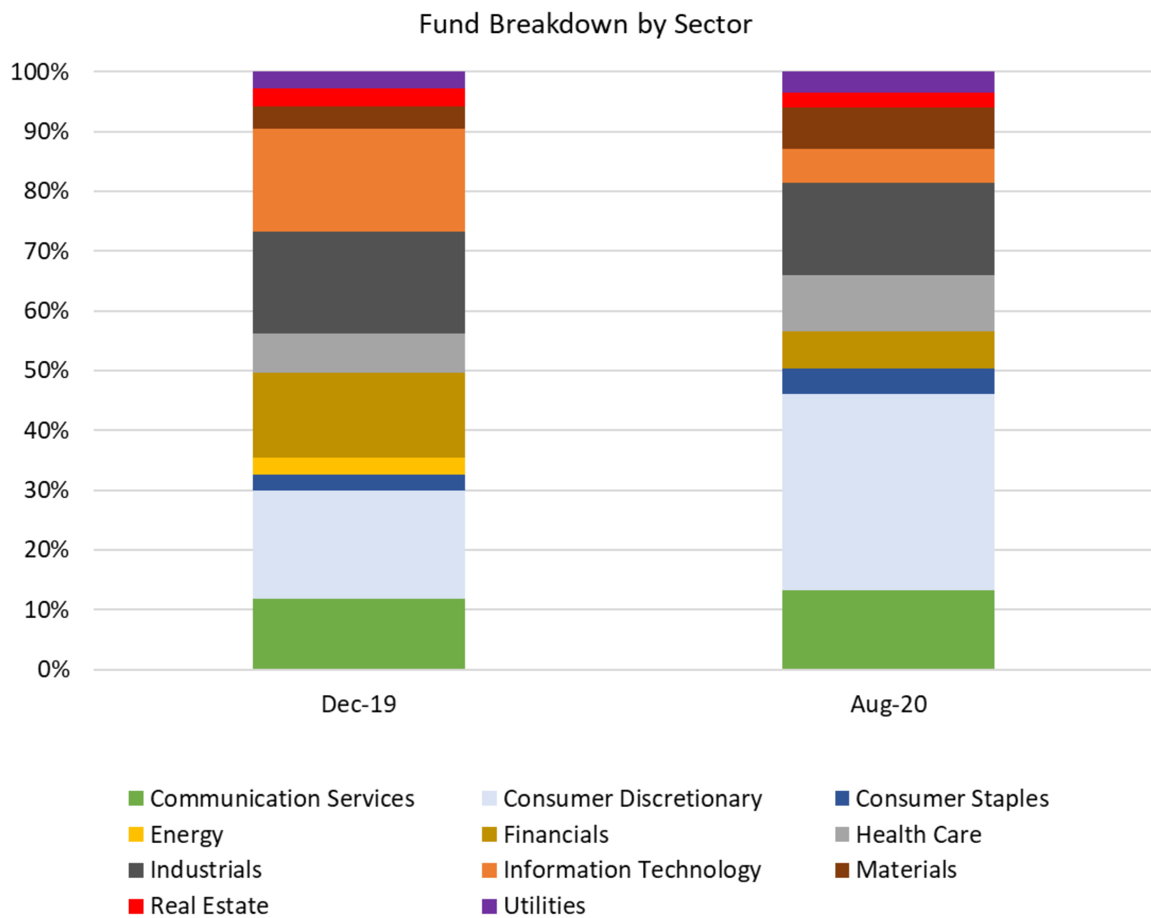
Sells	
Name	**Sector**
Travelsky	Information Technology
CNOOC	Energy
Tongda Group	Information Technology
AAC Technologies	Information Technology
Dali Foods	Consumer Staples
Qualcomm	Information Technology
Yangzijiang	Industrials
BOC HK	Financials
China Construction Bank	Financials
Noah	Financials

Buys	
Name	**Sector**
Zhejiang Supor	Consumer Discretionary
JD.com	Consumer Discretionary
Oriental Yuhong	Materials
Yili	Consumer Staples
Suofeiya	Consumer Discretionary
Venustech	Information Technology
CSPC Pharmaceutical	Healthcare
Sany Heavy Industry	Industrials

In August we sold Noah, a wealth and asset management business. The company is still feeling the effects related to a credit fund which was in default. The issues have dragged on for a year and combined with the businesses' ongoing shift in distribution, we felt **Sany Heavy Industry** was a better stock to be in. Sany is China's largest manufacturer of excavators and concrete machinery. We think the company can benefit from infrastructure stimulus and the downside risk is minimal at current valuations.

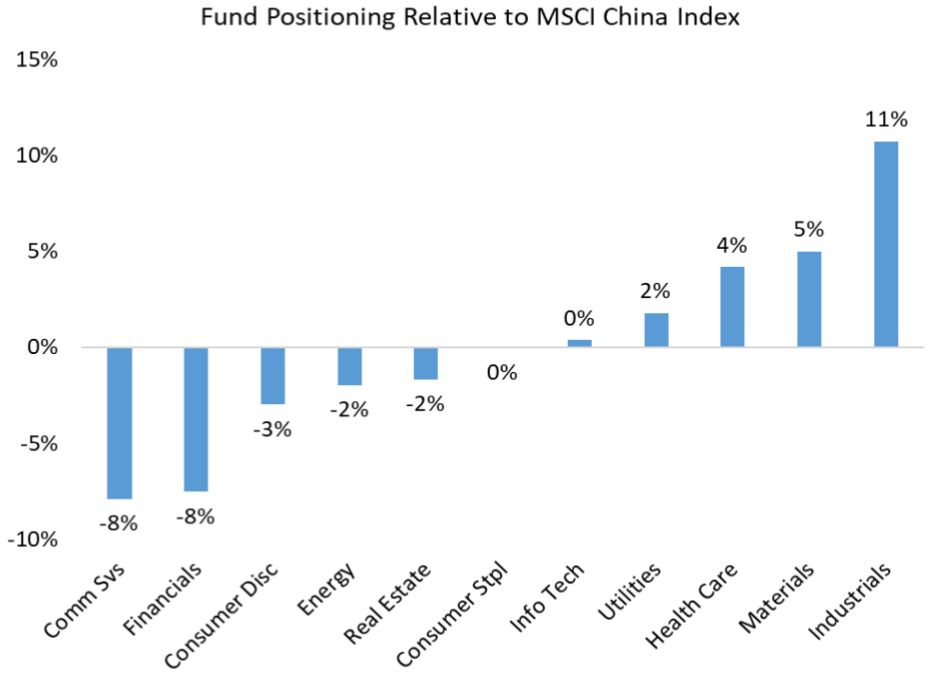
Portfolio Positioning

As a result of the changes made this year, the Fund's allocations to Information Technology and Financials have fallen by 11.5% and 7.9% respectively, compared to December 2019. Consequently, the allocations to Consumer Discretionary and Materials have risen by 14.8% and 3.3% respectively.



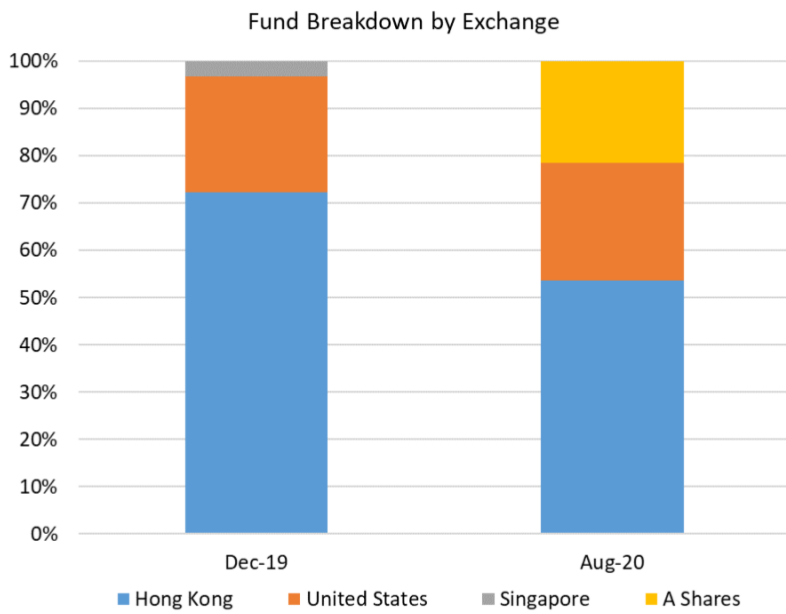
Source: Guinness Atkinson. Data as of August 31, 2020.

Relative to the MSCI China Index, the Fund is most overweight in Industrials, Materials and Health Care. The Fund is most underweight in Communication Services, Financials and Consumer Discretionary.



Source: Guinness Atkinson. Data as of August 31, 2020.

The Fund has increased its allocation to the domestic A share market by 21.4% this year, while the allocation to Hong Kong has fallen by 18.6%.



Source: Guinness Atkinson. Data as of August 31, 2020.

GUINNESS ATKINSON FUNDS

Outlook

The focus this year has been selling companies where either the competitive advantage has been lost or the prospect of earnings growth is unlikely. The replacements, we feel, all have a definable competitive advantage, have managed to grow their earnings in the past (pre-COVID) and are likely to do so in the current environment. The Fund has significantly increased its allocation to the A share market which we expect should give it exposure to any rallies in the mainland. We believe the Fund is now better placed to capture the growth opportunities present in China. These growth opportunities lie in structural growth areas such as e-commerce (JD.com), infrastructure stimulus (Yuhong and Sany), cybersecurity (Venustech) and consumption upgrades (Supor and Suofeiya). Edmund Harriss (portfolio manager)

Performance

As of 8/31/2020	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	0.89%	20.64%	5.19%	11.74%	4.10%
Hang Seng Composite Index TR	4.71%	17.23%	4.19%	9.30%	6.49%

As of 6/30/2020	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	-9.41%	2.87%	4.17%	3.79%	3.88%
Hang Seng Composite Index TR	-5.03%	-2.54%	3.82%	2.92%	5.81%

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

Expense Ratio: 1.69%

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. 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. The China and/or Hong Kong stock markets in which the Fund invests may experience periods of volatility and instability. These fluctuations may cause a security to be worth less than it was at the time of purchase. Market risk applies to individual securities, a particular sector or the entire economy. China and/or Hong Kong stocks may fall out of favor with investors, the value of Chinese currencies may decline relative to the U.S. dollar and/or China or Hong Kong stock markets may decline generally. The Fund invests in invest in small-cap or mid-cap, which involve additional risks such as limited liquidity and greater volatility, than investments in larger companies.

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.

The MSCI Zhong Hua Index is a composite index that comprises the MSCI China and MSCI Hong Kong Index. The index captures large and mid-cap representation across all China securities (B shares, H shares, Red Chips, PChips and foreign listed shares) as well as Hong Kong securities.

MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 703 constituents, the index covers about 85% of this China equity universe.

MSCI Hong Kong Index is a capital weighted stock index designed to measure the performance of the large and mid cap segments of the Hong Kong market. It has 48 constituents and covers approximately 85% of the free float-adjusted market capitalization of Hong Kong equity stocks.

Shanghai Composite Index, also known as SSE Index, is a stock market index of all stocks that are traded at the Shanghai Stock Exchange.

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 8/31/2020:

1.	JD.com Inc	4.48%
2.	Alibaba Group Holding Ltd	4.29%
3.	Inner Mongolia Yili	4.22%
4.	NetEase Inc - ADR	3.82%
5.	Suofeiya Home Collection	3.73%
6.	New Oriental Education & Technology Group Inc	3.73%
7.	Geely Automobile Holdings Ltd	3.72%
8.	Zhejiang Supor Cookware	3.67%
9.	Beijing Oriental Yuhong	3.63%
10.	Tencent Holdings Ltd	3.55%

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