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## Summary Review & Outlook

### Market

- In July, MSCI China fell 13.8% and MSCI Hong Kong fell 2.9%. The CSI 300 Index fell 7.4%.
- In July, MSCI China Value fell 9.6% while MSCI China Growth fell 17.7%.
- In China, the strongest sectors were Materials (total return of +7.0%), Utilities (+3.1%) and Industrials (-6.5%) while the weakest were Real Estate (-22.5%), Communication Services (-18.5%) and Consumer Discretionary (-16.8%).
- In Hong Kong, the Real Estate and Financials indices fell 2.6% and 2.2% respectively.
- In the Fund, strong performers were Nari Technology, Lead Intelligent, Venustech and Geely. Weaker stocks were Autohome, China Medical System, Suofeiya, Fuling Zhacai and Supor.

### Market Overview

Since February, Chinese markets have had their worst selloff since 2018, with MSCI China falling 30.6% (between 02/17/21 and 07/27/21). Government regulations affecting various industries led to a sharp derating in July. We think the government is introducing new rules for several reasons, with the aim of:

- Improving poor corporate behavior in industries where there has previously been relatively less regulation.
- Reducing social inequality.
- Protecting data security, which is linked to the structure that Chinese companies use to list overseas.

In certain industries, growth has been rapid while government regulation has been lax. This has led to instances of poor corporate behavior. For example, until recently, Alibaba did not allow vendors on its platforms to sell on other companies' websites. This was clearly not in consumers' best interests. In the food delivery sector, the largest company (Meituan) is not paying all its workers the minimum wage. The government is now pressing Meituan to ensure it does so, which is in the best interest of labor.

Another, related aim is to reduce social inequality. For example, the government is intending for much of the for-profit education sector to turn non-profit. The government is concerned that the gap between richer and poorer students could further increase, given the popularity of after school tuition services in middle class families. Additionally, expensive tuition is likely to discourage families from having more children, which makes it much harder for China to increase its birth rate.

Data security and the variable interest entity (VIE) structure are another concern. In China, foreigners are not allowed to invest in certain strategic sectors. To allow foreigners to invest in these sectors, the VIE structure was formed. The structure creates an offshore entity which foreigners own, which is typically domiciled in a location such as the Cayman Islands. This offshore entity in turn owns a Wholly Foreign

Owned Enterprise (WFOE) in China. This WFOE has a set of agreements with the actual operating company in China – it is this operating company which generates the sales and profits (and in which foreigners cannot directly invest in). Usually, the operating company agrees to pay management, technical and service fees to the WFOE, which is allowed under Chinese law. This agreement allows the profits of the operating company to flow through to the WFOE and then the offshore entity, giving foreign investors access to the profits of the underlying operating company.

The status of VIEs under China law is a grey area. Given its widespread use, the Chinese government has not explicitly banned the practice. However, the use of the structure remains a recurring risk for companies that use it. This risk became a reality for the education sector, as in addition to turning much of the sector non-profit, the government also banned the use of the VIE structure. This marked the first time that the VIE structure was explicitly prohibited.

Associated with VIEs is the issue of data security. Didi (the Chinese Uber) listed in the US at the end of June, using the VIE structure. Days after its listing, the company was told to remove its app from app stores, effectively stopping the company from signing up new users. This was due to a cybersecurity investigation, as the government was concerned about the data flow between Didi and offshore entities, which foreigners control. In particular, the government was concerned over potentially sensitive data on the location of government and military sites being shared.

Ever since the Holding Foreign Companies Accountable Act (HFCAA) was passed in Dec-20, we have been very skeptical of Chinese companies deciding to list in the US. The act requires foreign companies that do not comply with American audit standards to eventually delist from American exchanges. Specifically, the act requires the Public Company Accounting Oversight Board (PCAOB) to have access to accounting firms in China in order to conduct regular inspections and investigations. Chinese law does not allow Chinese audit companies to comply with this request without government authorization. So far, the government has not authorized any cooperation with the PCAOB. Three years of non-compliance with the HFCAA are needed before a delisting, so there is still some time until Chinese companies need to delist. Therefore, given the very low possibility that Chinese companies open their books to American regulators, we find it very odd if a company decides to list on an American exchange in 2021.

In the portfolio, there are five companies that use the VIE structure and are listed on American exchanges: Baidu, JD, Alibaba, Netease and Autohome. In response to the delisting risk, all five companies now have secondary listings in Hong Kong. For these five stocks, we are in the process of shifting exposure away from the US listing and towards the HK listing.

### **Stock Switches**

We sold Yuhong, a manufacturer of waterproofing materials used in the construction industry. We believe the share price has not yet fully reflected the company's exposure to Evergrande, and therefore took profit on the stock. We still like the company, and it remains on our watchlist as Yuhong's balance sheet is strong enough to weather a weaker year.

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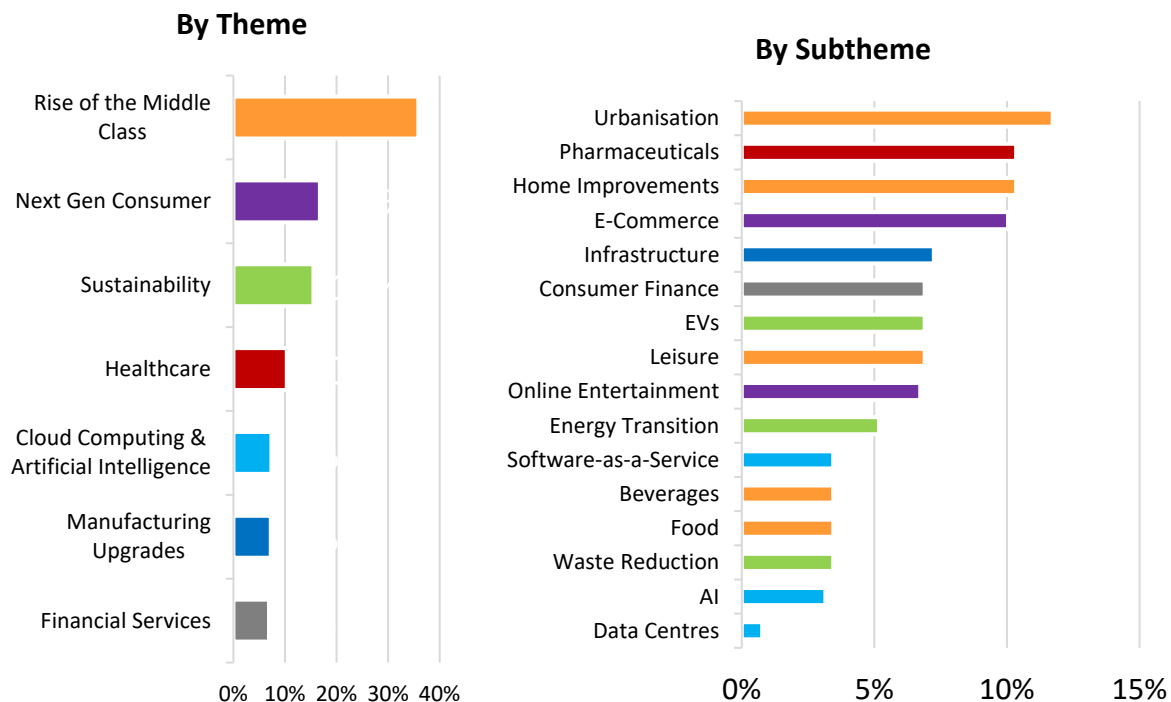


Our decision to sell New Oriental Education in June proved to be a good one. After the government announced the after-school tuition sector would become non-profit, New Oriental’s share price fell nearly 70% in two days. Part of the motivation for selling the stock was that tuition has a social element to it, and expensive tuition is likely to be a big obstacle to China’s birth rate picking up.

**Outlook**

We believe that despite the government’s increased regulatory focus, Chinese markets remain attractive. The online technology stocks affected by regulations come under our theme the Next Gen consumer, which only accounts for 17% of the Fund. This means 83% of the Fund has exposure to other themes, such as the Rise of the Middle Class, encapsulating Home Improvements, Urbanization, Beverages, Leisure and Food. Another theme is Sustainability, encapsulating Electric Vehicles, Energy Transition and Waste Reduction. Unlike the benchmark, the Fund is not dominated by online technology companies. The Fund’s exposure to the various themes is shown on the next page.

We believe our approach to investing in companies with exposure to structural growth themes is a sensible approach to investing in China. Additionally, our focus on valuations is important. While there are many interesting companies in China, their share prices often imply perfect execution of the companies’ strategy, where there can be no room for error. As the recent regulatory intervention has shown, headwinds can appear suddenly and from unlikely sources. We are looking for companies where growth is expected, but where if we are wrong, the downside is limited.



Source: Guinness Atkinson Asset Management. As of 6/30/21.

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Edmund Harriss (portfolio manager)

Sharukh Malik (portfolio manager)

**Performance**

In July, the Guinness Atkinson China & Hong Kong Fund fell 7.06% while the Hang Seng Composite Index fell 10.94%.

As of 07/31/2021	YTD	1 Year	3 Year	5 Year	10 Year
<b>China &amp; Hong Kong Fund (ICHKX)</b>	<b>-2.97%</b>	<b>13.06%</b>	<b>6.62%</b>	<b>11.94%</b>	<b>4.11%</b>
<b>Hang Seng Composite Index TR</b>	<b>-5.30%</b>	<b>9.76%</b>	<b>4.13%</b>	<b>9.69%</b>	<b>5.74%</b>

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

Expense Ratio: 1.60%

*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](http://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.*

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As of 06/30/2021	YTD	1 Year	3 Year	5 Year	10 Year
<b>China &amp; Hong Kong Fund (ICHKX)</b>	<b>4.40%</b>	<b>32.00%</b>	<b>8.50%</b>	<b>14.76%</b>	<b>4.74%</b>
<b>Hang Seng Composite Index TR</b>	<b>6.33%</b>	<b>29.76%</b>	<b>7.84%</b>	<b>13.24%</b>	<b>6.95%</b>
<b>MSCI China Net Total Return Index</b>	<b>1.83%</b>	<b>27.39%</b>	<b>10.34%</b>	<b>16.58%</b>	<b>7.70%</b>

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

Expense Ratio: 1.60%

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The Fund's underweight in the large online tech companies was a significant contributor to outperformance. The Fund is run on an equally weighted basis and so each position typically has a neutral weight of 3.3%. This limits the level of exposure to Tencent and Alibaba, two of the larger stocks in the benchmark.

The Fund's holdings were also notable contributors to outperformance. Nari Technology and Lead Intelligent are two such examples of this. Nari Technology makes hardware and software used to monitor operating information for the State Grid. The share price was boosted by news that the cap for electricity prices during peak hours is to be boosted by at least 20%. This should theoretically boost revenues for the grid, which should lead to higher procurement budgets, boosting Nari's potential sales.

Lead Intelligent makes equipment used to build out electric vehicle battery plants. It is well known for its winding equipment which packs battery cells together but is expanding into the earlier stages of the production process. The share prices of companies in the battery supply chain have rallied since the bottom in March, boosted by positive earnings revisions as EV sales have been better than expected.

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Supportive government policies by European and American policymakers have also boosted EV sales forecasts. Furthermore, Lead Intelligent's major customer, CATL, extended its agreement to supply batteries to Tesla. The market's rotation away from online tech towards growing industries with government support further led to a rally at the end of July.

On the other hand, detractors to performance include Autohome, China Medical System, and Suofeiya. Autohome continues to be weak, compounded by brokers cutting their price targets so they are closer to the current price. Autohome is facing more competition from Dongchedi and Bitauto, who are backed by Bytedance and Tencent respectively. The company's valuation multiple is at its lowest level since the company listed and though growth expectations have fallen, we believe the company is too cheap for the growth and profitability it offers.

China Medical System was by far the best performing stock in the first half of the year, rising 167%. The company historically sold generic drugs on behalf of other firms but is now expanding into the innovative drug market. The share price gave back some of its gains in July on no stock specific news. We believe even after its rally, the market is still underpricing the profitability of the company.

Suofeiya makes kitchen cabinets and wardrobes. Its biggest customer is Evergrande which is under pressure to deleverage and so Suofeiya's share price has been weak. Suofeiya's exposure to Evergrande is through overdue receivables and lost income. The company has reduced some of its exposure by exchanging receivables due from Evergrande for a 40% stake in a joint venture between the two companies. Suofeiya now has full control of the venture and can repurpose the assets for other customers. While Suofeiya's earnings are likely to take a hit from Evergrande, it is hardly a disaster. We estimate that in the worst-case scenario, if all Evergrande revenue is lost this year and all receivables due from Evergrande are written off, earnings could fall 7% in 2021. While this is obviously disappointing, this is also not a disaster - the company's balance sheet is strong enough to absorb the hit to earnings. We believe the current share price implies that Suofeiya's return on capital will return to the cost of capital. We regard this as far too pessimistic as lost earnings from Evergrande do not change the company's prospects in 2022, let alone in the medium term.

***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](http://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

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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.

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.

The Shanghai Shenzhen CSI 300 Index is a market capitalization-weighted stock market index designed to replicate the performance of the top 300 A-shares stocks traded in the Shanghai and Shenzhen stock exchanges.

The Variable Interest Rate (VIE) creates an offshore entity which allows foreign investors to invest in restricted sectors in China.

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 07/31/2021:

1	Wuxi Lead Intelligent Equipment Co Ltd	6.44%
2	NARI Technology Co Ltd	5.11%
3	China Resources Gas Group Ltd	4.55%
4	Xinyi Solar Holdings Ltd	4.46%
5	Geely Automobile Holdings Ltd	4.26%
6	CSPC Pharmaceutical Group Ltd	4.10%
7	Venustech Group Inc	4.05%
8	China Merchants Bank Co Ltd - H Shares	3.94%
9	NetEase Inc - ADR	3.94%
10	China Medical System Holdings Ltd	3.60%

Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security. Distributed by Foreside Fund Services, LLC.