Guinness Atkinson

China & Hong Kong Fund

Managers' Update - November 2021

GUINNESS ATKINSON FUNDS

Summary Review & Outlook

Market

- In October, MSCI China rose 3.2% and MSCI Hong Kong rose 1.3%. The CSI 300 Index rose 1.9%.
- MSCI China Value rose 2.0% while MSCI China Growth rose 4.3%.
- In China, the strongest sectors were Consumer Discretionary (+9.5%), Communication Services (+5.0%) and Consumer Staples (+2.9%), while the weakest were Health Care (-6.6%), Real Estate (-5.8%) and Energy (-5.2%).
- In Hong Kong, the Real Estate and Financials indices rose 6.4% and fell 1.8% respectively.
- In the Fund, strong performers were Geely, Lead Intelligent, Fuling Zhacai and Yili. Weaker stocks were CSPC Pharmaceutical, Sino Biopharmaceutical, Sany and Venustech.

Overview

- Chinese markets rallied in the first three weeks of the month before giving back some of the gains in the last week of October. This marks the pattern we have seen since the end of July, where Chinese markets have been range bound.
- Retail sales were stronger than expected, rising 4.7% (year-on-year unless stated otherwise) in October which was higher than the expected figure of 3.7%. On a two-year compound annual growth basis, retail sales grew 4.6% a year in October.
- Exports rose 2.6% month-on-month in October compared to 1.6% in September.
- Industrial production grew 3.5% in October. On a two-year compound annual growth basis, industrial production grew 5.2% a year in October.
- The real estate market remains weak. Home sale area (volume) and value fell 24% in October.
- Total social financing, the broadest measure of credit, grew 10% which was weaker than some were expecting. In light of the headwinds facing the economy, the government is not resorting to loosening monetary policy aggressively which is encouraging if China is serious about rebalancing its economy. Corporate bond issuance remains relatively weak, likely due to the property market. Banks have also moderated their lending for the same reason.
- On a more positive note, the central bank is offering discounted loans to companies involved in China's decarbonization efforts. Banks first need to lend to the relevant company, and then are able to access re-lending facilities (worth 60% of the original loan) from the central bank at discounted rates. The benefit of this approach is that as only 60% of the loan can be accessed at the re-lending facility, the bank still has to take on credit risk which reduces the problem of moral hazard. Additionally, this approach, which mirrors the scheme recently unveiled for small and medium enterprises (SMEs), allows the central bank to target liquidity to areas where it is needed. The traditional approach of lowering the required reserve ratio (RRR) is too blunt to achieve this goal, as the excess liquidity could potentially flow to undesirable parts of the market.

Portfolio Performance

The Fund's automobile holdings were the strongest in the portfolio, covering Geely and Lead Intelligent. Geely increased its stake in its electric vehicle (EV) brand *Zeekr*, buying a 10% stake from its parent company. Lead Intelligent, which makes equipment used in battery plants, reported third quarter results where revenue grew 17% and earnings per share (EPS) grew 10%. We think it is quite likely the company's order book should beat the company's guidance of RMB 15bn in 2021, which is equivalent to $2.4bn. The company has so far passed on rising raw material costs onto its consumers, showing its pricing power.

Price cuts in the latest round of tenders meant the Fund's pharmaceutical holdings were weak, affecting CSPC Pharmaceutical, Sino Biopharmaceutical and China Medical Systems (CMS). Price cuts are highest for generic products and lowest for more innovative drugs where high R&D capability is required. We feel that though our three healthcare holdings do have large exposure to generics, they have the ability to pivot towards the innovative end of the market. This is primarily through R&D for CSPC and Sino Biopharm, and through acquisitions for CMS.

Nari Technology reported third quarter revenue growth of 6% and EPS growth of 15%. The company is seeing good growth from its various segments and is expecting grid investment to grow at 5% a year over the next five years. This should support its grid automation business as well as its Ultra High Voltage segment.

Fuling Zhacai produces zhacai, a well-known pickled condiment. Its revenue grew 1% while its EPS fell 47% in the third quarter. The company's gross margin fell 7.3 percentage points due to higher mustard root costs, while marketing expenses rose 82% as the company attempts to build its brand and improve volumes. We are comfortable with this temporary reduction in earnings as the advertising is really a long-term investment to build the brand. In response to rising costs, Fuling Zhacai announced price increases of 3-19%, effective from November. More broadly, management think they can grow volumes by high single to low double digits by focusing on areas where consumption of zhacai is low. For example, per capita consumption of the product is RMB 5-6 in Guangdong, compared to only RMB 1-2 in Northeast China, implying potential to grow volumes.

Sany reported third quarter results where revenue fell 13% and EPS fell 36%. Sany's results were better than the industry's and it gained market share in the domestic market. Given the weakness in the property market, the growth outlook has dimmed which is reflected in the lower valuation multiple that the market is assigning the stock. Management is expecting at best flat sales in 2022 in the domestic market, while exports are expected to rise 50-60%.

Haier's revenue fell 1% while its EPS fell 38% but excluding the deconsolidation of a business, revenue and EPS grew 9% and 15% respectively. The gross margin rose 2.4 percentage points which is impressive given rising input costs. A better mix of higher margin products and the deconsolidation of the lower margin COSMOPlat business explained this higher margin. Haier continues to hold or gain market share in its most important categories.

Stock Switches

We sold Autohome due to its lack of earnings growth. The company operates China's largest online platform for buying and selling cars. However, the ongoing chip shortage has affected car sales which is out of the company's control. Increasing competition from well-funded business is another headwind the business is facing. The market is not expecting earnings to reach 2020's level until 2024 and we do not have a strong view as to why the market is wrong.

In its place, we bought H&T Intelligent. H&T makes controllers which are used in applications such as household appliances and power tools. H&T's controllers are used in well known brands and the company is recognized for the quality of its products. The company is well placed to take advantage of growing demand for the Internet of Things (IoT), which naturally complements the existing business. H&T is also is aiming to expand into the automobile market where electronic control units, which are not too dissimilar from controllers, are becoming increasingly used.

Outlook

The Chinese economy is facing various headwinds which we feel is reflected in the performance of Chinese markets this year. From an investing point of view, we think our approach on structural growth is sensible. We are looking for companies which give exposure to the various structural growth themes present in China, where even in a slower economy, they can still grow. These themes cover, but are not exclusive to, the Rise of the Middle Class, Manufacturing Upgrades and Financial Services. We look for quality companies which give exposure to these themes – the management of these companies show that in addition to giving the exposure we are looking for, they also make sensible capital allocation decisions. Finally, we are looking for the right combination of earnings growth and valuations to generate an acceptable level of return in the medium term. This process results in a portfolio where the companies in aggregate have grown sales and earnings by 10% a year for the past five years, which is contrast to the broader market where there has been no earnings growth over the same period. We are able to achieve this while ensuring the fund is essentially trading in line with the market on a forward-looking basis.

Edmund Harriss (portfolio manager)

Sharukh Malik (portfolio manager)

GUINNESS ATKINSON FUNDS

Performance

In October, the Guinness Atkinson China & Hong Kong Fund rose 3.35% while the Hang Seng Composite Index rose 2.38% and the MSCI China Net Total Return (NTR) Index rose 3.16%. In the Fund, strong performers were Geely, Lead Intelligent, Fuling Zhacai and Yili. Weaker stocks were CSPC Pharmaceutical, Sino Biopharmaceutical, Sany and Venustech.

As of 10/31/2021	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**-6.06%**	**7.74%**	**10.81%**	**9.65%**	**5.91%**
Hang Seng Composite Index TR	**-7.23%**	**4.19%**	**8.62%**	**7.87%**	**6.98%**
MSCI China Net Total Return Index	**-14.04%**	**-9.21%**	**11.50%**	**10.24%**	**7.49%**

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 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.

As of 09/30/2021	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	**-9.10%**	**5.41%**	**6.11%**	**8.78%**	**7.06%**
Hang Seng Composite Index TR	**-9.39%**	**5.46%**	**3.69%**	**7.16%**	**8.21%**

MSCI China Net Total Return Index	**-16.67%**	**-7.33%**	**5.94%**	**9.12%**	**8.68%**

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.

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

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.

MSCI China Value Index captures large and mid cap Chinese securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price, and dividend yield.

MSCI China Growth Index captures large and mid cap securities exhibiting overall growth style characteristics across the Chinese equity markets.

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

Earnings per share (EPS) is calculated as net income / total shares outstanding.

Price-Earnings (P/E) ratio is a valuation ratio of a company's current share price compared to its per-share earnings. Forward earnings differ from trailing earnings, which is the figure quoted more often, as they are a projection and not a fact.

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 10/31/2021:

1.	NARI Technology Co Ltd	5.68%
2.	Xinyi Solar Holdings Ltd	4.31%
3.	Inner Mongolia Yili - A Shares	4.26%
4.	China Resources Gas Group Ltd	4.15%
5.	NetEase Inc	3.95%
6.	JD.com Inc	3.94%
7.	China Merchants Bank Co Ltd - H Shares ADR	3.85%
8.	Wuxi Lead Intelligent Equipment Co Ltd	3.73%
9.	China Overseas Land & Investments Ltd	3.64%
10.	Haier Smart Home Co Ltd	3.55%

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

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