Guinness Atkinson

China & Hong Kong Fund

Managers' Update - December 2021

GUINNESS ATKINSON FUNDS

Summary Review & Outlook

Market

- In November, MSCI China fell 6.0% and MSCI Hong Kong fell 5.3%. The CSI 300 Index fell 0.9%.
- MSCI China Value fell 5.6% while MSCI China Growth fell 6.3%.
- In China, the strongest sectors were Industrials (+0.9%), Consumer Staples (-1.5%) and Information Technology (-2.9%), while the weakest were Consumer Discretionary (-10.8%), Energy (-7.8%) and Health Care (-5.4%).
- In Hong Kong, the Real Estate and Financials sectors fell 5.1% and fell 7.4% respectively.

Overview

- The new strain of COVID, Omicron, was identified in South Africa. The new strain seems to spread at a faster rate than the Delta strain, but it is currently unclear if it leads to more serious symptoms. China's zero covid policy, closed borders and past experience in stopping outbreaks means it is likely well placed to deal with the new strain.
- Presidents Xi and Biden held a virtual summit. While no major announcements were made, the fact the two held a summit is a positive sign that China and the US are trying to calm relations. Both stressed the need to avoid conflict, while remaining firm on their views on issues such as Taiwan and Xinjiang.
- During the COP26 climate summit, the two countries unexpectedly announced they would work together to limit temperature increases to 1.5C.
- In November, the Caixin manufacturing Purchasing Managers' Index (PMI), fell 0.7 points to 49.9. On the other hand, the official National Bureau of Statistics' (NBS) PMI, which is geared towards state firms, rose 0.9 points to 50.1. Easing power shortages, impacting the more energy intensive industries which are likely a higher component of the NBS PMI, explain most of the divergence in the two measures in November. Both PMIs showed improving sentiment on output, input prices and exports. However, both PMIs also show weak sentiment on new orders.

Portfolio Performance

It was a weak month for China, with the MSCI China index falling 6.0%. This was driven by weakness in the tech stocks. Tencent was asked by regulators to temporarily pause releasing new apps and to stop updating existing apps. This was because the company was found to violate data protection rules on four occasions in the past. Therefore, all app updates until the end of the year will need to be reviewed by regulators to make sure they comply with the law.

Alibaba reported weaker results than expected, which reflects the headwinds the business is facing. Though revenues grew 29% year-on-year, the core business, the customer management segment, only grew sales by 3%. In response to government rules lowering the barriers to entry in the industry, Alibaba has effectively had to subsidise some merchants on its platforms, which means revenue growth in this segment is lagging Gross Merchandise Value (GMV) growth. The company is investing to generate growth in other parts of the business, such as by continuing to target lower tier cities and by growing the group buying and cloud businesses. While these businesses contribute to revenue growth, they are still not material contributors to earnings as they are still building scale, and so Alibaba's margins may suffer. The Fund's underweight in Alibaba helps it in periods where Alibaba is weak, as Alibaba is the second largest constituent of the MSCI China Index. As of 29/10/21, Alibaba had a weight of 11.5% in the MSCI China Index compared to a neutral weight of only 3.3% in the portfolio.

On the other hand JD.com reported a better set of results despite being a competitor to Alibaba. Revenue grew 30% and the business continues to gain market share. Sales growth in the electronics and appliance category accelerated as JD takes market share from Suning. JD only has half of the users that Alibaba has, so still has room to grow its customer base in the coming years. The grocery business continues to grow but is still in the expansion phase, and so is not expected to become a material contributor to earnings for a few years. Government efforts to improve competition in the industry is a further tailwind for JD.

Baidu's results came in line with expectations but were still relatively weak. Marketing revenues from the search business grew 6% year-on-year. On the other hand, the cloud business grew revenues 73% but is still a small contributor to the overall business. We continue to hold the business because we think that using a sum of the parts valuation, there is upside potential in the stock. Baidu's share price has sold off partly due to increased government regulation over the broader industry, but we think it can benefit from certain changes. For example, making content on Tencent's platforms available for Baidu's search engine is a clear positive for Baidu.

Outlook

Based on consensus analyst earnings estimates, the fund is trading at 13.4x on 2022 earnings, which is slightly higher than the MSCI China Index which trades at 12.3x. This is despite the Fund being invested in higher quality businesses, as the Fund's Return on Equity of 19% is well above the market's value of 12%. The Fund is invested in companies which have, in aggregate, grown sales and earnings by 12% and 13% a year over the past five years, compared to 3% and 0% for the market. Based on consensus estimates, the Fund is expected to grow sales and earnings by 17% and 16% a year, over the next two years. This puts it a premium to the market's expected values of 12% and 13%. The Fund is run on an equally weighted basis which means its active share, relative to the MSCI China Index, is high at 85%.

We believe for the quality, historic earnings growth and forecast earnings growth that the Fund offers, paying 13.4x on 2022 estimated earnings is an attractive offer. The Fund has limited exposure to the Internet tech stocks which have been weak and subject to greater regulation this year, explaining the Fund's good relative performance year-to-date. Our focus on the structural growth themes in China means we give diversified exposure to growing businesses, which have become gradually cheaper over the year, even though the apathy towards China is not directed towards all of these companies. China is out of favor due to what is going on with the more well-known Internet and consumer companies, but we think investors are missing the opportunity to invest in less well known, but good quality growth stocks in the region trading at attractive prices. The companies we have invested in have proven they can take advantage of their respective structural growth themes, as they have in aggregate grown sales and earnings by 12% and 13% a year, over the past five years. We believe even absent a multiple recovery, the returns from the Fund can be driven from the earnings growth we expect the portfolio to deliver. The market is expecting the portfolio to grow earnings by 16% a year over 2021 and 2022. Assuming markets do eventually assign a higher multiple to China, as they have done over time, this should add to the overall expected return for the Fund.

Edmund Harriss (portfolio manager)

Sharukh Malik (portfolio manager)

Performance

In November, the Guinness Atkinson China & Hong Kong Fund fell 1.44% while the Hang Seng Composite Index fell 5.83% and the MSCI China Net Total Return (NTR) Index fell 5.97%. 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 11/30/2021	YTD	1 Year	3 Year	5 Year	10 Year
China & Hong Kong Fund (ICHKX)	-7.41%	0.49%	9.20%	9.24%	6.13%
Hang Seng Composite Index TR	-12.64%	-9.36%	4.10%	6.51%	7.33%
MSCI China Net Total Return Index	-19.17%	-16.94%	6.67%	9.14%	7.77%

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.

In China, the Caixin Manufacturing PMI Purchasing Managers' Index measures the performance of the manufacturing sector and is derived from a survey of private 430 industrial companies.

China Manufacturing Purchasing Managers Index (PMI) provides an early indication each month of economic activities in the Chinese manufacturing sector. It is based on data collected by the National Bureau of Statistics (NBS).

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.

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. Shareholders' equity is equal to a company's assets minus its debt, therefore ROE is considered the return on net assets.

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.

Active Share is a measure of the percentage of stock holdings in a manager's portfolio that differs from the benchmark index. Managers with high Active Share have been found to outperform their benchmark indexes and Active Share significantly predicts fund performance

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 11/30/2021:

1.	NARI Technology Co Ltd	6.17%
2.	NetEase Inc	4.44%
3.	JD.com Inc	4.31%
4.	China Resources Gas Group Ltd	4.07%
5.	Venustech Group Inc	3.98%
6.	Inner Mongolia Yili - A Shares	3.97%
7.	Shenzhen H&T Intelligent Control Co., Ltd.	3.94%
8.	Xinyi Solar Holdings Ltd	3.85%

9.	Wuxi Lead Intelligent Equipment Co Ltd	3.71%
10.	Haier Smart Home Co Ltd	3.61%

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.