# Guinness Best of China Fund

Investment Commentary - February 2022

This is a marketing communication. Please refer to the prospectus and KIID for the Fund before making any final investment decisions. Past performance does not predict future returns.

## ABOUT THE FUND

| | |
|---|---|
| **Launch date** | 15.12.2015 |
| **Team** | **Edmund Harriss** (manager)<br>**Sharukh Malik** (manager)<br>**Mark Hammonds** |
| **Aim** | **China and Taiwan** |

Guinness Best of China Fund is designed to provide investors with exposure to economic expansion and demographic trends in China and Taiwan.
The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle.

## RISK

| ◀ Lower risk | | | Risk & reward | | | Higher risk ▶ |
|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | **6** | 7 |

Typically lower rewards — Typically lower rewards

The risk and reward indicator shows where the fund ranks in terms of its potential risk and return. The fund is ranked as higher risk as its price has shown high fluctuations historically. Historic data may not be a reliable indicator for the future

## PERFORMANCE

Past performance does not predict future returns 31/01/2022

| | |
|---|---|
| **Fund** | Best of China Fund (Y GBP 0.89% OCF) |
| **Index** | MSCI Golden Dragon |
| **Sector** | IA China/Greater China |

| | 1 year | 3 years | From launch |
|---|---|---|---|
| **Fund** | -8.3 | 32.4 | 93.4 |
| **Index** | -15.0 | 27.1 | 108.7 |
| **Sector** | -19.7 | 31.6 | 100.7 |

**Annualised % total return from launch (GBP)**


The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations. Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. For further details on fund performance, please refer to the penultimate page of this document.

Source: FE fundinfo, Y class 0.89% OCF, bid to bid, total return. Launch date 15.12.15

## FUND PHILOSOPHY

The Fund invests in quality, profitable companies which give exposure to the structural growth themes in China. These seven themes are:

- Rise of the Middle Class
- Sustainability
- Manufacturing Upgrades
- Healthcare
- Cloud Computing & Artificial Intelligence
- Next Gen Consumer
- Financial Services

Once we have identified companies which give exposure to these themes, we also apply a set of quantitative filters to identify quality, profitable companies with strong balance sheets. Quality is defined as a return on capital above the cost of capital while a strong balance sheet is defined as debt/equity less than 150%. These filters reduce the universe from an initial ~1,600 companies to ~800 companies, of which we pick 30-40 to form an equally weighted portfolio.

Overall, we are looking for companies with the following characteristics:

- High return on capital.
- Growing operating cashflow, which we expect to continue to grow.
- The ability to deploy this cash at a high rate of return.
- Sensibly structured balance sheets with no excessive debt.
- Management we trust to grow the business.
- Companies that are judged to not harm society's wider interests.
- Growth opportunities undervalued by the market.

## Best of China Fund

The Fund has a valuation discipline to ensure that we do not overpay for future growth. When assessing the valuation of companies on a discounted cash flow basis, we adjust the discount rate where necessary to reflect the potential for higher global interest rates.

The Fund is run on an equally weighted basis, meaning it has high conviction in 30-40 stocks. This results in a high active share of 86% relative to the MSCI China Index.

## SUMMARY REVIEW & OUTLOOK

**Fund & market**

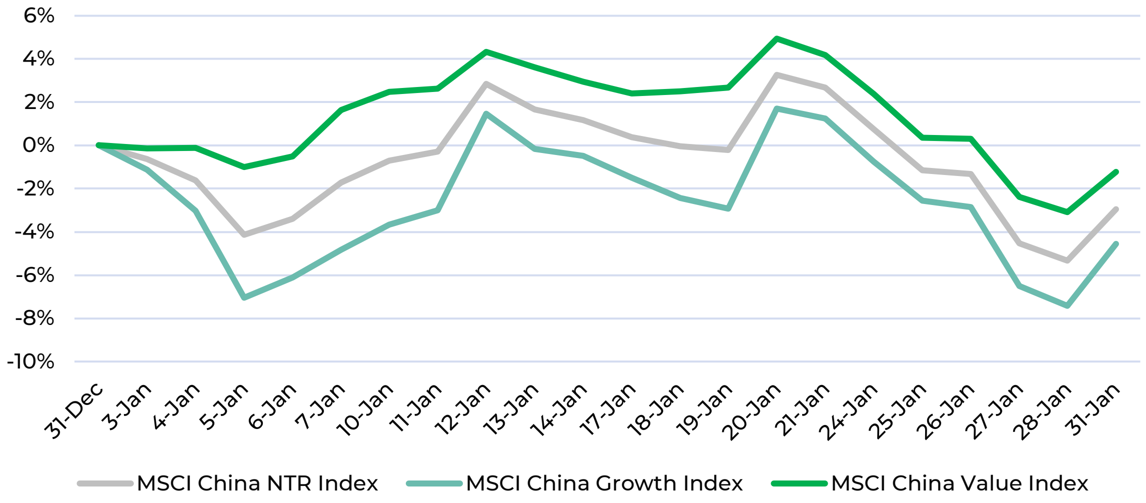
- In January, MSCI China fell 2.9% (in USD unless otherwise stated), MSCI Taiwan fell 2.2% and MSCI Hong Kong rose 1.0%. The CSI 300 Index, which covers the largest stocks in the onshore market, fell 7.7%.
- MSCI China Value fell 1.2% while MSCI China Growth fell 4.6%. The MSCI China A Onshore Value Index fell 5.7% while the MSCI China A Onshore Growth Index fell 12.2%.
- In MSCI China, the strongest sectors were Real Estate (total return +8.6%), Energy (+6.5%) and Financials (+5.7%), while the weakest were Health Care (-14.8%), Information Technology (-13.5%) and Utilities (-12.6%).
- In Hong Kong, the Real Estate and Financials sectors rose 0.9% and 1.7% respectively.
- In Taiwan, the Information Technology sector, which makes up more than 70% of the local market, fell 1.5%.

**Events**

- With Omicron rapidly becoming the dominant strain of covid worldwide, China's policy of maintaining zero-covid cases becomes harder. Lockdowns were introduced in Xi'an, Tianjin and even parts of Beijing. Cases were falling throughout the month but the start of the Winter Olympics has led to more cases being detected.
- The People's Bank of China (PBOC) cut the 7-day reverse repo rate by 0.1% to 2.1%. It also cut the 1-year medium lending facility (MLF) rate by 0.1% to 2.85%. The bank loan prime rate (LLPR) was cut by 0.1% to 3.7% and the 5-year LPR rate was cut by 0.05% to 4.6%. While these moves are encouraging in that they signal a loosening of monetary policy, we do not regard them as significant enough to stimulate economic growth.
- The difficulty China has is that there is already a significant amount of debt within the economy, which we think the government is keen on limiting. Cutting broad interest rates to stimulate growth is likely to add to this debt, so there is a fine balancing act between the need to stimulate growth and the need to ensure debt does not grow too quickly. Cutting domestic interest rates while US rates are increasing could also lead to downward pressure on the Renminbi, which is another consideration.
- Fourth quarter GDP growth for 2021 was 4.0% year-on-year, beating expectations. In 2021, GDP grew 8.1%, marking a recovery from 2020.
- But December data was mixed. Retail sales only grew 1.7%, with a notable 7% drop in auto sales due to the ongoing chip shortage. Industrial production grew 3.5%, with tech growing 14% but with cement and steel falling 17% and 23% respectively. Data from the property market remains weak.
- Consumer price inflation (CPI) remains under control, as headline CPI fell from 2.3% in November to 1.5% in December. Producer price inflation (PPI) remains high but fell from 12.9% in November to 10.3% in December.

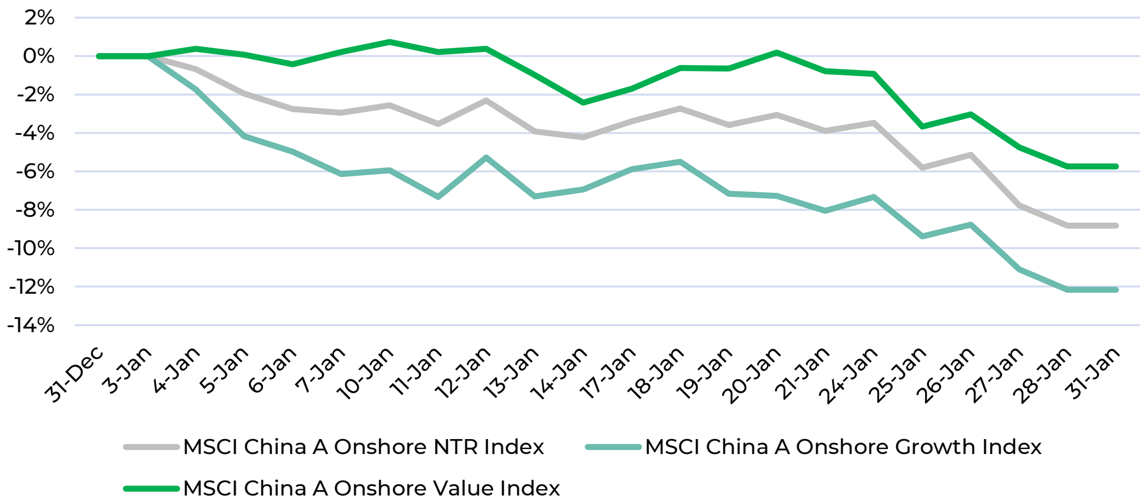
## MARKET

Offshore Performance




(Data from 31/12/21 to 31/01/22, returns in USD)

Onshore Performance




(Source Bloomberg: Data from 31/12/21 to 31/01/22, returns in USD)

Onshore markets were noticeably weak in January, with the CSI 300 Index falling 7.7% and the MSCI China A Onshore NTR Index falling 8.8%. We think the A share market was weak due to multiple reasons:

- The expectation of rising interest rates in the US led to a sell-off in higher growth and more expensive names in developed markets, which fed through to the A share market. The MSCI China A Onshore Growth Index fell 12.2%, falling much more than the MSCI China A Onshore Value Index which fell 5.7%.
- Continued weakness in the property market is affecting sentiment. While certain interest rates have been cut, a cut of 0.1% is not significant enough to boost growth, and so perhaps onshore markets were pricing in more aggressive monetary easing.

Offshore stocks, listed in Hong Kong and the US, were better performers as they started the year cheaper than the onshore stocks, and so were less exposed to rising interest rate expectations. The tech stocks affected by last year's regulations are listed in Hong Kong, and so already suffered from a derating last year. On the other hand, the A share market was up in 2021 and started the year more expensive, and so was more exposed to rising interest rate expectations.

## OVERVIEW

In the Fund, China Overseas Land Investment (COLI) was the strongest stock in the portfolio. It is a state-owned property developer which is conservatively financed, meaning it has not breached any of the debts limits set by the so called three red lines policy. As the property market has weakened following Evergrande's troubles, COLI has been much more active in land auctions, taking advantage of its competitors' weaknesses. It has even acquired projects from distressed property developers such as Shimao and Agile in the past month.

China Lesso makes pipes used in property and infrastructure developments. Its share price bounced in January on no stock specific news, but we think it was likely in anticipation of infrastructure stimulus and support for the property market. This should lead to a recovery in demand for Lesso's products.

Geely was the weakest stock, reflecting the weakness in China auto stocks more broadly. Shortages of chips have constrained production for automobile manufacturers globally, leading to the weak auto sales seen in retail sales data. Despite these challenges, Geely increased its sales volume by 1% in 2021 and in Dec-21, more than 10% of its sales were in electric vehicles. The company is now targeting a 24% volume increase in 2022

Reflecting the weakness in the A share market, generally the Fund's A shares were the weaker stocks in the portfolio, while the offshore stocks performed relatively better.

## SUMMARY & OUTLOOK

We think in the context of rising interest rates in the US, investors should be looking at China. While the US is tightening monetary policy, China is in the process of loosening monetary policy. American indices are trading at high multiples relative to their long-term average, while China is trading in line with its average. We are seeing some well-known American growth stocks disappoint in their results announcements in early February, leading to very sharp sell-offs. In China, given the weakness over the past 12 months, valuations and expectations are more reasonable.

Our companies have in aggregate grown net income by 13% a year over the past 10 years i.e. they have shown they can translate the structural growth opportunities into consistent earnings growth. Our companies have done this while maintaining a high return on equity of 22%. We believe, at current prices, the Fund's focus on quality, growing companies which gives exposure to the structural growth opportunities in China is worth considering.

**Portfolio Managers**

Edmund Harriss

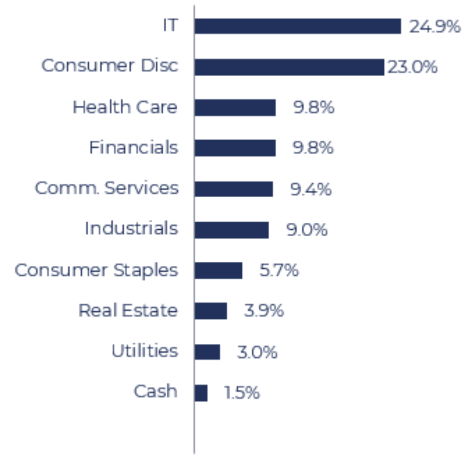
Sharukh Malik

## PORTFOLIO – 31.01.2022

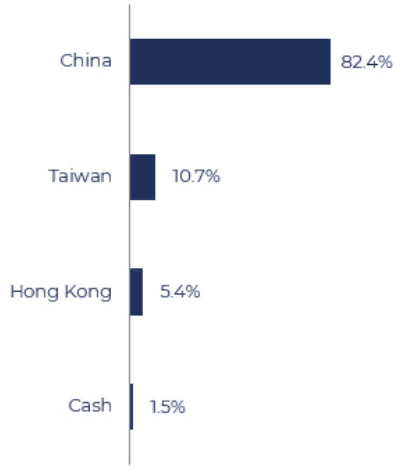
### Fund top 10 holdings

| | |
|---|---|
| Suofeiya Home Collection | 4.1% |
| China Overseas Land | 3.9% |
| CSPC Pharmaceutical Grp | 3.8% |
| Elite Material | 3.8% |
| Novatek Microelectronics | 3.7% |
| Ping An Insurance | 3.6% |
| NetEase | 3.5% |
| China Merchants Bank | 3.4% |
| Haier Smart Home | 3.4% |
| Zhejiang Supor | 3.4% |
| % of Fund in top 10 | 36.6% |
| Total number of stocks | 31 |

### Sector analysis




### Geographic allocation




## PERFORMANCE

**PERFORMANCE 31/01/2022**

*Past performance does not predict future returns*

**Annualised % total return from launch (GBP)**


| Discrete years % total return (GBP) | Jan '22 | Jan '21 | Jan '20 | Jan '19 | Jan '18 | Jan '17 |
|---|---|---|---|---|---|---|
| **Fund (Y Class, 0.89% OCF)** | -8.3 | 31.4 | 9.9 | -15.8 | 31.9 | 39.2 |
| MSCI Golden Dragon Index | -15.0 | 37.6 | 8.6 | -9.2 | 31.2 | 40.6 |
| IA China/Greater China sector average | -19.7 | 47.3 | 11.2 | -13.2 | 35.5 | 37.8 |

| Cumulative % total return (GBP) | 1 Yr | 3 Yrs | 5 Yrs | Launch |
|---|---|---|---|---|
| **Fund (Y Class, 0.89% OCF)** | -8.3 | 32.4 | 47.0 | 93.4 |
| MSCI Golden Dragon Index | -15.0 | 27.1 | 51.4 | 108.7 |
| IA China/Greater China sector average | -19.7 | 31.6 | 54.7 | 100.7 |

**RISK ANALYSIS** **31/01/2022**

| Annualised, weekly, from launch on 15.12.15, in GBP | Index | Sector | Fund |
|---|---|---|---|
| Alpha | 0.00 | -0.34 | -0.69 |
| Beta | 1.00 | 0.98 | 0.99 |
| Information ratio | 0.00 | -0.12 | -0.18 |
| Maximum drawdown | -21.94 | -27.54 | -25.95 |
| R squared | 1.00 | 0.93 | 0.87 |
| Sharpe ratio | 0.49 | 0.43 | 0.39 |
| Tracking error | 0.00 | 4.99 | 6.80 |
| Volatility | 17.82 | 18.23 | 18.86 |

Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. Source: FE fundinfo bid to bid, total return (0.89% OCF). Fund launch date: 15.12.2015.

## IMPORTANT INFORMATION

**Issued by Guinness Global investors** which is a trading name of Guinness Asset Management Limited which is authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about Guinness Best of China Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

**Risk**

The Guinness Best of China Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment and the income from it can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. Details on the risk factors are included in the Fund's documentation, available on our website. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Fund. This will have the effect of lowering the capital value of your investment.

**Documentation**

The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available in English from www.guinnessgi.com or free of charge from:-

- the Manager: Link Fund Manager Solutions (Ireland) Ltd (LFMSI), 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,the Promoter and Investment Manager: Guinness Asset Management Ltd, 18 Smith Square, London SW1P 3HZ.

LFMSI, as UCITS Man Co, has the right to terminate the arrangements made for the marketing of funds in accordance with the UCITS Directive.

**Investor Rights**

A summary of investor rights in English is available here:https://www.linkgroup.eu/policy-statements/irish-management-company/

**Residency**

In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients. **NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.**

**Structure & regulation**

The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

**Switzerland**

This is an advertising document. The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

**Singapore**

The Fund is not authorised or recognised by the Monetary Authority of Singapore ("MAS") and shares are not allowed to be offered to the retail public. The Fund is registered with the MAS as a Restricted Foreign Scheme. Shares of the Fund may only be offered to institutional and accredited investors (as defined in the Securities and Futures Act (Cap.289)) ('SFA') and this material is limited to the investors in those categories

**Telephone calls** will be recorded and monitored.