Guinness Asian Equity Income 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	19.12.2013
Team	Mark Hammonds Edmund Harriss Sharukh Malik

Aim

The Guinness Asian Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Asia Pacific region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time. The fund is actively managed and uses the MSCI AC Pacific ex Japan index as a comparator benchmark only.

Risk

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

31/01/2022

Past performance does not predict future returns

Fund	Guinness Asian Equity Income (Y)
Index	MSCI AC Pacific ex Japan Index
Sector	IA Asia Pacific ex Japan

	1 Yr	3 Yrs	5 Yrs	Launch
Fund	6.6	27.2	43.5	126.0
Index	-11.4	20.8	38.1	91.7
Sector	-4.9	31.4	47.6	107.4

Annualised % total return from launch (GBP)

Fund	10.6%
Index	8.3%
Sector	9.4%

Source: FE fundinfo, , bid to bid, total return. Launch date: 19.12.13. 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. The fund performance shown has been reduced by the current ongoing charges figure (OCF) of 0.89% per annum and would also be lower if an initial charge were included. Annual performance since launch is shown below.

Summary

- Asian markets, as measured by the Fund's benchmark, MSCI AC Pacific ex Japan Net Return Index managed to hold their ground for much of January until the final week, ending the month down 3.4% in GBP terms.
- Growth stocks bore the brunt of the selling pressure with the MSCI AC Asia Pacific ex Japan Growth Index down 6.6%.
- Value stocks were flat over the same period while High Dividend stocks were up 1.8% (as measured by their respective indices).
- Hong Kong, India, the Philippines and Thailand were the only markets which gained in January. China fell 2%, but as we have discussed previously its index is dominated by a small number of growth stocks; behind them are value stocks held in the Fund that did well.
- On a sector basis, only Energy and Financials rose. Healthcare saw the heaviest decline, down 15% as markets look beyond COVID. In the Fund, Sonic Healthcare fell 20% in GBP terms, but China Medical System climbed a little (+0.4%) during the month.
- Consumer price inflation (CPI) and interest rate policy dominated central bank actions in January and in stock markets the effects were felt most by growth stocks whose valuations depend upon significant earnings to come in the years ahead. The value of those future earnings in today's money diminished as interest rates climb and their stock valuations are dragged down at the same time.
- US CPI inflation hit 7% in December (Bureau of Labor Statistics), and this lay behind a much more assertive statement from the Federal Reserve chairman on the outlook for interest rates; this lay behind the sharp drop in markets in late January.
- CPI inflation remains modest in much of Asia. China reported 1.5%, Taiwan 2.6%, and even India with 5.6% is only 1% above the average of the last 5 years. There is little pressure in Asia to increase interest rates at the moment.
- The main inflation exception is Korea which has experienced a sharp rise in consumer prices (up 3.6%, over 2% above the 5-year average) combined with high household debt that has prompted the central bank to raise rates three times since August from 0.5% to the pre-pandemic rate of 1.25%.

- Producer Price Inflation in our view, is the most important source of pressure in Asia, where manufacturing plays such a big part of economic activity. In China this is running at 10.3%, in Korea at 9.0% and in Thailand at 8.7%. A year ago, these rates were near zero or negative.
- There are encouraging signs this 'cost-push' inflation is beginning to slow. Costs of some major raw materials, like iron ore, are well below their peaks as is the cost of shipping those materials. It may take some time for this to feed through, but the signs are there, in our view.

Macro

Inflation and interest rate policy have dominated market thinking for the past twelve months but this has intensified in recent weeks as consumer price inflation (CPI) in developed markets continues to rise. In the US, CPI inflation hit 7% year-on-year in December, in Germany it was 5.3% and in the UK it was 5.4%. The sharpness of the increases and their persistence is forcing central banks to take a much more assertive stance than markets had been pricing in even three months ago.

There is a multiplicity of causes behind rising inflation: there is the cost-push element linked to rising materials prices, higher energy costs, supply chain disruptions and more expensive transportation and then there is the demand-pull side as economies re-open, spending increases and the supply of labour remains tight. Unemployment rates in the US, Germany and the UK are running between 4% and 5%, all below their 5-year averages and back where they were pre-pandemic. This argues for an increase in US dollar, Euro and Sterling interest rates. Stock markets, which have risen strongly in recent years led by growth stocks against a backdrop of easy money, are becoming nervous as evidenced by the notable increase in volatility at the end of January.

Asian consumer price inflation remains considerably more benign; inflation rates vary across the region with China at 1.5% to India at 5.9% but in each case the inflation rate has not jumped significantly and is in line or a little above the 5-year average, in marked contrast to the experience in the US and Europe. Korea and Singapore are the two outliers, with the pressure felt especially in Korea with CPI inflation of 3.6%, some 2% above its recent average. This has been enough to prompt the Bank of Korea to lift its benchmark call-rate to 1.25% almost to the pre-pandemic level.

Singapore's inflation rate reached 4% in December, over 3% above its 5-year average which also prompted the Monetary Authority of Singapore (MAS) to tighten in an off-cycle move in January, by adjusting the currency band. To explain this: The MAS is unusual when compared to other central banks in that its meetings are held only twice a year, in April and October. And as an open economy, therefore highly sensitive to trade, it uses its currency rather than interest rates as its preferred monetary tool. The MAS allows the Singapore Dollar Nominal Effective Exchange Rate (S$NEER) to trade within an unspecified band against a trade-weighted basket of currencies from its major trading partners. If the currency moves outside the band, the MAS steps in and buys or sells the currency to bring it back. By increasing the slope of the band, it permits the currency to appreciate more quickly making imports cheaper and exports more expensive. For a faster and more immediate impact, the MAS can adjust the mid-point of the band (usually reserved for crises such as the global financial crisis or the pandemic) or it can widen the band, during times of increased volatility.

China reported economic growth of 4% in the fourth quarter of 2021 compared to the same period in 2020. This followed 4.9% growth in the third quarter. For the full year, China's economy grew 8.1% in real terms, powered by the 18% growth in the first quarter of the year. The deceleration we have seen in the second half of last year reflects the impact of Chinese efforts to impose borrowing discipline in the property market. The decision to force Evergrande, whose owner is known to be close to government, to comply with the new policy to the extent of forcing the company to dispose of assets to raise cash has sent a clear message to both lenders and borrowers. The decline in construction activity and in house prices has been an inevitable consequence.

We have been expecting the government to ease the pressure as these measures began to bite and this started to come through last year. We still expect heavily indebted developers to be severely constrained, but we also expect to see further monetary and targeted administrative support to other areas. China is in a strong position to employ counter-cyclical easing. Consumer price inflation, as we have discussed, is still modest and China also has financial resources having spent far less in COVID-related stimulus (less than 5% of GDP) compared to other countries.

Markets

Most regional stock markets have had a weak start to the year with the US, Europe and Japan all 5% to 6% lower (in USD terms) than at the beginning of the year. Asia has done a little better but is still 4.4% lower (as measured by MSCI AC Pacific ex Japan Index, in USD terms). Within the Asian region, the major markets of Australia and Korea have been among the weakest, down 9% and 10% as measured by their respective MSCI country indices. New Zealand fell in even further, down 15% as it follows its stringent lockdown policies. Only Hong Kong, Indonesia and the Philippines eked out any gains. The MSCI China Index fell 3%. Across Asian sectors, only Energy and Financials held up. Growth, as measured by the MSCI regional and country growth indices, underperformed in every country and was especially pronounced in Australia, Korea and Singapore. And even with its outperformance, Value only rose in Hong Kong, Singapore and Thailand.

The picture becomes more nuanced as we look at individual stocks. On the growth side for example, Korea was dragged back by weakness in the index heavyweight, Samsung Electronics (not held in the Fund) which fell 8% in USD terms whereas Taiwan fared better as its index heavyweight, Taiwan Semiconductor manufacturing (held in the Fund), advanced 3%. On the value side, Australian banks Commonwealth Bank, National Australia Bank and Westpac (none held) fell between 8% and 10% having performed well in 2021 whereas China Construction Bank and Ping An Insurance (both held) rose between 8% and 10%. The underlying issue we believe, is valuation. As we discussed earlier, market sentiment has changed dramatically on the realisation that inflation looks less transitory and more aggressive interest rises are now on the table. Stocks without earnings growth to support dividend growth, or stocks that price in too much future earnings growth, all look vulnerable, in our opinion.

Buys and sells

We made a change to the portfolio in the middle of the month with the sale of KT&G (formerly known as Korea Tobacco & Ginseng) and bought back into Industrial & Commercial Bank of China (ICBC), which we sold back in 2019.

KT&G has a high historic yield of over 6% but does not, in our view, have the earnings growth to support it over the long term. Some excitement over its tie-up with Philip Morris and the prospect of access to new markets does not fire us with enthusiasm. At the end of last year, the company announced the indefinite suspension of its US business on regulatory grounds and thus we think the company's moves are primarily defensive or compensatory.

ICBC is one of China's big four commercial banks. Chinese stocks have been out of favour in recent years and banks in particular as investors have been dazzled and then disappointed by the e-commerce companies and increasingly worried by regulatory and policy changes. This has created a valuation opportunity. When we sold it back in 2019 the stock was trading on a multiple of 6.5 times forward earnings. The stock now trades on a market multiple of 4 times consensus estimated earnings, which have continued to grow in the intervening period; the market forecasts earnings growth of 6% - 7% per annum over the next two years. The stock offers an historic yield of 5.6% and has grown its dividend since 2016, including through the pandemic period. The bank is priced for macro-economic stress, but we expect China's monetary backdrop to be one of counter-cyclical easing while the rest of the world tightens.

Stock commentary

China Overseas Land & Investment (COLI), the one new stock we added to the portfolio in 2021, was the best performer over the past month. This Chinese housebuilder is the one that has come out on top from all the upheavals in the sector as China finally clamped down on excessive debt accumulation by private developers. COLI has by far the strongest balance sheet in the sector; short term debt is 1.6x covered by cash reserves and assets exceed liabilities by 1.4x. This leaves the company in a very advantageous position relative to its peers, and able to buy up new land for future development at lower prices while its competitors are occupied with strengthening their own financial positions. We bought the stock on a low valuation, with an historic dividend yield of over 5%. It has maintained or increased its dividend per share every year since 2003 and we are confident in its ongoing ability to do so.

The worst performer was Hanon Systems, a Korean auto parts maker with a specific focus on engine cooling systems for conventional internal combustion engines and increasingly, for electric vehicles. Amongst its major customers, apart from Korean car makers Hyundai and Kia, are Ford and VW. Hanon continues to be affected by the same supply factors that have hurt the entire industry. Production has been lower because of a shortage of components and rising costs of materials and transportation. This has been reflected in weaker operating results. Nevertheless, new contract wins and the outlook from

electric vehicle (EV) makers looks very positive and the company's expectations for EV-related sales between now and 2025 have been revised up.

Results and dividend news

Largan Precision surprised the market during the Christmas and New Year period by announcing an additional dividend distribution to its usual annual payment cycle. The company has a solid balance sheet and is carrying more cash than it should. In recent months sales have slowed as smartphone upgrades have focused on screens and processors rather than cameras. Therefore, Largan has made a commitment to improve its capital management by returning more to shareholders.

Tisco Financial reported quarterly earnings that were ahead of market forecasts on higher margins, lower credit costs, a lower cost to income ratio and performance fees from the asset management side – everything we could ask for.

Taiwan Semiconductor Manufacturing reported quarterly earnings that were 3% ahead of consensus estimates but what really captured the market's attention was the substantial increase to its capital expenditure budget. Having previously announced in 2021, a plan to invest US$100 billion over the next five years the company reported it had spent $30 billion last year and plans to spend up to $44 billion this year as it seeks to address the shortage of chips, to diversify its production facilities and to upgrade its production technology.

Tech Mahindra reported quarterly earnings that were 6% behind expectations, the disappointment being margin erosion. The company managed to control costs well in 20201 but shortage of labour is increasing cost pressure. This will be the company's focus while it continues to build on the 5G opportunity. Tech Mahindra is the most communications-focused of its peers, deriving 40% of revenues from the sector.

CapitaLand Integrated Commercial Trust reported earnings for the full year that reflected the COVID challenges still faced by Singapore, but this is still a strong play on re-opening. Retail sales in its suburban malls are now back to 96% of pre-pandemic levels and while rental renewal rates are still falling, the pace of decline has now moderated. The outlook for the office market in 2022 is considerably brighter and there are new contributions expected from the completion of a major building upgrade and completion of a new building project.

Outlook

The companies in the portfolio in aggregate are forecast by the consensus to grow earnings by 10.6% per annum on average in 2022 and 2023 compared the Index which is expected to grow by 13.6%. We have high confidence in the forecasts for our companies (less so for the Index) given their historic robustness, not least through the pandemic. We think that the market is likely to be much more positive towards companies that can deliver earnings today, will be harsh on those that miss, and doubly so on stocks whose valuations price in future growth and subsequently fail to deliver. The portfolio is trading on a 2022 market multiple of 10.2 times estimated earnings and at a 21% discount to the market's multiple of 13 times.

Investment team

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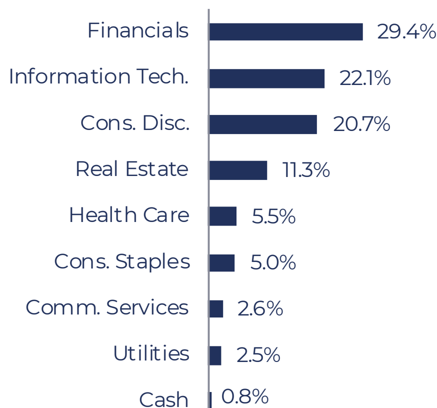
Portfolio

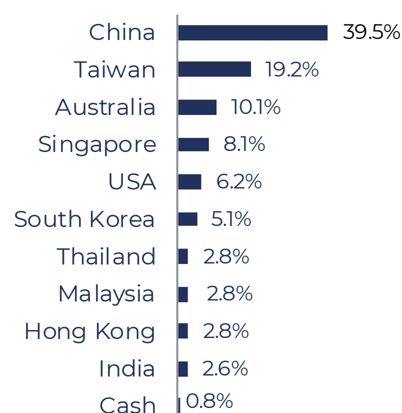
31/01/2022

Fund top 10 holdings	
China Overseas Land	3.4%
Aflac	3.3%
BOC Hong Kong	3.1%
Elite Material	3.1%
Ping An Insurance	3.1%
China Construction Bank	3.0%
China Medical System	3.0%
Suofeiya Home Collection	3.0%
Qualcomm	2.9%
ICBC	2.9%
% of Fund in top 10	30.8%
Total number of stocks	36

Sector analysis



Geographic allocation



Performance

Past performance is not a guide to future returns

Discrete 12m % total return (GBP)	Jan '22	Jan '21	Jan '20	Jan '19	Jan '18	Jan '17	Jan '16	Jan '15
Fund (Y class, 0.89% OCF)	6.6	13.1	5.5	-6.7	20.9	35.1	-5.7	28.7
MSCI AC Pacific ex Japan Index	-11.4	27.9	6.6	-6.6	22.4	39.4	-12.8	18.3
IA Asia Pacific ex Japan	-4.9	28.0	7.8	-7.4	21.3	38.0	-12.4	20.1

Cumulative % total return (GBP)	1 Year	3 Yrs	5 Yrs	Launch
Fund (Y class, 0.89% OCF)	6.6	27.2	43.5	126.0
MSCI AC Pacific ex Japan Index	-11.4	20.8	38.1	91.7
IA Asia Pacific ex Japan	-4.9	31.4	47.6	107.4

Annualised % total return from launch (GBP)

Risk analysis - Annualised, weekly, from launch on 19.12.2013, in GBP

31/01/2022	Index	Sector	Fund
Alpha	0	1.78	3.36
Beta	1	0.89	0.85
Information ratio	0	0.28	0.33
Maximum drawdown	-26.36	-24.54	-24.84
R squared	1	0.95	0.83
Sharpe ratio	0.30	0.41	0.48
Tracking error	0	3.49	6.41
Volatility	15.33	14.02	14.34

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: 19.12.2013.

Important information

Issued by Guinness Global investors, 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 equities and equity markets invested in by the Guinness Asian Equity Income 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 Asian Equity Income 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. The Fund invests only in stocks of companies that are traded on Asian stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. Details on the risk factors are included in the Fund's documentation, available on our website at guinnessgi.com/literature. 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