Guinness Greater China Fund

2022 Annual Review

GUINNESS GLOBAL INVESTORS

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

ABOUT THE FUND

Launch	15.12.2015
Benchmark	MSCI Golden Dragon
Sector	IA China/Greater China
Team	Edmund Harriss (Manager) Sharukh Malik (Manager) Mark Hammonds

Aim

The Guinness Greater 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. The Fund is actively managed with the MSCI Golden Dragon used as a comparator benchmark only.

The Fund's name changed from Guinness Best of China in December 2022 in order to reflect its geographic focus.

RISK

The value of an investment and the income from it can fall as well as rise as a result of market and currency movement; you may not get back the amount originally invested. The Greater China Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The Fund invests only in stocks of companies that are traded on the China markets or in Taiwan, or that derive at least 50% of their revenues from China or Taiwan, but which may be listed and traded on other recognised exchanges; it is therefore susceptible to the performance of that region and can be volatile. Further details on the risk factors are included in the Fund's documentation, available on our website.

PERFORMANCE

Past performance does not predict future returns

31/12/2022	1 year	3 years	5 years	Launch*
Fund (%)	-13.3	0.1	-0.5	72.0
Index (%)	-12.6	-0.8	6.9	84.9
Sector (%)	-16.0	0.2	5.1	76.5

Discrete 12m performance is shown at the end of this commentary. Source: FE fundinfo, bid to bid, total return in GBP. *Launch: 15.12.2015. Investors should note that fees and expenses are charged to the capital of the Fund. This reduces the return on your investment by an amount equivalent to the Ongoing Charges Figure (OCF). The fund performance shown has been reduced by the current OCF of 0.89% per annum. Returns for share classes with a different OCF will vary accordingly. The performance returns do not reflect any initial charge; any such charge will also reduce the return.

SUMMARY

In 2022, the Guinness Greater China Fund fell 13.3% (Y class, GBP) while the MSCI Golden Dragon Net Total Return Index fell 12.6% and the MSCI China Net Total Return Index fell 12.1%. Therefore the Fund underperformed the MSCI Golden Dragon Index by 0.7% and the MSCI China Index by 1.2%.

For much of 2022 China persisted with its zero-Covid policy, the economic costs of which increased significantly with the very transmissible Omicron strain. This policy led to a cycle of lockdowns and movement restrictions across the country, impacting economic growth.

At the end of the year, nearly all Covid restrictions were dropped. China is now expected to be the only major economy to accelerate economic growth in 2023.

In the Fund, the strongest names were China Overseas Land & Investment, AIA Group, China Medical System, CSPC Pharmaceutical and Ping An Insurance. The weakest were Shenzhen H&T Intelligent, Wuxi Lead Intelligent Equipment, Novatek Microelectronics, Geely and Shengyi Technology.

We sold four positions: China Resources Gas, Novatek Microelectronics, China Lesso and China Lilang.

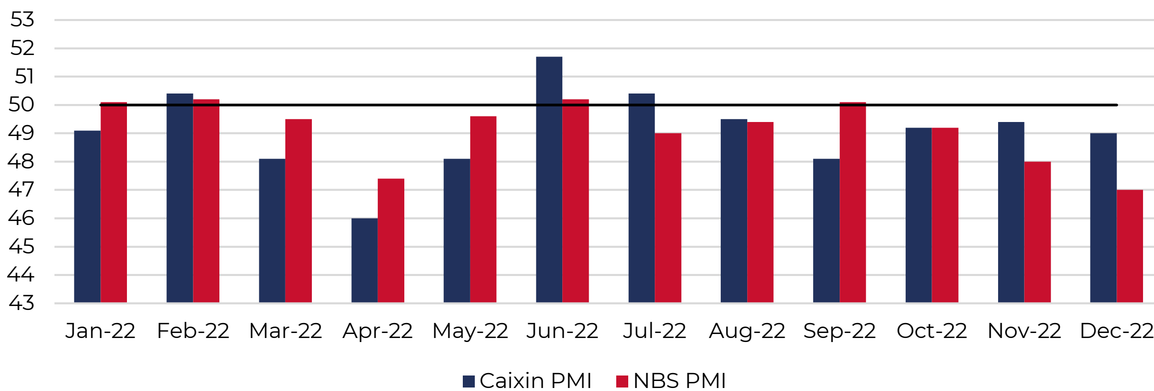
We bought four positions: Shenzhou International, Shenzhen Inovance Technology, Hong Kong Exchanges and Clearing, and Hangzhou First Applied Material.

China is trading at attractive valuations. Combined with the Fund's focus on high return on capital companies which give exposure to the structural growth themes in China, we believe the Fund's holdings are poised to grow earnings in the future. This expectation it not based on hope, but on our companies' track records of growing earnings over time. Over the past 10 years, the Fund's current holdings have, in aggregate, grown earnings by 14% a year. This compares to the MSCI China Index where earnings have actually contracted by 1% a year over the same period.

WHAT HAPPENED IN CHINA?

For much of 2022 China persisted with its zero-Covid policy, the economic costs of which increased significantly with the very transmissible Omicron strain. This policy led to a cycle of lockdowns and movement restrictions across the country, impacting economic growth. To illustrate this, we show below the Purchasing Managers Indices (PMIs) – monthly questionnaire asking purchasing managers about changes in new orders, output, employment, suppliers' delivery times and inventories. The answers are combined into one final value, where a value above 50 indicates expanding activity and a value below 50 indicates contracting activity. The Caixin PMI, which is more geared towards private enterprises, was below 50 for much of the year. The NBS PMI, which is more geared towards state-owned enterprises (SOEs), showed a similar trend. Whether one looks at the private or state sector, it is clear economic activity was weak in 2022.

Manufacturing Purchasing Managers Index (PMI)



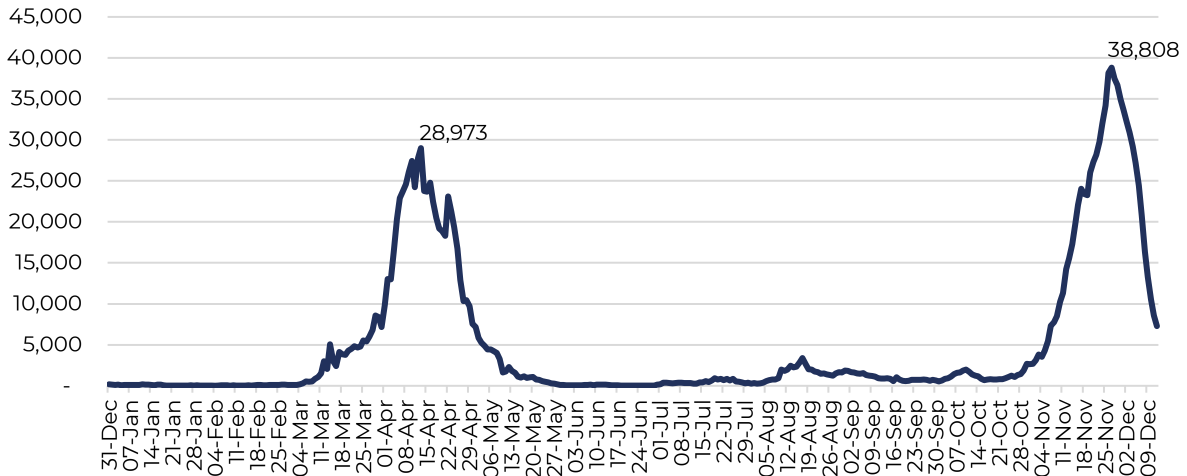
(Source – Bloomberg)

Early in the year, Russia began its invasion of Ukraine, which led to globally higher energy prices. In March, Chinese markets fell by the most in a month since the Global Financial Crisis. The MSCI China Index fell 7.7% (in USD unless otherwise stated) on 14th March 2022 and a further 6.1% on the following day. We believe the sharp fall over that two-day period was due to several reasons, which all combined to create a sense of panic selling:

- Rising Covid cases in China, prompting a tougher government response in line with its zero-Covid strategy.
- The potential that China could be sanctioned by the US if it provided military support to Russia.
- The risk of China ADRs delisting in the US, in response to the Holding Foreign Companies Accountable Act (HFCAA).
- A weakening Chinese economy and lack of significant fiscal and monetary support.
- Very weak sentiment towards China tech stocks, with talk of them being un-investable during the peak of the sell-off.

On 17th March, Vice Premier Liu He convened a meeting, chairing the Financial Stability Committee. The committee released a series of statements acknowledging market concerns. Chinese markets rallied sharply on the news, increasing 14.5% on 18th March and a further 6.0% on 19th March. They were essentially flat for the rest of the month.

However, in April Covid cases increased rapidly in Shanghai. The local government intended to tolerate a certain number of cases before locking down, but cases reached a critical level. The city entered full lockdown in April and May before reopening in June. Other cities avoided Shanghai's fate by locking down much earlier, but this led to weak economic activity in China. At the time we argued that Covid outbreaks and restrictions were likely to continue as the Omicron variant was too transmissible to eliminate completely.



(Source – Bloomberg, National Health Commission (NHC). Data from 31/12/21 to 12/12/22. In Dec-22, the NHC stopped posting case data)

The real estate market was behind the 9.5% fall in Chinese markets in July. There were protests in nearly 100 cities as homebuyers refused to make their mortgage payments on the grounds that construction work had stopped on houses which they had pre-purchased, off-plan. Construction projects were stalled because certain developers' finances were stretched and they did not have the cash to work on projects, an example being Evergrande. Later in the year, policymakers eased policy to extend financing to developers, to allow projects to continue.

In August, Chinese markets slightly recovered. A likely short squeeze led to a rally in the large tech stocks. In Sichuan province a record heatwave led to rivers and dams drying up, meaning hydropower could not generate enough energy. At the same time, the demand for air conditioning significantly increased, placing strain on the electricity grid in the province. The local government initiated power cuts which led to companies stopping production for a week. Rising Covid cases led to lockdowns in Tibet, Sichuan and Shenzhen. The US and China reached a deal to let the US regulator, the Public Company Accounting Oversight Board (PCAOB), inspect the audit work of Chinese companies listed on American exchanges.

In October, China was the weakest major market, falling 16.8% compared to the MSCI World Index which rose 7.2%. Investors were worried about the impact of leadership changes to the Politburo and Standing Committee of the Politburo. Xi Jinping began his third term as leader of the country while Premier Le Keqiang was not reappointed to the Standing Committee. The unofficial age limit for retirement at 68 years old was ignored as Zhang Youxia (Vice Chairman of Central Military Commission) and Wang Yi (Foreign Minister) retained their posts on the Standing Committee. Xi's new appointments to the Committee consisted of firm allies with whom he has worked in the past.

A lack of 'market-friendly' faces on the Standing Committee raised questions over China's commitment to growth. Despite the sell-off, we do not see any significant change to China's growth model. Decision making has become more centralised, but this is acceptable if decisions are rational and of course a problem if they are not. We have not seen any strong arguments explaining why the leadership changes will lead to irrational decision making. We think that in the medium term, the stability in leadership is likely to allow Xi to carry out his economic plan: to upgrade China's competence in fields including high-end manufacturing, pharmaceuticals, semiconductors, and so on. These will be examples of his pillar industries – not the current internet tech companies.

(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

Chinese markets were strong in November and the MSCI China Index rose 29.7%. It was a volatile month, with Chinese markets initially rallying in the first two weeks, giving back some of the gains the following week, and then rallying at the end of the month. Following the political events in October, we saw significant changes in China's Covid and real estate policies. On the Covid front, the time required in centralised quarantine was cut from seven days to five days. The classification of districts was simplified into high and low-risk districts, eliminating mid-risk. The number of days required for a district to move from high to low risk was cut by five days. Furthermore, close contacts of people testing positive for Covid were no longer identified, reducing the pressure on quarantine facilities. Some areas dropped the requirement to have a negative PCR test 48 hours before long-distance journeys. The People's Daily, a government-run newspaper, for the first time played down the long-term impact of Covid on health outcomes.

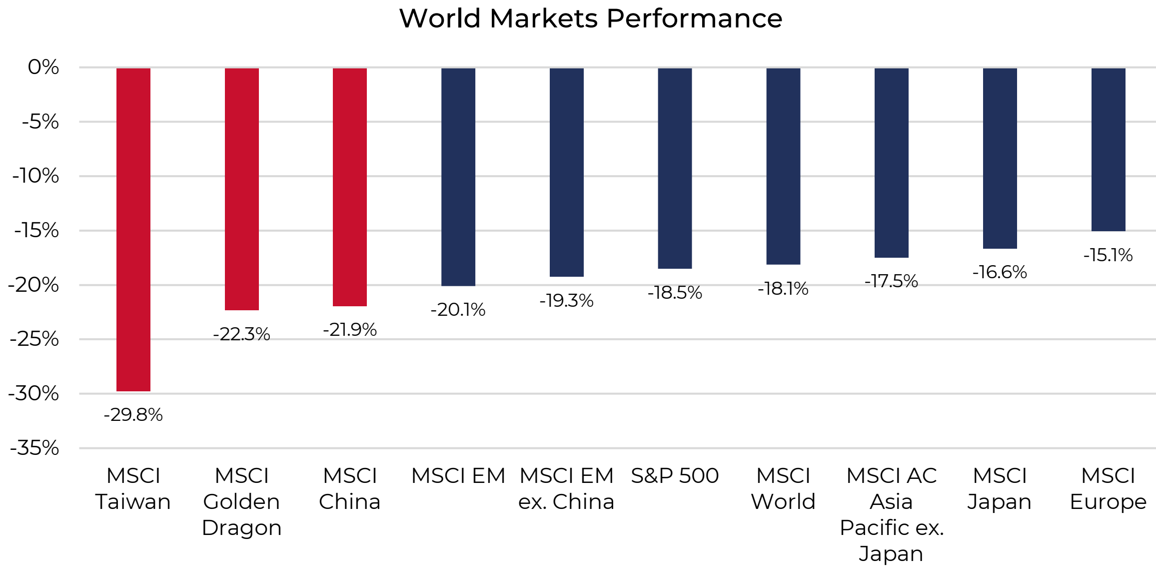
The government also announced a raft of policies designed to boost the property sector. More loans from the state-owned banks were extended to property developers to ensure work continued on existing projects. Private developers, which were struggling compared to their state-owned counterparts, were to receive equal treatment in stimulus measures. Loans could be rolled over for a year where the loan was maturing within six months, meaning the banks would not have to immediately classify as non-performing.

However, as the relaxation in Covid policies was announced, cases increased sharply, surpassing the peak seen in spring when Shanghai locked down. In response, many cities and towns introduced lockdowns and movement restrictions as local government officials ignored the new rules issued by central government. But, in a surprising turn of events, protests against lockdowns spontaneously erupted in cities across China. This demonstrated the frustration that had built up after nearly three years of restrictions. In our opinion, the level of discontent surprised the government and certainly increased the cost of maintaining the status quo.

Soon after the protests, China gradually dropped its zero-Covid policy in December. In the beginning of the month, for those who tested positive, the requirement for centralised quarantine in a government facility was dropped. Instead people could quarantine at home if they were asymptomatic or had mild symptoms. Close contacts were also allowed to home quarantine. At the end of December, nearly all restrictions were dropped. The only restriction left was on people coming into China, for whom a negative PCR test was required 48 hours before departure.

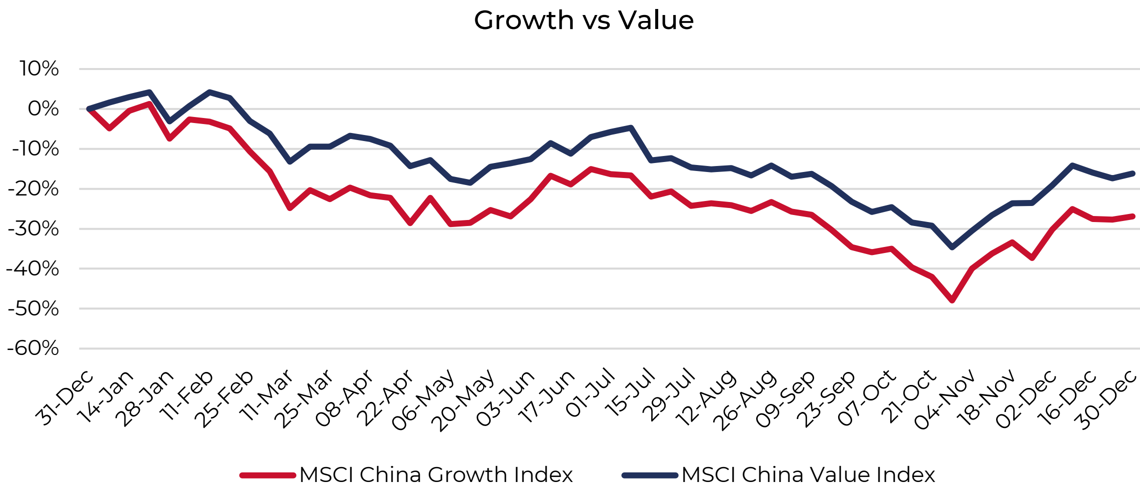
MARKET REVIEW

(Performance data in the section in USD terms)



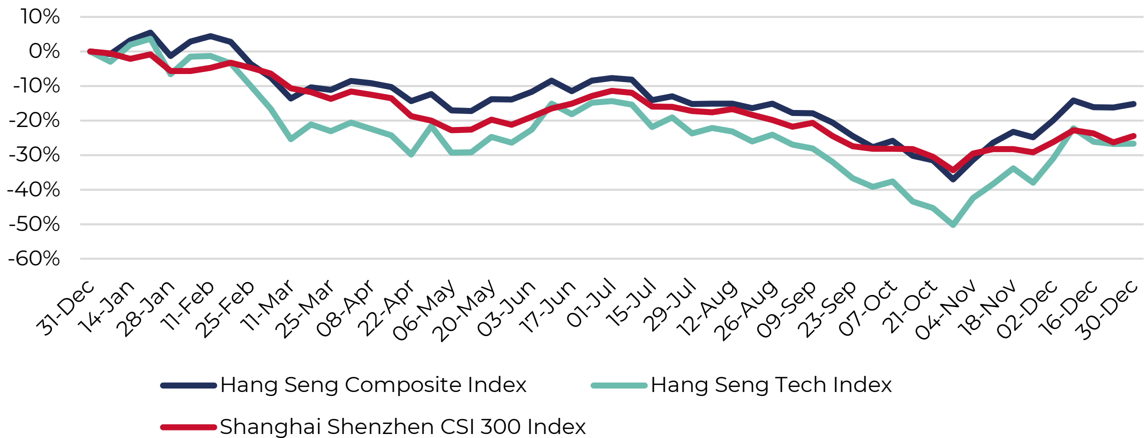
(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

It is probably no surprise that among major markets, Chinese markets were the weakest, falling 21.9%. MSCI Taiwan fell 29.8% as its semiconductor and information technology stocks faced lower demand, higher inventories and falling prices.



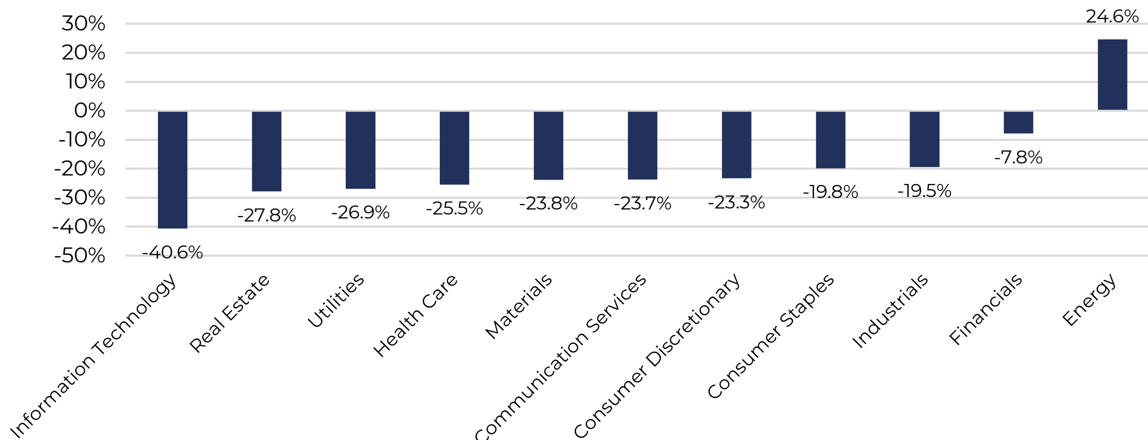
(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

For much of the year, value stocks outperformed growth stocks. After the political changes in October, and the resulting policy changes in November, Chinese stocks rallied and growth stocks outperformed in the last two months of the year.



(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

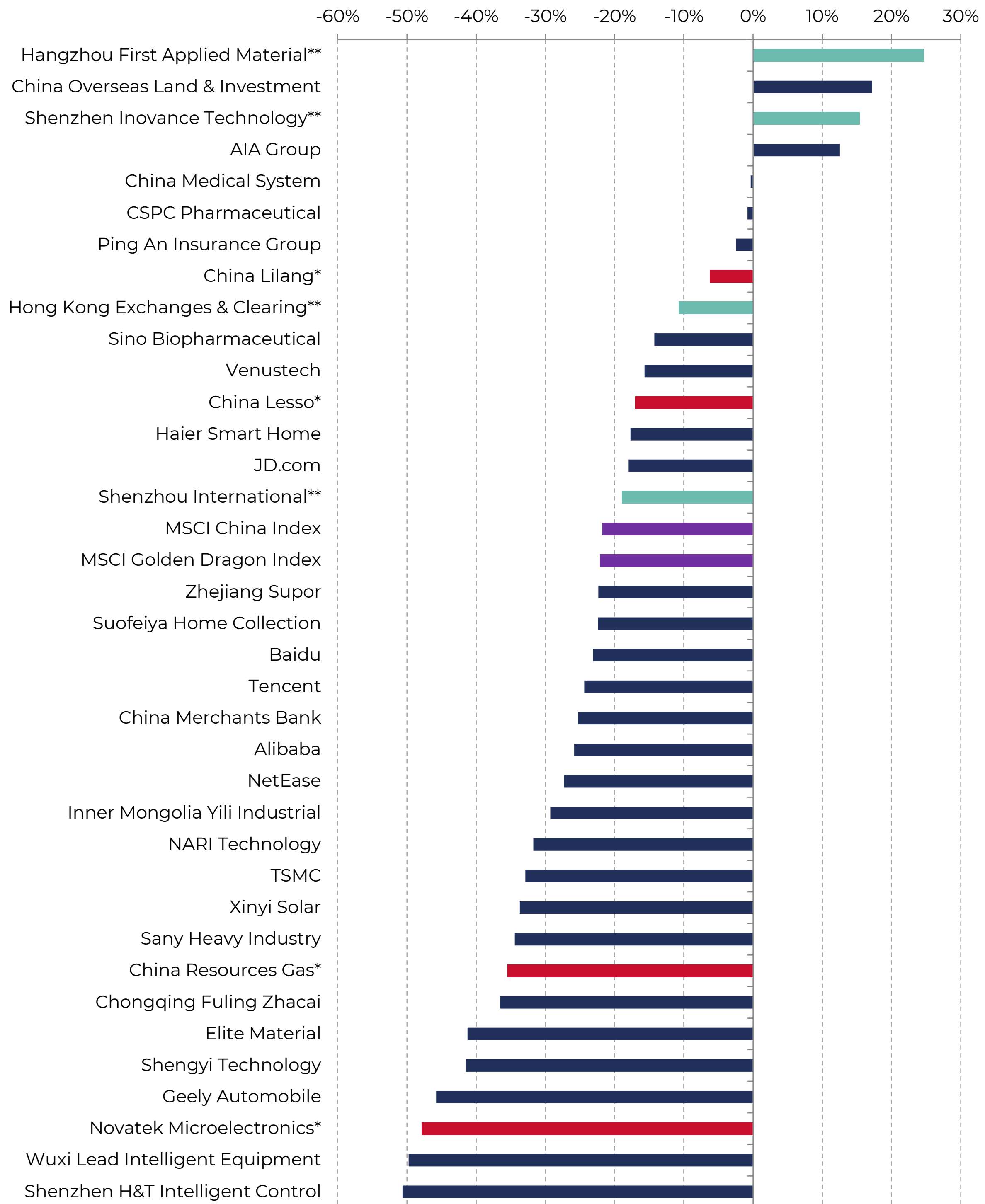
We find it helpful to show performance by market. Here we show performance split by offshore listed stocks (Hang Seng Composite Index) and onshore listed stocks (Shanghai Shenzhen CSI 300 Index). As mentioned, growth stocks underperformed for much of the year and this was particularly felt by the online tech stocks. The Hang Seng Tech Index significantly underperformed the offshore market in the downturn, as at its worst it was down 50% for the year compared to the Hang Seng Composite Index which was down 37%. When markets rallied at the end of the year, the online tech stocks rebounded significantly, causing the Hang Seng Tech Index to outperform in the rally.



(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

The strongest sectors were Energy and Financials. Higher oil and gas prices explain Energy's outperformance. As investors looked to value stocks in the sell-off, they bought the cheaper SOE banks, resulting in Financials doing well. The weakest sectors were Information Technology and Real Estate. As the global economy slowed down, consumer demand for laptops, smartphones etc. weakened, meaning the share prices of companies in the Information Technology sector have been weak. The ongoing slowdown in the Chinese property market led to poor performance for the Real Estate sector.

STOCK PERFORMANCE



(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

* sold during the year

** purchased during the year

Leaders

Below we discuss the best performing stocks that were held for the entire year.

It is probably a surprise that a property developer, China Overseas Land & Investment (COLI), was the best performing stock in the Fund. The property sector has been weak, but both absolutely and relatively COLI has done well. It is a conservatively financed state-owned enterprise (SOE) which has not breached any of the debt limits introduced by the government. SOEs fared much better than their generally more indebted private competitors in 2022, being able to take on projects where the private sector pulled back. For example, local SOEs' share of land auctions in 22 major cities increased from 23% in early 2021 to 59% in late 2022. Correspondingly, private developers' share fell from 54% to 24% in the same period. Following the political reshuffles in October, the government has extended support to the real estate sector, which bodes well for 2023.

AIA Group is a Hong Kong listed insurer that sees mainland China as its growth driver, due to the rise of the country's middle class. Lockdowns in China and movement restrictions between the mainland and Hong Kong resulted in a weaker year by AIA's standards, but the company still made investments to drive long-term growth. In 2022 AIA's Tianjin and Shijiazhuang branches obtained full licenses, allowing the company to open more branches in these cities. The company also received approval to open a new branch in Henan province.

China Medical System (CMS) and CSPC Pharmaceutical performed well. Both businesses have exposure to China's central procurement policy which aims to bring down prices paid for pharmaceutical drugs significantly in return for these companies receiving higher volumes. Due to the lower barriers to entry and greater number of competitors, generic products have faced the greatest pricing cuts whereas innovative drugs (i.e. developed from scratch) have fared better. Accordingly, China's entire pharmaceutical industry has for several years had an incentive to start developing its own drugs. CMS mostly sells generic pharmaceuticals on behalf of other firms. In response to China's central procurement policy, it has been building its own pipeline by acquiring early-stage products at reasonable prices. CMS also acquired a dermatology business to diversify its sales and reduce its exposure to centralised procurement.

CSPC Pharmaceutical is adjusting to the transition differently, preferring to develop its pipeline in-house through R&D (research & development). CSPC's R&D spend as a percentage of revenue has increased from 3.3% in 2016 to 12.1% in the first half of 2022. The company's sales have to an extent been affected by lockdowns, as fewer people went to hospitals for treatment, reducing the demand for certain products. CSPC's Vitamin C and caffeine sales, however, performed well. CSPC is also working on its own mRNA vaccine for Covid. The company has applied for Emergency Use Authorisation (EUA) and already has a production line ready with capacity for 500m doses.

Ping An Insurance's stock benefited from its relatively low valuation. At the beginning of the year, it was valued at 5.4x expected 2022 earnings, which at the time was close to its lowest valuation in the preceding 10 years. Ping An is undergoing a transition from a model with many agents to one with fewer but more productive agents. In the

context of repeated lockdowns, the business has coped well, managing to continue operating through online sales.

Laggards

Shenzhen H&T Intelligent makes controllers used in household appliances and power tools which convert user input into the output of the product. H&T's controllers are used in well-known brands such as Whirlpool, Siemens and Bosch. In the first half of 2022, 67% of sales were to the overseas market while 33% of sales were to the domestic market. Given the slowdown in both the domestic and Chinese economy, revenue in the first nine months of the year only grew 1% while operating income fell 21% and earnings per share (EPS) fell 24%. The gross margin in the period fell, driven by higher raw material prices and lower capacity utilisation. The one year forward P/E ratio fell from 31.1x at the beginning of the year to 16.7x at the end of the year, as growth was lower than expected.

Wuxi Lead Intelligent Equipment's operations were strong in 2022 – in the first nine months of the year, revenue grew 68%, operating income grew 70% and EPS grew 58%. But the one year forward P/E ratio fell from 55.5x at the beginning of the year to 15.7x at the end of the year. The market is concerned over whether the battery equipment cycle has peaked. We believe that the current market valuation is very undemanding given the areas of growth the company can target. Lead Intelligent is expanding into the European market, working with customers such as Volkswagen and Northvolt. Energy storage solutions are another avenue of growth.

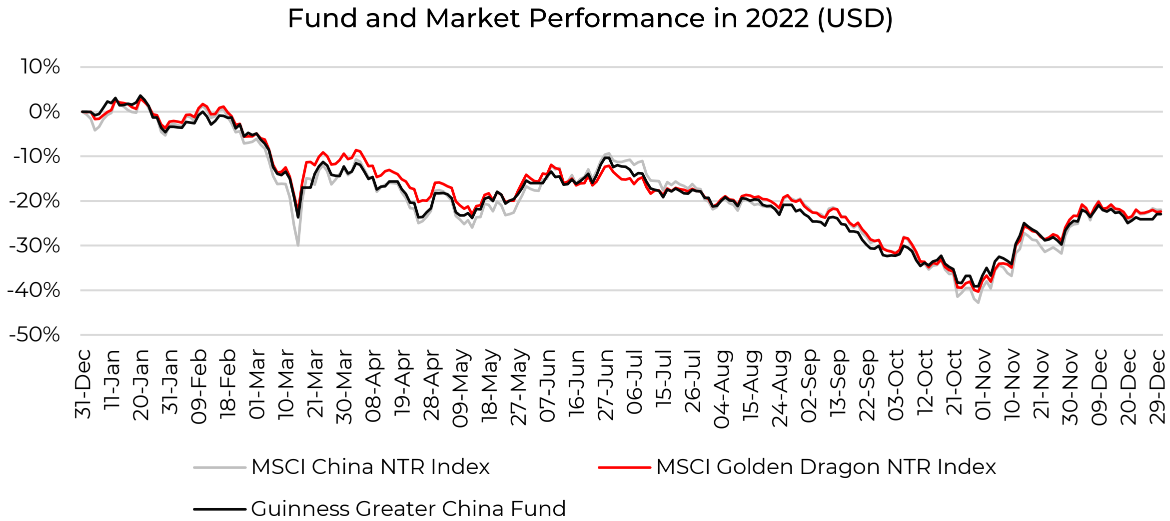
Novatek Microelectronics was one of the weakest stocks in the portfolio as demand in various end markets softened. Consensus analyst estimates show the market is not expecting any earnings growth over the next three years. Rising competition from China is another risk to factor in. We felt that though the stock's multiple had fallen to reflect the deteriorating outlook, we did not see the catalyst for a rerating. Therefore we sold the stock.

Geely is a car manufacturer gradually making the shift towards electric vehicles. In the first 11 months of the year, the number of cars sold by the business increased by 10%. Pure electric vehicles accounted for 17% of total cars sold while hybrid vehicles accounted for 7%. Various lockdowns impacted production while weak consumer sentiment affected demand. The investments in the electric vehicle segment are lowering margins but we remain confident in the business. In our view, Geely is one of the best-run car companies in China and is one of the companies more likely to manage the transition towards electric vehicles well.

Shengyi Technology makes copper clad laminates (CCLs) which are a base material in printed circuit boards. Its products are used in everyday household appliances as well as servers. Due to weak global demand for the end products, CCL prices have been weak, impacting Shengyi's margins. Shengyi can mitigate some of this impact through targeting higher margin complex CCLs, as well as through targeting the localisation trend seen in China.

ATTRIBUTION

In 2022, the Guinness Greater China Fund fell 23.0% (in US dollar terms) while the MSCI Golden Dragon Index fell 22.3% and the MSCI China Index fell 21.9%. Therefore, the Fund marginally underperformed the MSCI Golden Dragon Index by 0.7% and the MSCI China Index by 1.1%.



(Source – Bloomberg, Guinness calculations. Performance in USD. Data from 31/12/21 to 31/12/22)

Compared to the MSCI Golden Dragon Index (which is a weighted average of the MSCI China, Taiwan and Hong Kong indexes), the main sources of negative relative performance were:

- Stock selection within Industrials, driven by Wuxi Lead Intelligent, Sany Heavy Industry, Nari Technology and China Lesso.
- Stock selection within Consumer Staples, driven by Chongqing Fuling Zhacai and Inner Mongolia Yili.

Compared to the MSCI Golden Dragon Index, the main sources of positive relative performance were:

- Underweight in the large tech stocks of Tencent, Alibaba and Meituan. The Fund is run on an equally weighted basis and so each position has a neutral weight of c.3.2%. As these stocks underperformed the market, the Fund captured less of the downside.
- Stock selection within Health Care, driven by CSPC Pharmaceutical, China Medical System and Sino Biopharmaceutical.
- Stock selection within Real Estate, driven by China Overseas Land & Investment, which had a total return of 17.2% while the Real Estate sector fell 27.8%.

PORTFOLIO CHANGES

We sold four positions and bought four positions.

Sells

China Resources Gas is a gas distributor focusing on urban areas and targeting both residential and commercial customers. At the start of the year gas prices had risen, but following Russia's invasion of Ukraine, spiked up further. Although in theory gas distributors can pass on these higher costs, there was a possibility they would be asked to perform 'national service'. This could mean absorbing some of the higher costs rather than passing them onto small and medium enterprises (SMEs) and residential customers. Given the weak economy, we felt there was a non-trivial probability of this occurring, and so sold the stock.

We sold Novatek Microelectronics, a semiconductor designer of display controllers, due to a combination of no expected earnings growth and lack of catalysts to increase the valuation multiple.

We sold China Lesso, a manufacturer of plastic pipes used in infrastructure projects and the real estate industry. It unexpectedly omitted the dividend and announced an expansion into the solar business where it had no expertise. We did not see how the existing business gives Lesso a competitive advantage in solar and so sold the stock.

We also sold China Lilang, a clothing retailer targeting the men's casualwear segment. Given repeated Covid outbreaks in China, sales in the physical stores which make up most of revenue had been weak. Liquidity in the stock had also declined in the past year.

Buys

We bought Shenzhou International, a textile and apparel maker, after the stock sold off on a profit warning. Due to Covid-related suspension of production sites across Cambodia and Vietnam, costs increased and revenues fell in the second half of 2021. We do not think these conditions are likely to last for the next three years. The risk-reward ratio for the stock became much more attractive and so we bought the stock.

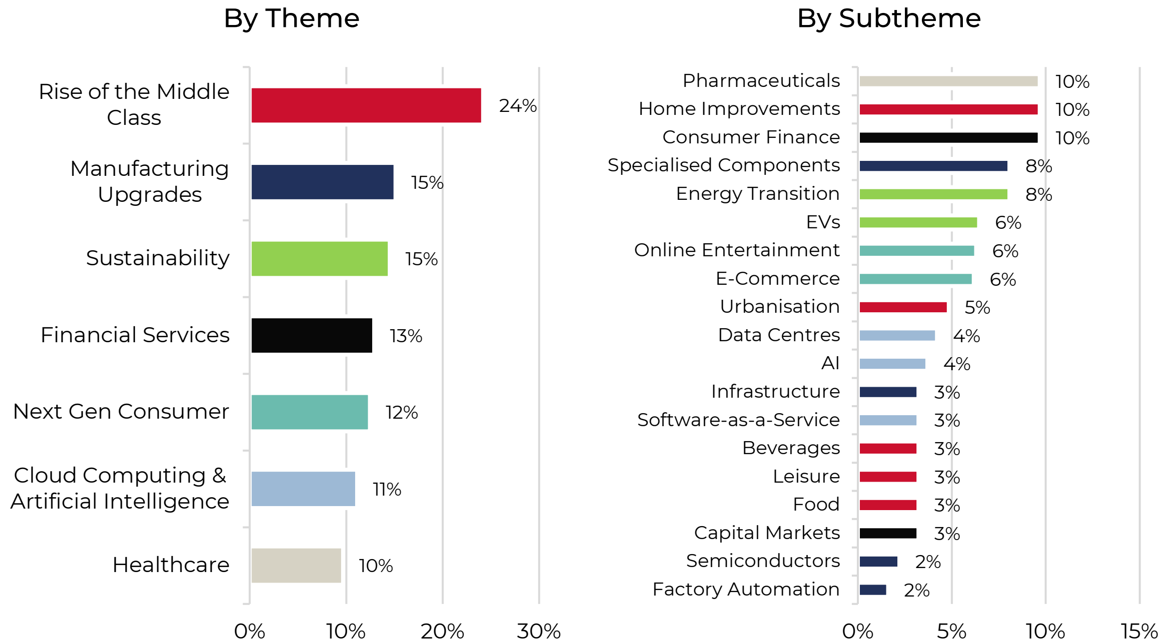
Following the sell-off in the middle of March, we bought Shenzhen Inovance Technology and Hong Kong Exchanges and Clearing. We felt that many quality stocks were selling off regardless of their fundamentals, and so we were assessing the ideas on our watchlist. The two additions made had been expensive for a very long time but within a few days presented an acceptable upside for the amount of risk taken. Inovance is a manufacturer of industrial automation equipment. It started off making inverters (frequency converters) for industrial equipment and elevators before successfully expanding into servos (error-sensing devices) and automation equipment. Inovance is now one of the top five firms in the inverter and servo market in China by revenue. The business gives exposure to various traditional industrial markets as well as newer markets such as electric vehicles (EVs) and solar panels. Inovance has a quickly growing EV controller business which may become profitable in 2022, and we expect this to become a further growth driver for the business.

Hong Kong Exchanges & Clearing (HKEX) is a high-quality stock which is often expensive. As we are clearly bullish on the demand for Chinese stocks over time, we expect the exchange, which facilitates the trade of Chinese stocks, also to do well. The exchange benefits through the Stock Connect scheme, which allows foreigners to buy domestic A-shares. The ETF Connect was approved in June which allows mainland investors to buy HKD-denominated ETFs in Hong Kong – a further positive step for HKEX.

We bought Hangzhou First Applied Material, which is the world's largest manufacturer of EVA (ethylene vinyl acetate) film, which is used to protect solar modules. In order for solar modules to operate for 20 years or more, high-quality EVA film is needed, and so brand image is important. Hangzhou First Applied is now the world's largest manufacturer of EVA film for the solar industry. Since the business listed in 2014, it has generated a cash return on capital above the cost of capital, which is encouraging as it is a sign that the business has withstood prior slowdowns in the solar space.

PORTFOLIO POSITIONING

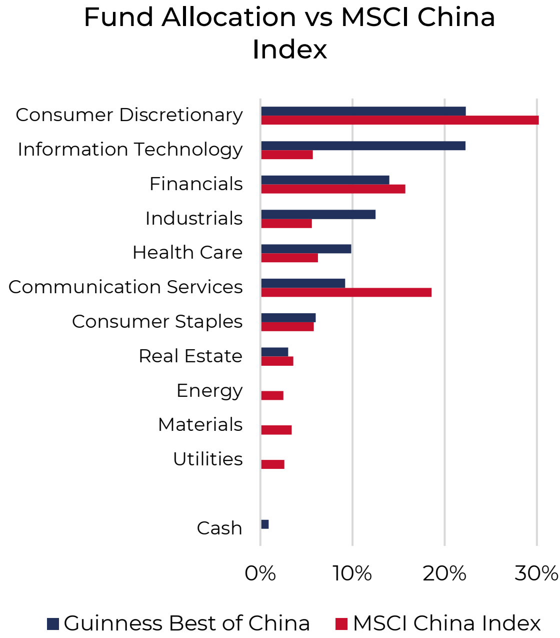
By theme, the Fund's largest exposures are to the Rise of the Middle Class, followed by Manufacturing Upgrades and Sustainability. Important subthemes include Pharmaceuticals, Home Improvements, Consumer Finance and Specialised Components.

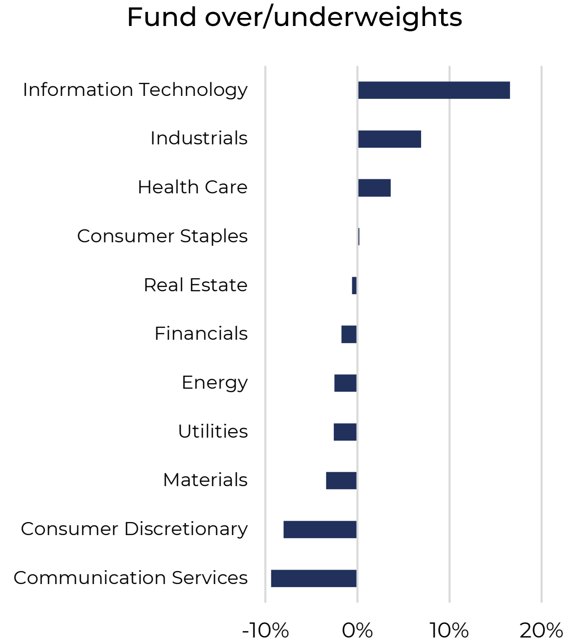


(Data as of 31/12/22, source: Guinness Global Investors calculations. Data assumes each position is equally weighted)

On a sector basis, the Fund's largest exposures are to Consumer Discretionary and Information Technology (IT). Relative to the MSCI China Index, the Fund is overweight in IT and Industrials. The Fund is underweight in Consumer Discretionary and Communication Services. On the surface, the Fund's IT weight is high but within this group there are completely different businesses whose operations are unrelated. Based on the classifications below, we believe our IT holdings are well diversified.

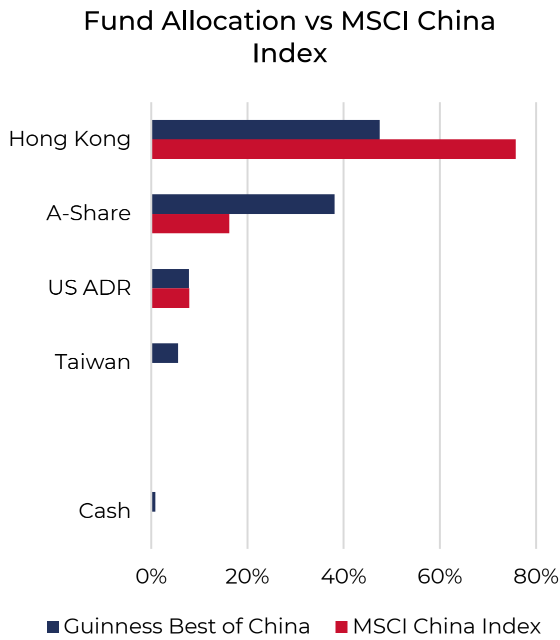
- Cybersecurity: Venustech, one of China's largest providers of cybersecurity services.
- Solar: Xinyi Solar, world's largest supplier of glass used in solar panels. Hangzhou First Applied, world's largest supplier of solar film.
- Semiconductors: TSMC, which is the world's largest foundry business.
- Copper clad laminates (CCLs): Elite Material and Shengyi Technology, which give exposure to smartphones and servers.
- Controllers and Internet of Things: H&T Intelligent, which gives exposure to household appliances and power tools.

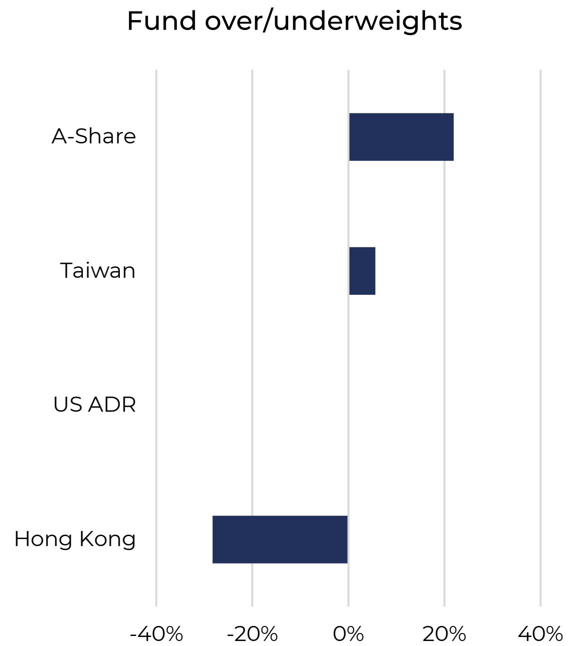




(Data as of 31/12/22, source: Guinness Global Investors calculations, Bloomberg)

On a listing basis, the Fund has 48% exposure to stocks listed in Hong Kong, 38% exposure to the A-share market and a small 6% allocation to Taiwan.





(Data as of 31/12/22, source: Guinness Global Investors calculations, Bloomberg)

OUTLOOK

Structural Growth

We briefly discuss our outlook on certain structural growth themes.

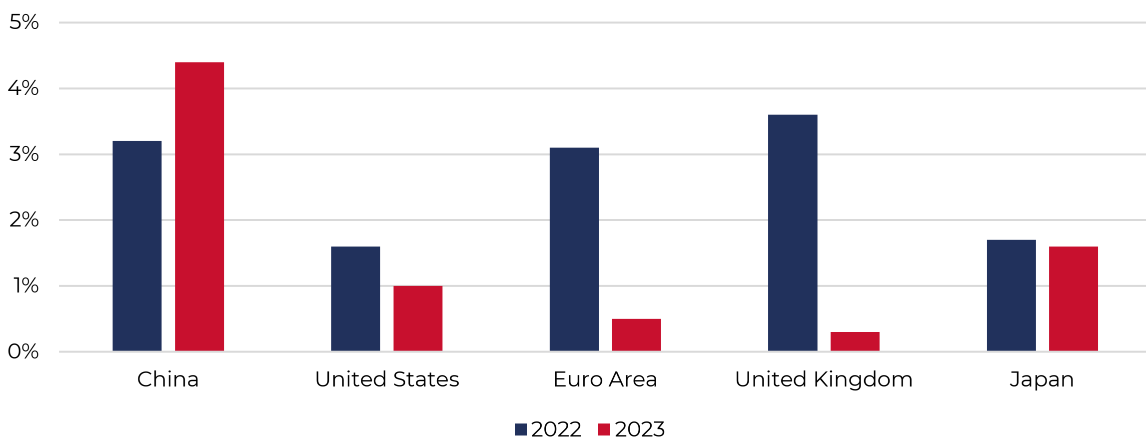
Rise of the Middle Class: Consumption was overall weak in 2022 due to lockdowns, but on the other hand, savings have built up, so we are expecting a sharp rebound in consumption in 2023. In particular, industries that were very weak over the past three years are expected to see large recoveries. This includes companies in the travel, hospitality and leisure industries. Support to the property sector has been extended further, with greater financing from the bank loans, equities and bonds channels. Deadlines for debt caps have been postponed, and mortgage rates will be allowed to be reduced where house prices continue to fall.

Sustainability: China's long-term plan is to achieve carbon neutrality in 2060. Associated with this is peak energy demand forecast to peak around 2035, that coal power should be phased out by 2050, and that renewable energy should meet 80% of total energy demand by 2060. To this end, China has continued to invest in its renewable energy capacity. The governments' latest Five Year Plan is aiming to increase energy produced from renewable sources by 50% by 2025, compared to 2020.

Manufacturing Upgrades: the US export controls on chips sold to China have further reinforced China's view that technology self-sufficiency is required. Policymakers are likely to incentivise capital to flow to areas of national importance such as automation and chip production. Well run Chinese companies with exposure to these areas are where we aim to position the Fund. China's reopening is likely to provide a boost to demand, offsetting weaker demand from some developed markets where growth is projected to slow significantly.

Next Gen Consumer: it seems the government has finished its regulatory push on the stocks exposed to this theme. Videogame companies have been receiving approval for new games, with Tencent receiving approval for its first blockbuster game at the end of 2022. The Central Economic Work Conference stated it would support platform companies to better compete globally, with a much more positive tone than in the previous year.

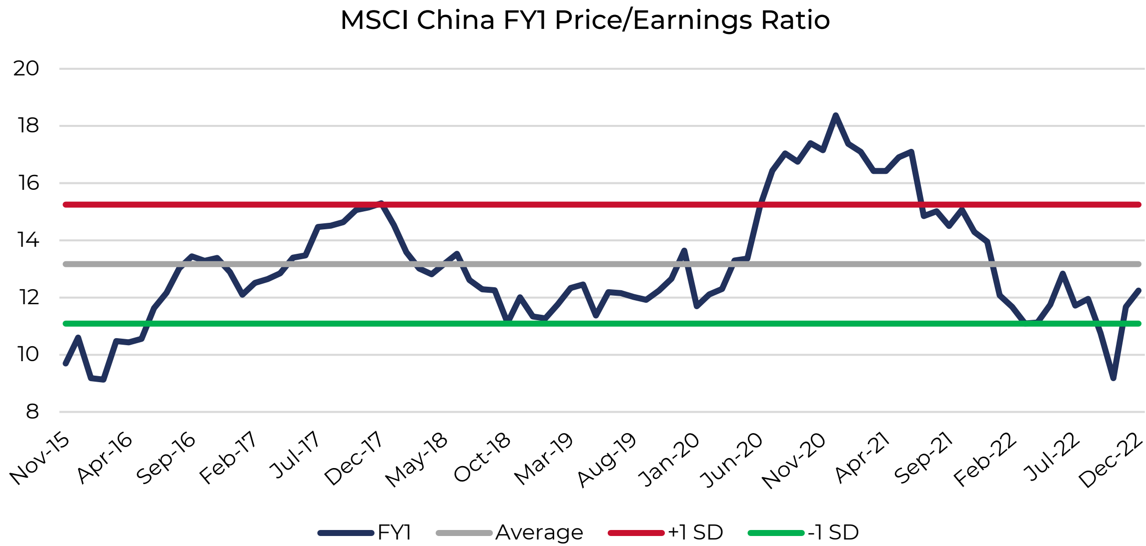
Investing in China



(Source: IMF, World Economic Outlook, October 2022)

As China has removed nearly all Covid restrictions, it is the only major economy which is expected to see an acceleration in economic growth in 2023. As the US has normalised monetary policy, developed markets are expected to see a deceleration in economic growth. This, along with other factors, means Europe and the United Kingdom may well enter a recession in 2023.

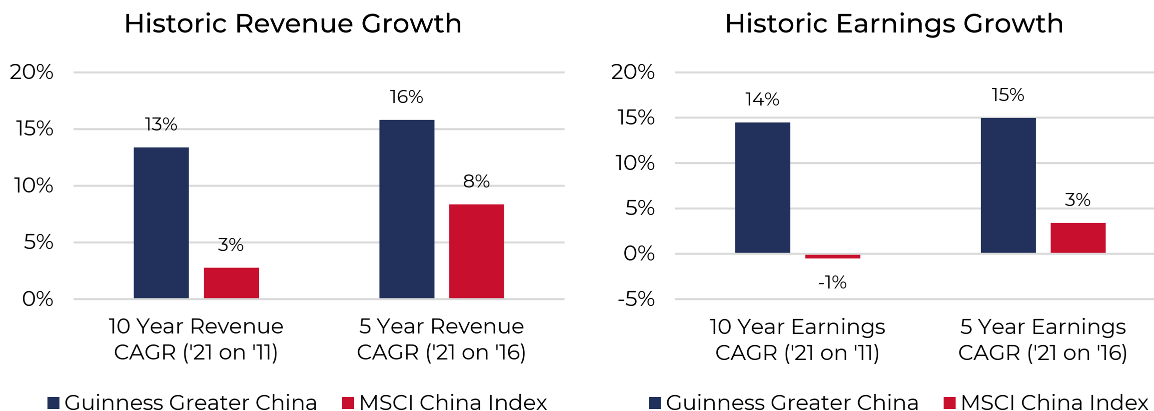
From an investment perspective, we remind readers that returns can be broken down into three components: changes in valuation multiples, earnings growth and dividends. Below we break down each component to argue why investors should be allocating to China and specifically the Guinness Greater China Fund.



(Data from 30/11/15 to 31/12/22, source: Guinness Global Investors calculations, Bloomberg)

Despite the bounce at the end of the year, Chinese equities remain attractively valued relative to their medium-term average. As of 31/12/22, the one-year forward price earnings ratio for MSCI China was 12.2x, below its medium-term average. (We use Nov-15 as the starting point to calculate this average this is when the US-listed ADRs, which are generally more expensive, were included in the index. Valuations before this point are less useful for making comparisons today). While of course valuations can fall below historic levels, we argue today there is a low probability that investors are overpaying for China.

On consensus estimated 2023 earnings, the Fund is trading on 13.6x. This, on the surface, is more expensive than the iShares MSCI China ETF (ticker ICHN NA Equity), which trades on 11.6x. However we point out that banks make up 10.0% of the ETF and given the very low valuation of the banks (3.4x), they distort the valuation of the market. We estimate that the valuation of the ETF excluding the banks was 15.1x, which puts the Fund at a 10% discount. The Fund does hold one bank (China Merchants Bank) but it is one of the more expensive Chinese banks due to its higher quality, trading at a P/E of 7.4x which puts it a premium of 118% relative to the banks industry.



(Data as of 31/12/22, in USD, source: Bloomberg, Guinness calculations. Earnings refers to net income. Data for Guinness Greater China is a simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015)

Over the long term, earnings growth provides investors with the bulk of their returns. We argue that our companies are likely to grow their earnings in the future because they give exposure to the structural growth themes in China. To back this up, we show above the 10-year compound annual growth rate in earnings for our holdings. Over the past 10 years, the Fund's current holdings have, in aggregate, grown earnings by 14% a year. This compares to the MSCI China Index where earnings have actually contracted by 1% a year in the same period. We argue a passive approach leads to poor outcomes for investors in China.

The dividend contribution is the final part of the equation. Although the Fund does not have distributing share classes, dividends are still a contributor to the total return of the Fund's holdings. In our opinion, the presence of a dividend is a sign that a business is cash generative. Generally, a healthy dividend is a signal that the business is generating excess cash, not all of which needs to be reinvested into the business. As of 31/12/22, the dividend yield of the Fund was 2.1% compared to 2.4% for the MSCI China Index. While the Fund's dividend yield is marginally lower than the market's, we argue this is more than offset by the Fund's significantly higher historic earnings growth.

Overall, we argue we offer a sensible approach to China, generally looking for companies with the following characteristics:

- High return on capital.
- Ability to convert revenues into cashflows.
- Growing operating cashflows, which we expect to continue to grow.
- The ability to deploy this cash at a high rate of return.
- Sensibly structured balance sheet with no excessive debt.
- Management which we trust to grow the business.
- Absence of activities judged to be harmful to society's wider interests.
- Growth opportunities undervalued by the market.

Now that China has dropped nearly all Covid restrictions and life should be back to normal in 2023, investors should be seriously looking to invest in the world's second largest economy. Global investors are significantly underweight in China despite its size – we expect this gap to close over time which is likely to serve investors in China well.

Portfolio Managers

Edmund Harriss

Sharukh Malik

Guinness Greater China Fund

PORTFOLIO

Fund top 10 holdings

Holding	%
Venustech Group	4.4%
Shenzhou International	3.9%
China Merchants Bank	3.8%
AIA Group Ltd	3.6%
Sino Biopharmaceutical	3.6%
HANGZHOU FIRST APPLIED MAT-A	3.5%
HONG KONG EXCHANGES & CLEAR	3.4%
China Medical System	3.3%
Ping An Insurance	3.2%
Baidu	3.2%
% of Fund in top 10	36.0%
Total number of stocks	31

Sector analysis

Sector	%
Information Technology	25.4%
Consumer Discretionary	22.3%
Financials	14.0%
Health Care	9.9%
Industrials	9.2%
Communication Services	9.2%
Consumer Staples	6.0%
Real Estate	3.0%
Cash	0.9%

Geographic allocation

Region	%
China	82.9%
Hong Kong	10.6%
Taiwan	5.6%
Cash	0.9%

PERFORMANCE

Past performance does not predict future returns.

Annualised % total return from launch (GBP)

Fund (Y Class, 0.89% OCF)	8.0%
MSCI Golden Dragon Index	9.1%
IA China/Greater China sector average	8.4%

Discrete 12m % total return	Dec '22	Dec '21	Dec '20	Dec '19	Dec '18	Dec '17	Dec '16
Fund (GBP)	-13.3	1.0	14.2	25.3	-20.7	37.6	22.1
MSCI Golden Dragon Index (GBP)	-12.6	-8.6	24.2	19.0	-9.5	31.3	25.7
IA China/Greater China sector average (GBP)	-16.0	-10.7	33.6	22.2	-14.2	35.9	18.5
Fund (USD)	-23.0	0.1	17.9	30.4	-25.3	50.4	2.3
MSCI Golden Dragon Index (USD)	-22.3	-9.5	28.2	23.8	-14.8	43.8	5.4
IA China/Greater China sector average (USD)	-25.4	-11.5	37.8	27.1	-19.2	48.7	-0.7

Cumulative % total return	1 Yr	3 Yrs	5 Yrs	Launch
Fund (GBP)	-13.3	0.1	-0.5	72.0
MSCI Golden Dragon Index (GBP)	-12.6	-0.8	6.9	84.9
IA China/Greater China sector average (GBP)	-16.0	0.2	5.1	76.5
Fund (USD)	-23.0	-9.1	-11.6	37.3
MSCI Golden Dragon Index (USD)	-22.3	-9.9	-5.0	47.8
IA China/Greater China sector average (USD)	-25.4	-9.0	-6.6	41.1

RISK ANALYSIS

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.45	-0.40
Beta	1.00	0.99	0.97
Information ratio	0.00	-0.12	-0.12
Maximum drawdown	-43.83	-46.93	-39.02
R squared	1.00	0.92	0.86
Sharpe ratio	0.29	0.23	0.21
Tracking error	0.00	5.64	7.45
Volatility	18.94	19.53	19.80

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, 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 Greater 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 Greater 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 Document (KID) / 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.