Guinness Emerging Markets Equity Income Fund

INVESTMENT COMMENTARY – July 2021

Launch date	**23.12.2016**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (manager) **Sharukh Malik** (manager)

Aim

The Guinness Emerging Markets Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in Emerging Markets world-wide. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

Performance

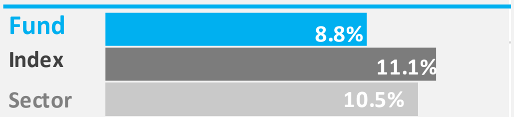
30/06/2021

Fund	Guinness Emerging Markets Equity Income (Z)
Index	MSCI Emerging Markets Index
Sector	IA Global Emerging Markets

	2020	2019	2018
Fund	4.0	14.6	- 9.5
Index	14.7	13.9	- 9.3
Sector	13.7	16.0	- 11.8

	YTD	1 Yr	3 Yrs	Launch
Fund	7.2	21.0	20.0	46.4
Index	6.3	26.0	31.7	60.8
Sector	6.5	27.8	31.7	57.0

Annualised % total return from launch



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	0.3	-0.2
Beta	1.0	0.9	0.9
Info ratio	0.0	-0.1	-0.2
Max drwdn	-22.6	-25.1	-23.1
Tracking err	0.0	3.6	6.6
Volatility	15.2	14.4	14.5
Sharpe ratio	0.5	0.5	0.4

Past performance should not be taken as an indicator of future performance. 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) of 0.35%; returns for share classes with a different OCF will vary accordingly.

Source: Financial Express, Z class (0.35% OCF), bid to bid, % total return.

Fund & Market

- Emerging markets ended higher in June. The MSCI Emerging Markets Net Total Return Index rose by 3.1% (all performance figures in GBP unless stated otherwise).
- The fund underperformed in the period, rising 1.4%.
- For the year to date, the fund remains ahead, up 7.2% versus the benchmark up 6.3%.
- In the month, value stocks underperformed growth. The value component of the index rose 2.4%, whereas the growth component rose 3.9%.
- Latin America was the best performing region, rising 5.7%. Asia was next, gaining 3.0%. EMEA (Europe, Middle East and Africa) was the worst performing, though still positive over the month, rising 2.1%.
- Of the largest countries in the benchmark, the best performing in the month were Brazil (+8.4%), Russia (+7.3%) and Saudi Arabia (+6.8%).
- The worst performing countries were South Africa (–5.1%), Thailand (–0.5%) and Mexico (+1.1%).
- The strongest performer in the portfolio by some margin was Elite Material, rising 35.3%. Also strong were Coca-Cola Femsa (+9.3%) and Porto Seguro (+8.5%).
- Among the good performers was also St Shine, a stock that we sold during the month (discussed below).
- The weakest performers were Jumbo (–11.5%), Suofeiya Home (–10.9%) and Credicorp (–9.4%).
- Emerging market currencies fell by 1.3% over the month.

Review of the quarter

Fund Performance

as at 30/06/21 in GBP	1Q21	1H21	1Y	3Y	Since Launch (23.12.2016)	June 21	June 20	June 19	June 18	June 17
Guinness Emerging Markets Income Fund (Z class, GBP)	**5.5%**	7.18%	21.02%	15.61%	46.42%	21.02%	-5.45%	4.85%	8.31%	-
MSCI Emerging Markets NTR	**1.2%**	6.32%	26.03%	25.93%	60.83%	26.03%	-0.49%	4.55%	6.46%	27.35%
MSCI Emerging Markets Value NTR	**3.0%**	8.86%	26.64%	13.56%	35.29%	26.64%	-13.21%	8.96%	2.59%	25.11%

Source: Bloomberg (inclusive of all annual management fees but excluding any initial charge or redemption fee), gross income reinvested. Performance would have been lower had the initial charge and/or redemption fee been included. Fund returns are for Z share class (0.35 OCF%); returns for share classes with a different OCF will vary accordingly. Past performance should not be taken as an indicator of future performance. The value of investments can fall as well as rise as a result of market and currency movements.

Coronavirus cases in India appear to have peaked; Brazil, on the other hand, saw rising case numbers as political protests continue.

As the left hand column shows the fund underperformed the index in the second quarter, up 1.6% in GBP terms, compared with the market (the middle row) up 5.1%.

However, the fund is ahead of the benchmark over the first half of the year, up 7.2% versus 6.3%

The fund gave up some of the outperformance from the first quarter in the second. Underperformance in the second quarter was due to individual stock weakness, as discussed in the stock performance section below. Negative attribution also came from not holding Vale in the materials sector, which has a significant weight in the benchmark and performed well. Corresponding positive attribution mainly came from individual stock holdings that performed well.

Since launch at the end of 2016, the fund has returned 46.4%, compared with the benchmark which is up 61.2%. The fund however, is meaningfully ahead of the value component of the index, shown as the bottom row, which is up 35.6% over that period.

Dividends

The fund announced a distribution for the first half of 2021 which represents a small decline of around 4% when compared with the first half of 2020 in USD terms. (In sterling the decline is larger at 13%.)

While we would obviously prefer to see increases, we think the outcome is reasonable given the relatively small decline in the full year dividend for last year, which declined 5% in both USD and GBP.

Partly explaining the fall, three companies deferred dividends; that is they paid a dividend in the first half of 2020 but not in the first half of 2021. One of the three declared a dividend shortly after the quarter end, and we expect the other two to resume in the second half of the year.

The highest dividend growth rates in the portfolio for final payments came from Tech Mahindra and Novatek Microelectronics which increased their payments by 100% and 49% respectively over 2020 and by 114% and 77% over their 2019 dividends.

B3 declared a quarterly dividend that was multiples higher of the 2020 comparative, and more than double the equivalent for 2019.

Other notable increases were Spar Group, which increased its interim dividend by 40%, restoring it back to the level of 2019. Hanon Systems raised its quarterly dividend for the first time in two years, up 12.5%. Netease also increased its quarterly dividend by 30% from the prior year.

Dividend declines in the portfolio (other than the deferrals discussed above) were relatively small and came from Hon Hai Precision (–5%) and Unilever (–1%).

Market review

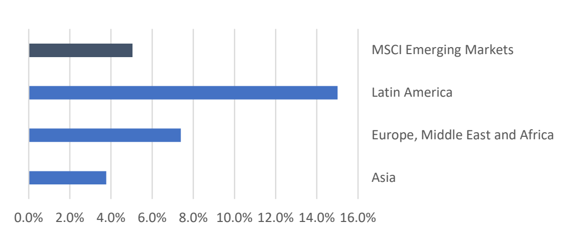
After outperforming developed markets in the second quarter, this quarter emerging markets underperformed. Nevertheless they still generated a strong absolute performance.

Emerging markets returned 5.1% for the period, whereas the MSCI World was up 7.7% and the S&P 500 Index rose 8.5%.

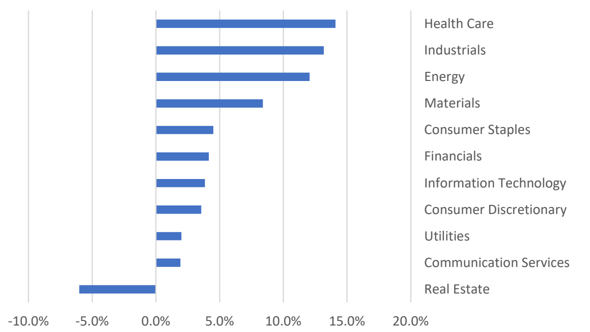
As in the previous two quarters, value again outperformed growth, although the difference in the performance of the two components was less pronounced, with value rising 5.7% versus 4.4% for growth.

Looking in more detail at the performance in the second quarter, the following charts show the individual regions, sectors and countries within the overall benchmark.

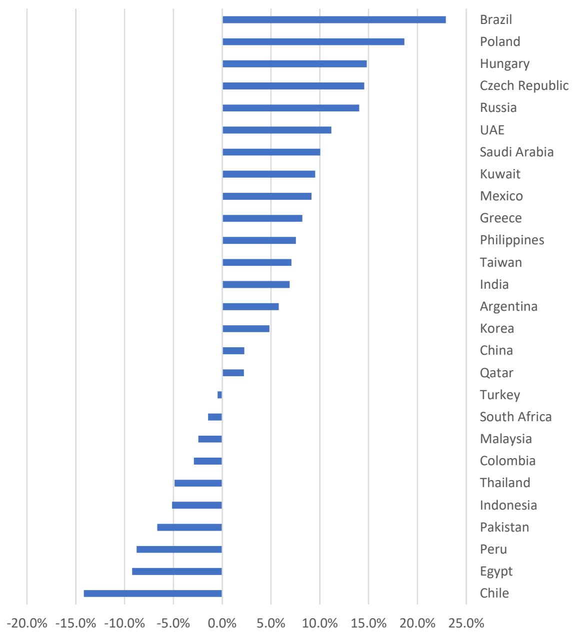
Region



Sector



Country



Source: Bloomberg. Total return for MSCI indices shown in GBP, Q2 2021

Within emerging markets, Latin America (+15.0%) rebounded from the first quarter, rising sharply in the second. EMEA (Europe, Middle East and Africa) (+7.4%) was the next strongest performer and Asia (+3.8%) was the weakest, though all three generated positive returns.

In terms of individual country MSCI indices, among the larger countries, the better countries were Brazil (+22.9%, reversing its position as the weakest in the first quarter), Russia (+14.0%) and Saudi Arabia (+10.0%). Weaker larger countries were Thailand (–4.9%), South Africa (–1.5%) and China (+2.3%).

In terms of sectors, strong performers were Healthcare (+14.1%) and Industrials (+13.2%). Also notable were Energy (+12.1%) and Materials (+8.4%) (which continued its strong run in the first quarter) after rallies in the oil price and strength in other commodities. The weakest sector was Real Estate (–6.0%), followed by Communication Services (+1.9%) and Utilities (+2.0%).

Portfolio performance

The top five and bottom five performing stocks over the first quarter were as follows:

Top 5 performing stocks – Q2

	Total return
China Medical System	34.9%
Porto Seguro	33.9%
Elite Material	31.9%
Shenzhou International	22.6%
Coca-Cola Femsa	17.4%

Bottom 5 performing stocks – Q2

	Total return
Suofeiya Home	-23.7%
Ping An Insurance	-16.1%
Haitian International	-12.1%
Catcher Technology	-12.0%
Credicorp	-11.3%

Source: Bloomberg

Performance across the portfolio was more muted than the first quarter, with 13 stocks outperforming the index. It was somewhat concentrated at the top end, with four stocks gaining 20% or more. And at the bottom end, six stocks fell by more than 10% and only one fell by more than 20%.

The best performer in the portfolio was again China Medical System, after having risen 75.2% in the first quarter. The company, a pharmaceutical sales and marketing business, has continued to earn strong returns on capital, despite concerns in the sector regarding drug pricing reforms. Price cuts in the company's generic business have been less than feared, and its pipeline of innovative drugs has been expanded. China Medical System has accordingly benefitted from a strong re-rating by the market.

Porto Seguro, an insurer, has reported good operating results recently, but its strength also reflects the broader gains seen in the Brazilian market as the country was the top performer in the index in the quarter, rising 22.9%. Brazil has benefitted from a reopening of its economy and an easing of pandemic restrictions – energy and materials stocks in particular performed well in the rebound.

Elite Material is a producer of environmentally friendly printed circuit board materials. The company's increased exposure to the server, network infrastructure and high performance computing sectors has become more recognised by the market. These areas of growth are reflected in an increased dividend in 2020 of 15% versus 2019.

Weaker performers were mainly Chinese companies. Suofeiya Home, Ping An Insurance and Haitian International. However in each case, we feel that any weakness is business activity is likely to be short term in nature, and we are confident about the long term outlook for each.

Suofeiya Home has suffered recently due to its exposure to the indebted real estate sector, and specifically to China Evergrande, which is a significant customer. While Suofeiya has provided for some of debt, there may be a short term hit to profitability. Nevertheless we expect business to recover in time.

Haitian's business of selling injection moulding machines tends to be more lumpy in nature than much of the rest of the portfolio, so it is not unusual for the business to go through slower periods, as the machines represent significant capital outlays for their customers. Some small and medium sized Chinese manufacturers have been scaling back capex, which caused a decline in the company's May sales over the previous month. However, Haitian's latest products have received good feedback, and operational performance has been strong. Margins have held up as the company has raised selling prices to pass on increases in material costs and to offset a weaker Renminbi.

Catcher Technology is in the process of transitioning and restructuring its business, and we await further news from the company in this respect.

Credicorp fell as Peru, where the bank is based, was the third weakest country in the index, falling 8.8% owing to heightened political turbulence. The tight election victory of the "leftist" candidate, Pedro Castillo, who has proposed windfall taxes on businesses to 'reshape' the economy post-COVID, looks set to be confirmed shortly.

Portfolio changes

In the second quarter, we made one change to the portfolio, selling St Shine Optical and replacing it with Inner Mongolia Yili, a domestically-listed China A-share, (which we access in Hong Kong through the Stock Connect programme). (To recap, we made no changes to the portfolio in the first quarter.)

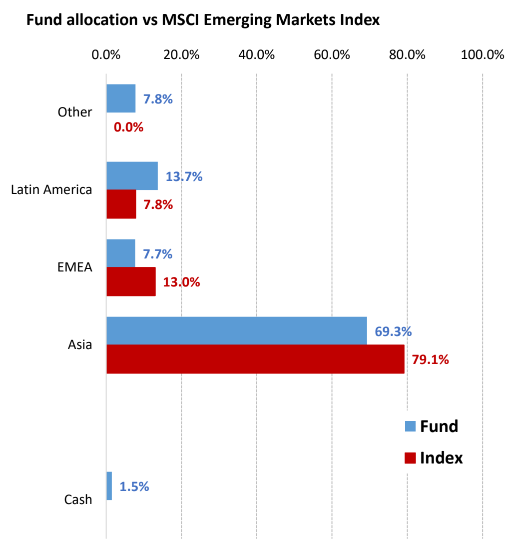
Yili is a stock we hold in the Asian Equity Income Fund, and is a producer of milk and dairy products, including fresh milk, UHT milk, milk powder, yoghurt and cheese. The company benefits from a combination of both high market share and a favourable structural trend, with growth in consumption expected over time.

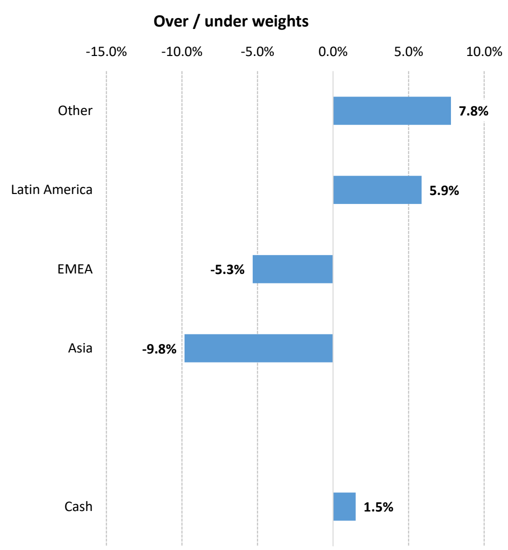
St Shine has suffered from reduced demand owing to the pandemic, and margins have declined as the customer mix has shifted over time. Increased competition has also been a factor in our decision to sell. We took advantage of some of the price volatility in the stock and exited amid a run-up in the stock price.

Portfolio positioning

We currently have 69% of the portfolio in Asia, 14% in Latin America, 8% in EMEA, mostly in South Africa, and 8% in 'other' (which is companies listed in the US and UK markets but deriving the majority of their business from emerging markets).

The following chart shows the regional weights relative to the benchmark:





Source: Guinness Asset Management. Data as at 30/06/2021.

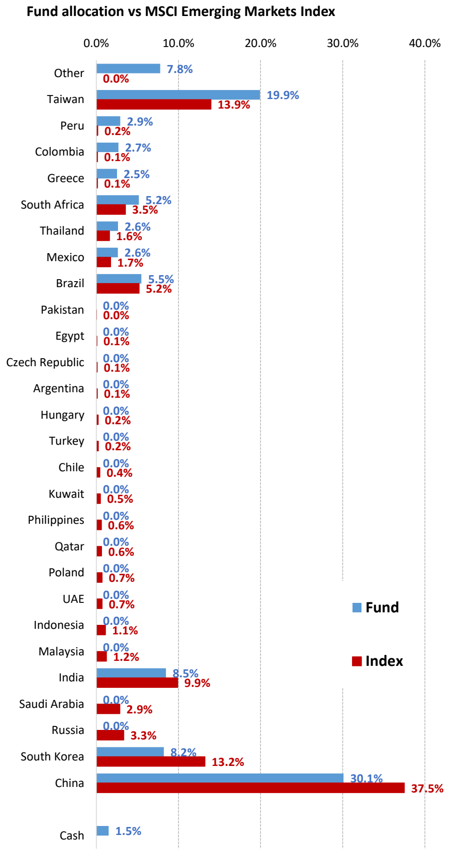
Relative to the benchmark, our biggest overweight (apart from the 'other' category) is Latin America, and our largest underweight is to Asia.

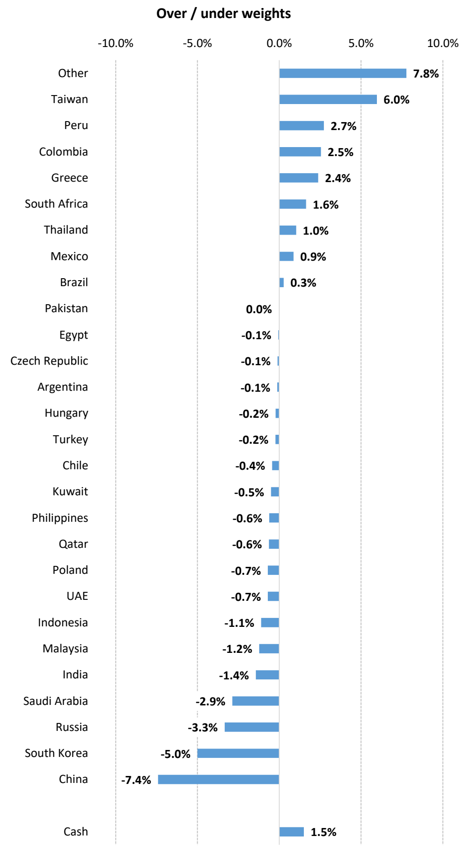
Part of the reason for the overweight in Latin America has been the decline of the region's weight in the index. By comparison, at the end of 2019, Latin America accounted for 11.4% of the benchmark – more than 3 percentage points higher than at the end of the quarter just gone. Much of the loss has been to the benefit of Asia over that time frame, which has increased from 73.6% to 79.1%.

One of the companies included in the 'other' category generates a significant proportion of its revenues from Asia, and so could be reallocated, which would reduce the underweight by about 3 percentage points.

Our approach, and one of the ways we differ from peers is to put together the portfolio on a bottom-up basis, rather than by making top-down judgements. Therefore the allocations should be viewed more as being a result of our individual stock selection decisions.

Next we show country weights relative to the benchmark:





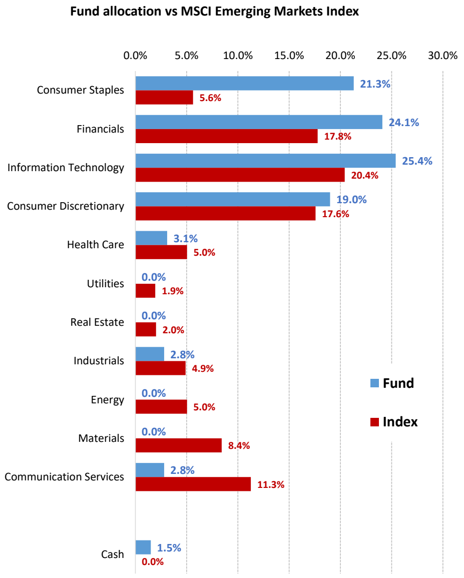
Source: Guinness Asset Management. Data as at 30/06/2021.

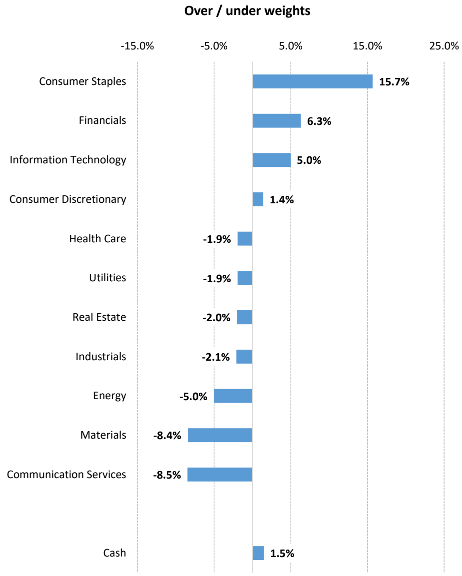
Our largest overweights are in Taiwan, 'Other' (which is our off-benchmark stocks), and then Columbia, Greece, Peru – in all cases relatively small proportions of the benchmark, but where we hold one position in each, putting us 2.5 to 3% overweight.

Our largest underweights are to China, where we don't hold the internet stocks—Tencent and Alibaba, in particular—that represent a significant proportion of the index, and to South Korea where we struggle to find large numbers of quality companies available at reasonably valuations. We have an even smaller universe in the case of Russia, our next largest underweight, where we hold no positions currently.

Finally, the following table shows sector weights relative to the benchmark:

Guinness Emerging Markets Equity Income Fund





Source: Guinness Asset Management. Data as at 30/06/2021.

Our main overweights are to the consumer sectors, financial and information technology.

We are underweight communication services, and we have no holdings in the materials, energy, real estate or utilities sectors.

Recent results

A few company updates have been released recently; more are expected as earnings season gets underway:

- Hon Hai investing NT$1bn in a private placement in Gigasolar Materials, a company that produces conductive paste for solar cells, but is also moving into electric vehicle (EV) battery materials. The move follows other investments by the company in the EV supply chain, as it develops an EV platform

- Broadcom management recently commented that they are seeing greater synergies between the hardware and infrastructure software segments of their business. For example, clients are increasingly adopting 'whitebox switching' network equipment, moving away from that produced by the incumbent vendors – this approach combines commoditized hardware (e.g. built on Broadcom's platform) with a separate software layer. Management's approach to capital allocation also appears sensible, with surplus capital likely to be used for share buybacks if attractive future M&A deals are not forthcoming.

- Very strong results reported by Nike are likely to benefit portfolio holding Shenzhou International, which derives 31% of its revenues from the global fashion brand (including supplying the 'fyknit' fabric used in Nike trainers). Nike reported sales up 88% year on year on a currency-adjusted basis. (20% ahead of 2019 levels). North America grew the most, up 141% or 30% ahead of 2019 levels. China also grew by 9%, up 10% on 2019 levels.

Outlook

The second quarter saw strong positive revisions to earnings estimates, both for emerging and developed markets, reflecting a robust post-pandemic recovery. Over the last three months, estimates for 2021 earnings are up 11.6% for emerging markets compared with 10.2% for world equities. Latin America has led the way with earnings forecasts for the region moving up 26.6%. Asia has trailed, though still up a healthy 9.5%. There have similarly been positive (though smaller) revisions to 2022 earnings across regions.

Emerging market valuations in aggregate look attractive, and we find this looking at multiple valuation metrics – price to book, price to earnings, price to average earnings etc. Low starting valuations should act as a tailwind for attractive future returns.

At the end of June, the portfolio traded on 13.6x 2021 earnings and 12x 2022 earnings, both representing discounts from the benchmark which traded at 14.6x 2021 earnings and 13.4x 2022 earnings (discounts of 7% and 11%, respectively).

Of course the sustainability of earnings will be paramount in supporting future returns. In the recent environment, we have seen a strong rebound in cyclicals, which can muddy the earnings growth picture somewhat – and is one of the reasons that the rebound in Latin America has been so strong. Our process naturally steers us away from the more cyclical commodity-based companies, and we generally look for a more sustainable earnings outlook, where structural growth is expected to be the main driver over time.

The pandemic is ongoing and is one of the main risks threatening the realisation of earnings growth. Sentiment continues to be affected by consumer caution in many places as uptake in service industries has not fully recovered. Supply chain disruption is also still a problem in many industries, particularly in those dependent on semiconductors, but also in a host of other areas, for example in shipping and logistics. Macro data has very recently pointed towards a more mixed picture about the recovery, as the rise of the new Delta variant has dented confidence. One of the key questions is whether governments will be reluctant to reintroduce restrictions as case number rise, as vaccination programmes in many emerging market countries pick up speed.

The overall strength in the recovery is such that for much of the second quarter, attention was focussed on the potential for higher inflation as a consequence of strong growth (and supply chain disruptions). We have also seen plenty of signs of tight labour markets, particularly in the US, which are likely to put upward pressure on inflation (and are also more likely to be ‘sticky’).

Until very recently, the fed had generally indicated it will follow a very loose policy – believing much of the inflation to be transitory, but following the more hawkish tone at the June meeting, investors’ attention has once again returned to tapering and the speed at which monetary support will be withdrawn. Offsetting this, and lending support to markets in the quarter, fiscal policy has continued to be accommodative with the announcement of the $1.2 trillion US infrastructure plan.

Again we stress that our process is not led by top down allocations, rather we are looking for attractively valued quality companies across regions.

Our approach is to identify companies that have sustained returns on capital above the cost of capital persistently over time. Such companies—typically in possession of a superior competitive advantage—are generally robust to external circumstances, and have often demonstrated excellent capital allocation track records.

Businesses that have earned high returns can generally afford to pay out a dividend. Strong capital allocation skills on the part of management should also help to ensure that that dividend will grow over time as the company reinvests.

Where we can identify such companies at a discount to their intrinsic value, we think shareholders should do well over time.

Edmund Harriss
Mark Hammonds
Sharukh Malik
(portfolio managers)

Data sources
Fund performance: *Financial Express, total return*
Index and stock data: *Bloomberg*

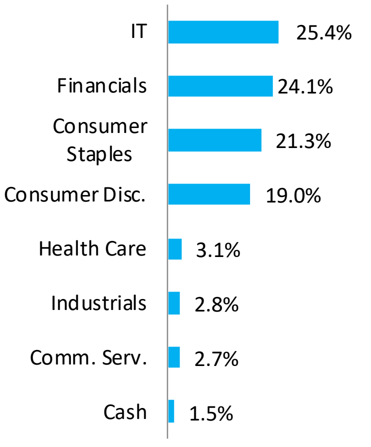
PORTFOLIO

30/06/2021

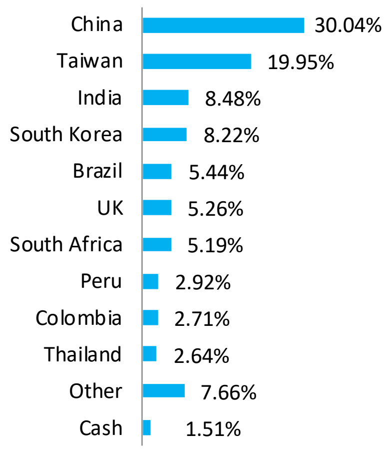
Fund top 10 holdings

Elite Material	3.4%
China Medical System	3.1%
China Merchants Bank	3.1%
Shenzhou International	3.1%
Bajaj Auto	3.0%
Hon Hai Precision Industi	3.0%
Taiwan Semiconductor	2.9%
Tech Mahindra	2.9%
Credicorp	2.9%
LG Household & Health Ca	2.8%
% of Fund in top 10	30.3%
Total number of stocks	36

Sector analysis



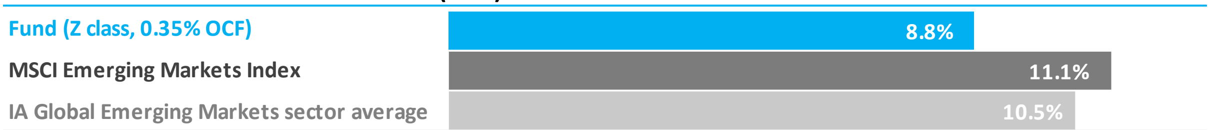
Geographic allocation



PERFORMANCE

30/06/2021

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Jun '21	Jun '20	Jun '19	Jun '18	Jun '17
Fund (Z class, 0.35% OCF)	21.0	-5.5	4.9	8.3	-
MSCI Emerging Markets Index	26.0	-0.1	5.4	6.8	27.8
IA Global Emerging Markets sector average	27.8	-2.9	6.1	3.7	27.5

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z class, 0.35% OCF)	1.4	7.2	21.0	20.0	-	46.4
MSCI Emerging Markets Index	3.1	6.3	26.0	31.7	5.9	60.8
IA Global Emerging Markets sector average	3.2	6.5	27.8	31.7	5.5	57.0

RISK ANALYSIS

30/06/2021

Annualised, weekly, from launch on 23.12.16, in GBP	Index	Sector	Fund
Alpha	0.00	0.00	-0.17
Beta	1.00	1.00	0.86
Information ratio	0.00	0.00	-0.24
Maximum drawdown	-22.63	-22.63	0.81
R squared	1.00	1.00	0.81
Sharpe ratio	0.47	0.47	0.37
Tracking error	0.00	0.00	6.60
Volatility	15.18	15.18	14.52

Past performance should not be taken as an indicator of future performance. 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.
Source: Financial Express, bid to bid, total return (0.35% OCF). Fund launch date: 23.12.2016.

Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about Guinness Emerging Markets 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.

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Risk

The Guinness Emerging Markets 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. 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 from the website www.guinnessfunds.com , or free of charge from:-

- the Manager: Link Fund Manager Solutions (Ireland) Ltd, 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.

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

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Telephone calls will be recorded and monitored.