

# Guinness Best of China Fund

INVESTMENT COMMENTARY – October 2021

**Launch date** 15.12.15

## Team

Edmund Harriss (manager)  
Sharukh Malik (manager)  
Mark Hammonds

## Aim

Guinness Best of China Fund is designed to provide investors with exposure to economic expansion and demographic trends in China and Taiwan.

The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle.

*This is a marketing communication. Please refer to the prospectus and KIID for the Fund before making any final investment decisions.*

**Performance (in GBP)** 30.09.2021

Past performance does not predict future returns

<b>Fund</b>	Best of China Fund (Z Cls, 0.74% OCF)
<b>Index</b>	MSCI Golden Dragon
<b>Sector</b>	IA China/Greater China

	2020	2019	2018
<b>Fund</b>	14.8	26.0	-20.3
<b>Index</b>	24.2	19.0	-9.5
<b>Sector</b>	33.6	22.2	-14.2

	1 year	3 years	From launch
<b>Fund</b>	6.4	21.2	94.5
<b>Index</b>	1.0	27.0	116.5
<b>Sector</b>	1.6	35.1	116.4

## Annualised % total return from launch (GBP)

<b>Fund</b>	12.2%
<b>Index</b>	14.3%
<b>Sector</b>	14.2%

## Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
<b>Alpha</b>	0.0	-0.2	-1.7
<b>Beta</b>	1.0	1.0	1.0
<b>Info ratio</b>	0.0	-0.1	-0.3
<b>Max drwdn</b>	-20.6	-23.8	-25.7
<b>Tracking err</b>	0.0	4.9	6.7
<b>Volatility</b>	18.0	18.3	19.0
<b>Sharpe ratio</b>	0.6	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.

Source: Financial Express, bid to bid, total return 0.74% OCF. Returns for share classes with a different OCF will vary accordingly

## Fund & Market

- In September, the Best of China Fund fell -3.5% (in GBP, Z class) while the MSCI Golden Dragon Net Total Return (NTR) Index fell -2.9% and the MSCI China Net Total Return (NTR) Index fell -3.1%.
- In September, MSCI China fell -3.1%, MSCI Taiwan fell -2.1% and MSCI Hong Kong fell -4.1%. The CSI 300 Index rose 3.4%.
- MSCI China Value fell -2.7 while MSCI China Growth fell -3.5%.
- In China, the strongest sectors were Energy (total return of +9.4%, in USD), Consumer Staples (+3.7%, in USD) and Utilities (+3.2%, in USD) while the weakest were Consumer Discretionary (-9.9%, in USD), Information Technology (-9.6%, in USD) and Materials (-8.9%, in USD).
- In Hong Kong, the Real Estate and Financials indices fell 6.7% and 2.7% respectively (in USD).
- In Taiwan, the Information Technology Index, which makes up more than 70% of the local market, fell 5.1% (in USD).
- In the Fund, strong performers were Fuling Zhacai, Yili, Autohome, Nari Technology and China Overseas Land & Investment. Weaker stocks were China Lesso, Geely, Xinyi Solar, China Resources Gas and Netease.
- In the third quarter, the Best of China Fund fell -9.6% (in GBP) while the MSCI Golden Dragon NTR Index fell -11.2% (in GBP) and the MSCI China NTR Index fell -16.2% (in GBP).

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## Guinness Best of China Fund

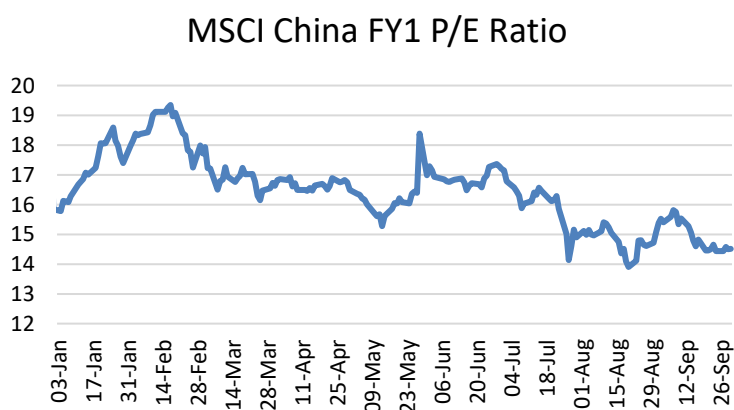
- MSCI China fell -16.2% (in GBP), MSCI Taiwan rose 0.3% (in GBP) and MSCI Hong Kong fell -7.2% in GBP).
- MSCI China Value fell -11.4% while MSCI China Growth fell -20.4%.
- In China, the strongest sectors were Energy (total return of +12.4%, in USD), Utilities (+12.1%, in USD) and Materials (+6.7%, in USD) while the weakest were Consumer Discretionary (-26.3%, in USD), Communication Services (-23.7%, in USD) and Real Estate (-19.5%).
- In the Fund, strong performers were Nari Technology, Lead Intelligent, China Overseas Land & Investment, Elite Material and Haier Smart Home. Weaker stocks were Alibaba, China Lesso, Suofeiya, China Medical System and Ping An.

## Market Overview

It was an eventful quarter for Chinese markets, with headwinds including:

- The government focusing more on common prosperity, leading to unanticipated regulatory activity in industries such as e-commerce, gaming and education.
- Evergrande was unable to borrow more to pay off its liabilities, meaning it could not repay a bond due in September. This led to concerns over potential contagion in the property market, as well as in the wider economy.
- Unexpected power cuts led to weaker economic activity in September. We think these cuts were due to inefficiencies in Chinese power markets, meaning power plants were reluctant to produce in light of higher cost prices.
- Economic growth is slowing down, as the government winds down monetary stimulus.

These factors have led Chinese markets to sell-off. The forward price/earnings ratio for the broader market, as measured by the MSCI China Index, has fallen from the peak of 19.4x in February to 14.5x at the end of September.



Source: Bloomberg, 31.12.20 –30.09.2021

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Value stocks outperformed growth stocks in the third quarter. In July and August, it was the high growth stocks affected by regulation which were weak, meaning value did relatively well. In September, the fallout from Evergrande meant value and growth fell in line with each other.



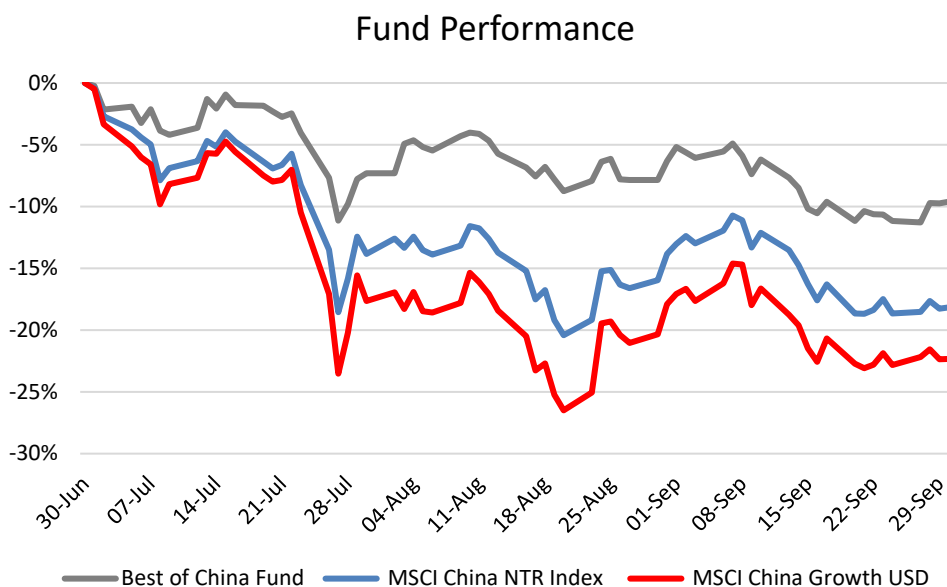
*Source: Bloomberg, 30.06.21 –30.09.2021*

In the quarter, the Fund outperformed both the MSCI China NTR Index, as well as the MSCI China Growth Index. This outperformance came in July, where the Fund’s underweight position in large online tech companies was a significant contributor to outperformance. The Fund is run on an equally weighted basis and so each position has a neutral weight of 3.1%. This is in contrast to the MSCI China Index, where as of June 30 2021, Tencent had a weight of 13.4% and Alibaba had a weight of 13.3%. We think this level of stock specific risk is too high in the index, whereas our equally weighted approach limits the risk to these two companies. As Tencent and Alibaba were two of the weaker stocks in the market, the Fund’s underweight was a source of outperformance. Fund holdings Nari Technology and Lead Intelligent were further contributors to performance. Nari’s share price was boosted by news that the cap for electricity prices during peak hours is to be boosted by at least 20%. This should theoretically boost revenues for the grid, leading to higher procurement budgets, boosting Nari’s potential sales. For Lead Intelligent, the share prices of companies in the battery supply chain have rallied since the bottom in March, boosted by positive earnings. The market’s rotation away from online tech towards growing industries with government support further led to a rally at the end of July.

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## Guinness Best of China Fund



Source: Bloomberg, 30.06.21 –30.09.2021.

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Cumulative % total return, in GBP, to 30/09/2021	YTD	1 year	3 years	5 Years	Launch
Guinness Best of China	-3.53	6.18	19.72	-	89.43
MSCI Golden Dragon	-6.44	0.98	27.04	61.92	116.52
IA China/Greater China sector average	-8.04	1.64	35.11	70.80	116.37
IA China/Greater China sector ranking	16/56	20/56	32/50	-	25/43
IA China/Greater China sector quartile	2	2	3	-	3

Source: FE, Total Return in GBP, 15.12.2015–30.09.2021.

In August, the Fund was flat while the MSCI China NTR Index was also flat. The Fund's underweight position in Alibaba was a key contributor to outperformance, boosted by positive contributions from Xinyi Solar, Nari Technology and China Overseas Land & Investment. On the other hand, detractors to performance included Shengyi Technology, Fuling Zhacai and Novatek Microelectronics.

In September, the Fund fell 5.6% while the MSCI China NTR Index fell 5.1%. Evergrande and power cuts were the main stories in the month, meaning that in addition to the Energy sector, defensive sectors Consumer Staples and Utilities were outperformers. The Fund holds one property developer, China Overseas Land & Investment (COLI), which was one of the strongest stocks in the fund (see section on portfolio performance for more details). In September, Fuling Zhacai and Yili were contributors to performance, offset by weakness in Lesso, Geely and Xinyi Solar.

## Portfolio Performance

In September, the top and bottom five contributors to performance are shown below, with the contribution to relative performance shown in brackets:

Top 5 Contributors	Top 5 Detractors
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## Guinness Best of China Fund

Underweight in Alibaba (+0.9%)	China Lesso (-0.6%)
Fuling Zhacai (+0.6%)	Geely (-0.4%)
Yili (+0.5%)	Xinyi Solar (-0.3%)
Autohome (+0.3%)	China Resources Gas (-0.3%)
Nari Technology (+0.2%)	Wuxi Biologics (not held) (-0.2%)

*Source: Guinness Asset Management, data as of 30/09/2021.*

*Attribution relative to the iShares MSCI China ETF.*

In the third quarter, the top and bottom five contributors to performance are shown below, with the contribution to relative performance shown in brackets:

Top 5 Contributors	Top 5 Detractors
Nari Technology (+2.0%)	Shengyi Technology (-0.6%)
Underweight in Alibaba (+1.9%)	China Lesso (-0.5%)
Lead Intelligent (+1.3%)	Suofeiya (-0.4%)
Elite Material (+0.7%)	China Medical System (-0.4%)
China Overseas Land & Investment (+0.6%)	China Construction Bank (not held) (-0.3%)

*Source: Guinness Asset Management, data as of 30/09/2021.*

*Attribution relative to the iShares MSCI China ETF.*

In the third quarter, the best contributor to outperformance was Nari Technology, which benefited from a rerating during the quarter. The company makes software and hardware for the electricity grid, focusing on dispatching and distribution solutions. Nari is an indirect beneficiary of China's buildout of renewable energy, which requires investment in the state grid network, which should lead to greater demand for Nari's products.

Alibaba's share price was very weak in the quarter due to tighter government rules affecting the technology sector. Alibaba's weight in the MSCI China Index (10.4% as of 30/09/21) is significant. Meanwhile, as the Fund is run on an equally weighted basis, Alibaba's neutral weight is ~3.1%, meaning the Fund was much less affected than the index by Alibaba's weakness.

Lead Intelligent makes equipment used to manufacture battery cells. In the second quarter, its revenue increased 107% and its earnings per share (EPS) increased 118%. As automobile companies worldwide continue to shift their focus towards electric vehicles, we think there is a long path of growth ahead of Lead Intelligent. CATL, one of the world's largest battery manufacturers, has a significant stake in Lead Intelligent, which gives Lead Intelligent exposure to an important customer. Additionally, Lead Intelligent's products are being used in Northvolt's phase I expansion in Europe.

Elite Material continues to deliver outperformance for the fund. The company specialises in environmentally friendly laminates, which are the base material for printed circuit boards. Elite offers exposure to rising demand for 5G smartphones and cloud services. In addition to these structural growth drivers, the company is also gaining market share in the server market, and is increasing capacity to gain share in the premium end of the laminate market.

China Overseas Land & Investment (COLI) is a real estate developer which has performed well despite the fallout from Evergrande. COLI has much of its focus on tier 1 cities such as Beijing, Shanghai and Hong Kong, where demand is more stable compared to lower tier cities. Before Evergrande dominated the

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headlines, COLI's more conservative nature meant it was trading cheap relative to peers. But this conservative approach is now a strength, as COLI has a strong enough balance sheet to weather a period of volatility. The low level of debt means COLI has the ability to acquire high quality assets trading at depressed prices.

China Lesso (plastic pipes) and Suofeiya (kitchen cabinets) were weak due to the fallout from Evergrande. It is our understanding that most of China Lesso's sales are related to infrastructure investments rather than property investments, so the decline in price is partly unwarranted. Suofeiya historically sold its kitchen cabinets through distributors, but has been increasing its exposure to property developers. In the first half of 2021, sales from property developers accounted for 17% of total sales. Therefore the market is worried about potential write-offs from these sales. We believe the market price is implying that the returns of the business drop to the cost of capital, which we think is unlikely.

China Medical System was by far the best-performing stock in the first half of the year, rising 167%. The company historically sold generic drugs on behalf of other firms but is now expanding into the innovative drug market. The share price gave back some of its gains in the third quarter on no stock-specific news. We believe even after its rally, the market is still under-pricing the profitability of the company. Sales in the first half grew 20% while net income grew 27%.

## Stock Switches

In July we sold Yuhong and in August we bought AIA and Shengyi Technology.

Yuhong is a manufacturer of waterproofing materials used in the construction industry. We believe its share price did not fully reflect the company's exposure to Evergrande, and therefore took profit on the stock. We still like the company and it remains on our watchlist as Yuhong's balance sheet is strong enough to weather a weaker year.

AIA gives the fund exposure to growing demand for life and health insurance. It is headquartered in Hong Kong and derives more than 50% of its revenue from the China region. AIA also has exposure to Southeast Asia, namely Thailand, Malaysia and Singapore. However, much of the future earnings growth is likely to come from mainland China. AIA is targeting the rising middle class in the country and we believe there is a lot of room for the company to grow from a relatively low base. AIA targets the premium end of the market, using its highly trained workforce which is viewed as giving some of the best service in the industry. This is backed up by AIA's very low turnover rate amongst its staff, relative to its competitors.

Shengyi Technology makes copper clad laminates (CCLs), which are the main base material for printed circuit boards (PCBs). It benefits from multiple trends which point to greater demand for CCLs and PCBs: growing popularity of 5G compatible devices, growing demand for servers and cloud services as well as localisation towards Chinese suppliers in the Chinese market. Shengyi is quickly moving up the value chain, supporting a gradual rise in margins over time.

## Portfolio Stats

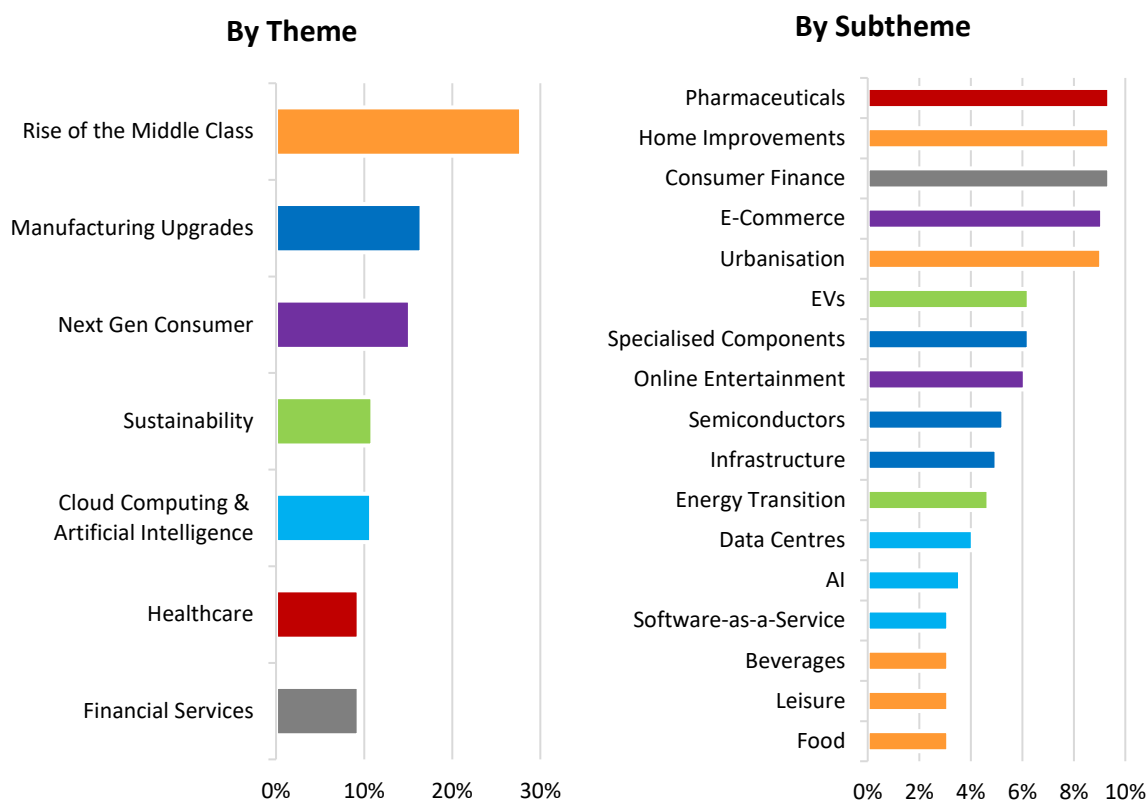
Below we show the Fund's exposure to the structural growth themes we focus on. The Fund's largest exposure is to the Rise of the Middle Class, Manufacturing Upgrades and the Next Gen consumer. The

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## Guinness Best of China Fund

Fund's largest exposures to subthemes include Pharmaceuticals, Home Improvements and Consumer Finance.

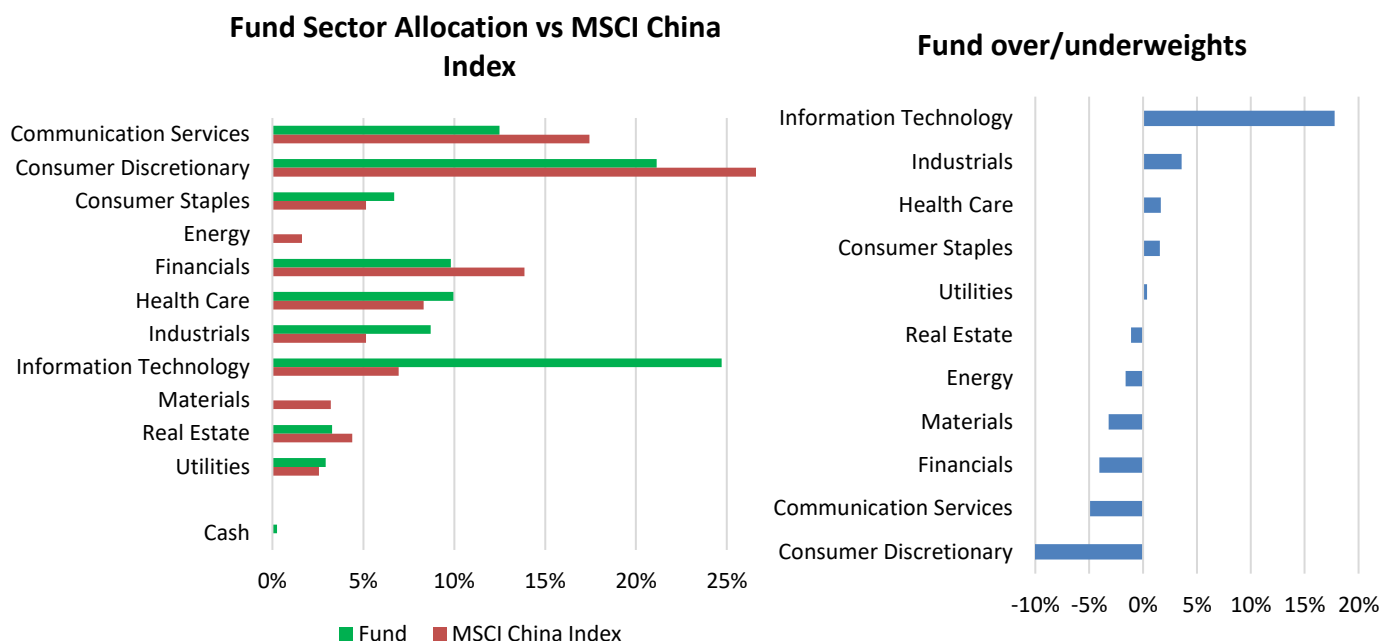


*Source: Guinness Asset Management, data as of 30/09/2021.*

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## Guinness Best of China Fund

Below we show the Fund's sector exposure. The Fund's largest exposures are to Information Technology, Consumer Discretionary and Communication Services. Relative to the MSCI China Index, the Fund is significantly overweight to Information Technology, and underweight to Consumer Discretionary.



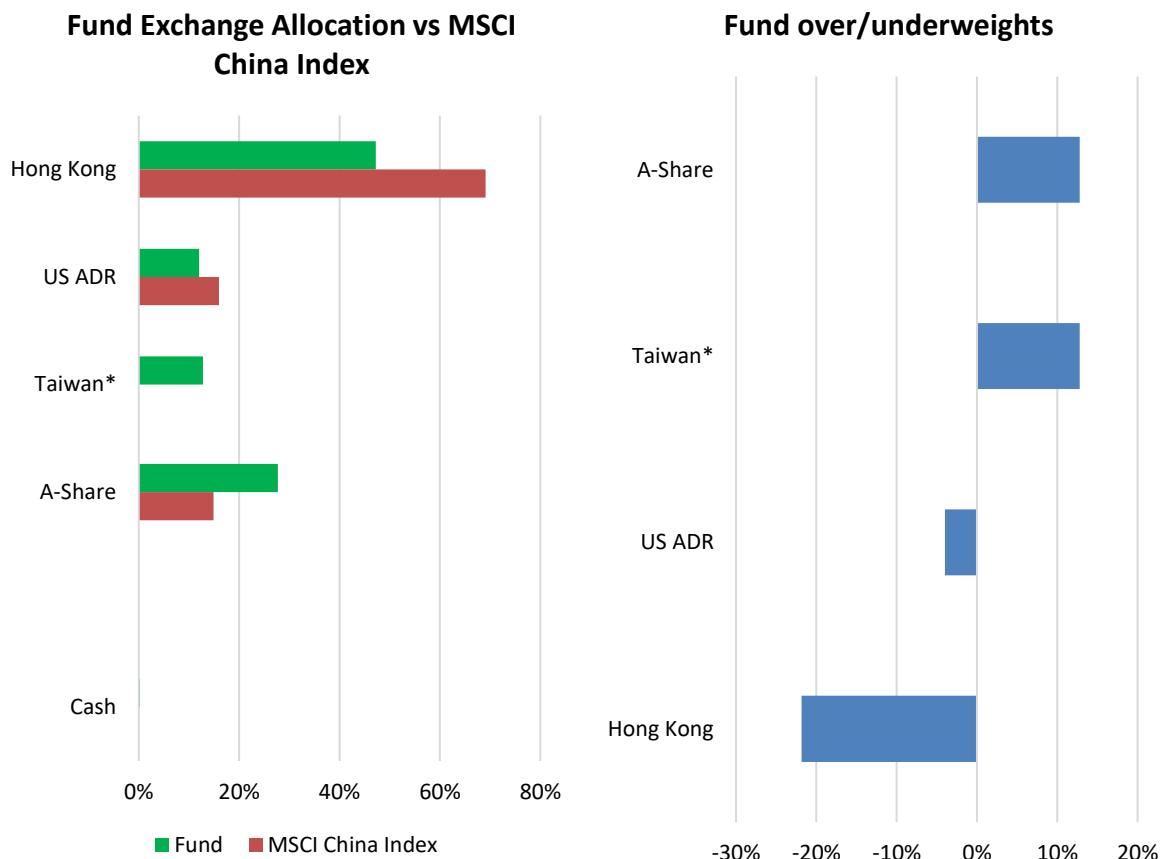
*Source: Guinness Asset Management, data as of 30/09/2021.*

Below we show the Fund's exposure by exchange. Relative to the MSCI China Index, the Fund is overweight in A-shares and underweight in Hong Kong listed shares. The Fund has a 13% allocation to Taiwan.

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Source: Guinness Asset Management, data as of 30/09/2021.

## Summary view & outlook

Below we summarise the portfolio’s characteristics. Relative to the MSCI China Index, the Fund is invested in higher return on equity businesses. The Fund’s net debt/equity ratio is negative, meaning that on the whole, the portfolio is invested in businesses with enough cash on the balance sheet to pay off all debt. The Fund is invested in businesses which historically have grown sales and earnings at 11% a year. This is in contrast to the broader market, where there has been no earnings growth over the past five years. Based on consensus analyst earning expectations, the Fund and the market are expected to grow earnings by 14% a year. Despite the Fund’s higher return on capital and higher historic earnings growth, it trades at a discount to the index. As the Fund is run on an equally weighted basis, it is not concentrated in the large online tech businesses, and so the Fund has a high active share of 86% relative to the MSCI China Index.

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## Guinness Best of China Fund

Quality			Growth			Conviction	
	Fund	MSCI China		Fund	MSCI China		
Return-on-Equity	22%	13%	Sales growth (Historic 5 yr annualised)	11%	3%	Positions	32
Net debt/equity	-11%	28%	Earnings growth (Historic 5 yr annualised)	11%	0%	Top 10 %NAV	34%
			Expected sales growth (2 yr annualised)	18%	13%	Bottom 10%NAV	28%
			Expected earnings growth (2 yr annualised)	14%	14%	Active share <sup>1</sup>	86%
			PE (2022e)	11.9	12.5		

Source: Guinness Asset Management, data as of 30/09/2021.  
Attribution relative to the iShares MSCI China ETF.

We think this combination of factors means the Fund is well placed to offer exposure to the structural growth themes in China. At the same time, the Fund does this while paying attention to valuations – we do not want to overpay for growth. Since the Fund’s repositioning in June 2020, the Fund was able to capture 113% of the upside in markets (covering 30/06/20, when the fund was repositioned, to 17/02/21, for the MSCI China NTR Index). In the downturn, the Fund captured 73% of the downside (covering 17/02/21 to 30/09/21).

**Edmund Harriss**  
**Sharukh Malik, CFA**  
Portfolio Managers

### Data sources

Fund performance: *Financial Express*, total return 0.74% OCF

Index and stock data: *Bloomberg*

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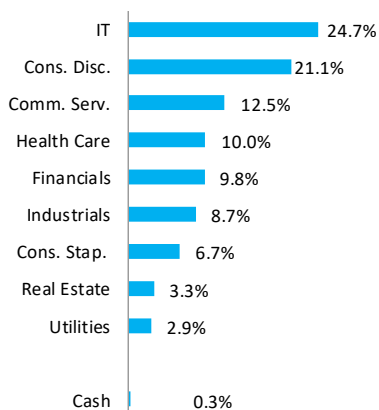
### PORTFOLIO

30/09/2021

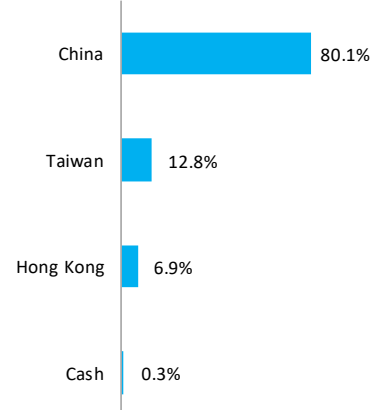
#### Fund top 10 holdings

China Merchants Bank	3.6%
Sino Biopharmaceutical	3.6%
Inner Mongolia Yili Industrial	3.5%
Autohome	3.5%
Catcher Technology	3.4%
Elite Material	3.4%
JD.com	3.4%
AIA Group Ltd	3.4%
CSPC Pharmaceutical Group Ltd	3.3%
Zhejiang Supor	3.3%
% of Fund in top 10	34.4%
Total number of stocks	32

#### Sector analysis



#### Geographic allocation



### PERFORMANCE

30/09/2021

*Past performance does not predict future returns*

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

Fund (Z Class, 0.74% OCF)	12.2%
MSCI Golden Dragon Index	14.3%
IA China/Greater China sector average	14.2%

Discrete years % total return (GBP)	Sep '21	Sep '20	Sep '19	Sep '18	Sep '17
Fund (Z Class, 0.74% OCF)	6.4	13.9	-0.0	0.1	27.4
MSCI Golden Dragon Index	1.0	22.3	2.9	4.2	22.4
IA China/Greater China sector average	1.6	26.8	4.8	2.7	23.1

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Z Class, 0.74% OCF)	-3.5	-3.4	6.4	21.2	54.7	94.5
MSCI Golden Dragon Index	-2.9	-6.4	1.0	27.0	61.9	116.5
IA China/Greater China sector average	-0.3	-8.0	1.6	35.1	70.8	116.4

### RISK ANALYSIS

30/09/2021

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.17	-1.73
Beta	1.00	0.98	0.99
Information ratio	0.00	-0.10	-0.31
Maximum drawdown	-20.57	-23.77	-25.74
R squared	1.00	0.93	0.88
Sharpe ratio	0.57	0.53	0.42
Tracking error	0.00	4.90	6.67
Volatility	17.99	18.30	19.04

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Source: Financial Express, bid to bid, total return (0.74% OCF). Fund launch date: 15.12.2015. Fund returns are for share classes with a current Ongoing Charges Figure (OCF) of 0.89%; returns for share classes with a different OCF will vary accordingly.

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

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

### Risk

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

### Documentation

The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available in English from [www.guinnessfunds.com](http://www.guinnessfunds.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](http://www.carnegie-fund-services.ch). The paying agent is Banque Cantonale de Genève, 17 Quai de l'Île, 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.

**GUINNESS**

ASSET MANAGEMENT

Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

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