Guinness Best of China Fund

Investment Commentary - August 2022

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

ABOUT THE FUND

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

Aim

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

RISK

Lower risk			Risk & reward			Higher risk
1	2	3	4	5	**6**	7
Typically lower rewards						Typically higher rewards

The risk and reward indicator shows where the Fund ranks in terms of its potential risk and return. The Fund has been classed as 6 because its volatility has been measured as above average to high. Historic data may not be a reliable indicator for the future. 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.

PERFORMANCE

Past performance does not predict future returns

31/07/2022	1 year	3 years	5 years	Launch*
Fund	-8.3	10.1	13.7	78.2
Index	-12.9	3.7	17.5	90.2
Sector	-14.1	6.7	21.8	85.6

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 July, the Guinness Best of China Fund fell 8.5% while the benchmark, the MSCI Golden Dragon Net Total Return Index (MSCI Golden Dragon Index) fell 5.8%, and the MSCI China Net Total Return Index (MSCI China Index) fell 9.4% (in GBP).

Consumer price inflation (CPI) rose to 2.7% in July compared to 2.5% in June, primarily driven by rising food prices (specifically pork and fresh vegetables). Core CPI, which excludes food and energy, was 0.8% in July compared to 1.0% in June.

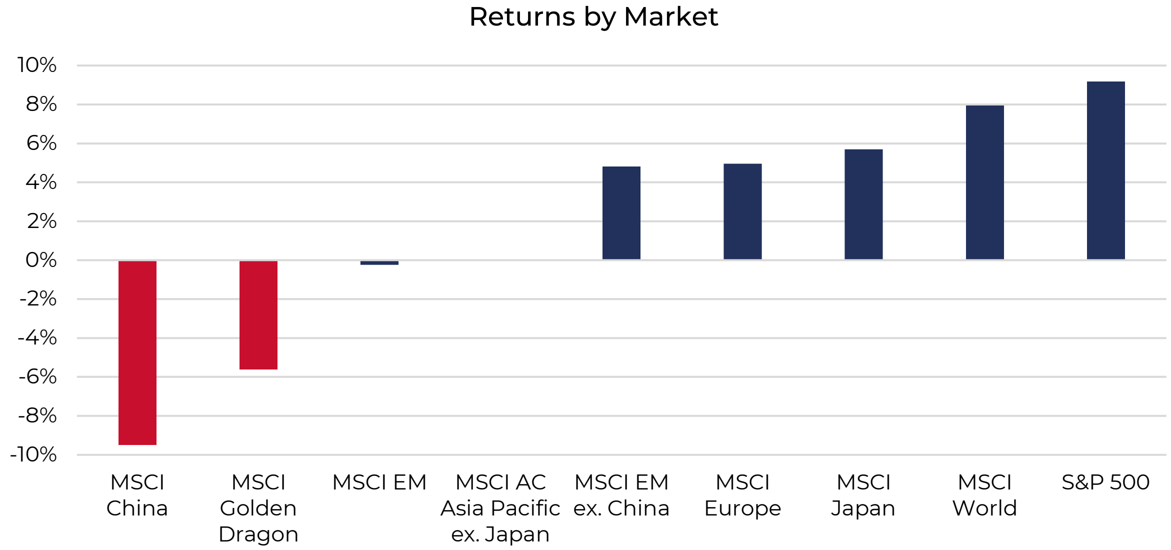
Producer price inflation (PPI) was 4.2% in July, lower than the 6.1% reading for June, as commodity prices weakened on a sequential basis.

Stronger stocks in the portfolio were CSPC Pharmaceutical, Xinyi Solar and Nari Technology. Weaker stocks were Suofeiya and Alibaba.

No changes were made to the portfolio in July.

As of 31/07/22, MSCI China traded on a price/earnings ratio of 11.7x on estimated 2022 earnings, putting it at valuations last seen during the trade war. The portfolio trades on a price/earnings ratio of 14.7x on estimated 2022 earnings, which puts it at a 25% premium to the market. We think this premium is worth paying for given the Fund's higher return on equity (27% vs 8% for MSCI China) and the Fund's low debt (net debt/equity -45% vs 30% for MSCI China). Over the past 10 years, the Fund's current holdings have grown their net income by 286% compared to virtually no growth for the MSCI China Index.

MARKET COMMENTARY



(Data from 30/06/22 to 31/07/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

Chinese markets fell by 9.5% in July in USD. The weakness was predominantly caused by protests in nearly 100 cities in China as homebuyers refused to make their mortgage payments. This was because construction work has stopped on houses which they had bought off plan. The risk was that these protests would broaden, and Chinese markets sold off. This fear was not realised; the protests were mostly limited to cities in Henan, Hubei and Hunan provinces. The affected banks, which were not receiving their mortgage payments, said overdue loans represented less than 0.01% of their total mortgage book. Assuming the protests remain limited, the issue is manageable given the small scale. The problem is not that homebuyers cannot pay their mortgages; in this case they are unwilling to do so because of incomplete projects.

Why were these construction projects not going ahead? Certain developers' finances are stretched and they do not have the cash to work on projects, an example being Evergrande. There were several factors:

1. 'Three red lines' policy: Since 2020, the government has tried to reduce the amount of leverage in the property market by introducing debt caps on those failing to meet three financial thresholds – the so-called three red lines policy. This was one of the catalysts for Evergrande entering default as it was not able to borrow more to fund its growth.

2. Caps on the presale model (which permits the sale of properties off plan, prior to construction): In 2021 the rules were tightened to restrict what property developers could do with the pre-sale funds. Developers must put these funds into escrow accounts, and these funds can only be used for the specific project they were paid for. Though these rules previously existed, they were not rigorously enforced, so developers would use the presale proceeds raised for one project to fund a completely different project. Again, this is something developers like Evergrande used regularly, so enforcement of the rules has further dampened activity.

3. Zero-Covid policy: This is certainly impacting economic growth, leading to subdued demand not just in the property market but in the whole economy. Weakening global growth, along with the aforementioned issues, are all occurring simultaneously, making a difficult job even harder to resolve.

The government is now mulling over its options. China Construction Bank (CCB), a large state-owned bank which is not held in the portfolio, may be asked to contribute CNY40bn ($5.9bn) towards a bailout fund to support distressed developers. This would be in addition to the People's Bank of China (China's central bank) contributing another CNY 40 bn to set up an initial CNY80bn fund. Reports indicate the fund could grow to at least CNY 300 bn ($44bn).

The problem from the government's point of view is that any sort of bailout fund could encourage other developers to take on too much risk if they expect eventually the government will step in. This is often called moral hazard and is something the government is keen to prevent; but the short-term problem of a moribund property market seems to be greater than the medium-term cost of moral hazard.

In the Best of China Fund, we own one property developer, China Overseas Land & Investment (COLI). It is probably the most conservatively financed major developer in China and its financial position is well within the three red lines. COLI is majority owned by a state-owned enterprise and has been acquiring more projects over the past 12 months as its private competitors have struggled. We are alert to any suggestions that the company may be called upon to assist distressed developers, but there have been no signs of this occurring so far. COLI was the best-performing stock in the portfolio in the first half of the year, rising 37.8% compared to the MSCI China Index which fell 11.3%. In July, COLI fell 12.8% while the MSCI China Index fell 9.5%. Other well-known property names fell more steeply in July, reflecting their greater risk – Longfor Group fell 26.4%, Country Garden Holdings fell 37.7% and China Vanke fell 19.1%.

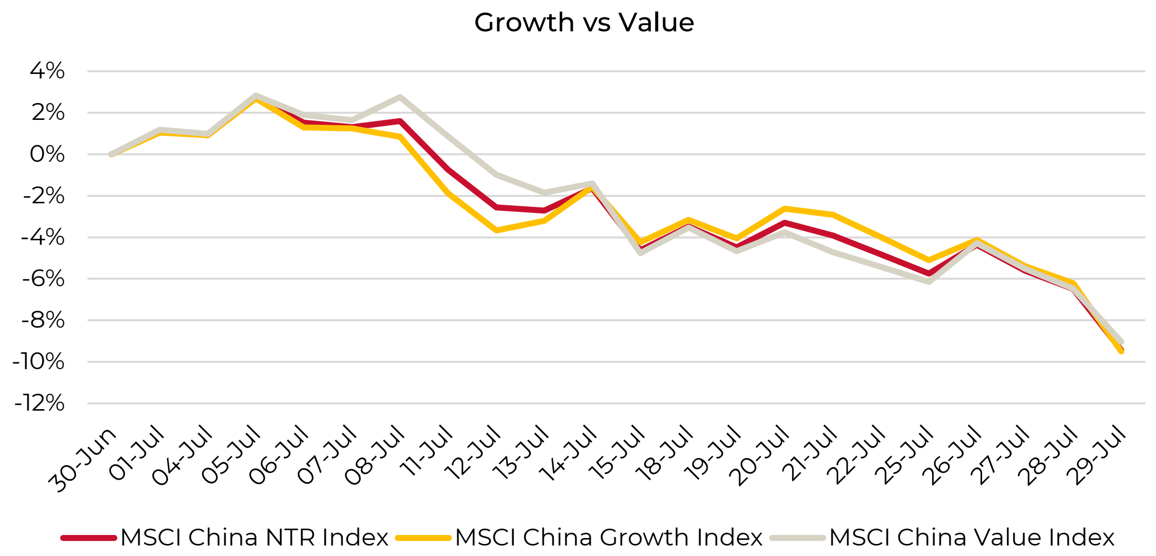
We own one bank – China Merchants Bank (CMB). Its overdue mortgages linked to the protests were worth only CNY 12m (c.$2m). To put this into context, as of 12/07/22 the total value of CMB's assets was $1.49 trillion.

We also hold names which have indirect exposure to the property market. Sany Heavy makes construction equipment such as excavators. Suofeiya makes kitchen cabinets and so its prospects are linked to property sales. To a lesser extent China Lesso is also impacted. It makes plastic pipes used in all types of construction, but we think more than half of the business comes from infrastructure projects rather than property.

Taiwan

Towards the end of the month, markets were also worried over the consequences of Nancy Pelosi's trip to Taiwan. The Chinese leadership viewed the visit by Pelosi, the Speaker of the House of Representatives and so one of the most senior politicians in the US, as a strong provocation. After many days of suspense, Pelosi landed in Taiwan in the evening of Aug 2nd and departed the following day. She met Taiwan's President Tsai Ing-wen as well as Deputy Speaker of Parliament Tsai Chi-Chang. China responded by carrying out a series of military drills around Taiwan. The drills were closer to Taiwan than ever before and extended into its territorial waters. China also announced a ban of certain imports from Taiwan, including some agricultural products. However according to DBS, agricultural exports to China only accounted for 0.6% of Taiwan's exports in 2021, so the ban was not significant.

In July, value stocks and growth stocks in China essentially fell in line.



(Data from 30/06/22 to 31/07/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

The strongest sectors were Energy, Industrials and Healthcare. The weakest were Real Estate, Consumer Discretionary and Communication Services. Due to the mortgage protests, it is no surprise Real Estate was so weak.

(Data from 30/06/22 to 31/07/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

COMPANY UPDATES

There was no specific news regarding CSPC Pharmaceutical, but it was the best-performing stock in the Fund in July. Management expects some growth in the business in the second quarter even though lockdowns led to fewer patients in hospitals. In August, CSPC is likely to publish the results of its phase-I trial of its mRNA Covid vaccine. Assuming the results are satisfactory, the company is expecting to complete a phase-II trial in September, involving patients in southeast Asia.

Xinyi Solar was also strong, rising 10%. It reported first-half results where revenue grew 20% but net income fell 38%. Solar glass volumes grew 45% but the gross margin fell 24.5 percentage points to 26.7%. This was driven by 13-16% lower average selling prices (ASPs) compared to the preceding period in 2021, which had relatively high ASPs. Additionally, higher raw material and energy prices (soda ash and gas) were another factor. In the short term it is likely gas prices will remain high, so further margin pressure is likely. But given much of the world's focus on transitioning towards renewable energy, we see room for more demand through higher volumes. Xinyi Solar increased capacity by 40% in the first half of the year by adding new production lines and through older plants coming back online after completing maintenance. The company is targeting more capacity additions including a new facility in Malaysia, which diversifies its sources of production. We think this diversification is a sensible move in case geopolitical disputes escalate.

Suofeiya was the weakest stock in the portfolio, falling 35%. It makes kitchen cabinets and its prospects are linked to the property market. Given the property protests at the beginning of July, the stock was weak. At the same time the deputy general manager/CEO unexpectedly resigned, which further added to the weakness. We continue to hold the stock because we think the business can use its strong brand to generate a high return on capital. Currently we think the market price implies the returns of the business dip to the cost of capital, which we think is unlikely. The business went public in 2011, and through considerable changes over that period it has sustained earnings well above the cost of capital. The preceding 10 years have contained multiple downturns that the business has navigated well, and we expect Suofeiya's strong balance sheet should give it time to manage the current slowdown.

TSMC grew revenue by 44% in the second quarter while earnings per share (EPS) grew 77%. Management sees an inventory correction occurring in the industry and expects the overall industry to be weak for a few quarters. TSMC upgraded its growth guidance for the year from a percentage in the high 20s to the mid-30s. The company still expects the business to grow in 2023, driven by price increases and revenue from the new N3 (3nm nodes) range. Additionally, TSMC expects stronger demand for N5 (5m nodes) products from smartphone and high-performance computing customers, as these products upgrade to more powerful chips. In a sign of the company's strong pricing power, gross margins increased from 50.0% in 2Q21 to 59.1% in 2Q22, driven by price increases and positive foreign exchange movements.

Elite Material reported second-quarter revenue which rose 4% and EPS which fell 13%. The lockdown in Kunshan, where Elite has a factory, led to lower utilisation and dragged on margins. Higher transportation and Covid-related costs were also factors weighing on earnings. Given the delay in Intel's Eagle Stream platform for servers, the industry has extra capacity which added to the weakness in selling prices. But Elite has only pushed back mass production of its products targeting this Intel platform by one quarter, so the extra capacity should begin to be used relatively soon. Management have revised their full-year guidance for the overall business downwards but still expect the infrastructure/server business to grow 15-25% this year. The smartphone segment is expected to be flat at best or to see revenue fall to up to 10% as Android sales remain lacklustre.

Fuling Zhacai's sales grew 15% in the second quarter while net income grew 75% (zhacai is a type of pickled mustard plant stem and very popular). Due to lockdowns, volume growth was rapid in April since more people were in their homes. As lockdowns were lifted, there was a slowdown for the rest of the quarter. For the quarter as a whole, zhacai volumes were down 10% but ASPs were up 14%, driven by the price increases implemented in November 2021. Gross margins increased 5.3 percentage points on a quarterly basis as mustard roots prices, a key cost, continued to fall.

Alibaba applied to convert its secondary listing in Hong Kong (HK) into a primary listing, which means the company will have dual primary listing in both the US and HK. The company expects the process to be completed this year, which should allow the stock to be eligible for Southbound trading (Southbound trading refers to mainland Chinese investors buying HK-listed stocks through the Stock Connect). The flows from these Southbound flows can be substantial; for example, mainland investors own c.10% and c.15% of the free float shares for Tencent and Meituan respectively.

OUTLOOK

Appetite for Chinese stocks remains weak among global investors, which is the reason why we think China remains an interesting investment proposition. Current valuations reflect current sentiment and the debate is whether they reflect future outcomes. If China's economy is stronger in the medium term (3-5 years) than it is today, then there is potential for a valuation re-rating, boosting shareholder returns. We think at some point China is likely to move away from its zero-Covid policy, which would lead to stronger economic growth, since lockdowns and movement restrictions would no longer occur. In this scenario, China is cheap, since today's valuations do not reflect likely future outcomes and so we argue investors should be looking at the country for this very reason.

As of 31/07/22, MSCI China traded on a price/earnings ratio of 11.7x on estimated 2022 earnings, putting it at valuations last seen during the trade war. The portfolio trades on 14.7x on estimated 2022 earnings, which puts it at a 25% premium to the market. We think this premium is worth paying for given the characteristics of the Fund. The Fund's return on equity (ROE) was 27% in 2021 compared to only 8% for the MSCI China Index. That is a function of the Fund's process, where we only look at companies with a return on capital above the cost of capital. Our companies in aggregate are much better at allocating capital than the overall market. The Fund's premium ROE is, we believe, to be a function of better margins and operational efficiencies and not a function of financial leverage. The aggregate net debt/equity ratio for the portfolio is -45% (i.e. net cash, with cash levels higher than debt), compared to 30% debt for the MSCI China Index. We think being invested in companies with strong balance sheets is an attractive characteristic given the challenges the Chinese economy is facing.

Portfolio Managers

Edmund Harriss

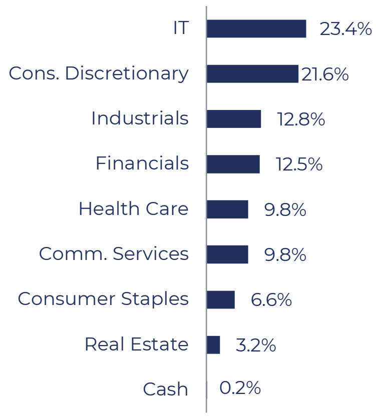
Sharukh Malik

PORTFOLIO

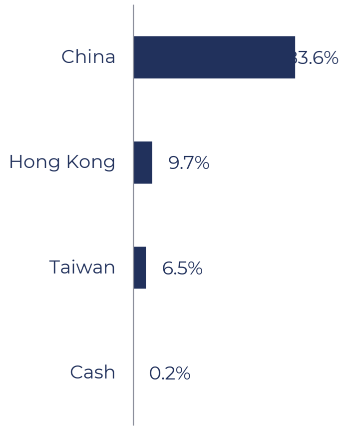
Fund top 10 holdings

NetEase	3.6%
Wuxi Lead Intelligent Equipment	3.5%
China Medical System	3.5%
Xinyi Solar	3.4%
Shengyi Technology	3.4%
Inner Mongolia Yili Industrial	3.4%
Geely Automobile Holdings	3.4%
JD.com	3.4%
Taiwan Semiconductor	3.3%
AIA Group Ltd	3.3%
% of Fund in top 10	34.3%
Total number of stocks	32

Sector analysis



Geographic allocation



PERFORMANCE

Annualised % total return from launch (GBP)

Discrete years % total return (GBP)	Jul '22	Jul '21	Jul '20	Jul '19	Jul '18	Jul '17
Fund (Y Class, 0.89% OCF)	-8.3	9.7	9.5	-3.1	6.6	36.0
MSCI Golden Dragon Index	-12.9	5.7	12.6	4.8	8.1	33.2
IA China/Greater China sector average	-14.1	5.4	17.9	4.1	9.7	32.8

Cumulative % total return (GBP)	YTD	1 Yr	3 Yrs	5 Yrs	Launch
Fund (Y Class, 0.89% OCF)	-10.2	-8.3	10.1	13.7	78.2
MSCI Golden Dragon Index	-10.0	-12.9	3.7	17.5	90.2
IA China/Greater China sector average	-11.7	-14.1	6.7	21.8	85.6

RISK ANALYSIS **31/07/2022**

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-0.20	-0.36
Beta	1.00	0.99	0.98
Information ratio	0.00	-0.08	-0.11
Maximum drawdown	-30.24	-37.41	-28.06
R squared	1.00	0.92	0.85
Sharpe ratio	0.36	0.31	0.28
Tracking error	0.00	5.26	7.44
Volatility	17.95	18.54	19.02

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

IMPORTANT INFORMATION

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

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

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

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

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

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

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

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

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

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

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

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

Telephone calls will be recorded and monitored.