Guinness Best of China Fund

Investment Commentary – October 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

30/09/2022	1 year	3 years	5 years	Launch*
Fund	-13.9	3.7	2.8	63.2
Index	-18.6	0.5	7.7	76.3
Sector	-19.7	3.5	11.4	73.7

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 the third quarter, the Guinness Best of China Fund (Y class, GBP) fell 16.2% while the benchmark, the MSCI Golden Dragon Net Total Return Index (MSCI Golden Dragon Index) fell 12.2%, and the MSCI China Net Total Return Index (MSCI China Index) fell 15.2% (in GBP).

The strongest stocks in the portfolio were CSPC Pharmaceutical, Venustech and Elite Material. The weakest were Suofeiya, Geely and Shenzhou International.

We sold China Lilang and China Lesso. We bought Hangzhou First Applied Material.

On estimated 2022 earnings, the Fund trades on a price/earnings ratio of 13.8x, which puts it at a 17% premium to the MSCI China ETF. However, banks make up 10% of the market and with their very low valuation (3.6x), they distort the valuation of the market. We estimate that the valuation of the ETF excluding the banks was 15.6x, which puts the Fund at a 12% discount.

Hong Kong announced an easing of its quarantine policy for incoming travellers. The requirement for a PCR test before boarding has been scrapped and travellers now only need an antigen test a day before flying. Inbound travellers no longer need to stay in a quarantine hotel and instead can stay in any hotel of their choosing. They must monitor their Covid status for three days and cannot go to certain public areas such as restaurants and bars during this period. After three days, travellers can move freely but must still conduct PCR and antigen tests until the seventh day of their stay. However, if one tests positive they must still go to a hospital or isolation hotel for a minimum of seven days.

Macau will allow tour groups from mainland China to enter the region for the first time since Covid. This will provide a boost for the local economy.

However, in the mainland, there are no signs of an immediate reopening. We await progress on domestic mRNA vaccines and an uptick in booster shots for the elderly.

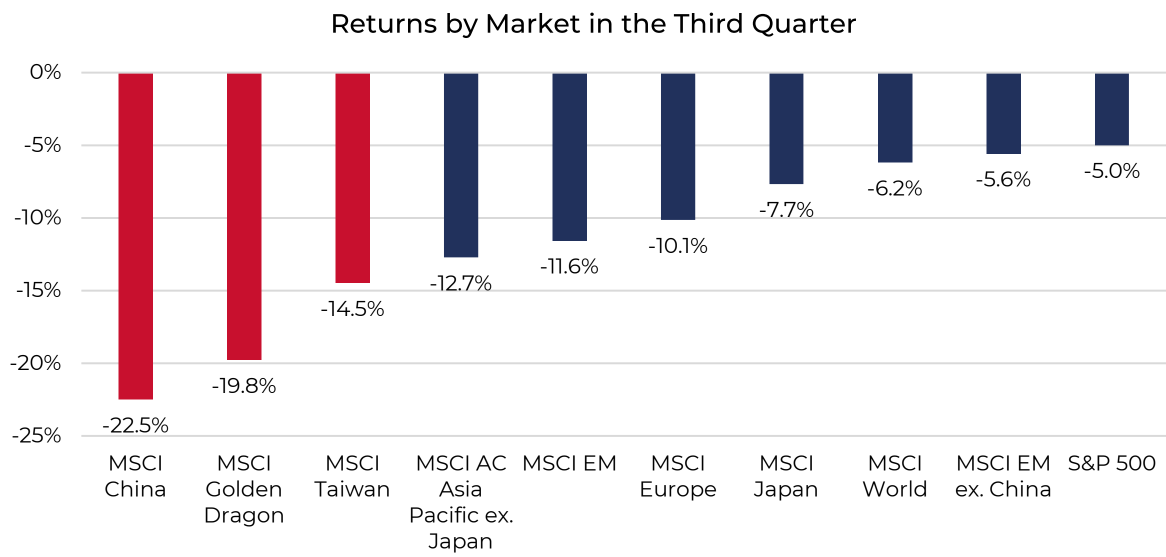
The US dollar appreciated against major currencies including the Renminbi. The Renminbi weakened past the USDCNY 7.2 level which happened at a greater pace than the central bank was comfortable with. This led to the People's Bank of China increasing the risk reserve requirement for forward foreign exchange trading from 0% to 20%, increasing the cost of these trades, aiming to reduce the selling pressure on the Renminbi.

The Caixin Manufacturing Purchasing Managers Index (PMI), which is more geared towards private businesses, was 48.1 in September (a value below 50.0 indicates weakening activity). The NBS Manufacturing PMI, which is more geared towards state owned firms, was 50.1, which marked expanding activity. Policy stimulus through infrastructure and property support is likely benefiting state-owned firms more than private firms.

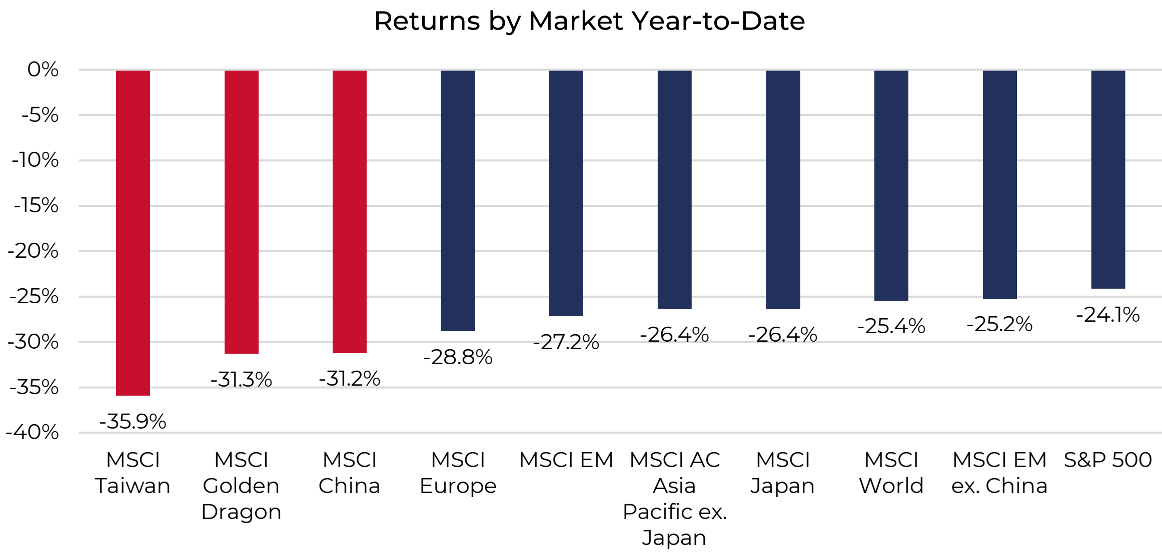
After a disappointing 2.7% rise in July, retail sales rose 5.4% in August, driven by a rebound in car sales and restaurant sales.

Consumer price inflation was 2.5% in August, with a softening in food and energy prices. Producer prices rose 2.3% in August. Low inflation gives the central bank room to ease monetary policy, in our opinion.

MARKET COMMENTARY

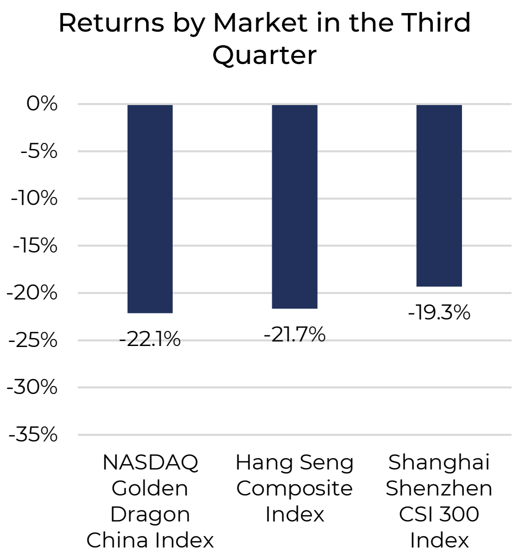


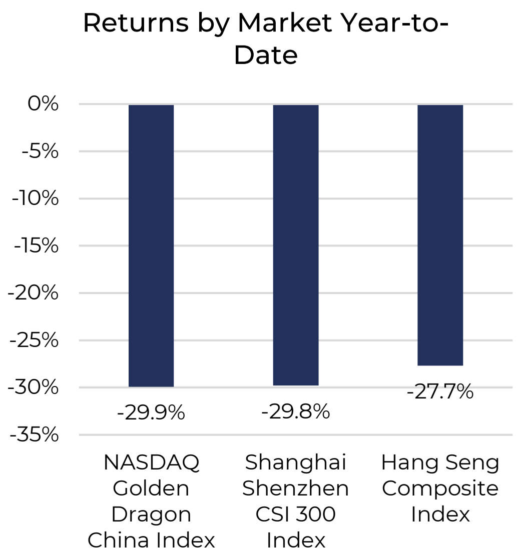
(Data from 30/06/2022 to 30/09/2022, returns in USD, source: Bloomberg, Guinness Global Investors calculations)



(Data from 31/12/21 to 30/09/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

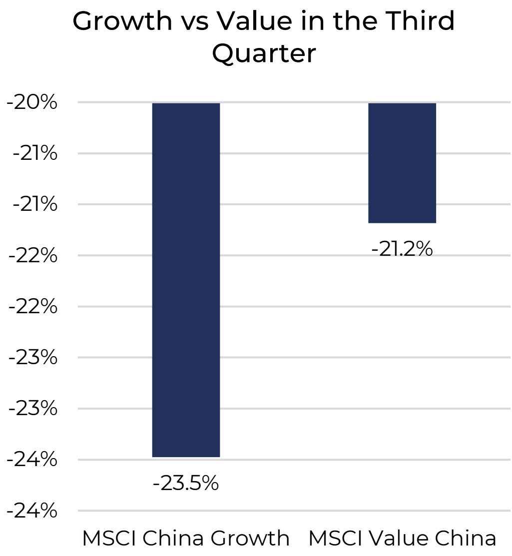
In the third quarter, Chinese markets were weak relative to other major markets. The MSCI China Index fell 22.5% (in USD) while the MSCI Taiwan Index fell 14.5%, compared to the MSCI World Index which fell 6.2%. Year-to-date, MSCI China has fallen 31.2% while MSCI Taiwan has fallen 35.9%, compared to a 25.4% drop for the MSCI World. China's zero-Covid policy and related weak property market are in our view the main reasons for China's weak equity performance.

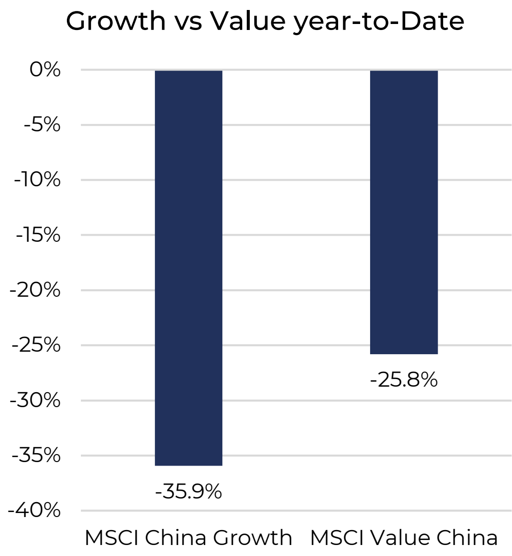




(Left chart: data from 30/06/22 to 30/09/22. Right chart: Data from 31/12/21 to 30/09/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

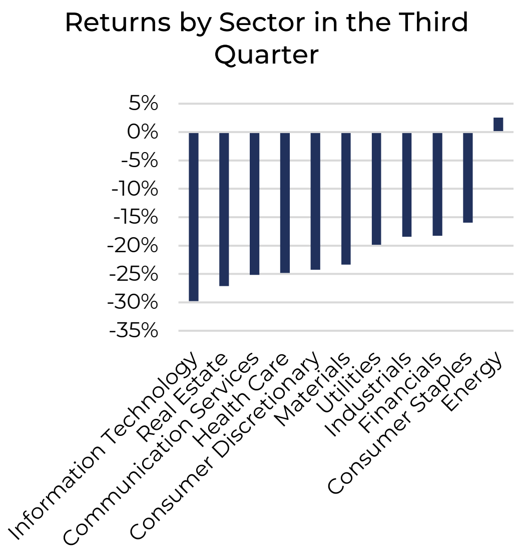
In the third quarter, the performance of the offshore stocks (the ADRs in the US and HK-listed stocks) was marginally weaker than the A-share market. Year-to-date, all three markets have performed similarly, down 28% to 30% in USD.

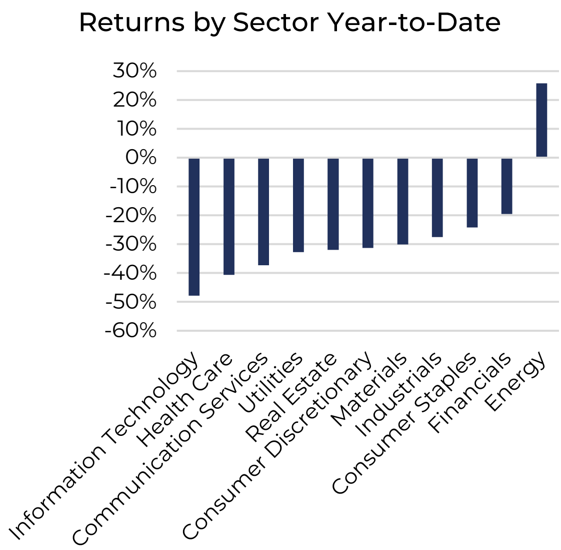




(Left chart: data from 30/06/22 to 30/09/22. Right chart: Data from 31/12/21 to 30/09/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

Growth stocks were slightly weaker than value stocks in the third quarter. Year-to-date, value stocks are outperforming, down 25.8% vs the growth index down 35.9% in USD.





(Left chart: data from 30/06/22 to 30/09/22. Right chart: Data from 31/12/21 to 30/09/22, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

In the third quarter, the best-performing sectors were Energy, Consumer Staples and Financials. Expectations for elevated oil and gas prices explain Energy's strong performance. The weakest-performing sectors were Information Technology, Real Estate and Communication Services. As estimates for global growth weaken, it is likely consumer demand for laptops, smartphones etc. will weaken, meaning the share prices of companies in the supply chain have been weak. The ongoing weakness for Chinese property developers explains why Real Estate was weak.

PORTFOLIO PERFORMANCE

In the third quarter, the Fund fell 23.0% (Y class, USD) while the MSCI Golden Dragon Index fell 19.8% and the MSCI China Index fell 22.5%. Compared to the MSCI China Index, the Fund marginally underperformed. The main sources of underperformance came from:

- Stock selection within Industrials - property exposure (Lesso and Sany) and Lead Intelligent (electric vehicle exposure).
- Overweight in Information Technology – the sector was the weakest in the quarter, falling 30%. However the following stocks we hold outperformed the sector – Venustech (down 4%), Elite Material (-11%), TSMC (-16%), Shenzhen H&T Intelligent (-27%) and Shengyi Tech (-27%). Only Xinyi Solar underperformed the sector, falling 31%.

Areas which aided the Fund's performance in the quarter:

- Underweight in Communication Services – driven by the underweight position in Tencent. As of 30/09/22, Tencent accounted for 12.2% of the MSCI China Index. The Fund is run on an equally weighted basis and so each position has a neutral weight of c.3.2%. As Tencent underperformed the broad sector, the Fund captured less of the downside.
- Underweight in Materials – the Fund has no exposure.
- Good stock selection within Consumer Discretionary – underweight in Alibaba (same reasoning as Tencent above). The Fund does not hold Meituan and Nio because historically they have not been able to achieve a cash return on capital above the cost of capital for an extended period of time.

Year-to-date, the Fund has fallen 32.2% (Y class, USD) while the MSCI Golden Dragon Index has fallen 31.3% and the MSCI China Index has fallen 31.2%. Compared to the MSCI China Index, the Fund has marginally underperformed. The main sources of underperformance have come from:

- Overweight in Information Technology – the sector has been the weakest year-to-date, falling 48%. However the stocks we hold in aggregate outperformed the sector, driven by Xinyi Solar (down 38%), Venustech (-38%) and TSMC (-40%). Shengyi Tech (-48%) and Elite Material (-48%) fell in line while Shenzhen H&T Intelligent marginally underperformed, falling 51%.
- Stock specific within Industrials – property exposure (Lesso and Sany), Lead Intelligent (electric vehicles), Nari (grid automation), Inovance (high-end manufacturing).

Areas which have aided the Fund's performance year-to-date:

- Underweight in Communication Services – underweight in Tencent.
- Good stock selection in Consumer Discretionary – underweight in Alibaba (same reasoning as Tencent above). The Fund does not hold Meituan and Nio because historically they have not been able to achieve a cash return on capital above the cost of capital for an extended period of time.

CHANGES TO THE PORFOLIO

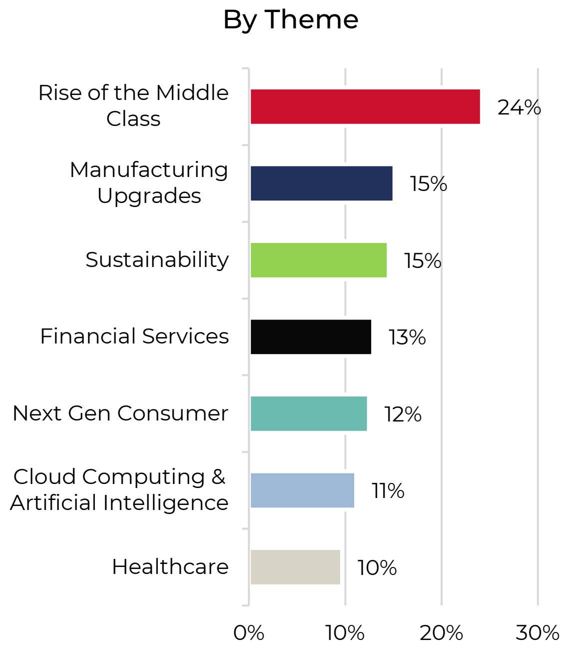
We sold China Lesso, a manufacturer of plastic pipes used in infrastructure projects and the real estate industry. It unexpectedly omitted the dividend and announced an expansion into the solar business where it has no expertise. We do not see how the existing business gives Lesso a competitive advantage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

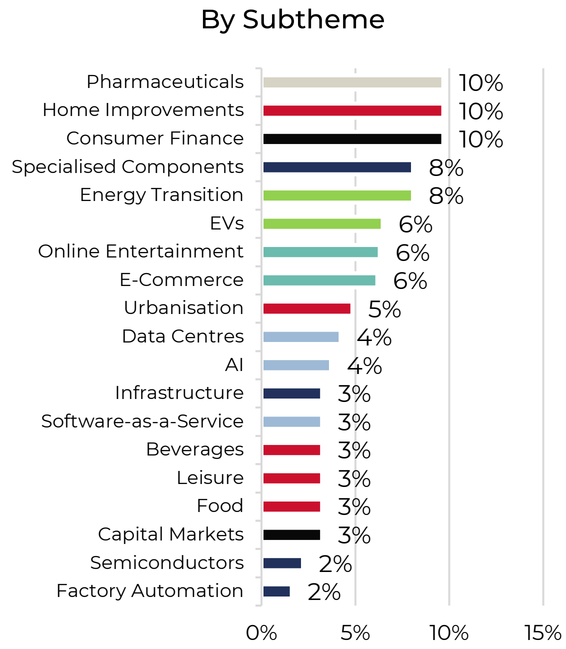
We also sold China Lilang, a clothing retailer targeting the men's casualwear segment. Given repeated Covid outbreaks in China, sales in the physical stores which make up most of revenue have been weak. Liquidity in the stock has also declined in the past year and for both of these reasons, we exited the position.

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 or more years, 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.

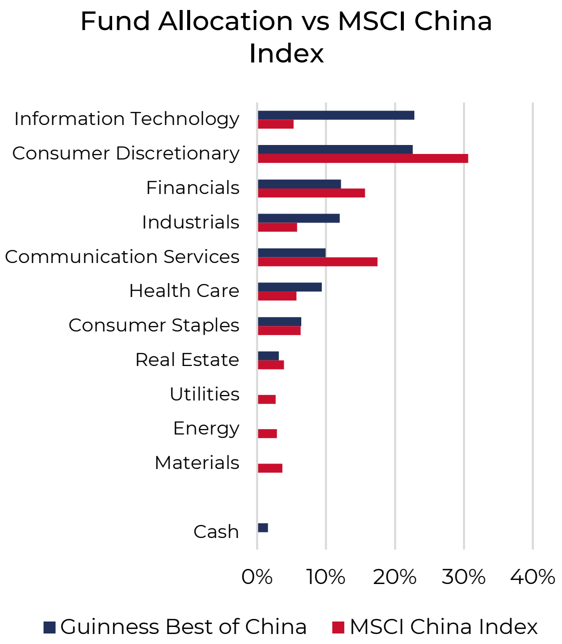


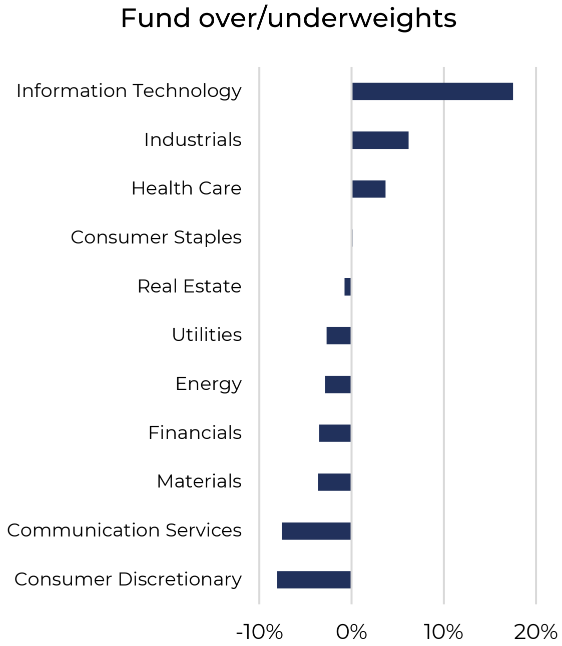


(Data as of 30/09/22, source: Guinness Global Investors calculations. Data assumes each position is equally weighted)

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 Information Technology 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.

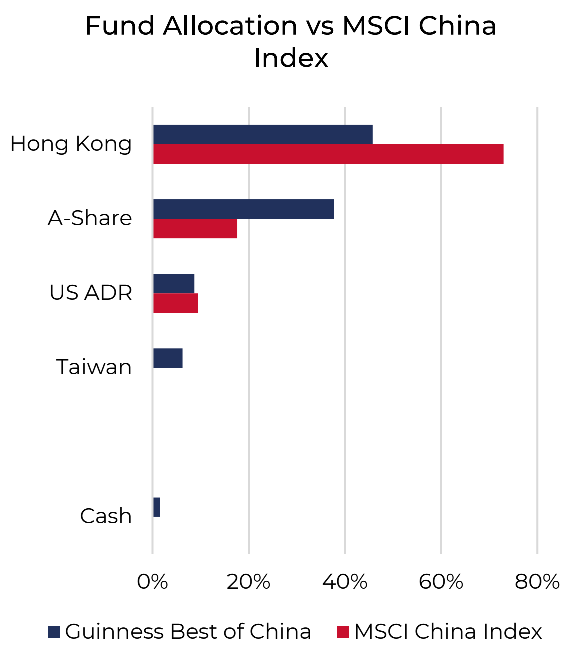
- Cybersecurity – Venustech, one of China's largest providers of cybersecurity services.
- Solar – Xinyi Solar, world's largest supplier of glass used in solar panels. Hangzhou First Applied, world's largest supplier of solar film.
- Semiconductors – TSMC, the world's largest foundry business.
- Copper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

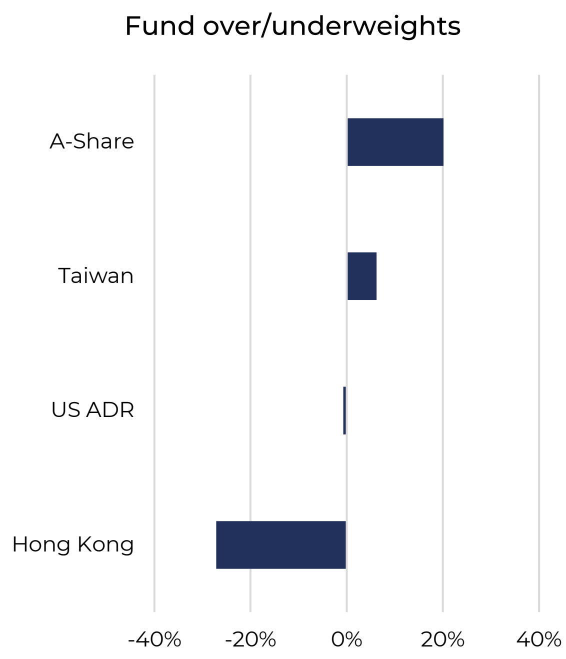




(Data as of 30/09/22, source: Bloomberg, Guinness Global Investors calculations)

On a listing basis, the Fund has 46% exposure to stocks listed in Hong Kong, 38% exposure to the A-share market, 9% in China ADRs trading in the US, and a 6% allocation to Taiwan.



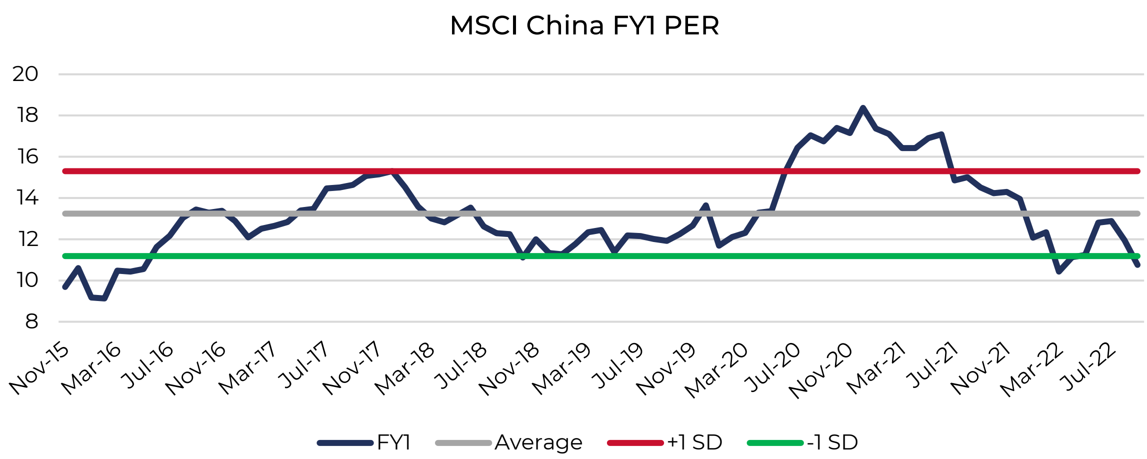


(Data as of 30/09/22, source: Bloomberg, Guinness Global Investors calculations)

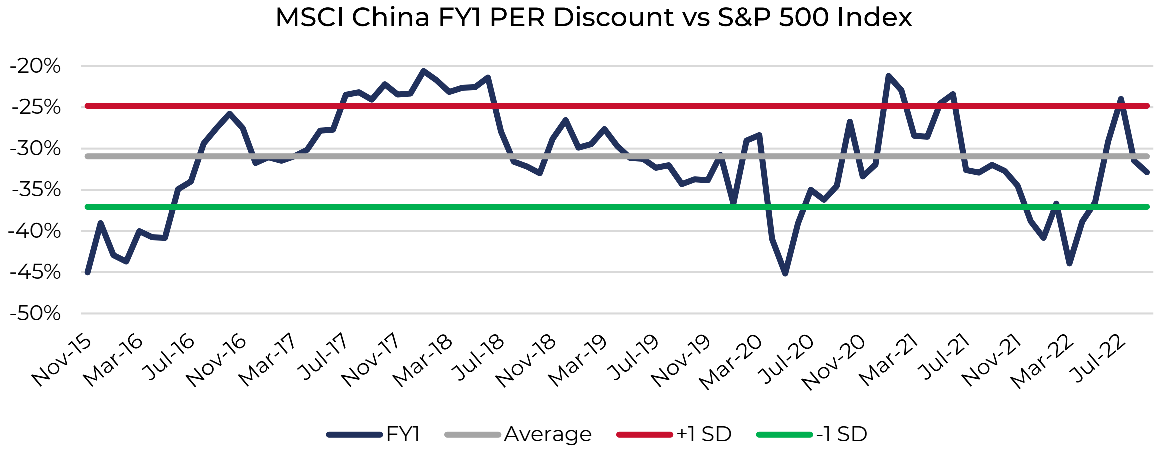
WHY INVEST IN THE FUND TODAY?

We emphasise that we focus on total shareholder return, which is broken down into changes in valuation multiples, earnings growth and the dividend yield. For this portfolio, which invests in growing companies, valuations and earnings growth are most important.

Given the headwinds China is facing, valuations for the broader Chinese market have now dropped to levels last seen during the US-China trade war. Compared to developed markets, which are trading at above their historic average, we think China's low valuation is attractive. As of 30/09/22, MSCI China was trading at 11.2x on a one-year forward looking price/earnings (P/E) basis, well below the S&P 500 at 16.7x. One may fairly argue that China often trades at a discount to the US, so we also show MSCI China's historical discount to the S&P 500. As of 30/09/22, MSCI China was trading at a 33% discount to the S&P 500, which is around its long-term average discount.

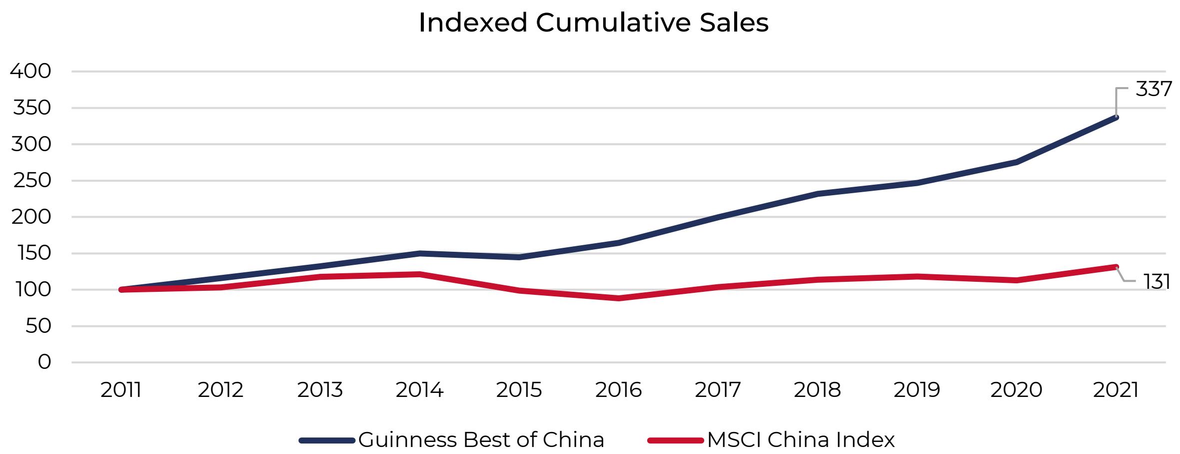


(Data from 30/11/15 to 31/09/22, SD refers to standard deviation. Source: Bloomberg, Guinness Global Investors calculations)



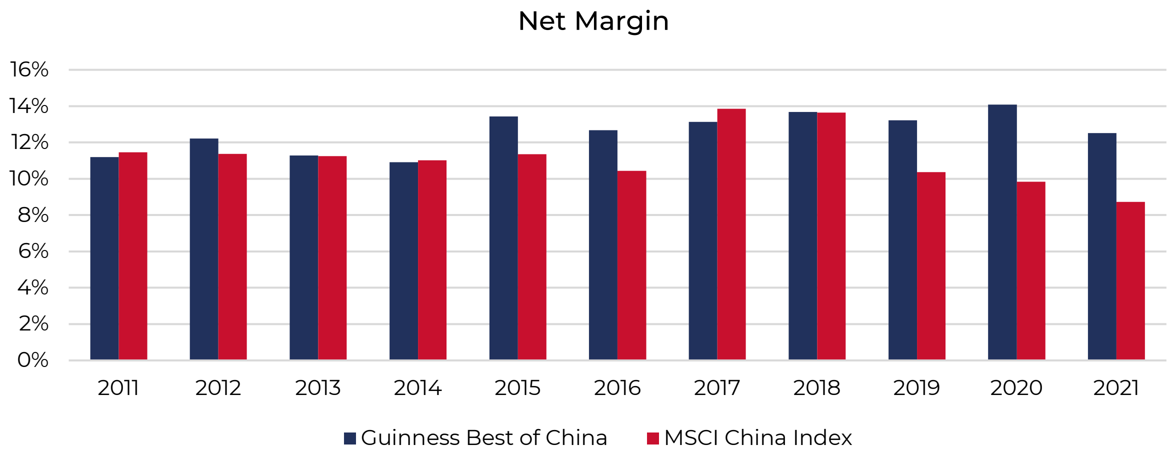
(Data from 30/11/15 to 30/09/22, SD refers to standard deviation. Source: Bloomberg, Guinness Global Investors calculations)

But low valuations are not enough on their own to justify an investment into the Fund. Over the long term, we believe it is earnings growth which drives shareholder return. Our focus on structural growth themes means the Fund's current holdings have, over the past 10 years, grown sales at a much higher rate than the broader market. (Note for the cumulative calculations for the Fund, we look at the aggregate sales growth of the current holdings over the past 10 years. When calculating the aggregate sales growth for the MSCI China Index, the holdings and weights change each year, so the companies whose 2021 sales are calculated are different to those whose 2011 sales are calculated). Below we show that the aggregate sales of the Fund's current companies over the last 10 years have grown by a total of 237%. This is much higher than the 31% aggregate sales growth of companies in the MSCI China Index.



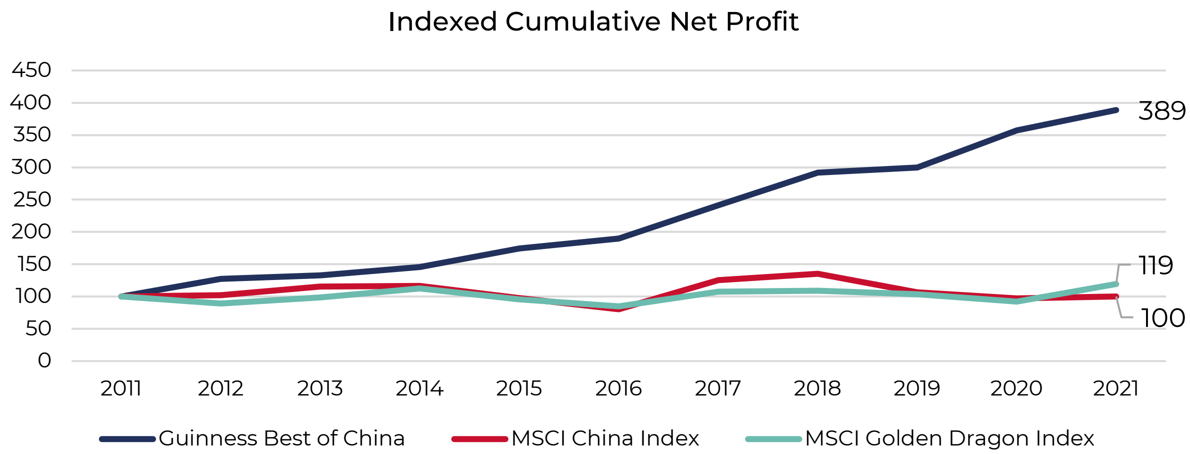
(Data as of 30/09/22, sales in USD, source: Bloomberg, Guinness Global Investors calculations. Data for Guinness Best of China is a simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015)

Now we must look at margins to see if the Fund's higher sales growth translates to earnings growth. Since 2015, the Fund's net margins have remained stable, whereas for the broader market, margins have been volatile. We point out that since 2017, MSCI China's net margins have fallen by 5.2 percentage points whereas for the Fund, the drop has only been 1.4 percentage points.



(Data as of 30/09/22, sales in USD, source: Bloomberg, Guinness Global Investors calculations. Data for Guinness Best of China is a simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015)

The aggregate net income of the Fund's current companies, over the last 10 years, has grown by 289%. This compares to essentially no growth in the aggregate net income of the companies in the MSCI China Index. We believe the Fund has superior growth because of our focus on structural growth themes and because the Fund's net margins have been stable over the past 10 years, whereas for the MSCI China Index, net margins have fallen significantly. This is no coincidence; it is an outcome of our disciplined process. From time to time, some commentators argue China is not investable because of the lack of long-term earnings growth in the broader market. We agree that the earnings growth of the broader market is poor, which is what makes the Fund so attractive. We are not investing in the broader market – we are investing, with high conviction, in a set of well-run companies which give exposure to the structural growth themes in China. This has resulted, as we have shown, in a very different set of outcomes for the Fund.



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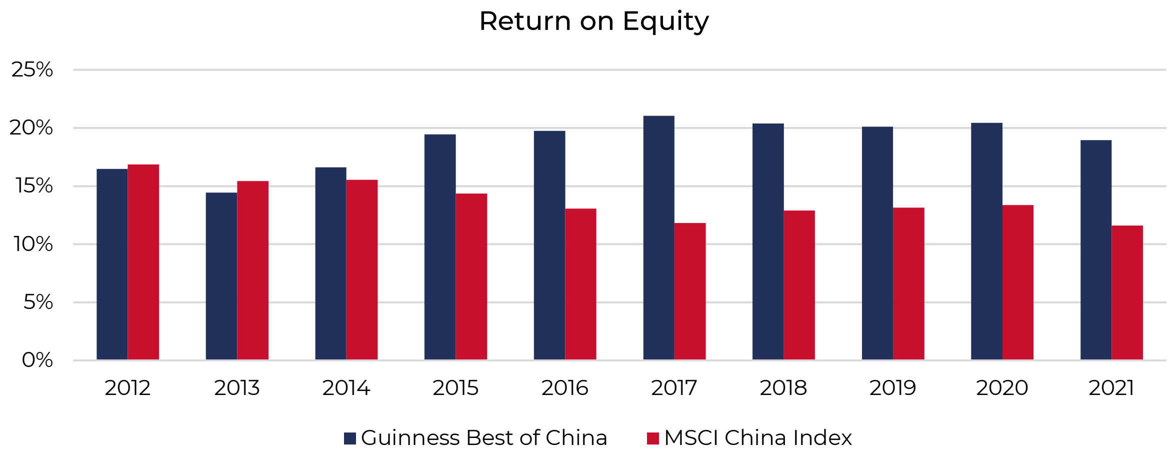
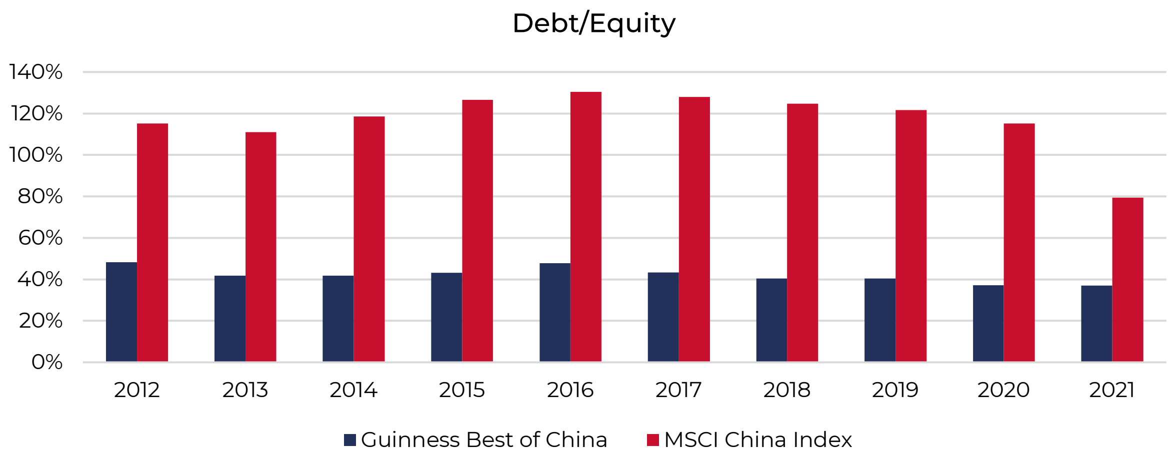
As a result of the process's focus on quality, since 2015 the Fund's holdings have had a much higher aggregate return on equity (ROE) than the broader market. Furthermore the Fund's ROE has been relatively stable while that of the broader market has fallen. In 2021, the Fund's ROE was 19% compared to MSCI China which had a ROE of 12%. So not only have our companies grown sales and earnings at a faster rate than the market, but they are doing so more efficiently. This is because each dollar of equity has generated a significantly higher return compared to the broader market.



(Data as of 30/09/22. Source: Bloomberg, Guinness Global Investors calculations. Data for Guinness Best of China is a simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015. Return on Equity refers to trailing 12 months net income / average total common equity)

Leverage can boost a company's ROE, as taking on debt reduces the need to raise equity. So we also show the debt/equity ratios for the Fund's current holdings over the past 10 years as well as that of the MSCI China Index. The chart shows that for the past decade, the Fund's debt/equity ratio has hovered around 40%. This is significantly below the broader market, which has had a debt/equity ratio well above 100% for the majority of the period. We also show the Fund's net debt/equity ratio which subtracts cash from the debt for each company. The Fund has persistently had a negative net debt/equity ratio. This means our companies, in aggregate, have enough cash on the balance sheet to theoretically pay back all of their debt. This is in stark contrast to the broader market – in 2021 the net debt/equity ratio was -19% for the Fund vs 30% for the market.



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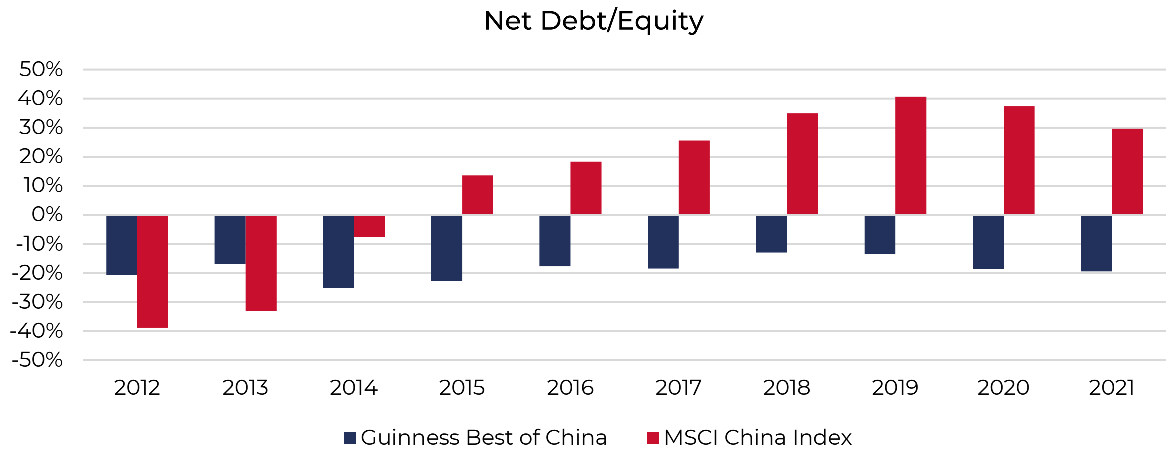

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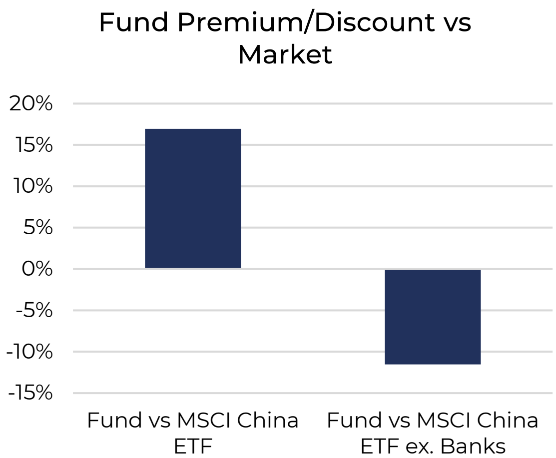
In summary, we have shown the Fund is invested in quality, profitable companies which have compounded earnings over time, at a much more efficient rate than the market. This set of companies is trading at one of its cheapest valuations in recent years. As of 30/09/22, The Fund was valued at 13.8x on estimated 2022 earnings, which put it at a 17% premium to the MSCI China ETF, which was valued at 11.8x. However, we point out that banks make up 10.0% of the ETF and given the very low valuation of the banks (3.6x), they distort the valuation of the market. We estimate that the valuation of the ETF excluding the banks was 15.6x, which puts the Fund at a 12% 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 6.4x, which puts it a premium of 78% relative to the broader bank industry.



(Data as of 30/09/22. Source: Bloomberg, Guinness Global Investors calculations. MSCI China ETF refers to the iShares MSCI China ETF (MCHI US))

OUTLOOK

Due to China's zero-Covid policy, the market is trading at a cheap valuation relative to history. We argue current valuations reflect current sentiment and the debate is whether they reflect future outcomes. 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, demand for Chinese stocks would likely increase, leading to a valuation re-rating. The operating environment would be better for companies, which is more supportive for earnings growth. We argue China is cheap as today's valuations do not reflect likely future outcomes and so we argue investors should be considering it closely. The investor who waits for China to move away from its zero-Covid policy before investing in the country is likely to miss the valuation re-rating which would occur the moment China announces a change in policy.

Though there are risks with investing in China, we argue we have a disciplined process which steers investors away from these risks. Through this process we invest in high-quality, growing companies which give exposure to the structural growth themes in China, a style Guinness has been using across the business for some time. This process results in a Fund whose holdings have historically grown sales and earnings at a premium to the broader market, at a much higher return on equity. We follow a valuation discipline to make sure we do not overpay for this growth. We believe our systematic approach gives investors a solution which results in outcomes which are superior to the broader market.

Portfolio Managers

Edmund Harriss

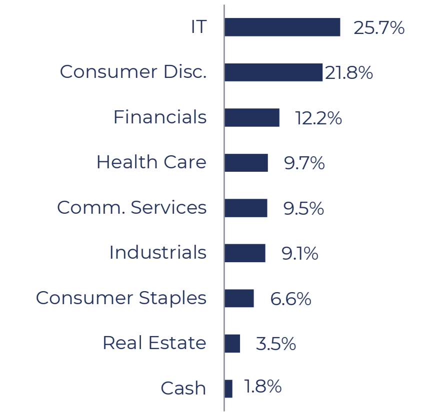
Sharukh Malik

PORTFOLIO

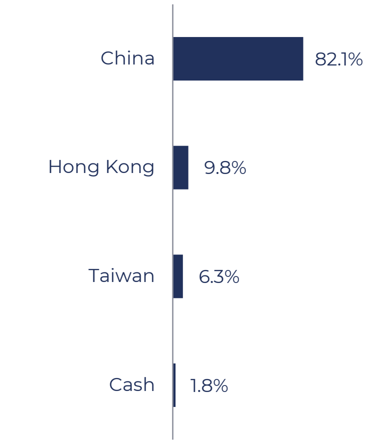
Fund top 10 holdings

Venustech Group	4.0%
China Overseas Land	3.5%
Haier Smart Home	3.4%
Inner Mongolia Yili Industrial	3.4%
NetEase	3.4%
Sino Biopharmaceutical	3.4%
CSPC Pharmaceutical Group Ltd	3.3%
Elite Material	3.3%
Alibaba Group	3.3%
JD.com	3.3%
% of Fund in top 10	34.2%
Total number of stocks	31

Sector analysis



Geographic allocation

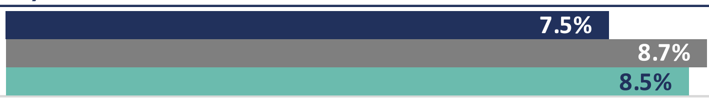


PERFORMANCE

Past performance does not predict future returns **30/09/2022**

Annualised % total return from launch (GBP)

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



Discrete 12m % total return	Sep '22	Sep '21	Sep '20	Sep '19	Sep '18	Sep '17
Fund (GBP)	-13.9	6.2	13.4	-0.5	-0.4	26.8
MSCI Golden Dragon Index (GBP)	-18.6	1.0	22.3	2.9	4.2	22.4
IA China/Greater China sector average (GBP)	-19.7	1.6	26.8	4.8	2.7	23.1
Fund (USD)	-28.7	10.7	18.9	-6.0	-3.2	30.8
MSCI Golden Dragon Index (USD)	-32.6	5.3	28.3	-2.8	1.2	26.4
IA China/Greater China sector average (USD)	-33.6	6.0	33.1	-1.0	-0.2	27.1

Cumulative % total return	YTD	1 Yr	3 Yrs	5 Yrs	Launch
Fund (GBP)	-17.7	-13.9	3.7	2.8	63.2
MSCI Golden Dragon Index (GBP)	-16.6	-18.6	0.5	7.7	76.3
IA China/Greater China sector average (GBP)	-17.4	-19.7	3.5	11.4	73.7
Fund (USD)	-32.2	-28.7	-6.1	-14.6	20.9
MSCI Golden Dragon Index (USD)	-31.3	-32.6	-9.0	-10.4	30.8
IA China/Greater China sector average (USD)	-31.9	-33.6	-6.3	-7.3	28.9

RISK ANALYSIS

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	0.01	-0.52
Beta	1.00	0.98	0.97
Information ratio	0.00	-0.05	-0.13
Maximum drawdown	-33.27	-37.41	-29.49
R squared	1.00	0.92	0.85
Sharpe ratio	0.28	0.24	0.19
Tracking error	0.00	5.38	7.40
Volatility	17.94	18.41	18.92

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

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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/

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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.