Managers	Funds
 **Edmund Harriss** (manager)	**Guinness Asian Equity Income Fund** Invests in Asian companies with persistently high return on capital, that are well placed to pay a sustainable dividend into the future.
 **Mark Hammonds** (manager)	**Guinness Best of China Fund** Invests in companies benefiting from exposure to economic expansion and demographic trends in China.
 **Sharukh Malik** (analyst)	**Guinness Emerging Markets Equity Income Fund** Invests in dividend paying companies in Emerging Markets world-wide.

The Reality of Tariffs – July 2018

At the beginning of July, the US fired its opening salvo in its trade dispute with China and introduced a 25% tariff on $34bn of Chinese imports, with tariffs on another $16bn due to follow. The US is now planning to impose a 10% tariff on $200bn worth of Chinese imports, with the potential of more to come. Many are now becoming concerned over the impact of these tariffs not only on the Chinese and US economy but also on global growth.

In 2017, China's exports of goods totalled $2.3 trillion and its imports were $1.8tn. The largest trade partner in 2017 was the United States, which according to US Census Bureau data received $506bn of Chinese exports and in return sold goods to China worth $130bn. While China has an overall trade surplus with the world of $420bn, the US runs a trade deficit of $375bn.

The focus of the trade dispute was initially on the trade imbalance between the US and China which has been above $250bn per year for the past 10 years. The US's complaints were mainly directed at unequal access to China's domestic market and the appropriation of foreign technology along with insufficient protection for intellectual property rights. As the dispute has continued, however, the complaints have extended to China's industrial policy and its level of state involvement – issues which cut to the heart of China's effort to wean itself off debt-fuelled state investment and move towards more advanced industrial manufacturing. This makes the task of resolution much harder to achieve.

The question of what the US actually wants is tricky to unpick. Donald Trump was elected President with the promise of a protectionist stance and he knows he must deliver. Mid-term Congressional elections are approaching, which make it even more pressing for him. However, there is more to the matter than just Donald Trump. The harder line against China enjoys bi-partisan support in Congress, something which very few issues achieve. US foreign policy appears to be shifting from one of engagement to containment. There are two powerful themes at work in the US: the free-traders point to the benefits to investment and consumption through globalisation and lower prices; the American worker counts the cost of globalisation in terms of lost jobs and stagnant wages – not everyone participates equally.

The direct impact on China is likely to be limited because the country is no longer as dependent on exports as it used to be. At their peak, exports of goods and services in 2006 were worth 36% of China's GDP or around $1 trillion. In 2017 China exported $2.3tn, but this represented only 20% of GDP, a much smaller proportion because China's economy is many times larger. The overall impact of the potential upcoming tariffs is a 6.5% increase in overall tariffs on $250bn of exports to the US which it is estimated could reduce exports by 8%-10% and shave 0.2% off GDP growth. Job losses in China as a direct result are estimated to be around one million. The harder part of the analysis comes in trying to assess the wider implications in terms of the effects on business and consumer confidence. Much of this depends on what China's response will be. Will it continue to counter with its own tariffs? On top of the $250bn it has already targeted, will the US impose tariffs on the remaining imports from China? If the situation were to escalate, the impact on China's and the US's growth rates will become more significant, along with a reduction in global growth. It is worth noting that the US administration has not targeted certain sectors at all. Toys, apparel and smartphones have remained unscathed so far because if tariffs were to be imposed, consumers would most likely be affected immediately through higher prices. The US has targeted intermediate goods and household items such furniture and fixtures where it is likely that the burden of the tariff could be shared by both manufacturers and consumers.

There is also the potential for tariffs to inadvertently affect American companies. Data from China's customs department shows 70% of the largest 100 companies exporting to the US are foreign, with Taiwanese and overseas divisions of American companies (including joint ventures) the largest in this group. The case of plastic injection moulding machines is a good example to illustrate the effect of collateral damage. Tariffs have already been introduced in this industry and their intended targets are Chinese manufacturers such as Haitian International and Chen Hsong. But Engel, an Austrian company that manufacturers certain ranges of its products in China, is likely to be subject to the tariff. Milacron Holdings is a US company that should benefit but may end up paying more for intermediary components made in China. Given how integrated China is in global supply chains, it is very likely that US firms in the manufacturing sector will face disruption in one way or another. This dynamic represents leverage for the Chinese to negotiate with.

China has the capacity to respond to tariffs but it is restricted in how it can do so. The US exported $130bn of goods in 2017 to China. Having already introduced tariffs on $50bn, China only has $80bn of US trade to put tariffs on. There are, however, other ways China can respond. China can make life difficult for US companies operating in the country by increasing the amount of red tape businesses face or the amount of time goods are held up at customs. Although in our view it is a measure of last resort, the government can whip up anti-American sentiment and encourage a boycott of American goods, which it did in recent disputes with Japan and South Korea. Large consumer-facing American companies that have significant exposure to China include:

- Apple, which derives 20% of its revenue from the region and manufactures virtually all of its iPhones in Asia
- 27% of Starbucks stores are in the China/Asia Pacific region, which has much faster growth in sales compared to the US
- Nike derives 12% of its revenue and 30% of its earnings from Greater China; much of its manufacturing base is in the region

The business lobby in the US will no doubt be voicing its concerns to the US administration and this will be a factor in determining the next steps forward.

Finally it is worth comparing the rhetoric over trade with the reality in terms of earnings growth. We are still seeing decent earnings growth for the Asia Pacific ex Japan region, with forecast earnings growth of 10% for 2019. Having traded more than one standard deviation above its historic average on a forward basis, the region is now trading at 13.5x FY1 earnings – in line with the historic average. On a relative basis the region is still looking cheap versus the S&P 500, trading at a 22% discount – nearly one standard deviation below the historic average. The Guinness Asian Equity Income Fund is even more attractively valued, trading at a further 7% discount to its benchmark on forecast earnings. In aggregate, the portfolio trades on only 11.9x 2018 earnings and 10.8x 2019 earnings, implying 10% earnings growth. The net yield of the portfolio at 3.9% is significantly higher than both the benchmark (on around 3%) and many other regions around the world. Given the compression in valuation multiples, we think now is a great opportunity to be buying into quality companies that are persistent cash generators.

Edmund Harriss, Manager, Guinness Asian Equity Income Fund

Fund managers

Edmund Harriss has managed Asian Funds since 1994 both from London and Hong Kong. He worked for ten years from 1993 for Guinness Flight, which merged with Investec in 1998. He joined the Far East Investment Desk in 1994 as part of the team managing the China & Hong Kong Fund (now the Guinness Atkinson China & Hong Kong Fund, for US investors). In 1998 he moved to Hong Kong and became the Fund's lead manager. Edmund now manages Asia funds and China & Hong Kong funds in a Dublin OEIC for Guinness Asset Management and SEC-registered funds (for US investors) for Guinness Atkinson Asset Management. Edmund graduated from Christ Church, Oxford, with a Master's degree in Management Studies and has a Bachelor's degree in History from the University of York. He is an Associate of the Society of Investment Professionals.

Mark Hammonds joined Guinness Asset Management as an investment analyst in September 2012. Previously he qualified as a Chartered Accountant at Ernst & Young. Mark graduated from Corpus Christi College, Cambridge, in 2007 with a First Class degree in Management Studies.

Sharukh Malik joined Guinness Asset Management as an investment analyst in October 2015. Sharukh graduated from Fitzwilliam College, University of Cambridge, in 2014 with a degree in Economics.

Guinness Asset Management

Guinness Asset Management provides a range of long-only actively managed funds to individual and institutional investors. Founded in 2003, Guinness is independent and is wholly owned by its employees.

We believe in in-house research, intelligent screening for prioritisation of research and well-designed investment processes. We manage concentrated, high conviction portfolios, with low turnover and no benchmark constraints. At heart Guinness is a value investor.

Since our establishment we have developed a variety of specialisms in global growth and dividend funds, global sector funds and Asian regional and country funds.

The Guinness funds sit within an Irish-listed OEIC. They are managed alongside a range of mirror SEC-registered funds offered to US investors by our US sister company, Guinness Atkinson Asset Management Inc.

We also offer Enterprise Investment Schemes investing in UK renewable energy projects and AIM-listed companies.