THE CASE FOR DIVIDEND INVESTING IN ASIA

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CONTENTS

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INTRODUCTION

The UK has traditionally been a popular market for dividend investing. Since 2014, the MSCI UK Index has consistently yielded over 4%, providing a regular source of income for investors. In contrast, the Asia region has been more associated with growth because companies have chosen to reinvest profits rather than distribute them.

This paper seeks to show how Asia has become an important destination for income investors. Asia's contribution to the world's dividend pool has grown over the past 15 years; the region accounted for approximately 15% of dividends paid out globally in 2018. Moreover, in considering the sources of this income – from countries, sectors, and individual companies – we will contend that a UK investor should consider Asia for their income portfolio because it provides not only regional diversification but also diversification across different countries and sectors.

Asia's contribution has accounted for approximately 15% of dividends paid out globally in 2018.

THE CASE FOR DIVIDEND INVESTING IN ASIA

There are three main reasons as to why dividends form an integral part of an investment strategy. Firstly, reinvested dividends account for a significant component of total returns. Secondly, dividend payments play an important role in a company's capital allocation decision. Thirdly, a reliable and supported dividend stream can help to reduce the downside risk to the share price.

TOTAL RETURNS

The reinvested dividend component of the total shareholder return (the other being price appreciation) is often the most significant component over time. **Figures 1 to 3** display the total returns – separated into returns from reinvested dividends and price appreciation – that an investor would have received from an investment made in 2003 in Asia, the UK, or Europe respectively.

It is important to note that it is the discipline of reinvesting the dividends - investors increasing their capital invested in a company, in order to benefit from future price appreciation - that leads to this powerful compounding effect.

CAPITAL ALLOCATION

In our view, a company's commitment to a dividend policy provides tangible evidence of disciplined capital allocation. Management must decide how much capital is required by the business to operate and grow and how much to return to shareholders. A disciplined approach to reinvestment tends to reflect a more selective approach to re-investment, making sustained profitability more likely.

A dividend policy stands as very visible evidence of this discipline, because dividend payments are typically regularised, and changes to the policy are immediately apparent. In this context, while share buy backs also represent a return to shareholders and may in some cases be more tax efficient, they are irregular and do not place the weight of a commitment onto management.

DOWNSIDE PROTECTION

The downside protection stocks offer comes not from the size of the payment but from an assessment of its sustainability. A profitable business that re-invests to grow profits and cash flows but generates more cash than it requires to fund that re-investment provides a solid base.

Those businesses with long track records of paying and growing the dividend, supported by cash flow growth, can engender confidence from investors that it will continue to be paid and are in the best position to afford investors downside protection.

Fig. 1: Total returns in Asia since 2003, in USD

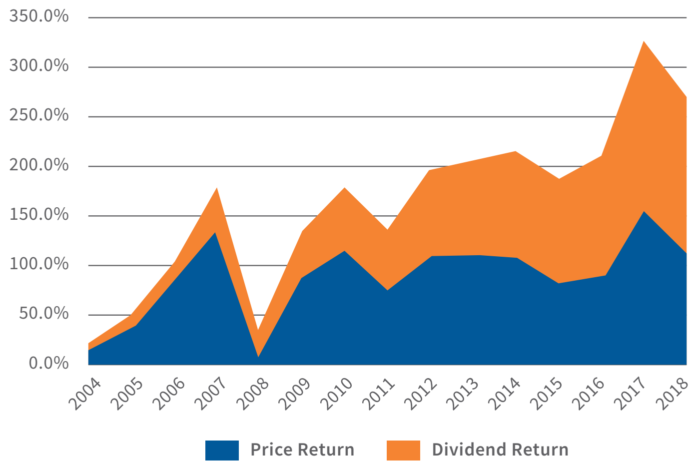


Fig. 2: Total returns in the UK since 2003, in USD

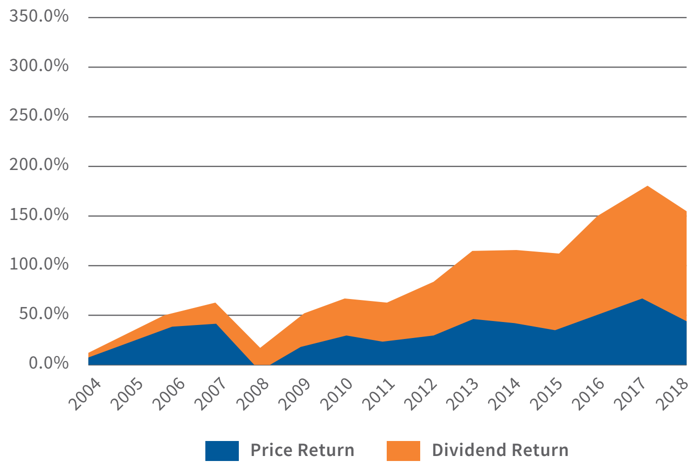
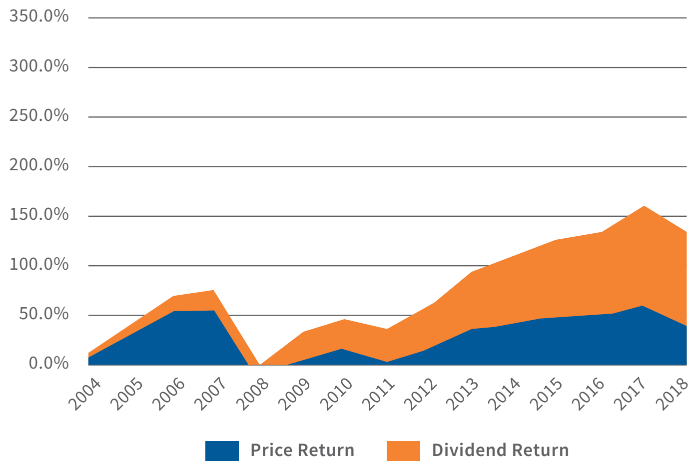


Fig. 3: Total returns in Europe since 2003, in USD



ASIA'S ECONOMIC RISE

The nature of Asia's economies has evolved significantly in the 21st Century. Emerging markets in Asia have shifted from being centres of commodity-led growth to become hubs of increasingly complex manufacturing. Additionally, as a result of rising prosperity, the goods they produce are increasingly consumed within the region.

As the prosperity of the Asian population has risen, so Asian companies have also undergone extensive change, especially since the 1997 Asian Financial Crisis. The most notable has been an improvement in capital discipline.

Prior to the crisis, many companies pursued top-line growth through high levels of reinvestment of profits, leading to diminishing returns. By 1995, average capital expenditure across developed Asia was 2.4 times the cost of depreciation and amortisation. With the onset of the Asian financial crisis in 1997 and its aftermath, this plummeted to 0.75x (i.e. companies shrank) and has since remained around a more sustainable 1-1.5x.

Fig. 4: GDP based on PPP (% global contribution)

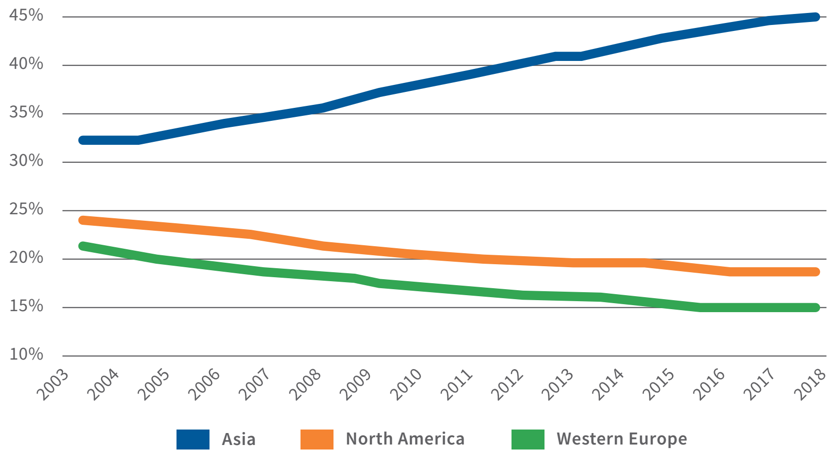


Fig. 5: GDP based on PPP (% global contribution)

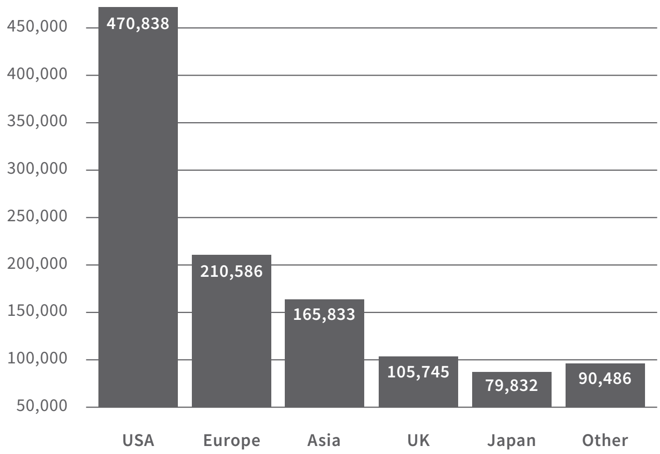
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Asia	32%	33%	33%	34%	35%	36%	37%	38%	39%	40%	41%	42%	43%	44%	45%	45%
North America	24%	24%	23%	23%	22%	21%	21%	20%	20%	20%	20%	19%	19%	19%	19%	19%
Western Europe	21%	20%	20%	19%	19%	19%	18%	17%	17%	16%	16%	15%	15%	15%	15%	15%
Eastern Europe	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	6%	6%	6%	6%
South America	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	5%	5%	5%
Middle East	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Rest of World	5%	5%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

ASIA AS A SOURCE OF DIVIDENDS

The Asia region has been the major driver of global economic growth over the past 15 years. Asia's contribution to GDP has increased from 32% in 2003 to 45% in 2018. Over the same period, North America and Western Europe's contribution has shrunk from 45% in 2003 to 34% in 2018.

Asia's dividend growth is a relatively recent and under-appreciated story. In 2018, $1.12 trillion of dividends were paid worldwide. The largest contributor to this by some distance was the USA, which paid out $470.8 billion of dividends, followed by Europe with $210.6 billion and then Asia with $165.8 billion. However, Asia's share of the total figure has risen significantly, from less than 9% in 2003 to nearly 15% of the world's total at the end of last year, as measured by the MSCI indices.

Fig. 6: 2018 dividends by region (US $m)



Since 2003, Asian gross dividend payments have seen a compound annual growth rate (CAGR) of 11.9%. When we look later at the region's different markets, it is evident that this growth is driven in part by a growing commitment to dividend distribution, but that it has primarily been driven by growth in earnings across emerging markets. This significantly outstrips 8.1% compound annual growth in gross dividends globally, 8.0% annual growth in the USA, and just 3.9% annual growth in the UK.

The graphs to the right compare Asia's dividend growth (in US dollars) with the other regions over the last 15 years, having rebased the indices to 100 in 2003. **Figure 10** shows the dividend growth of the MSCI Asia ex Japan Index plotted against the MSCI All Country World Index.

Asia's superior growth is evident, with its companies paying out over five times the dividend amount in 2018 than in 2003, compared to a growth of three times worldwide.

Figure 8 compares Asia's dividend growth with the United States, whose growth story is similar to the global one with 8% CAGR since 2003, but with a steeper trend over the last decade.

Fig. 7: Asia vs World

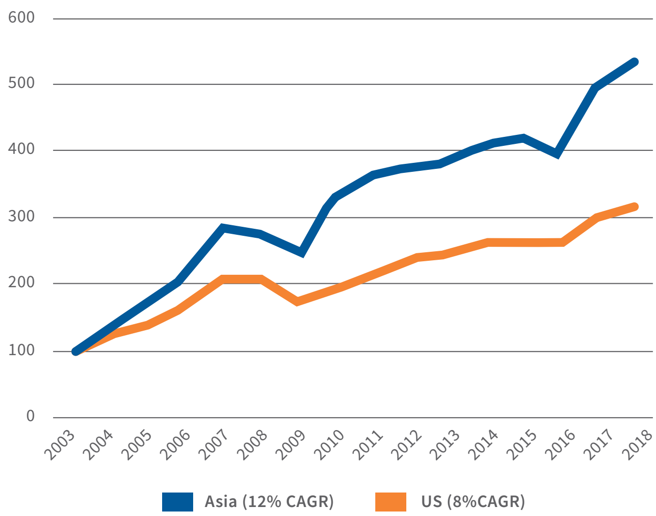


Fig. 8: Asia vs USA

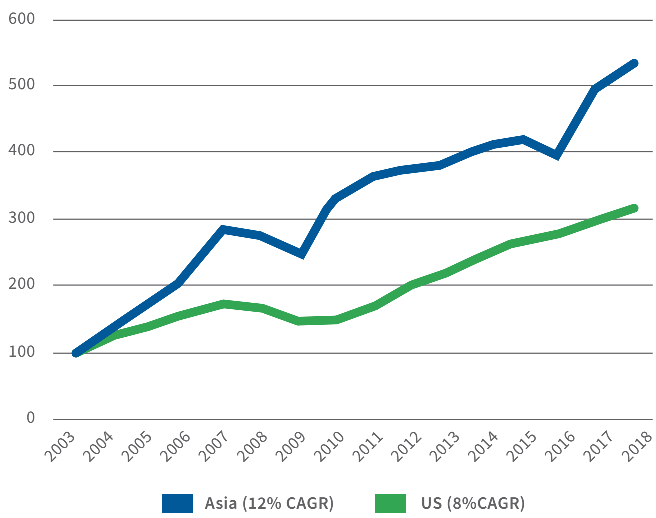


Figure 9 plots the growth of Asia against that of Europe (excluding the UK). It is apparent that Europe's dividend was hit hard by the Global Financial Crisis, only returning to pre-crash dividend levels at the end of 2017. The UK's growth trajectory has been even lower, experiencing only a 4% CAGR over the last 15 years, and seeing significant downturns beginning in 2008 and 2014.

Figure 9: Asia vs Europe

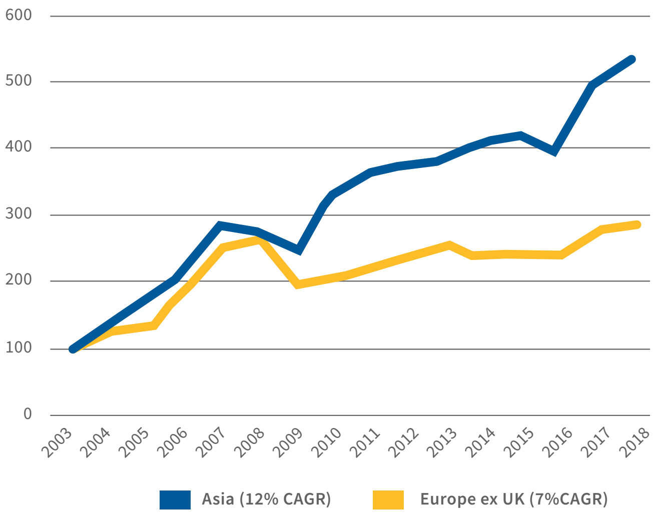


Figure 10: Asia vs UK

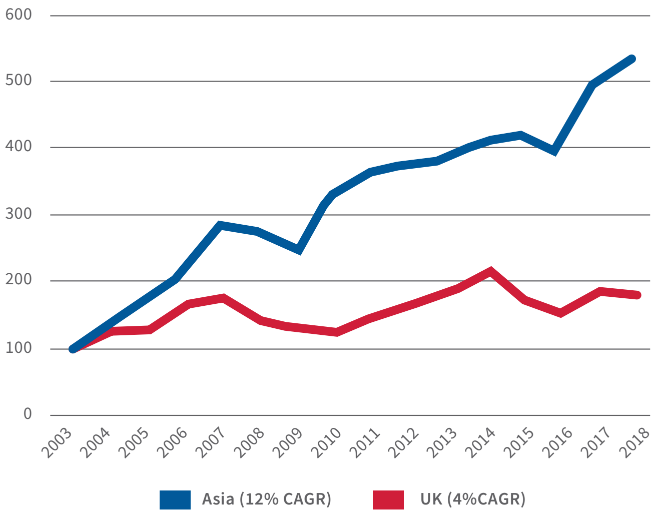
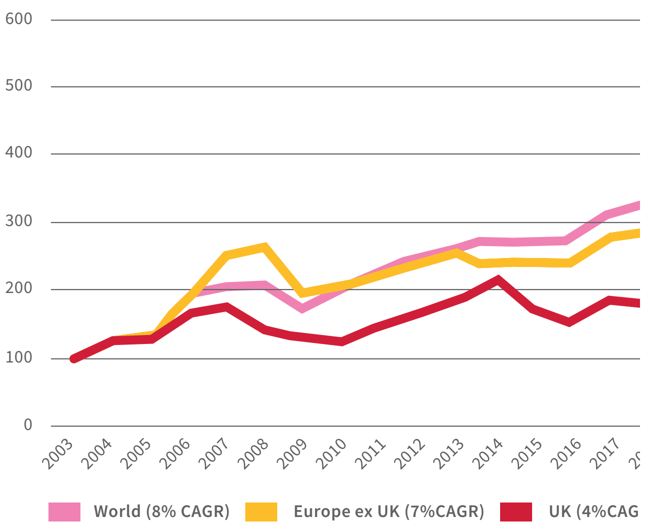


Figure 11: World vs Europe & UK



CURRENCY

Although the period shown above covers times of dollar strength and weakness, overall, currency had minimal impact on Asian returns. Looking at the total return from the end of 2003 to the end of 2018, the local currency version of the MSCI AC Asia Pacific ex Japan index returned 9.03% annually, versus the index measured in USD, which returned 9.11% annually. In other words, the currency effects have worked themselves out over time.

Currency movements can obviously impact an investor's returns—and we comment further on this subject in the methodology section—but for the sake of comparability, we calculate all of the long-term data in this paper in USD terms.

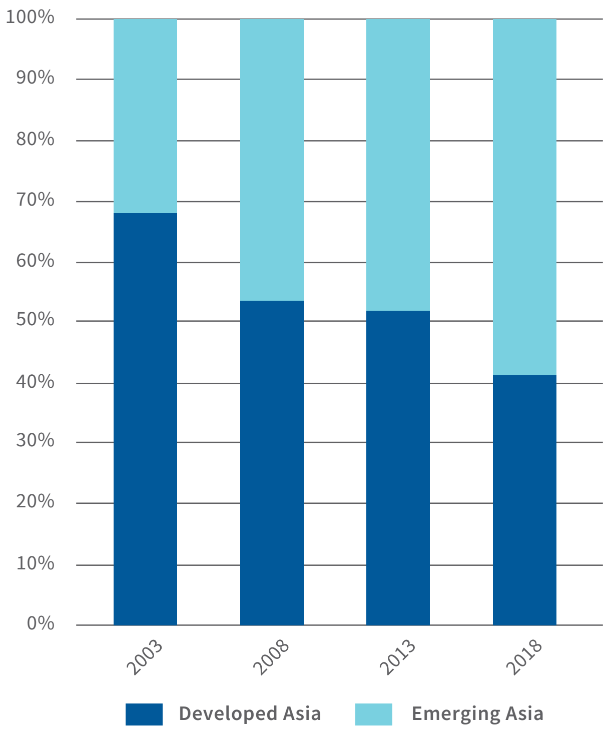
THE DIVIDEND LANDSCAPE IN ASIA IS EVOLVING

Asia combines established developed economies with burgeoning emerging markets. From a dividend perspective, this means that traditionally attractive markets such as Australia and Singapore continue to pay large amounts in dividends whilst emerging markets such as China and Taiwan drive rapid dividend growth. For an income-seeking investor, this is good news on two accounts: firstly, it suggests that dividends in the region will continue to grow; secondly, it means that the source of these dividends is increasingly diverse.

Whereas developed Asia (Australia, Hong Kong, New Zealand and Singapore) comprised 68% of dividends paid out by Asian companies in 2003, this figure had fallen to 41% at the end of 2018, with most of Asia's dividends being paid out by companies in emerging markets. As can be seen below, total dividends paid by developed Asia has stagnated over the last decade while those from Asia's emerging markets have increased nearly tenfold in 15 years.

China and Taiwan paid out USS3.25 billion of dividends in 2003, just 11% of Asia's total dividends paid. Over the last 15 years, established companies have increased their dividend distribution, driven in particular by large-cap companies such as China Mobile, China Construction Bank and TSMC (Taiwan Semiconductor Manufacturing Company). New companies have also been introduced to the market. By 2015, China and Taiwan paid out over a third of Asia's total dividends. Last year, they distributed US$63.0 billion of dividends, more than Australia and Hong Kong combined.

Figure 12: Dividend proportions



CHINA A-SHARES INCLUSION

As stated above, the indices do not capture all of China's public corporate sector. Domestically-listed, or 'A' shares have only been included in the MSCI emerging markets indices since the end of 2018. At present they only carry a 20% 'inclusion factor' (up from 5% when first included), meaning that their full weight in the index would be much higher than the […]% they currently occupy.

At the time of writing, MSCI has paused further increases in China A-shares inclusion, pending further reforms in the equity markets that will help improve access and ease of trading for international investors.

Assuming that China continues on the path of opening-up its financial markets to foreign institutions, we can assume that China will occupy a greater proportion of the total dividends paid by Asia as a whole.

Figure 13: Asia dividend contribution country breakdown

	2003	2008	2013	2018
Australia	48%	35%	37%	26%
Hong Kong	12%	12%	9%	10%
China	5%	12%	20%	22%
Taiwan	6%	18%	10%	16%
Rest of Asia	30%	22%	24%	26%
Total	**100%**	**100%**	**100%**	**100%**

Figure 14: 15-year developed vs emerging Asia dividend growth

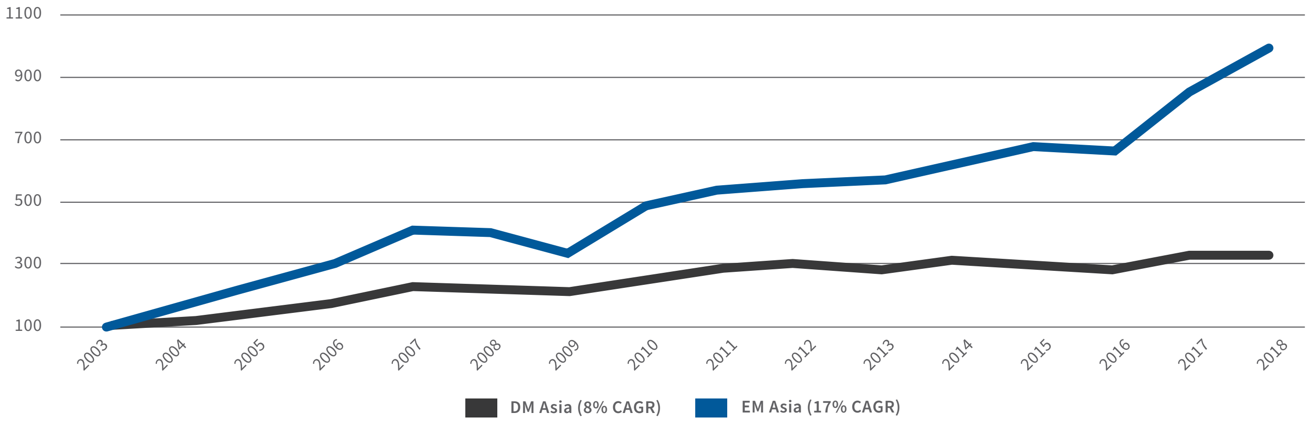


Figure 15: Asia dividend contribution country breakdown

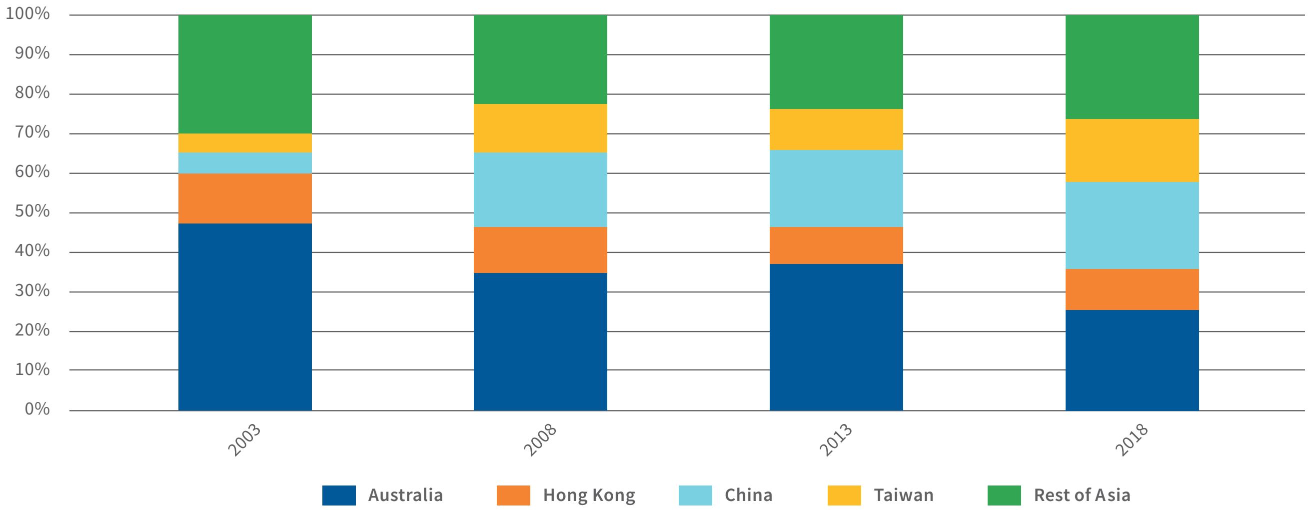
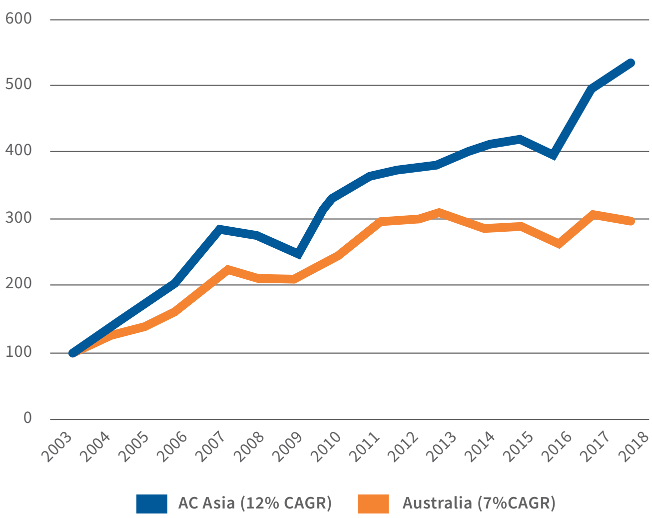


Figure 16: Australia's growth has plateaued in the last few years



Other emerging market countries contribute to the growing share of total dividends, although they are still small in scale. Certain companies in India (4.1% contribution), Malaysia (2.4%), Thailand (2.2%) and Indonesia (1.7%) can also provide geographical diversity for an investor wary of a portfolio of stocks from only two or three countries.

By contrast, Australia's dividend payments have plateaued in the last few years. It still contributed 26% of Asia's dividend payments in 2018, but this has decreased from 47% in 2003. Dividends from Australia peaked at US$45 billion in 2012 and have changed little over the last six years.

PAYOUT RATIOS VARY ACROSS COUNTRIES

The proportion of earnings paid out as dividends (the payout ratio) varies widely across the region. Overall, Asian companies paid out 41% of their 2018 earnings, consistent with average over the last decade.

The proportion of earnings paid out as dividends (the payout ratio) varies widely across the region. Overall, Asian companies paid out 41% of their 2018 earnings, consistent with average over the last decade. When we look at payout ratios for individual countries, we need to be aware that some markets are dominated by one or two companies (Tencent and Alibaba in MSCI China or Samsung Electronics in MSCI Korea), which influences the analysis. We also need to bear in mind that the constitution of some indices has changed substantially over time. In the MSCI China Index technology and financials accounted for 59% up from less than 5% in 2003.

Since 2009, Australia has on average paid out 86% of its earnings as dividends. It has long had a culture of high dividends because of the large number of superannuation funds that demand income and because of its dividend franking system, which eliminates the issue of double taxation (at the company and investor level).

However, the 86% average is skewed upwards by outlier years – 2009, 2015 and 2016 – which saw large swings in commodity prices, resulting in dividend payments outstripping earnings. Excluding the outliers, the average payout ratio over the last decade has been 71%, matching the ratio for 2018.

The two other significant developed markets for dividends in the region are Hong Kong and Singapore. Over the past 10 years, Hong Kong companies have paid out 34% of their profits but this has increased to 40% in recent years. The best dividend growth has been found in consumer and industrial segments. Their ten year average payout ratios differ at 34% and 49% respectively, but both markets see dominant contributions from the Financial and Real Estate sectors. Hong Kong's Utilities companies are also high paying low growth businesses.

China's payout has ranged between 29% and 32% over the last decade. 31% of profits were distributed in 2018. For investors, lack of growth in the proportion paid out has been more-than-offset by an earnings pool that has risen 4.6 times (16.6% per annum, on average) over the same period. This expanded profit pool has been driven by the increased scale of operations in China's banking and insurance sectors as well as by new arrivals in the communications services and consumer discretionary areas, with Tencent and Alibaba being the most obvious.

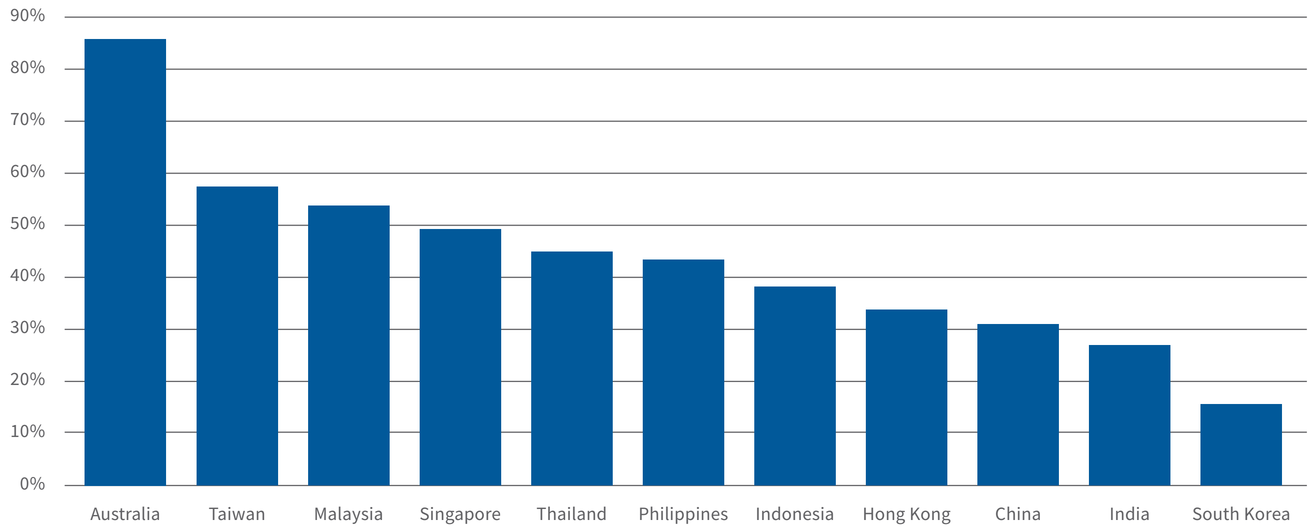
Payout ratios in Taiwan and Korea diverge significantly: Taiwan has paid out an average of 58% of earnings since 2009, Korea just 16%. Taiwan's regulatory environment encourages high distribution, because no withholding tax is charged on residents' dividends and a surtax is charged on undistributed profits. At the other end of the scale, Korea's Chaebols have traditionally had an aversion to dividends, preferring to maintain large cash reserves on balance sheets rather than distribute profits to minority shareholders. However, pressure to distribute more of the cash reserves is coming from the government and shareholders, with the country's biggest pension fund adopting a stewardship code to promote minor shareholder interests in 2018. From 2017 to 2018, the average payout ratio increased by five percentage points to 21%. The Korean Kospi 200 Index is expected to increase its dividends by 10% from 2018 to 2020, twice the growth rate of the Asia region.

India also has less of a dividend-paying business culture, but the average payout ratio has been increasing, from 21% in 2010 to 37% in 2018. The Securities and Exchange Board of India (SEBI) introduced new regulations in 2016 mandating the top 500 companies to disclose a dividend policy, another sign of regulatory pressure in the region. Although its dividends are still a small proportion of the overall region, they are well distributed across sectors, with significant income from Information Technology sector (primarily the IT consultants), which pays out around 40% of earnings, to Financials and Energy sectors distributing around 25% of earnings.

Out of the other constituents, Thailand and Malaysia have maintained a fairly consistent dividend payout, with a ten-year average of 45% and 54% respectively. The lion's share of Thailand's dividends comes from PTT, its state-owned oil company, whereas Malaysia's are most diverse in source.

Indonesian companies have gradually been distributing more earnings (ten-year average of 38%); the opposite can however be seen in the Philippines, where the payout ratio has been declined over the last ten years, from 50-60% to 30-40%, making it a less attractive market for income seeking investors.

Figure 17: Australia's growth has plateaued in the last few years



FINDING DIVIDENDS ACROSS SECTORS

As well as diversifying across countries, being able to diversify across sectors is a key requirement of a dividend investor's portfolio. In markets like the UK, however, where banks and extractive industries typically represent a significant proportion of dividends, this can be difficult to achieve. Mining companies alone accounted for over 11% of 2018 dividends.

For a UK-based dividend across developed and emerging Asia, investors can gain dividend exposure to a range of different sector sources, from world-leading technology companies in Taiwan and Korea to the ever-growing Asian consumer market across the continent.

In this section, we will consider our investment universe of around 350 companies we define according to their quality: that is, companies that have achieved persistently high returns on capital (above the cost of capital) for at least the past eight years.

We also require debt to equity to be no greater than one and a market capitalization of at least $500m. By looking at this universe of stocks on an equally-weighted basis, we remove some of the distortions caused by the market cap weighting of the index.

Although a dividend payment is not one of our criteria for the universe, it is remarkable that 94% of the companies in the universe distributed dividends in 2018. It is also worth noting that the average payout ratio of each sector's stocks in our universe is larger than that of the Asia region as a whole.

The only exception is Utilities, primarily because few stocks in that sector make it into the universe on account of their inconsistent return on capital. In aggregate, the companies in our universe paid out US$83.6 billion of dividends in 2018.

The largest contributors were Financials (38%), Information Technology (30%), Consumer Discretionary (15%) and Consumer Staples (11%). Consumer-based sectors and technology therefore allow an investor to diversify away from pure-play exposure to Financials. If we consider the companies that have a dividend yield of over 2%, the consumer sectors account for a third of dividends paid.

Figure 18: Average sector payout ratio

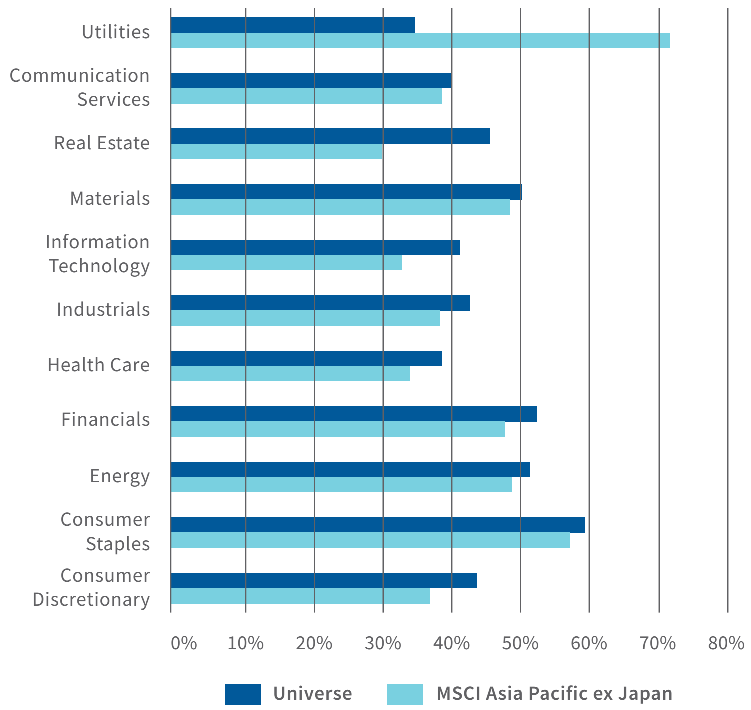
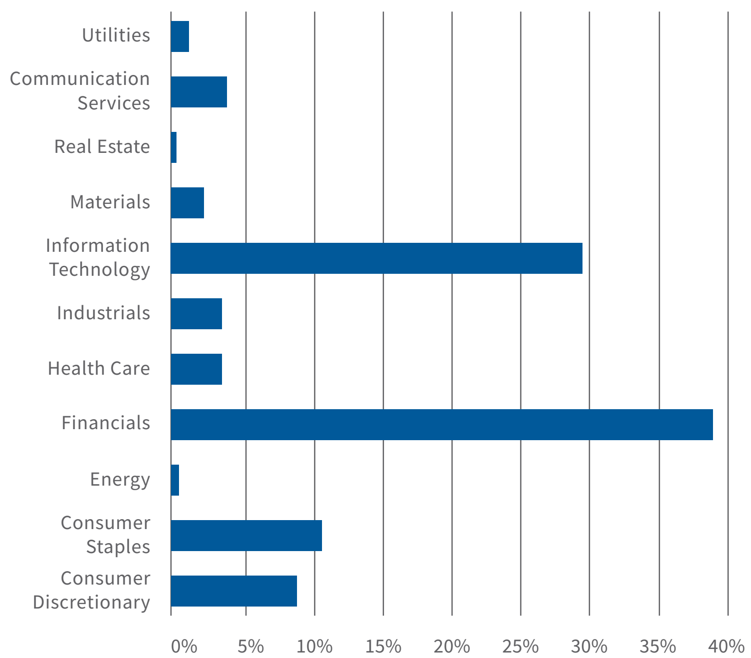


Figure 19: Universe dividend sector contribution



CONCLUSION

The Asia region now pays out 15% of the world's dividends, exceeding its 12.5% proportionate share of world market capitalisation. This figure will continue to rise as companies across the region distribute more of their profits and China's markets becomes increasingly accessible to foreign shareholders.

The dividend growth in Asia during this century has helped to enlarge shareholders' total returns, but it also provides an investor with evidence of improving company management and capital discipline. For a UK or European investor seeking consistent dividend returns, the Asia region now represents a critical market that diversifies their income away from the traditional European markets. This diversification can be found geographically from India to South-East Asia to Australasia; it can be found in western-influenced developed markets and rapidly growing emerging ones; and it can be found across sectors, from finance and real estate to consumer-driven industries and advanced technology and manufacturing. For investments that provide both growth and a steady source of dividends, an investor should consider Asia as an essential component of their strategy.

APPENDIX: METHODOLOGY & SCOPE

We have used data from the MSCI Global Investable Market Indices (GIMI), using the MSCI All Country World Index (ACWI) as our base index. The MSCI ACWI Index captures 2,852 large- and mid-cap companies across 49 countries – 23 Developed Markets (DM) and 26 Emerging Markets (EM) – covering approximately 85% of global investible equity opportunities.

It is then possible to break the ACWI index down into six broad regions: the UK, Europe (excluding the UK), North America, Japan, Asia Pacific (excluding Japan), and Emerging Markets (other than Asia). Asia Pacific (excluding Japan) includes both developed and emerging counties. Its constituents are Australia, Hong Kong, New Zealand and Singapore from developed markets and China, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Taiwan and Thailand from emerging ones. As of the end of 2018, China included a 5% weighting of onshore A Shares, which rose to 20% in November 2019 (although that will not be included in this paper). The majority of investible Chinese equities considered here are therefore offshore listings from Hong Kong and the USA.

In order to gain greater granularity within each region, we can sub-divide these indices. MSCI identifies eleven discrete sectors: Consumer Discretionary, Consumer Staples, Energy, Financials, Healthcare, Industrials, Information Technology, Materials, Real Estate , Communication Services , and Utilities. The regions can then be separated into their constituent countries.

It is necessary to acknowledge the shortfalls in this method. Firstly, we consider all stocks that are in the MSCI ACWI, whether they pay a dividend or not, so the figures for the market dividend yield have a larger denominator (and hence lower yield) than if only dividend payers are included. Secondly, while we consider the total dividends or dividend yield of each index or sub-index, over time the constituency of those indices changes as both new companies are added and existing companies removed (for various reasons). Finally, from time to time there are reclassifications by MSCI between sectors. For example, Tencent was moved from Information Technology to Communication Services in 2018, dramatically changing the sectors' market capitalisations.

We have chosen an historical scope of 15 years, back to 2003, because we feel that it is necessary to look that far back to appreciate the changes in global markets. This period captures the boom of the early 2000s, the effects of the Global Financial Crisis, and the last decade of recovery.

Using this time period and set of indices, we have calculated the market capitalisation, the annual dividend per share (in US dollars) and the annual gross cash dividend (also in US dollars). It is worth noting that the dividend figure is calculated by summing the gross dividend amounts for all dividend types (including specials) that have gone 'ex' over the course of the calendar year. Although there should be little difference, the dividend amount at the ex-date may vary from that at the declaration date and even from that at the payment date. It also included taxes, dividend-related fees and tax-related credits.

All data is in USD; Source: Bloomberg

CURRENCY

From an investor standpoint, the dividends received from an individual company can fluctuate for two main reasons:

1. Fluctuations in the underlying dividend payment. This is occurs particularly with companies that calculate their dividends on a payout ratio basis. If earnings decline for whatever reason, (and assuming the payout ratio is unchanged) the dividend will also decline by the same proportion.

2. Fluctuations in the underlying currency of payment. Even if the dividend payment is unchanged year on year in local currency terms, when converted back into base currency (for example, US dollars), the final amount received will depending on prevailing exchange rates.

Over time, we expect the companies in our universe to be able to grow their dividends at satisfactory rates. However, over any short term period their may be fluctuations both positive and negative.

THE INVESTMENT TEAM

EDMUND HARRISS
Fund Manager

Edmund has managed Asian Funds since 1994 both from London and from Hong Kong.

Edmund worked for ten years from 1993 for Guinness Flight, which became Investec after the merger in 1998. After joining the Far East Investment Desk in 1994, he served as a member of the investment team managing the China & Hong Kong Fund (now the Guinness Atkinson China & Hong Kong Fund, for US investors). He moved to Hong Kong and became the Fund's lead manager in 1998.

Edmund is head of Asian and Emerging Markets investments.

MARK HAMMONDS
Fund Manager

Mark joined Guinness Asset Management in 2012 and is co-manager of the Guinness Asian Equity Income Fund.

Prior to joining Guinness, Mark worked at Ernst & Young, where he qualified as a Chartered Accountant. Mark graduated from Corpus Christi College, University of Cambridge, in 2007 with a First Class degree in Management Studies. He is a CFA Charterholder.

SHARUKH MALIK
Analyst

Sharukh 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. Sharukh has passed the IMC and CFA Level 3.

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The Guinness Asian 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. The Fund invests only in stocks of companies that are traded on Asian stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. 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 3H

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.

GUINNESS
ASSET MANAGEMENT

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