Guinness Greater China

Investment Commentary – July 2024

GUINNESS GLOBAL INVESTORS

RISK

This is a marketing communication. Please refer to the prospectus, supplement, KIDs and KIIDs for the Fund, which contain detailed information on its characteristics and objectives, before making any final investment decisions.

The Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. Further details on the risk factors are included in the Fund's documentation, available on our website.

Past performance does not predict future returns.

ABOUT THE STRATEGY

Launch	15.12.2015
Index	MSCI Golden Dragon
Sector	IA China & Greater China
Managers	Sharukh Malik CFA Edmund Harriss
EU Domiciled	Guinness Greater China Fund

OBJECTIVE

The Guinness Greater 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.

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SUMMARY

In the first half of the year, the Guinness Greater China Fund (Y class, GBP) fell by 4.9%, while the benchmark, the MSCI Golden Dragon Net Total Return Index (MSCI Golden Dragon Index) rose by 12.5%, and the MSCI China Net Total Return Index (MSCI China Index – not a benchmark for the Fund but which we note due to its bias to China, like the Fund) rose by 5.7%.

After a tough start to the year, China was one of the strongest major markets in the second quarter. Its rally was led by growth stocks in the offshore market.

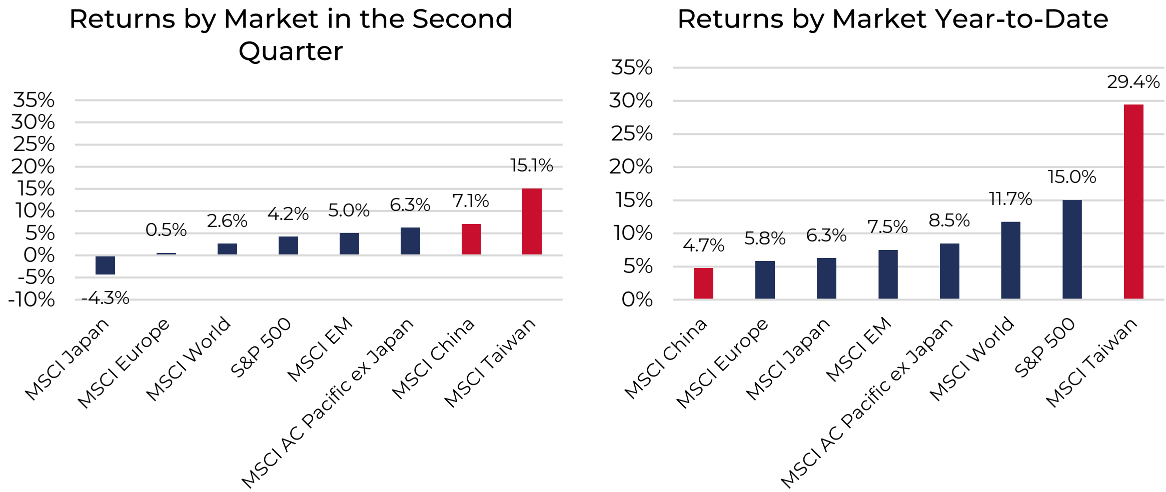
In May, we spent two weeks in China and saw nine companies. We remain of the view that while the economy is weak by China's standards, the quality companies that we are interested in are generally doing fine. In contrast to the gloomy macro news, our companies overall have a growth mindset, investing both domestically and internationally to secure future growth.

Year-to-date, the strongest three stocks in the Fund are TSMC, China Merchants Bank and Tencent. The weakest three stocks are Venustech, Wuxi Lead Intelligent Equipment and Travelsky.

For the set of high-quality companies in our portfolio, we are seeing the most attractive valuations since the Financial Crisis. Our companies have strong balance sheets and can weather the next few years as China completes its economic transition. To be conservative and assume our companies continue to grow at their historic rate of 9% a year, then combined with a 3.1% dividend yield and an eventual valuation re-rating, we argue China is a very attractive investment opportunity. A potential catalyst on valuations is any decent government stimulus for the property market, which would help stabilise earnings estimates for China as a whole.

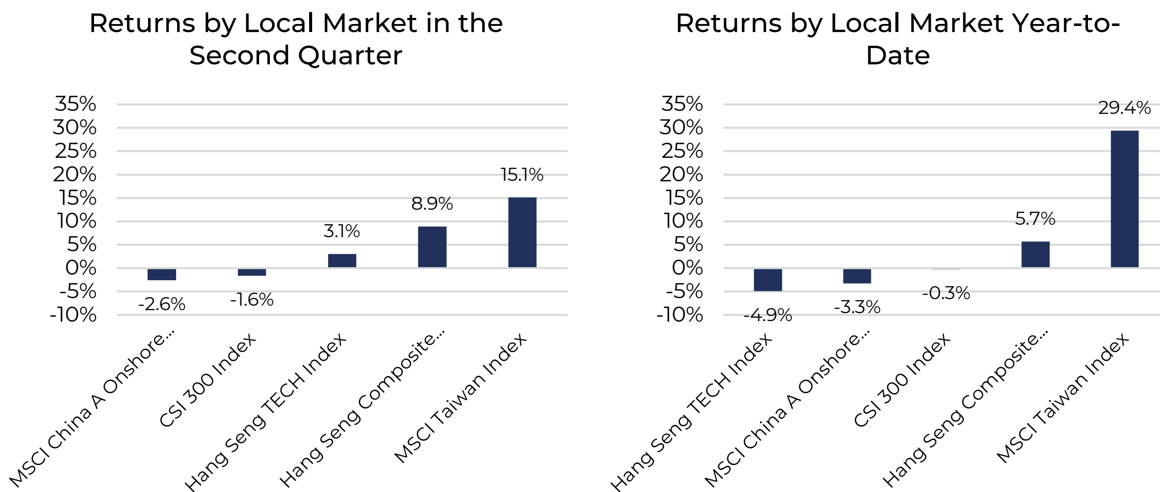
COMMENTARY

(Performance data in the section in USD terms unless otherwise stated)



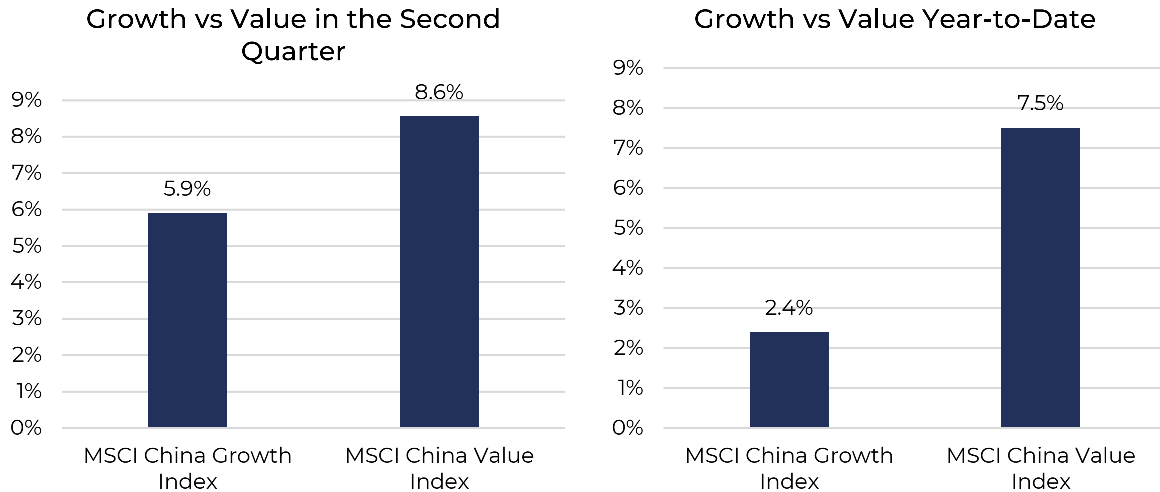
(Left chart: data from 31/03/24 to 30/06/24, right chart: data from 31/12/23 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

In the second quarter, Chinese markets were outperformers relative to other major markets. The MSCI China Index recovered by 7.1% while the MSCI World Index rose by 2.6%. After a weak first quarter, China rebounded in April and for the first half of May, before giving back much of the gains in the second half of May and rising slightly in June. Year-to-date, however, China remains a laggard. The MSCI China Index rose by 4.7% in the first half of the year, trailing the MSCI World Index which rose by 11.7%. Taiwan has been a bright spark in the region, with the MSCI Taiwan Index rising by 15.1% in the second quarter and 29.4% year-to-date, making it the strongest major market in both periods. Taiwan's market is concentrated in Information Technology stocks and so gives good exposure to AI-related names.



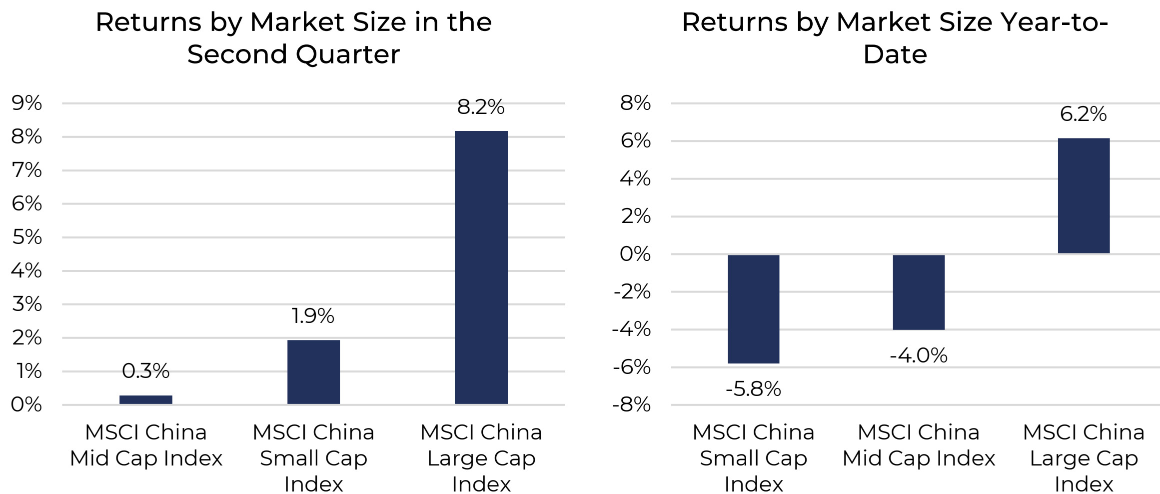
(Left chart: data from 31/03/24 to 30/06/24, right chart: data from 31/12/23 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

Offshore markets did far better than onshore markets in the second quarter, as the Hang Seng Composite Index rose by 8.9% while the MSCI China A Onshore Index fell by 2.6%. Year-to-date, the Hang Seng Composite Index has risen by 5.7% while the MSCI China A Onshore Index has fallen by 3.3%.



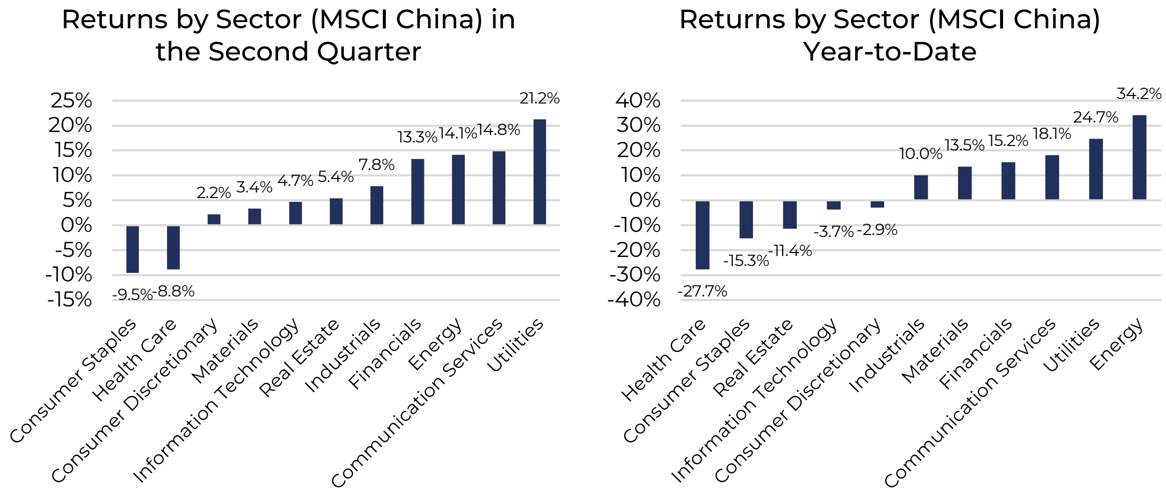
(Left chart: data from 31/03/24 to 30/06/24, right chart: data from 31/12/23 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

In the second quarter, growth stocks slightly underperformed value stocks, as the MSCI China Growth Index rose by 5.9% while the corresponding value index rose by 8.6%. Year-to-date, the value index has risen by 7.5% while the growth index has risen by 2.4%.



(Left chart: data from 31/03/24 to 30/06/24, right chart: data from 31/12/23 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

Large-caps outperformed significantly in the second quarter, rising 8.2% against the small and mid-cap indexes which rose 1.9% and 0.3% respectively. Year-to-date, large-caps have risen by 6.2% whereas small-caps and mid-caps have fallen by 5.8% and 4.0% respectively.



(Left chart: data from 31/03/24 to 30/06/24, right chart: data from 31/12/23 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

In the second quarter, the best performing sectors in the MSCI China Index were Utilities (total return +21.2%), Communication Services (+14.8%) and Energy (+14.1%). In their search for value stocks, investors rewarded more stable companies in the Utilities and Energy sector. Tencent's good performance drove the strength in the Communication Services sector.

The weakest sectors in the second quarter were Consumer Staples (total return -9.5%), Health Care (-8.8%) and Consumer Discretionary (+2.2%). Broadly speaking, lower than expected growth for several well-known companies led to weakness in the Consumer Staples sector. The most significant laggards were Kweichow Moutai, China Resources Beer and Nongfu Spring. Within Healthcare, the Biosecure Act in the US led to weakness for affected Chinese names. The Act essentially prevents federal agencies from working with companies with links to certain Chinese biotech companies. In the Consumer Discretionary sector, weaker names were Li Auto, Yum China and New Oriental Education.

TRIP TO CHINA

We spent two weeks in China seeing a range of companies across the country. The trip was independently arranged without the help of brokers.

Haier

In Qingdao, we met with Haier Smart Home, one of the world's largest household appliances companies. While the company's sales are linked to the domestic real estate cycle, the company is still expecting solid growth. For example, washing machines have an average life cycle of 8-10 years, after which they need to be replaced regardless of how the real estate market is doing. To boost sales, Haier has launched its own trade-in program whereby customers can trade in older products for a discount on new products. Meanwhile, the company is expanding its air conditioning (AC) business to catch up with its larger peers. In the past three years, the research team has doubled within the AC segment and CNY 200m (c.$28m) has been spent on quality control labs. Management aim to grow revenue for the AC business from CNY 46bn in 2023 to CNY 80-90bn by 2028, with operating margins in the segment to expand from c.4% in 2023 to 7-8% in 2028.

Near Hangzhou we saw a prospective company which manufactures forklifts. The company was relatively early in focusing on electric forklifts and this move is now paying off as revenue and profit growth has accelerated. The company's exports are increasing rapidly and the company's brand is gaining a reputation for quality. Management is aiming for revenue to increase from CNY 16bn in 2023 to c.30bn in three years' time. The company's products are sold in Europe and the US, with

management focusing on quality and after-sales service to catch up with its established competitors. We were given tours of two manufacturing sites, which were impressive, and a run-through of the various models the company sells.

We also saw Hangzhou First Applied Material, which is the world's largest manufacturer of solar film, which protects solar modules. While much of the solar industry is in significant oversupply, in the solar film segment the supply imbalance is less pronounced. Smaller companies are loss-making and are likely to eventually leave the industry, meaning First Applied may increase its market share. Next year the company plans to open two new manufacturing plants in China and one in Vietnam.

In Suzhou we visited a plant run by Shenzhen Inovance Technology, which makes automation equipment. We saw the high level of automation in the plant, partly driven by the company's own robots. We also communicated some of the reasons behind our proxy voting, where we voted against one director as he was an insider on the audit committee, and another director as the company does not have a nomination or remuneration committee. In response, the company said it has recently refreshed its board and this year is planning on creating a nomination and remuneration committee.

We met with China's two largest video game developers, Netease (in Hangzhou) and Tencent (in Hong Kong). With Netease, we discussed the latest quarterly results and the company's approach to shareholder return. With Tencent, the company's video accounts (equivalent to Tiktok) have relatively few ads compared to Douyin and Kuishou so there is potential for revenue in this segment to increase significantly. On semiconductors, the business has a stockpile of cutting-edge chips which management expect to last a few generations. Tencent's large language model (LLM) *Hunyuan* is being used by all teams as the foundational model, which teams can then tailor according to their specific needs. On capital management, the company argues its shares are undervalued and higher buybacks and dividends generate a better internal rate of return than other investments at this moment in time.

In Chengdu, we saw Sinoseal, which manufactures mechanical seals mostly used in petrochemical applications, with use cases also in pipelines, nuclear, water and paper making industries. The company explained that it has taken market share from foreign competitors in the domestic market by focusing on lower prices, investment in R&D and very good after-sales service. Management think that from a technical perspective, their products are now nearly at the same level as their foreign competitors. To increase export sales, the aim is now to catch up on the technical front and then increase brand awareness abroad in countries on the Belt and Road path. On capital management, Sinoseal is cautious on M&A and will not grow at all costs. The dividend frequency has now increased to a semi-annual payment with a higher payout ratio.

Near Chongqing, we met with Chongqing Fuling Zhacai, which makes pickled condiments. Due to climate change the company is seeing more volatility in supply of mustard roots. To deal with this greater volatility, when input prices are low the company likes to put mustard roots into storage. But current storage capacity is limited so the company is building a new state-of-the-art production facility with significantly greater storage capacity. On ESG, we made numerous suggestions on where disclosure could improve and our sense is that we can have a genuine impact on the company's disclosures.

In Guangzhou we saw Suofeiya Home Collection which makes kitchen cabinets and cupboards. Given that it is smaller than the primary market, the secondary market (purchases of older homes) is a channel that Suofeiya has not previously focused on. However as the primary market continues to weaken, management now views the secondary market as a growth driver for the business. In contrast to some of its competitors, Suofeiya has much more control of its sales process which management believes is one of the main drivers behind its good reputation with customers. For example, Suofeiya owns its own software, logistics and after-sales service, whereas some of its competitors use third parties for some of these services. By focusing on good service, the aim is that customers enhance the reputation of the business through word of mouth.

STOCK COMMENTARY

Year-to-date, the strongest three stocks in the Fund are TSMC, China Merchants Bank and Tencent.

TSMC (total return +54.9% in USD): As the world's largest and most advanced foundry, TSMC is benefiting from the surge in demand for AI-related chips. Large tech firms, mostly concentrated in the US, are rapidly increasing their investments into generative AI. There are only a few foundries worldwide with the knowhow and capacity to meet these orders, and TSMC expect revenue to grow by at least 20% this year. In addition, it seems Apple's higher-end iPhones are in greater demand. These phones use more advanced chips, which should increase utilisation rates of TSMC's newer and more advanced facilities, potentially leading TSMC to raise its prices further.

China Merchants Bank (CMB) (total return +30.4% in USD): As Chinese markets have been weak, value stocks have outperformed and the Chinese banks have been notable outperformers, driven by a valuation re-rating. In our view CMB is the best run bank in China, with a cash return on equity well above its peers over the past decade. Supported by a dividend yield of c.6.0% and a dividend which has increased every year over the past decade, the stock has outperformed year-to-date.

Tencent (total return +28.0% in USD) is China's largest video game developer, who we met with on our recent trip to China. Tencent's video accounts (equivalent to Tiktok/Douyin) have relatively few ads compared to Douyin and Kuaishou so there is potential for revenue in this segment to increase significantly. Consequently, Tencent has been one of the few Chinese companies seeing positive earnings revisions this year. On capital management, the company argues its shares are undervalued and so has been buying back shares and increasing dividends, with the rationale that this is likely to generate a higher internal rate of return than other investments at this moment in time.

Year-to-date, the weakest three stocks in the Fund are Venustech, Wuxi Lead Intelligent Equipment and Travelsky.

Venustech (total return -37.5% in USD) is a major provider of cybersecurity services in China. Historically its customer base was targeted toward government clients and large companies, but due to the weaker macro environment government clients are cutting budgets, which is an issue facing the whole industry. Venustech, however, does benefit from closer cooperation with its largest shareholder China Mobile. Last year China Mobile became the controlling shareholder in Venustech and as a result China Mobile disbanded its internal cybersecurity business and is now redirecting business towards Venustech. Venustech should benefit from greater demand from China Mobile's customers, diversifying Venustech's customer base. Last year Venustech derived CNY 200-300 million from sales to China Mobile and in the medium term the target is to grow this to CNY 1 billion. Overall, management is targeting at least 20% revenue and net profit growth in 2024.

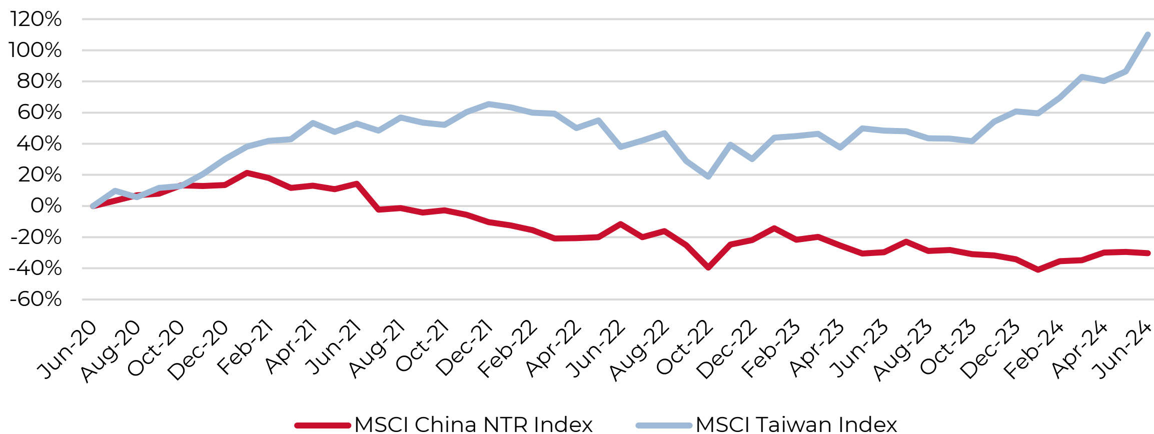
Wuxi Lead Intelligent Equipment (total return -36.5% in USD) is a manufacturer of battery production equipment. With concerns over potential battery overcapacity in China, the market is paying attention to Lead Intelligent' s order book. We expect growth in the company's new orders to come from overseas. We know Lead Intelligent has exposure to major customers abroad such as Volkswagen and ACC (a joint venture between Stellantis, Mercedes and TotalEnergies). CATL, which is one of the world's largest battery manufacturers, is the second largest shareholder in Lead Intelligent. Therefore we expect Lead Intelligent to benefit from CATL's new plant in Hungary.

Travelsky (total return -30.9% in USD) supplies data for China's aviation industry and processes nearly all passenger flights in the country. One segment of the business, System Integration, is involved with installing equipment and software to airports and airlines. The segment saw a significant drop in revenue in the second half of 2023 whereas management had been guiding for positive growth. It seems slower progress on certain projects as well as payment delays led to the miss. Additionally across the business higher labour costs led to a rise in expenses, overall leading to a large earnings miss. The stock sold off 25% on the profit alert in January. Our view was that the System Integration segment, due to being project based, can have a more volatile growth profile than the core business. It may turn out that the segment rebounds in the future once the delayed projects are completed and indeed management are expecting a recovery here this year. Travelsky remains one of the cheapest quality stocks which give exposure to China's rebound in travel, both in the short and long term. Therefore we decided to top up on the position following the sell off and have so far made a positive return.

ATTRIBUTION

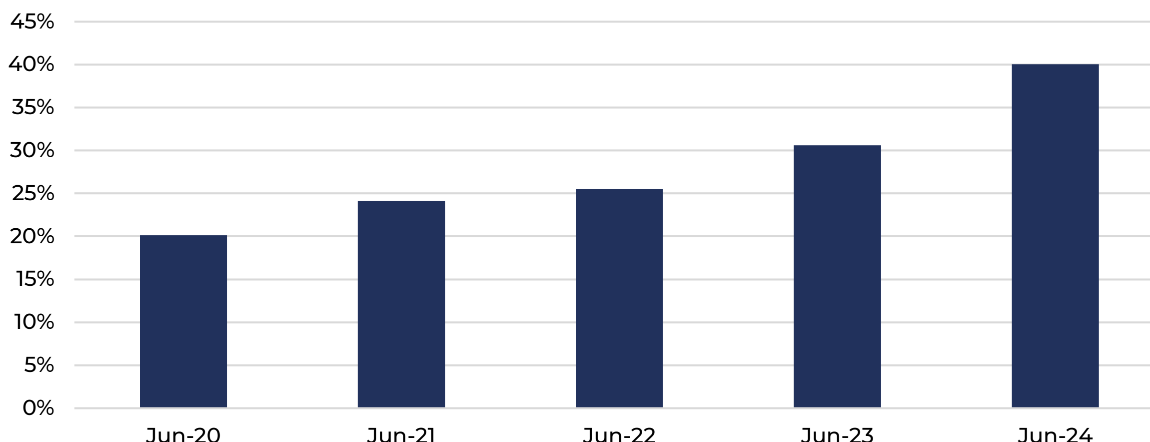
In the first six months of the year, the Guinness Greater China Fund (Y class, USD) fell by 5.7%, while the benchmark, the MSCI Golden Dragon Index rose by 11.6%, and the MSCI China Index rose by 4.5%.

The MSCI Golden Dragon Index is a weighted average of the MSCI China, Taiwan and Hong Kong indexes. As of the end of June, Taiwan's weight in the Golden Dragon Index was c.40%. Over the past four years, as mainland China has been transitioning its economy away from real estate and towards the new pillar industries, mainland markets have fallen. Meanwhile, Taiwan with its large weighting to tech, has performed much better, boosted more recently by the surge in AI-related stocks. As a result, over the past four years the MSCI Taiwan Index has risen by 110.1% while the MSCI China Index has fallen by 30.4%.



(Data from 30/06/20 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

Therefore, Taiwan's weight in the MSCI Golden Dragon Index has nearly doubled over the period, from 20.1% in Jun-20 to 40.0% in Jun-24.



(Data from 30/06/20 to 30/06/24, returns in USD, source: Bloomberg, Guinness Global Investors calculations)

In the Fund, we hold two positions in Taiwan which collectively have a weight of c.6.5%. As the MSCI Taiwan Index has risen by 29.4% year-to-date, the MSCI Golden Dragon Index has captured far more of the stronger performance in Taiwan than the Fund. The Fund aims to give exposure to the structural growth themes in China. We also allocate to Taiwan, targeting stocks which meet either of the following two criteria:

- Significant exposure to China. We define this as more than 50% of sales from China or more than 50% of assets in China.
- Exposure to the semiconductor industry. While there are semiconductor companies in mainland China, often the quality or the price of the companies can be unattractive relative to the opportunities in Taiwan. In Taiwan there can be many good-quality, growing businesses trading at more reasonable prices.

As the Fund is designed around a framework of structural growth in China, we expect therefore our Taiwanese exposure to the Fund to be more limited. We can see this in the composition of the universe, which consists of high-quality companies with exposure to the various themes. Of the universe of 770 stocks, 720 are Chinese and 50 are Taiwanese. Equivalently, 94% of the universe consists of Chinese companies and 6% consists of Taiwanese companies. Therefore the Fund's 6.5% weight to Taiwan broadly reflects Taiwan's weight in the universe.

In the first half of the year, relative to the MSCI China Index, areas which helped the Fund's performance were:

- Individual stock performance, led by TSMC (total return +54.9%), China Merchants Bank (+30.4%), Tencent (+28.0%), Sany Heavy Industry (+18.7%) and Haier Smart Home (+18.4%).
- Stock selection in the Real Estate sector, driven by China Overseas Land & Investment (+1.6%) compared to the sector which fell 11.4%.
- Stock selection in the Consumer Staples sector, led by not holding names such as Kweichow Moutai (-15.2%), Mengniu Dairy (-30.6%) and JD Health (-45.6%).

In the first half of the year, areas which detracted from the Fund's relative performance were:

- As discussed earlier, offshore stocks outperformed onshore stocks, as the Hang Seng Composite Index rose by 5.7% while the MSCI China A Onshore Index fell by 3.3%. As of the end of June, the Fund was c.25% underweight to stocks listed in Hong Kong and 20% overweight to A shares. Therefore the Fund benefited from less of the rally in the Hang Seng Composite than the MSCI China Index.

- The Fund has an overweight to mid-caps which, along with small-caps, have significantly underperformed large-caps. Year-to-date, the MSCI China Large Cap Index has risen by 6.2% while the small and mid-cap indexes have fallen by 5.8% and 4.0% respectively. Particularly because of the chase for 'safer' stocks, investors are targeting value stocks of which many are large state-owned enterprises (SOEs), where we are underweight.

- Structural underweight to Tencent (total return +28.0%). The Fund is run on an equally weighted basis and so each position has a neutral weight of 3.2%. As of the end of June, Tencent's weight in the MSCI China Index was 16.6%, making it the largest stock by far in that index. Tencent's share price has risen 28.0% so the index benefited much more from Tencent's rally than the Fund. We estimate that of the Fund's 10.2% underperformance relative to the MSCI China Index, 3.0% can be attributed to the Fund's underweight in Tencent.

- Underweight to Financials, and more specifically the underweight to the large SOE banks. The Fund does not hold any of these, which have been significant outperformers as a value play e.g. the offshore lines of CCB, ICBC and ABC are up 24.1%, 21.5% and 19.2% respectively. We do not own these large SOE banks as they do not give exposure to the long-term structural growth themes in China. We estimate that of the Fund's 10.2% underperformance relative to the MSCI China Index, at least 2.0% can be attributed to the underweight in the large SOE banks.

- The combined underweight to Materials, Energy and Utilities where the Fund has no exposure, whereas in the index these sectors have a cumulative weight of 10.6%. The Fund targets quality companies which give exposure to the structural growth themes in China. In our universe, there are no Energy names which give this exposure. The Material names which have been strong this year are related to metals and cement – these companies do not generally make the quality threshold we target in the Fund. Relevant companies are Zijin Mining, China Hongqiao (aluminium), Aluminium Corp, Jiangxi Copper and Zhaojin Mining. The Fund holds no companies in the Utilities sector. We estimate that of the Fund's 10.2% underperformance relative to the MSCI China Index, c.2.1% can be attributed to the Fund's lack of exposure to the Materials, Energy and Utilities sectors.

- Therefore, of the Fund's 10.2% underperformance relative to the MSCI China Index, a total of 7.4% can be attributed as follows:

    - c.3.0% can be attributed to the underweight position in Tencent.

    - c.2.0% can be attributed to the underweight in the large SOE banks.

    - c.2.1% can be attributed to the Fund's lack of exposure to the Materials, Energy and Utilities sectors.

- We are completely comfortable with the positioning of the Fund, with respect to the three points above as well as our overweight to the onshore market and our overweight to mid-cap companies. The onshore market makes up c.80% of our structural growth universe and the most interesting names are the 'Little Giants' – companies which are in the industries that are likely to help China reach developed country status. These companies are getting government support in the form of a lax regulatory environment, greater government orders and lower taxes. These Little Giants are currently being ignored by the market and we strongly believe that once China completes its economic transition away from property, these companies are likely to have a long path of compounded growth ahead of them.

- This leaves c.2.8% of underperformance which we have not yet touched on, with detractors driven by:

- Stock selection in the Industrials sector, driven by Wuxi Lead Intelligent Equipment (total return -36.5%) and Shenzhen Inovance Technology (-20.0%).

- Stock selection in the Health Care sector, driven by China Medical System (-50.7%, see below), Sino Biopharmaceutical (-22.2%) and CSPC Pharmaceutical (-12.5%). The generic pharmaceutical companies are in the midst of transitioning away from a generics-based model towards an innovation model, where drugs are developed in-house. During this transition, earnings growth is likely to be muted, though we argue valuations more than compensate for the wait.

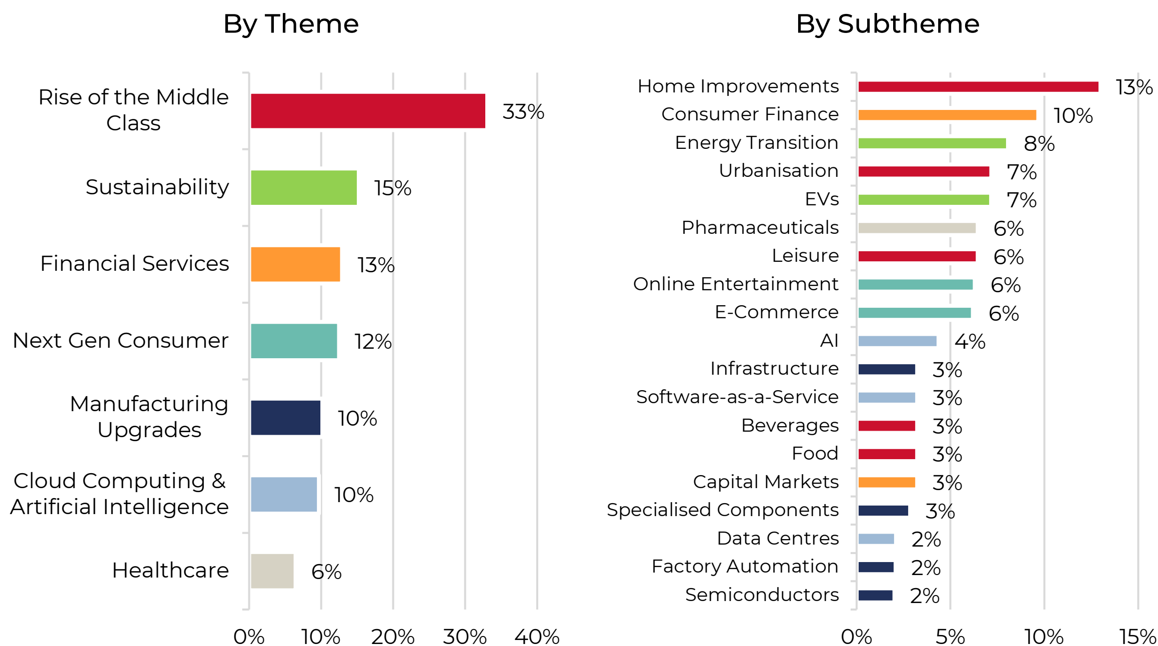
CHANGES TO THE PORTFOLIO

We sold the full position in China Medical System following its profit warning at the end of March. CMS reported an unexpected decline in sales in the second half of 2023, as for some of its major drugs the decline in prices was larger than management had previously guided for. The gulf between guidance and reality concerned us, reflecting poor communication from management. The company expects it will take until 2025 for revenue to beat 2022's amount, and until 2026 for net profits to do the same.

For a slightly higher valuation multiple, we initiated a position in Midea. Midea is one of the world's largest household appliances companies, selling items such as fridges, freezers and dishwashers. It is also one of the world's largest air conditioner manufacturers. The company has a long track record of growing its asset base at a high cash return on capital. We expect revenues and profits to continue to grow, which is attractive in the current economic environment in China. We also like Midea because it owns Kuka, which it bought from a German company in 2016. As China's working population shrinks and wages rise, greater automation is likely to be a trend and so owning one of the world's most advanced robotics companies makes Midea very attractive.

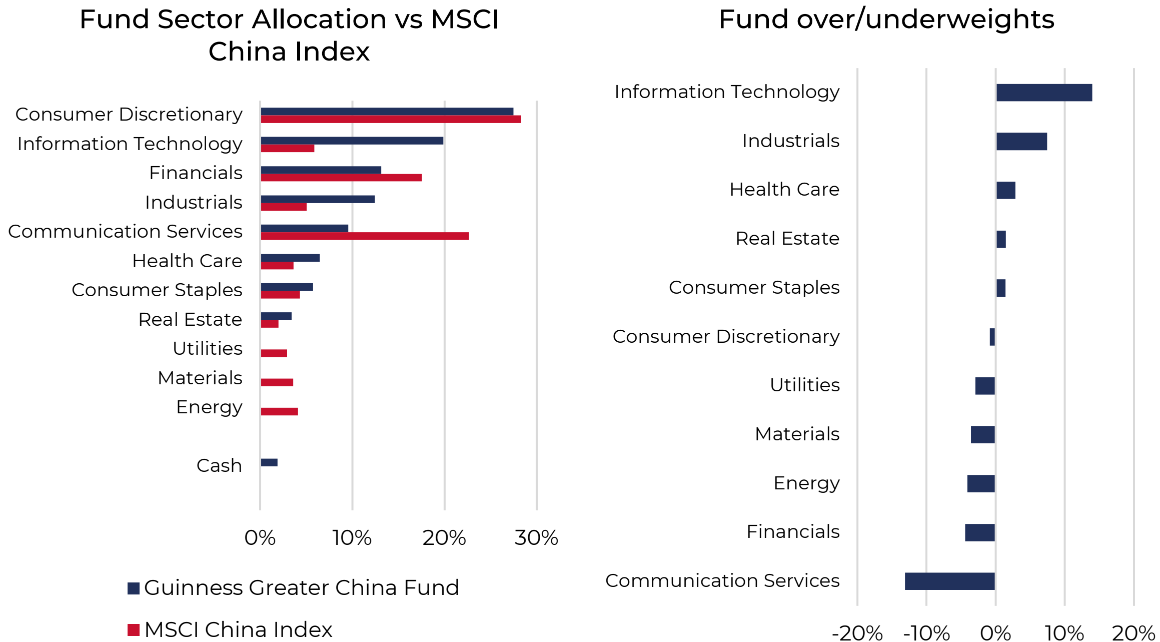
PORTFOLIO POSITIONING

By theme, the Fund's largest exposures are to the Rise of the Middle Class, followed by Sustainability and Financial Services. Important subthemes include Home Improvements, Consumer Finance and Energy Transition.



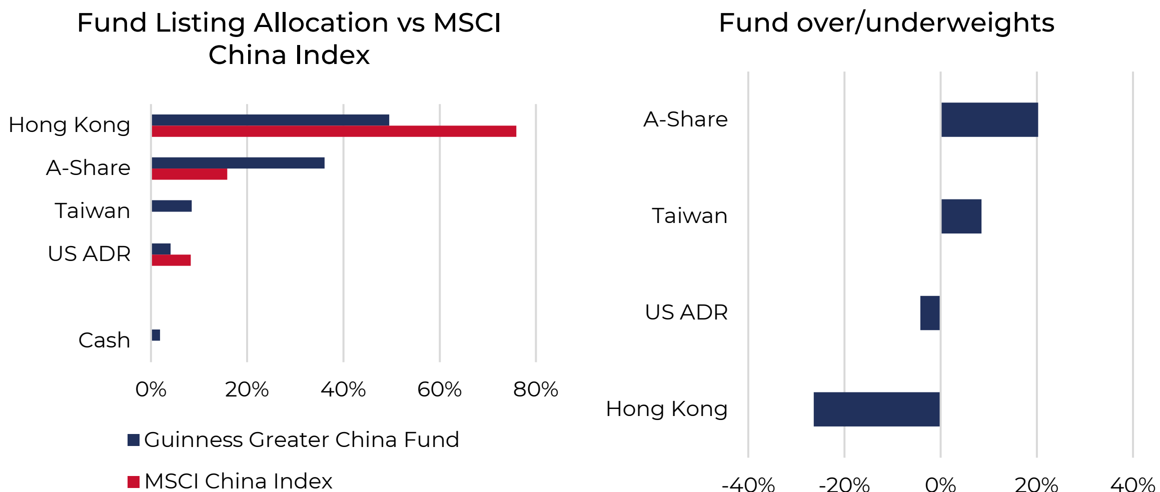
(Data as of 30/06/24, source: Guinness Global Investors calculations. Data assumes portfolio is equally weighted)

On a sector basis, the Fund's largest exposures are to the Consumer Discretionary and Information Technology sectors. Relative to the MSCI China Index, the Fund is overweight in Information Technology and Industrials. The Fund is underweight in Communication Services.



(Data as of 30/06/24, source: Guinness Global Investors calculations, Bloomberg)

On a listing basis, the Fund has 49% exposure to stocks listed in Hong Kong, 36% exposure to the A share market and a small 8% allocation to Taiwan. Relative to the MSCI China Index, this makes the Fund 20% overweight to the A share market and c.25% underweight to stocks listed in Hong Kong.

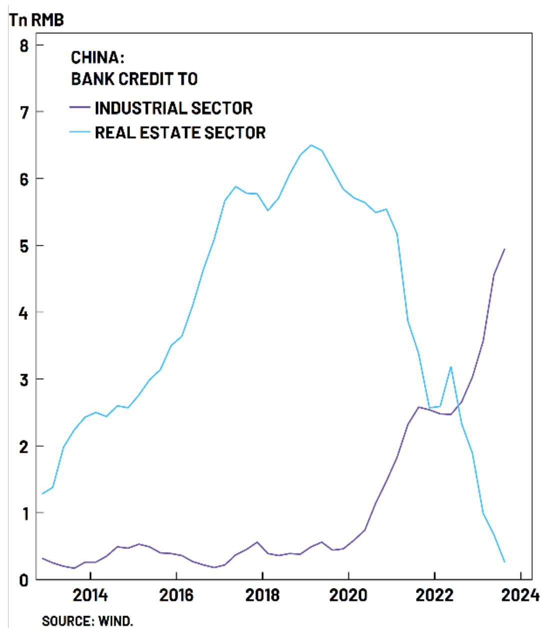


(Data as of 30/06/24, source: Guinness Global Investors calculations, Bloomberg)

OUTLOOK

Following our trip to China, we remain of the view that while the economy is weak by China's standards, the quality companies that we are interested in are generally doing fine. In contrast to the gloomy macro news, our companies overall have a growth mindset, investing both domestically and internationally to secure future growth. For our manufacturing companies in particular, the general trend is they are moving up the value chain and from a quality perspective, are catching up to their Western competitors. Export sales are becoming more of a focus for our companies and we expect Chinese companies across the board to become more competitive on the global front.

We argue that the government has for the past few years been intentionally deleveraging the property sector. One of the reasons behind this was to tackle the accumulation of debt, particularly amongst private property developers, which has for some time presented itself as a source of systematic risk. Since 2020, the government has been clamping down on the use of the aggressive debt-funded growth in the property sector, leading to the failure of Evergrande's and other private property developers' business models.



The second reason behind the intentional deleveraging push in the property market is driven by China's long-term economic plan. Ultimately, for China to become rich on a per-capita basis, capital needs to be diverted away from property and towards the new pillar industries with higher value add per person. Real estate accounts for at least 20% of China's GDP and 23% of its capital investment. China's GDP per capita is currently c.$12,500 per person, and to take it to the level of countries such as Korea and Japan, with GDP per capita of c.$35,000 and $39,000 respectively, real estate is not the answer. The answer is also unlikely to be found in other industries that foreign investors have historically been attracted to in China, such as video games (Tencent) and e-commerce (Alibaba). For China to become a wealthy nation, the new pillar industries are going to need capital to grow. These industries include (but are not limited to) the EV supply chain, industrial automation, semiconductor manufacturing and research into pharmaceutical development and healthcare equipment. We can see in the chart that while lending to the real estate sector has plummeted, at the same time lending to the industrial sector, which contains many of these pillar industries, has increased significantly.

Source – BCA Research, January 2024

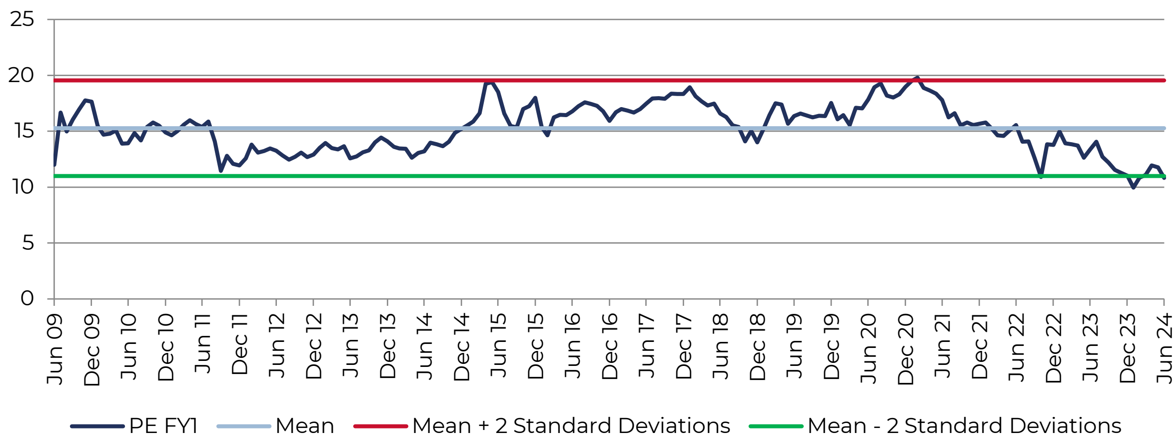
China's current problem is that while in the long term the deleveraging of the property sector is positive, in the short term, because of its large contribution to GDP, the declining real estate market is creating a drag on growth. Meanwhile, although the new pillar industries are growing, they are still relatively small and are certainly not large enough to offset the weakness in real estate.

When could the new pillar industries reach this point? Goldman Sachs looked specifically at EVs, batteries, wind and solar power generation as their proxies for the pillar industries. In their scenario, the new pillar industries become large enough to offset the weakness in property by 2028, assuming property continues to decline. Of course their work only looks into three specific industries and ignores China's other pillar industries, so using similar logic we believe that well before 2028, China's pillar industries are likely to become large enough to offset the falling real estate market. Work by Bloomberg points to a similar conclusion.

However this point is still a few years away. Until then, government stimulus is needed to help the economic navigate the ongoing economic transition. The real estate sector continues to plummet and now requires stabilisation. Recently, more loosening measures were announced for the property market. Loans obtained from the Housing Provident Fund had their interest rates cut by 0.25 percentage points - the fund is a social security savings scheme modelled on the Central Provident

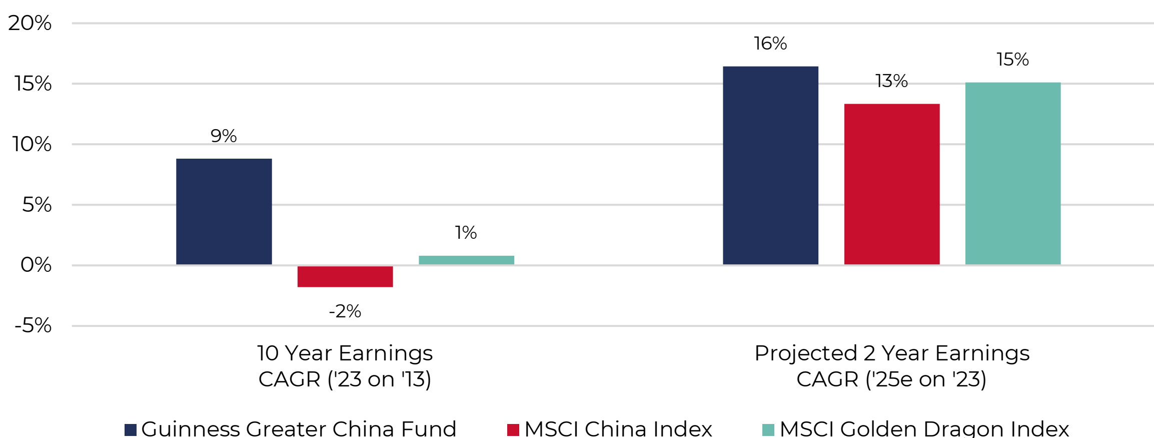
Fund in Singapore. The large cities of Hangzhou (population 10.4 million) and Xi'an (population 13.0 million) removed virtually all restrictions on property purchases. In April, Chengdu (population 16.3 million) did the same.

From an investment perspective, we break down prospective returns into changes from valuation multiples, earnings growth and dividends. On valuations, our holdings remain cheap. The Fund's holdings in aggregate are trading at a forward price/earnings ratio of 10.8x which is two standard deviations below the holdings' 15-year average. Historically our holdings have bottomed at a price/earnings ratio of 10x which implies only c.8% downside. Taking a more optimistic view, if investors believe our argument that China is undergoing an economic transition which will move it into higher value-add industries, then a higher valuation multiple in three to five years may be more appropriate. Our holdings long-term average price/earnings ratio is 15.3x, which implies 42% upside from current levels.



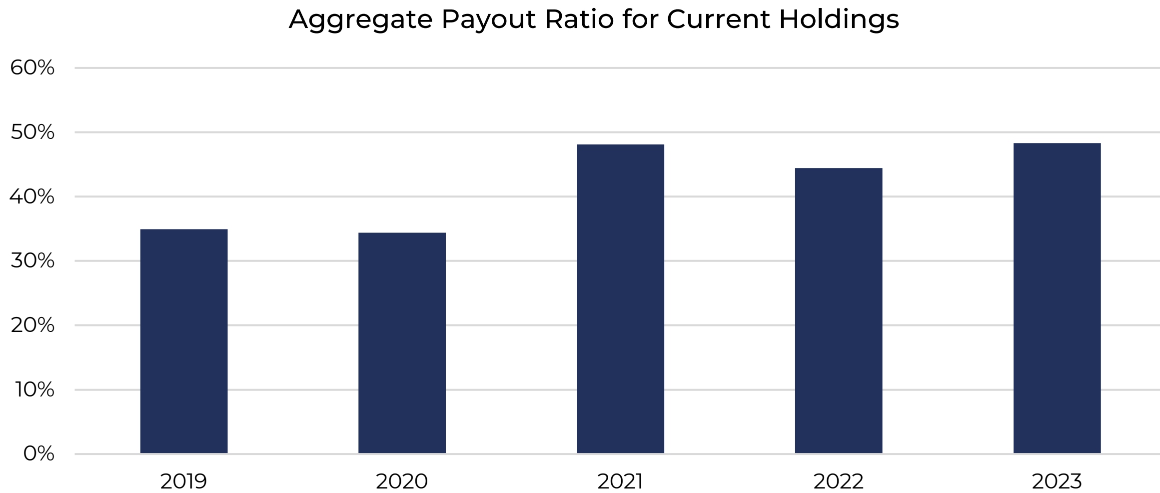
(Data from 31/12/08 to 30/06/24. Source: Bloomberg, Guinness Global Investors calculations. A simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015. Calculations assume an equally weighted portfolio)

The longer the time horizon, the more important earnings growth is. Here we point out the Fund's strong track record in this respect. Over the past decade, our holdings in aggregate have grown earnings by 9% a year. Meanwhile the MSCI China Index has seen earnings fall by 1% a year over the past decade, despite all of the economic growth in China. We argue a passive approach is not the best way to get exposure to high quality, compounding companies in China. Based on consensus analyst estimates, the Fund's holdings in aggregate are expected to grow earnings by 16% a year over the next two years. But we will be more conservative and assume a 9% growth rate is more appropriate. At such an attractive risk reward ratio (as measured by valuations), a 9% earnings growth rate is surely of interest to investors.



(Source: Bloomberg, MSCI, Guinness calculations. Data as of 30/06/2024. Fund series assumes $1m equally weighted into current holdings. Data for Guinness Greater China is a simulation based on actual historic data for the Fund's current holdings. The Fund was launched on 15.12.2015.)

Finally we point out better capital allocation from our holdings. The government is encouraging companies to distribute excess cash to shareholders and improve payout ratios. For our current holdings, the aggregate payout ratio has improved from 35% in 2019 to 48% in 2023. Though the Fund does not have a distribution share class, the forward net dividend yield is 3.1%.



(Source: Bloomberg, MSCI, Guinness calculations. Data as of 30/06/2024. Fund series assumes $1m equally weighted into current holdings. A simulation based on actual historic data for the Fund's current holdings.)

In summary, for our set of high-quality companies, we are seeing the best valuations since the Financial Crisis. Our companies have strong balance sheets and can weather the next few years as China completes its economic transition. If we be conservative and assume our companies continue to grow at their historic rate of 9% a year, then combined with a 3.1% dividend yield and an eventual valuation re-rating, we argue China is a very attractive investment opportunity. A potential catalyst on valuations is any decent government stimulus for the property market, which would help stabilise earnings estimates for China as a whole.

Portfolio Managers

Sharukh Malik
Edmund Harriss

GUINNESS GREATER CHINA FUND - FUND FACTS

Fund size	$8.2m
Fund launch	15.12.2015
OCF	0.89%
Benchmark	MSCI Golden Dragon TR

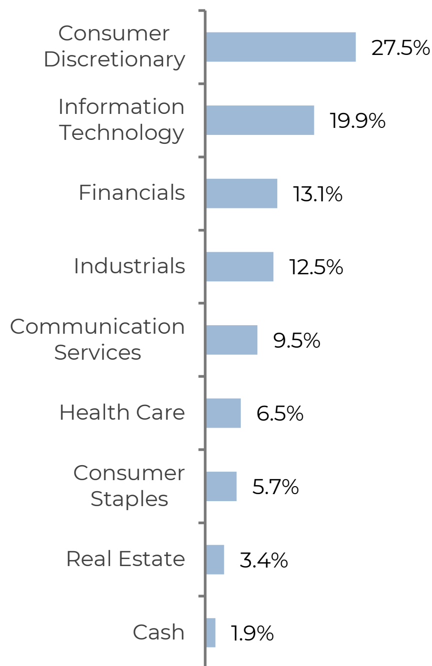
GUINNESS GREATER CHINA FUND - PORTFOLIO

Top 10 holdings

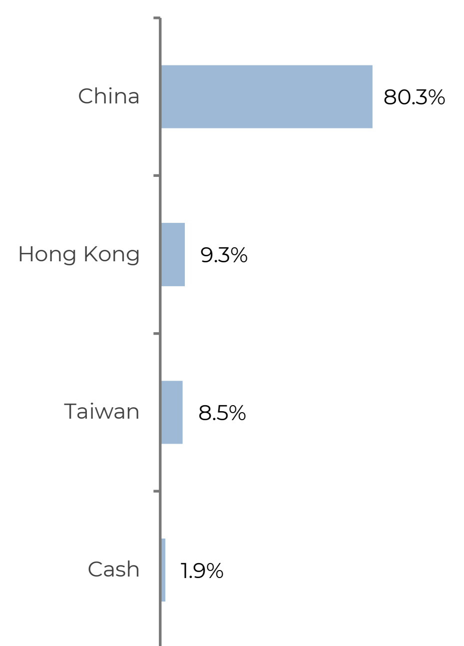
Taiwan Semiconductor	4.7%
China Merchants Bank	3.9%
Elite Material	3.8%
Haier Smart Home	3.6%
Tencent Holdings	3.5%
Sany Heavy Industry	3.5%
China Overseas Land	3.4%
NetEase	3.4%
NARI Technology	3.3%
CSPC Pharmaceutical Group	3.2%

Top 10 holdings	36.3%
Number of holdings	31

Sector



Country



Past performance does not predict future returns.

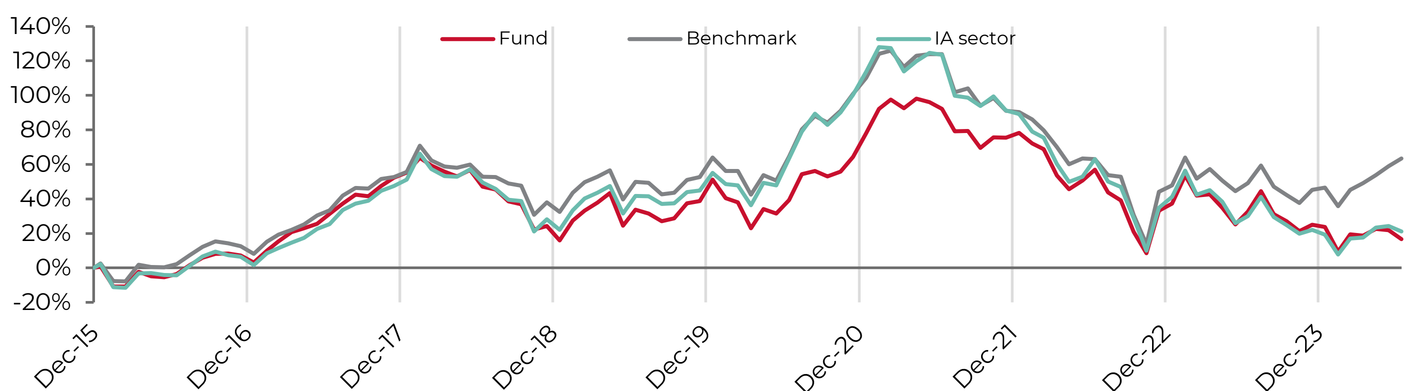
GUINNESS GREATER CHINA FUND - CUMULATIVE PERFORMANCE

(GBP)	1 Month	YTD	1 yr	3 yr	5 yr	10 yr
Fund	-3.6%	-4.9%	-11.5%	-33.6%	-12.1%	-
MSCI Golden Dragon TR	+3.5%	+12.5%	+10.2%	-20.2%	+9.9%	-
IA China/Greater China TR	-1.8%	+2.4%	-6.2%	-40.8%	-13.9%	-
(USD)	**1 Month**	**YTD**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
Fund	-4.3%	-5.7%	-12.0%	-39.3%	-12.7%	-
MSCI Golden Dragon TR	+2.8%	+11.6%	+9.6%	-27.0%	+9.1%	-
IA China/Greater China TR	-2.5%	+1.5%	-6.8%	-45.8%	-14.5%	-
(EUR)	**1 Month**	**YTD**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
Fund	-3.0%	-2.8%	-10.5%	-32.8%	-7.2%	-
MSCI Golden Dragon TR	+4.1%	+15.0%	+11.5%	-19.2%	+15.9%	-
IA China/Greater China TR	-1.2%	+4.6%	-5.1%	-40.0%	-9.2%	-

GUINNESS GREATER CHINA FUND - ANNUAL PERFORMANCE

(GBP)	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Fund	-15.0%	-13.3%	+1.0%	+14.2%	+25.3%	-20.7%	+37.6%	+22.1%	-	-
MSCI Golden Dragon TR	-6.5%	-12.6%	-8.6%	+24.2%	+19.0%	-9.5%	+31.3%	+25.7%	-	-
IA China/Greater China TR	-20.2%	-16.0%	-10.7%	+33.6%	+22.2%	-14.2%	+35.9%	+18.5%	-	-
(USD)	**2023**	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**
Fund	-9.9%	-23.0%	+0.1%	+17.9%	+30.4%	-25.3%	+50.4%	+2.3%	-	-
MSCI Golden Dragon TR	-0.9%	-22.3%	-9.5%	+28.2%	+23.8%	-14.8%	+43.8%	+5.4%	-	-
IA China/Greater China TR	-15.4%	-25.4%	-11.5%	+37.8%	+27.1%	-19.2%	+48.7%	-0.7%	-	-
(EUR)	**2023**	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**
Fund	-12.9%	-17.9%	+7.7%	+8.1%	+32.8%	-21.5%	+32.3%	+5.5%	-	-
MSCI Golden Dragon TR	-4.3%	-17.3%	-2.6%	+17.6%	+26.1%	-10.5%	+26.3%	+8.6%	-	-
IA China/Greater China TR	-18.3%	-20.5%	-4.8%	+26.4%	+29.4%	-15.1%	+30.6%	+2.3%	-	-

GUINNESS GREATER CHINA FUND - PERFORMANCE SINCE LAUNCH (USD)



Source: FE fundinfo to 30.06.24. 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 current OCF for the share class used for the fund performance returns is 0.89%. Returns for share classes with a different OCF will vary accordingly. Transaction costs also apply and are incurred when a fund buys or sells holdings. The performance returns do not reflect any initial charge; any such charge will also reduce the return.

IMPORTANT INFORMATION

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

This report is designed to inform you about Guinness Greater 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. OCFs for all share classes are available on www.guinnessgi.com.

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.

Documentation

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

• the Manager: Waystone Management Company (IE) Limited (Waystone IE) 2nd Floor 35 Shelbourne Road, Ballsbridge, Dublin D04 A4E0, Ireland: or ,

• the Promoter and Investment Manager: Guinness Asset Management Ltd, 18 Smith Square, London SW1P 3HZ.

Waystone IE is a company incorporated under the laws of Ireland having its registered office at 35 Shelbourne Rd, Ballsbridge, Dublin, D04 A4E0 Ireland, which is authorised by the Central Bank of Ireland, has appointed Guinness Asset Management Ltd as Investment Manager to this fund, and as Manager 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.waystone.com/waystone-policies/

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 KID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Reyl & Cie S.A., Rue du Rhône 4, 1204 Geneva, Switzerland. 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.