Guinness Atkinson
Dividend Builder Fund
Managers Update – February 2018

January in Review

The turn of the year saw equity markets surge ever higher on optimism over the strength of the world economy and amid upbeat corporate earnings releases. Despite the pullback towards the end of the month, the MSCI World and S&P Index enjoyed their best starts to the year since 1994 and 1987, respectively. The global macroeconomic environment remains supportive of asset prices, with the IMF revising 2017 global GDP growth to 3.7% – 0.1% higher than the last projection at the start of Q4 2017. Growth forecasts for 2018 and 2019 were also raised by 0.2%, to 3.9% in both years. These revisions come in part due to the IMF's inflation expectations; figures published indicate that consumer price inflation was 1.7% among developed economies in 2017 and is expected to rise to 1.9% in 2018, and 2.1% in 2019. Low and stable inflation provides a supportive environment for GDP growth since it makes it less likely that central banks would need to abruptly raise interest rates.

In the U.S., the latest batch of economic data indicated that momentum remained strong going into 2018. In contrast to IMF expectations, retail sales were robust, inflation continued to climb, unemployment remained unaltered at 4.1%, and perhaps most significantly, there were signs that long-awaited improvements in wage growth were emerging. Average hourly earnings increased 2.5% year-on-year in December after a similarly strong November number; data released in early February confirmed an unexpected further pick-up in wage growth during January. The updates strengthened the prospect of more aggressive rate hikes and prompted investors to consider the implications for bond markets; 10-year U.S. treasury yields rose to 2.71%, raising speculation that the long-term downward trend in yields had been broken.

U.S. tax cuts also added to the heat in the economy and helped drive higher earnings expectations, and subsequently higher stock prices. The tax reform bill, approved in December 2017, was a major legislative victory for President Trump, and led to the corporate tax rate falling from 35% to 21%. The current earnings season has presented the first opportunity for analysts to factor in the tax impact, and the graph below shows that upward adjustments to earnings have been at their fastest pace since the rebound from the financial crisis in 2008-09.

Chart depicts upward less downward earnings per share estimate revisions by analysts divided by the total number of revisions for companies in MSCI World Index.
Source: Charles Schwab, FactSet data as of 02/02/2018.

At the sector level, health care and consumer discretionary stocks led the gains on optimism that Republican tax cuts would result in higher corporate earnings. The expectation is that the health care sector, which has a high concentration of cash and investments overseas, would return part of those assets to shareholders in the form of stock buybacks and dividends. At the end of January, though, the health care sector did dip lower on news that Amazon, Berkshire Hathaway and JP Morgan Chase would create a non-profit healthcare company to help manage drug prices. Rate-sensitive sectors such as utilities, real estate and telecoms were the worst performing sectors on news of rising treasury yields and higher expectations of rate hikes.

In Europe, economic growth is at its strongest rate in a decade (2.5% year-on-year, in 2017 overall) and unemployment is on a downward trend, though inflation remains muted. This raises some uncertainty regarding the pace of ECB tapering in 2018, though it is still expected that the strong consumer demand figures will translate into higher prices and allow for a gradual normalization in monetary policy. A positive rhetoric in the ECB's December minutes saw rate hike expectations and bond yields rise – financials were the prime beneficiary from this and finished the month with the strongest performance. By contrast, bond proxies such as consumer staples and utilities were the worst performing.

In the UK, equity market performance faltered in January as concerns around the economic outlook and the risk of a "hard Brexit" weighed on consumer-driven sectors. Data shows that inflation levels are moderating, unemployment is at a record low, and GDP growth for 2017 came in at 1.8% – the slowest annual rate since 2012. The FTSE 100 Index fell 2.0% (in GBP) over January, as currency pressures (strong Sterling against the U.S. dollar) weighed negatively on the overseas earnings of the UK market's many multinational corporations. This was aided by U.S. Treasury Secretary, Steve Mnuchin, who claimed that the U.S. welcomed a weaker dollar as it would benefit the country.

In Asia, equity markets ended January up 7.6% (in USD), driven by positive earnings revisions, increased confidence in the growth outlook, and a weak dollar. The Chinese market led, as fourth quarter GDP growth (6.8% year-on-year) came in ahead of estimates. This was followed by Taiwanese equities, which were supported by the strength of the semiconductor manufacturers, which benefited from robust demand for high-end computer chips.

Portfolio Update

In terms of individual holdings in January, the strongest performer in the fund was **Vodacom Group** (+17.0% in USD). The South African company provides a cellular telephone network with operations also in Tanzania, Mozambique, Lesotho and the Democratic Republic of Congo. The market rewarded the company after its third quarter revenue growth accelerated to 6.7%. This is compared with 1.2% in the same quarter a year earlier. The company has been able to take advantage of its large market share (~60% in South Africa) and expand its active subscriber base by 13% over the year, to 73.6 million. Initiatives to cut the cost of mobile data increased smartphone penetration and led to both customer growth and increased mobile usage. Gross margins have remarkably been increasing year on year for a decade, and the company has been able to generate a consistent cashflow return on investment of above 14.6% for the past 18 years. The Group has a strong balance sheet and attractive dividend yield of 5.1%. Capital expenditure has been directed to better the company's network, which has reached 78% 4G population coverage and 99% 3G population coverage.

AbbVie (+16.9% in USD) also performed very well. The pharmaceutical giant focuses on producing drugs for specialty therapeutic areas such as immunology, chronic kidney disease, hepatitis C, oncology, and neurology. We have owned the company since the end of 2012 and over the holding period it has returned 283%. It's recent surge in price came after both earnings and sales beat consensus analyst estimates for 2017, and company guidance for 2018 was raised. A key driver of this growth has been the Humira drug, which makes up 60% of total revenue. It has been described as the "world's best-selling drug"; it is an injectable therapy used to treat several autoimmune diseases, predominantly related to arthritis. The company is also set to benefit hugely from tax reform, whereby its effective tax rate will fall from 18.9% to 9%, mainly due to the intended use of capital expensing.

The worst performing stock in January was **Hengan International** (-13.6% in USD). The company is one of the largest producers of sanitary napkins, diapers and tissue paper in China. Historically the company has captured significant market share in established distribution channels (maternity stores, hypermarkets) and more recently it is seeing growth from online exposure. Management has built up an e-commerce team to take advantage of the channel shift in China, whereby consumers are increasingly purchasing everyday items online. Alongside this there are new brand launches and a revitalized "Amoeba" sales strategy to maintain its offline market share. Growing revenues, high and stable margins, year-on-year earnings growth and a well-covered, high dividend are some of the highlights making this a compelling stock. Its recent sell-off points to two reasons: firstly, a slowing momentum of sales growth in December, and secondly the increasing year-on-year price of wood pulp – a major input for Hengan's product. We believe the market has been overly pessimistic considering that slowing sales growth has been explained as voluntary curbing, after some regional offices had already hit their yearly sales targets by December. Furthermore, structurally the company is still in the process of reforming its sales strategy that has shown early signs of success.

We made no changes to the portfolio in January.

Outlook

Given market volatility in the last week of January and first week of February, there are concerns that a market correction is imminent. Despite a very strong run through 2017, today's valuations are not nearly as stretched when compared to other times in history. Companies are showing solid sales and earnings coming through; if we take the dotcom boom as an example, the market is very different today. Some firms in the 1990s were trading on eye-watering valuations despite having never made a profit or, in some cases, realized any material revenue.

Nevertheless, with an increasingly volatile environment perhaps on the horizon, we believe that our approach to finding quality companies at attractive valuations is more important than ever. The Guinness Atkinson Dividend Builder fund currently trades close to par with the MSCI World on a price to earnings basis and has a free cash flow yield 50% higher than the MSCI World (6.34% vs 4.21% respectively). We believe this provides good value to our investors and puts us in good stead in our search for long-term capital growth and a steady, growing income stream.

Thank you for your continued support.

Portfolio Managers
Matthew Page, CFA
Ian Mortimer, CFA

Analysts
Sagar Thanki
Joshua Cole

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GUINNESS ATKINSON FUNDS

Performance

In January, the Guinness Atkinson Dividend Builder Fund produced a total return of 5.14% (TR in USD), compared to the MSCI World Index return of 5.31%. The fund therefore underperformed the Index by 0.17%.

It was however a month of two halves. The first half saw equity markets continue their relentless ascent. Much like the story of 2017, this was driven by growth-oriented sectors. However, towards the end of the month, markets began to stutter with most of the major equity indices seeing a significant pullback. During both periods, the Guinness Atkinson Dividend Builder fund performed as we would expect. The fund is positioned to preserve capital during falling markets and keep up with growing markets. This was the case over January, where the fund underperformed the MSCI World at the start of the month and outperformed towards the end when the MSCI World index began to fall.

Performance

as of 01/31/18	YTD	1 YR	3 YR	5 YR	10 YR	Since inception (3/30/12)
Dividend Builder Fund	5.14%	25.44%	9.75%	11.41%	N/A	11.40%
MSCI World Index	5.31%	26.54%	12.48%	12.34%	N/A	12.23%

as of 12/31/17	YTD	1 YR	3 YR	5 YR	10 YR	Since inception (3/30/12)
Dividend Builder Fund	21.34%	21.34%	7.70%	11.24%	N/A	10.61%
MSCI World Index	23.10%	23.10%	9.91%	12.30%	N/A	11.42%

All returns over 1 year annualized. Source: Bloomberg, Guinness Atkinson Asset Management
Expense Ratio: 0.70% (net); 2.11% (gross)

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. For most recent month-end and quarter-end performance, visit https://www.gafunds.com/our-funds/dividend-builder-fund/#fund_performance or call (800) 915-6566. Total returns reflect a fee waiver in effect and in the absence of this waiver, the total returns would be lower.

The Advisor has contractually agreed to reduce its fees and/or pay Fund expenses (excluding Acquired Fund Fees and Expenses, interest, taxes, dividends on short positions and extraordinary expenses) in order to limit the Fund's Total Annual Operating Expenses to 0.68% through June 30, 2018. To the extent that the Advisor waives its fees and/or absorbs expenses to satisfy this cap, it may seek repayment of a portion or all of such amounts at any time within three fiscal years after the fiscal year in which such amounts were waives or absorbed, subject to the 0.68% expense cap.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-915-6566 or visiting gafunds.com. Read it carefully before investing.

Mutual fund investing involves risk and loss of principal is possible. The Fund's strategy of investing in dividend-paying stocks involves the risk that such stocks may fall out of favor with investors and could reduce or eliminate the payment of dividends in the future or the anticipated acceleration of dividends could not occur. The Fund invests in foreign securities which will involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets. Medium- and small-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Top Fund Holdings as of 1/31/18

1.	VF Corp	3.34%
2.	Microsoft Corp	3.33%
3.	Novo Nordisk A/S	3.17%
4.	AbbVie Inc	3.08%
5.	Danone SA	3.03%
6.	Schneider Electric SE	3.02%
7.	Cisco Systems Inc	3.00%
8.	Deutsche Boerse AG	2.95%
9.	CME Group Inc	2.94%
10.	Vodacom Group Ltd	2.94%

Current and future fund holdings and sector allocations are subject to change and risk, and are not recommendations to buy or sell any security.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Dividend yield is calculated by annualizing the last quarterly dividend paid and dividing it by the current share price.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed countries.

Ex-dividend is a classification of trading shares when a declared dividend belongs to the seller rather than the buyer.

One cannot invest directly in an index.