Guinness Global Equity Income Fund

INVESTMENT COMMENTARY - October 2015

About the Fund

Guinness Global Equity Income Fund is designed to provide investors with global exposure to dividend-paying companies.

The Fund is managed for income and capital growth and invests in profitable companies that have generated persistently high return on capital over the last decade, and that are well placed to pay a sustainable dividend into the future.

Fund size	£92.5m
Launch date	31.12.10
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA

Performance 30.09.15

	1 year	3 years	From launch
Fund	-1.0	32.3	43.3
Index	1.6	36.5	41.3
Sector	-2.7	24.1	31.3

Annualised % total return from launch (GBP)

Fund	7.9%
Index	7.5%
Sector	5.9%

Benchmark index	MSCI World Index
IA sector	Global Equity Income

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.
Source: Financial Express, bid to bid, total return.

Guinness Global Equity Income
BEST FUND OVER 3 YEARS
EQUITY GLOBAL INCOME

Quarterly review

In September the Fund produced a total return of -1.68% (in GBP) compared to the MSCI World Index return of -2.21%. The Fund therefore outperformed the Index by 0.53% over the month.

Over the third quarter as a whole the Fund produced a total return of -4.26% (in GBP), versus the Index return of -4.94%. The Fund therefore outperformed by 0.68%.

It's pleasing to see that the Fund held up better relative to the broader benchmark over what has been a very difficult quarter for markets – much has been made of Q3 2015 marking the worst quarter since the European crisis in 2011.

The sell-off in late August was particularly sharp, and particularly swift. Correlations between different parts of the equity market increased significantly – showing that investors were not focusing so much on fundamentals but rather reducing risk across the board. Between August 18th and August 25th the MSCI World Index decreased in value by 10.01% in just six trading days. Over the same period the Fund lost 9.09%. Markets then staged a rally into the end of August, rising just over 6% between the 26th August and the 31st August. In September the MSCI World Index fluctuated between negative 1% and 2% total return, which represented a period of relative calm after the large swings seen in August.

Performance drivers

In the first half of the year we saw growth stocks significantly pull ahead of value stocks (continuing the trend seen since October 2014) as investors paid up for revenue and earnings growth wherever they could find it. The 'style' of the Fund – with its strong value discipline – was

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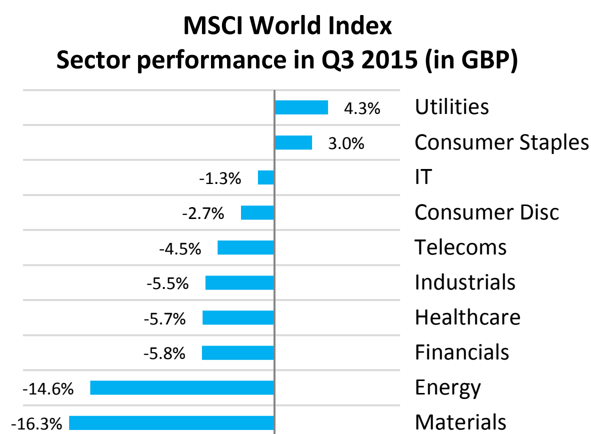
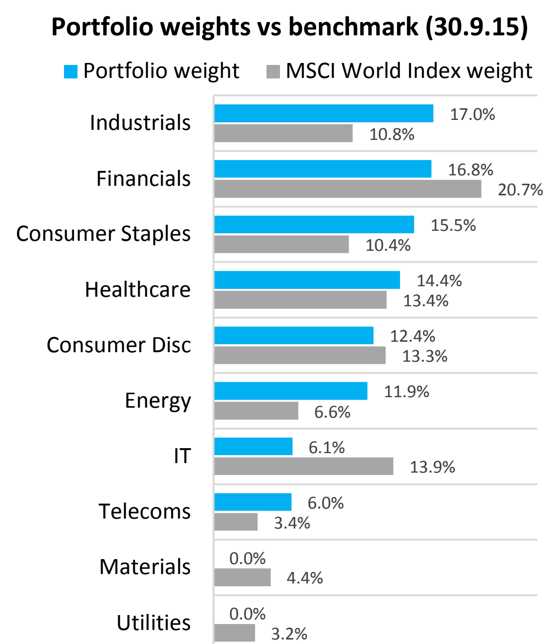
therefore rather out of favour. However, as investors became rattled by China's economic slowdown and the sudden drop in Chinese locally-listed shares through August, potential implications from the uncertainty regarding the Federal Reserve policy towards finally raising interest rates, and not least how these factors would affect corporate earnings in the future, the market became more focused once again on the factors we typically like to look for. These are: the ability of a company to continue to generate returns on capital above their cost of capital; a safe and growing dividend; and some kind of discount to the intrinsic value of the shares.

Looking at the individual performances of the ten sectors in the MSCI World Index, only two posted positive performance in the third quarter – utilities and consumer staples, both of which are seen as 'defensive' in nature.



Materials and energy were the worst performing sectors over the quarter as demand worries shook commodities markets on the back of weaker growth prospects emanating from China.

The Fund benefitted from having no exposure to the materials sector, but also had no exposure to utilities. Both sectors account for less than 5% each of the benchmark. We have maintained our exposure to the energy sector, through rebalancing of positions in the portfolio rather than any additions. The benchmark, as it is market capitalisation weighted, has had a reduced energy weighting as the sector has declined; it now accounts for just under 7% of the Index. Of the four energy companies held in the Fund, three are integrated European supermajors (Royal Dutch Shell, ENI and Total), and actually held up better than the overall energy sector in the quarter. We continue to watch our energy holdings closely, paying particular attention to their ability to pay a sustainable dividend, but believe today is not an opportune time to be selling at such depressed oil prices. As the majors continue to adapt to the current price environment and place greater emphasis on investment returns rather than purely growth in production, we believe a reasonable re-rating of these companies could occur. That noted, if we were to sell two of our four holdings in this sector then the Fund would move to slightly underweight versus the benchmark, so we do not believe we have taken an excessive risk, considering our zero weight to materials alongside.



We've been slowly reducing the Fund's weighting in consumer staples companies over the last few years, which had reached a peak of just under 30%. Today the Fund remains overweight to consumer staples with a weighting to the sector of 16%, versus the benchmark at just over 10%.

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IT remains our largest underweight, at some 8% less than the benchmark. Generally speaking the IT sector does not have a long history of paying reasonably-sized dividends, and as such we have found few companies that meet the criteria we seek for inclusion in the Fund. That said, with the recent sell off, and the start of a trend for IT companies (and particularly those based in the US) to pay dividends alongside buybacks, we are beginning to see more opportunities in the sector. This is likely a longer-term trend, however, and not something that will change the make-up of the Fund greatly in the short term.

Healthcare, on the other hand, has a long history of divided payments and would typically be seen as a ‘go to’ sector for the yield-hungry investor alongside utilities and, until not so long ago, financials. The Fund is invested in both ‘traditional’ healthcare companies such as Johnson & Johnson, and also companies such as Teva, the Israel-based generic drug manufacturer. The Fund does not have any direct exposure to the clutch of highflying biotech stocks (e.g. Biogen) that have been the stand-out performers over the last two years but that are now struggling to maintain their elevated valuations and high market expectations as their momentum weakens.

It’s worth pointing out that the Fund’s sector weightings are a by-product of our wholly bottom-up investment process (and equally-weighted portfolio), rather than being driven by any thematic or top-down approach.

Portfolio changes

We made two changes to the portfolio in the quarter. We sold our positions in L-3 Communications and Reckitt Benckiser. In their place we bought new positions in Eaton and WPP. These changes have decreased our weight in consumer staples (Reckitt) and increased consumer discretionaries (WPP). Eaton and L-3 Communications are both in the industrial sector so these changes did not affect the overall allocation of the Fund.

For the new buys we identified the three things we look for in any new investment – persistence of return on capital, reasonable valuation, and a sustainable and growing dividend. In the case of WPP we anticipate that a greater proportion of our expected total return will come from earnings and dividend growth, and only a moderate return from a multiple re-rating as the company is trading only slightly below its medium-term multiple. By contrast, Eaton, an industrial power management company based in the US, has a higher dividend yield (just over 4%) but slower dividend growth, and we expect a greater re-rating in terms of its multiple as the stock is more out of favour and has been de-rated versus the broader market since the end of 2013.

We decided to exit Reckitt Benckiser on valuation and dividend yield grounds. The company, in our view, remains very well run but we began to question whether the current valuation could justify us continuing to hold the stock. We have owned Reckitt since August 2011 and it has been a strong performer for the Fund; it’s risen 103% (in GBP), versus the Fund return of 47.2% over the same period. However, as the chart below shows, the majority of this total return has come from a re-rating of the multiple the stock trades on – it has risen from around 11x forward earnings to 25x today. As the dividend paid by the company has only grown by about 8% over our entire holding period (which is somewhat disappointing) the dividend yield has compressed from about 4% to 2%. The market has rewarded the company for focusing on household and personal care, costing cutting, and selling off the pharma division. We question whether the market has now baked-in excessive estimations for what the company can do from here. If we were to see the stock underperform the market in the future and move towards a more reasonable valuation, then it is certainly something we would consider owning again in the future.

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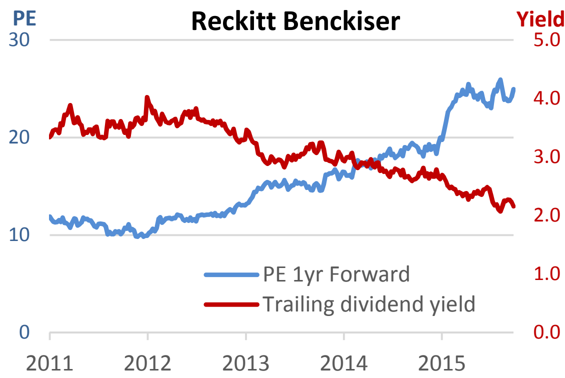
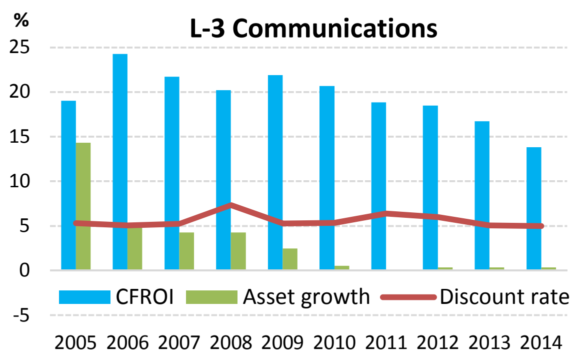


We have owned L-3 Communications for even longer than Reckitt. In fact we've held it from the Fund's launch on 31st December 2010. Over that time it has risen 72% (in GBP), versus the Fund return of 38.4% over the same period, so we are again taking profits. L-3 has also experienced a significant re-rating, rising from approximately 9x forward earnings when we bought it to just under 16x when we sold it. This is broadly in line with other defence companies, all of which were deeply out of favour post the financial crisis as investors worried about government spending cuts. L-3 has never had a very large dividend yield – it has averaged around 2.5-3%. The dividend has grown significantly over time, however, averaging around 9% growth per annum over the (almost) five years we have held the company. It is likely this strong dividend growth has helped support and 'drag up' the share price over time.

From a valuation point of view the company appears to be trading at stretched multiples, and certainly in respect to where the company has traded historically. This has been a concern. What really drove us to sell the company, however, was the deterioration in the underlying quality of the business.



L-3's cash flow return on investment has declined quite significantly over the last year, and current expectations are for this decline to continue. Sales growth has been negative for a number of years, and we have just started to see a decline in operating margins too. With little or no asset growth expected, it appears unlikely the company can reverse the decline in both its economic profits and the market's expectations.

Outlook

At the end of the quarter the Fund was trading on 14.5X 2015 earnings, and 13.4X 2016 earnings – a discount of 7.8% and 6.0% respectively to the broad market. We therefore see the portfolio as providing good value to our investors on these simple metrics. The correction in Q3 means that the valuation levels of some of the previously overbought parts of the market, like biotech or healthcare, have come down somewhat. But the correction was not nearly enough to make markets standout 'cheap'. We are therefore keeping a close eye on maintaining a discount for the portfolio versus the market.

We feel the Fund is well placed to continue its good performance. With heighted valuations, worries around increases in interest rates, and plenty of geopolitical uncertainty around the globe, our approach of focusing on the quality of the underlying companies we own and not chasing high dividend yields should stand us in good stead.

Dr. Ian Mortimer & Matthew Page
Co-managers, Guinness Global Equity Income Fund

October 2015

Data sources

Fund performance: *Financial Express, total return in GBP*

Index and stock data: *Bloomberg*

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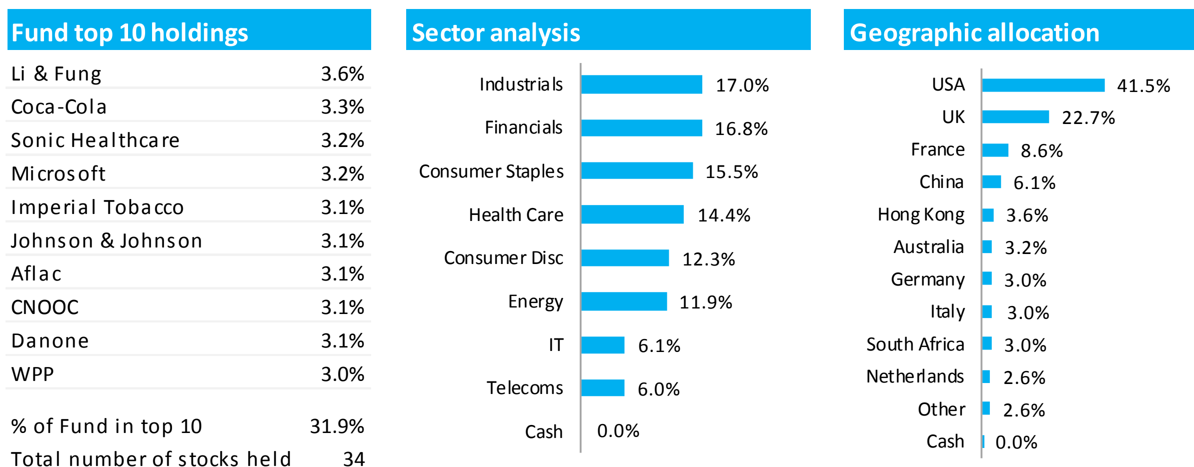
PORTFOLIO

30/09/2015



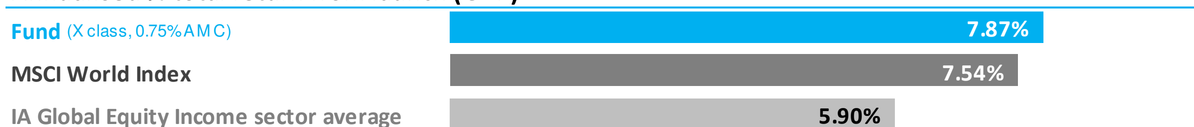
Fund top 10 holdings

Holding	%
Li & Fung	3.6%
Coca-Cola	3.3%
Sonic Healthcare	3.2%
Microsoft	3.2%
Imperial Tobacco	3.1%
Johnson & Johnson	3.1%
Aflac	3.1%
CNOOC	3.1%
Danone	3.1%
WPP	3.0%
% of Fund in top 10	31.9%
Total number of stocks held	34

PERFORMANCE

30/09/2015

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Sep '11	Sep '12	Sep '13	Sep '14	Sep '15
Fund (X class, 0.75% AMC)	-	13.8	21.0	10.5	-1.0
MSCI World Index	-3.2	17.3	19.9	12.1	1.6
IA Global Equity Income sector average	-0.5	15.5	17.3	8.8	-2.7

Cumulative % total return (GBP)	1 month	3 months	Year-to-date	1 year	3 years	From launch
Fund (X class, 0.75% AMC)	-1.68	-4.26	-5.0	-1.0	32.3	43.3
MSCI World Index	-2.21	-4.94	-3.3	1.6	36.5	41.3
IA Global Equity Income sector average	-2.97	-6.00	-4.9	-2.7	24.1	31.3

RISK ANALYSIS

30/09/2015

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.35	1.49
Beta	1	0.76	0.83
Information ratio	0	-0.22	0.06
Maximum drawdown	-18.26	-15.50	-16.34
R squared	1	0.80	0.89
Sharpe ratio	0	0.23	0.37
Tracking error	0	6.01	4.47
Volatility	13.33	11.39	11.69

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Source: Financial Express, bid to bid, total return. Fund launch date: 31.12.10. **Fund X class**: Simulated performance based on actual returns of E share class (available from Fund launch), calculated in GBP. **IA sector** performance based on highest fee share classes for each fund (C Class (1.5% AMC) for Guinness Global Equity Income). **See Notes overleaf.**

Performance data notes

1) The performance numbers displayed on the previous page are calculated in GBP (Sterling). Please note: The Fund's X class was launched on 15/02/2012. The performance shown is a simulation for X class performance being based on the actual performance of the Fund's E class, which has the same annual management charge as the X class, and has existed since the Fund's launch. The Fund's E class is denominated in USD but for the purposes of this performance data its performance is calculated in GBP. Hence the Fund's E Share class is used here to illustrate the performance of a GBP-based clean-fee (RDR-compliant) share class since the Fund's launch on 31.12.10.

2) The performance of the IA Global Equity Income sector is based on the average of the highest fee share class of each constituent fund, e.g. C class for the Guinness Global Equity Income Fund, with an annual management fee of 1.5%.

Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about Guinness Global Equity Income Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

Risk

The Guinness Global 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. 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: Capita Financial Managers (Ireland) Limited, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

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

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.

Telephone calls may be recorded and monitored.