Guinness Global Equity Income Fund

INVESTMENT COMMENTARY – July 2019

About the Fund

The 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	£660m
Launch date	31.12.10
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA
Analysts	Sagar Thanki Joseph Stephens

Performance 30.06.19

	1 year	3 years	From launch
Fund	13.7	39.0	147.7
Index	10.3	46.6	149.2
Sector	8.5	34.0	105.1

Annualised % gross total return from launch (GBP)

Fund	11.3%
Index	11.3%
Sector	8.8%

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. Y Class 0.99% OCF. Please refer to 'Performance data notes' for full details

Summary performance

In June the Guinness Global Equity Income Fund was up 4.7% (in GBP) versus the MSCI World Index benchmark which was up 6.0%. The Fund therefore underperformed the index by 1.3% over the month.

In the second quarter of 2019, the Fund was up 5.1% (in GBP), versus the MSCI World Index benchmark, which was up 6.4%. The Fund has therefore underperformed the index by 1.3%.

It is pleasing to see that both the short and long-term performance of the strategy remain strong versus IA Global Equity Income sector peers.

	YTD	1yr	3yr	5yr	Since Launch*
Fund	14.8%	13.7%	39.0%	74.2%	147.7%
Index	17.1%	10.3%	46.6%	85.0%	149.2%
IA sector average	14.2%	8.5%	34.0%	53.2%	105.1%
Rank vs peers	22/55	12/53	15/46	11/40	2/17
Quartile	2nd	1st	2nd	2nd	1st

Source: Financial Express. Cumulative Total Return in GBP as of 30th June 2019

Underperformance in the quarter can largely be attributed to the Fund's defensive qualities facing a market which saw a particularly strong rally in June (as shown below). This came after easing of both the Fed's interest rate rhetoric and the US-China trade tensions.

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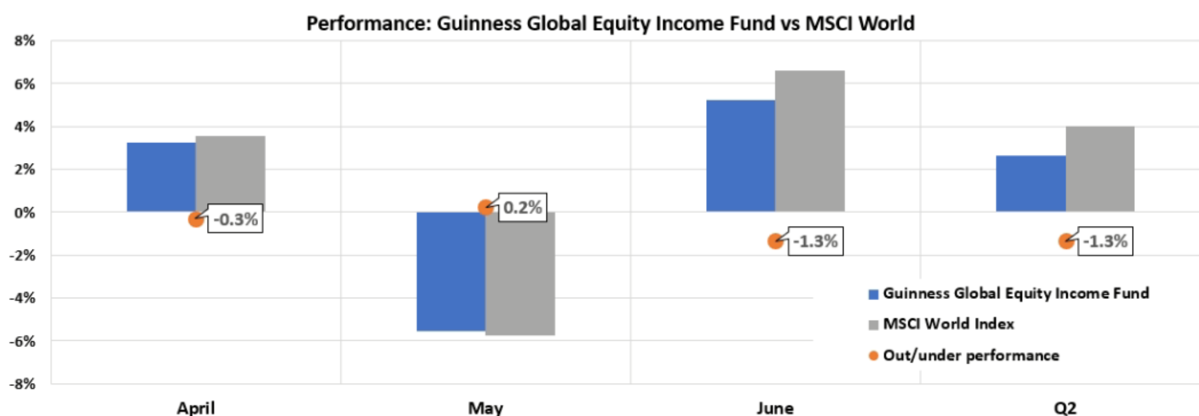
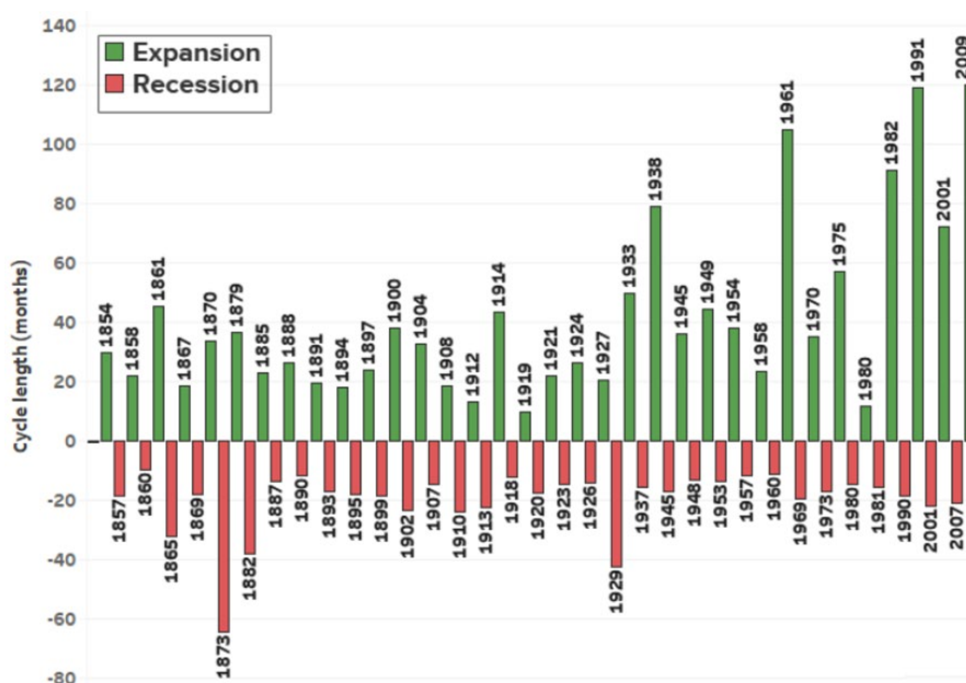


Data as of 30.06.2019 in GBP. Source: Financial Express

Quarter in Review

The US economic expansion and recovery from the Great Recession officially made history on 1st July: the 10-year, 121-month expansion that started in June 2009 is now the longest ever. The previous record was set during the 120-month expansion from March 1991 to March 2001 and ended with the infamous bursting of the dotcom bubble.



Source: National Bureau of Economic Research. Year indicates start of cycle

While the current expansion is a record-breaker in terms of longevity, it has been one of the slowest in terms of growth magnitude. US GDP has grown 25% cumulatively since the start of the expansion, which is lower than others on record:

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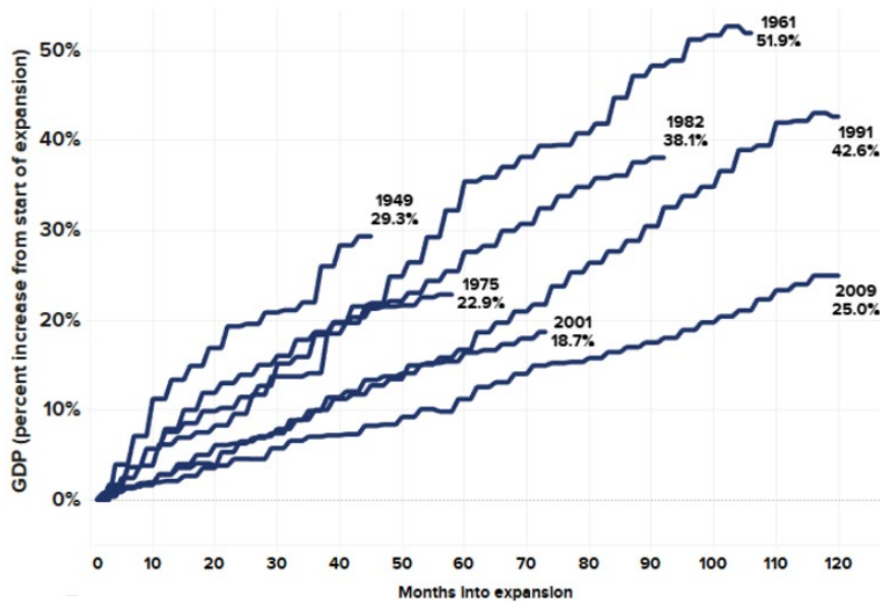
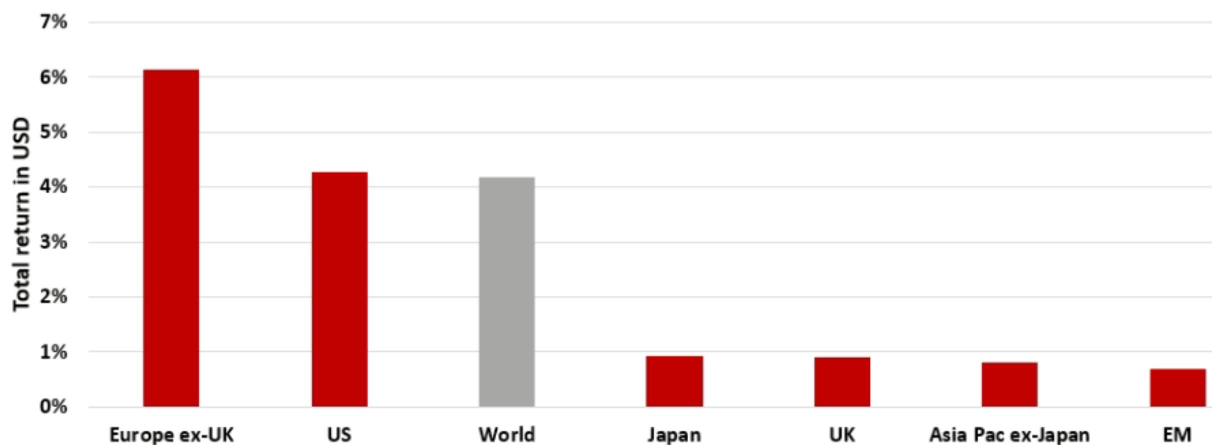


Source: St Louis Federal Reserve. Year indicates start of cycle

As we wonder just how long the current expansion can keep going, there have recently been mixed signals from the US market about the likelihood of a recession on the horizon. On one hand, the S&P 500 Index has soared to new highs. On the other, trade tensions sparked a panic in the bond market, triggering a yield-curve inversion – seen as a sign that a recession may be pending. Though these tensions somewhat eased at the end of June with President Trump indefinitely suspending Mexican tariffs and engaging in further talks with Chinese President Xi Jinping, no long-term solutions have yet been established and hence the 'trade war' cloud continues to overhang.



Source: Bloomberg. As of 30th June 2019

Nonetheless, all regions posted positive gains over the last quarter with Europe ex UK and the US leading as investors were cheered by the dovish rhetoric from both the Federal Reserve and European Central Bank. Fed chair Jerome Powell's comment that "an ounce of prevention is worth a pound of cure" led to the market forecasting 0.5%-worth of rate cuts by the end of 2019. This was followed by ECB chair Mario Draghi stating monetary policy would be loosened unless the economy improves, suggesting that interest rates could fall into negative territory.

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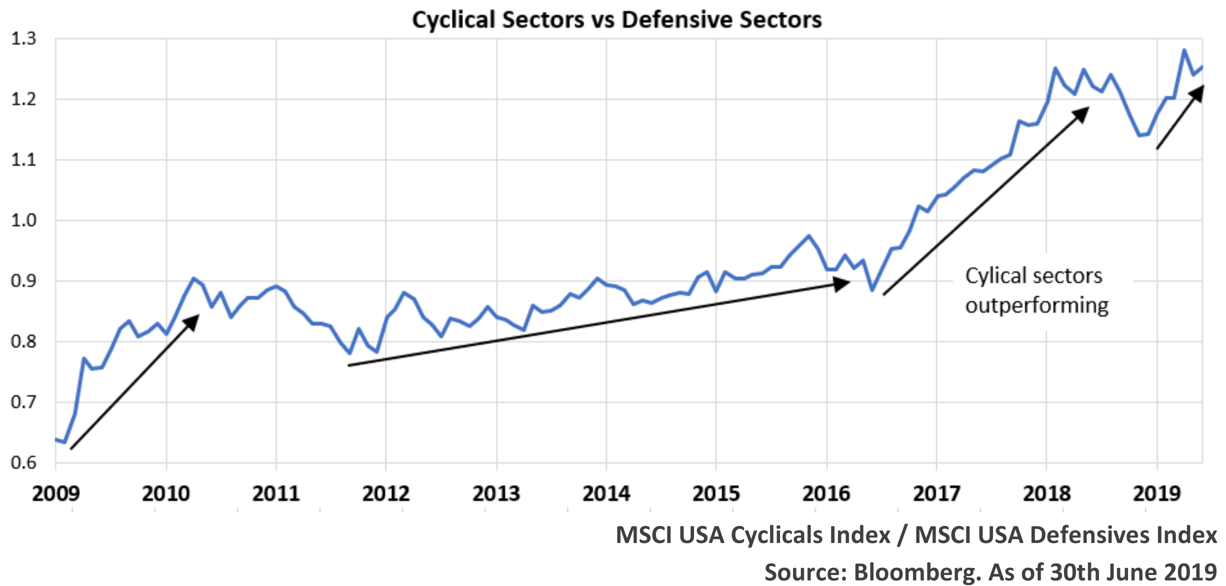
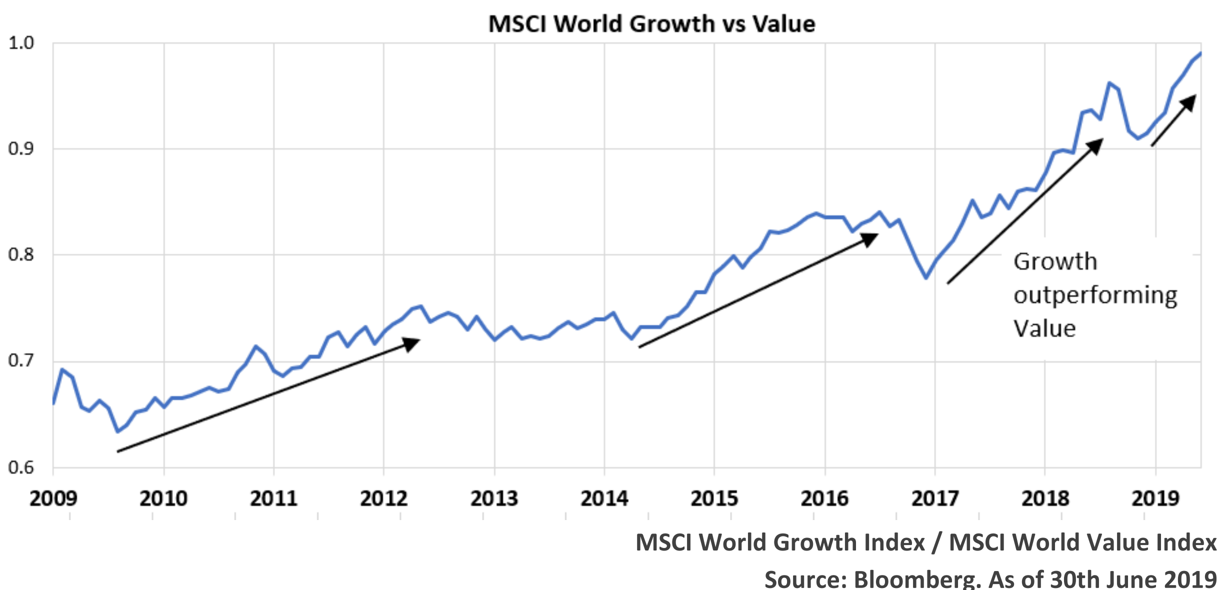
Low interest rates (vs history) for the past decade have resulted in a sustained outperformance of cyclical sectors and growth stocks, and the last quarter was no different:



MSCI USA Cyclicals Index / MSCI USA Defensives Index
Source: Bloomberg. As of 30th June 2019



MSCI World Growth Index / MSCI World Value Index
Source: Bloomberg. As of 30th June 2019

Although the Fund is broadly positioned to outperform when markets are weaker (i.e. also when we tend to see a value bias and the outperformance of defensive sectors), our stringent focus on investing in high-quality businesses – ones that have persistently high returns on capital throughout all periods in a business cycle – has led to us keeping up with strong markets and outperforming in moments of weaker markets. This is reflected in our high ranking (2/17 funds since launch) versus our peer group, the IA Global Equity Income sector. The Fund launched on 31st December 2010.

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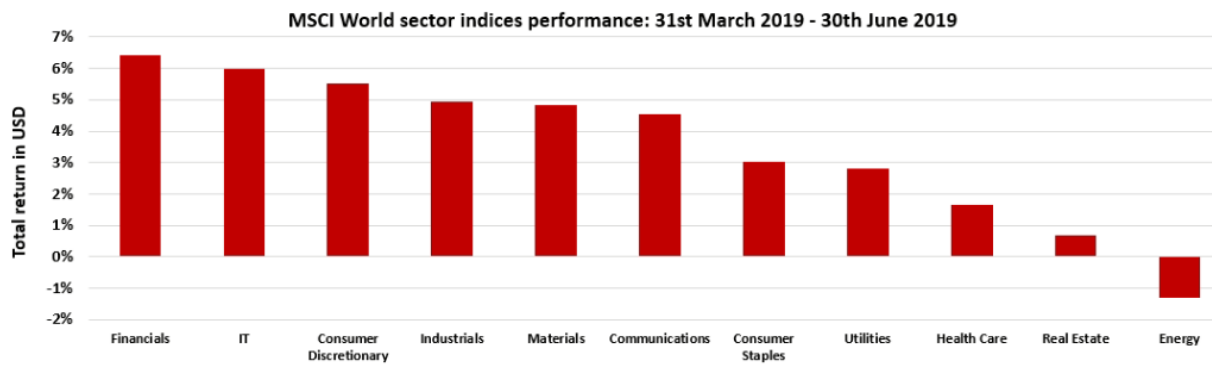
Guinness Global Equity Income Fund



Source: Bloomberg. As of 30th June 2019

Last quarter, Financials were the strongest-performing sector. The sector saw its biggest one-month gain in April 2019 since November 2016 – when Donald Trump's election win spurred hope for deregulation, tax reform and expectations that economic stimulus plans would stoke inflation and drive up interest rates. This time round, the rally in bank stocks specifically came after a solid first-quarter earnings season. This was a drag on relative Fund performance since we have zero exposure to banks; the financial crisis and the Euro crisis tend to screen out such stocks from our investment universe since they do not meet our criteria of persistently high cashflow returns on investment.

The IT sector also continued to perform well in the quarter, powered by Microsoft, which became the largest publicly traded company in the world by market capitalisation and the third company to achieve a US$1tn valuation, alongside Apple and Amazon. The jump in Microsoft's share price followed better-than-expected sales and earnings in the first three months of this year as businesses continued to sign up to its expanding cloud services suite. We have held Microsoft in the Fund since launch, and over that time it has been the best-performing stock, up 490% in USD terms. Azure cloud services, used to store and run customers' applications in Microsoft's data centres, is number two in the cloud sector behind Amazon Web Services, though the market is growing fast enough to lift both companies' revenue. Windows and Office subscribers are likely to give Microsoft an edge as corporate users shift newer workloads to the cloud for greater agility. Margins should also improve – as they have been doing – as cloud-based applications and infrastructure products gain scale.

Over the course of quarter, the Fund avoided significant exposure to the poorer-performing sectors: we hold no positions within the Real Estate and Utilities sectors and only one stock in the Energy sector. Nonetheless, our overweighting to Consumer Staples and Healthcare proved to be a drag on performance. Healthcare was a poor performer, facing headwinds from ongoing concerns over changes to drug pricing legislation. As drug pricing comes under scrutiny in the US and is given increased attention ahead of the 2020 Presidential Election, we decided to lower the Fund's exposure to the sector.

We made one change to the portfolio in the quarter, replacing our position in Merck with Blackrock.

This reduced our Healthcare exposure and increased our Financials exposure.

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Merck, the global Healthcare company, saw poor performance at the start 2019. This followed a very strong 2018 during which Merck's lung cancer drug Keytruda won a string of clinical trials, placing it in the top spot for treating lung cancer.

Other best-selling drugs in the Pharmaceutical segment include type 2 diabetes drug Januvia, which brings in about $4 billion in revenues annually. Other products earning more than $2 billion include diabetes drug Janumet, HPV vaccine Gardasil, and cholesterol medication Zetia. Meanwhile, $1 billion top sellers include Keytruda, cholesterol medication Vytorin, skin antibiotic treatment Cubicin, HIV therapy Isentress, inflammatory treatment Remicade, and chickenpox vaccine ProQuad.

Our decision to take profits and sell our holding comes after considering Merck's peak valuation and weakening balance sheet profile, as well as the sector's prospects discussed above. At sale, on a price-to-earnings basis, the stock traded at 1.5 standard deviations above its 10-year average and the company has also been accumulating higher levels of debt. Total debt to equity stood at 93% and cashflow returns on invested capital dipped below 10%, thus removing Merck from our quality-driven investment universe.

As part of our 'one in, one out' process, we bought a position in **BlackRock**, the world's largest asset manager with $6.5 trillion in assets under management (AUM). The company stands out in its industry due to its strong brand loyalty and focus on institutional investors. The firm's moat, arising from its breadth as the largest manager globally by AUM, proprietary Aladdin software, and dominating iShares division, is very strong.

The increase in global wealth and ever-rising interest in ETFs act as the backbone for BlackRock's success. Through its iShares offering, BlackRock is the ultimate ETF leader with assets totalling nearly $1 trillion in AUM. Vanguard is second with $610bn; in third, with $471bn, comes State Street. BlackRock earns nearly 50% of its base fees from equity products, although it has historically had a strong fixed income offering.

BlackRock has been especially profitable due to its focus on institutional investors, who are willing to pay higher fees in order to get the liquidity they require. Actively managed and iShares funds tend to have larger asset bases and trade frequently in the open market, making it easier for big financial institutions to make large orders without the worry of disrupting funds' trading operations.

While profit margins have come under pressure in the short term as passive investments have grown more quickly in AUM and are priced lower than actively managed funds, BlackRock has invested in alternative technologies to expand its capabilities. One of these investments include its Aladdin platform. Short for 'Asset Liability and Debt and Derivative Investment Network', the operating system for investment managers combines sophisticated risk analytics with comprehensive portfolio management, including trading and operations tools, on a single platform.

BlackRock's push to diversify its revenue sources is a positive and lowers the stock price's beta to the wider market. Asset managers have recently performed poorly due to fee pressures, strains on profit

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margins, and looming worries about the late-cycle stage of the economy. This has meant they have collectively sold off. We believe, however, that Blackrock has become cheaper than its true valuation giving us an attractive entry point into a stock with a solid stream of dividends and good potential for growth. The company has also boosted its dividend, with year-on-year growth (2018 vs 2017) greater than 20%.

Stock Selection

Individual stock performance over quarter (total return USD)

-40% -30% -20% -10% 0% 10% 20% 30%

WPP PLC
Schneider Electric SE
CME Group Inc
Microsoft Corp
Vodacom Group Ltd
Danone SA
Arthur J Gallagher & Co
Deutsche Boerse AG
Randstad NV
Nestle SA
BlackRock Inc (Bought in Q2)
Aflac Inc
Unilever PLC
Sonic Healthcare Ltd
VF Corp
Procter & Gamble Co/The
Illinois Tool Works Inc
Royal Dutch Shell PLC
Eaton Corp PLC
Paychex Inc
BAE Systems PLC
Roche Holding AG
Cisco Systems Inc
United Technologies Corp
ANTA Sports Products Ltd
Johnson & Johnson
Taiwan Semiconductor Manufactu
Novo Nordisk A/S
Reckitt Benckiser Group PLC
Broadcom Inc
Merck & Co Inc (Sold in Q2)
Japan Tobacco Inc
AbbVie Inc
Hengan International Group Co
British American Tobacco PLC
Imperial Brands PLC

Source: Bloomberg

WPP was the best-performing stock in the Fund over the quarter (+23.9% in USD).

After a difficult 2018, WPP's new strategies seem to focus on merging advertising networks and selling lower-growth parts of the business to become more streamlined overall. Strong performance in the quarter comes after WPP announced it would be selling 60% of Kantar, its

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market research unit, to Bain Capital. Valued whole at $4 billion, this was seen by the market as a move that will help WPP manage leverage and pursue M&A to accelerate the shift towards becoming a more technology-centric company. The mergers of Wunderman with Thompson and VML with Y&R are further evidence of WPP's efforts to become more streamlined as part of its three-year cost-cutting plan and profitability plan.

Further, the return on capital profile is high and stable, operating margins are around 20%, the company has historically had positive sales growth every year since 2002 (including 2009), the dividend is well covered, and the balance sheet is strong. The company's shares traded on a 1-year forward price-to-earnings multiple of 8.2x at the start of the quarter – almost 2 standard deviations below its 10-year average – and the current dividend yield is close to 6.2%. Management is implementing extensive restructuring plans to achieve better profitability and growth, and the market seems to be warming to this.

Schneider Electric also performed well (+19.3% in USD). The global market leader in low and medium voltage, and critical power solutions, benefits from exposure to several growth trends including big data, the internet of things and energy efficiency. Specific products include data centre software and cooling services, electrical surge protection, electric vehicle charging, buildings management and lighting control, sensors, motion control and robotics. FY 2018 sales underscored the attractive nature of Schneider Electric's end markets with sales rising by 7% on an organic basis, with the €20bn-sales Energy Management division growing 7% and the €6bn Industrial Automation division growing 8%. Sales in Asia Pacific rose 10%, with notable strength in China and medium voltage. Higher-margin service sales grew 9% and still only account for 12% of total sales, which means that the company has plenty of runway for growth and margin expansion amid ongoing trends towards outsourcing and remote monitoring and maintenance. Other measures that suggest that Schneider's moat continues to widen include a 20% rise in digital-related sales and a three-fold increase in connected customers since 2015. Management highlighted ongoing potential to increase cross-selling between low and medium voltage businesses lines and secure power; while the Aveva industrial software merger is running ahead of expectations in terms of synergies. The full-year dividend was increased by 7% and was also accompanied by a new €1.5bn - €2bn share buyback.

CME Group was another top performer (+18.4% in USD). After underperforming in the first quarter, the second was much stronger for CME and coincided with a return of higher volatility arising from global political instability, and the company also reported quarterly EPS above market expectations. Longer-term, the exchange is well positioned to integrate the NEX acquisition and offer clients a more holistic solution given its futures, options and data products. The NEX deal should also support CME's international expansion plans, since 50% of NEX's revenue is generated outside of the US. Data and analytics are a key focus area for the company in 2019 with an outlook to expand recurring revenue. CME is also particularly well placed to benefit from increased interest rate hedging around Fed rate hikes and rising US oil exports thanks to its dominant Fed Funds and WTI futures contracts. The company has largely opted to pursue an organic growth strategy which has meant low debt-to-equity at 10% with returns on capital increasing every year for the last five.

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Imperial Brands (-30.2% in USD) and **British American Tobacco** (-14.4% in USD) were the worst performers in the quarter.

Imperial Brands, the traditional tobacco company which has been developing its alternative e-cigarette business, reported results during the quarter that missed expectations after slower than forecasted e-cigarette sales, particularly in the US, where the FDA has been increasing its scrutiny on the fast-developing industry. Imperial Brands has been divesting non-core assets including its premium cigar business whilst investing in the fast-growing alternative tobacco industry as the company looks to offset falling demand for its traditional tobacco products. The company continues to trade at a significant discount to its peers whilst offering the 12th largest dividend among UK companies – a dividend which has been growing at an average of 10% per year for the last five years.

British American Tobacco also performed poorly. The largest tobacco company in the world differs from its competitors in that it is a truly global operation, rather than operating within geographic confines. This was enhanced with the acquisition of Reynolds American in 2017 which gave BATS greater scale in the US market. The company has been battling increased proposed regulation in the US as well as industry pessimism. More broadly, BATS is hugely cash-generative, has a stellar return on capital profile, a market-leading dividend yield of 6.3%, and a price-to-earnings ratio 2 standard deviations below its 10-year average.

Outlook

The four key tenets to our approach are: quality, value, dividend, and conviction. We are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI World Index.

		Fund	MSCI World Index
Quality	Average 10 year Cashflow Return on Investment	17%	8%
	Weighted average net debt / equity	28%	98%
Value	PE (2019e)	15.5	16.3
	FCF Yield (LTM)	6.2%	5.4%
Dividend	Dividend Yield (LTM)	2.5%	2.4%
	Weighted average payout ratio	66%	70%
Conviction	Number of stocks	35	1650
	Active share	91%	-

Portfolio metrics versus index. As of 30th June 2019
Source: Guinness Asset Management, Credit Suisse HOLT, Bloomberg

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At the end of the quarter the Fund was trading on 15.5x 2019 expected price to earnings, a discount of 5% to the broad market. Additionally, on a free cashflow basis, the Fund trades at a 15% discount to the market.

With more sensitive markets and many uncertainties, any risks should be considered in the context that global equities now trade below their 10-year average price-to-earnings multiple, and our Fund is at a discount to the market despite holding higher-quality companies. Our perpetual approach of focusing on the quality of the underlying companies we own should stand us in good stead in our search for rising income streams and long-term capital growth.

We thank you for your continued support.

Portfolio Managers
Matthew Page, CFA
Dr Ian Mortimer, CFA

Analysts
Joseph Stephens
Sagar Thanki

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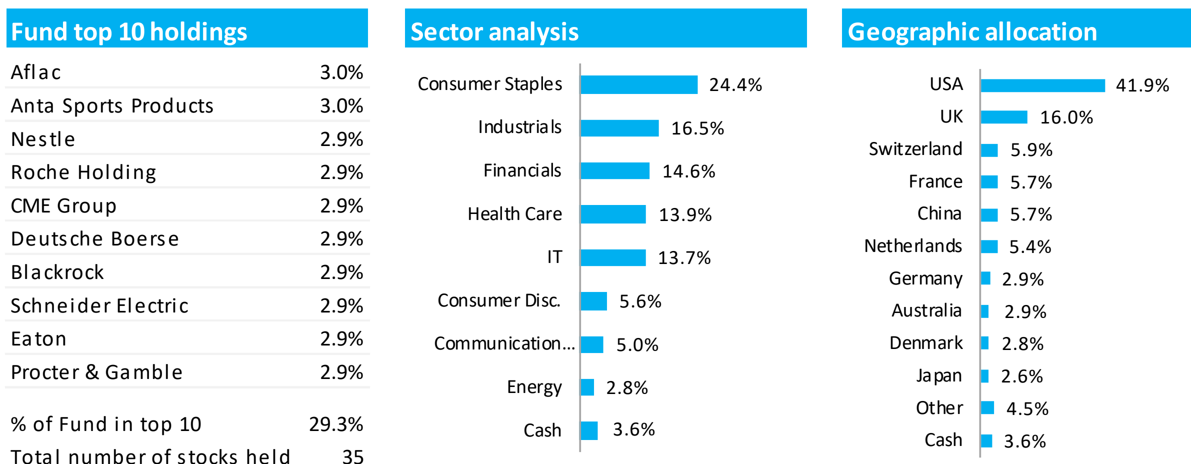
PORTFOLIO

30/06/2019



Fund top 10 holdings

Holding	%
Aflac	3.0%
Anta Sports Products	3.0%
Nestle	2.9%
Roche Holding	2.9%
CME Group	2.9%
Deutsche Boerse	2.9%
Blackrock	2.9%
Schneider Electric	2.9%
Eaton	2.9%
Procter & Gamble	2.9%
% of Fund in top 10	29.3%
Total number of stocks held	35

PERFORMANCE

30/06/2019

Annualised % total return from launch (GBP)

Discrete years % total return (GBP)	Jun '15	Jun '16	Jun '17	Jun '18	Jun '19
Fund (Y class, 0.99% OCF)	5.4	18.9	16.1	5.3	13.7
MSCI World Index	10.3	14.4	21.6	9.3	10.3
IA Global Equity Income sector average	4.3	9.6	19.2	3.6	8.5

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y class, 0.99% OCF)	4.3	14.8	13.7	39.0	74.2	147.7
MSCI World Index	5.6	17.1	10.3	46.6	85.0	149.2
IA Global Equity Income sector average	4.4	14.2	8.5	34.0	53.2	105.1

RISK ANALYSIS

30/06/2019

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.32	1.43
Beta	1	0.76	0.86
Information ratio	0	-0.37	-0.02
Maximum drawdown	-18.26	-15.50	-16.34
R squared	1	0.80	0.89
Sharpe ratio	1	0.47	0.63
Tracking error	0	6.06	4.52
Volatility	13.83	11.33	12.21

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Source: Financial Express, bid to bid, total return. Fund launch date: 31.12.10. Fund Y class (0.99% OCF): Composite simulated performance based on actual returns of E share class (available from Fund launch), calculated in GBP.

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Performance data notes

1) The performance numbers displayed on the previous page are calculated in GBP (Sterling). Please note: The Fund's Y class was launched on 11.03.15. The performance shown is a composite simulation for Y class performance being based on the actual performance of the Fund's E class, which has an annual management charge 0.75%, 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.

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: Link Fund Administrators (Ireland) Ltd, 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.

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.