GUINNESS

# Global Innovators Fund

**A high conviction global growth fund managed by Dr. Ian Mortimer, CFA, and Matthew Page, CFA,**

## Annual review

# 2016

GUINNESS
ASSET MANAGEMENT LTD

| **Fund size** (31.12.16) | **£62m** |
|---|---|
| **Launch date** | **31.10.14** |

## Aim

The Fund is a large cap. growth fund designed to provide exposure to companies benefiting from innovations in technology, communication, globalisation or innovative management strategies. The Fund holds a concentrated portfolio of large and medium-sized companies in any industry and in any region.

## Performance

31/12/2016

| | |
|---|---|
| **Strategy** | Guinness Global Innovators* |
| **Index** | MSCI World Index |
| **Sector** | IA Global sector average |

| Cumulative % total return (GBP) | 1 year | 3 years | 5 years | 10 years |
|---|---|---|---|---|
| **Strategy*** | 28.0 | 55.6 | 154.9 | 236.1 |
| **Index** | 28.2 | 49.9 | 106.4 | 130.6 |
| **Sector** | 23.3 | 35.7 | 80.7 | 92.1 |
| **Position in sector** | 71 /266 | 26 /238 | 3 /205 | 1 /138 |

**Annualised % total return**
**from strategy inception (GBP)**

| | |
|---|---|
| Strategy* | 12.74% |
| Index | 9.99% |
| Sector | 9.06% |

**Risk analysis** - Annualised, weekly, 5 years, in GBP

| | Index | Sector | Strategy* |
|---|---|---|---|
| **Alpha** | 0 | 0.18 | 2.53 |
| **Beta** | 1 | 0.81 | 1.11 |
| **Info ratio** | 0 | -0.44 | 0.69 |
| **Max drawdown** | -14.03 | -17.08 | -17.14 |
| **R squared** | 1 | 0.78 | 0.86 |
| **Sharpe ratio** | 0.95 | 0.78 | 1.09 |
| **Tracking error** | 0 | 5.84 | 5.73 |
| **Volatility** | 12.38 | 11.31 | 14.88 |

**Past performance should not be taken as an indicator of future performance. The value of this investment can fall as well as rise as a result of market and currency fluctuations.**

*The returns stated above are a simulation based on the actual returns of Guinness Atkinson Global Innovators Fund (a mutual fund for US investors, launched on 31/04/2003) until the launch of the UCITS version on 31.10.14. Both funds are managed in accordance with the same investment process and with the same portfolios. Source: Financial Express, bid to bid, total return. Guinness Atkinson Global Innovators Fund is not included in the IA Global sector. The sector's performance and the Fund's ranking are included for a comparison of the Fund with the average performance of global equity funds available in the UK.

# Annual review

In what was a tumultuous year the Fund produced a total return of 28.00% in GBP, benefiting significantly from its global exposure through the Brexit vote and subsequent depreciation of Sterling. In USD terms the Fund produced a total return of 6.8%.

In 2016 the benchmark MSCI World Index total return was 28.24% (in GBP) meaning the Fund had a small underperformance of 0.24%. This still placed the fund in the 27% percentile for the year versus the IA Global Equity sector

**Figure 1: Global Innovators strategy performance**

| Cumulative % total return (GBP) | 1 year | 3 years | 5 years | 10 years |
|---|---|---|---|---|
| **Guinness Global Innovators Fund** | 28.0 | 55.6 | 154.9 | 236.1 |
| **IA Global Sector average** | 23.3 | 35.7 | 80.7 | 92.1 |
| **MSCI World Index** | 28.2 | 49.9 | 106.4 | 130.6 |
| **Position in sector** | **71/266** | **26/238** | **3/205** | **1/138** |

**Review of 2016**

As many commentators have noted, 2016 provided reasonable, but not spectacular, global equity returns (MSCI World Index up 7.51% in USD over the year) despite the myriad of events that occurred throughout the year that could have knocked markets off course. Clearly, UK investors with global exposure did far better when rebasing back into sterling due to the currency moves after Brexit: in GBP the MSCI World Index was up 28.24%.

The year started with a continuation of the slide in oil prices. The WTI crude price had stabilised in mid-2015 around $60 per barrel, having dropped from around $100 per barrel in 2014. But as OPEC and Saudi Arabia in particular continued to pump oil and proceed with their stated aim of conserving market share, the price slumped to a low of $27 per barrel at the end of January as supply overwhelmed demand. The steep fall in the oil price coincided with a focus on one of the market's biggest concerns from 2015, namely the underlying growth in the Chinese economy. Fears of slowing growth in China alongside a sharp depreciation of the Renminbi caused a steep sell-off in all risk assets, both credit and equities. On February 11th the S&P500 was back to 1829 – more than 10% below where it ended 2015.

This proved to be the low for the S&P500 for the year, however. The rally in equities through the end of February and into March began after better than expected economic results in the US, which helped assuage some doubts following the weak Q1 GDP data released earlier in the year. The Fed was then more dovish at its March meeting and talked specifically about taking global market conditions into consideration when deciding on the path of interest rate rises and other policies. In China policymakers continued with the stimulus plan outlined in 2015 which broadly entailed slowing fiscal reforms and increasing credit growth to maintain target GDP growth in 2016. The oil price began to recover alongside equity markets which had the effect of improving future earnings estimates for the energy sector and therefore the broader indices, and high yield credit associated with indebted oil and gas companies began to recover significantly. Oil-exposed countries also benefited from the recovery in crude.

It would be fair to say that political uncertainty then dominated market sentiment through the rest of 2016. It started with the beginning of official impeachment proceedings against Dilma Rousseff in Brazil in April and then moved swiftly on to the Brexit vote in June.

Arguably the shock vote to leave to the European Union by British voters was the biggest political surprise in 2016, perhaps even when measured against the US election in November. The implications of the actual triggering of Article 50 remain to be seen, and the outcome of trade negotiations and whether the Brexit is 'soft' or 'hard' will not be known potentially for several years. The immediate impact was felt most in the currency markets with the sharp depreciation of sterling, but equities recovered remarkably quickly after an initial slump in the days after the vote.

European politics then took a back seat as the world looked towards the US and the Presidential election in November. Once again experts were confounded as Donald Trump became President-elect. The result, having been predicted to crater equity markets, caused a strong equity rally into the year-end with domestically oriented businesses gaining significantly on the prospect of more protectionist policies being enacted by the incoming administration.

**Figure 2: Sector performance in 2016 (all TR in USD)**

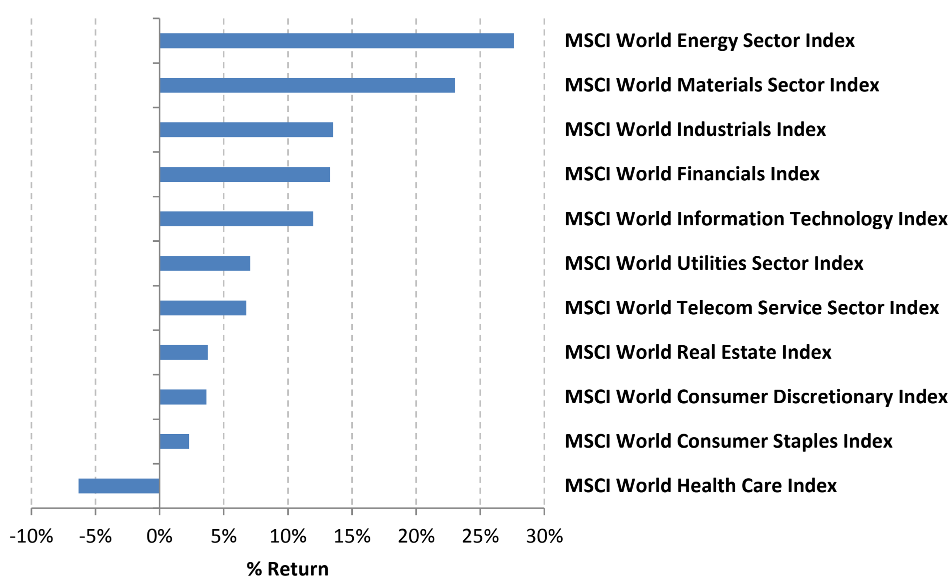


Figure 2 illustrates the individual sector performances of the MSCI World Index over 2016. The big winners in 2016 were the commodity companies, with Energy and Materials topping the list. Consumer Staples and Healthcare posted the weakest performance, with Healthcare the only sector with a negative total return over the period.

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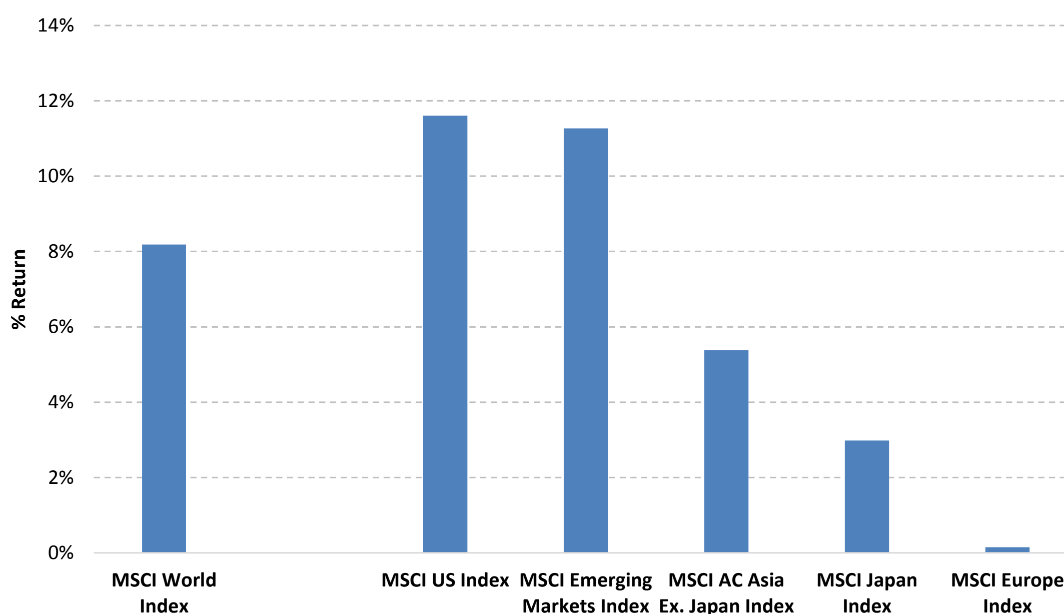
Clearly the rebound in commodity prices and especially oil which began in late February drove returns, but it is important to note those returns were based on low starting points; the Energy sector was down 22% (in USD) and Materials down 15% in 2015. Healthcare, on the other hand, suffered on the back of negative sentiment based on Hillary Clinton's desire to clamp down on drug pricing.

The Consumer Staples performance, however, hides a more dramatic change within markets through 2016, namely the large sector rotation from defensive sectors towards more cyclical sectors which began in earnest at the end of July. But to use a convenient mid-point, the Consumer Staples sector was up 8.73% (in USD) at the end of June and then was down 5.92% from that point to the end of the year, giving a full year return of just 2.30%.

The election of Donald Trump in November, which fuelled the expectation of large fiscal stimulus, lower taxes, and thus faster growth in inflation, served to accelerate this rotation rather than necessarily cause it.

Geographically the US and Emerging Markets were the best performing regions, as Figure 3 highlights. Asia showed reasonable returns but Japan and Europe lagged. In local currency terms Japan actually had a negative return of -0.4% whilst Europe was up 3.1%

**Figure 3: Regional performance in 2016 (all TR in USD)**




When considering Emerging Markets, however, it is important to distinguish between the large differences in individual country performances. When we look more closely at the drivers of the 11.3% return for the Emerging Markets Index we find that over 60% of that return can be attributed to just three countries: Brazil, Russia, and South Africa. All three benefitted significantly from the rebound in commodity prices and in fact make up less than 18% of the index in terms of their average weights over the year. Apart from Taiwan, which contributed over 20% to the index return thanks to a very strong IT sector, the majority of emerging markets had a relatively weak year.

Another notable move in markets was the strengthening of the US dollar from the middle of the year after it had been range bound for the previous 12-18 months. With the potential for significant rate rises from the Fed in 2017 and continued low interest rates in the rest of the world, the prospect of further dollar strength is very possible this year. However, if inflation is slower than the market expects or full employment in the US is in fact not as close as it currently seems then this trend could be curtailed. Whatever happens, the level of the

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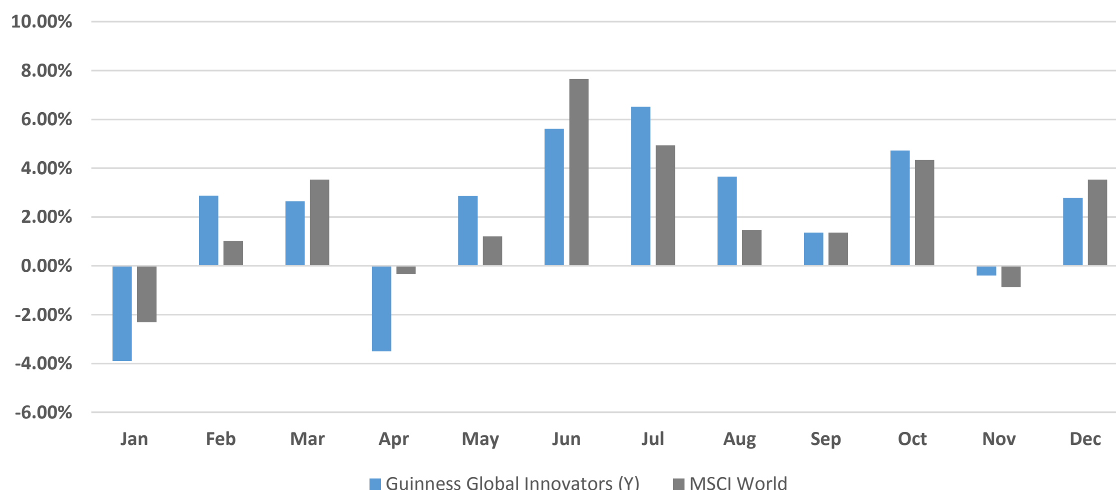
dollar relative to other world currencies is likely to be a hotly debated topic as it can have such a profound effect on a multitude of asset classes.

**Figure 4: US Dollar index (DXY)**

## Review of 2016 fund performance

As we have highlighted in previous reviews, historically the Global Innovators Fund has tended to outperform in months where the index performance has been positive and underperform in months where the index performance has been negative. On average that picture held true for 2016. The chart below shows there were nine months of positive market returns and in those the fund outperformed in six of them. There were three months of negative market performance and the fund underperformed in two of them.

**Figure 5: Monthly returns of Fund vs benchmark in 2016 (all TR in GBP)**




The months where the fund underperformed in positive markets were March, June, and December. In March weak results from H&R Block sent the shares down 19% and were the main contributor to the underperformance of the fund in what was a strong month for the market. In June the fund's underweight allocation to Consumer Staples and overweight to IT companies combined with a sharp sell-off in State Street

shares during the Brexit vote meant the fund did not capture the full upside of market returns. Finally, the relative underperformance in December was caused mainly by New Oriental Education shares falling 16% as Reuters reported potential academic fraud at the business (which as we write appears an overreaction - the shares having rallied back to the level before the sell-off).

November was the month where the fund outperformed the market in a down month. This outperformance was driven in the main by very strong returns from our holding in Nvidia which was up over 30% in the month, a remarkable return considering the stock was already up over 117% for the year to the end of October. In fact Nvidia was the best performing stock in the S&P 500 for 2016 with a total return of 227%.

If we consider the year as a whole, however, the fund's low weighting to Energy (we held only one position in that sector - Schlumberger) and zero weighting to Materials meant the fund did not participate significantly in the commodities rally. Similarly, the fund had a low exposure to the banking industry, which also rallied strongly in the second half of the year as the expectation of interest rate increases boosted the prospects for their returns and the potential for reduced regulations from a Trump administration served to stoke that rally after the US election. On a stock-specific basis, weaker results from stocks held in the Consumer Discretionary sector (Li&Fung, H&R Block, New Oriental Education) were more than offset by very strong returns from holdings in the IT sector and the semi-conductor industry specifically. The fund's large overweight to IT did not significantly add to overall performance relative to the benchmark.

Figure 6 below highlights these trends in more detail by showing all the companies held in the portfolio over the year, and their total returns over our holding period. Red and green highlighted bars indicate the company was sold or bought, respectively, intra year.

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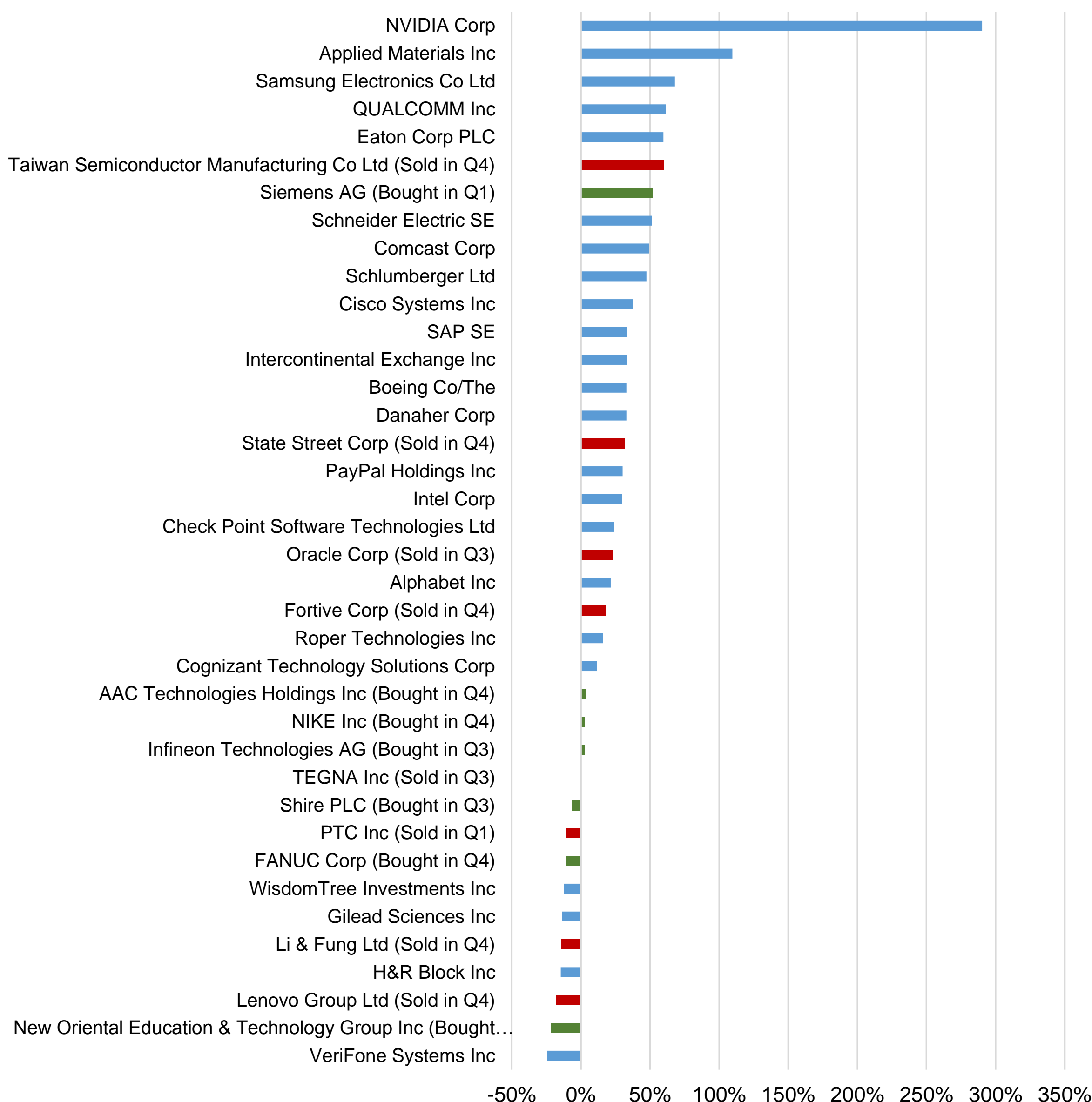
**Figure 6: Individual stock performance over 2016 (total return USD)**




We have always sought to apply a valuation discipline when running this strategy and to avoid the temptation to invest in exciting stories at heady valuations. This style held the fund back in 2015, as highly valued growth stocks accounted for almost the entirety of market returns. Our valuation discipline does not preclude investment in companies with high levels of anticipated growth. It just means we will only do so when we are comfortable that we are not taking on too much risk from a valuation perspective.

This was tested again when the fund underperformed in the first half of 2016 despite the good valuations we saw in many of the companies held in the portfolio. However, we stuck to our beliefs as long-term investors and it was pleasing that as market sentiment began to turn, the performance of those stocks that had suffered relatively the most were the ones that began to lead in the second half of the year.

As we mentioned above, when we look at stock performance in the first half of the year versus the second half there is a stark difference and this was also true for the fund, as figure 7 below illustrates.

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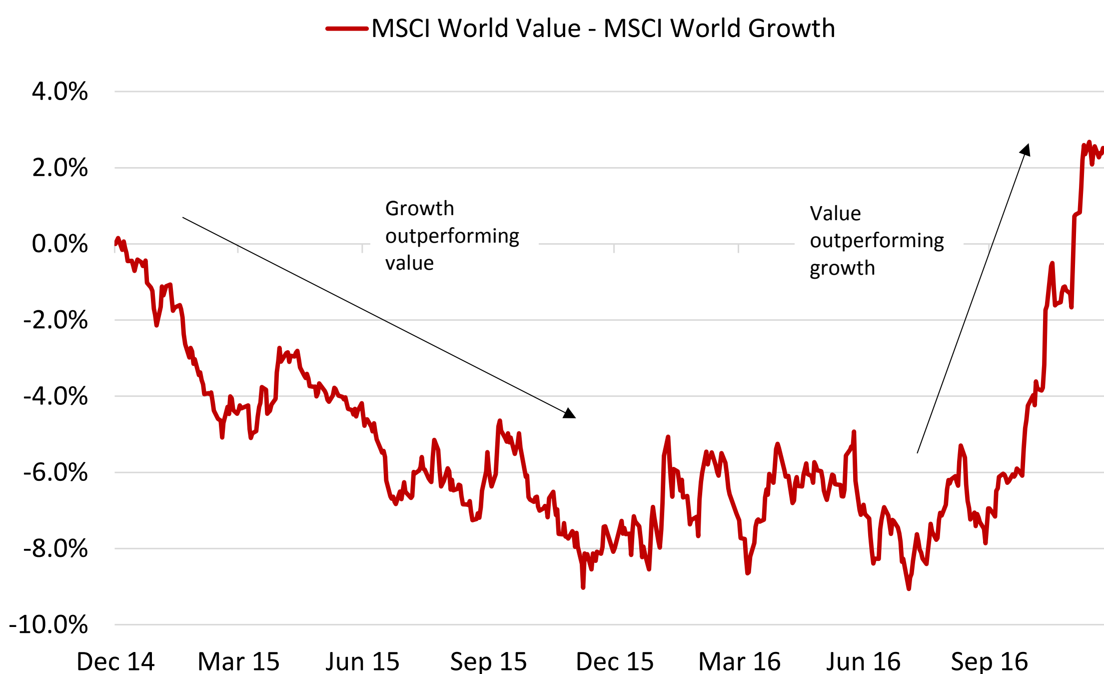
**Figure 7: Performance of the fund versus MSCI World Index (all TR in GBP)**

| Name | H1 2016 | H2 2016 |
|---|---|---|
| Global Innovators Fund | 6.55% | 20.13% |
| MSCI World TR in GB | 10.98% | 15.55% |
| Difference | -4.43% | 4.58% |

One factor that goes a long way to explaining the relative swing between the underperformance in the first half of the year versus the strong outperformance in the second half of the year is the change in sentiment towards value stocks that began in earnest in late July, as can be seen in figure 8 below.

**Figure 8: Value vs growth index performance since start of 2015 (all TR)**




Although we are investing for growth, our valuation discipline and bottom-up approach mean we have generally steered away from the most expensive parts of the growth universe. The value rally towards the year-end benefitted some of the more cyclically-oriented businesses we held as the market began to price in better prospects for economic growth and higher inflation. Whether this ‘rotation’ can be sustained is up for debate, since the move we have seen already has been stark and swift.

## Changes to the portfolio

We sold seven positions and initiated seven new positions over the course of 2016 which was one more than in 2015 and in line with the long-term turnover of the strategy.

**Figure 9: Number of changes to the portfolio**

| | 2015 | 2016 |
|---|---|---|
| Buys | 6 | 7 |
| Sales | 6 | 7 |
| Total Holdings | 30 | 30 |

We made one change to the portfolio in the **first quarter**. We sold PTC and replaced it with Siemens.

PTC had been a long-term and successful holding in the strategy. We purchased the company in late 2006 and it provided a total return almost double that of the broad market while it was in the portfolio. However, as the company began its transition to a subscription-based revenue model, the strong earnings growth we enjoyed over our holding period slowed significantly. Management expectations were for operating margins to 'trough' in 2018 as this transition developed before expanding rapidly over subsequent years alongside good growth in revenues. We remain admirers of the company and believe management have made sensible decisions, but ultimately we felt the valuation of the business no longer gave a reasonable margin of safety to reflect the increased risks associated with the changes planned for the business. If the valuation of the company decreases significantly in the future and company results begin to reflect expectations set, then we may consider repurchasing the company for the portfolio.

Siemens is an industrial conglomerate which generates less than 30% of its revenues from the US and is diversified across multiple divisions. The company had underperformed the wider market and its peers for the previous couple of years as it struggled to grow its revenues, and its margins weakened alongside. Its exposure to the oil and gas sector had also been a drag. However, much of this pessimism was reflected in the share price. At purchase the stock traded on a PE multiple of just over 13x 2016 expected earnings and a stock price that reflected long-term free cash flow growth of less than 1%.

Management committed to cost savings, the high dividend yield (of over 4% at purchase) was well covered, and the most recent results had begun to indicate margin improvements. Our expectation is for earnings growth in the high single digits over the longer term which, when combined with the undemanding multiple and its good history of earning a return on capital consistently above its cost of capital, appeared good value – especially so when compared to how the market is rewarding (and valuing) any company that can offer a reasonable growth 'story' today.

The overall effect on the portfolio was to reduce our exposure to the IT Sector and the US and increase our exposure to Europe and the Industrial sector.

We did not make any changes to the portfolio in the **second quarter**.

We made two changes to the portfolio in the **third quarter**. We sold positions in Oracle and Tegna and initiated new positions in Infineon and Shire.

ORACLE TEGNA infineon Shire

Oracle had been a long-term holding in the strategy, having been in the portfolio since the end of 2003. The total return of the stock over our holding period was 222% (in USD), versus the MSCI World Index return of 132% (a significant 2.8% annualised return difference). While we held the stock its earnings improved by 441%, which came through both net income growth (c.325%) and a reduction in the shares outstanding (c.21% reduction). The PE multiple contracted significantly, however, reducing by approximately 46%, which reflects the maturity of the business and its ability to grow cash flows in the future. The contribution from shareholder returns in terms of dividends was modest, as the company only began to pay a dividend in 2009.

We saw the company's reasonable valuation multiple at sale as reflective of the lower prospects for growth and this combined with the declining return on capital suggested the business was struggling to find good projects for reinvestment of capital. The bull case was that the company is undergoing a period of restructuring as it transitions from a license-model to software as a service (SaaS) model and that the higher margins afforded to the restructured segments will provide an uplift to both earnings and the multiple. We feared that the transition may be more difficult than management suggested and despite the company's market share and large size we saw increased competition in its end markets, especially in the database segment. We therefore felt the prospects for short to medium-term growth were potentially limited, that the reasonable valuation was a fair reflection of this, and that there were better opportunities elsewhere.

Tegna had been held in the strategy since October 2013, originally through the Gannett business which subsequently split into Tegna and Gannett(NewCo) in June 2015. Gannett(NewCo) took on the publishing business and Tegna the broadcast television and digital media businesses. Part of the rationale for the split was that the faster-growing and more profitable Tegna could command a higher multiple and ultimately we took the same view – selling our holding in Gannett(NewCo) and increasing our stake in Tegna to a full position in the portfolio.

The market rewarded the reorganisation of the business leading up to the June 2015 split, but subsequently Tegna disappointed somewhat with quarterly earnings below expectations. The company has also announced that one of its main digital media assets, cars.com, would be spun out in 2017 and that careerbuilder.com was under strategic review. We perceived the broadcast television model to be under potential threat, and the fact that the company was struggling despite a 'bumper' year of the Olympics and a presidential election made us question the long-term opportunities for the business. The very low multiple (less than 10x 2016 expected earnings) did not, in our opinion, make up for the potential for near-term earnings declines and the headwinds in the sector more generally. Over our holding period (adjusting for the split in June 2015) we calculate the position made a small loss versus the MSCI World.

Shire is a business we held in the strategy from October 2013 to August 2014. We sold as the share price rose dramatically when a bid from Abbvie was tabled for the company. After our sale the bid was withdrawn by Abbvie due to the growing backlash against so-called 'tax inversions' at that time (Abbvie would have been able to utilise Shire's Dublin domicile to reduce significantly the overall group tax rate). We repurchased shares in Shire in September 2016.

In the time between the failed Abbvie bid and our repurchase Shire made a number of notable transactions itself: NPS and Dyax in 2015 and the transformation deal for Baxalta in 2016. In doing so the company reduced its dependence on its legacy drugs, created the largest biopharma company focussed on rare diseases, and created a strong future pipeline of new drugs. We were attracted back to the company by its having increased its return on capital every year for the last three years, its potential ability to protect margins with its new

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focus and specialisation, and the fact we could purchase shares at reasonable valuations that were trading at the time below the average five year multiple and below the broad market.

Infineon was a new holding for the fund. The €17bn market cap company is listed in Germany and manufactures and designs semiconductors. Originally part of the Siemens group, it was spun out as a separate entity in 1999. The stock price was strong over the year preceding our purchase but we still saw good opportunities for growth. The company has a number 1 or number 2 position in very fast growing markets and especially in the automotive sector where we see significant prospects for future growth through advanced driver assistance to completely autonomous vehicles. All the stages in this transition will require higher and higher densities of chips per car to enable the increased functionality and safety features required.

Infineon traded at the high end of valuation multiples we are comfortable with (at around 20x forward earnings) and we recognised it as a cyclical business, but we also saw high operating margins, improving returns on capital and the prospect of growing economic profits through asset growth. When combined with a secular growth trend supporting the business we could envisage earnings growth around the 15% CAGR level over the next five years. This, if achieved, would certainly justify the current price. We also recognised that we have not factored in any significant multiple rerating into our analysis of potential future returns.

We made a number of changes to the portfolio in the **fourth quarter.** First, we sold our positions in Lenovo and State Street and bought new positions in New Oriental Education and Fanuc.

We decided to cut our losses on Lenovo after a tumultuous period for the company with falling global demand for notebook computers. In contrast, we decided to sell our position in State Street after a rapid rerating since the end of June.

New Oriental is a leading Chinese private education company. It is a mid-sized company with a market capitalisation of around $8 billion. The company operates 67 schools and nearly 800 education centres in China and they have grown rapidly. Revenues have doubled in the last four years, driven by increasing demand for language and test preparation courses. The growth in the business is attractive and we believe it has considerable scope to continue to grow for years to come. We also like the fact that the company generates high margins and has no debt. It is therefore highly cash generative and importantly requires a relatively modest amount of this cash to finance its organic growth. We believed the valuation underestimated both the quality of the business model and the long-term growth opportunity.

Fanuc is a Japanese company and is one of the largest producers of industrial robots in the world. Like New Oriental, Fanuc had no debt and a large cash pile. It is geographically diversified, with around 60% of revenues coming from Asia and the balance from Europe and the US. While New Oriental Education is on a secular growth trend, Fanuc is more cyclical. Sentiment towards the company is currently quite negative, having been far more positive in the spring of 2015, but this meant we could buy the same high quality company at a 25-30% discount to its price in May 2015.

The overall effect of these changes was to reduce our exposure to Financials and IT and increase our exposure to Industrials and Consumer Discretionary. It also had the effect of increasing our exposure to Asia and reducing our exposure to the US.

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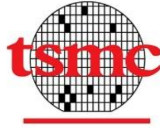
At the end of the fourth quarter we also sold positions in Li & Fung and Taiwan Semiconductor, and replaced them with new positions in Nike and AAC Technologies.



We decided to cut our losses on Li & Fung, a position we bought in 2014 and one where we ultimately we got it wrong. We really liked the company's asset-light business model as we could see how growth would translate into significant operational leverage. Growth had been weak for some time but we thought there was a reasonable chance that it would turn around. Unfortunately, that did not occur and with the election of Donald Trump we felt the company's model of being a global outsourcing business was becoming more vulnerable. We also came to the conclusion that there is now a real risk of a dividend cut, which could also lead to further selling in the market.

Taiwan Semiconductor was a very long-term holding in the strategy (since 2003) and had performed extremely well over that period, providing a total return almost five times that of the MSCI World Index. It is one of the highest quality businesses in its sector with very steady cash flow returns on investment despite the cyclical nature of its market. The company had more recently enjoyed good share price performance with the rotation from growth to value and from the rerating of the semiconductor industry more generally. We noted, however, that the this took the company's forward earnings multiple from a low of around 10X in late 2015 to around 15.5X, a high relative to where the company has traded historically. The speed and magnitude of this rerating suggested to us that there was little further upside without significant earnings growth in the near term, which we felt was unlikely.

Nike was a company we had admired for some time as it had all the characteristics we seek: a strong balance sheet, good returns, and good capital allocation discipline that shows the company selectively and profitably re-investing cash flows. However, the market tended to over-reward the company for its growth, in our view, and the company traded on over 30 times forward earnings at its peak at the end of 2015. At such lofty valuations the market inevitably expects perfect execution and if these expectations are not met the share price reaction is usually stark and swift. This was the case for Nike through 2016. Slower growth led to the share price falling 19.2% (total return in USD) from the end of 2015 to the end of November versus the S&P500 equivalent return of +9.8%, a difference of almost 30%. The forward earnings multiple fell in unison from approximately 30X at the start of the year to just over 21X at purchase. The threats remain of increased competition, inventory overhang, and whether future lines are well received, but we believed the market had moved from overly optimistic to overly pessimistic – and this presented us with the opportunity to add the company to the portfolio.

AAC Technologies is a HK-listed company that is a market leader in the design and manufacture of various components for consumer electronic components. It historically specialised in acoustic parts, most notably speakers and microphones for smart phones and tablets but has been diversifying into non-acoustic parts such as haptic vibrators and RF antenna. Like many Asian technology companies its client base is concentrated, with companies such as Apple and Samsung accounting for significant proportions of overall revenue - which poses obvious risks. However, unlike many other product manufactures AAC has consistently managed to maintain high operating margins of around 30% and has a strong balance sheet. Despite significant revenue growth the company had sold off with the wider market from a high in August of 2016. This presented us with a good opportunity to purchase a high quality business, with very good growth potential, at a much more attractive valuation.

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The overall effect of these changes was to reduce our exposure to Asia and increase our exposure to the US slightly, whilst also decreasing our exposure to the IT sector.

## Portfolio characteristics

The charts below show the sector, market capitalisation, and geographic breakdown of the portfolio at the end of each quarter since the fund inception.

**Figure 9:** Portfolio sector breakdown (all dates at quarter end)

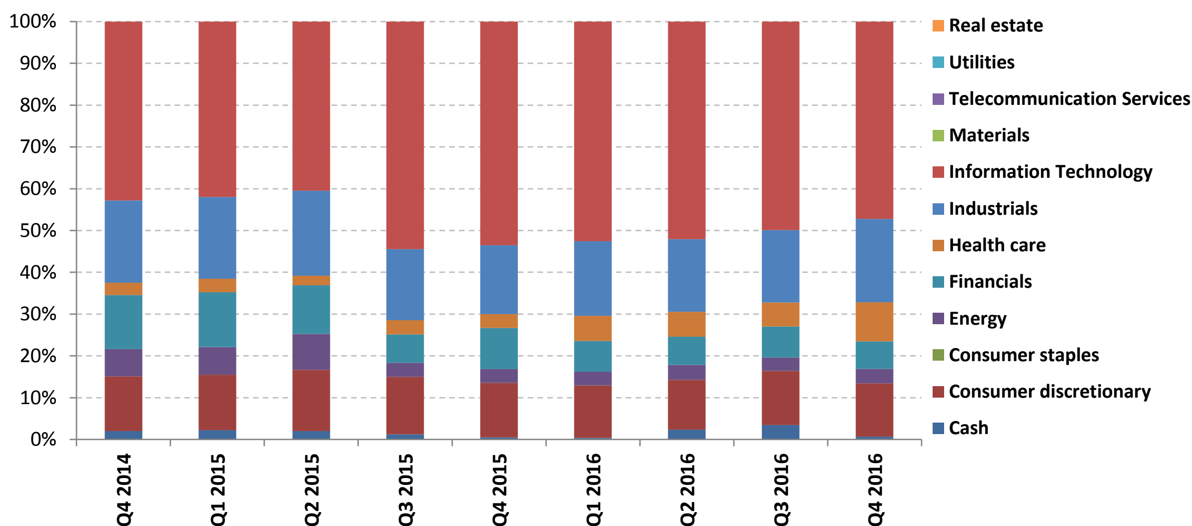


**Figure 10:** Portfolio market capitalisation breakdown (all dates at quarter end)

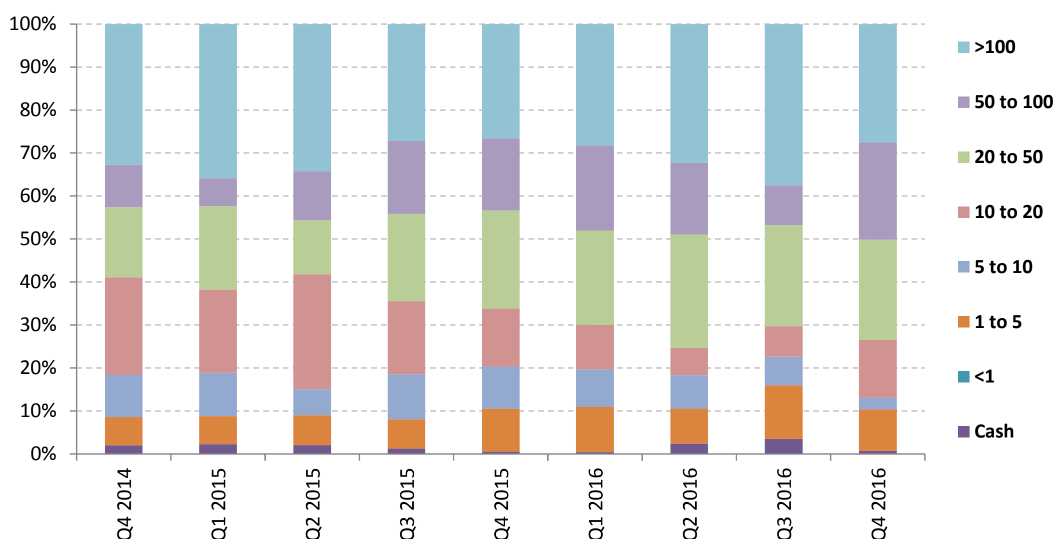


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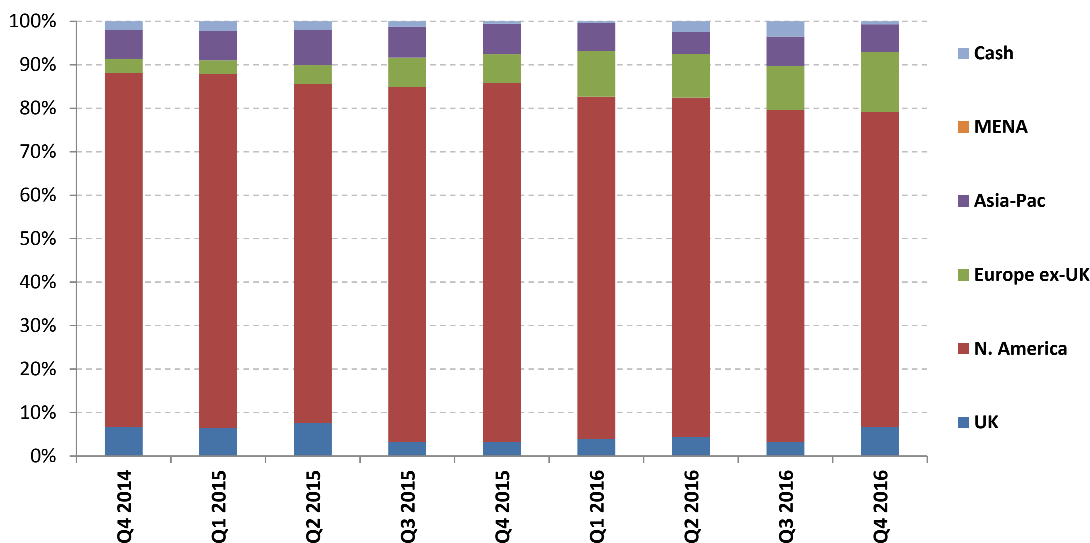
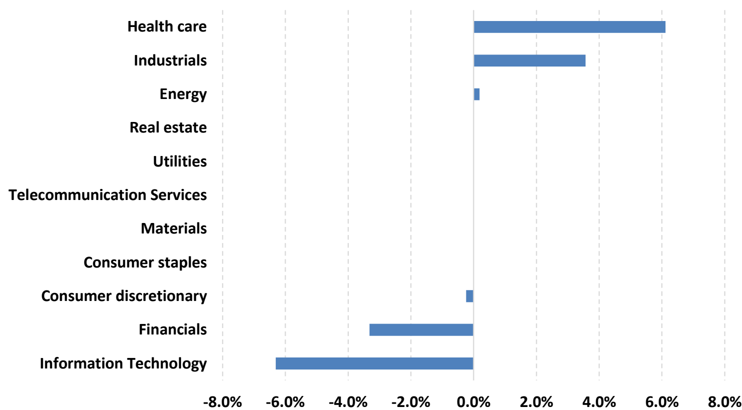
**Figure 11:** Portfolio geographic breakdown (all dates at quarter end)




In terms of sector allocations over the year we reduced our exposure to Information Technology and Financials and increased our exposure to Healthcare and Industrials. We still have no holdings in Consumer Staples, Materials, Telcos, Utilities, or the newly 'spun out' Real Estate sector.

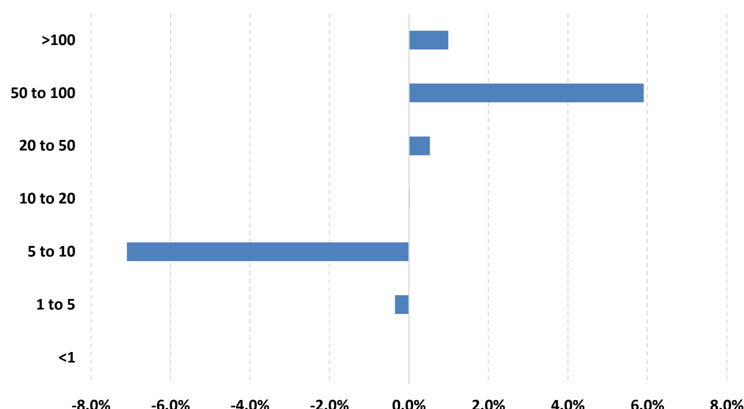
**Figure 12:** Change in portfolio sector allocation (31.12.2016 vs 31.12.2015, adjusted for cash balances)




In terms of the market cap breakdown we have reduced our exposure to companies with a market cap between $5 and $10 billion and increased our exposure to those companies with a market capitalisation between $50 and $100bn.

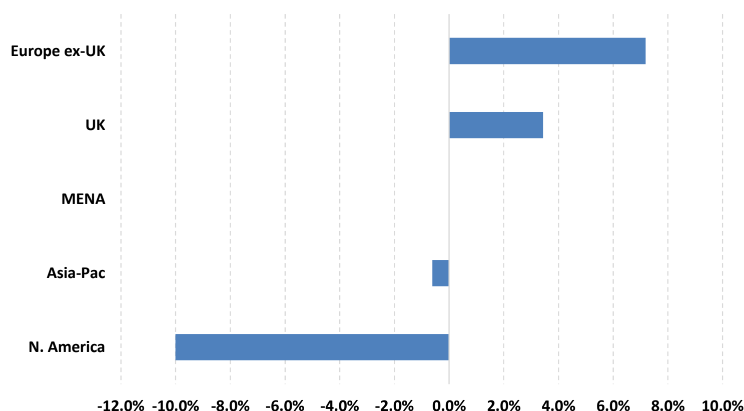
Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

**Figure 13:** Change in portfolio market capitalisation allocation (31.12.2016 vs 31.12.2015, adjusted for cash balances)




In terms of the portfolio's geographic breakdown the portfolio continues to have a bias to the US, but we reduced this significantly over 2016, decreasing the fund's allocation by just over 10%. We increased our exposure to the UK and Europe.

**Figure 14:** Change in portfolio geographic allocation (31.12.2016 vs 31.12.2015, adjusted for cash balances)




At the year end the portfolio is trading on a 2016 PE ratio of 18.0X, which is at a discount of 6.0% to the MSCI World Index equivalent PE multiple of 19.1X. The expected growth in earnings of the portfolio (2017 on 2016) stands at 9%.

## Outlook

As we reflect on 2016 and look forward to 2017, there is considerable uncertainty in markets.

On the political front the vote in the UK appeared to give a boost to populist political parties in the rest of the Europe many of which have anti-immigration, anti-EU, and protectionist policies at their heart. We saw the resignation of Matteo Renzi in early December following the defeat of his referendum proposals on constitutional reform, which may leave space for the populist 5 Star Movement to gain further ground when elections are finally called. The election cycle in France which begins in February 2017 will see if Marine Le Pen's Front National moves into the second round run-off to decide the next President in May. Earlier in the year we also have elections in the Netherlands and in September Angela Merkel will seek a fourth term as

Chancellor against a backdrop where the populist Alternative für Deutschland has been gaining ground in regional elections consistently. We will also get a clearer picture of the actual policies the Trump administration will try to enact and an indication of which of them may ultimately come to pass.

Politics ultimately overshadowed central bank policy in the second half of 2016, whereas central bank policy shifts had arguably been the major driver of markets since the end of the financial crisis. It is likely that any decisions made by the central banks will still be an important driver of markets and market sentiment in 2017, especially as a divergence in policy begins between the Fed, which has indicated three further rate rises in 2017, and the Bank of Japan and the European Central Bank, who seem poised to continue their polices of asset purchases. We will also see whether any of the policies enacted in 2016, or indeed before, could be unwound and undo their shorter-term benefits.

This uncertainty leaves us a little apprehensive, but our investment process has never been one in which we try and position the portfolio based on our macro view or to try and capture any short-term trends. 2016 was clearly an example of why this type of approach can be problematic.

Instead, we will continue to try to focus on looking for companies that show an ability to avoid the competitive threat of their peers, that have healthy balance sheets, that are earning returns on capital above their cost capital and growing their economic profit, and that can reinvest their cash flows in profitable projects to grow their business sustainably in the future. The fact that the portfolio remains at a healthy discount to the broad market on a PE basis despite the companies we hold having what we believe to be superior fundamentals is at least some demonstration that good opportunities still exist in the market today. The expected earnings growth of the portfolio in 2017 of 9% is slightly below what the fund has had historically but with anaemic historic and expected growth in the broader market we still see this as compelling, especially since the fund has not yet closed the valuation discount versus the MSCI World which opened up through 2015.

We wish you a happy and prosperous year and look forward to updating you on the progress of the fund over the course of 2017.

**Matthew Page, CFA**

**Dr Ian Mortimer, CFA**

**Portfolio managers, Guinness Global Innovators Fund**

**January 2017**

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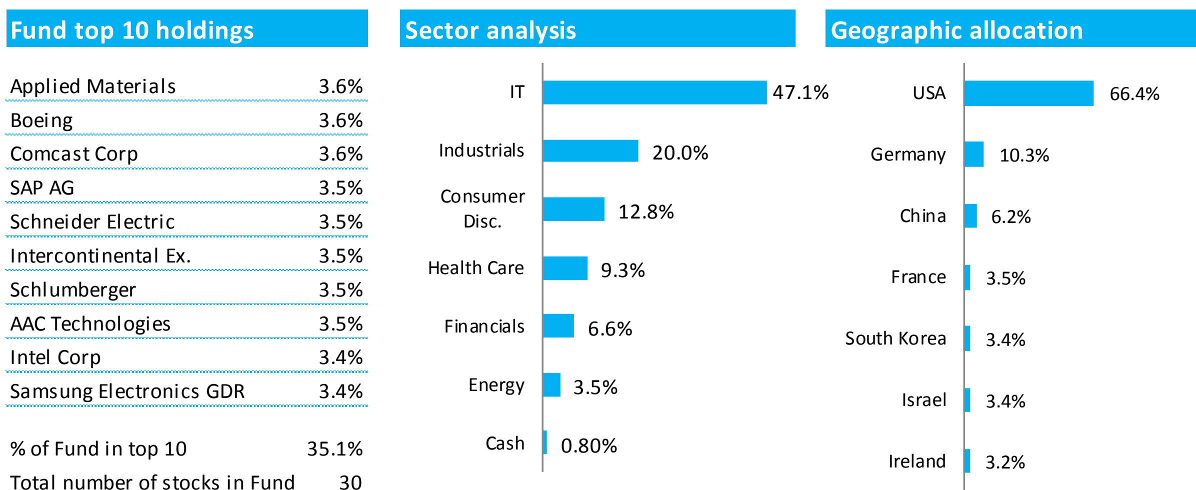
## PORTFOLIO

31/12/2016




## PERFORMANCE *(composite simulation - see below)*

31/12/2016

### Annualised % total return from strategy inception (GBP)

| | |
|---|---|
| Guinness Global Innovators strategy* | 12.74% |
| MSCI World Index | 9.99% |
| IA Global sector average | 9.06% |

| Discrete years % total return (GBP) | Dec '12 | Dec '13 | Dec '14 | Dec '15 | Dec '16 |
|---|---|---|---|---|---|
| Guinness Global Innovators strategy* | 14.9 | 42.6 | 18.9 | 2.2 | 28.0 |
| MSCI World Index | 10.7 | 24.3 | 11.5 | 4.9 | 28.2 |
| IA Global sector average | 9.4 | 21.7 | 7.1 | 2.8 | 23.3 |

| Cumulative % total return (GBP) | 1 month | Year-to-date | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| Guinness Global Innovators strategy* | 2.8 | 28.0 | 28.0 | 55.6 | 154.9 |
| MSCI World Index | 3.5 | 28.2 | 28.2 | 49.9 | 106.4 |
| IA Global sector average | 3.1 | 23.3 | 23.3 | 35.7 | 80.7 |

## RISK ANALYSIS

31/12/2016

| Annualised, weekly, 5 years, in GBP | Index | Sector | Strategy* |
|---|---|---|---|
| Alpha | 0 | 0.18 | 2.53 |
| Beta | 1 | 0.81 | 1.11 |
| Information ratio | 0 | -0.44 | 0.69 |
| Maximum drawdown | -14.03 | -17.08 | -17.14 |
| R squared | 1 | 0.78 | 0.86 |
| Sharpe ratio | 0.95 | 0.78 | 1.09 |
| Tracking error | 0 | 5.84 | 5.73 |
| Volatility | 12.38 | 11.31 | 14.88 |

**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.**

***Composite simulation***: Guinness Global Innovators Fund (UCITS version) launched on 31.10.14. The returns stated above are a simulation based on the actual returns of Guinness Atkinson Global Innovators Fund (a mutual fund for US investors) until the launch of the UCITS version on 31.10.14. Both funds are managed in accordance with the same investment process and with the same portfolios. Guinness Atkinson Global Innovators Fund is not included in the IA Global sector. The sector's performance is included for a comparison of the Fund with the average performance of global equity funds available in the UK. Source: Financial Express, bid to bid, total return.

# 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 Innovators Fund. Any investment decision should take account of the subjectivity of the comments contained in the report. It 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 Innovators 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.

**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 guinnessfunds.com, or free of charge from:-

- the Manager: Capita Financial Managers (Ireland) Limited, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland;
- 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. **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.