Guinness European Equity Income Fund

Investment Commentary - January 2022

About the Fund

Launch date	19.12.2013
Manager	Nick Edwards
Aim	

The Guinness European Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Europe ex UK region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

This is a marketing communication. Please refer to the prospectus and KIID for the Fund before making any final investment decisions.

Performance

Past performance does not predict future returns

Fund	European Equity Income (Y Class, 0.89% OCF)
Index	MSCI Europe ex UK
Sector	IA Europe ex UK

	1 year	3 years	From launch
Fund	17.5	45.4	93.6
Index	16.7	50.5	99.0
Sector	15.8	53.6	104.3

Annualised % total return from launch (GBP)

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. Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. For further details on fund performance, please refer to the penultimate page of this document.

Source: FE fundinfo, Y class 0.89% OCF, bid to bid, total return. Launch date 19.12.13

Summary performance

In 2021 your fund rose +17.5% (in GBP) over the year, versus the MSCI Europe Ex UK Net Return Index, which rose +16.7% (in GBP). The fund therefore outperformed the Index by 0.7% over the year and was ranked first quartile or 7/27 among Europe ex UK income peers. The result being well ahead of the performance of MSCI Europe Value Index +15.3%% and High Dividend Index +11.8% but behind MSCI Europe Growth Index +20.7%.

Investment summary

Your fund is well balanced across a select 30 quality value cyclical and defensive Europe ex UK companies; characterised by structural growth and supported by long histories of generating persistent high cash returns alongside strong balance sheets. Meaning that macro and short-term fluctuations should prove of little consequence to long-run returns. That said the backdrop for the Europe ex UK region looks increasingly favourable. With potential for accelerating global growth playing to Europe's higher cyclical exposure, alongside a much-improved European political backdrop vs pre-pandemic.

Continued income scarcity set against attractive dividend yields relative to bonds and other regions also looks supportive for quality dividend-paying equities. While high savings rates and cash on balance sheets leaves ample room for improved capital returns. The ongoing tailwind to Europe from smart green fiscal policy and the increasing global focus on sustainability also looks set to drive top line growth for the long term.

	Dec	Q4	1yr	3yr	5yr
Guinness European Equity Income	3.95%	2.76%	17.46%	45.44%	46.84%
MSCI UK net total return Index	4.81%	5.14%	19.59%	20.76%	23.00%
MSCI Europe Value Index	4.91%	3.82%	15.32%	21.50%	23.80%
MSCI Europe High Index	5.02%	6.52%	11.79%	28.98%	36.70%
MSCI Europe Euro Index	3.86%	3.71%	16.95%	45.16%	51.50%
MSCI Europe Midcap Index	3.13%	3.86%	14.69%	56.34%	64.60%
MSCI Europe Growth Index	3.32%	6.85%	20.69%	70.17%	83.40%
MSCI Europe ex UK	3.94%	5.20%	16.73%	50.54%	57.20%
Out/underperformance against MSCI Europe Ex UK	0.01%	-2.44%	0.73%	-5.10%	-10.36%

Figure 1: Performance data as of 31st December 2021 in GBP.

Source: Bloomberg/FE fundinfo

The Dividend

The fund Z class GBP dividend grew by 21.4% to 0.3790 in 2021 (July 2021, January 2022 payments), in line with the MSCI Europe ex UK Index in GBP. To regain 2019 highs of 0.4468 the dividend will need to grow by 18.5% in 2022 vs expectations for 19.7% Index dividend growth as European dividends continue to normalise post pandemic and after regulators allowed financials including banks to resume payments in H2 2021. Thereafter we would expect fund dividend growth to outpace the Index, driven by its higher return profile and focus on companies characterised by structural growth opportunities.

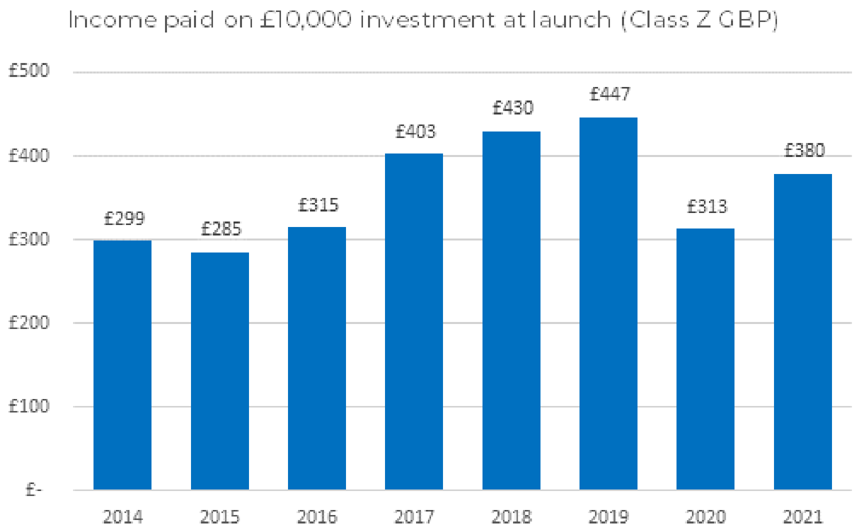


Figure 2: Fund dividend income paid on £10,000 investment since launch. (Class Z GBP)

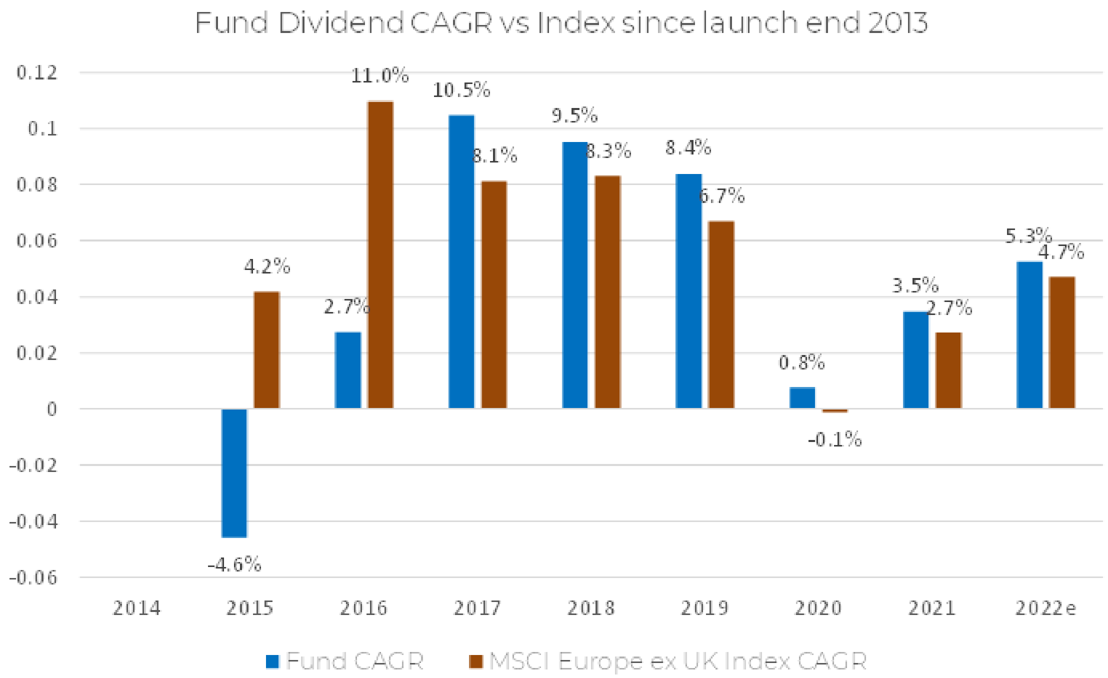


Figure 3: GBP Dividend CAGR, Fund vs. Benchmark 2014 to 2021.

Source Bloomberg.

Investment Backdrop

As we start 2022 the growth deceleration that has been ongoing since Q2 2021, driven primarily by the spike in input costs and supply chain disruption, shows signs of drawing to a close. The Citi European economic surprise index has now turned higher and the German 10Y yield rose nearly 30bps in December to -0.05%. European recovery funds have started to find their way to national governments, and further targeted smart green policy looks likely. The Omicron variant has inflicted more pain on services sectors but that will reverse in due course; while indicators of industrial demand remain robust as US trade policy has shifted back towards Europe and despite soft near-term demand out of China, which stands a good chance of reversing. Concerns over an inflationary upswing are abundant, but if 2.3% Eurozone labour cost growth is an indicator (historically the main driver of long-term inflation expectations) the reality may prove rather moderate once transitory factors finally make their way through the system. That said we do of course appear to be at the start of a long delayed and arguably shallow rate rising cycle.

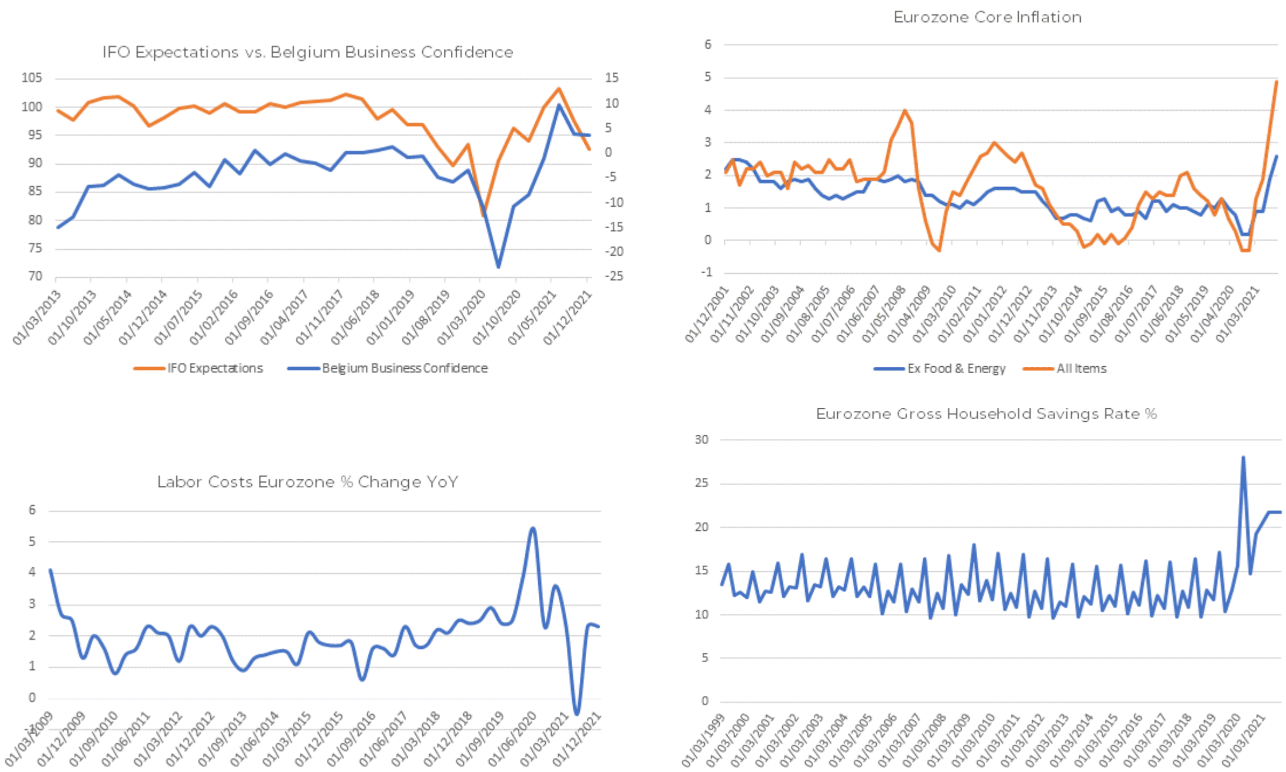


Figure 4: Clockwise from to left: IFO / Business expectations, Eurozone core inflation, Eurozone labor costs % change YoY, and Eurozone Gross Household Savings Rate %.

Source: Bloomberg.

Assuming we are right about the shallow part with respect for inflation and in turn rates, the large and still accumulating cash piles at both consumers (see chart above right bottom) and corporates will continue to look for a home outside of bonds and cash for a long-time to come. Policy makers are incentivised to keep nominal rates low and real rates negative (currently -3.6% based on 10Y German yield minus CPI ex Food and Energy) with longer-term deflation deemed to be a greater risk than a near-term moderate inflation overshoot. In this respect European quality income looks very attractive, offering superior levels of yield without giving up on quality. Regular readers may remember our last monthly highlighting that your portfolio of European global market leaders offered a near 70% yield premium over a comparable US portfolio of closest peer holdings.

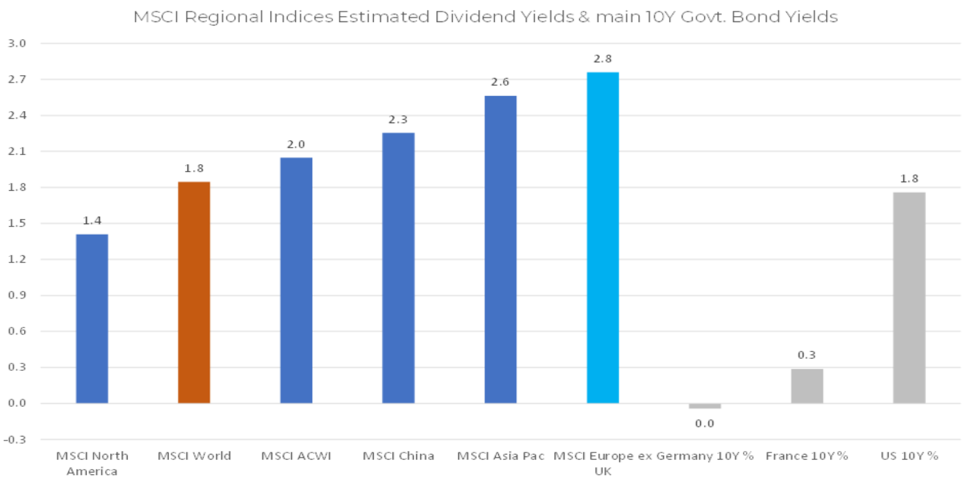


Figure 5: Main MSCI regional index dividend yields and developed market bond 10Y govt. bond yields.

Source: MSCI data.

It is worth meditating for a moment on the extent of value stocks outperformance over growth stocks in the last rate rising cycle 2004 – 2007 (blue line below). That was however a very different environment where German one-month rates rose from 2% to 4.4% and returns were characterised by excess risk taking and bank leverage. Fast forward to 2022 and the latter look over-capitalised, checked by regulation and potentially at risk from fintech rivals. Traditional energy has rebounded and is pricing a long-term oil price of around $55/bl against a difficult long-term outlook. While commercial real estate will take some time to adjust to a post-covid world of flexible working. Your fund continues to have no exposure to highly cyclical (commodity) or regulated sectors including banks.

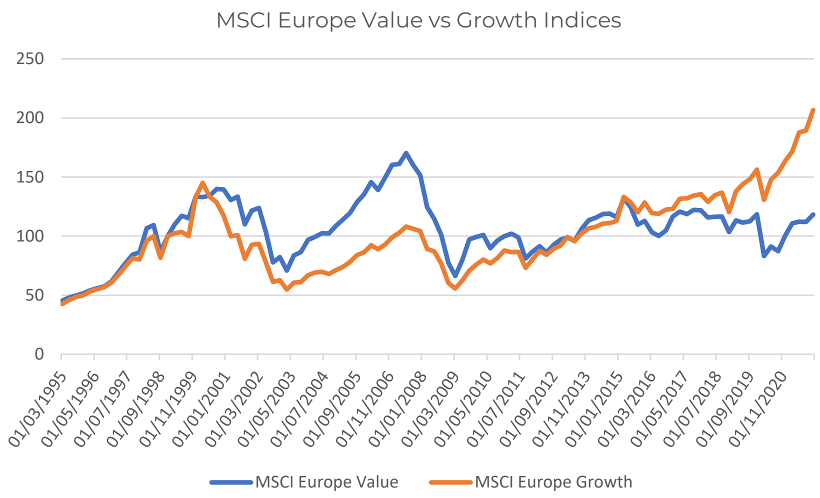


Figure 6: Main MSCI Europe Value vs Growth Indices.

Source: Bloomberg data.

Whatever the weather your fund is well balanced, holding approximately 60% quality cyclicals and 40% quality defensives. If anything, the balance of stimulus may favour Europe in 2022 with plans afoot for further fiscal stimulus over and above the existing European Recovery fund to accelerate green and digital transitions (see IMF Euro area assessment referencing green investment fund at EU level, and an aggregate €520bn/annum of capex over next decade enabled via carbon pricing and border adjustment mechanisms). Your fund is well positioned in this respect with its large overweight in smart green industrial technology; and European markets more generally should prove well placed given their higher cyclical exposure vis-à-vis the US.

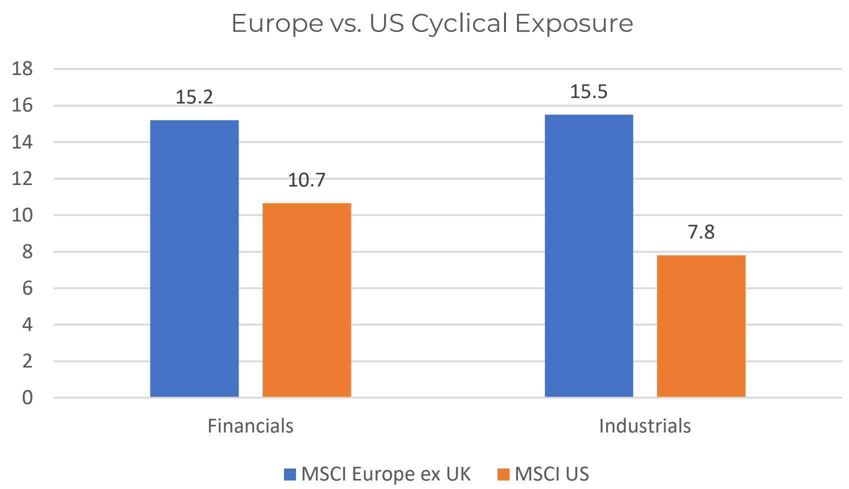


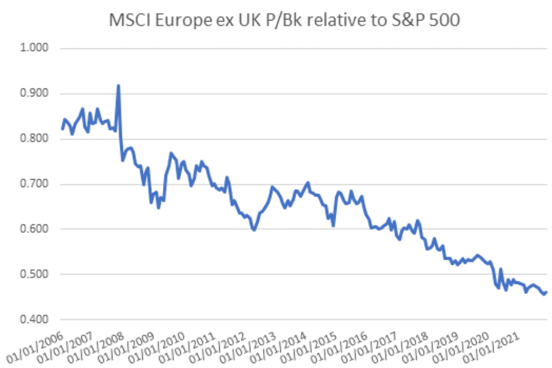
Figure 7: MSCI Europe ex UK vs MSCI US Financials and Industrials sector exposure.

Source: Bloomberg data.

What of political risk and the European risk premium? The pandemic turned things on their heads. Germany went from pariah status in the eyes of the Italian electorate to darling as it endorsed common borrowing for fiscal transfers under exceptional circumstances with Italy and Spain the largest beneficiaries at around €70bn each. The move itself also implying far longer-term positives via the creation of a pan European yield curve enabling greater levels of long-dated investment from actors with deep pockets like the pensions industry. The new coalition government in Germany lead by the SDP and Chancellor Olaf Scholz is pro further European integration, constructive on increased fiscal, climate and infrastructure spending and business friendly, being checked by the Free Democrats. The most interesting news we saw towards the end of 2021 was that the Dutch had turned French, well very nearly, with the new coalition government now including the liberal left leaning D66 party, aiming for deeper EU integration (namely banking and capital markets union), ending national vetoes in foreign policy, strengthening the role of the EU parliament, and turning the spending taps on climate.

We cannot tell you what will happen in the French election except to say that Macron's rating is improving at 25%. Valerie Pécresse could be a serious contender, and one we like, if she makes it through to the second round. While Le Pen and Eric Zemmour look likely to erode each other's vote unless one of them pulls out, while standing little chance in the second round.

In short, European quality equity income looks attractive relative to other asset classes and vs other regions, and European policy makers look very likely to continue to look through transitory factors when setting rates. Though US interest rate changes will of course echo across Europe. Europe ex UK trade prospects are much improved vs the Trump era and should continue to improve assuming China picks up. Equally the size and duration of smart green and digital fiscal expenditure may just be dawning on markets, and Europe looks well placed to take advantage of such trends globally, given its pre-existing IP in the area. European markets may also prove better placed for a cyclical recovery vs other markets like the US given high relative exposure to sectors such as Industrials and Financials. Added to which valuations continue to look fair vs "growth markets" such as the US on 21x 2022e earnings vs MSCI Europe ex UK on 16.5x. A look a P/Book relative to the US also gives pause for thought.



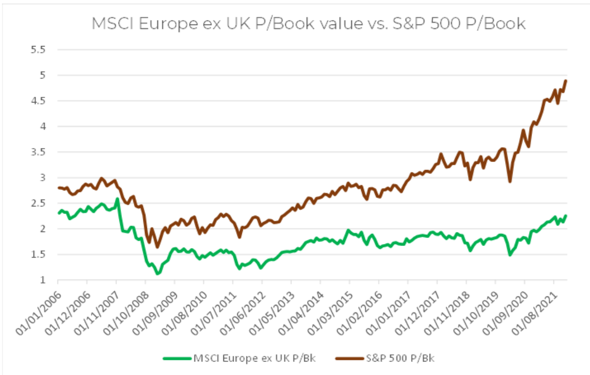


Figure 8: LHS: P/Bk relative to S&P 500. RHS: MSCI Europe ex UK P/Bk (green) and S&P500 (red).

Source: Bloomberg data.

What is of prime importance to Guinness European Equity Income Fund holdings and long-term outlook are structural drivers of returns, many of which look likely to be supported by the cyclical tail winds discussed. The following table gives a simple breakdown of the 60% quality cyclical and 40% quality defensive exposure of the portfolio; all companies use technology well and benefit from structural growth drivers.

Quality Cyclicals						Defensives			
Smart green enablers		Digital fast forward		Various Rate Sensitive		Healthy living, EM growth, Pandemic recovery		Various Rate Sensitive	
Konecranes Oyj	Industrials	TietoEVRY Oyj	IT	AXA SA	Financials	Novo Nordisk	Health Care	Euronext NV	Financials
Epiroc AB	Industrials	Capgemini SE	IT	Mapfre SA	Financials	Fresenius SE	Health Care	Deutsche Boerse	Financials
Thales SA	Industrials	Kering SA	Cons. Disc.	Helvetia Holding AG	Financials	Recordati	Health Care	Amundi SA	Financials
Deutsche Post AG	Industrials			Kaufman & Broad SA	Cons. Disc.	Roche Holding	Health Care		
ABB Ltd	Industrials					Nestle SA	Staples		
Siemens AG	Industrials					Danone SA	Staples		
Schneider Electric SE	Industrials					Salmar ASA	Staples		
Assa Abloy AB	Industrials					Unilever PLC	Staples		
Smurfit Kappa Group	Materials					Bakkafrost P/F	Staples		
Daimler AG	Cons. Disc.					Henkel AG	Staples		

The Insurers of course have a more cyclical aspect; but also have real strengths that look under appreciated. Helvetia leads in life insurance in Switzerland and dominates niches in digital online only insurance in the form of Smile along with a real asset focus including property and art. Axa's Alternatives division generates excellent returns on capital and is in a strong position to benefit from an upturn in infrastructure spending.

Nearly all of our Healthcare and Staples holdings suffered over the last year as elective surgeries were curtailed and consumers have stayed home. Suggesting good potential for 2022 against generally discounted valuations versus history. Roche suffered as much needed oncology treatments fell short, Novo Nordisk as new patient adoptions slowed, the Salmon farmers as eating out ground to a halt, and Danone as event-based water sales stopped almost entirely. Roche's world class diagnostics platform is now seeing tremendous growth with real potential for higher levels of recurring revenue, while new management at Danone looks likely to exit under-performing commodity assets giving investors more exposure to the attractive higher return parts of its high quality premium foods portfolio. Similar dynamics continue to play out at the other names, all of which look likely to be accompanied by improved demand as the pandemic normalises.

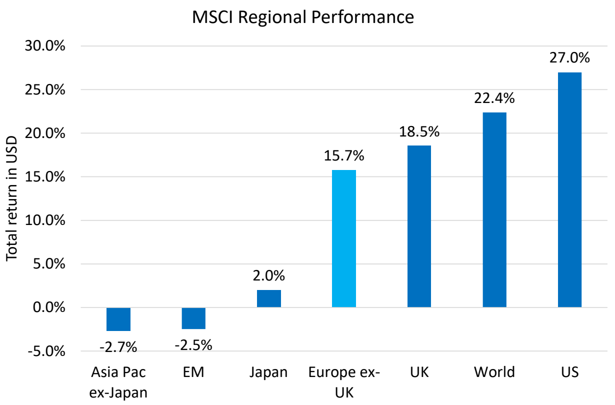
Valuations across our (largely smart and green) Industrial enablers have risen over the last year, with multiples ranging from 12 - 14x 2022e earnings for Konecranes, Thales and Deutsche Post to 20 – 24x for Schneider, Assa Abloy and Epiroc. What really excites us about these global market leaders is how critical they are to and embedded within their customers operations; with large installed bases guaranteeing high levels of recurring service revenues; and the shift to digital only increasing barriers to entry as smaller operators fail to keep up with the pace of innovation or the global reach increasingly demanded by customers. Offering investors a very high quality multi-decade growing annuity on the single largest area of global (climate) capex growth. Against a backdrop of generally high global technology multiples and a rapidly evolving outlook, European industrial technology stands out in terms quality and value. In the shorter-term a return to form for China would also prove helpful, but far from critical given the growing opportunities at home.

Amongst the remaining names our exchange holdings Deutsche Boerse and Euronext continue to look well placed to capitalise on the increasing political will evident towards greater levels of Continental European integration, with 2022 likely to see renewed tailwinds to capital markets and banking union. Following Euronext's purchase of Borsa Italiana both companies now occupy strong footholds in clearing, critical to increased capital formation within the Eurozone. Amundi's captive active funds base may hold some margin risk but the Lyxor acquisition looks very scalable from a top line perspective and the group's wider platform unparalleled from a European perspective. Kering's brands are second to none and the group uses digital better than perhaps any other luxury goods company we have looked at, and above all the family have a great track record for capital allocation.

The following table summarises the portfolio core attributes. Strong levels of self-determination, characterised by identifiable barriers to entry, market leadership positions, widening moats, aligned interests and a large market opportunity in terms of growth and or market share.

	Holdings	
Strong Self determination	Identifiable Barriers to Entry	Intangibles, Switching Costs, Scale, Network Effects, Regulation
	Market Leadership Positions	Dominates a market or niche, number 1, 2 or 3 position. Balance sheet strength.
	Widening Moat	Market share gains. R&D spend. New Products. Widening margins. Eye on capital cycle / new entrants.
	Aligned Incentives	Active shareholders. Capital allocators. Returns based incentives. Business owner culture. Stakeholder focus.
	Market Opportunity	Long runway. Secular growth. Not forgetting about the supply side.
External factors	Commodity industries	Materials, Energy.
	Regulated Industries	Utilities, Telecoms.
	Banks	Leverage, regulation.

Performance Drivers



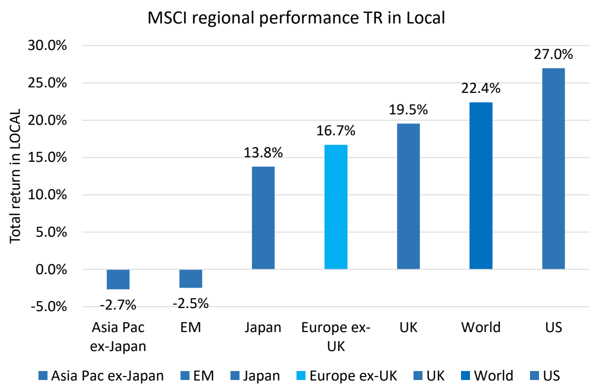


Figure 9: MSCI World Index geographic total return breakdown for 2021, in USD (left) and Local currency (right). Europe in light blue.

Source: Bloomberg data

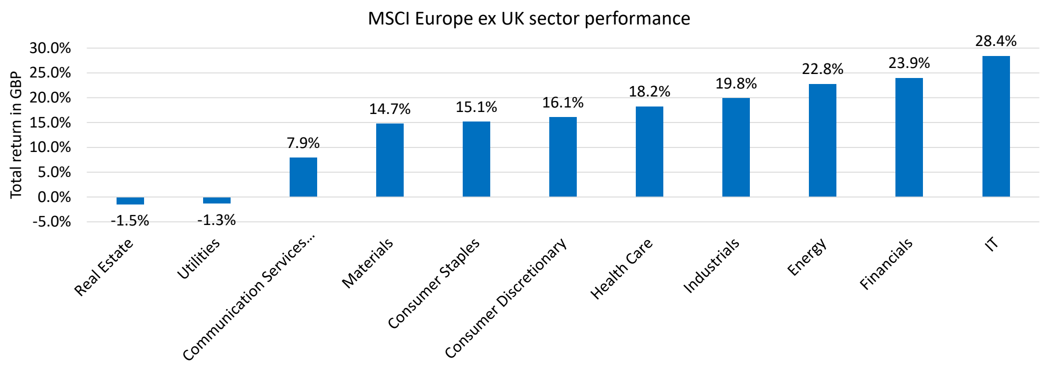


Figure 10: MSCI Europe ex UK Index sector total return breakdown for 2021, in GBP.

Source: Bloomberg

In USD terms the MSCI Europe ex UK Index rose 15.7% in 2021, while in local currency the Index rose 16.7%, well ahead of the Asia and Emerging Markets but behind MSCI World. Much of which can be attributed to varying regional states of Covid-19 seen over the course of the year, along with the increased levels of regulation seen in China, and the strength of the dollar.

Regulated markets continued to prove unreliable. Real Estate suffered as pandemic effects including home working disrupted commercial property markets and the long-run outlook for returns. Utilities also performed poorly as rapidly rising input costs for many operators destroyed returns. The Telecoms sector continued to suffer from a high number of operators and remains yet ripe for consolidation. While Energy had a bumper year as cars returned to the roads and supply growth failed to match demand with operators maintaining good capital discipline.

Your fund's principal overweight sectors of Industrials, Staples and Financials continued to do well in aggregate in the upper middle ranges of sector performance with our Industrials holdings generating notable alpha versus the sector. Outside of those sectors, within the IT sector, Capgemini (+72% in EUR) was the star performer and should continue to shine given its status as a digital enabler to multiple industries, its unique position in industrial engineering R&D (ER&D), and position as the only European world class IT services operator. In the Materials sector Smurfit Kappa also outperformed (+32% in EUR) and continues to display rising margins and top line growth driven by strong pricing and global capacity additions, as demand for smart alternatives to plastic consumer packaging continues to rise.

Above all the different portfolio components combined to produce an attractive risk adjusted return. Outperforming the market and, in an all-weather fashion, ahead of MSCI Europe Growth or Value Indices at any one time.

Looking ahead fund earnings are estimated to grow 10.6% in 2022 following 21.7% growth last year, producing a 3Y earnings CAGR of 13.1% over the 2020 – 2023 timeframe. That is below market levels because we don't hold any of the highly cyclical components of the market such as energy, materials and banks which saw large rebounds in 2021. Also, as touched on earlier, we expect a significantly higher dividend return over earnings in 2022, given 9 company dividends remain below their 2019 levels and with the purchase of Daimler (soon to be Mercedes) yet to contribute to the dividend plus a €2/share (~5.5%) special due from Konecranes in 2022.

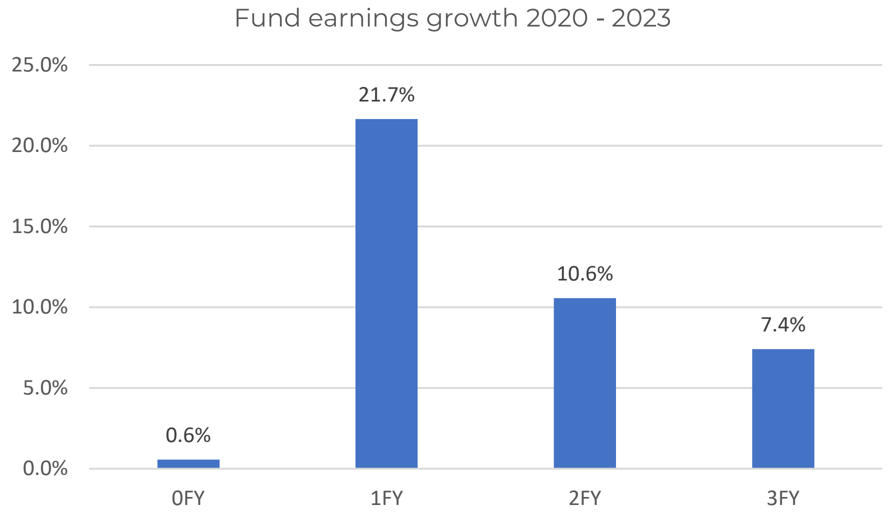


Figure 11: Fund consensus earnings growth estimates to 2020 - 2023.

Source: Bloomberg.

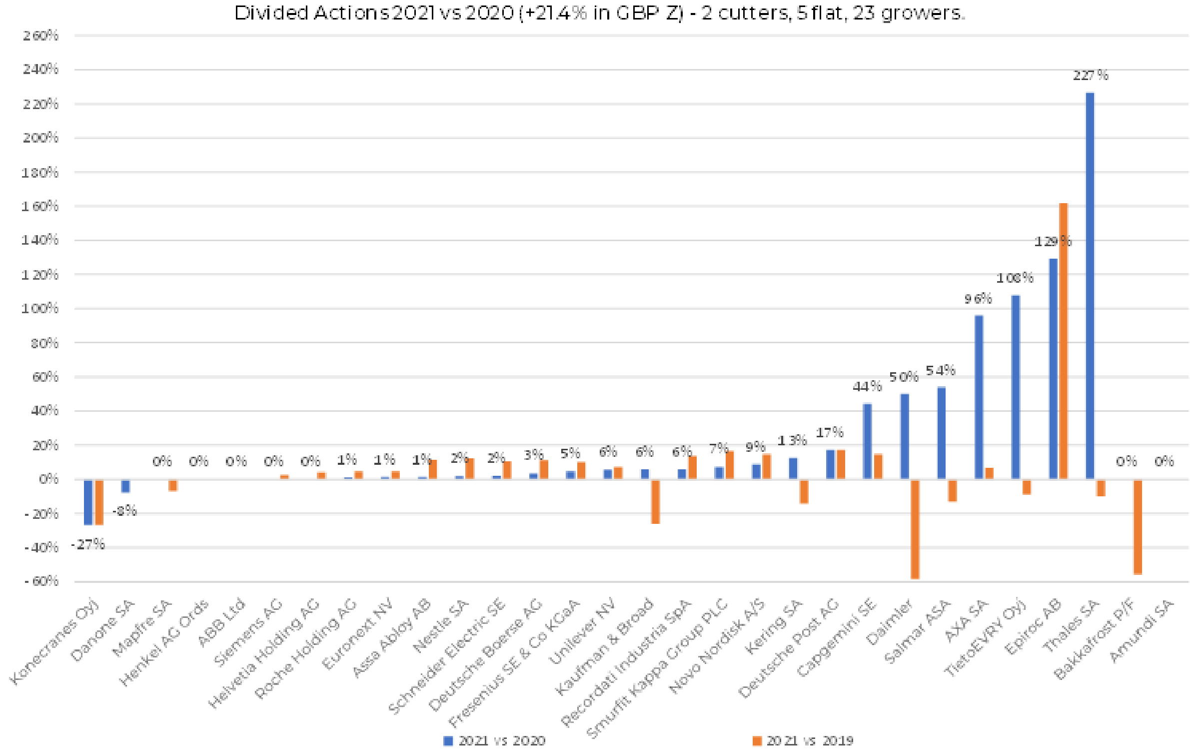


Figure 12: Current holdings 2020 YoY dividend growth in local currency.

Source: Bloomberg.

Positioning

The Guinness European Equity Income fund is characterised by a high, 82%, active share against the MSCI Europe Ex UK benchmark. Our focus on companies with good track records that are in charge of their own destiny and have the potential to deliver high and rising returns for a long-time to come means the fund has virtually no exposure to commodity and regulated sectors like Materials, Utilities, Real Estate, Energy and Banks. Meanwhile sectors like Industrials, other Financials and Consumer Staples in which your fund is overweight, hold many of the high quality and scalable companies which we find attractive. Fund headline exposure to Information Technology is underweight, but all companies held in the fund use technology well. Notably our large overweight to industrial technology, which includes many market leaders across areas including automation, software, low voltage and cyber security.

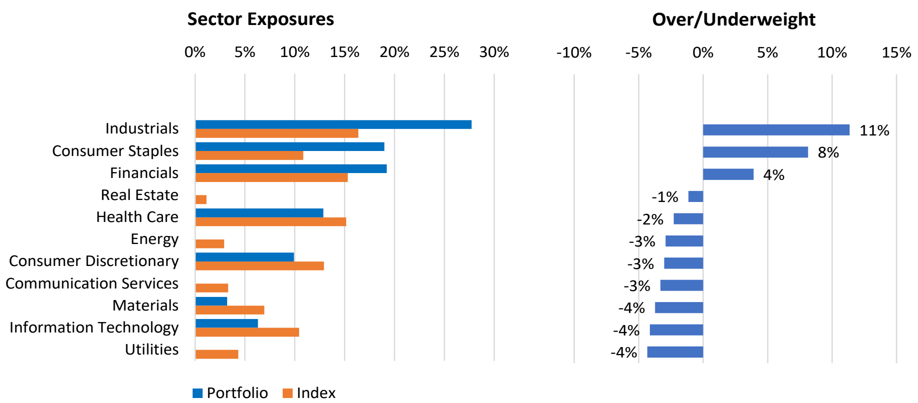


Figure 13: Sector over/underweight % breakdown of the fund versus MSCI Europe ex UK.
Guinness Asset Management, Bloomberg (data as at 31.12.2021).

The Guinness European Equity Income Fund's country over and underweight positions result from a pull between two factors. Naturally, France and Germany represent high absolute weights in the index at 22.5% and 16.5% respectively; but it is also the case that we simply find a greater number of high-quality companies with strong prospects in the "high IP" markets of northern Europe with good corporate governance, notably in Scandinavia.

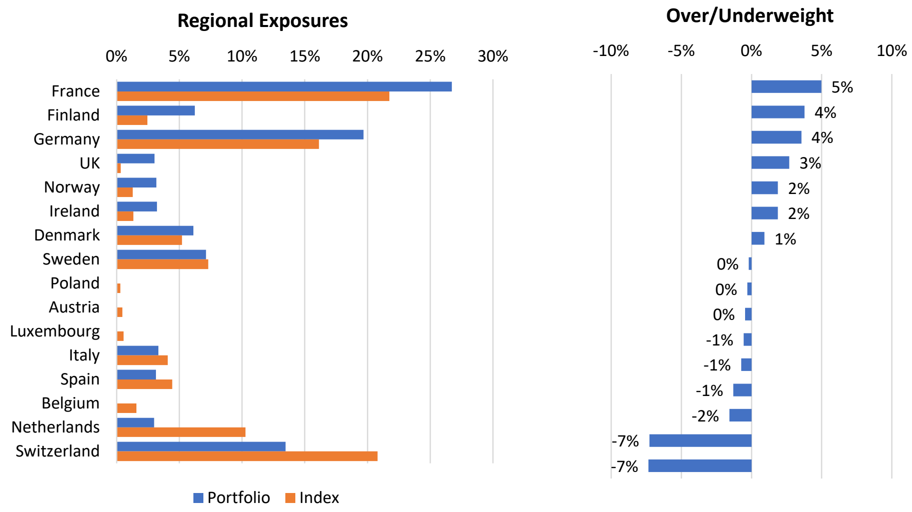


Figure 14: Regional breakdown of the fund versus MSCI Europe ex UK Index on a geographic basis. Guinness Global investors, Bloomberg (data as at 31.12.2021).

*UK exposure represents Unilever which is now domiciled in the UK and listed in the UK and also on Euronext Amsterdam.

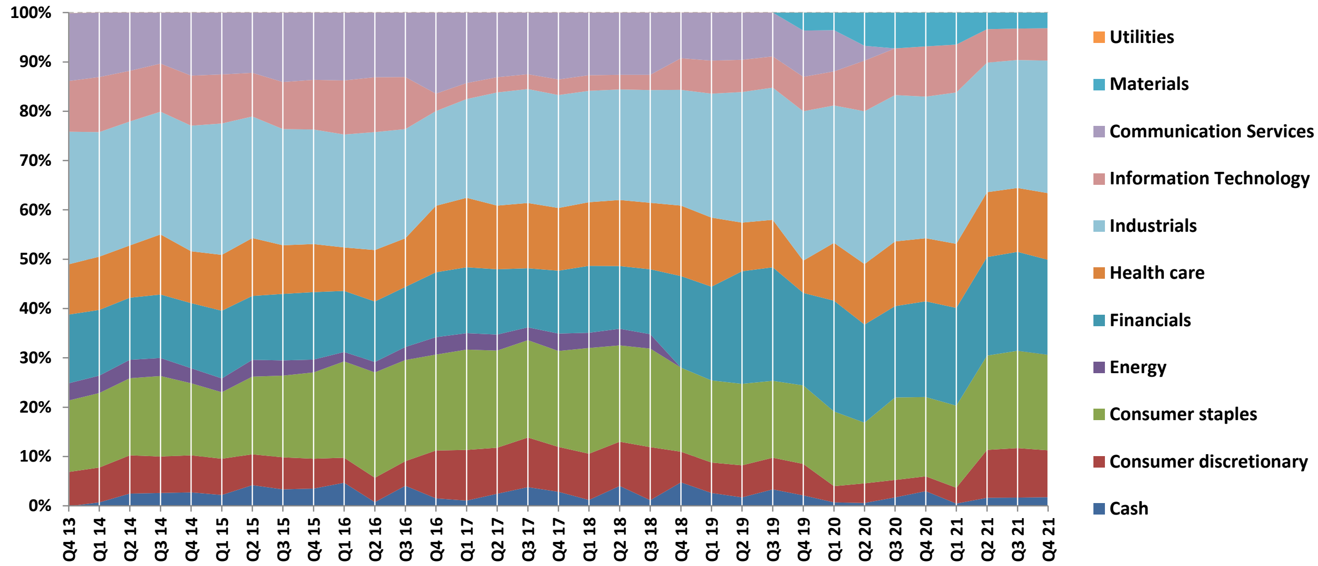


Figure 15: Portfolio sector breakdown at year end 2021

Our underweight in Consumer Discretionary was largely neutralised in Q2 2021 through the addition of Daimler and Kaufman & Broad. Exposure to Consumer Staples also rose with the addition of Henkel. Correspondingly Materials, IT and Industrials exposure all fell as ASML, Sika and Aalberts departed. In keeping with sell discipline ASML's dividend yield had fallen from nearly 1.5% to 0.5%, and overall the buys represented better risk rewards. Daimler on ~7x earnings set to become significantly less capital intensive with the spin out of Trucks and scope for higher recurring revenue as Mercedes-Benz. Kaufman & Broad a capital light business with a long runway for sustainable housing development in France and the Paris area in particular; and

Henkel Adhesives a market leader and great value relative to Sika along with good potential for recovery across its Laundry and Beauty divisions.

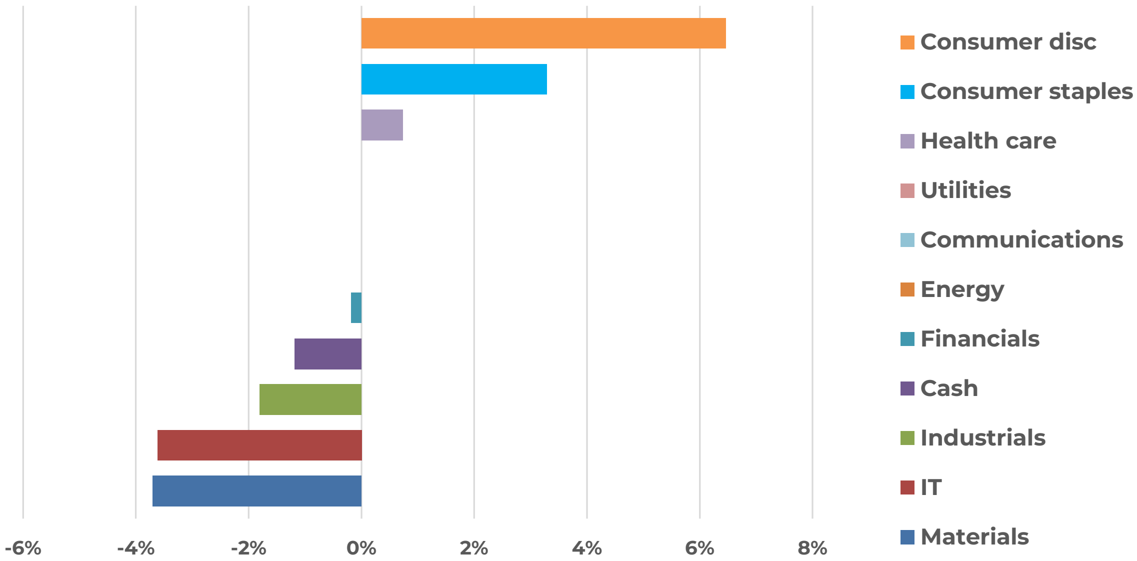


Figure 16: Year on year change in sector breakdown

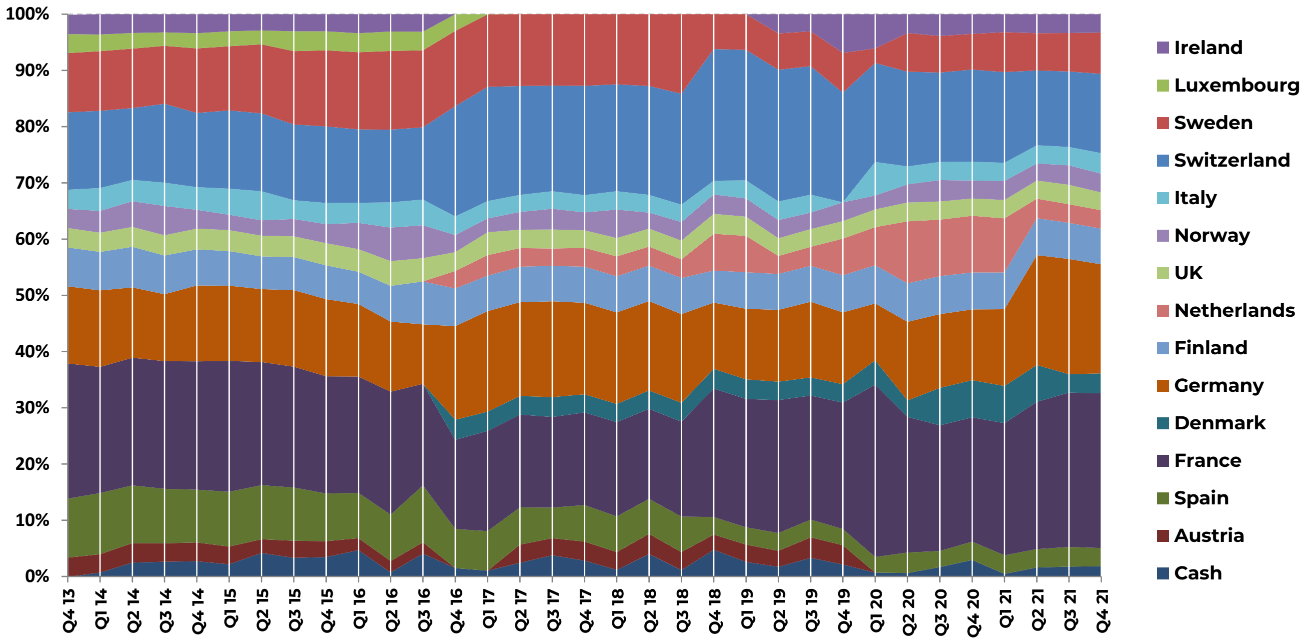


Figure 17: Portfolio geographic breakdown at year end 2019

Net exposure increased in Germany with the acquisition of Daimler and Henkel and in France with Kaufman & Broad. Conversely Netherlands exposure fell sharply with the sale of ASML and Aalberts, and Switzerland exposure on sale of Sika AG. Whatever the exact country breakdown, the majority of our holdings look likely to remain in the higher IP markets of northern Europe.

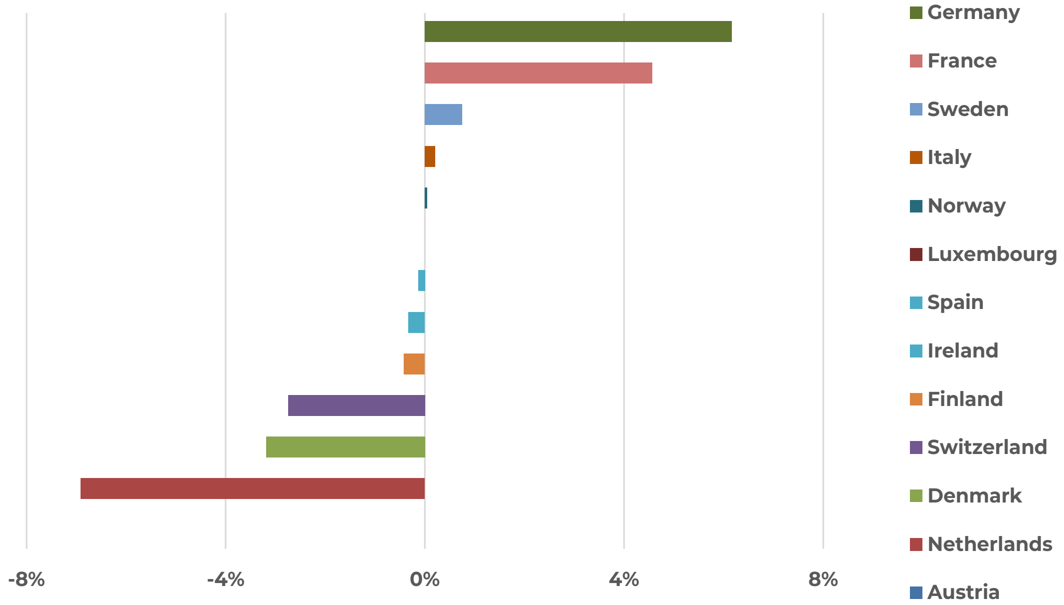


Figure 18: Year on year change in geographic breakdown

Individual Holdings

Companies that performed well in Q4 2021 were broadly characterised by growth and innovation. Ranging from Novo Nordisk boosted by the release of new market leading GLP1 oral diabetes medication, through Capgemini in pole position to help other companies through the digital and sustainable fast forward, to our smart green industrial champions including Epiroc and Schneider Electric. At the other end of the spectrum Henkel and Fresenius performed rather less well but hold good potential for 2022 with positive change coming at Henkel's Laundry and Beauty divisions and Fresenius likely to become a more focused company under the auspices of Michael Sen who oversaw Siemens Energy spin off. Bakkafrost was the worst performer in Q4 following supply chain issues which prevented it from undertaking biological treatments at salmon farms in Scotland.

Best 5 performing stocks	Total return
Epiroc AB	22.6%
Schneider Electric SE	19.8%
Capgemini SE	19.6%
Novo Nordisk A/S	18.3%
Nestle SA	18.1%

Worst 5 performing stocks	Total return
Bakkafrost P/F	-18.1%
Fresenius SE & Co KGaA	-14.6%
Thales SA	+10.4%
Henkel AG & Co KGaA	-7.6%
Danone SA	-7.6%

Figure 19: Best and worst five performing shares in Q4 2021 in EUR.

Source: Bloomberg .

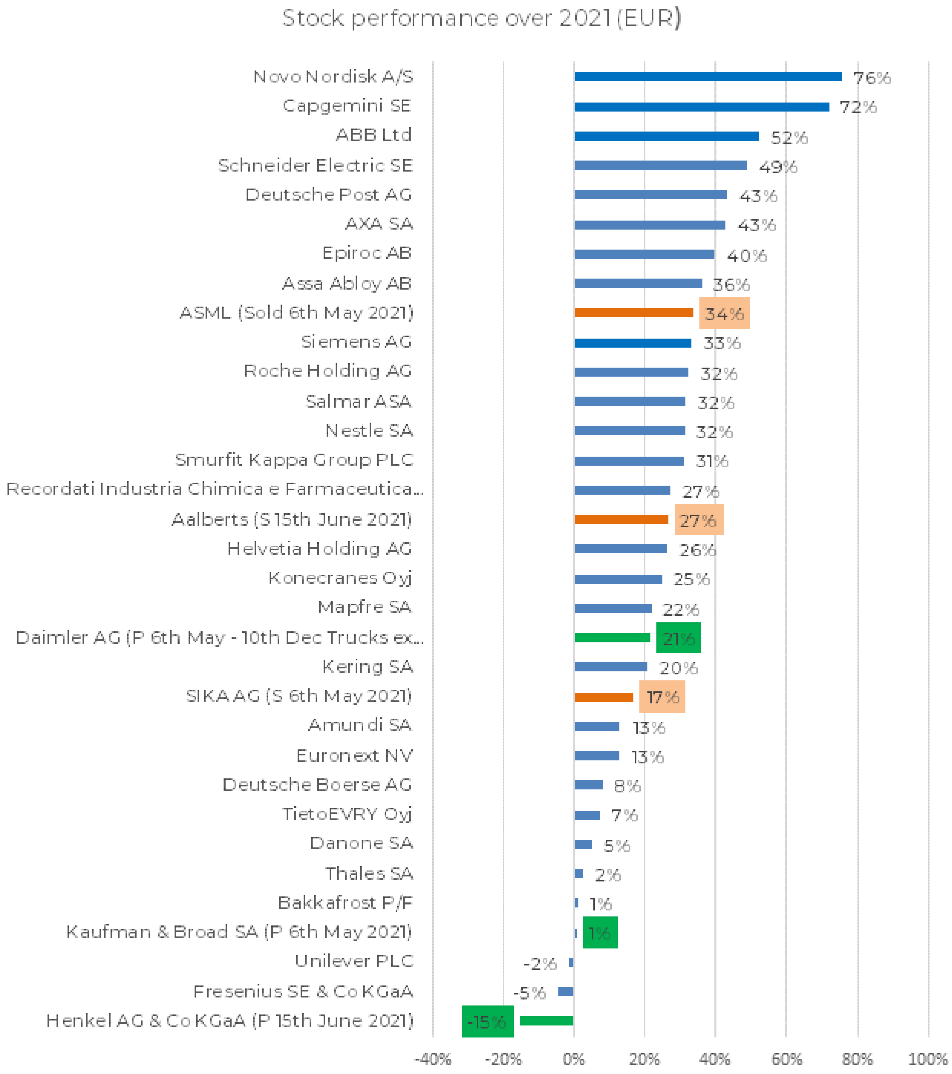


Figure 20: Fund share performance in 2021 in EUR. Sales in orange, performance YTD at sale. Purchases in green, performance YTD since purchase

Source: Bloomberg data.

In 2021 portfolio turnover totalled approximately 10% (buys only). With all three switches made in the second quarter of 2021, we took profits in ASML, Sika and Aalberts against the purchase of Henkel, Daimler and Kaufman & Broad. Leaving the portfolio with the same number of 30 broadly equally weighted positions at the end of the year.

Henkel

Henkel occupies global market leading positions (1-3) across its three divisions: Adhesive Technologies (45% sales), Laundry & Home Care (35%) and Beauty Care (19%). Key brands include Loctite, Pritt and Ceresit in Adhesive Technologies; Persil, Purex and Sun in Laundry & Home Care and Schwarzkopf, Dial and Syoss in Beauty Care. Adhesives Technologies looks well placed for a fiscally led pick-up in activity across its industrial and construction facing sub-segments which include Packaging & Consumer Goods, Automotive & Metals, Electronics & Industrials, and General Industry (craftsmen, construction and professional). While Laundry & Home Care and Beauty Care both hold strong durable brands but also scope for meaningful portfolio optimisation amounting to approximately 20% of division sales or ~10% of group revenues. On 9.6x EV/EBITDA the shares are valued at an over 20% discount to peer group multiples, while margins and cash flow returns are also both depressed vs. history. We see potential for group margins to level up vs. peers, rising to mid-teens after a period of higher digitally focused capex and as under-performing areas are addressed. New management across both Laundry and Beauty look well placed to make the right decisions, following the appointment of Alan Wolpert (ex Colgate) to head Laundry North America in October 2020, and Wolfgang Koenig (ex Kellog NA, Colgate and Beiersdorf) to Beauty in April 2021. That they also know each other and are well acquainted with the NA market, which has been the prime source of product specific under-performance, should prove a plus.

Another opportunity for Henkel against recent softer trading is its conservative balance sheet, with net debt / equity of near zero vs. many close peers at over 100% ND/E. We detect a shift in mentality from management and an acceptance that the perhaps overly conservative culture, historically driven by high family influence (61.54% Ords / voting ownership), may have contributed to recent market share losses, and needs to be addressed - scale matters, particularly when your largest competitors are P&G, L'Oreal, Unilever and Sika. Suggesting accretive bolt-ons alongside portfolio reshuffle and a reduced cost of capital, are likely outcomes. Henkel's track record of persistent high cash returns in the order of 15% - 20%, and peer leading spend on R&D both underscore that this is a company that understands where it is going and what needs to be done. Recent product announcements also suggest the company is on the right track, characterised by circular product launches and bio-based adhesives. Barriers to entry in Adhesives are also perhaps higher than the market gives credit for (vs. Sika's over 40x PE valuation), owing to the multi-year customised nature of partnerships. In short, Henkel is a company that shareholders can feel good about owning, with a strong track record, and potential for a both a meaningful uplift in valuation as well as earnings, along with a 2.6% dividend with potential for solid long-term growth.

Daimler AG (DAI GR, €78bn) joined the portfolio ahead of the spin-out of Daimler Trucks (~6% op. margin), leaving high-quality Mercedes-Benz (14% op. margin) as a stand-alone company, with good potential for rerating against a track record for generating persistent high cash returns. The spin-out will see EV focused Mercedes-Benz keep the software assets, and Mobility services shared between the two separate companies. This is a business that ticks a lot of boxes in terms of our focus on market leaders that we trust with widening moats. Mercedes will have a strong balance sheet, with the ~20% net cash position set to be shared across the two businesses. It is also a global top 10 brand, with Mercedes-Benz no.8 in 2020 according to Best Global Brands, and the split may also unlock potential for other portfolio brands. Crucially for the future the company occupies a leadership position in electric vehicles, with approximately 10% global and 25% European EV market share. By 2030 all new sales and some 50% of fleet is expected to be all electric.

In our view the moat is stable and widening with both persistent high R&D/sales of over 6% and premium brand resilience in downturns set to endure. While incumbent and premium combinations look best placed in terms of both the capex needs of the shift to EV and the longer-term potential to grow the TAM via mobility services including ride hailing, car sharing and charging. The recent analyst spin-out call highlighted the potential for recurring revenues to rise towards ~50% of sales from the current ~30% as the business becomes more circular, which, along with brand quality, strongly argues for a higher valuation vs. the current pre spin ~7x earnings and ~5.8% dividend yield (at ~40% payout ratio). We also think that there is strong potential in spite high transition costs for the margin to at minimum endure, given the potential for some 20% fixed cost savings from automation over-time.

We feel this is a company and management team which we can trust. Despite minor involvement in the German emissions scandal, Daimler leads peers on governance, and management long-term incentives are well aligned with shareholders with a significant portion based on returns (vs peers). Large shareholdings by Li Shu Fu the Chairman of Geely (9.7%) and BAIC Motor (5%) speak to high brand perception in China and access to the largest auto market in the world along with a technological edge. In a world increasingly focused on the sustainable and circular along with premium quality it is hard to see why Mercedes-Benz standalone shouldn't be treated more like other high quality European green industrials characterised by large installed bases and high levels of recurring revenue. In the meantime we can look forward to a rare good 5.8% 2022e dividend yield.

Kaufman & Broad SA (KOF FP, €811m) based in Neuilly-sur-Seine, Paris, is one of France's largest housebuilders, and has a strong track record for generating persistent high cash returns averaging ~20% per annum for the last eight years. Cash conversion is excellent supported by the sale-before completion model, and the balance sheet is robust characterised by negative net debt to equity of -15% at year-end 2020. We think the company is in a good place vis-à-vis the pandemic response to build back more sustainably and create jobs; and K&B's focus on residential and commercial to residential rebuild along with its strong sustainability profile (MSCI A ESG rating) puts it in pole position for the job. Supply and demand dynamics are attractive in our view, with a scarcity of supply due to limited permits likely to improve through 2022/23 as the reality of the necessity of new housing eclipses pre-election hesitancy harking back to the last elections where many REM candidates won on pledges not to build. In the meantime K&B will remain busy and pricing positive with a favourable backlog €3.4bn against a backdrop of positive pricing with most units located in high demand low supply category areas.

We think this is a management team that you can trust and is well aligned with shareholders. Management and employee share ownership is high at some 10.7% of shares outstanding, while the Rolloy family have recently increased their holding from 13.6% to approximately 18% of stock ensuring a long-term focus. The CEO Nordine Hachemi is ex Bougues Construction, La Saur and Sechilienne-Sidec (Albioma); and sustainable know-how is evident in the Paris Austerlitz train station redevelopment being 30% less dense than the Paris average, solar accounting for 50% of building energy requirements and a biodiversity label with over 20k sq.m of planted areas and a commitment to reuse building materials.

Whilst there is still some debate over what or if a portion of the €1bn Austerlitz project may be recognised in 2021 accounts, this business represents good value on just ~11x 2022e earnings relative to sustainable cash flow returns of over 20%. Against peers multiples also look favourable, and lower than average margins indicate a business that is not "over earning" and looks after its stakeholders. We are naturally cautious when it comes to the construction industry, but we think this smaller addition to the portfolio should pay dividends. Indeed with a dividend yield of over 6% one is paid to wait, and the 10% share buyback underway adds to confidence.

The best and worst performing stocks over 2021, aside from Henkel discussed above, were Novo Nordisk (+76 in EUR) and Fresenius SE (-5%).

Novo Nordisk soared in 2021 as its culture of innovation came up trumps yet again, seen in the success of its new GLP-1 class of drugs. Rybelsus its new once daily oral medication for diabetes is a game changer for customers. While its new weight loss medicine Wegovy got off to a very successful start in the US, taking ~60% market share, and continuing to open up a whole new adjacent market for Novo Nordisk with a large unmet need (including some 650m sufferers of whom only around 2% are currently treated). Both launches highlighted the willingness of buyers to pay up for better products, good news in a market where the focus of concern is often on cost and generic competition. The run of good news was interrupted in December by news that a manufacturer of filling syringes for Wegovy pens in the US market had stopped deliveries due to reported issues manufacturing issues. Novo expects to be able to meet patient demand again from H2 2022. In sum the impact looks set crimp 2022e top line growth by about 1-2%, and in the short-term the market may miss the prospect of a strong near-term ex US Wegovy launch. We look forward to further guidance at FY results on 2nd February 2022. Whatever the outcome Novo remains differentiated by its focus on the long-term and its innovation model (expressed in 10Y of near 20% cash returns on investment), and we remain optimistic that the new areas of growth coming to the fore over the last couple of years will continue to drive top line growth and surprise to the upside over the medium term.

Fresenius SE struggled in 2021 as its Helios hospitals business was held back by the pandemic, in spite of market share gains and clear evidence that it had outperformed municipal counterparts across Germany and Spain in terms of patient care. It's Fresenius Medical Care business was similarly impacted as the pandemic interrupted dialysis care regimes. Group cash returns on investment fell to 8% in 2020/21 vs. a 20Y history of 11% - 15%. Against which, on a valuation of ~10x PE / 8x EV/EBITDA the shares are priced for nearly no growth, with a market implied historic growth rate of 1% vs. a 10Y FCF CAGR of 9.5%. There is of course good potential for a demand recovery as we exit the pandemic, but more medium-term we also see scope for high single digit to low double-digit earnings growth. Management may also alleviate shareholders frustration sooner than that as the group is currently undergoing a strategic review due to come to a head in February 2022. With Michael Sen who oversaw the spin out of Siemens Energy and Health the new CEO of Fresenius Kabi and appointee to the supervisory board of Fresenius SE. There may be some question marks around business model attrition in diabetes care, but this is far from being an ex-growth business, and we see good potential for turnaround in 2022.

Portfolio today and outlook

The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level to make sure we are providing what we say we will. At the quarter end, we are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI Europe ex UK Index.

		Guinness European Income Fund	MSCI Europe ex UK Index	Guinness Delta vs. MSCI Europe
Quality	Debt / equity %	83.5	233.0	-149.5
	Net debt / Equity %	39.7	51.0	-11.3
	ROE %	21.4	10.8	10.6
Value	PE (2022e)	14.9	16.3	-1.4
	FCF Yield %	7.3	5.5	1.8
Dividend	Dividend Yield (Best) % gross	3.3	2.8	0.5
	Weighted average payout ratio %	44.9	65.3	-20.4
Conviction	Number of stocks	30	344	-314.0
	Active share	82	NA	

Figure 23: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 31.12.2021)

Conclusion

Whatever the economic weather in 2022, we believe our focus on quality companies that generate persistent high cash returns supported by strong balance sheets will serve investors well for the long term. Guinness European Equity Income Fund holdings are characterised by high levels of self-determination; namely identifiable barriers to entry, leading market positions, widening moats, aligned interests and long runways for growth. Based on the above measures, holistically, the high-conviction fund has companies which are significantly higher quality and better value versus the index.

From where we stand at the beginning of 2022 the investment backdrop is characterised by a number of significant opportunities. We will continue to work hard to deliver long-term capital growth and a steady, growing income stream. Your fund is equipped for all weather, being well balanced across quality and value, and international companies supported by strong structural growth drivers alongside more domestically focused companies where returns and ratings have the potential to benefit from a mixture of self-help and improving domestic demand.

We thank you for your continued support.

Nick Edwards

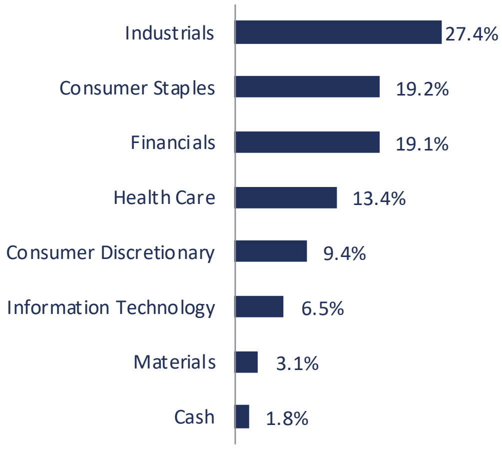
Portfolio Manager

Portfolio

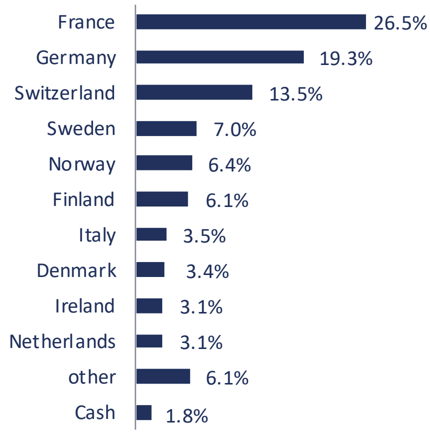
Fund top 10 holdings

Epiroc AB	3.8%
Schneider Electric	3.7%
AXA	3.6%
Capgemini SE	3.6%
Recordati SpA	3.6%
Roche Holding	3.6%
Novo Nordisk	3.5%
Nestle	3.5%
Helvetia Holding	3.4%
ABB	3.4%
% of Fund in top 10	35.5%
Total number of stocks	31

Sector analysis



Geographic allocation



Performance

% Total return from launch (19/12/2013) GBP

Fund (Y Class, 0.89% OCF)
MSCI Europe ex UK Index
IA Europe ex UK sector average

Discrete years % total return (GBP)	Dec '21	Dec '20	Dec '19	Dec '18	Dec '17
Fund (Y Class, 0.89% OCF)	17.5	0.1	23.7	-8.8	10.7
MSCI Europe ex UK Index	16.7	7.5	20.0	-9.9	15.8
IA Europe ex UK sector average	15.8	10.3	20.3	-12.2	17.3
Fund vs sector	1.7	-10.2	3.4	3.4	-6.6

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y Class, 0.89% OCF)	4.0	17.5	17.5	45.4	46.8	93.6
MSCI Europe ex UK Index	3.9	16.7	16.7	50.5	57.2	99.0
IA Europe ex UK sector average	3.4	15.8	15.8	53.6	58.3	104.3

RISK ANALYSIS Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund (31/12/2021)
Alpha	0.00	1.38	0.30
Beta	1.00	0.88	0.94
Information ratio	0.00	0.07	0.05
Maximum drawdown	-25.02	-24.43	-30.36
R squared	1.00	0.89	0.90
Sharpe ratio	0.31	0.49	0.42
Tracking error	0.00	5.22	4.98
Volatility	15.72	14.60	15.64

Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. Source: FE fundinfo bid to bid, total return (0.89% OCF). Fund launch date: 19.12.2013.

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The Guinness European 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. The Fund invests only in stocks of companies that are traded on European stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. 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.

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

- the Manager: Link Fund Manager Solutions (Ireland) Ltd (LFMSI), 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,the Promoter and Investment Manager: Guinness Asset Management Ltd, 18 Smith Square, London SW1P 3HZ.

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Telephone calls will be recorded and monitored.