Guinness Global Equity Income Fund

A high conviction equity fund managed by Dr. Ian Mortimer, CFA, and Matthew Page, CFA, in accordance with their intelligent investment process for high quality income portfolios.

INVESTMENT COMMENTARY - November 2012

Fund size (31.10.12) **£15.2m**

Aim

We don't chase yield, we want capital and dividend growth

Our aim is long-term capital growth and a steady rising dividend stream, balanced with a yield of 3-4%.

Process

Quality before yield

We buy companies that have generated at least 10% Cash Flow Return on Investment every year for 10 years.

"It's a rare achievement for a company to meet our investment criteria – 10% cash flow return on investment every year for ten years is a mark of genuine quality. That's where our portfolio starts – persistent cash generation before yield."

Some thoughts on company management

One question we are often asked by investors is, how important is meeting management of the companies we invest in?

Generally we do not consider meeting management as a high priority, and we certainly don't consider it a prerequisite for investment, as some do. We much prefer to focus on the objective metrics of a company such as long-term profitability, balance sheet metrics, valuation etc. There are two main reasons for this. First, it is impossible to assess the impact of management or quantify the degree of success or failure that should be attributed to management in any objective way. Second, meeting management can put your objectivity at risk.

There are various questions which we have to ask ourselves, such as how well can we assess management of a company? Can we measure it? Do we have the skills to do so, and if we do, what level of certainty could we muster from any conclusion? What makes good management? Are we any good at sifting out the good from the bad? Do we have the time to do it?

The first thing we have to consider is how much influence do senior management (essentially the CEO and CFO) have on the future prospects of a company? Intuitively it seems likely that they are very important. After all they are the people responsible for setting the goals and strategy for the company and ensuring its implementation. They make significant decisions about how capital is employed, the level of employee headcount, which growth opportunities to pursue etc., which can all have a significant bearing on the future prospects of a company.

Given that management are the public face of the company, people often attribute company successes and failures to management. The media love to praise management when the company is performing well and criticise them when the company is performing poorly. However, there are clearly many other factors, be they macro, industry-specific or company-specific that could, individually or in combination, have a stronger effect on the prospects of a company than the decisions of management.

Management could make what you might consider to be all the right decisions, yet over time factors outside of their control have negative consequences for the company. Equally management could make what you might consider all the wrong decisions, yet over time factors outside of their control have positive consequences for the company. In practice what you often see is management blaming factors outside their control when things are going poorly, and taking credit when things go well, independent of what the real causes are. This asymmetric attribution by management, and people's conflation of management with the company as a whole, ignores the reality, which is often grey, fuzzy, uncertain and difficult to determine.

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There is also a problem with definition. What is an objectively good decision? So often good decisions only appear to be good decisions when you look back with hindsight. It is a lot harder to define an objectively good decision ex ante when the future is uncertain.

Therefore, we think too much emphasis is often attributed to management decisions.

Even so, can we actually measure the influence management is having on one company to the next? Can we take a quantitative approach and look at some key financial metrics over the tenure of the management team and see whether management have improved the profitability of the company, produce higher returns on capital, strengthen the balance sheet etc?

The problem with this approach is that, by looking at these metrics, you are assessing all the factors that affect a company at once. Mathematically it's impossible to isolate the degree of impact that management has on financial metrics and show causation. Other macro or industry or company specific factors are at play, which are potentially more important, such as an improving economic backdrop, a favourable foreign exchange environment, weak competition etc.

Even if we did have a suitable metric we could use, what would be the appropriate period over which to assess performance and when should it begin? Many of the big capital budgeting decisions that management make will not have a noticeable effect for perhaps a year, two years or more. Therefore, arguably we wouldn't be able to objectively assess management without a considerable time lag.

So perhaps we can't quantitatively deduce the degree of success or failure of a company that should be attributed to management. But perhaps we could make a qualitative assessment of the absolute quality of management? Should we research the backgrounds of the management team and try to find out as much as possible about them? What is their approach, what is their style, what are their successes and failures? How are they viewed by other professionals?

But first, what is good management?

Lots of books have been written which profess to define what the key tenets are that make a good manager. They tend to be based on studies that show that most of the senior managers they analysed shared X number of skills or characteristics or areas of focus, therefore to identify good management you have to identify the people who have these X number of skills etc. These characteristics will likely make sense because they support one's existing notions of what makes a good manager. Bold, visionary, shrewd, decisive, good under pressure, organised, level headed etc.

At the same time lots of biographical books have been written that attribute successful businesses to individuals, perhaps the maverick who did everything differently to the commonly held idea of good management. They explain the effect their childhood, culture or some other personal experience had on their business philosophy. They discuss the key people that influenced them and why. They explain important decisions they made to which they attribute their success. The books are often packed with proverbs, aphorisms and insights that are all interesting and intuitively make sense.

However, what these books really provide are simply good stories: stories that appeal to the way our brains function. They provide clear, rhetorical, definitive arguments, often stated as "facts" or truths. They may appeal to our existing beliefs creating emotional resonances which confirm the "truths" we already know.

Much of the role of management when they meet investors is that of a salesperson. They are trying to sell us a good story about the company. They will attempt to provide us with the elegant, persuasive, optimistic, appealing story that will resonate with our way of thinking to convince us that they are in control of the company's destiny, they are improving the company, they are going to reach their goals, the value of the company will increase and therefore we should buy their shares. They aren't going to provide us with the highly complex, conflicting, uncertain, uncomfortable reality, that there is much outside of their control. Who would want to buy that?

We have to be very careful about listening to what management tell us. We need to be clear what is fact and what is opinion. What is an expectation or forecast and what is real and present.

Proverbs are an interesting example to illustrate this point. Proverbs are defined as "a short well-known saying that expresses an obvious truth and often offers advice". For example:

1. If at first you don't succeed, try, try again
2. Nothing ventured, nothing gained
3. All good things come to those who wait
4. Look before you leap

We have all heard them and they all make sense. But here are another four that state the opposite "truth" to each of the above in the same order.

1. Don't flog a dead horse
2. Better safe than sorry
3. Time and tide wait for no man
4. Strike while the iron is hot

When we hear any individual proverb in isolation they seem true. Yet when we read the numbered pairs of these proverbs we are hit with an awkward feeling. We "know" both proverbs are "true", yet they state opposite "facts". In reality proverbs are not "truths" or facts they are simply phrases which we associate with truth.

This is an incredibly important and somewhat uncomfortable realisation: in many instances when analysing aspects that affect the future prospects of a company, not just management, all we can genuinely conclude is, "we don't know". We can't rely on predictions and forecasts, we can't rely on an elegant, optimistic story that "makes sense". Whilst uncomfortable, it is vital to realise this, and it focuses the mind away from what we think we know towards what we don't know, i.e. away from attempting to make predictions and forecasts based on unprovable qualitative factors but instead towards the risks of our decisions. It makes us prefer a strong balance sheet today over expectations of earnings growth in the future, diversified established product offerings over hot new products, cash over earnings, and companies that have been successful in most economic and industry scenarios.

There is a reasonable chance that, rather than read what we have written above, you would have preferred us to have written something more positively deterministic about management. Perhaps something along the lines of:

> "We won't invest in a company until we have met management. We want to press the flesh, look in to the whites of their eyes and understand what they are doing and why. We believe this is one of the ways that we really can add value and attribute a significant proportion of our good performance since we launched the fund to our ability to weed out mediocre management from the great."

Evidence suggests that all of us as have a human psychological bias towards confident statements over balanced statements, certainties over probabilities, simplicity over complexity. Just look at the types of people the media tend to interview: they make strong assertions, condense complex issues into bitesize chunks, and make clear conclusions. This makes it easier for our minds to understand, remember and make sense of the world. Our minds naturally use stories to make sense of our world in any situation where there is conflicting information as our way of dealing with what psychologists term Cognitive Dissonance (for a fascinating example of Cognitive Dissonance in action, see Leon Festinger's book, *When Prophecy Fails*). Conflicting information is everywhere when you are trying to decide whether to invest in a company – arguments both for and against. We need to be aware that our mind's natural desire to resolve cognitive dissonance towards a certainty can be an obstacle to making good decisions, and meeting management won't help us maintain our objectivity.

As Mark Twain said, "It's not what you don't know that kills you, it's what you know for sure that ain't true."

Guinness Global Equity Income Fund

In October the Guinness Global Equity Income Fund was up 0.24% (in GBP) outperforming the MSCI World Index which was down -0.44% (in GBP). The US presidential election and China's leadership change were both on the horizon with the US election expected to be a close run race. Markets were fairly flat over the month with positive unemployment figures from the US being offset by the effects of Hurricane Sandy.

Dr. Ian Mortimer & Matthew Page

Co-managers, Guinness Global Equity Income Fund

November 2012

PORTFOLIO (31.10.12)

Fund top 10 holdings (%)	
General Dynamics	3.6%
Procter & Gamble	3.6%
Abbott Laboratories	3.3%
Illinois Tool Works	3.2%
Pfizer	3.0%
Aberdeen Asset Management	3.0%
Johnson & Johnson	3.0%
Mattel	3.0%
Reckitt Benckiser	3.0%
Aflac	3.0%
% of Fund in top 10	31.6%
Total number of stocks in Fund	36

Geographic allocation (%)	
United States	54.0%
Great Britain	27.7%
France	5.6%
Italy	3.0%
Hong Kong	2.9%
Netherlands	2.8%
Australia	2.8%
Germany	2.7%
Cash	-1.4%
	100.0%

Sector analysis (%)	
Consumer Staples	29.1%
Financials	16.6%
Health Care	15.1%
Industrials	12.3%
Consumer Discretionary	8.8%
Energy	8.6%
Telecoms	5.6%
Information Technology	5.3%
Cash	-1.4%
	100.0%

PERFORMANCE

12 months to month end:	Oct '08	Oct '09	Oct '10	Oct '11	Oct '12
Guinness Global Equity Income Fund	-	-	-	-	6.7
MSCI World Index	-25.2	16.1	16.2	0.8	9.7
IMA Global Equity Income sector average	-27.5	21.8	14.9	3.5	8.3

Cumulative % total return

31/10/2012	1 month	3 months	6 months	1 year	From launch
Guinness Global Equity Income Fund	0.2	0.4	3.4	6.7	7.2
MSCI World Index	-0.4	1.8	2.6	9.7	3.0
IMA Global Equity Income sector average	0.2	1.9	4.3	8.3	6.0

Risk analysis - Annualised, month end, from launch on 31.12.10

31/10/2012	Index	Sector	Fund
Alpha	0	1.82	2.60
Beta	1	0.88	0.73
Information ratio	0	0.32	0.50
Maximum drawdown	-14.06	-10.95	-10.76
R squared	1	0.78	0.83
Tracking error	0	4.97	4.41
Volatility	10.28	10.28	8.23

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, C class shares, GBP. Launch date: 31.12.10.

IMPORTANT INFORMATION

This report is primarily designed to inform you about the Guinness Global Equity Income Fund, including recent activity and performance. For regulatory purposes it falls within the legal definition of a financial promotion. Please therefore note the risk warnings below and the following statements: it contains facts relating to equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report. It is 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 content of the document should not therefore be relied upon. It should not be taken as a recommendation to buy or sell individual securities.

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 the Fund's portfolio changes daily and can be affected by changes in currencies, interest rates, general market conditions and other political, social and economic developments, as well as specific matters relating to the companies in whose securities the Fund invests. Investment in the Fund carries with it a degree of risk and investors should read the risk factors section in the prospectus before investing.

The full Fund documentation contains more complete and detailed information of risk, fees, charges and expenses that are to be borne by an investor. The documentation should be read carefully before investing. The full documentation needed to make an investment, including the Prospectus, the KIID and the Application Form are available, free of charge, from the Manager: Capita Financial Managers (Ireland) Limited, Montague House, Adelaide Road, Dublin 2 Ireland or the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA. **Documentation is also available from the website guinnessfunds.com.** This document should not be distributed to Retail Clients who are resident in countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful. THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.

The Guinness Global Equity Income 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. The Fund has been approved by the Financial Services Authority for sale in the UK. The Company and the Fund have been recognised in the UK by the FSA pursuant to section 264 of the FSMA. Guinness Asset Management Ltd is authorised and regulated by the Financial Services Authority.

Telephone calls to Guinness Asset Management may be recorded.

The prospectus for Switzerland, the simplified prospectus for Switzerland, the articles of association, the annual and semi-annual reports, as well as the list of the buying and selling transactions 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, Fax: + 41 22 705 11 79, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

GLOSSARY

Alpha
Alpha is a measure of a fund's over or underperformance by comparison to its benchmark. It represents the return of the fund when the benchmark is assumed to have a return of zero, and thus indicates the extra value that the manager's activities have contributed.

Beta
Beta is a statistical estimate of a fund's volatility by comparison to that of its benchmark, i.e. how sensitive the fund is to movements in the section of the market that comprises the benchmark. A fund with a Beta close to 1 will move generally in line with the benchmark. Higher than 1 and the fund is more volatile than the benchmark.

Information Ratio
An assessment of the degree to which a manager uses skill and knowledge to enhance returns, this is a versatile and useful risk-adjusted measure of actively-managed fund performance. It is calculated by deducting the returns of the fund's benchmark from the fund's overall returns, then dividing the result by its Tracking Error. In this way, we arrive at the value, per unit of extra risk assumed, that the manager's decisions have added to what the market would have delivered anyway.

Maximum Drawdown
Represents the worst possible return over a period, e.g. buying at the highest price over the period and selling at the lowest.

R-Squared
The R-Squared measure is an indication of how closely correlated a fund is to an index or a benchmark. It can be treated as a percentage, showing what proportion of a fund's movements can be attributed to those of the benchmark. Values for R-Squared range between 0 and 1, with 0 indicating no correlation at all, and 1, rarely, showing a perfect match.

Tracking Error
This statistic measures the standard deviation of a fund's excess returns over the returns of an index or benchmark portfolio. As such, it can be an indication of "riskiness" in the manager's investment style. A Tracking Error below 2 suggests a passive approach, with a close fit between the fund and its benchmark. At 3 and above the correlation is progressively looser: the manager will be deploying a more active investment style, and taking bigger positions away from the benchmark's composition.

Volatility
Standard deviation is a statistical measurement which, when applied to an investment fund, expresses its volatility, or risk. It shows how widely a range of returns varied from the fund's average return over a particular period. Low volatility reduces the risk of buying into an investment in the upper range of its deviation cycle, then seeing its value head towards the lower extreme.

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