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 - January 2013

Fund size (31.12.12) **£16.0m**

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."

ANNUAL REVIEW

How did the Fund perform in 2012?

In 2012 the Fund had a total return of 4.74% (in GBP, C class) compared to the MSCI World Index return of 10.74% (in GBP). The Fund therefore underperformed the Index by 6.0%. However, during the two years we have been running the Fund we have managed to deliver positive total returns in both 2011 and 2012, are ahead of the Index since launch and we have done this with relatively low volatility. We have also grown the dividend distribution year-on-year.

In 2012 the Fund performed largely in line with how we expected it to: underperforming in sharp rallies and outperforming in sideways and declining markets.

At the beginning of 2012 we wrote the following outlook.

"Our investment process is unlikely to outperform in all market conditions, but it is our expectation, given the in-depth research we have undertaken on the set of companies that meet our criteria, that over a 3-5 year period these companies should outperform the market.

2011 proved to be a good year for this process. While volatile markets reacted wildly to global economic uncertainty, our focus on quality, cash-generative, dividend-growing businesses proved an effective hedge against the down swings and rallied well from the lows.

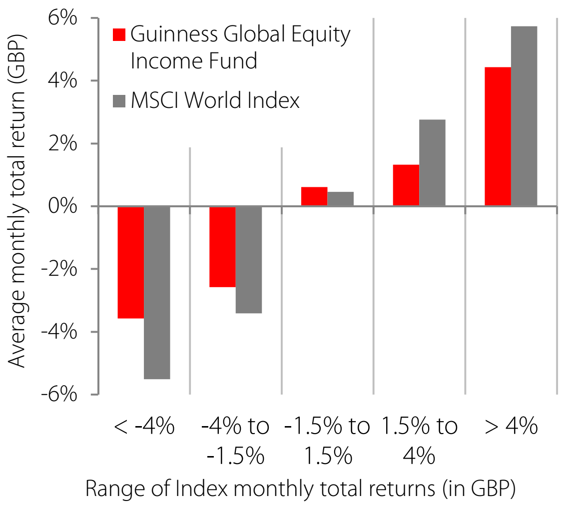
If 2012 turns out to be a strong market for equities in response to an improving outlook for a global economic recovery, then we may well struggle to outperform as our lack of exposure to commodity stocks would likely hold us back. This scenario is not the most likely in our view, given our expectation of low growth in Europe for a considerable period of time, but that does not mean that the market may not rally strongly on increased optimism.

If 2012 turns out to be similar to 2011, characterised by continued macro risks and uncertainty, then our approach is likely to continue to perform well, with stable, cash-generative businesses continuing to appeal to investors in search of income. In periods of relatively low returns for equities, dividends make up a significant proportion of total returns; the market will likely realise this and valuations of these types of companies should increase.

We do not spend too much time worrying about how the global economic environment will fare in the near future but instead we will continue to focus our time and thoughts on our process and on identifying high quality companies and including the best value opportunities in the portfolio."

The chart overleaf demonstrates how the Fund has performed over the last two years by breaking down the 24 months of total returns in to different bands of monthly total returns of the MSCI World Index.

Average monthly total returns 2011-2012



In months where the Index had a total return of 4% or more the Fund has underperformed. At the opposite end of the scale, in months where the Index is down by more than 4%, the Fund has outperformed. Given these characteristics the Fund performed well relative to the Index in 2011 when the Index was down 4.48% and the Fund was up 1.95%, but underperformed relative to the Index in 2012 as equities rallied.

The global macro environment has clearly received a lot of attention since the beginning of the US housing crisis. We have seen large fluctuations in GDP growth, volatile sovereign debt yields, rising unemployment, austerity versus stimulus debates, Balkanisation of banking activity, the fiscal cliff and unprecedented central bank policies, to name a few. This has led to a widely heard commentary that this economic volatility and uncertainty has forced asset class correlations to converge, and therefore macro views have been driving returns – the so called "risk on, risk off" strategy.

Our investment process is not designed to exploit this idea. In fact we think the idea of cranking up and down the "risk" in a portfolio within short periods of time is closer to speculation than investing. The implications of using a "risk on, risk off" strategy goes against our core approach to investing. Here are three reasons why:

1. **Risk on, risk off implies high portfolio turnover and a short time horizon.**

   Our portfolio turnover is low; in 2012 we only sold three positions and bought four. This is a consequence of our investment time horizon. When we are considering investing in a company we do so on the basis that the valuation discrepancy that we are seeking to take advantage of may well take more than two or three years to come good. Market fear and confidence can fluctuate many times over this period, as we have seen over the last five years. Moving in and out of stocks with every lurch in the market would simply create extra trading costs which erode your return over time.

2. **Risk on, risk off implies you believe you are good at market timing.**

   Market timing is more luck than anything else. Given the short time horizons implied by the risk on, risk off approach, market timing is very important for it to succeed. You need to feel confident you know when the inflection points are coming. When we have decided we like a company's valuation we get on and buy it, without trying to pick the perfect moment. In addition our equally weighted portfolio construction means we don't have to be too precise in choosing our moment to invest. The act of rebalancing the portfolio means we sell down a small proportion of our winners to invest in the companies that have underperformed and therefore have become cheaper. This allows us to improve our average purchase price.

3. **Risk on, risk off implies you are able to make good economic forecasts.**

   Statistical studies of expert predictions of future events show that they are not very accurate. Philip Tetlock looked at the predictions of 284 experts over a 20 year period. He analysed the resulting 28,000 predictions and found that these experts' predictions were about as good as a dart-throwing monkey. Despite all the hugely confident predictions we hear from economists in the media, in fact they aren't much better than chance. That isn't to belittle the work of economists; considering different scenarios, the effects of political decisions, shocks, etc. is clearly valuable, but relying on specific predictions can be dangerous. We take the approach of looking at companies from a bottom-up perspective and consider how they will perform in different economic environments. If we can find companies that can continue to grow in numerous economic climates then we can be less concerned with predicting the specifics of how the future will turn out.

Our investment approach is to look for companies that consistently generate high returns on capital and therefore consistently create shareholder value year-on-year. This shareholder value creation is independent of what price the market will attribute to its shares at any point in time, but we do receive a proportion of this value creation each year in the form of a dividend from all the companies we own.

What changes did we make to the portfolio during the year?

We kept the portfolio turnover low in 2012 and only sold three positions. We sold Telefonica, Pepsico and Sanofi, and bought Merck, Arthur Gallagher, ENI and H&R Block.

When we review our portfolio for sale candidates there are six key issues that might provoke us to sell a position.

Reasons for sale:

1. A company fails or is expected to fail our criteria for inclusion in our Universe
    - CFROI falls below 10%
    - Debt/Equity ratio rises above 1
    - Market cap. falls below $1bn
2. Valuation becomes too rich
3. Balance sheet deteriorates
4. Dividend outlook is unfavourable
5. Original reason for purchase no longer holds
6. Yield contribution to portfolio is insufficient

We sold Telefonica for reasons 3 and 4 and sold Pepsico and Sanofi for reason 1.

We **sold Telefonica** in August as the company had announced dividend cuts and cancellations in response to a balance sheet which had significant amounts of debt coming due over the next couple of years. With yields on European sovereign debt still high and a balkanised European banking system, combined with increasing competition in the European telecoms market, the outlook for the company was not very encouraging. We had held the position as a hedge to our core view of slow economic growth in Europe as well as liking the company's exposure to Latin America and thought it was offering good value. The yield was clearly attractive and the dividend cut and cancellation was painful. However, our portfolio construction rule of equally weighting all our positions meant that the effect on the portfolio was limited. By the time we sold the stock in August it was down 20.2%, making it our worst performing position for the year.

It is mentally easy to sell a company which has performed well but less easy when it has performed poorly as often valuation metrics look attractive, and your positive initial conviction is hard to overcome. However, given that we equally weight all our positions, we have to rebalance our portfolio when they move out of line. One advantage of this approach means that when we rebalance the portfolio we have only two options when it comes to poorly performing stocks. We can either buy more to bring it back in balance or we can sell the whole position. But what we cannot do is just let it drift and forget about it. Consequently our portfolio can never have a long tail of low conviction "legacy" positions. When deciding what to do in these situations we have come to the conclusion that the best question to ask ourselves is "Why must we own this company?". Given our long-term time horizon we might conclude that the market is wrong and sentiment is unjustifiably negative, the balance sheet can be repaired and the price now offers exceptional value. But in the case of Telefonica we couldn't come up with strong reasons to keep it in the portfolio and therefore sold it. Despite the poor performance of Telefonica it was more than outweighed by our best performing position, Aberdeen Asset Management, which was up 89.1%.

We **sold Sanofi** in September. This was prompted by the fact that the company had fallen out of our investable universe due to the company's CFROI falling below 10% in 2011. This was mainly due to the fact that Sanofi had acquired Genzyme, which was generating lower returns on capital. The company was looking particularly cheap when we bought it two years ago, along with a number of other large cap. pharmaceutical companies, but by September the company was trading on multiples closer to that of the market. The share price had also recovered above its 2008 peak and we felt it was a good opportunity to realise a profit. We bought another pharmaceutical company, **Merck**. Merck had the attraction that it had recently started to grow its dividend and has the balance sheet strength and dividend cover to sustain this growth going forward. The yield was also attractive in absolute terms at around 4%.

Later in September we **bought Arthur Gallagher**, the insurance broker, and the Italian integrated energy company **ENI**. Arthur Gallagher has grown its business largely through acquisitions and has been disciplined and successful at integrating these businesses and finding cost efficiencies. Typically the company focuses its acquisitions on niche groups such as marine, energy and aviation. The company has been growing its returns on capital for the last 20 years and has a very strong balance sheet with net cash. ENI has lagged the broader energy market in recent years. We see the company as offering good value both in terms of earnings and based on the value of their assets in the ground. The company is undergoing a step-change as it divests its holdings in SNAM, the gas transport group, and moves towards selling down its stake in Galp, the Portuguese energy company. This will leave the group with a greater focus on exploration and production and better able to grow production in the future, a feat it has struggled to execute in recent years.

We **sold our position in Pepsico** in October when it failed our Universe criteria with its debt to equity ratio going above 1 after it took on more debt. The share price had performed well over the course of the year, yet earnings expectations were declining and consequently the valuation was starting to look stretched. The business still seems in fairly good shape but we concluded the risk-reward profile had shifted somewhat and decided to take a profit. We used the proceeds of this sale to **buy a position in H&R Block**, a tax service provider where we see significant value within a strong business model. The company is highly cash-generative and has recently refinanced a debt facility which has strengthened their balance sheet. The dividend is well covered and offers an attractive yield of over 4%, particularly in the context of a long corporate history of paying dividends. The company is not well covered by the analyst community and short-term investors will be put off by the seasonal nature of its business, which gives some explanation to the attractive valuation. The effect of this switch at the portfolio level was to reduce our exposure to large cap. stocks and increase our exposure to small caps while also improving the P/E multiple of the portfolio as Pepsi was trading on a 2012 P/E of 17x whereas H&R Block was trading on 10x.

Over the course of the year our best performing positions more than outweighed our worst performing positions.

Best Performers

The companies that contributed most positively to performance of the Fund were Aberdeen Asset Management (+89.1% total return in USD), Halma (+49.8%) and Mattel (+36.8%).

Aberdeen Asset Management has benefitted from the success of their Global Emerging Markets strategy which continues to attract inflows at high margins. Aberdeen is an example of a company that provides us with an indirect way of playing Asia and emerging markets. We have found better value over the last couple of years by gaining exposure in this indirect manner. The company has grown its dividend at 28% per year in both 2011 and 2012 making a cumulative growth of 64%.

Halma generates a growing proportion of its revenues from Asia and emerging markets and is focused on developing industrial products that will benefit from globally shifting demographics such as urbanisation, demand for water, healthcare. The company focuses on the characteristics we like to see in a business, prioritising high returns on capital, low debt, and therefore the ability to pay an increasing dividend. The company increased the dividend by 7% year-on-year, the 33rd consecutive year the company has increased its dividend by more than 5%.

Mattel, the toy company, grew its dividend by 35%, supported by strong margin expansion over the last couple of years. The share price benefitted from analysts upgrading their earnings estimates on a positive outlook. The company generates 15% of its revenues from Latin America and 45% of its operating profits outside of the US.

Worst performers

The companies that had the largest negative impact on performance of the Fund were Telefonica (-20.2% total return in USD), Willis Group (-10.9%) and Metcash (-6.3%).

Telefonica we discussed above; we sold it in August after the deterioration of its balance sheet.

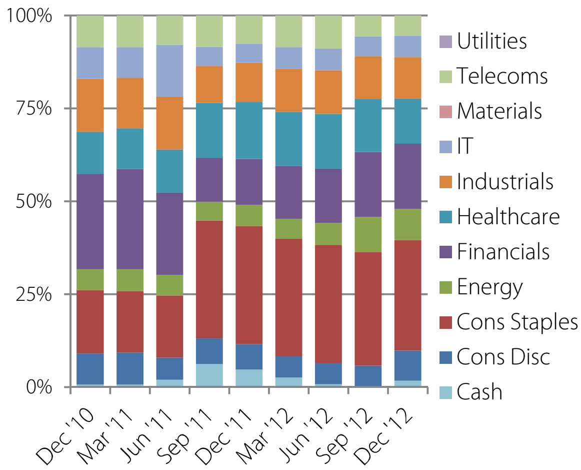
Willis Group suffered from low global economic growth leading to reduced commissions on insurance premiums.

Metcash, an Australian grocery wholesaler, struggled with the integration of a number of stores it had secured through an acquisition. Combined with some deflation in the price of the goods it sells, this led to a decline for the company's earnings outlook.

The Portfolio

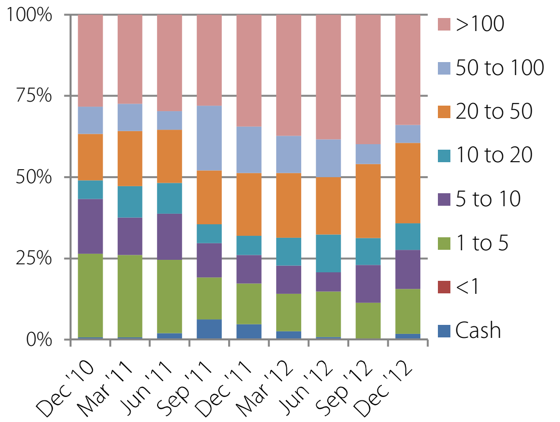
The chart below shows how the sector breakdown of the portfolio has evolved over the last two years. The sector breakdown this year has remained fairly stable as the turnover in the portfolio has been low. Our largest sector weight remains the Consumer Staples sector, followed by the Financials sector. Our weighting to the Consumer Staples sector has fallen slightly over the course of the year while our weighting to Financials has increased. We have not owned any materials or utility stocks as our universe criteria tend to exclude these types of companies.

Portfolio sector breakdown (at each quarter end)



The chart below shows how the market capitalisation breakdown of the portfolio has evolved over the last two years. Our weighting to companies with a market cap. over $50 billion fell from approximately 50% at the end of 2011 to 40% by the end of 2012. Our weighting to companies with a market cap. of less than $10 billion remained fairly stable throughout the year.

Portfolio market cap. split ($bn, at each quarter end)



Outlook for 2013

The mood in the market at the beginning of 2013 certainly appears more upbeat than it was at the beginning of 2012 and perhaps closer to that of early 2011. In a poll of fund managers at a recent conference we attended, the least popular equity class was defensive companies, with most favouring cyclicals (although the Energy sector remains out of favour). Perhaps we should expect a continued "risk on" rally in shares of companies with less sustainable business models at the expense of those with recurring and steady profitability. Or perhaps macro concerns will again come to front of mind and it will be the opposite. This is all just short-term noise, really; as we wrote in our November brief we believe the demand for equities that offer a relatively safe and rising dividend is likely to remain strong for some time, driven by the medium-term exceptionally low yields on bonds and cash and the long-term demand for income from shifting global demographics.

As we have discussed our portfolio starts 2013 in a very similar shape to where we started 2012 in terms of its geographic and sector exposures. The Fund also remains good value, trading on a price/earnings multiple of 11.6x 2013 forecast earnings, which is very similar to 12 months ago and is a reasonable discount to the MSCI World Index of 13.2x.

The blue chip stocks that looked exceptionally good value in the summer of 2011 are no longer the bargains that they were but we still think quite a few continue to offer good value, as we discussed in our update in September 2012. We did reduce our exposure to blue chips by selling Pepsico which was looking expensive, but we can still identify plenty of value within our high quality investable universe outside of the blue chips, H&R Block being a good example of this.

Our investment process remains unchanged, and we will continue to apply it with discipline, no matter what 2013 may bring.

Dr. Ian Mortimer & Matthew Page

Co-managers,
Guinness Global Equity Income Fund

January 2013

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.

PORTFOLIO (31.12.12)

Fund top 10 holdings (%)

Willis Group Holdings	3.4%
Aberdeen Asset Management	2.9%
Halma	2.9%
Deutsche Boerse	2.9%
ICAP	2.9%
General Dynamics	2.8%
China Mobile	2.8%
H & R Block	2.8%
Danone	2.8%
Royal Dutch Shell	2.8%
% of Fund in top 10	28.9%
Total number of stocks in Fund	36

Geographic allocation (%)

United States	50.9%
Great Britain	28.0%
France	5.5%
Germany	2.9%
Hong Kong	2.8%
Netherlands	2.8%
Italy	2.7%
Australia	2.7%
Cash	1.7%
	100.0%

Sector analysis (%)

Consumer Staples	29.3%
Financials	17.3%
Health Care	13.4%
Industrials	11.0%
Energy	8.2%
Consumer Discretionary	8.0%
Information Technology	5.6%
Telecoms	5.4%
Cash	1.7%
	100.0%

PERFORMANCE

12 months to month end:	Dec '08	Dec '09	Dec '10	Dec '11	Dec '12
Guinness Global Equity Income Fund	-	-	-	2.0	4.7
MSCI World Index	-17.9	15.7	15.3	-4.8	10.7
IMA Global Equity Income sector average	-18.4	17.4	14.3	-2.1	9.7

Cumulative % total return

31/12/2012	1 month	3 months	6 months	1 year	From launch
Guinness Global Equity Income Fund	-1.5	-0.2	1.9	4.7	6.8
MSCI World Index	0.5	1.8	5.5	10.7	5.4
IMA Global Equity Income sector average	0.4	1.6	6.5	9.7	7.5

Annualised % total return from launch

	31/12/2012
Guinness Global Equity Income Fund	**3.33%**
MSCI World Index	**2.65%**
IMA Global Equity Income sector average	**3.67%**

Risk analysis - Annualised, weekly, from launch on 31.12.10

31/12/2012	Index	Sector	Fund
Alpha	0	2.19	1.19
Beta	1	0.76	0.76
Information ratio	0	0.24	0.15
Maximum drawdown	-18.26	-15.50	-16.40
R squared	1	0.80	0.90
Tracking error	0	7.06	5.51
Volatility	15.70	13.35	12.54

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. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Funds. This will have the effect of lowering the capital value of your investment.

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.