Guinness Global Equity Income Fund

INVESTMENT COMMENTARY – March 2016

About the Fund

Guinness Global Equity Income Fund is designed to provide investors with global exposure to dividend-paying companies.

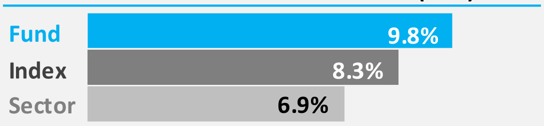
The Fund is managed for income and capital growth and invests in profitable companies that have generated persistently high return on capital over the last decade, and that are well placed to pay a sustainable dividend into the future.

Fund size	£101m
Launch date	31.12.10
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA

Performance — 29.02.16

	1 year	3 years	From launch
Fund	1.3	32.5	62.2
Index	-1.3	27.2	51.2
Sector	-2.3	17.9	40.8

Annualised % total return from launch (GBP)



Benchmark index	MSCI World Index
IA sector	Global Equity Income

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.
Source: Financial Express, bid to bid, total return.

Guinness Global Equity Income Fund passed its fifth anniversary on 31st December 2015. For our full review of the Fund's history, visit **guinnessfunds.com**

Fund review

February was another good month for the fund in terms of performance. Over the month the fund was up 3.57% (in GBP) versus the MSCI World Index which was up 1.03%. The fund therefore outperformed by 2.54%.

This leaves the fund up 4.25% (in GBP) for the year-to-date, well ahead of the benchmark, which is now down 1.31% for the year. It is pleasing that the style of the fund (quality, value, dividend growth) as well as good individual stock performance have driven these returns.

In this month's update we take a look at how recent market movements have affected companies and strategies that have a high dividend yield – and what investors might consider when assessing these businesses and strategies.

High dividend yield stocks are often thought of as being fairly defensive in nature. For example, highly regulated industries such as utilities will often offer a fairly reliable and high dividend yield. These "bond-like" equities have also benefitted from quantitative easing driving their valuations higher in a world starved of income producing assets.

However, another group of companies that offer high dividend yields today are in fact challenged or leveraged businesses where the market is sceptical of their ability to be able pay their dividend. With any external shock these companies can see their equity valuations slashed and dividends can be cut - making for a particularly painful impairment of both capital and income for anyone left holding these companies.

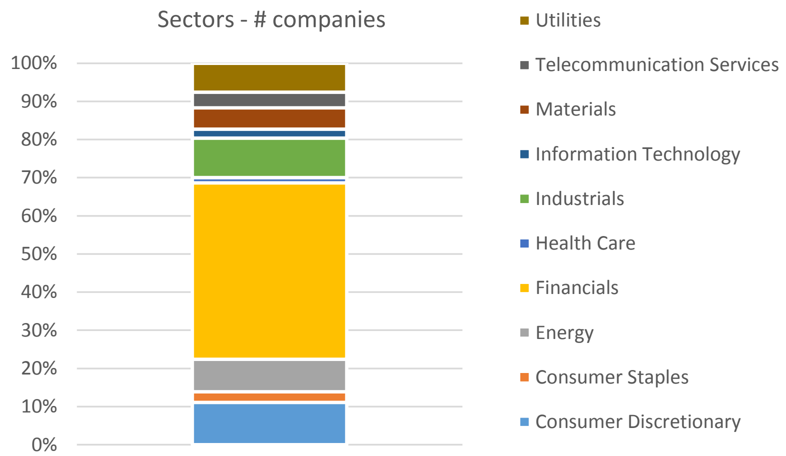
Energy MLPs have been a good example of this recently. Many of these were purported to have little direct exposure to commodity prices instead generating revenue as "toll takers" through transportation and storage of the commodities. However, as commodity prices collapsed the market questioned this assertion as the clients of these businesses, such as exploration and production companies, were no longer able to pay the tolls they had signed up to. Added to this MLPs generally employ a great deal of leverage, have weak pricing power, and have potentially complicated financial structures because they are created to a large extent for beneficial tax purposes. The dramatic fall in the S&P MLP index from its peak in mid 2014 to the low seen last month (a peak to trough decline of 60%) puts this in stark contrast.

Source: Bloomberg, Guinness Asset Management

The MLP example above is just one corner of the 'high dividend yield' market and whilst simply looking for companies with a high dividend yield is anathema to us, it is interesting to see which other companies make up this opportunity set today.

For simplicity, we simply looked at all companies with a market capitalization over $1bn, which were domiciled in developed markets, and that offered a dividend yield of more than 4%. Today there are 845 companies that meet these criteria. In the charts below we look at which types of business make up this group.

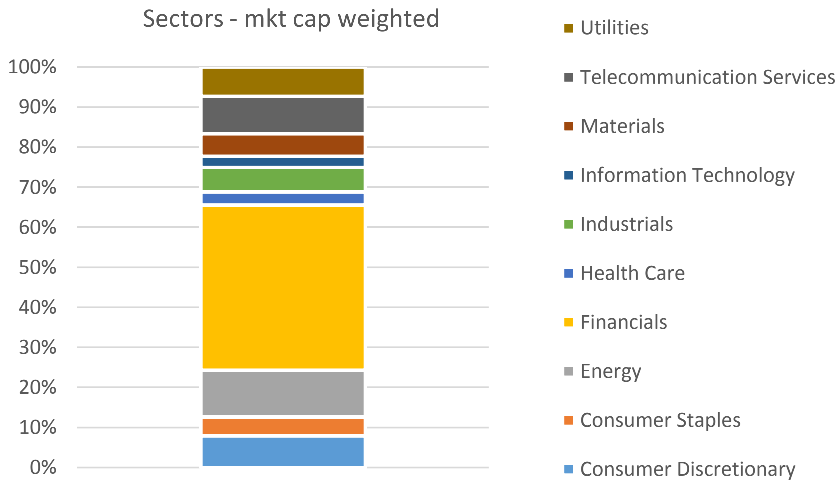
The first thing to note is which sectors these companies come from. In the below chart we look at the number of companies in each sector as a proportion of the total 845.



Source: Credit Suisse HOLT, Guinness Asset Management

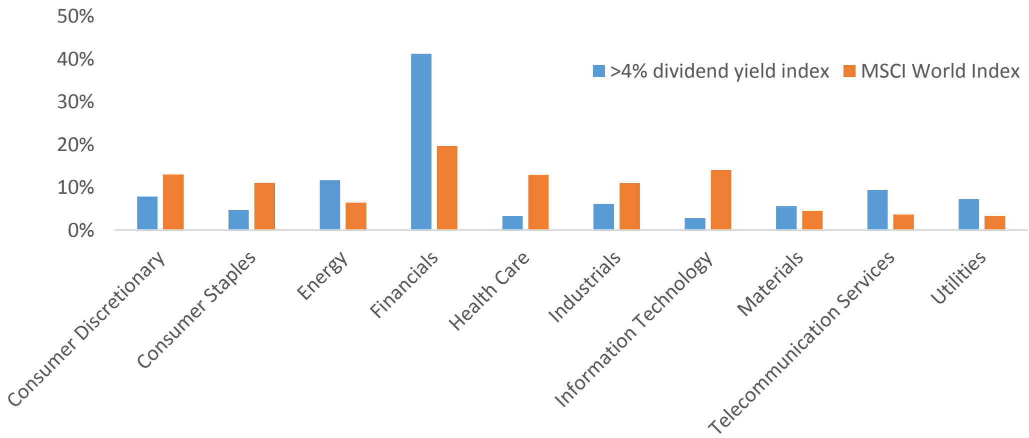
The chart highlights the significant proportion of financial companies that make up our high dividend yield index. Financials account for almost half of the group (390 companies). Of these 187 are real estate, 77 banks, 75 diversified financials, and 51 insurance. On the other side of the coin, some important sectors are underrepresented. Most notably consumer staples, healthcare, and information technology - which between them account for just 7% of this high yield universe.

If we consider the same data, but instead market cap weight the distribution we see a similar story. So we are not seeing a 'small cap bias' influencing the data set particularly.



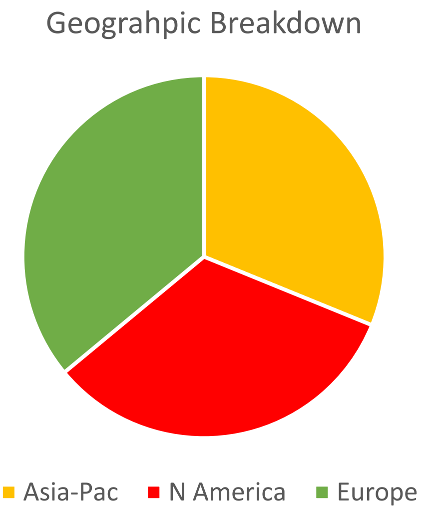
Source: Credit Suisse HOLT, Guinness Asset Management

These significant over and underweights are more easily seen when comparing to the broader MSCI World Index of developed markets (using the market cap weighted version of our high yield index for a like-for-like analysis).



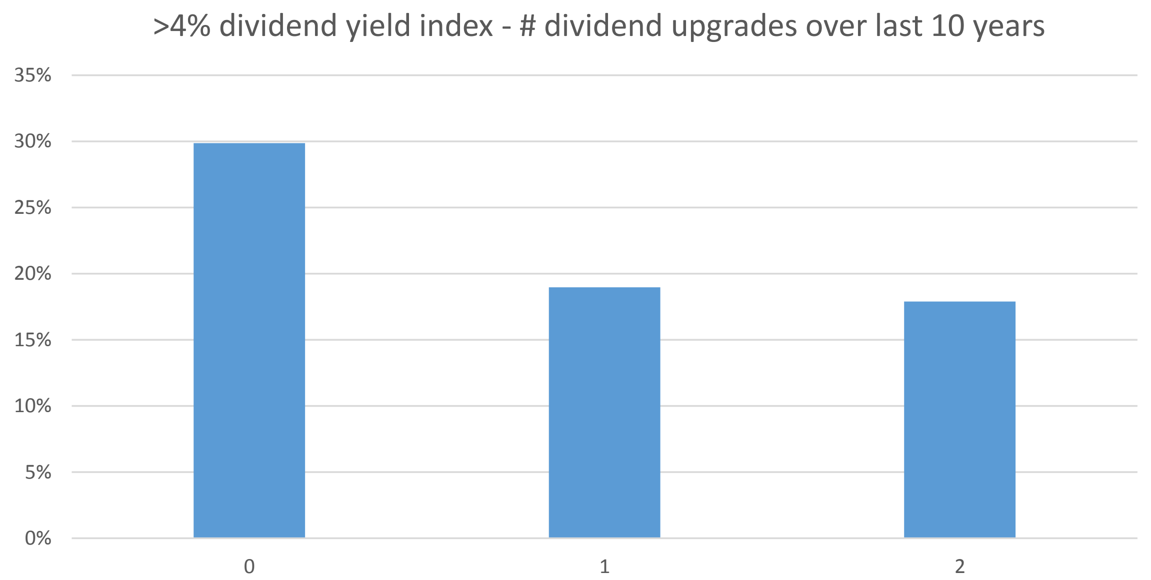
Source: Credit Suisse HOLT, Bloomberg, Guinness Asset Management

The geographic breakdown of where these companies are listed is also interesting – they are split almost evenly between each of Europe, North America, and Asia-Pacific. Which is again is quite skewed versus the wider market.



Source: Credit Suisse HOLT, Guinness Asset Management

Lastly, let's consider dividend growth. If we look back over the last ten years it is striking to see how many of the high dividend yield companies we see today have struggled to grow their dividend. Almost a third have never had a single year-on-year dividend increase over the last decade. And fully two thirds of this high dividend yield group have had 2 or less year-on-year increases.



Source: Credit Suisse HOLT, Guinness Asset Management

The final aspect we consider is the return on capital these high dividend yield companies are able to achieve. We believe this is the best metric on which to gauge the strength of a business and its prospects for the future. In aggregate, the MSCI World Index has a cash flow return on investment (in real terms) of 10%, which is fairly reasonable when we consider the average (real) cost of capital is somewhere around 6-7%.

If we analyse our high dividend yield index then, in aggregate, we see it has a cash flow return on investment of 8%. Which suggests many of the 845 companies must have a return on investment below their cost of capital. This is not only value destructive for the shareholder but presents a significant risk of a dividend cut in the future – which is likely why the market is discounting the income they could receive from these types of business, and thus why they have a high dividend yield in the first place.

Looking with perfect hindsight it is clear that a lot of the 'pain' seen in the share price of a company that cuts its dividend occurs well before the cut is actually announced – typically 3-6 months before in fact. And share prices can in fact rise once the cut is announced; the market might like the fact that the company is 'protecting its balance sheet' or simply that the uncertainty has been removed as to managements plans. But what we are trying to highlight here is the importance of pre-emptively avoiding companies that might cut their dividend in advance of the cut occurring. We would suggest many of the high dividend yield companies in our simple index, and particularly those with weaker return on capital profiles, could well be the dividend cutters of the future. We will look more closely at this analysis in future fund updates.

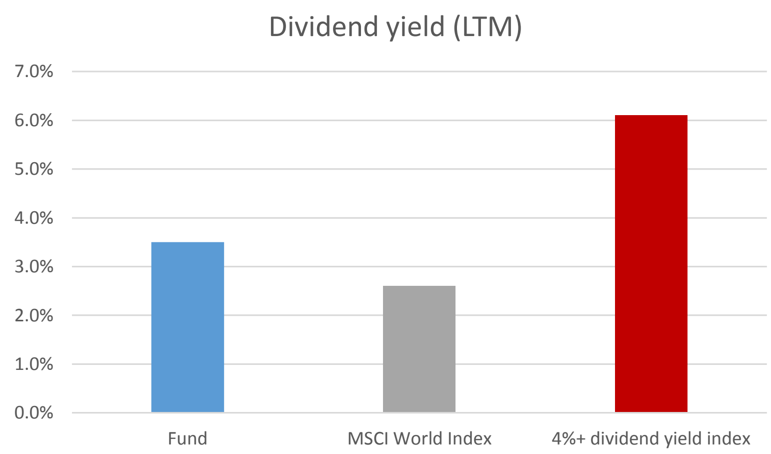
So to summarise, we see the four key issues with targeting a high dividend yield approach in today's market:

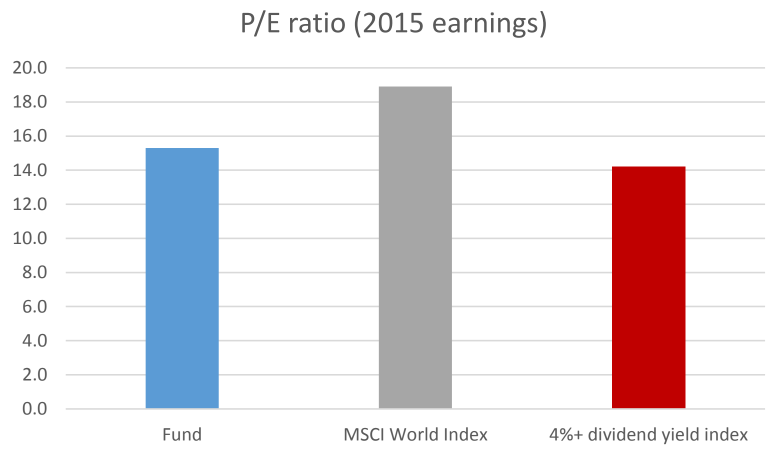
1. Significant sector biases
2. Significant geographic biases
3. Lower chance of regular dividend growth
4. A focus on lower return on capital businesses, and potential dividend future cutters

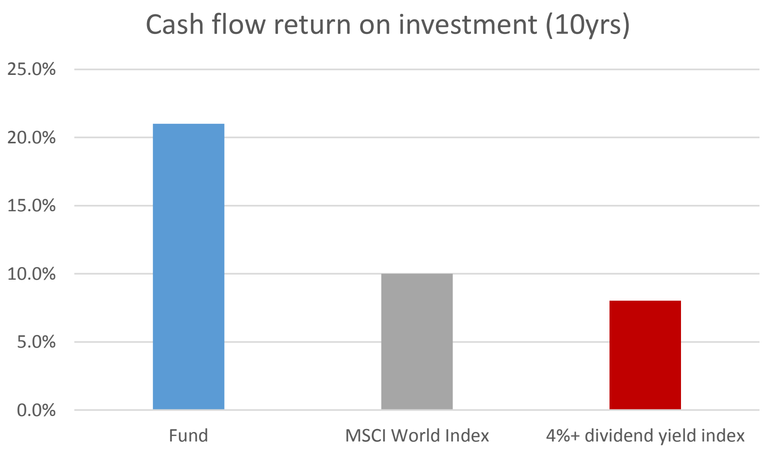
So what approach should you take today when looking for income from equities?

We believe a better approach is to seek a more moderate dividend yield but one with good prospects for decent dividend growth alongside. This more flexible approach provides a much wider and better balance of companies to select from. Which means there is a better chance of being able to find companies that also have the characteristics you would associate with good businesses, as well as a decent dividend yield.

This is exactly the approach we take in the fund and this is neatly illustrated when we compare the portfolio to both the MSCI World Index and our 4%+ high dividend yield basket on various metrics.







Source: Credit Suisse HOLT, Bloomberg, Guinness Asset Management

So the high dividend yield approach, unsurprisingly, has a far higher current dividend yield than broad market, and at a discounted valuation. But the lower valuation is at the expense of the quality of the underlying businesses – as shown by the lower cash flow return on investment.

The fund cannot match the current yield of the 4%+ index, but it does have a dividend yield greater than the MSCI World Index. It also has a lower valuation than the broad market, and is only marginally more expensive than the 4%+ index. But, crucially, the quality of the underlying businesses in the fund – as measured by the cash flow return on investment are far superior to those of both the indices.

When we assess the companies we own in the fund with respect to dividend growth we find over half have provided year-on-year dividend increases in at least 5 of the last 10 years, and almost a third have increased their dividend every year for the last 10 years.

Conclusion

In today's market the prospect of a high dividend yield can be quite eye catching. But these high dividend yields must be taken in context with the types of businesses that are providing them, and the risks of over (and under) weighting certain areas of the market.

As ever we believe a more moderate and longer term approach will provide a more favourable outcome and that the quality and valuation of the businesses you are investing in must never be overlooked.

Thank you for your continued support.

Dr. Ian Mortimer & Matthew Page
Co-managers, Guinness Global Equity Income Fund

March 2016

Data sources

Fund performance: *Financial Express, total return in GBP*

Index and stock data: *Bloomberg*

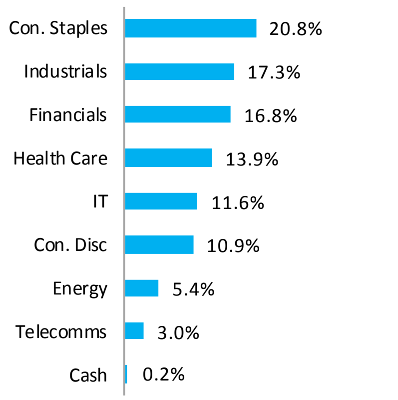
PORTFOLIO

29/02/2016

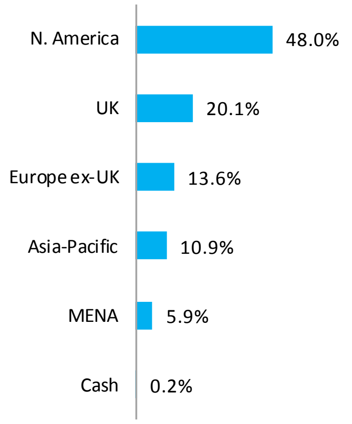
Fund top 10 holdings

Mattel	3.3%
Unilever	3.2%
Largan Precision CO LTD	3.1%
Japan Tobacco	3.1%
Eaton	3.1%
Sonic Healthcare	3.1%
Danone	3.0%
Johnson & Johnson	3.0%
CA Inc	3.0%
Aflac	3.0%
% of Fund in top 10	30.9%
Total number of stocks held	35

Sector analysis



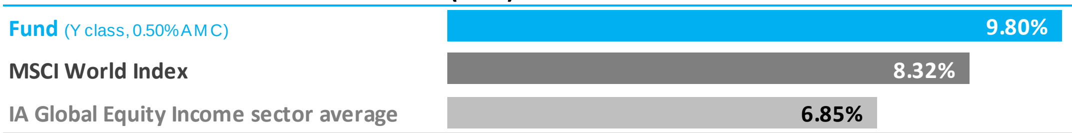
Geographic allocation



PERFORMANCE

29/02/2016

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Feb '12	Feb '13	Feb '14	Feb '15	Feb '16
Fund (Y class, 0.50% AMC)	5.3	15.9	11.1	17.8	1.3
MSCI World Index	0.1	16.5	10.2	17.0	-1.3
IA Global Equity Income sector average	4.1	15.1	8.3	11.5	-2.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y class, 0.50% AMC)	3.6	4.3	1.3	32.5	61.6	62.2
MSCI World Index	1.0	-1.3	-1.3	27.2	48.4	51.2
IA Global Equity Income sector average	3.7	0.5	-2.3	17.9	41.3	40.8

RISK ANALYSIS

29/02/2016

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.40	2.54
Beta	1	0.76	0.85
Information ratio	0	-0.24	0.30
Maximum drawdown	-18.26	-15.50	-16.19
R squared	1	0.80	0.89
Sharpe ratio	0	0.28	0.51
Tracking error	0	6.30	4.58
Volatility	13.97	11.87	12.63

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. Fund launch date: 31.12.10. **Fund Y class**: Composite simulated performance based on actual returns of E share class (available from Fund launch), calculated in GBP. **IA sector** performance based on highest fee share classes for each fund (C Class (1.5% AMC) for Guinness Global Equity Income). **See Notes overleaf.**

Performance data notes

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

2) The performance of the IA Global Equity Income sector is based on the average of the highest fee share class of each constituent fund, e.g. C class for the Guinness Global Equity Income Fund, with an annual management fee of 1.5%.

Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about Guinness Global Equity Income Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

Risk

The Guinness Global Equity Income Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment and the income from it can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. Details on the risk factors are included in the Fund's documentation, available on our website. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Fund. This will have the effect of lowering the capital value of your investment.

Documentation

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

- the Manager: Capita Financial Managers (Ireland) Limited, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

Residency

In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients.

NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.

Structure & regulation

The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

Switzerland

The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

Telephone calls may be recorded and monitored.