Guinness Global Equity Income Fund

INVESTMENT COMMENTARY – May 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	£110m
Launch date	31.12.10
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA

Performance — 30.04.16

	1 year	3 years	From launch
Fund	-0.2	26.1	62.0
Index	0.5	27.5	56.0
Sector	-1.8	16.8	44.4

Annualised % total return from launch (GBP)

Fund	9.5%
Index	8.7%
Sector	7.1%

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

In April the Guinness Global Equity Income Fund produced a total return of -1.80% (in GBP) vs the MSCI World Index return of -0.33%. The fund therefore underperformed the benchmark by 1.47% giving back some of the outperformance seen in the first quarter of the year.

The bumpy ride in global equity markets we saw in the first quarter continued in April. In April the market rewarded cyclical and more distressed business, with rising commodity prices supporting the energy and commodities sectors, while the defensive consumer staples and utilities sectors lagged the broader index. However, the worst performing sector was actually the IT sector.

Our holdings in the portfolio generally reflected this pattern, our energy holdings in Total and Royal Dutch Shell were amongst our best performing positions over the month while our IT holdings in Microsoft, Largan Precision, CA, and Cisco were amongst our worst performing positions.

We also saw particularly weak performance in our holding in H&R Block, a company we have held in the portfolio since 2012. The company is the largest tax preparation service provider in the US. Tax preparation is a very seasonal business and H&R Block records 75% of annual revenues and 100% of profits coming from just one quarter.

The company saw a 6% decline in volumes this year that lead to lower revenues and profitability than analysts had been expecting. However, H&R Block has seen declining volumes for a number of years now due to an increasing number of tax payers using less expensive "do it yourself" services, so a decline was not unexpected. H&R Block has been offsetting this decline with a higher pricing mix focussing on customers with more complex tax preparation requirements. What was unexpected was the degree of this decline, i.e. while 3-4% might have been expected 6% was not.

In our opinion the share price reaction (-23.4% over April in USD) has been overdone. Indeed when we wrote about the company back in our January 2013 managers review we noted that *"short-term investors will be put off by the seasonal nature of its business"*. However for investors with a longer-term horizon, the reality is this company has generated a top quartile return on capital for each of the last 17 years which has allowed them to pay a steady and, in most years, a rising dividend. The company has 98% brand recognition amongst Americans and has a market share that is multiple times larger than its nearest peer.

While the market reaction to the news was somewhat disappointing we must remember we are in a market environment where companies that beat earnings are particularly well rewarded by the market and those that don't are punished, and the seasonality of this business only exacerbates this.

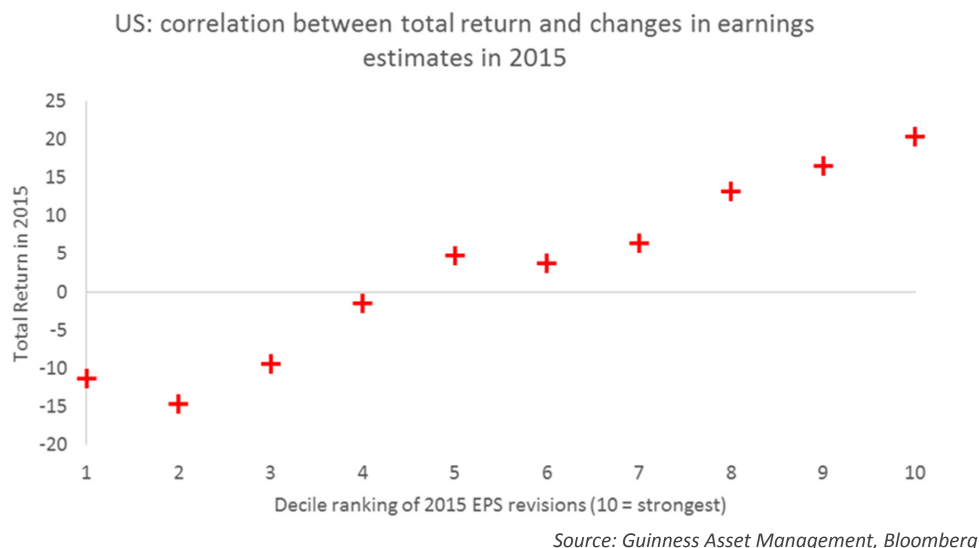
To highlight this point we looked at how aggregate share prices reacted to earnings revisions over the course of 2015 for the 1000 largest US companies.

We first calculated the size of the change in the consensus earnings per share (eps) estimate for each of the 1000 companies in 2015. So for company A, if on January 1st 2015 the average eps estimate was $1.00 and by 31st December 2015 it had increased to $1.10 then the earnings revision is +10%.

We then ranked these companies by the size of their earnings revision from most positive to most negative and put these companies into ten groups (deciles). Decile 1 was the group with the worst and most negative earnings revisions and decile 10 was the group with the most positive earnings revisions.

We then calculated the total return for each of the companies so we could calculate the average total return of each decile.

We were then able to plot the average total return of each decile against the average earnings revision of each decile and the chart below shows this.



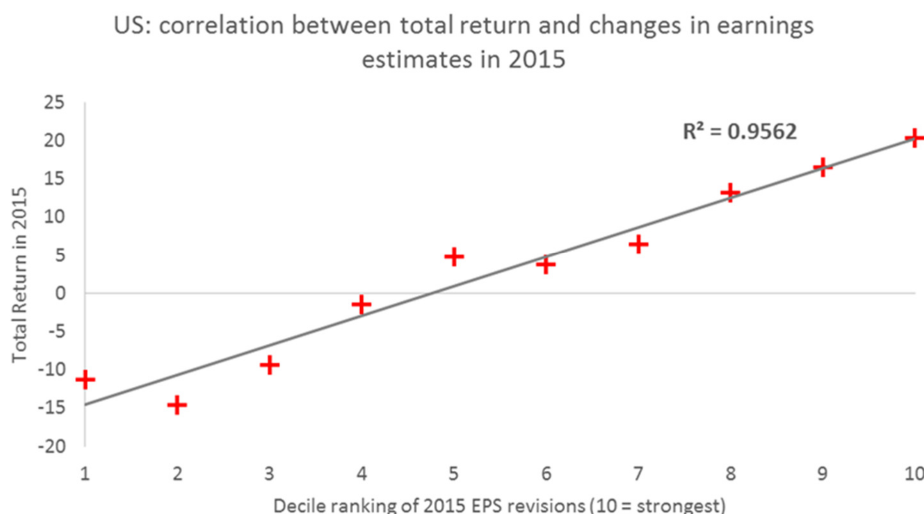
Source: Guinness Asset Management, Bloomberg

This chart is extraordinary. It clearly shows that those companies who beat earnings expectations at the beginning of the year were rewarded and those that missed were punished and the degree to which they were rewarded or punished was closely linked to the size of their beat or miss.

If we then add a line of best fit (regression line) to this data set and calculate the R^2 you can see we get the result of 0.9562. The R^2 is a measure of how closely the real data points fit the regression line or in this case the degree to which the average earnings revision of each decile explains the total return. 0.9562 is

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

extremely high. A result of 1 would be a perfect fit and a result of 0 would indicate no correlation whatsoever.

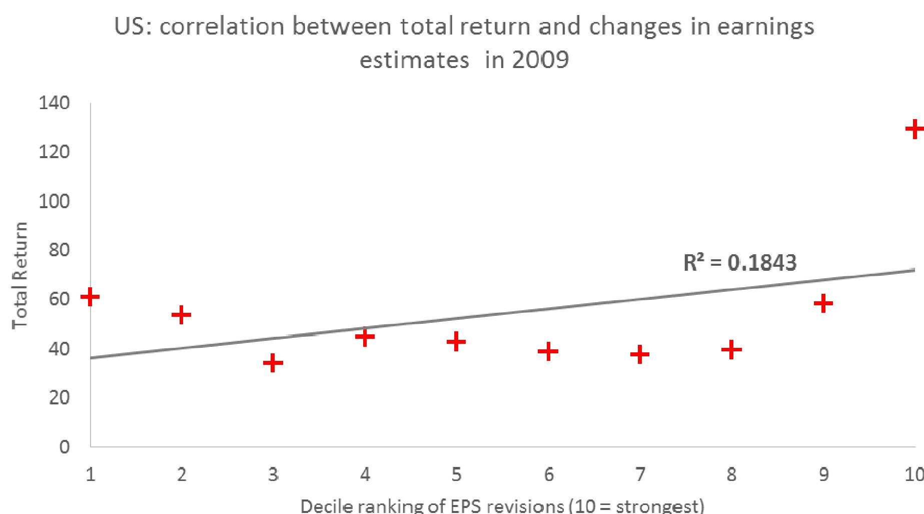


Source: Guinness Asset Management, Bloomberg

It makes intuitive sense that companies that beat earnings expectations should be rewarded by the market. It still requires confidence that you believe this is not a one off and we would suggest that the market is generally too focused on short-term results rather than long-term economic profits. But what is surprising is just how stark this was in 2015. It tells us that important long-term factors like valuation were of little consequence to share price returns in 2015.

So what does this look like in other years?

If we look at the "dash to trash" environment of 2009, where we saw very strong price performance, we see a very different picture. While share price performance was very strong, it was completely indiscriminate in nature. Whilst the 10th decile was an outlier and performed very well, companies with the worst earnings revisions (decile 1) outperformed decile 9 (the second best).

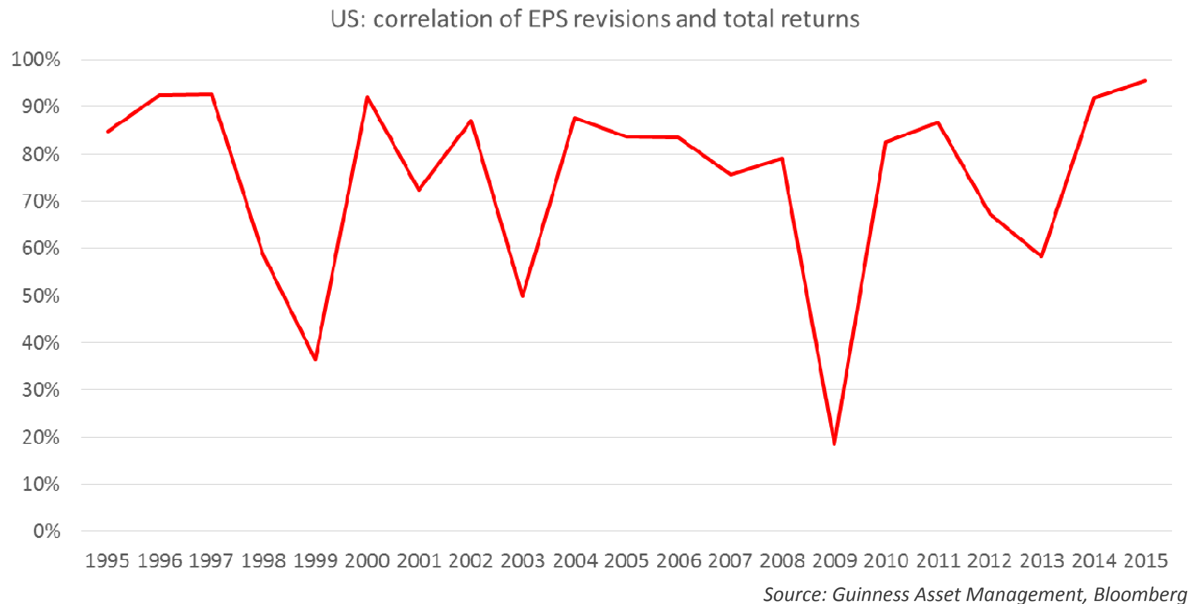


Source: Guinness Asset Management, Bloomberg

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

The R^2 for 2009 of 0.1843 shows us objectively that earnings revisions explained very little of share price returns.

We did the above analysis for each of the last 21 years going back to 1995 and the chart below plots the R^2 for each year.



Source: Guinness Asset Management, Bloomberg

This shows us that on average over the last 21 years short term earnings revisions for the 1000 largest US stocks explain circa 75% of share price returns. In our minds this is too high, showing the market is too focussed on the short-term. Most importantly though it provides opportunity for active managers with long-term horizons and disciplined value based approaches to buying companies. We don't need to tell you there is much academic evidence to suggest over the long-term valuation is what drives total returns. Over the long-term companies that gradually grow their cash-flow and reinvest it wisely will be rewarded.

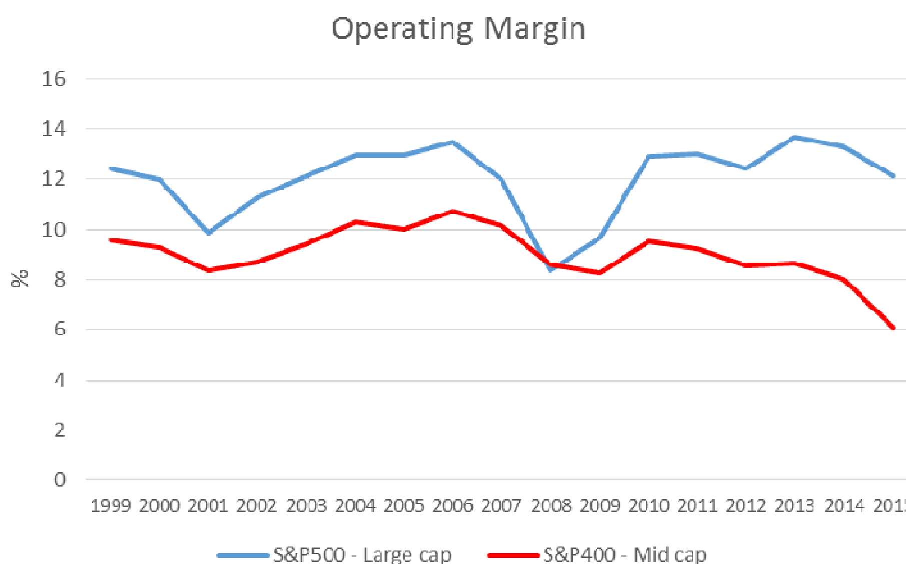
Companies that seek to dampen down earnings expectations at the beginning of the year so they can beat expectations by the end of the year are playing a very short-term game, perhaps driven by the metrics on how they are compensated. We would certainly like to see more management teams being compensated on metrics that capture real long-term drivers of valuation creation such as maintaining a high return on capital.

It's also worth noting here that we have been looking at earnings per share rather than simply the total earnings of the company. Earnings per share can clearly be boosted by companies buying back shares and there has been a worrying trend occurring in US mid-cap stocks where companies have been taking on debt to buy back shares in order to boost their eps whilst masking the deteriorating margins of these businesses.

It is quite clearly shown in the following three charts looking at data of the S&P400 which generally covers companies in the $1-10 billion market cap range and contrasting it with the large-cap S&P500.

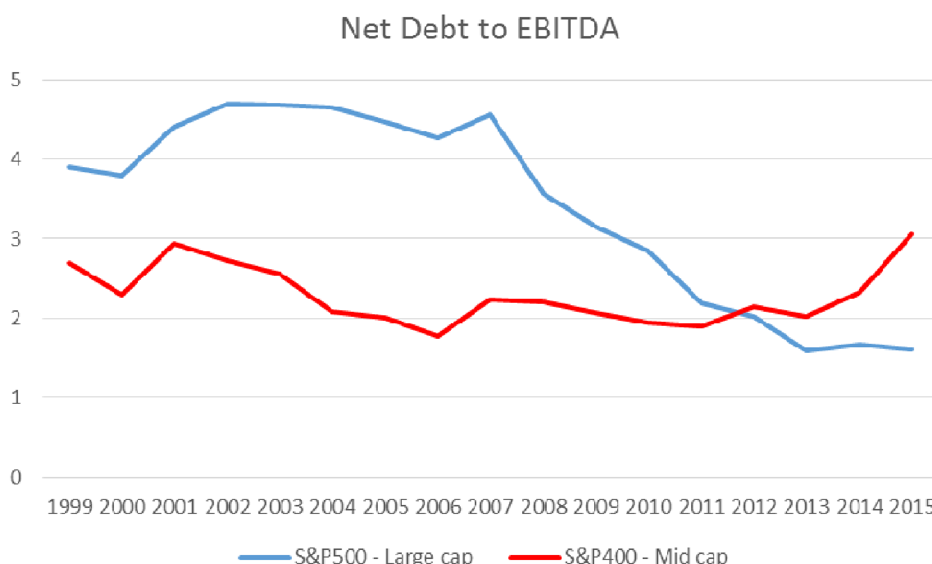
Firstly operating margins have not really recovered for US mid-caps since the financial crisis, and over the last few years they have decline by around 25%. Large-cap companies margins have recovered since the financial crisis and while they have fallen in the last couple of years they remain close to their long-term average range. Operating margins are of course not affected by the share buybacks so give a clearer indication of profitability.

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



Source: Guinness Asset Management, Bloomberg

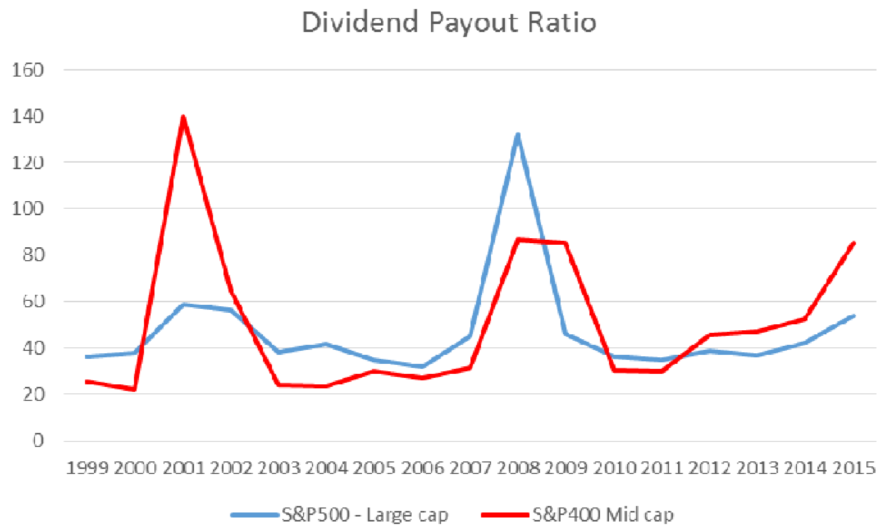
However, while large-cap companies have been deleveraging mid-cap companies have the highest net debt to EBITDA ratio they have had in in the last 16 years and have just gone through the level we saw in the dot-com boom and bust.



Source: Guinness Asset Management, Bloomberg

Many of these companies have been taking on more debt to repurchase shares, and thereby drive their earnings per share figures higher. As interest rates have been so low there has been increased demand for them to pay higher dividends as well, irrespective of whether it reflects their long-term profitability. Consequently mid-cap stocks now have a dividend payout ratio which is approaching 100% this year. Large-cap companies look fairly comfortable at just over 50%.

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



Source: Guinness Asset Management, Bloomberg

These mid-cap companies cannot continue to take on more debt if operating margins continue to decline whilst also paying out more cash as a dividend. If margins continue to fall these companies will struggle to refinance let alone take on more debt and that pain will swiftly transmit to equity holders. Dividend cuts or cancellations are also an almost certainty in that scenario.

H&R Block meets the definition of a US mid-cap company and it is fair to say that some of these trends we have observed above apply to them. They have taken on debt to repurchase shares and this has added some risk to the balance sheet.

However, operating margins are high at over 25% and have grown over the last few years having been 20% in 2010. Meanwhile their dividend is sustainable with a modest payout ratio of 45% which is nearer that of the US large-caps.

It is during times of stock specific poor performance that our equally weighted portfolio is particularly helpful to us as fund managers. As we described in our white paper in June 2014 on why we construct a concentrated and equally weighted portfolio, when we see a set of earnings that the market dislikes we have two decisions we can ultimately make. Sell the entire position as we agree that the long-term thesis has changed or disagree with the market and rebalance the position by buying more of a company we continue to like at an attractive valuation. H&R Block fits into the latter category and we have rebalanced our position.

As always we would like to thank you for your continued support. We are pleased to say the fund continues to grow in size and at the time of writing we are now just shy of $200 million in size.

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

May 2016

Data sources

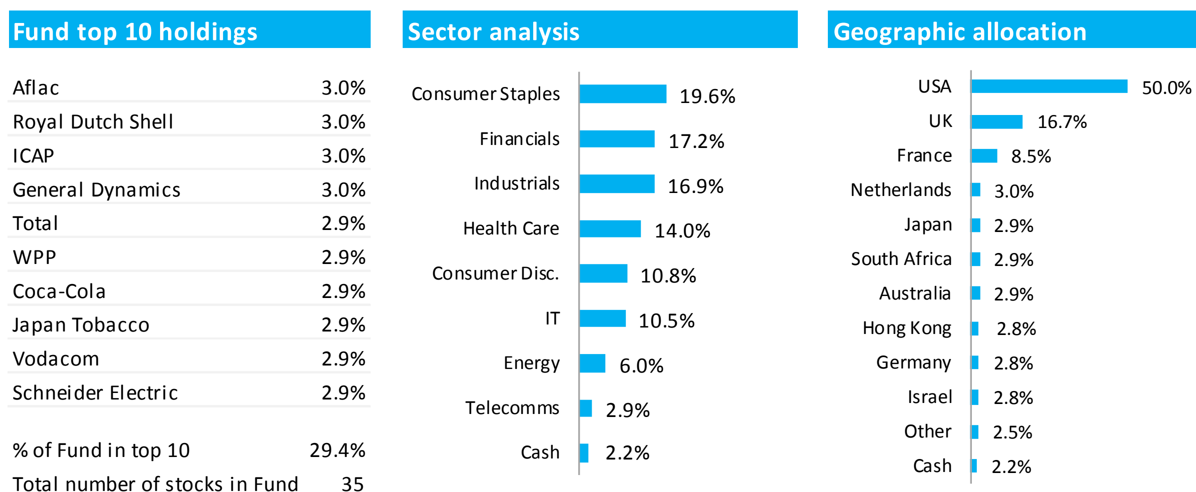
Fund performance: *Financial Express, total return in GBP*

Index and stock data: *Bloomberg*

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

PORTFOLIO

30/04/2016



Fund top 10 holdings

Holding	%
Aflac	3.0%
Royal Dutch Shell	3.0%
ICAP	3.0%
General Dynamics	3.0%
Total	2.9%
WPP	2.9%
Coca-Cola	2.9%
Japan Tobacco	2.9%
Vodacom	2.9%
Schneider Electric	2.9%
% of Fund in top 10	29.4%
Total number of stocks in Fund	35

PERFORMANCE

30/04/2016

Annualised % total return from launch (GBP)

Discrete years % total return (GBP)	Apr '12	Apr '13	Apr '14	Apr '15	Apr '16
Fund (Y class, 0.50% AMC)	1.4	22.4	8.1	16.8	-0.2
MSCI World Index	-2.0	21.8	7.5	18.0	0.5
IA Global Equity Income sector average	-0.9	21.6	6.0	12.2	-1.8

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y class, 0.50% AMC)	-1.8	4.2	-0.2	26.1	56.4	62.0
MSCI World Index	-0.3	1.9	0.5	27.5	52.1	56.0
IA Global Equity Income sector average	-0.1	3.0	-1.8	16.8	40.8	44.4

RISK ANALYSIS

30/04/2016

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.55	1.89
Beta	1	0.76	0.86
Information ratio	0	-0.22	0.16
Maximum drawdown	-18.26	-15.50	-16.19
R squared	1	0.80	0.89
Sharpe ratio	0	0.30	0.47
Tracking error	0	6.25	4.60
Volatility	13.83	11.78	12.55

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

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

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.