Guinness Global Equity Income Fund

INVESTMENT COMMENTARY – August 2016

About the Fund

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

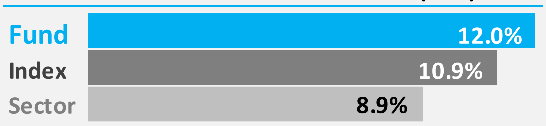
The Fund is managed for income and capital growth and invests in profitable companies that have generated persistently high return on capital over the last decade, and that are well placed to pay a sustainable dividend into the future.

Fund size	£165m
Launch date	31.12.10
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA

Performance 31.07.07

	1 year	3 years	From launch
Fund	21.0	35.9	88.0
Index	17.0	38.3	78.4
Sector	13.6	26.9	61.2

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**

Performance

In July the Guinness Global Equity Income Fund produced a total return of 4.52% (in GBP), vs that of the MSCI World Index, 4.94%. The fund therefore underperformed the index by 0.42%. This year to the end of July the fund has produced a total return of 20.86%, outperforming both the MSCI World index (16.46%) and peer group the IA's Global Equity Income sector (15.02%).

With the initial Brexit shock from the 23rd of June and subsequent market reverberations dying down through July, financial markets digested the prospect of further easy monetary policy by rewarding equities. Asian and emerging market equities were the main beneficiaries, while UK and European equities lagged.

This heightened risk appetite meant small-cap stocks outperformed large-cap. Similarly, defensive sectors lagged cyclicals with the exception of the energy sector where we saw a sharp decline in the oil price due to short-term shifts in the supply and demand balance.

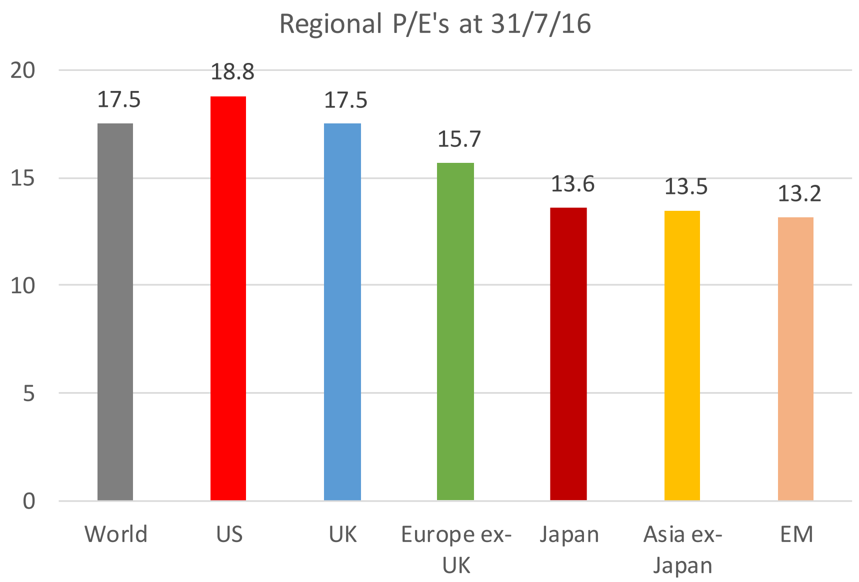
The companies we owned in the fund largely reflected this broader picture. Technology was the strongest performing sector over the month and our holdings in Largan Precision, Microsoft and Cisco all ranked in our top 10 performing positions over the month. Our holdings in Consumer Staples generally lagged, with Danone being the exception.

In light of the Brexit fall-out we have been looking closely at more attractive entry points for a number of companies on our watchlist, and while we have so far not added any new names we have been rebalancing positions.

Summer thoughts

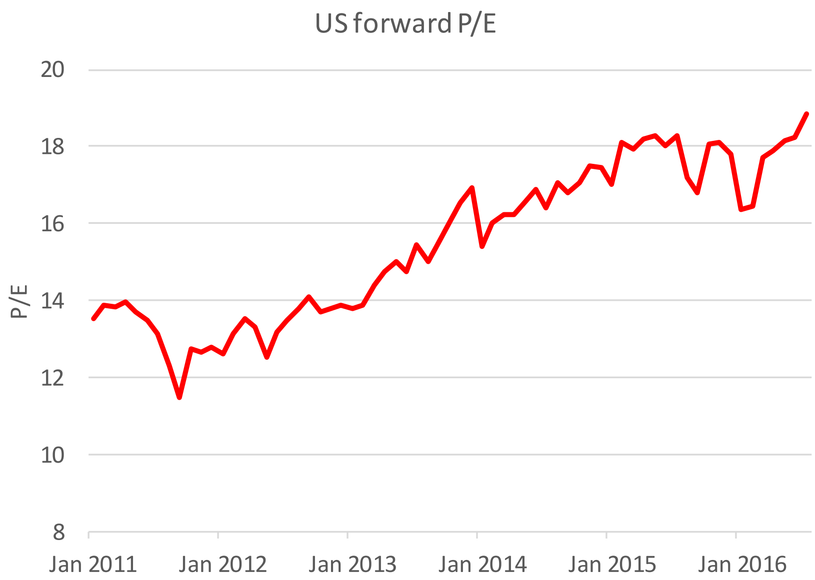
With global equity valuations grinding higher, swings in FX rates post the Brexit vote and potentially further political shocks on the horizon it is worth considering where value opportunities can be found within global equities today.

By looking at valuation multiples by region you can see that on a P/E (2016) basis the US looks expensive and emerging markets look cheap.



Source: Guinness Asset Management, Bloomberg, MSCI

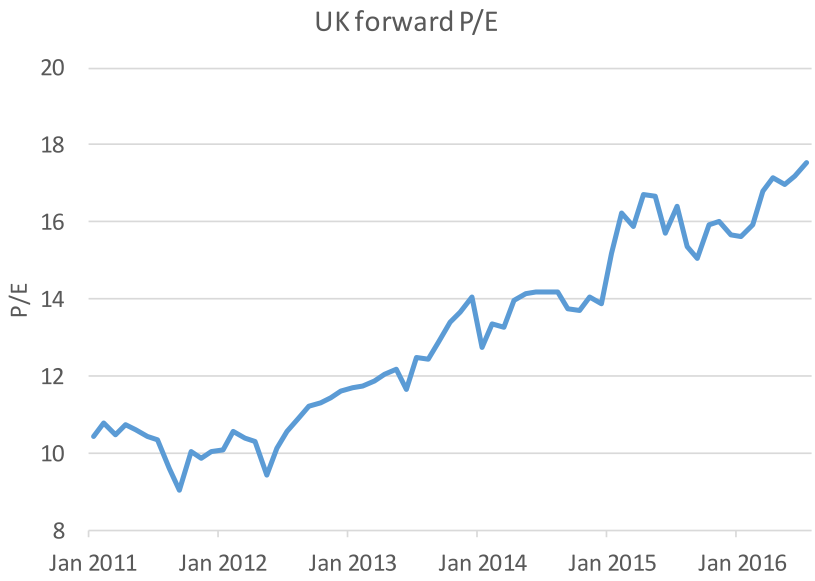
And if we look at the 1 year forward P/E multiple of just the US going back to the end of 2010 (when we launched our fund), you can see from the chart below that the US currently trades at its highest multiple over this period.



Source: Guinness Asset Management, Bloomberg, MSCI

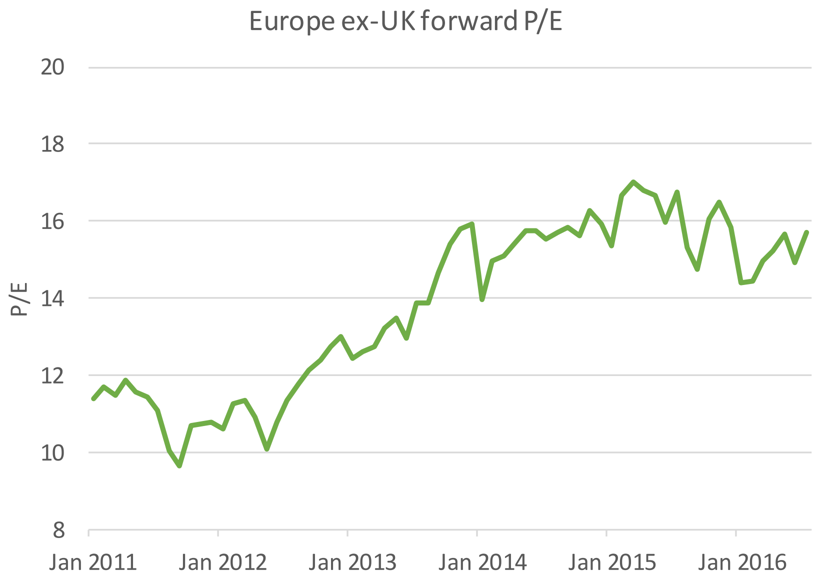
Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

The UK also shows a very similar picture having gradually worked up to a higher multiple, despite the recent gyrations due to the Brexit referendum result.



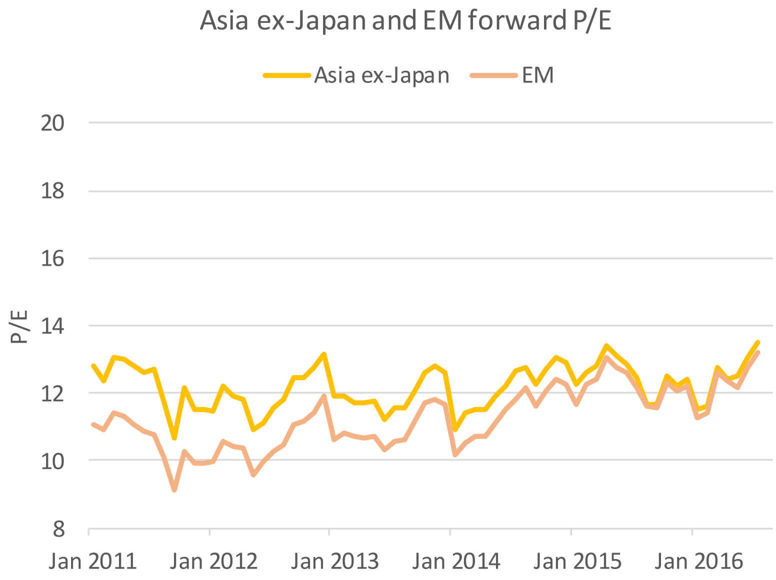
Source: Guinness Asset Management, Bloomberg, MSCI

Europe has also seen a significant expansion in its multiple over this period and is not far off the highs we saw in 2015.



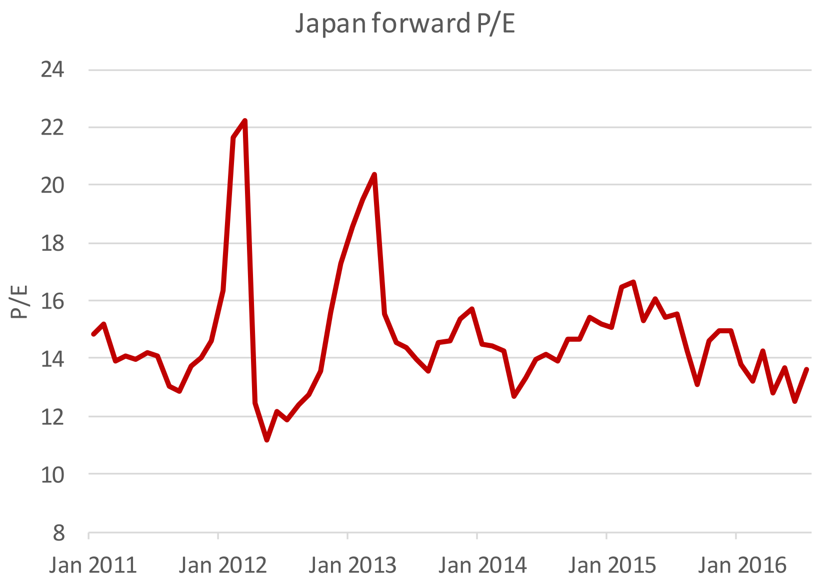
Source: Guinness Asset Management, Bloomberg, MSCI

While Asia ex-Japan and Emerging Markets look cheaper than the US and UK, they also both trade at their highest multiples over this period.



Source: Guinness Asset Management, Bloomberg, MSCI

However, Japan is the only region that is trading on a multiple below its recent historic average. While Japan therefore looks attractive on this basis we find that relatively few Japanese companies meet our criteria of having generated consistently high return on capital. Of those that have met our criteria many of those trade at high multiples given their scarcity. We currently own one position in Japan which is Japan Tobacco. However, we also have exposure to Japan through our position in Aflac which is listed in the US but generates 75% of its revenue from Japan.



Source: Guinness Asset Management, Bloomberg, MSCI

Indeed this scenario of the US and UK appearing expensive, and Asia and emerging markets appearing cheap would have looked the same if you looked at in at almost any point throughout the last five years. Taking this top down view on valuation is interesting, but is not particularly useful for our investment process which is ultimately about selecting individual companies that have the characteristics we seek.

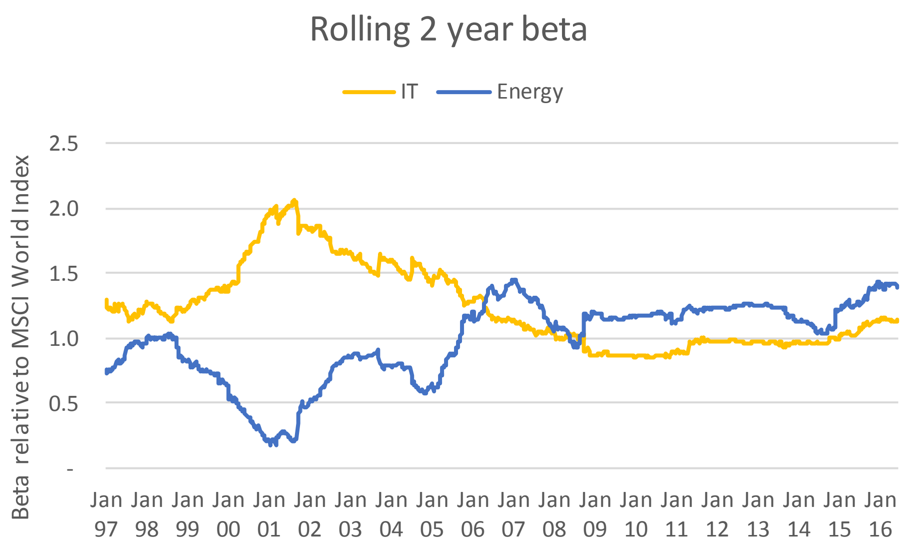
If you look back to what we wrote in January 2014 on page 10 of our manager's update you will see we were addressing this same concern back then:

"Clearly valuations in aggregate are higher today than they have been for some time, but we are cautious about drawing too many conclusions for our investment process from looking at aggregate data like this. An average can obscure huge amounts of useful and interesting data in the underlying spread and the bias that market capitalisation can have on these weighted averages. Indeed, our investment process is designed to focus on identifying companies whose valuations are at the far left of the distribution, not the average (i.e. are cheap relative to their peers)."

Any historic analysis of index valuations has its limitations so we are cautious about drawing too many conclusions from it. The constituents of indices change over time and over relatively short periods of time this will have a minimal impact. However, over a period of 20 years it can have a quite a meaningful impact. For example, the S&P500 has on average had 22 companies added or removed each year since its inception. So over 20 years that's 440 changes to an index of supposedly 500 stocks!

Sector weights can also change quite considerably over time. For example, the energy sector represented over 15% of the S&P500 in 2008 while today it is less than half that at 7%. Or more dramatically, financials represented 8% in 1990 vs 22% by 2005.

Similarly, the beta of a sector can also change quite dramatically over these time periods, as you can see in the chart below. From 1997 and through most of the last decade the World IT sector had a beta above 1 and peaked at around 2 in the dot-com bubble of 2001. However, for most of the last 6 years it has essentially been 1. In contrast the energy sector has had a beta well above 1 for most of the last ten years, while for the ten years prior to that it had a beta well below 1.



Source: Guinness Asset Management, Bloomberg, MSCI

So while a historic analysis has its limitations perhaps we can get more out of looking in more detail at the current valuations of sectors in each region. When we look at it in this more granular fashion a more complex picture emerges.

Although the energy sector stands out as trading on an exceptionally high multiple this is largely a consequence of last year's dramatic fall in the oil price affecting near term earnings.

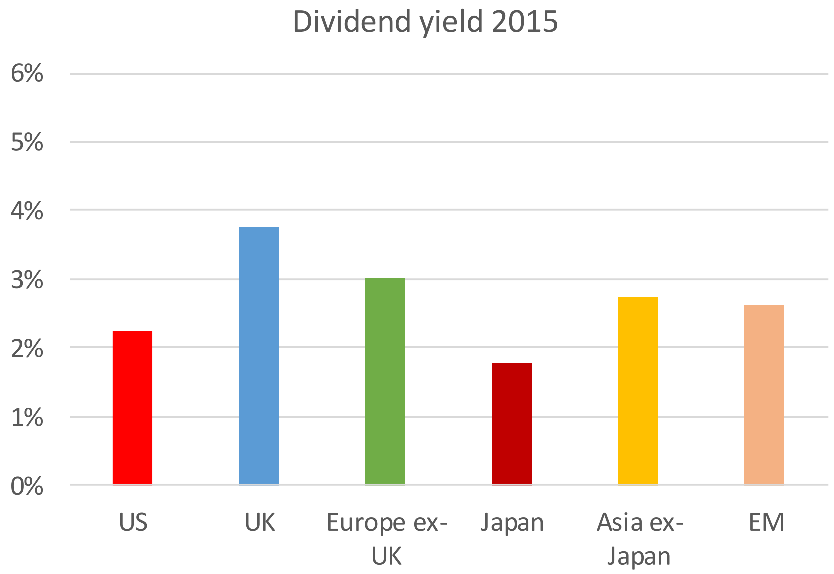
	World	US	UK	Europe ex-UK	Japan	Asia ex-Japan	EM
Index	17.5	18.8	17.5	15.7	13.6	13.5	13.2
Energy	52.0	109.3	24.9	20.2	10.4	17.8	10.7
Materials	19.5	18.4	24.0	18.2	14.4	14.4	14.6
Industrials	17.3	18.7	16.8	16.6	14.0	14.1	15.3
Cons Disc	16.9	19.3	14.5	13.5	13.1	14.3	16.2
Cons Staples	21.9	21.8	21.1	22.5	22.9	23.3	23.8
Healthcare	17.5	17.2	17.0	17.9	25.3	27.7	26.1
Financials	13.1	14.8	12.1	10.9	9.9	9.8	9.2
IT	18.3	18.1	35.6	20.5	17.5	16.2	16.3
Telecomms	15.6	15.8	23.2	16.0	11.3	17.5	16.6
Utilities	17.3	18.9	16.5	14.7	11.1	11.6	10.0

Source: Guinness Asset Management, Bloomberg, MSCI

What is most notable to us is to look at the valuations of defensive sectors such as consumer staples and healthcare. Much is written about how expensive high quality consumer staples and healthcare companies are in the US and Europe. Indeed we agree with much of it and we reduced our exposure to this sector substantially from 2012 to 2014 on valuation concerns. What is notable however, is that consumer staples and healthcare companies are more expensive in Asia and emerging markets than they are in developed markets.

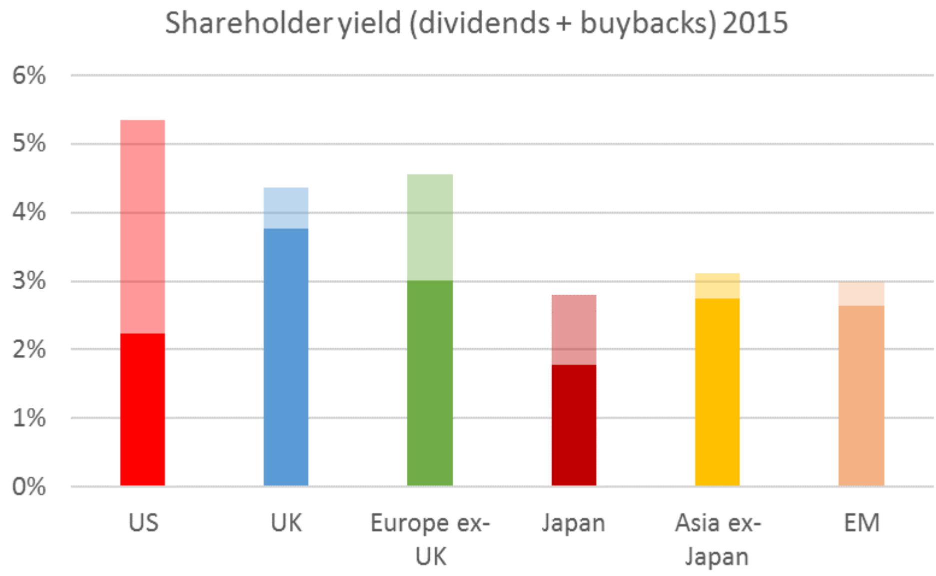
What does look cheap in Asia and emerging markets is financials and since the financial sector makes up around one third of these regions' benchmarks it has a significant effect of dragging down the regions' multiples.

It is also worth looking at dividend yields by region. The chart below shows the dividend yield of each region at the end of 2015. As you can see, the US and Japan offer the lowest dividend yields by region whereas the UK and Europe offer the highest.



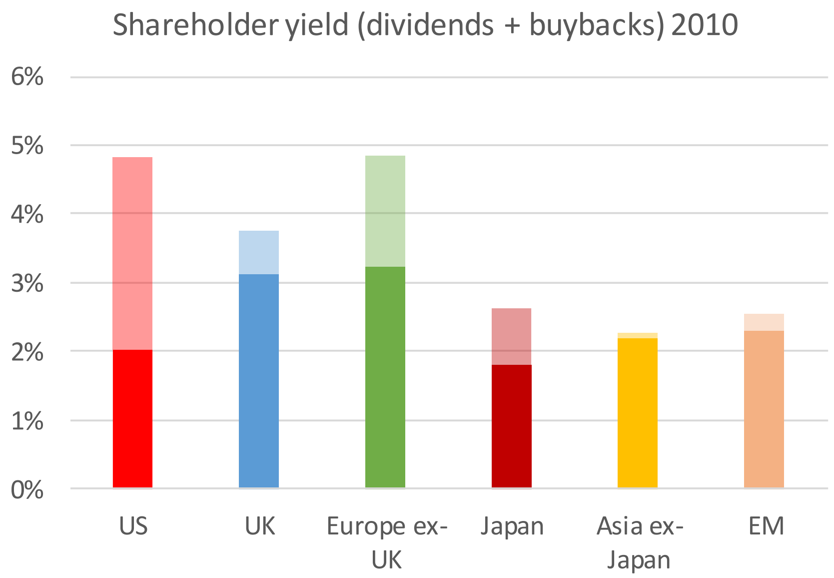
Source: Guinness Asset Management, Bloomberg

However, if we add in the other way of returning excess cash to shareholders, share buybacks, a somewhat different picture emerges (see chart below). US companies are offering a shareholder yield of well over 5% when you factor in share buybacks (the faded bars).



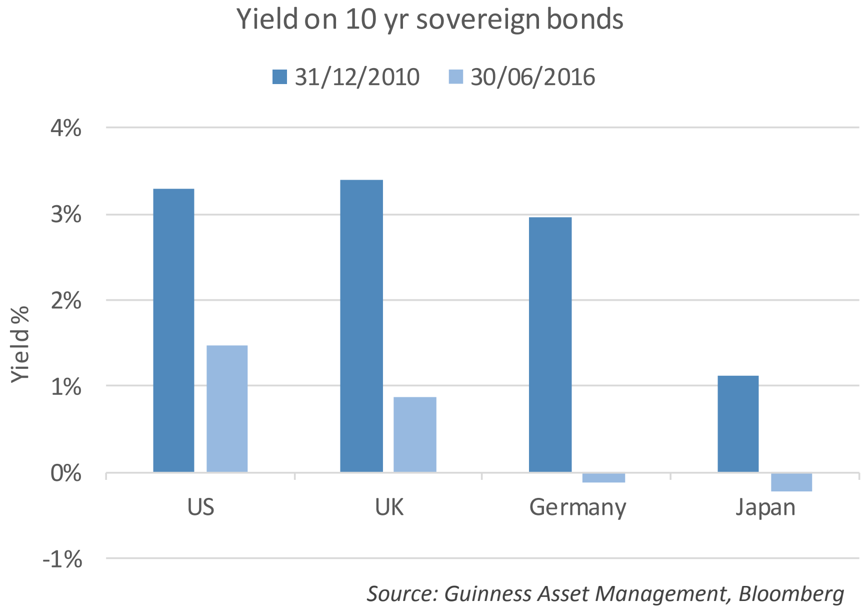
Source: Guinness Asset Management, Bloomberg

US companies have long used share buybacks as a method of returning cash to shareholders as for US investors it tends to be more tax efficient. Over the last 15 years share buybacks have represent somewhere between 50% and 60% of shareholder yield, other than in 2007 when it reached 70%. As you can see below, back in 2010 it was not dramatically different to today, despite the fact that US equities have rallied substantially over this period.



Source: Guinness Asset Management, Bloomberg

When you consider the decline in the yields on government bonds over this period it is certainly one way to feel more comfortable with equities trading on higher multiples today than in 2010. If you can identify a few quality companies with consistent cashflow and these kinds of yields then one might consider them highly attractive.



Our conclusion from all of this analysis is that there is a very mixed picture out there.

- All regions look expensive today relative to their valuations over the last 5 years.
- Asia and EM look cheap relative to the US, Europe and UK, but less dramatically so if you strip out the effect of financials.
- Financials look particularly cheap but given we are in an ultra-low interest rate environment and global growth looks weak they may turn out to be value traps.
- US companies are expensive on P/E valuations but are distributing more cash to shareholders than any other region.

In these uncertain times of low bond yields and extended global equity valuations we believe more than ever these are the conditions in which we must be carefully selective. We need to look for the companies where their valuations are the exceptions relative to their peers, where a company's outlook offers some uncertainty but comes with a heavily discounted valuation and where a long-term time horizon can enable us to wait for a valuation gap to close. The macro noise can all be rather distracting.

Our philosophy on this has not changed. Back in January 2012 we noted:

"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."

With this in mind a more relevant analysis for our investment process is to focus on looking at the companies that meet our requirements of a decade of consistently high return on capital and a debt to equity ratio limited to 100%. There are around 500 companies that currently meet these requirements and this defines our investible universe.

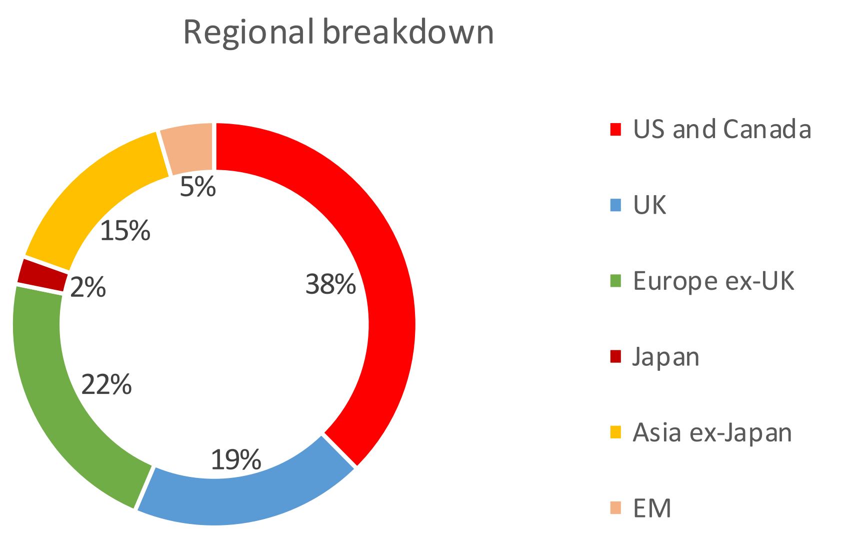
We don't just look for these elements of quality, but also for attractive value. We also want a dividend that can grow as well as a healthy dividend yield.

So if we take a quick look at those companies that have a dividend yield of at least 1.5% and trade on a P/E multiple of less than the MSCI World Index (17.5x), we find that there are approximately 130 companies today. That's 130 companies with consistently high return on capital for a decade, all with a strong balance sheet, that all pay a dividend.

These companies are therefore very different to the average company of the benchmark. In a nutshell they are objectively far higher quality, yet despite that they are cheaper than the benchmark.

Not only that but the average dividend yield of these 130 companies is 3.8% which is well above that of the MSCI World Index at 2.6%.

Pleasingly these companies are well diversified globally as can be seen in the regional breakdown chart below. It is not an exact mirror of the MSCI World Index, with the UK being overweight and the US being underweight but it is more than sufficiently diversified for our purposes of finding candidates to replace one of the 35 companies in the portfolio.

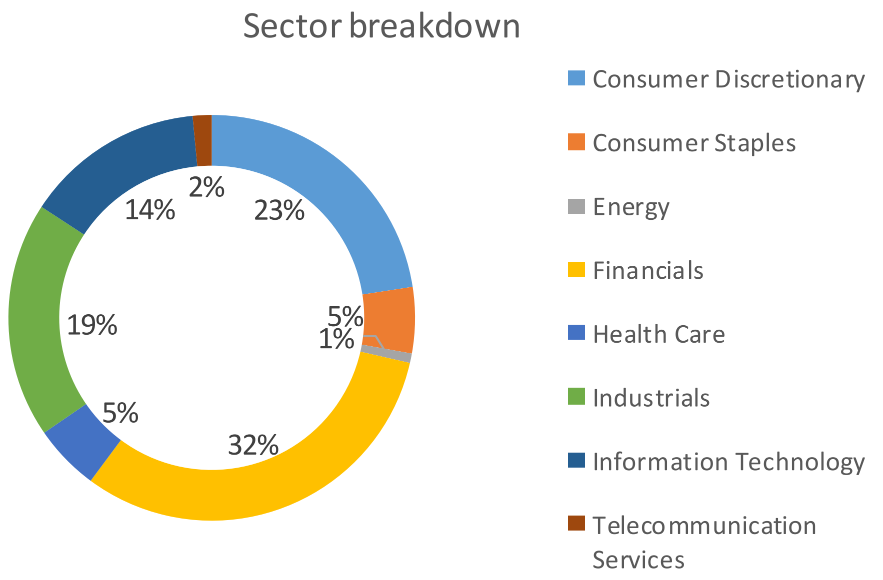


Source: Guinness Asset Management, Bloomberg, CS HOLT

When we look at these 130 companies on a sector basis we can see that cyclical sectors outweigh defensive sectors. It is also notable that no Utilities or Materials companies are in this opportunity set. Whilst Financials is the largest sector there are very few banks within this. The financials that meet our criteria are generally asset managers, financial exchanges, insurance brokers or other financial services companies.

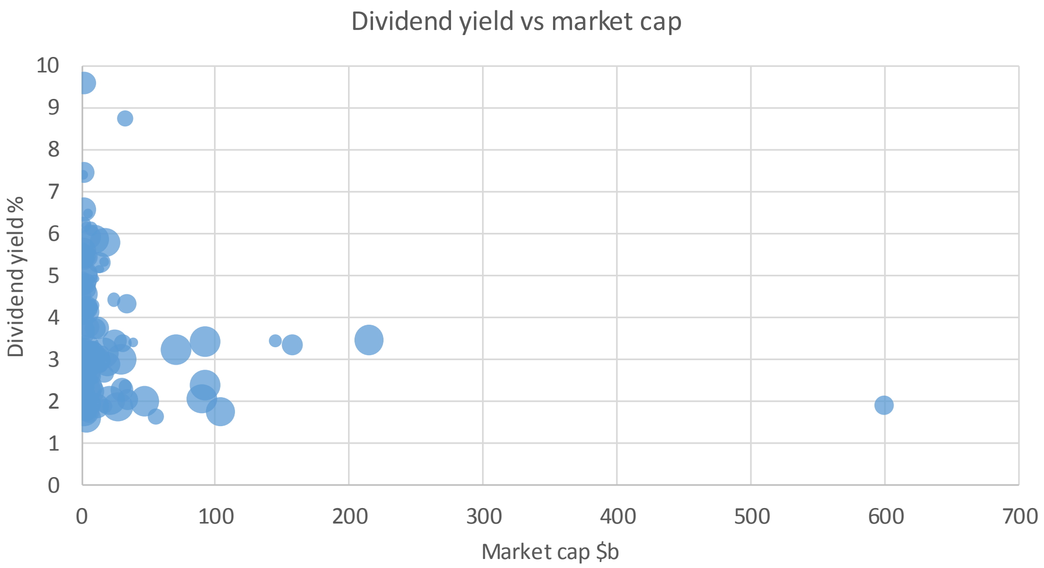
Consumer Staples and Health Care together only represent 10%. Although this is a small proportion it does also prove there are still some opportunities in these sectors if you are selective.

Whilst the cyclical sectors dominate the opportunity set today it is worth remembering that the companies in this analysis have all maintained their high return on capital over the last ten years. Our initial screen effectively removes companies that are the most sensitive to the economic cycle. Those that make it through tend to be best of breed cyclical companies with some element of secular growth, niche, or dominant market position allowing them to weather periods of economic instability.



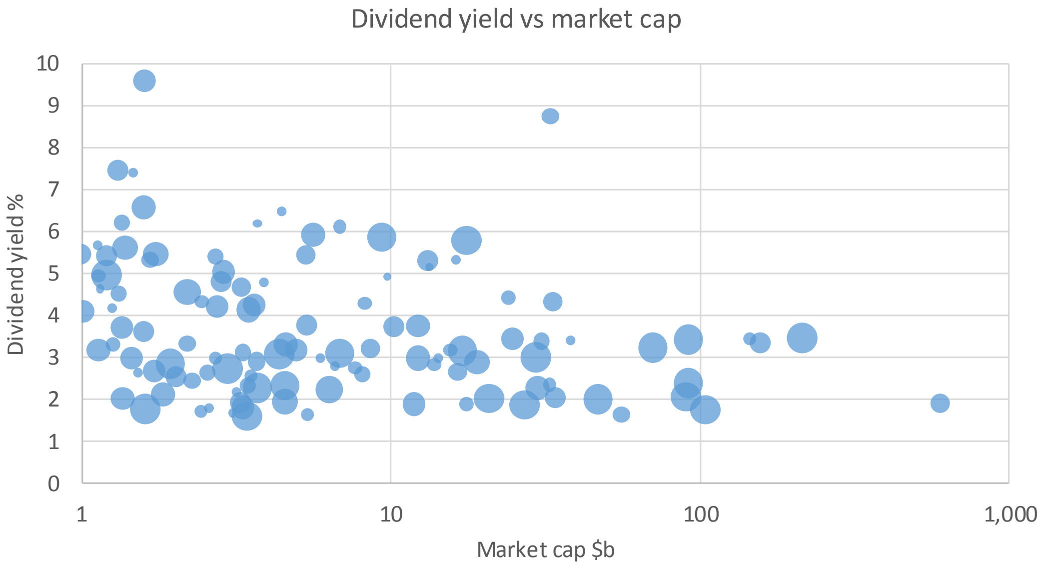
Source: Guinness Asset Management, Bloomberg, CS HOLT

We can drill in some more to look at the dividend yields on offer, and historic dividend growth, compared to the market cap of these companies. The chart below shows this by comparing the dividend yield on the vertical axis and the market cap on the horizontal axis. Each blue point on the chart represents one company, and the size of the point represents how many times they have grown their dividend in the last ten years. The larger the dot, the larger the number of dividend increases.



Source: Guinness Asset Management, Bloomberg, CS HOLT

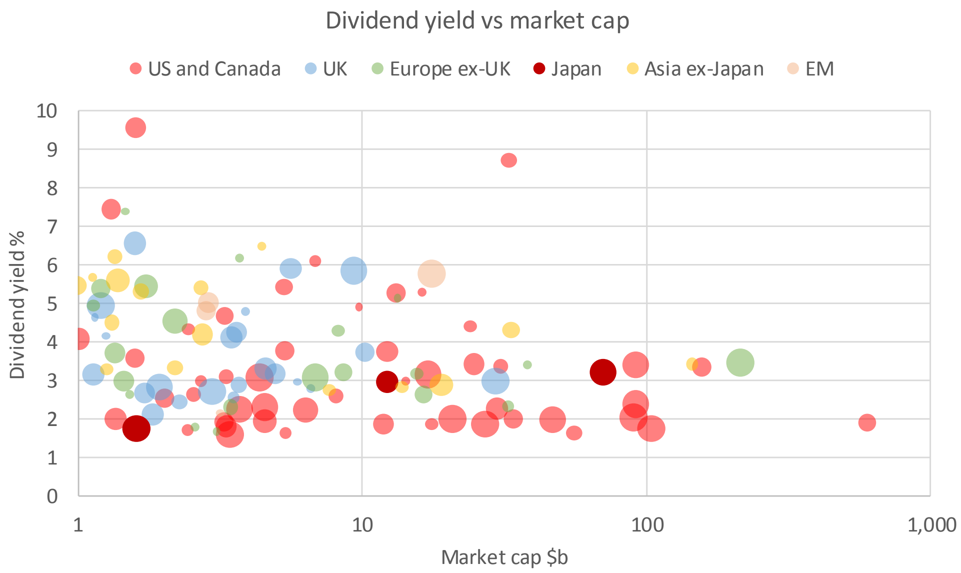
This chart is somewhat difficult to read due to a few mega cap stocks skewing the scale (particularly Apple at the far right of the chart with its market cap of around $600 billion). However, if we change the market cap scale to a log scale then it is far easier to analyse as you can see in the next chart.



Source: Guinness Asset Management, Bloomberg, CS HOLT

This chart shows more clearly how there is good diversification across market caps and across the dividend yield spectrum. It also shows there are a still a good number of companies with long track records of consistent dividend growth (the larger dots) that still offer a valuation discount to the market.

In the next chart we take the same data but highlight each region. As you can see and as we might expect many of the US and Canadian stocks are towards the bottom of the chart as they have a lower dividend yield. However, given the size of their data points we can also see that these US and Canadian companies have more consistent dividend growth than other regions.



Source: Guinness Asset Management, Bloomberg, CS HOLT

Therefore, from a stock selection perspective, it is certainly harder today than it was in 2010 to find attractively valued companies that have the robust return on capital profile and the balance sheet depth that we desire. However, we continue to have a diverse opportunity set to select from as the above analysis shows. With hindsight the valuations that consumer staples and health care stocks traded on in 2010 seem obviously cheap. However, they were by no means consensus trades back in 2010 when the market was laser focused on patent cliffs and low growth in emerging markets. Value is by definition non-consensus and that means what offers value today is not going to stare you in the face. What is important to us is not to be tempted into lower quality names and find ourselves in value traps. We think the key to finding value opportunities that are not value traps is to ensure the companies have our quality characteristics – persistence of high return on capital without excessive debt.

Our approach has consistently been to look for companies which when brought together in a portfolio will be able to weather whatever economic shocks are thrown at us, and pleasingly it has proven to work over the last five and half years. Whilst we like to have a macro and top-down perspective we actively seek to avoid allowing it to influence our stock selection. Making macro forecasts such as predicting the price of commodities or the changes in policy of the ECB or the outcomes of elections is just not our skill set. If we conclude, as we have, that we can't predict the future then it changes the way you construct a portfolio, and the characteristics you want in a company. As we put it in September 2014:

"We continue to invest in companies that have weathered macro storms remarkably well and where valuations are attractive, certain in the knowledge that we don't know what the future holds."

Thank you for your continued support.

Dr. Ian Mortimer & Matthew Page
Co-managers, Guinness Global Equity Income Fund
August 2016

Data sources

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

Index and stock data: *Bloomberg*

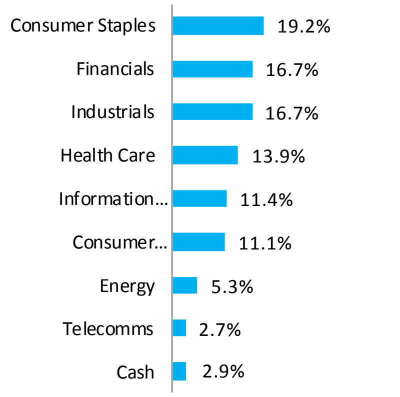
PORTFOLIO

31/07/2016

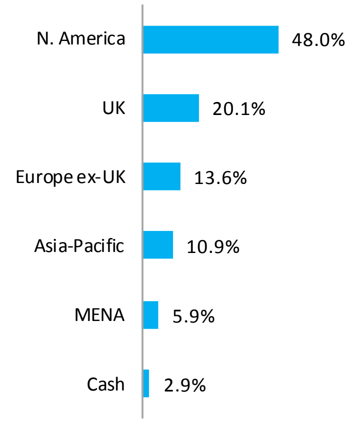
Fund top 10 holdings

Largan Precision	3.0%
ICAP	3.0%
Danone	3.0%
Microsoft	2.9%
Schneider Electric	2.9%
Sonic Healthcare	2.9%
Abbvie	2.9%
CME Group	2.8%
Mattel	2.8%
Illinois Tool Works	2.8%
% of Fund in top 10	29.0%
Total number of stocks held	35

Sector analysis



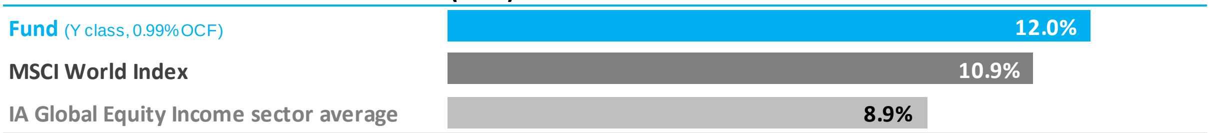
Geographic allocation



PERFORMANCE

31/07/2016

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Jul '12	Jul '13	Jul '14	Jul '15	Jul '16
Fund (Y class, 0.99% OCF)	6.0	27.6	1.8	10.3	21.0
MSCI World Index	2.7	27.4	4.1	13.5	17.0
IA Global Equity Income sector average	4.2	22.1	5.1	6.3	13.6

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y class, 0.99% OCF)	4.5	20.9	21.0	35.9	83.8	88.0
MSCI World Index	4.9	16.5	17.0	38.3	80.9	78.4
IA Global Equity Income sector average	5.3	15.0	13.6	26.9	61.4	61.2

RISK ANALYSIS

31/07/2016

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.58	2.31
Beta	1	0.77	0.87
Information ratio	0	-0.28	0.21
Maximum drawdown	-18.26	-15.50	-16.19
R squared	1	0.80	0.89
Sharpe ratio	1	0.45	0.66
Tracking error	0	6.21	4.55
Volatility	13.89	11.96	12.75

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.

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.

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.