FUND PROFILE

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# GUINNESS ASSET MANAGEMENT

# GUINNESS GLOBAL EQUITY INCOME

December 2020

RSMR RATED FUND

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# FUND PROFILE – GUINNESS GLOBAL EQUITY INCOME

**OUR FUND PROFILES** provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

**Guinness Global Equity Income Fund** has been rated by RSMR since March 2014. The fund was launched in December 2010. The strategy now has over £1.4 billion of assets under management and it can be accessed via a Dublin-based OEIC and a UK domiciled OEIC fund.

Having worked together on global growth mandates for a number of years the fund managers – Ian Mortimer and Matthew Page – decided to launch an income producing strategy, recognising the importance of income in the production of total returns and the fact that their approach should result in investors being provided with a sustainable and growing level of income. Whilst not having a specific income target, dividend payments have grown every year since launch and the fund has generated capital growth.

The clearly defined investment process has been consistently applied. Investments are selected taking a three to five-year time horizon and, as with other Guinness portfolios, it is a high conviction strategy with an active share in excess of 90% relative to the benchmark. The portfolio is equally weighted with 35 holdings and is managed on a one-in-one-out basis. The investment managers are very conscious of liquidity concerns and by its nature, the fund typically has a low turnover.

Guinness Global Equity Income provides a solid core holding for global equity income investors.

**Stephen O'Mara – Investment Research Manager, RSMR**

Prior to joining RSMR in 2015, Stephen was Head of Investment Solutions at Ashcourt Rowan (formerly UK Wealth Management and Yorkshire Investment Group). Before that he ran the investment division of Pointon York and he worked as a discretionary portfolio manager at David Booler & Co. In these roles, he gained extensive experience in fund research, building investment propositions (advisory & discretionary) and working with clients, advisors & investment managers. He is a Chartered Fellow of the Chartered Institute for Securities and Investments, has a Diploma in Financial Planning and an Investment Management Certificate.

# IA GLOBAL EQUITY INCOME

Guinness Global Equity Income sits in the IA Global Equity Income sector. Funds in this sector invest at least 80% of their assets globally in equities which must be diversified by geographic region.

Stock markets look forward, so investors are now looking out to the end of 2021 to try to see how far the global economy will be below what it would have been without Covid-19. A key question is whether there has been financial scarring or permanent damage, and if either does not occur, this recession, although extremely sharp, will not last as long or impact nearly as much as the global financial crisis. A lot will depend on governments making the correct decisions on health. Treatments for coronavirus are improving, which partly explains the lower mortality rates, even in countries now enduring a second wave. Positive news in recent weeks on Covid-19 vaccine trials from Pfizer, Moderna and Oxford University has advanced the possibility that we may begin to see some return to normality at some stage in 2021 but the vaccines still need to be reviewed and approved by the Regulator before they can be distributed. The World Health Organisation (WHO) does not expect widespread vaccinations against Covid-19 until the middle of 2021. In the meantime, the focus remains on policies designed to contain the spread of the virus.

This pandemic has demonstrated the importance for investors to think not just geographically, but also in terms of sectors and themes which arguably have been a greater driver of returns than country selection. Even in the US, the best performing major market, there has been a huge divergence between the S&P 500, especially the internet related names, and the median US listed company. This pattern has been seen across the globe with the market leaders in every country being 'new economy' related names. Within the service sector, companies not reliant on high levels of personal service have fared best, whilst those dependent on high levels of human interaction have seen significant declines in demand for their product, often with a highly damaging impact on their balance sheets. This has resulted in the permanent destruction of value for equity holders.

Companies that can adapt with the changing environment have fared best, and there is no sign of a reversal to the accelerated level of structural change in this pandemic affected world – many spending patterns, even with a vaccine, may well have been permanently altered. Asian economies without a history of legacy businesses, traditions, or brands, seem well placed to capitalise on the opportunities presented in a fast-changing world and global technology and consumer internet stocks look likely to continue to benefit from network effects in which the strong get stronger. ESG factors are likely to also remain an important factor for consideration by investors. Increased fund flows into ESG conscious managers means equity flows are shifting towards certain sectors, and managers who have ignored the importance of ESG have struggled in recent years. Investors should continue to focus on the prospects of continued economic recovery in 2021 in an environment where low rates and plentiful global liquidity should continue to support financial assets.

# GUINNESS ASSET MANAGEMENT

Guinness Asset Management (founded in 2003) is an independent asset management business 100% owned by its employees. It is part of a group of companies founded by Tim Guinness to manage investment products. Other firms in the group are Guinness Atkinson Asset Management (which runs funds for US investors) and Guinness Capital Management (which provides seed capital for new funds). The investment teams for all products are based in London. The firms benefit from shared resources and shared investment management costs. Business strategy, sales and marketing, compliance and operations for Guinness Asset Management and Guinness Capital Management are undertaken in London. These functions are undertaken in the US for Guinness Atkinson Asset Management.

The combined assets under management were £2.4 billion as at 31 October 2020. Guinness Asset Management has no debt. The group has 35 employees, and it manages a range of OEICs, US Mutual Funds and Segregated Mandates. It is well known for managing Global Equity, Energy and Asian Equity strategies.

All the firms within the group are 100% owned by their employees. Guinness Asset Management's major shareholder is Tim Guinness (60%). There is an equity incentive scheme in place whereby key team members have acquired equity in both Guinness Asset Management and Guinness Atkinson Asset Management.

The group is focused purely on active, non-benchmark constrained, investment management.

# GUINNESS GLOBAL EQUITY INCOME

| | |
|---|---|
| **Manager** | Ian Mortimer and Matthew Page |
| **Structure** | OEIC (UCITS). UK Onshore and Offshore Dublin Based options available |
| **IA Sector** | IA Global Equity Income |
| **Launched** | 31 December 2010 |
| **Fund Size** | £1,058m as at 30 November 2020 |

## Fund Manager

The fund has been co-managed by Ian Mortimer and Matthew Page since launch. Having managed global growth portfolios together, this fund was their idea and the fundamental aspects of the process draw upon the style of management that they employ on their growth portfolios. This provides the fund with a unique approach to global equity income investing.

Ian and Matthew share equal responsibility for the fund, and they work together with two dedicated analysts – Sagar Thanki and Joseph Stephens.

### Dr Ian Mortimer, CFA , Portfolio Manager

Ian joined Guinness Asset Management in December 2006. Prior to this, he completed a DPhil in Experimental Physics at Christ Church, University of Oxford, in 2006. He also obtained a Master's in Physics in 2003 from University College, University of London. He is a CFA Charterholder. Ian is also co-manager of the Guinness Innovators strategy.

### Matthew Page, CFA, Portfolio Manager

Matthew joined Guinness Asset Management in September 2005. Prior to this, he joined Goldman Sachs on the Graduate scheme working in foreign exchange and then fixed income. He graduated from New College, University of Oxford, in 2004 with a Master's in Physics. He is a CFA charterholder.

The two managers have material stakes (>5%) in the equity of Guinness Asset Management.

### Sagar Thanki, Analyst

Sagar joined Guinness Asset Management on February 2017, prior to which he worked at Bloomberg as an equity specialist, within Financial Analytics and Sales. He graduated from Selwyn College, University of Cambridge, with a Master's in Economics.

### Joseph Stephens, Analyst

Joseph joined Guinness Asset Management in July 2018. He graduated with a Master's in Mathematics from the University of Bath before obtaining a Master's in Investment Management from the Henley Business School. He has also passed the CFA level 3 examination.

In addition to Guinness Global Equity Income, the investment team manages the Guinness Atkinson Dividend Builder, a US mutual fund, and dVAM Global Equity Income, each of which mirrors Guinness Global Equity Income. They also manage Guinness Global Innovators and Guinness Atkinson Global Innovators, which mirror each other and have a global growth focus.

The investment team is relatively stable. An analyst left in Q3 2018 (and he left the investment management industry) and was replaced with Joseph Stephens.

## Fund Objectives

Having managed portfolios focusing on global growth, the fund managers made the decision to launch an income fund which would draw on the investment philosophy and process of their growth orientated portfolios, adapted to produce a growing level of income and offer the prospect of long term capital growth.

## Investment Philosophy & Process

Fundamental analysis is at the heart of the philosophy. The starting point is to determine the investment universe which is about identifying quality, well run, and profitable companies, not just looking for companies with a high dividend yield. The basis of the investment thesis is that good companies tend to stay good.

The first part of the process involves screening the c.16,500 companies listed across the globe and identifying those that have achieved at least a 10% return on capital in each year over the last ten years.

Ten percent is well above the average real cost of capital of around 5-7% over the past 10 years. This means the companies that are achieving this threshold are truly creating value for their shareholders. Consistently achieving this level excludes cyclical companies or those with high but declining or volatile earnings. As business cycles tend to last less than ten years, the companies in the investible universe have shown they can weather most economic environments. On average, the managers estimate that only 3% of global listed companies pass the threshold. Given that, they think it is a mark of genuine quality.

The managers calculate that those that pass the threshold have a 95% chance of achieving a return greater than 10% in the following year, and an 80% chance that they will continue to do so for the next four years. This level of returns enables companies to reinvest in their businesses and compound their equity growth. It also often coincides with the ability to pay a sustainable dividend and, more importantly a growing dividend in the future.

In addition to this screen, the managers also screen for balance sheet strength and critical mass by excluding companies with a debt to equity ratio greater than 1, and companies with a market capitalisation of less than $1 billion.

After applying these screens there is an investment universe of around 500 companies from which to build the portfolio.

The managers have applied these screens to the full range of globally listed companies each year back to 2000 and have noted the following trends and characteristics:

- Turnover – The universe's turnover is relatively low. Excluding the impact of new entrants, the average fall-out rate is 5%

- Sectors – There is good sector diversity and weights in the universe have been reasonably constant. More cyclical sectors (such as energy and commodities) tend to have a lower weighting, as do sectors with no pricing power (e.g. Utilities).

- Geography – The geographic split has evolved over time. Whilst the number of companies from developed markets has increased, qualifying Asian and other emerging market companies have increased much faster.

- Market capitalisation – As well as a good range of large and mega cap stocks, a healthy number of mid-sized companies deliver consistent returns.

These characteristics combined (wide diversification across sector, market cap, and geography) mean that the managers are not constrained when selecting potential investments for the portfolio. The screening for persistent high returns on capital identifies many high yielding companies, despite there being no screen applied to dividend yields. On average, since 2000, over 50% of qualifying companies have yielded over 2%.

The next stage of the process is to prioritise companies for further due diligence. Three factors are considered in idea generation: Quality, Valuation and Dividends. In many respects, this is about determining the direction of travel on all three counts. In terms of Quality they consider margins (absolute and growth), return on capital (absolute and growth) and balance sheet strength (debt/equity, net debt/equity, and interest rate cover). On Value they look at price multiple (price/earnings, EV/EBITDA, and Price/Cash Flow). Dividend yields, pay-out ratios and growth rates are also considered. Idea generation is about screening for a combination of different factors.

Once the ideas have been generated, they subject companies to a thorough due diligence process. Financial models are constructed to understand how the business has evolved over the previous 15 years (if possible). The models cover factors such as: growth, margins, uses of cash amongst capital expenditure, acquisitions, share buybacks, repayment of debt, balance sheet evolution, drivers on return of capital, key geographic regions, valuations relative to peers and the company's own history, earnings sentiment and dividend cover.

They also seek to understand what the wider analyst community is forecasting for the business and understand the drivers behind this. They seek to form an opinion on subjective factors surrounding industry trends and company specific issues.

Meeting company management is not essential. As physicists, the managers prefer metrics over compelling themes or catalysts. Identified themes or catalysts are often priced-in to the valuations of companies, with stretched expectations of growth leading to higher risk than is often perceived.

The process has a strong sell discipline. The key considerations of which are:

1. Quality – If the quality of a business deteriorates in terms of its return on capital, its balance sheet and growth opportunities
2. Valuation – If the valuation anomaly the managers identified is diminished or has disappeared
3. Dividend – If there is a change in capital budgeting or dividend policy
4. Conviction – If the original thesis no longer holds or they have a better idea

## ESG Considerations

Guinness Asset Management are signatories to the United Nations PRI. The operate a proprietary ESG scorecard and undertake a qualitative assessment of all potential investments.

## Portfolio Construction

The fund will typically hold 35 stocks (equally weighted). The advantages to this approach are that:

- It reduces stock specific risks as the portfolio cannot be overweight in a small number of favoured companies
- There is no long tail of small holdings which can detract from performance
- The one-in-one-out approach results in a strong sell discipline being applied
- The portfolio is truly active and not tied to its benchmark

The portfolio will normally only hold up to a maximum of 30% in any one Global Industry Classification (GICs) sector. In addition, there is a limit of 20% being directly invested in emerging markets.

Typical regional exposures will vary but will be within the following bands:

| | |
|---|---|
| **UK** | 0-30% |
| **Europe ex-UK (Developed Markets)** | 0-60% |
| **Pacific ex-Japan (Developed Markets)** | 0-30% |
| **North America** | 0-60% |
| **Emerging Markets** | 0-20% |
| **Other Developed Markets** | 0-20% |
| **Cash** | 0-5% |

Normally 100% of the fund will be invested in companies with a market capitalisation of over US$1 billion. The level of turnover on the fund is normally expected to be between 20-30% per annum. With an average 3-5 year holding period.

# CURRENT POSITIONING/STRATEGY

The fund is fundamentally driven by stock selection and is index agnostic. Whilst macro factors are considered at stock level, there is no over-arching macro or thematic strategy. The portfolio structure owes more to the four key tenets to the approach: Quality, Value, Dividend and Conviction.

Quality is all about selecting companies with a long history of persistent high return on capital and avoiding highly leveraged companies. As at 30 September 2020, the average 10 year CFROI of the portfolio was 17% compared to 8% from the benchmark. The weighted average net debt/equity of the portfolio was 53% whilst it was 68% on the benchmark.

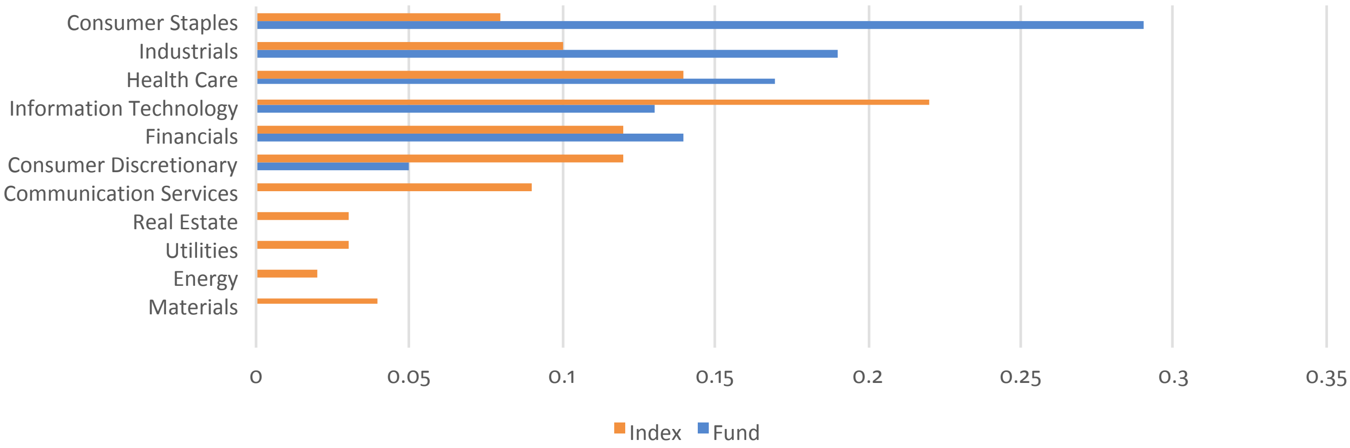
Value is about selecting companies that are cheap relative to the market, their peers, or their own history. The PE (2020e) stands at 18.3x on the portfolio – it is 24x on the benchmark. The FCF yield on the portfolio was 6.2% whilst it stood at 5.5% on the benchmark as at 30 September 2020.

The portfolio targets a moderate dividend yield and does not screen for high dividend companies. The aim is to grow the dividend stream year on year. The net dividend yield on the portfolio was 2.5%, the gross yield on the benchmark was 2.2%. The weighted average pay-out ratio on the fund was 62%. It was 79% on the benchmark as at 30 September 2020.

In terms of Conviction, the portfolio holds 35 stocks and has an active share in excess of 90%. The managers believe that the companies they hold are well placed to weather whatever happens next and will come out the other side ready for their next stage of growth.

In terms of sectors and geography, the portfolio is still well diversified:

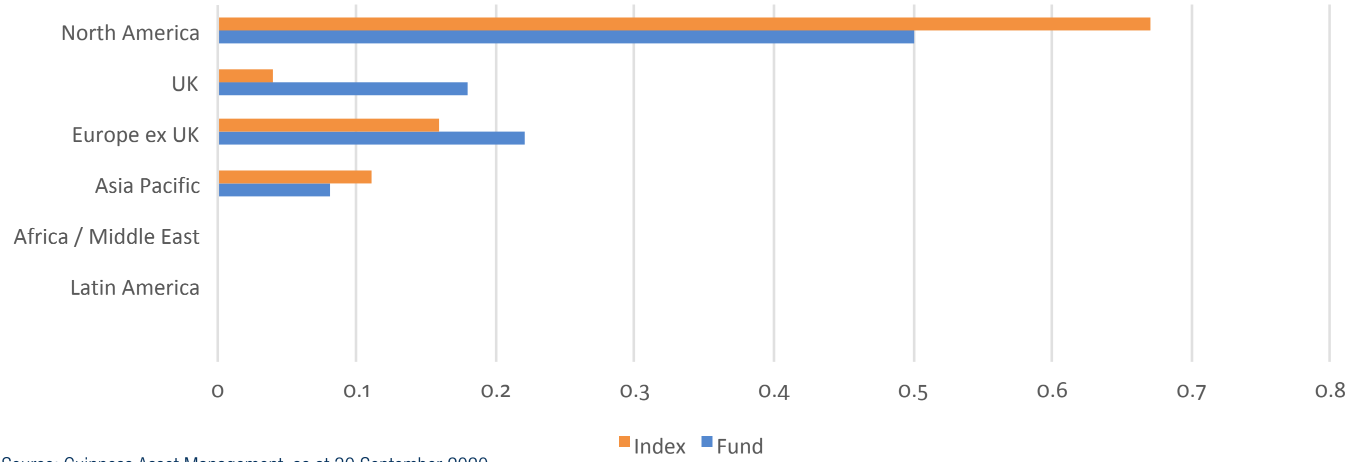
### Sector Allocation vs Benchmark




Source: Guinness Asset Management, as at 30 September 2020

The managers continue to maintain an even balance between quality defensive and quality cyclical/growth companies. They have approximately 50% in quality defensive companies (for example, Consumer Staples and Healthcare companies) and around 50% in quality cyclical or growth orientated companies (for example, Industrials, Financials, Consumer Discretionary, Information Technology, etc). Within Financials they do not own any Banks, which helps to dampen the cyclicality of the other Financials held. The fund also has zero weightings to Energy, Utilities, Materials, and Real Estate. The largest overweight is to Consumer Staples.

### Geographic Allocation vs Benchmark




Source: Guinness Asset Management, as at 30 September 2020

In terms of geographic exposure (see chart above), the largest difference between the portfolio and the benchmark is the exposure to the US (as measured by country of domicile). The portfolio over the quarter had, on average, c50% exposure to North America which comprises around 67% of the benchmark. The largest geographic overweight remains Europe ex UK and the UK (with a combined weighting of 40%).

With regards to the UK exposure, there are two points to note:

1. The fund has a lower exposure to the UK when considered in revenues (c.4%) versus by domicile (c.18%). This is because they have favoured UK domiciled companies with a more global exposure (such as Unilever and Imperial Brands); and

2. There is a larger exposure to Asia Pacific by revenues (c.20%) than the equivalent statistic as measured by domicile (c.8%).

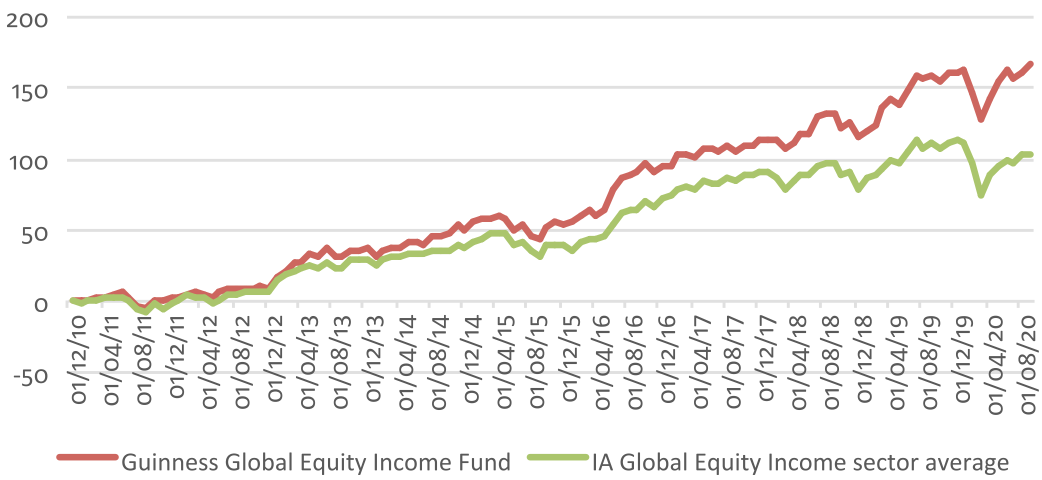
Within the Asia Pacific region there is one company listed in Hong Kong (Anta Sports), one company listed in Taiwan (Taiwan Semiconductor) and one company listed in Australia (Sonic Healthcare)

# PERFORMANCE

Year to date, and longer term (one, three and five years), the fund has outperformed the IA Global Equity Income sector average. As the portfolio is equally weighted and alpha comes from stock selection, driven by the investment process, any additional contributions from other factors are marginal.

The following graph illustrates the cumulative performance of the fund versus the IA Global Equity Income sector average since launch.

### Performance vs IA Sector Average



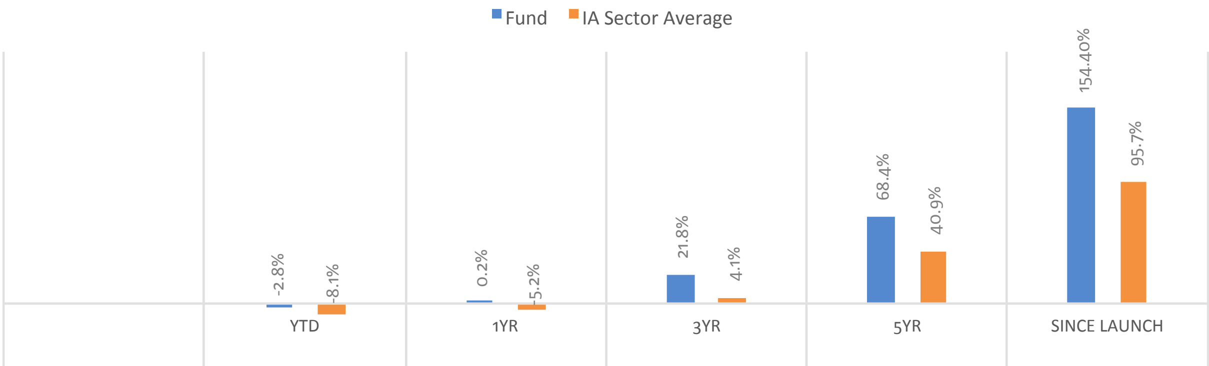

Source: Guinness Asset Management, as at 30 September 2020

The type of companies they invest in have enabled the fund to outperform its benchmark when markets have fallen. There have been five 10% plus corrections on markets since the fund was launched. The fund did not capture the whole of the downside on each occasion and this has provided it with the kind of resilience that has enabled it to outperform its peers. Here are the corrections and the downside capture of the fund:

| Reason for Sell Off | Start Date | End Date | Downside Capture |
|---|---|---|---|
| European Crisis / Greece | 05/02/2011 | 04/10/2011 | 71% |
| US Credit Rating Downgrade | 19/03/2012 | 04/06/2012 | 72% |
| China Growth Concerns | 31/12/2015 | 11/02/2016 | 53% |
| Tech Sell Off / US China Trade Issues | 03/10/2018 | 25/12/2018 | 69% |
| Coronavirus | 19/02/2020 | 23/03/2020 | 96% |

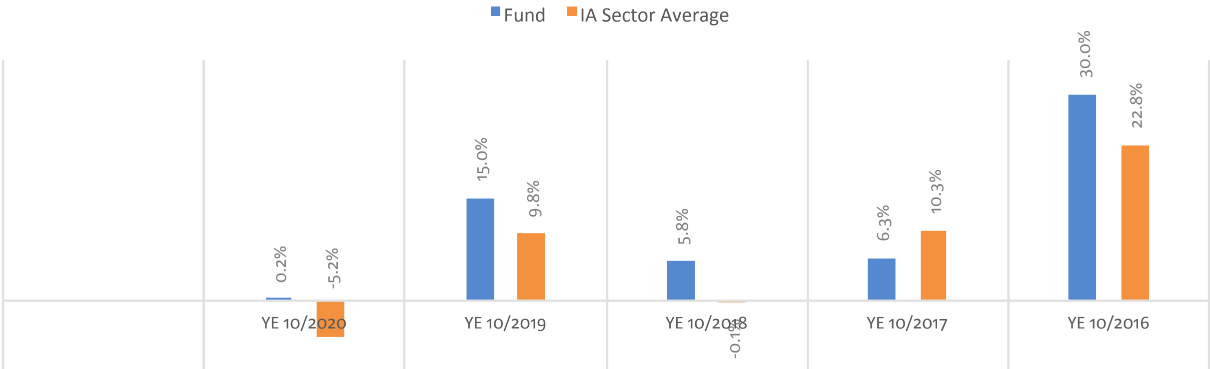
On average the fund only captured 72% of market downside in the five corrections (>10% drawdown) since the fund was launched at the end of 2020 (Source: Guinness Asset Management, Bloomberg).

## Guinness Global Equity Income vs IA Global Equity Income Sector




Source: Guinness Asset Management (as at 31 October 2020)

## Fund vs IA Global Equity Income Sector Discrete Years




Source: Guinness Asset Management (as at 31 October 2020)

The current expectation (as at the end of October) is that the 2020 fund distribution will be similar to 2019, subject to some moving parts (for example, foreign exchange rates and portfolio changes). Since launch, the dividend payment on the fund has grown each year, producing compound annualised growth of 5.6% to the end of 2019.

So far, out of the 35 holdings:

- 27 companies have grown their dividend this year
- 6 companies have kept their dividend flat
- 1 company cut its dividend (Imperial Brands)
- 0 companies cancelled their dividend

For the 1 remaining company, Broadcom, the managers expect a dividend increase to be announced in December – this is when the company typically announces its year-on-year growth in its quarterly dividend.

# SUMMARY & EVALUATION

Guinness Global Equity Income has been rated by RSMR since March 2014. It was launched in December 2010 when the fund managers decided that their approach to managing global growth mandates which they had applied for several years could be adapted and applied to global equity income mandates with sustainable dividends being a significant part of total returns.

The crux of the process is to invest in companies which have delivered a 10% yield on capital in every year over the last decade, which have balance sheet strength and critical mass. Having screened the universe of global listed stocks since 2000, over 50% of qualifying companies delivered a yield of over 2%. The screen pays no attention to yield with a focus on quality, stable, profitable companies. This approach differentiates it from its peers. In terms of dividends, the managers target a moderate dividend yield with a view to grow the dividend stream year on year. There is merit in prudence. The dividend stream has increased in every year since launch and the fund has delivered capital growth.

This is a high conviction strategy with an active share of over 90% relative to its benchmark, being equally weighted in 35 stocks but the nature of the process makes it an attractive core holding for global equity income investors.

# RSMR

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality, without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

## Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients, backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

## Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.

## Ratings

Our innovative ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead. based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

**Our research. Your success.**

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# NOTES

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