GUINNESS

European Equity Income Fund

Annual review

2020

GUINNESS
ASSET MANAGEMENT

Launch date	19.12.2013
Team	Nick Edwards

Aim

The Guinness European Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Europe ex UK region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

Performance 31.12.2020

Fund	European Equity Income (Z Class, 0.35% OCF)
Index	MSCI Europe ex UK
Sector	IA Europe ex UK

	1 year	3 years	From launch
Fund	0.7	14.5	70.2
Index	7.5	16.2	70.5
Sector	10.3	16.6	76.5

Annualised % total return from launch (GBP)

Fund	7.9%
Index	7.9%
Sector	8.4%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	1.2	0.6
Beta	1.0	0.9	0.9
Info ratio	0.0	0.1	0.0
Max drwdn	-25.0	-24.4	-30.3
Tracking err	0	5	5
Volatility	16.3	15.2	16.2
Sharpe ratio	0.3	0.3	0.3

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, Z class 0.35%, bid to bid, total return.

Performance

In 2020, the Guinness European Equity Income Fund rose +0.7% (in GBP) over the year, versus the MSCI Europe ex UK Net Return Index, which rose +7.5% (in GBP). The fund therefore underperformed the Index by 6.75% over the year and was ranked second quartile, or 13/33, among European income peers. The Fund's performance was well ahead of the performance of MSCI Europe Value Index -7.2% and High Dividend -3.6% but behind MSCI Growth +12.4%.

On a relative basis Q4 was a soft period for the Fund, underperforming the MSCI Europe ex UK Net Return Index's 9% rise by -3.3%, as the Fund gave up ground it had made back in Q3 as "value" components of the index (Energy, Banks and Leisure) rallied on positive vaccine news.

The Fund has outperformed its Benchmark the MSCI Europe ex UK Net Return Index over 5 years but lagged the Index in 2020 primarily because we entered the pandemic with a large underweight exposure to healthcare and a number of consumer-facing mid-cap positions. The latter subsequently reallocated into high quality long-term solutions providers to the crisis, namely enablers of resilience (communications and automation) and job creation (green infrastructure).

	1 month	YTD	1 Yr	3 Yr	5 Yr	Since Launch
Fund	2.3%	0.7%	0.7%	14.5%	64.4%	70.2%
Index	2.1%	7.5%	7.5%	16.2%	59.7%	70.5%
Sector	2.6%	10.3%	10.3%	16.6%	59.2%	76.5%
Fund performance vs Sector	-0.3%	-9.6%	-9.6%	-2.1%	5.3%	-6.3%

Figure 1 source: Financial Express 0.35% OCF. Cumulative Total Return in GBP as of 31.12.2020

The Dividend

The pandemic abruptly interrupted our track record of persistent dividend growth (8% CAGR GBP Z Class YE 2019), with the 2020 FY dividend (July 2020 + Jan 2021 payments) collectively -30% lower YoY, but characterised by a much

larger H2 payment as some companies that had withheld dividends out of caution or due to delayed AGMs (many of which moved online) subsequently paid. Many of our companies that cancelled or reduced dividends were forced to by governments and/or regulators despite having attractive balance sheets. Others like the salmon farmers, characterised by above average capital intensity, did so out of caution and have since made partial dividend payments. We can attribute some 2/3rds of the -30% fall in dividend payment to the pandemic and approximately 1/3rd to the YoY benefit received from the increased proportion of French dividend payers held in 2019, where we are not charged dividend withholding tax which led to a tougher YoY comparison base. Owing to several portfolio switches into companies with lower yields but higher dividend growth and better long-term total return potential, the 2021 dividend looks unlikely to quite match 2019 levels (barring significant unexpected specials) but should return to 2019 levels in 2022 all else being equal, one year ahead of current market expectations for the Index dividend to return to 2019 levels.

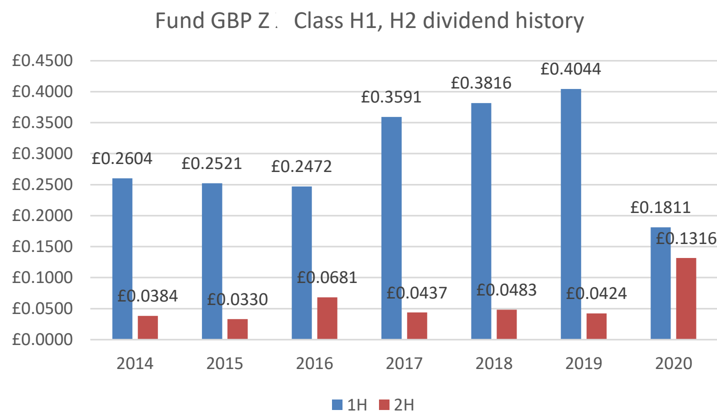
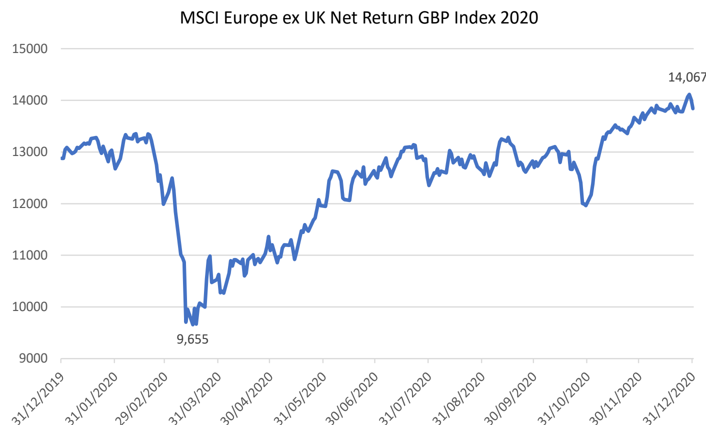


Figure 2: Dividends paid since launch (19.12.2013). Source: Guinness Asset Management

Investment Backdrop



The Guinness European Equity Income Fund is well balanced across high quality defensive and cyclical Europe ex-UK companies characterised by track records of persistent high cash returns and strong balance sheets. It is also diversified across value and growth and domestic and international exposures. Meaning that macro and short-term fluctuations should prove of little consequence to long-run returns. What matters is that at any one time we hold the best long-term total return ideas among dividend-paying companies.

As such I will keep the 2020 retrospective brief. In many places we start 2021 not far off where 2020 began but with some notable differences. After a torrid ride business confidence and Eurozone PMIs have moved higher again, manufacturing PMIs and industrial confidence much more than services and consumer confidence, but

the latter two should follow as vaccines take effect. Leading us out of a deflationary scare where consumer price growth fell to Eurozone crisis lows and core inflation fell below zero. Meanwhile Eurozone household savings rates nearly doubled to just shy of 30%, leaving plenty of dry powder for when lockdowns finally end.

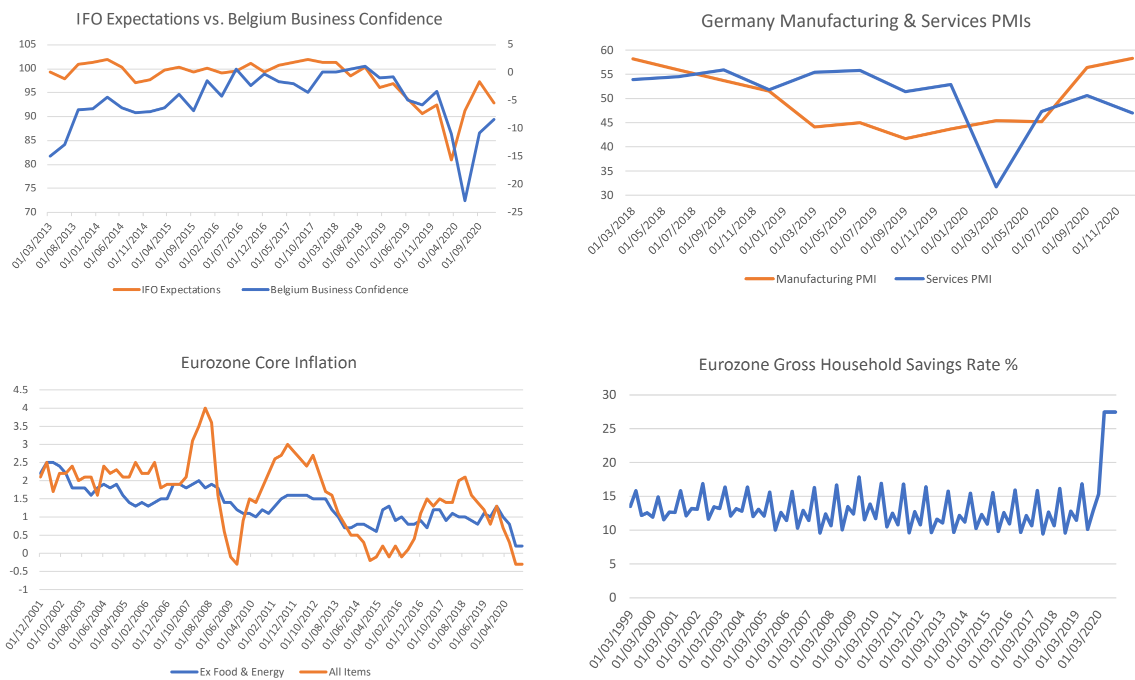


Figure 3: Clockwise from to left: IFO / Business expectations, German manufacturing PMIs, Eurozone Gross Household Savings Rate %, and Eurozone Core Inflation. Source: Bloomberg.

The anaesthetic of QE and expectation for fiscal policy has been a huge panacea and is a sharp reminder to those that had started to question the crisis fighting credentials of central banks at the zero bound.

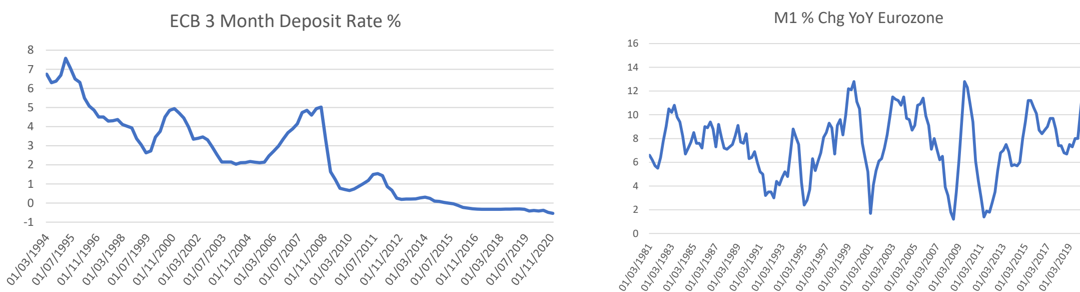


Figure 4: LHS: ECB 3m Deposit Rate %. RHS: M1 % Change YoY Eurozone. Source Bloomberg data.

The nature of stimulus looks set to morph towards direct targeted fiscal policy, even open monetary policy. As far as Eurozone political impacts are concerned the shift over the year has been massive, from distrust to trust and improved confidence in the Eurozone on the part of Italy and other southern countries as Germany shaped the €750bn Recovery Fund. Linked to which is the potential for the creation of a pan European yield curve with strong positive implications for long-term infrastructure investment. It seems hard to imagine that yield curves, value vs. growth, domestic and services won't do better as life is breathed back into the economy and an end to austerity mentality ensues, opening a positive feedback loop for fiscal policy. However, the deflationary effects of the digital fast forward together with higher levels of borrowing, ageing populations and reduced trade tensions may all work in the opposite direction, keeping a lid on major price growth and inflation. While on a

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related note the ECB asset purchase programme is on track for net purchases above sovereign issuance in 2021, meaning the outlook for dividend paying companies looks strong as **income remains scarce**.

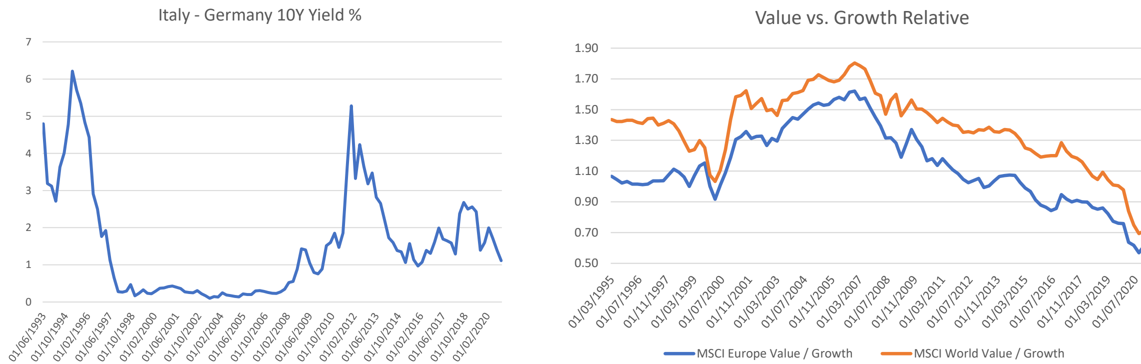

Figure 5: LHS: Italy – Germany 10Y Yield %. RHS: Value vs. Growth Relative (Europe in blue). Source: Bloomberg data.

At 04/01/2021 — Govt bond yields

	Switzerland	Germany	Netherlands	France	Japan	Sweden	Spain	UK	Italy	US	Australia
1Y	-0.98	-0.71	-0.66	-0.60	-0.14	-0.25	-0.60	-0.16	-0.48	0.10	0.03
2Y	-0.87	-0.73	-0.74	-0.70	-0.15	-0.39	-0.62	-0.18	-0.44	0.12	0.09
3Y	-0.85	-0.78	-0.75	-0.73	-0.15		-0.58	-0.13	-0.31	0.17	0.09
5Y	-0.80	-0.76	-0.74	-0.68	-0.12	-0.34	-0.41	-0.10	-0.03	0.37	0.37
7Y	-0.74	-0.72	-0.67	-0.59	-0.10		-0.28	-0.01	0.18	0.65	0.67
10Y	-0.63	-0.61	-0.53	-0.38	0.01	-0.02	0.02	0.17	0.53	0.93	1.01
15Y	-0.50	-0.43	-0.47	-0.20	0.21		0.34	0.37	0.90		1.31
20Y	-0.40	-0.40	-0.30	0.05	0.39	0.26	0.60	0.66	1.12	1.46	1.71
30Y	-0.43	-0.20	-0.13	0.33	0.64		0.85	0.72	1.40	1.66	1.95

Figure 6: Developed market negative sovereign yields (red), with an even smaller proportion offering a real yield after inflation. Source: Goldman Sachs.

With confidence in European politics improving (and prospects for capital markets union on the cards) along with waning trade tensions and an end to the beginning of Brexit; set against the prospect of an increased US fiscal stimulus, but also US tax hikes and a tougher line on the tech giants from the incoming Biden administration, there is fair argument for exposure to Europe on relative basis. The E in the PE is out of kilter this year but a look at relative Price to Book value histories gives pause for thought.

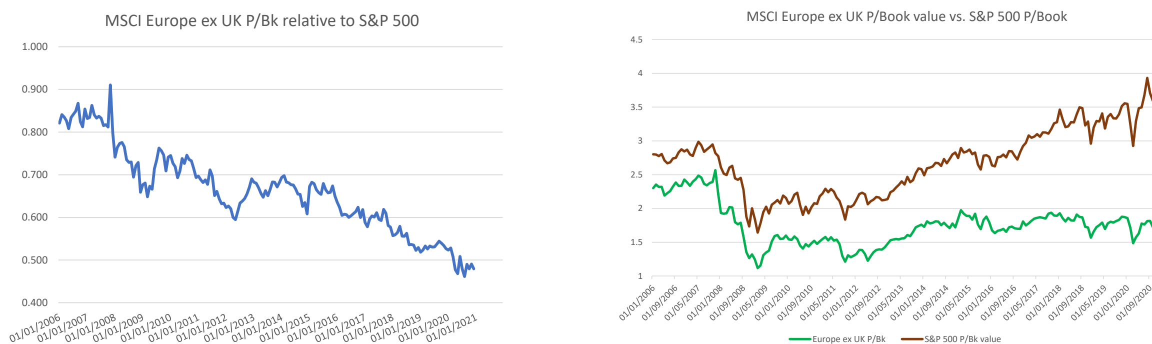

Figure 7: LHS: P/Bk relative to S&P 500. RHS: MSCI Europe ex UK P/Bk (green) and S&P500 (red). Source: Bloomberg data.

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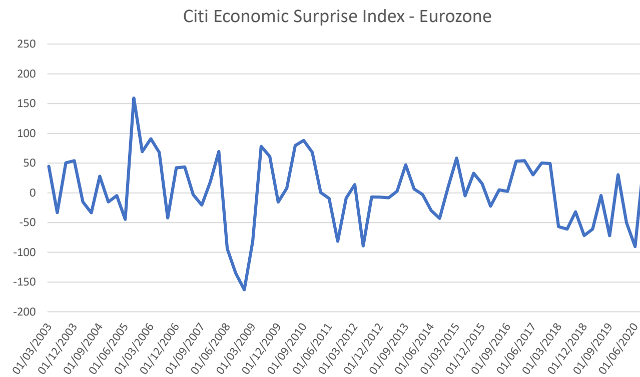

Figure 8: Citigroup Economic Surprise Index – Eurozone. Source: Bloomberg data.

What is of importance to Guinness European Equity Income Fund holdings and long-term outlook are structural drivers of returns, and here the backdrop is improving. The fund has a large overweight position in high quality **green industrial leaders**. We also own innovative companies that **use technology well** alongside companies that are **enablers of resilience and job creation**, notably via our overweight holdings in information technology leaders and smart green materials. We think these groups look well positioned amid the long-term pandemic response to resilience (sustainability, health, communications & automation) and job creation via green infrastructure stimulus. We used the sell off to pick up a number of such names (discussed below), that look set to come out of the crisis stronger while we sold some where liquidity risk had risen or had been weakened by the crisis.

The outlook for sentiment relating to trade for Europe's highly export sensitive economy is improving with the exit of Trump and a more open incoming government. The recent China trade deal is also good news for Europe's industrial exporters in general and several our portfolio holdings like **Schneider Electric, Siemens** and **Capgemini** specifically, due to the cessation of tech transfer and JV requirements in China. We will have to wait and see how US and European joint plans to tackle **China** on technology shape up. We do however continue to sense that **Europe** will look to both export its climate standards globally and develop its own global champions amid increasing competition from the US and China. European competition commissioner **Margarethe Vestager** has now seen first-hand the impact of an excessive focus on price to the consumer over and above free markets that give a green light to consolidation to the benefit of scale, R&D investment and returns, in what in many areas remains a market largely fragmented along country lines.

The recently approved €750bn European recovery fund, primarily focused on building back better in the most impacted countries via **climate and digital transition** plans, looks set to run through to 2030. The outlook for green and healthy infrastructure focused stimulus out of the US has also just taken a leg up after the Democrats won control of the Senate as well as the House of Representatives following the Georgia election victories. Meanwhile ECB policy review due in Q3 2021 looks likely to break with the market neutrality principle, using ratings agencies to focus asset purchases on more highly ESG rated paper over heavy emitters of carbon. A European carbon border tax looks probable and a higher price on carbon via the ETS also seems likely.

One of the big events of 2021 in Europe looks set to be the **German general election** and related choice of new Chancellor, where a CDU/CSU coalition with the Green party appears a likely outcome. The election is currently a contest between CSU leader Marcus Soder (the CSU being the sister party to Angel Merkel's CDU) and Armin Laschet for the CDU. Crucially all three are supportive of further European integration and working with the greens, now the number two party ahead of the beleaguered SPD in the polls. A **green coalition government** at the centre of Europe would complement a European parliament where the Green party is now effectively kingmaker, as no two of the three major parties now command a majority.

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In short there is a lot to be positive about in this rather green and fiscally led backdrop. However, context alone is of course not enough. The most important thing as a driver of returns are the qualities and longevity of the unique franchises we own. Despite the fund's high AA MSCI ESG rating, we would stress that we are wary of companies trying to do or be too many different things to too many people. Stakeholders are important but excessive box ticking is not prudent and can work to the detriment of shareholders and returns. The ideal set up generally includes a highly competent management with plenty of skin in the game and well aligned with shareholders, with real passion for their work and a strong customer focus. A company that understands its core competencies and is supported by a strong Board and an employee base that is fully on board is at a real advantage. Alongside a growing opportunity set – is it a growth market or is there plenty of room to take market share? If it is not one of the two then you probably are not going anywhere fast unless there is a supply side opportunity.

In this respect the key attributes of the Guinness European Equity Income Fund – encompassing high levels of self-determination and low-to-no exposure to commodity and regulated industries – are well aligned with you as shareholders.

	Holdings	
Strong Self determination	Identifiable Barriers to Entry	Intangibles, Switching Costs, Scale, Network Effects, Regulation
	Market Leadership Positions	Dominates a market or niche, number 1, 2 or 3 position. Balance sheet strength.
	Widening Moat	Market share gains. R&D spend. New Products. Widening margins. Eye on capital cycle / new entrants.
	Aligned Incentives	Active shareholders. Capital allocators. Returns based incentives. Business owner culture. Stakeholder focus.
	Market Opportunity	Long runway. Secular growth. Not forgetting about the supply side.
External factors	Commodity industries	Materials, Energy.
	Regulated Industries	Utilities, Telecoms.
	Banks	Leverage, regulation.

Figure 9: Guinness European Equity Income Fund holding key attributes. Source: Guinness Asset Management

Performance Drivers

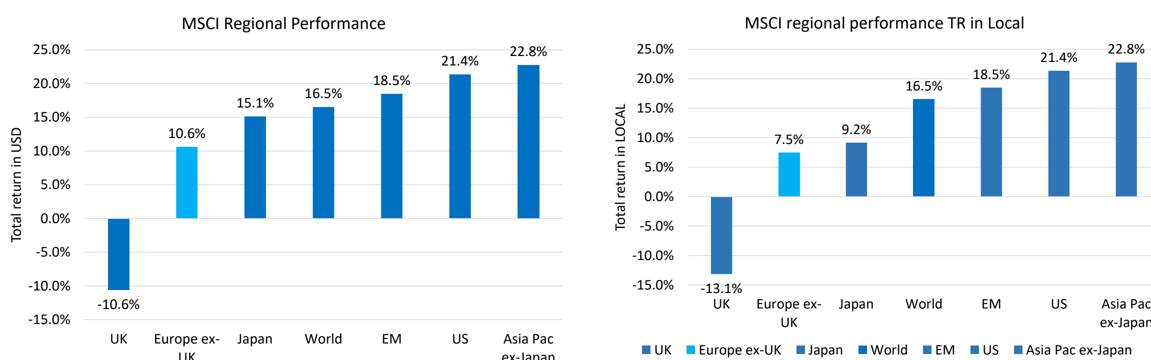

Figure 10: MSCI World Index geographic total return breakdown for 2020, in USD (left) and Local currency (right). Europe in light blue. Source: Bloomberg data

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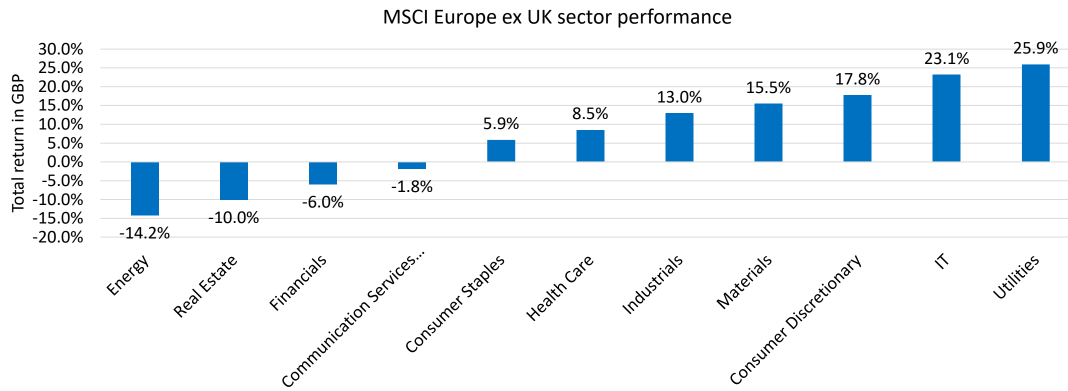

Figure 11: MSCI Europe ex UK Index sector total return breakdown for 2020, in GBP. Source: Bloomberg

In USD terms the MSCI Europe ex UK Index rose 10.6% in 2020, while in local currency the Index rose 7.9%, well ahead of the UK but behind MSCI World and Asia Pacific which led performance – broadly reflective of regional Covid-19 impacts and Europe's relative inexperience in dealing with outbreaks like those seen in Asia under SARS. Principal drivers of sector relative performance included pandemic effects, interest rates and the development of expectations around fiscal policy along with relief on trade and Brexit. The big surprise from a small sector was the strong performance of **Utilities** (+26%, 5.4% index weight) driven both by risk aversion and declining rates but also strong clean asset growth and a rising carbon price set against high fixed cost bases. This outperformance was however counterbalanced by the underperformance of the other commodity and regulated areas to which the fund also has no exposure: **Energy, Real Estate, Telecoms** and **Banks**. Periodic bouts of outperformance there will be but the fact remains that the higher levels of income offered by these sectors which your fund avoids comes with lower capital growth potential and higher risk of permanent capital loss.

Naturally, we wish we had come into 2020 with a portfolio more attuned to the market events that unfolded from February 2020. Our new portfolio additions, primarily undertaken in Q2 2020, focused on companies that look set to come out of the crisis stronger across Technology, Materials, Healthcare and Industrials, collectively outperformed their respective sectors over the second half of the year. However, they did not manage to compensate for the large ~8% underweight in Healthcare and the mid-cap biased consumer focused holdings we started the year with (C&C Group, Metropole Television, Cerved, Adecco, Millicom and Publicis discussed below).

What **Healthcare** holdings we had outperformed as the crisis took hold but have since, in general, been weighed down by pressure on elective surgeries and the impact on hospital capacities. We envisage strong recoveries from **Roche** and **Fresenius** as the crisis unwinds, both of which have been fundamentally strengthened by the crisis and appear positioned to take market share. Roche as governments step up long-term investment in diagnostics capacity and Fresenius as it has outperformed municipal healthcare and hospital providers which are now sadly further in the red.

Staples proved worthy through the crisis phase, and all our FMCG exposures (Nestle, Unilever and Danone) hold good self-help potential. **Unilever** is now positioned to step up portfolio management after fully incorporating in the UK. **Danone** is at the front end of a restructuring that has plenty of room to unlock value, particularly if new management focus a little more on capital allocation and returns to shareholders and touch less on the minutiae of the company's ESG profile. Over at **Nestle** we see the portfolio reshuffle continuing towards higher margin, premium and healthy areas. Also in Staples, we remain upbeat on our salmon farmers **Salmar** and **Bakkafrost** for a number of reasons including supply growth slowing to near zero in 2021 as demand growth accelerates.

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Among **Financials** our three **Insurers** remained well underwater for most of the year, before making a last-minute appearance at the top of the leader board. Here we see fundamentally sound businesses with robust market positions and attractive dividend yields. Some contrarian upside exposure to higher rates and inflation is also no bad thing just in case reflation does manage to find its way into the system. Our **Exchanges** look well positioned to take market share, notably after the lack of incorporation of Financial Services in the Brexit deal. We fully expect to see **Deutche Boerse** take share in Euro derivatives and clearing and **Euronext** in Euro government bond trading from LSE. While our **Asset Manager** holding, **Amundi**'s JVs in China and India are showing real results in terms of asset gathering.

Our strongest performers post the Q2 lows, unsurprisingly, came from the **IT, Industrials** and **Materials** sectors, primarily driven by their status as solutions enablers to the pandemic and or the climate crisis, the two interlinked by the fiscal response towards the latter. We discuss several of these below (under the Individual Holdings segment), including new portfolio holdings **ASML, Epiroc** and **Sika**.

Counterintuitively **Consumer Discretionary** also closed the year near the top of the sector rankings; much of this strong performance driven by companies focused on luxury, auto and online delivery models, and as countries unlocked and an end to the crisis became more tangible. We fully accept that as vaccines work their way through the system there may be some more meaningful "one off" bounces from hard impacted sectors. Meanwhile your portfolio remains focused on companies that have both the cash generation and runway to continue compounding into the long-term.

If **dividends** do rebound at least in line with market earnings growth estimates for our current portfolio holdings the dividend should exceed 2019-year end levels in 2022, all else being equal.

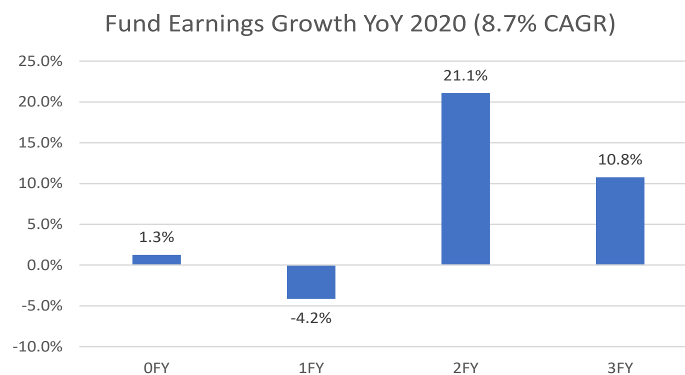

Figure 12: Fund consensus earnings growth estimates to 2022. Source: Bloomberg.

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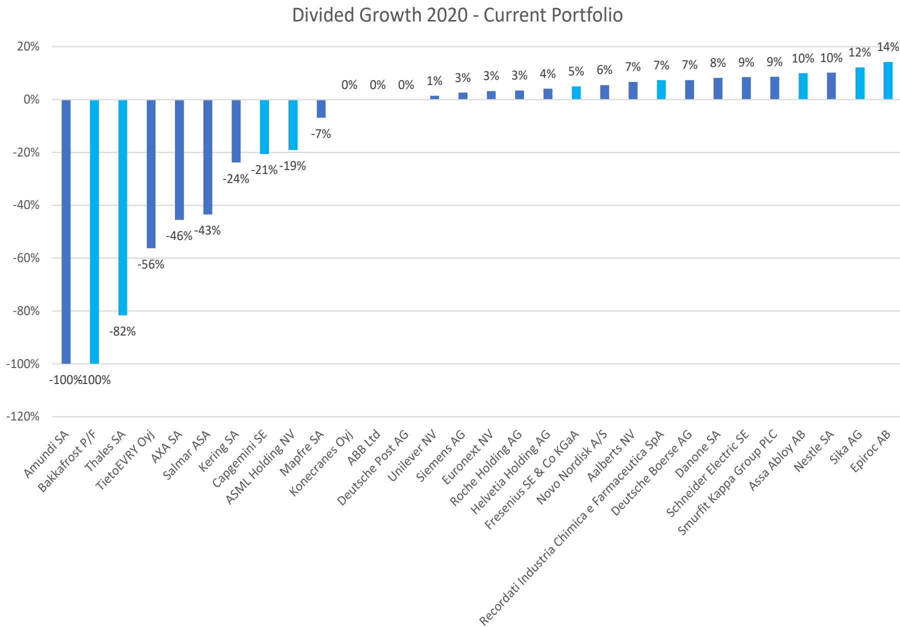


Figure 13: Current holdings 2020 YoY dividend growth in local currency. Source: Bloomberg.

Positioning

The Guinness European Equity Income Fund is characterised by a high 85% active share against the Europe Ex UK benchmark. Our focus on companies with good track records that are in charge of their own destiny and have the potential to deliver high and rising returns for a long-time to come means the fund has virtually no exposure to commodity and regulated sectors like Materials, Utilities, Real Estate, Energy and Banks. Meanwhile sectors like Industrials, other Financials and Consumer Staples in which your fund is overweight, hold many of the high quality and scalable companies which we find attractive.

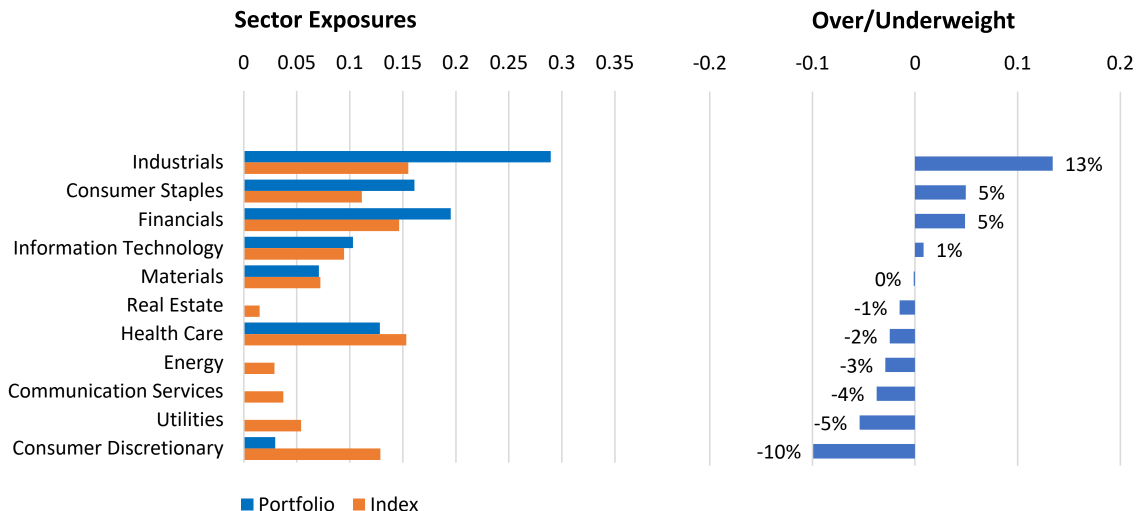


Figure 14: Sector over/underweight % breakdown of the fund versus MSCI Europe ex UK. Guinness Asset Management, Bloomberg (data as at 31.12.2020).

The fund's country over and underweight positions result from a pull between two factors. Naturally, France and Germany represent high absolute weights in the index at 22.5% and 18% respectively; but it is also the case that we simply find a greater number of high-quality companies with strong prospects in "high IP" markets with good corporate governance, notably in Scandinavia.

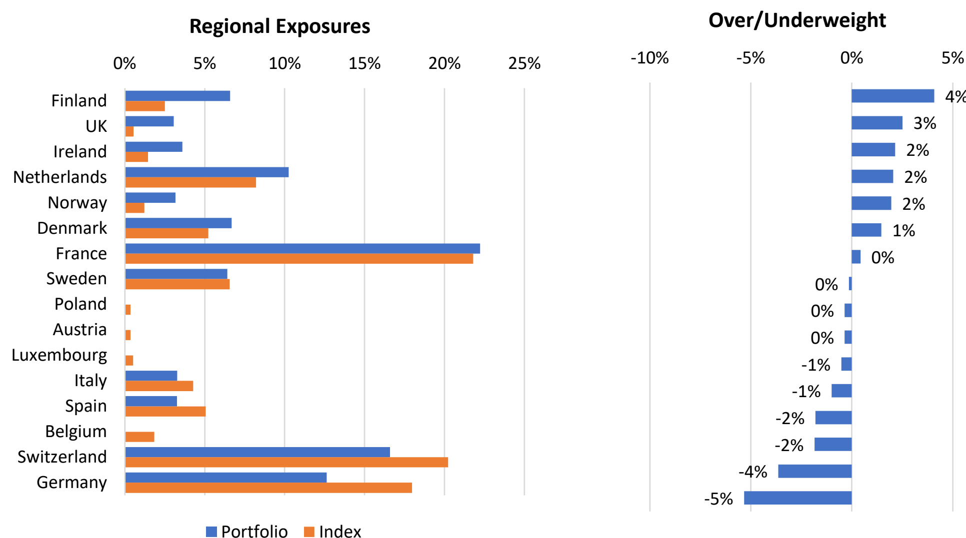
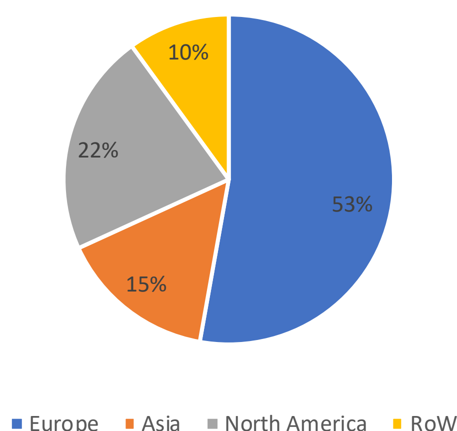


Figure 15: Regional breakdown of the fund versus MSCI Europe ex UK Index on a geographic basis. Guinness Asset Management, Bloomberg (data as at 31.12.2020). *UK exposure represents Unilever which is now domiciled in the UK and listed in the UK and also on Euronext Amsterdam.

The Guinness European Equity Income Fund's company holdings represent a mixture of domestic and global exposures, with total sales derived from domestic Europe amounting to 53% of total portfolio sales. If the euro does strengthen against the dollar in 2021 the Guinness European Equity Income fund is conservatively positioned with more than half of fund sales derived from domestic Europe.

Fund Regional Sales Exposure



Europe ■ Asia ■ North America ■ RoW

Figure 16: Sales exposure of fund holdings on a geographic basis. Guinness Asset Management, Bloomberg (data as at 31.12.2020)

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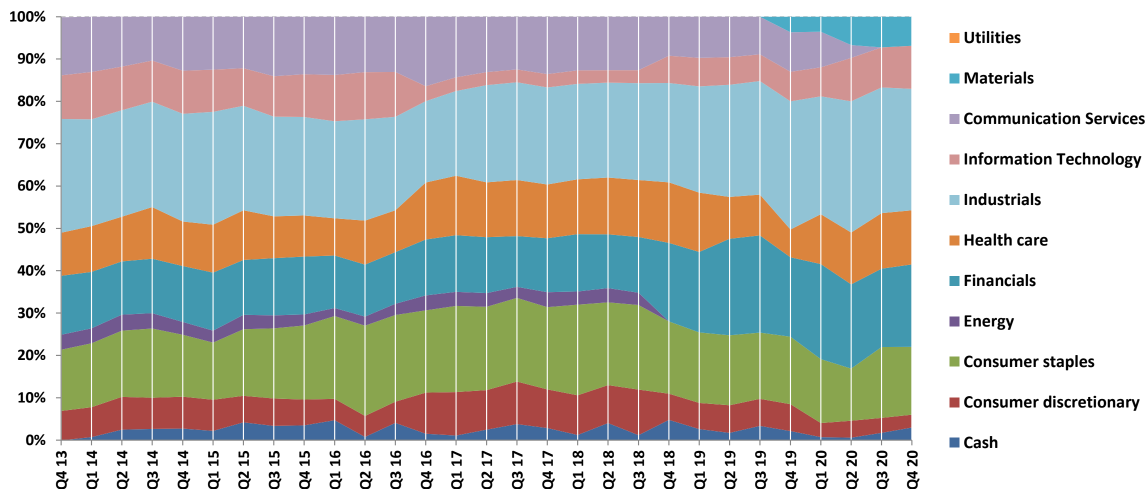

Figure 17: Portfolio sector breakdown at year end 2020

Our underweight in Healthcare was largely neutralised over the course of the year through the addition of Recordati and Fresenius to the portfolio along with the good performance of Roche and Novo Nordisk in Q2. Naturally, we are disappointed to have come into this unexpected crisis with a large underweight to the sector but believe that all our current sector holdings will ultimately prove to have been strengthened by the crisis. Our exposure to high quality smart green materials increased as Sika joined Smurfit Kappa in the Materials sector. While IT exposure rose with the addition of two digital communications enablers, ASML and Capgemini, both of which look set to sustain high levels of top line growth through the 2020s as the digital fast forward unfolds.

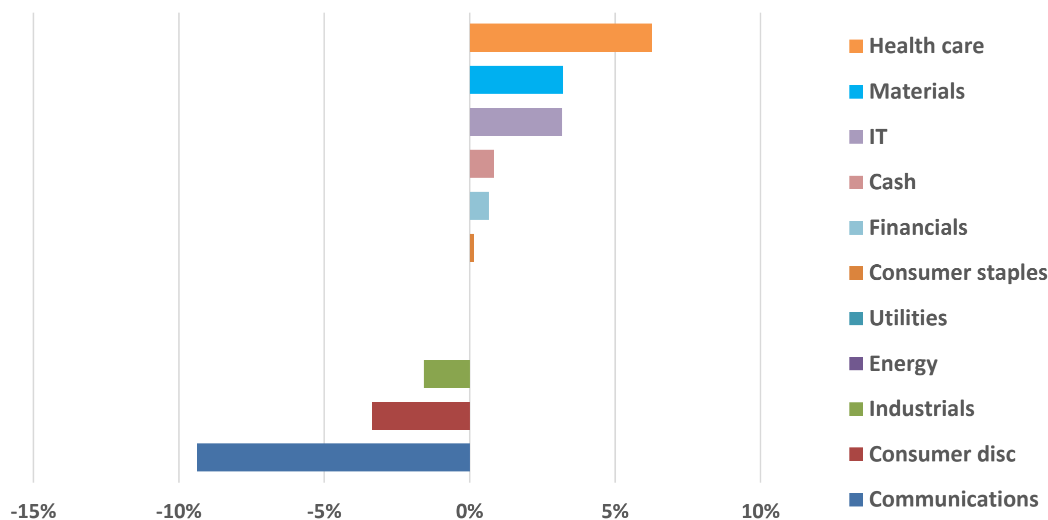

Figure 18: Year on year change in sector breakdown

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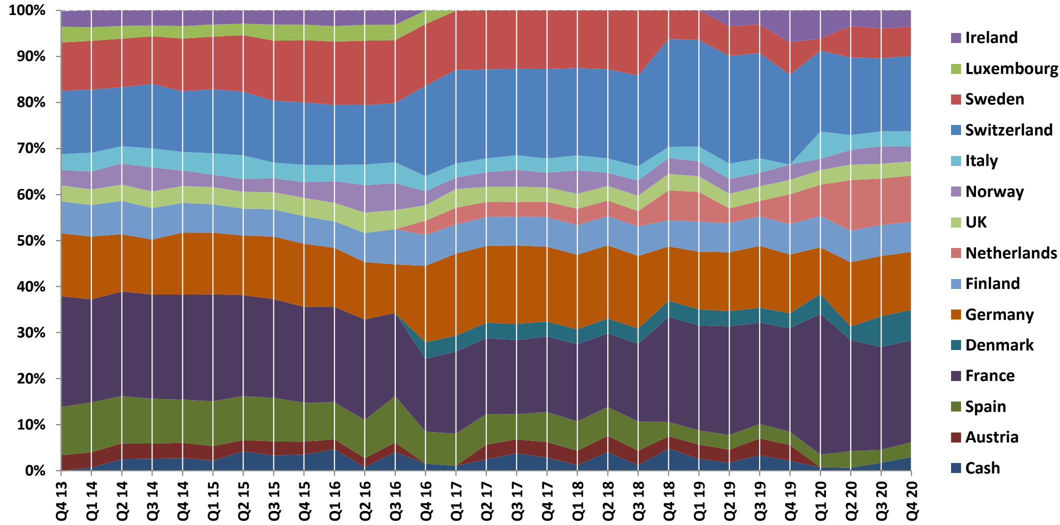

Figure 19: Portfolio geographic breakdown at year end 2020

Net exposure increased in three countries with the addition of three high quality compounders. In the Netherlands with the addition of ASML – the global market leader in ultraviolet based semiconductor manufacturing equipment – in Denmark with Bakkafrost – the Faroe-based premium salmon farmer – and in Italy with the addition of specialty care and rare diseases specialist Recordati SpA. Exposure to Austria, Ireland and Switzerland fell with the sales of Andritz, C&C Group and Inficon respectively.

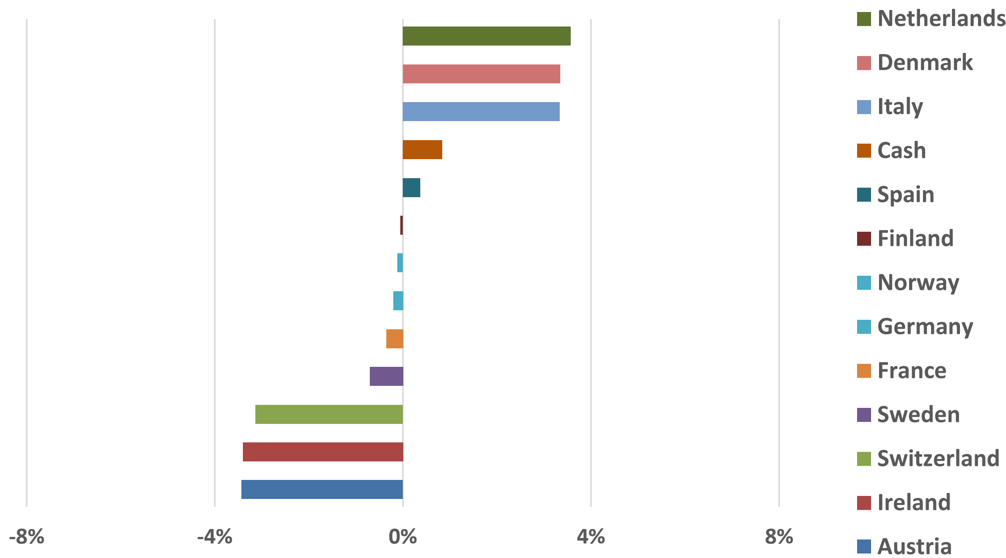

Figure 20: Year on year change in geographic breakdown

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Individual Holdings

Individual companies that performed well in Q4 2020 were characterised by a mix of growth, namely ASML, and value in the form of our insurers Axa, Mapfre and Helvetia Holdings, along with industrial efficiency enabler Aalberts. Companies that fared less well were largely defensive, including our exchanges Euronext and Deutsche Boerse AG, along with staples Nestle, Unilver and Novo Nordisk among our healthcare holdings.

Best 5 performing stocks	Total return
ASML Holding NV	27%
AXA SA	24%
Mapfre SA	23%
Helvetia Holding AG	19%
Aalberts NV	18%

Worst 5 performing stocks	Total return
Euronext NV	-16%
Deutsche Boerse AG	-7%
Nestle SA	-5%
Unilever PLC	-3%
Novo Nordisk A/S	-3%

Source: Bloomberg data

Figure 21: Five Best and worst-performing shares in Q4 2020 in EUR. Source: Bloomberg data.

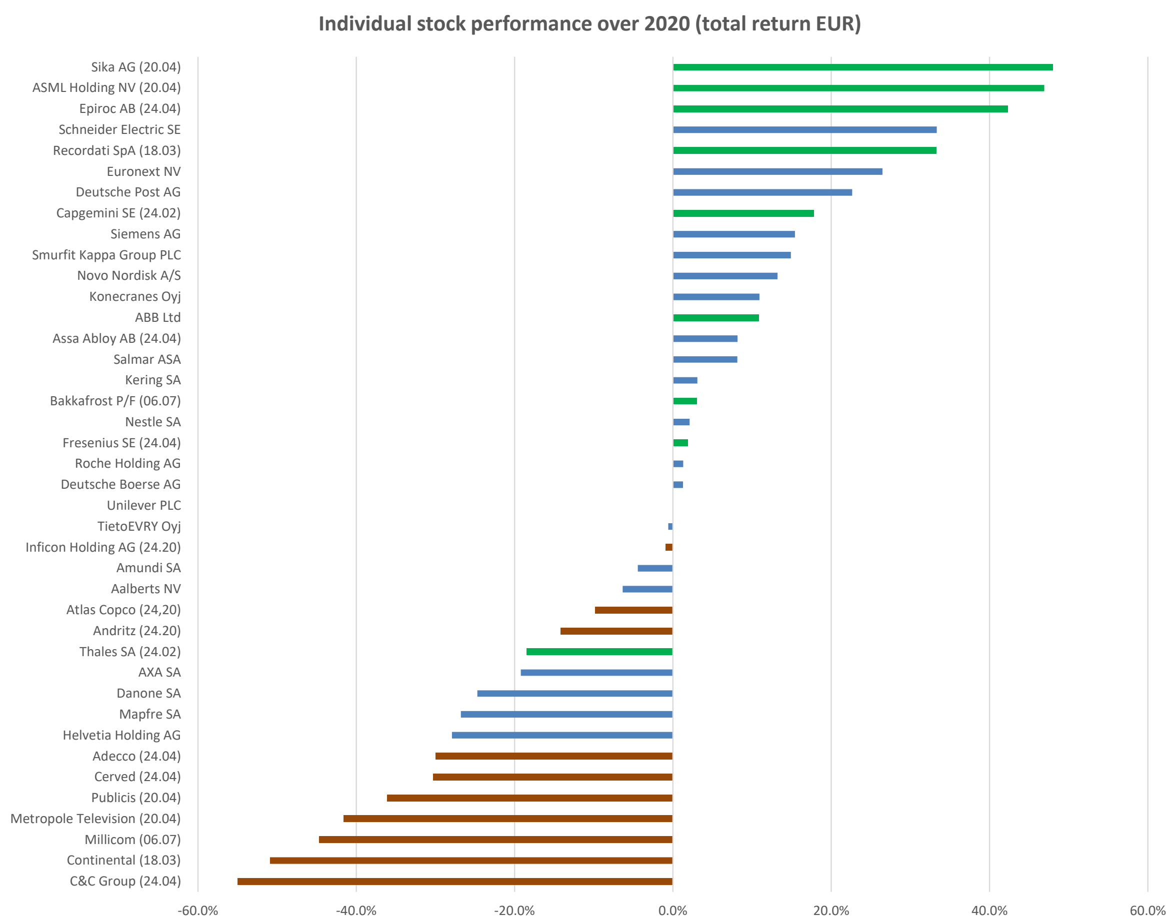

Figure 22: Individual holdings performance over 2020 in EUR. Orange = Sold (date sold by name). Green = New Holding (date purchased by name). Source: Bloomberg data.

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Changes to the Portfolio

In 2020 portfolio turnover totalled approximately 30% vs. an average of 13% since inception in December 2013. We made three switches in the first quarter, five in second and one in the third quarter of the year, leaving the portfolio with the same number of 30 broadly equally weighted positions at the end of the year.

In Q1, in February, just before the onset of the crisis we bought **Thales** and **Capgemini** replacing **Inficon** which had become expensive vs. peers and history and **Andritz** where cash returns had been deteriorating and we had become uncomfortable with the outlook for the capital-intensive metals forming division. In March **Recordati** replaced **Continental** where we had near-term concerns around dilution relating to potential impacts of the crisis on working capital and cashflow and the associated longer-term acceleration in decline in demand for the Group's internal combustion engine (ICE) related products.

Thales has a strong track record of generating persistent high-cash returns and has a good balance sheet characterised by just 40% net debt / equity. **Identifiable barriers to entry** stem predominantly from high switching costs, due to extensive integration in customer platforms. **Leading market positions** (global top 3 or 1 in Europe) are apparent in the Aerospace division (36% sales and 34% adj profit, and service just 30% of sales vs. Honeywell at 50%) notably in in-flight avionics, microwave systems (no.1 80% mkt share ahead of Varian Medical Systems) and in in-flight entertainment and connectivity (after Panasonic). Thales is the only global aerospace company with leadership positions in both onboard equipment and ground equipment (radar and air traffic management systems). In Defence & Security (51% sales, 60% adj profit of which 20% service) Thales is the European market leader in ground radar systems and airforce optronics, and the global no.1 in air traffic management with some 40% of world airspace controlled by its TopSky platform. Thales also makes sensors, mission systems and focuses on cybersecurity. Thales is the number-one supplier of defence electronics in Europe and should be a principal beneficiary of rising defence spending in Europe. The smaller Transport division, which is under review, represents 13% of sales, largely accounted for by signalling and digital traffic management systems equipment; key competitors include: Siemens, Alstom, CRSC. By geography Europe represents 55% of sales, Asia 14%, US 9%, ME 10%, Auz & NZ 5%.

Evidence of **a widening moat** is apparent in the high and rising 6% of sales spent on R&D in 2019, vs. 5% in 2018 and 4% three years ago and 3% ten years ago. Also notable has been the steadily rising gross margin, (and increasing cash returns to shareholders paused by the Covid-19 outbreak). The Acquisition of Gemalto in Dec 2017 effective April 2019 consolidates Thales lead in digital and builds its position in the digital security market. Gemalto is focused on software, biometrics, multi-factor authentication and issuance of secure physical and digital certificates. Leaving Thales as arguably the only player in the world able to offer "comprehensive solutions for securing critical decision-making chains all the way through from data generation by sensors to real-time decision making". We also note Thales was recently selected by the US army to equip regiments with inter team radio and satcom terminals, which speaks to the quality of the communications product.

The French state's 26% holding in company shares meant we only received a small interim dividend in 2020, but 2021 should see the Thales return towards its historical trajectory of consistently rising dividends. With regards to valuation Thales represents excellent value vs. peers and history and has a **long runway for growth** in the form of rising European defence (and corporate cyber security expenditure), which looks set to continue to move up to 2% of GDP in aggregate vs. 1.6% in 2019. Equally the potential for rising higher margin service revenue from 30% of sales towards some peers at 50% should see continued margin growth resume once the current environment stabilises.

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Capgemini has a track record of generating persistent high cash returns in the area of 12% - 14%. It has high and identifiable barriers to entry in the form of high switching costs. Once embedded in a client Capgemini is indispensable, and service revenues are ongoing. Capgemini is the no.1 IT service provider in Europe and in France, and an enabler of business agility and productivity. Global partners include: SAP, Salesforce, AWS, Microsoft, IBM, Adobe, Oracle and Google. Key clients range from private sector SMEs to government and infrastructure led clients including Heathrow Airport and the Environment Agency, highlighting that Capgemini has the potential to benefit from the upturn in infrastructure investment we expect as fiscal policy starts to make itself felt. We find strong evidence of a **widening moat** in the form of continued high net new client wins and market leading product offerings. Management and employee incentives look well aligned with shareholders, with holdings of company shares amounting to 6.1% of outstanding share capital. The company's sustainability policy focuses on addressing the digital divide (outside of its corporate work) underscoring that this is a company that shareholders can feel good about owning.

Capgemini looks great value versus peers trading at a near 40% discount to its closest peer Accenture's near 30x multiple, along with some 20% upside to Accenture's operating margin of 15%. Meanwhile in absolute terms Capgemini at purchase was trading on around a 10% free cash flow yield which we consider exceptional for a market leader. Key growth drivers include digital transformation and cloud services including edge computing and reshoring, cybersecurity, AI and digital printing. In terms of runway core application services are expected to approximately double by 2025 (according to McKinsey pre crisis) and IDC estimated the offshore IT Services market will grow 7% annually to reach $112bn by 2023. In our view such growth rates may be impacted in the short-term, but if anything, one would expect this crisis to drive higher levels of digital transformation over the medium-term as companies increasingly focus on resilience and efficiency. The inclusion of digital services in the EU China trade deal at year end, which looks set to end the requirement for tech transfer and JV requirements, also represents a boon for Capgemini.

Recordati SpA has a ten year plus track record of generating cash returns on capital invested of between 10% and 16%. Barriers to entry are clearly identifiable in the form of both patent IP and its strong marketing and distribution infrastructure. The company occupies a market leading position in rare diseases (~20% sales), alongside a strong specialty and primary care drug franchise characterised by high market shares in attractive areas focused on an ageing demographic including cardiovascular, gastrointestinal, urology, muscolo-skeletal and respiratory. A widening moat can be seen in high levels of R&D amounting to some 10% of sales annually for over ten years.

A strong culture of capital allocation can be seen in regular growing dividends alongside periodic buybacks, all funded out of organic cash from operations. Management and shareholder incentives look well aligned, with Fimei Spa owning 51.8% of shares, encompassing a private equity consortium led by CVC and the Recordati family. Optically multiples may look quite high on near 20x earnings but this is a business than makes excellent ~40% returns on tangible capital, and when paired with the long growth duration of the company's core "ageing" markets, does call for a sustained sector premium. In rare diseases the company has some 500 approved indications vs. over 7000 designated diseases highlighting good potential for continued double digit growth rates.

In Q2, five new holdings joined the fund as we moved to address places where the risk reward had deteriorated in response to the crisis, including some holdings where dividends had been cancelled. As we said at the time, the most important thing is that at any one time the portfolio holds our best European dividend paying ideas on a three-to-five-year view. The net result of this rare bout of activity was a slightly higher multiple portfolio at

just over 15x 2020 earnings (still a ~10% discount to market) and a lower headline yield of ~3.2%, alongside more conservative payout ratios and higher long-term topline and dividend growth.

The Sells

- **C&C Group** – When we bought C&C Group we could not have imagined that the entire on-trade could be shut down, let alone for the best part of a year. With 70% net debt / equity and a ~6% net margin we saw a chance of permanent capital loss (i.e. dilution) if a soft lockdown persists into 2021, as is currently the case.

- **Cerved**'s sale of its credit marketing (or debt collection) division fell through due to the crisis in Italy, thereby blocking the route to becoming a pureplay financial data business and meaningfully capping the upside potential.

- **Adecco**, a holding we had been reviewing anyway, having paid its 2019 dividend appears a candidate not to pay its 2020 dividend in 2021 amid a sizeable impact on the temporary staffing industry.

- **Metropole Television** and **Publicis** had always looked too cheap (alongside offering sizeable dividends) relative to modest ad industry digital attrition. What we had not envisaged was the possibility of an environment where ad capex could become entirely discretionary, and one where digital attrition only looks likely to accelerate further.

The Buys are all positioned to lead us out of this crisis into the mid-2020s and beyond, being high quality enablers of resilience and or job creation. Namely enablers of communications, automation and infrastructure, including health infrastructure.

ASML is unique and sets the bar for long-term thinking, having built up its market leading position in advanced lithography over the past twenty years; resulting in a rapidly growing installed base of cutting edge EUV equipment (extreme ultraviolet micro patterning equipment that is now the key enabler of increased semiconductor efficiency) at the world's major logic (foundry and integrated device manufacturers) and memory (NAND and DRAM) chipmakers. In turn, at the most tangible level, aiding the transition to amongst other things sustainable transport and energy, digital health, efficient agriculture and bridging the digital divide (5G, IoT and AI). To give an idea of runway, ASML estimate that by 2025 around 75% of enterprise generated data will be created and processed outside a traditional centralised datacentre or cloud vs. about 10% today. We cannot say that there isn't scope for short-term supply-chain bottlenecks given the recent gyrations in the global economy, but events strongly suggest that communications and digital capex growth will only accelerate in the next few years, likely aided by COVID-19 response and fiscal packages, many of which look likely to focus on 5G capex. Headline multiples do not look optically cheap on ~25x 2021 earnings nor the dividend high at a 1% yield, but this is a franchise with prospective top line and dividend growth of around 20% per annum, alongside a large net cash position and R&D/Sales of 17%. The coming years will also see resilient higher margin service revenue develop, which shorter-term market estimates often don't capture and tend to command stubbornly higher earnings multiples (as demonstrated by the elevator industry, where "mature" Schnindler Holdings trades on similar multiples). This is a company that looks set to both pay rapidly growing dividends and continue to have a large positive impact on the global communications landscape.

Sika is the global market leader and innovator in the fragmented and relatively low-tech construction chemicals industry. Sika holds around 9% market share in an industry where the top ten players hold about 40% market share. Key drivers range from tightening environmental regulations, driving sales of Sika's sealants and lightweight bonding and waterproofing products, to increasing demand for digital intelligence on construction sites, setting Sika apart

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with its industrial scale 3D concrete printing. The company has over 1100 employees in its R&D function across 21 global technology centers. A widening moat can be seen in both market share gains and the 25% of sales generated from products released in the past five years. That Sika is decentralised across its global customer base offers it an advantage, both in terms of understanding and working closely with customers, and the ability to transfer techniques across markets. Sika enables its clients to minimise resource consumption and carbon footprint, with average reductions in CO2 emissions per ton of ~12% through 2023. If as we strongly suspect and already see evidence of, the response to COVID-19 results in a green job enabling infrastructure and building boom for as long as low rates last, Sika is in pole position. Like ASML earnings multiples aren't optically cheap and a near 2% dividend yield may not look like bargain basement stuff, but that needs to be seen in the context of potential for a double digit sales and DPS CAGR. In a fragmented industry it generally pays to own the scale and innovation leader.

Fresenius SE had been excessively priced down by the market due to concerns around the Covid-19 outbreak but holds solid long-term potential, with market leading positions and high levels of recurring sales of consumable products off a large installed base; supported by an innovative culture where R&D represents nearly 7% of sales. The largest of the four units accounting for ~50% of sales and EBIT stems from its majority owned and listed holding in Fresenius Medical Care (FMC) which is the European and US market leader in dialysis care and services with a market share of 36%. In the US FMC is a supplier to the number two player DaVita Health, and the recent acquisition of NxStage looks set to drive growth in at home care. Fresenius's Kabi division, accounts for just over 25% of EBIT and specialises in intravenous drug delivery, clinical nutrition and infusion therapy and biosimilar drug development. The division is characterised by scale advantages that in turn lower costs for customers while generating attractive repeat sales of consumables relating to pumps. The Helios division is Germany and Spain's largest operator of hospitals accounting for just under 20% of EBIT and has arguably been the key source of recent share price discrepancy. We can't predict how long the disruption to hospital operations relating to COVID-19 will last, but Fresenius looks well positioned to take market share following treatment outperformance vs. municipal providers that have been weakened by the crisis. Similarly, the smallest division Vamed, which specialises in health infrastructure solutions looks well placed into the long-term as governments respond to the crisis.

Epiroc supplies productivity and efficiency solutions to capital intensive industries including mining and infrastructure, and claims some 45% market share of the hard rock drilling equipment market, which requires large quantities of consumables. Key drivers of sales include emissions regulations, declining ore grades and global infrastructure spend. Aftermarket recurring revenue is high with service revenue representing 39% of total sales in 2019 and consumables (tools and attachments) 27% of revenue; key drivers of persistently high ~30% return on capital employed. Counter cyclicality is quite high too as service benefits when customers defer on new capital expenditure. The remainder of revenues are accounted for by machine sales, where Eprioc is the market leader in clean electric mining and drilling equipment. From a COVID-19 point of view most mines (which are increasingly automated) have been deemed critical by governments, and therefore have bypassed much of the shutdown. There will of course be some shut-downs at the higher end of the cost curve; but other than in the very short-term clean infrastructure and climate, which require increased quantities of high value metals like copper and nickel (not to mention gold from a QE response point of view), look like very strong candidates to be part of long-term policy response and recovery packages. As such we feel that this is a company with both a rock-solid competitive position, and scope for a ~10% sales CAGR stretching out through the 2020s. Given the strong balance sheet and attractive cash conversion and free cash flows we also see potentials for special dividends over and above a ~2% yield growing around 14% per annum.

Assa Abloy like all these names uses technology well, being the global market leader in electronic locking systems. It is also highly resilient with two thirds of

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sales stemming from the aftermarket, namely upgrades, components, software and virtual or digital key card issuance all spanning a buildings lifetime. Barriers to entry are characterised by high switching costs enhanced by strong relationships with installers and security systems experts. A good analogy is the electrical industry where electricians are very loyal (through training) to a specific brand, and once you have one type of system installed it is extremely expensive to switch. Assa Abloy has a long runway for growth driven both by emerging markets and by market share gains. Mechanical locks still make up around 30% of Assa Abloy's sales, and with smaller traditional lock brands generally lagging in the technology required for electrotechnical locking systems, Assa Abloy is often able to purchase such operators at reasonable multiples of earnings and enjoy a long runway upgrading clients to digital, whilst also assimilating complimentary products or services. Irrespective of what happens over the next few quarters, Assa Abloy, with its strong balance sheet and high levels of cash conversion, looks well placed by way of longer-term response to this crisis. With some 70% of sales relating to corporate expenditure Assa Abloy is both one step removed from a downturn, but also exposed to sustainable buildings refurbishment and infrastructure investment. Something that looks likely to be high up on agendas as governments look to get economies moving again, create jobs and make sure that fiscal packages are put to good use.

In **Q3**, July, your fund acquired **Bakkafrost** while selling **Millicom**, after the latter cancelled its dividend for the foreseeable future having decided to increase capex to focus on growth and market share after reference shareholder Kinnevik sold out.

Bakkafrost dominates salmon farming in Faroe and is arguably the industry leader in terms of quality and sustainability, persistently earning a premium derived from superior genetics alongside best in class biologics. Market prices have been hit in the short-term by lower demand from the on-trade relating to COVID-19 and also as Chilean farmers raise cash by selling frozen ahead of the difficult transition away from chemical treatment to biological (which Norwegian operators have already made). That in turn looks likely to see a marked shortage of supply in 2021. Further, Bakkafrost recently acquired the number two farmer in Scotland, The Scottish Salmon Company (SSC), on approximately half its own EV/EBITA multiple. Here there appears to be good scope for Bakkafrost to add value following a degree of mismanagement by prior owners. Ebitda margins at SSC are currently in the ~5% range vs. Bakkafrost's historical range of 20% - 40%. Introducing smolts later should drive better biological efficiency alongside group cost overhead synergies. Meanwhile premium Hebridean genetics complement Faroese genetics, and a respected brand portfolio leaves Bakkafrost with a channel down which to increase sales of higher margin value added products (VAP) in the off-trade channel, where demand is now rising. The starting yield is just over 2.1% gross and we expect rapid growth to near 3% in 2022 against the current share price. Bakkafrost is a very well-run company, and shareholders are in good hands with Regnin and Oddovor Jacobsen, both of whom own over 7% of shares outstanding and are well known in the industry for taking the long view and industry best practice.

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Portfolio today and outlook

Key Fund Metrics Today

The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level to make sure we are providing what we say we will. At the quarter end, we are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI Europe ex UK Index.

		Guinness European Income Fund	MSCI Europe ex UK Index	Guinness Delta vs. MSCI Europe
Quality	Average 8 year CFROI %	13.2	8.4	4.8
	Debt / equity %	78.0	229.0	-151.0
	Net debt / Equity %	50.1	60.8	-10.7
	ROE %	20.3	7.9	12.4
Value	PE (2021e)	16.2	18.3	-2.1
	FCF Yield % 12m trailing	5.4	3.3	2.1
Dividend	Dividend Yield (2021e) % gross	3.2	2.8	0.4
	Weighted average payout ratio %	46.0	63.0	-17.0
Conviction	Number of stocks	30	344	-314.0
	Active share	85	NA	

Source: Bloomberg, Guinness data

Figure 23: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 31.12.2020)

Conclusion

Whatever the economic weather in 2021, we believe our focus on quality companies that generate persistent high cash returns supported by strong balance sheets will serve investors well for the long-term. Guinness European Equity Income Fund holdings are characterised by high levels of self-determination; namely identifiable barriers to entry, leading market positions, widening moats, aligned interests and long runways for growth. Based on the above measures, holistically, the high-conviction fund has companies which are significantly higher quality and better value verses the index.

From where we stand at the beginning of 2021 the investment backdrop is characterised by significant opportunities in our view, particularly for companies that enable resilience and job creation and that use technology well, like those in the Guinness European Equity Income Fund. We will continue to work hard to deliver long-term capital growth and a steady, growing income stream. The Fund is equipped for all weather, being well balanced across quality and value, as international companies supported by strong structural growth drivers alongside many more domestically focused companies, shielded from the risks of trade and currency wars, where returns and ratings have potential to benefit from a mixture of self-help, improving domestic demand.

We thank you for your continued support.

Nick Edwards
Portfolio manager, Guinness European Equity Income Fund
January 2021

All Index and performance data source: Bloomberg, except Fund performance data, which is sourced from Financial Express and Guinness Asset Management.

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PORTFOLIO

31/12/2020

Fund top 10 holdings

Holding	%
ASML Holding	3.6%
Smurfit Kappa Group	3.5%
AXA	3.4%
Bakkafrost	3.4%
ABB	3.4%
Sika	3.4%
Capgemini SE	3.4%
Nestle	3.4%
Recordati SpA	3.3%
Konecranes	3.3%
% of Fund in top 10	34.1%
Total number of stocks	30

Sector analysis

Sector	%
Industrials	28.8%
Financials	19.5%
Consumer Staples	16.1%
Health Care	12.8%
Information Technology	10.2%
Materials	6.9%
Consumer Discretionary	3.0%
Cash	2.5%

Geographic allocation

Country	%
France	22.2%
Switzerland	16.5%
Germany	12.6%
Netherlands	10.1%
Norway	6.7%
Finland	6.6%
Sweden	6.4%
Ireland	3.5%
Italy	3.3%
Spain	3.3%
Other	6.3%
Cash	2.5%

PERFORMANCE

31/12/2020

Annualised % total return from launch (19/12/2013 in GBP)

Fund (0.35% OCF)	7.9%
MSCI Europe ex UK Index	7.9%
IA Europe ex UK sector average	8.4%

Discrete years % total return (GBP)

	Dec'20	Dec'19	Dec'18	Dec'17	Dec'16
Fund (0.35% OCF)	0.7	24.2	-8.5	11.2	29.2
MSCI Europe ex UK Index	7.5	20.0	-9.9	15.9	18.6
IA Europe ex UK sector average	10.3	20.3	-12.2	17.3	16.4

Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (0.35% OCF)	2.3	0.7	0.7	14.5	64.4	70.2
MSCI Europe ex UK Index	2.1	7.5	7.5	16.2	59.7	70.5
IA Europe ex UK sector average	2.6	10.3	10.3	16.6	59.2	76.5

RISK ANALYSIS

31/12/2020

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	1.17	0.59
Beta	1.00	0.88	0.94
Information ratio	0.00	0.05	0.02
Maximum drawdown	-25.02	-24.43	-30.29
R squared	1.00	0.89	0.90
Sharpe ratio	0.26	0.29	0.26
Tracking error	0.00	5.49	5.24
Volatility	16.28	15.15	16.18

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.
Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. Source: Financial Express, bid to bid, total return (0.35% OCF). Fund launch date: 19.12.2013.

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 equities and equity markets invested in by the Guinness European 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 European 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. The Fund invests only in stocks of companies that are traded on European stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. 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: Link Fund Manager Solutions (Ireland) Ltd, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 18 Smith Square, London SW1P 3HZ.

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.

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Singapore

The Fund is not authorised or recognised by the Monetary Authority of Singapore ("MAS") and shares are not allowed to be offered to the retail public. The Fund is registered with the MAS as a Restricted Foreign Scheme. Shares of the Fund may only be offered to institutional and accredited investors (as defined in the Securities and Futures Act (Cap.289)) ('SFA') and this material is limited to the investors in those categories

Telephone calls will be recorded and monitored.