# Guinness Global Equity Income Fund

**A high conviction equity fund managed by Dr. Ian Mortimer and Matthew Page, CFA, in accordance with their intelligent investment process for high quality income portfolios.**

## INVESTMENT COMMENTARY - May 2012

**Fund size** (30.4.12) **£14.8m**

**Aim**

**We don't chase yield, we want capital and dividend growth**

Our aim is long-term capital growth and a steady rising dividend stream, balanced with a yield of 3-4%.

**Process**

**Quality before yield**

We buy companies that have generated at least 10% Cash Flow Return on Investment every year for 10 years.

***"It's a rare achievement for a company to meet our investment criteria – 10% cash flow return on investment every year for ten years is a mark of genuine quality. That's where our portfolio starts – persistent cash generation before yield."***

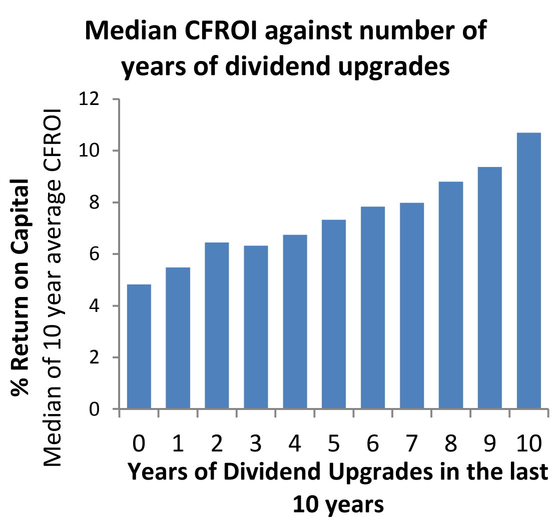
After the sharp rally in equity markets in the first quarter of 2012 we saw markets take a pause in April. The Fund delivered a total return of -1.74% (in GBP) outperforming the MSCI World Index fall of -2.58%. Our current bias towards large cap blue-chip companies contributed to this relative outperformance. We did not make any changes to the portfolio.

Our starting point when identifying companies for inclusion in the Fund is to identify strong robust companies that have a business that can weather changes in economic growth over an entire business cycle. These are what we consider to be "quality" companies. We look for companies that have proven track records of generating top quartile returns on capital every year for 10 years as we believe companies that have delivered this consistent evidence of value creation are well placed to pay a steady and rising dividend. (For a more in depth discussion of our investment process visit the Fund's page at **guinnessfunds.com**.)

Our objective definition of quality pays no respect to the size of the company, where it is listed or the geographical breakdown of its revenues. Most importantly it also ignores the dividend yield of the company. We want to start with a universe of high quality companies, and then later in our investment process consider all these factors and many more. This way we don't waste time looking at poor quality companies and avoid the temptation of attempting to persuade ourselves of the quality of a company, on some subjective measure, when we find one that offers a high dividend yield.

It is generally accepted wisdom that the payment of a dividend is a good indicator of a company's long-term level of sustainable profitability, so it follows that companies that are objectively and consistently profitable relative to their cost of capital are good candidates to be able to pay a steady and rising dividend.

The chart below supports this idea. It shows how the average return on capital of companies over the last ten years corresponds with how many times those companies have upgraded their dividends in the last ten years. The more consistent that companies have been at upgrading their dividends the higher the median return on capital. This is therefore a key criteria for us to be confident we can produce a portfolio of companies that are likely to be able to grow their dividends.



We used the HOLT database to export all companies that had a 10 year CFROI history (9,319 companies – April 2012). We exported this CFROI history and calculated the average CFROI over the last ten years, and a dataset that showed how many times the company had increased its annual dividend in the last 10 years (i.e. min of 0 and max of 10). We then divided these companies into buckets depending on how many times they had upgraded their annual dividend in the last ten years, and calculated the median value of those companies' 10-year-average CFROI.

While it does not follow that all companies that generate consistently high returns on capital will pay a dividend, it does increase the probability that they have the ability both to pay and, most importantly, grow their dividend going forward. Whether the management and board decide to pay a dividend will depend on their outlook for growth opportunities and capital budgeting discipline.

Last month two companies that meet our consistent high return on capital universe criteria and are included in our portfolio announced increases in their dividends. Aberdeen Asset Management and Proctor & Gamble are at the opposite ends of the market capitalisation ranges that we look at (Aberdeen Asset Management $5.3 billion, Proctor & Gamble $174 billion, as at 30/4/12) and have very different business models, yet both have a history of consistent high return on capital and both have grown their dividend significantly.

Aberdeen Asset Management has a long history of growth through acquisition; indeed the seeds of today's company was formed when current CEO Martin Gilbert and a group of investors bought an investment trust in 1983. The company later found itself embroiled in the split-capital trust scandal of the early 2000s but has since recovered well making a number of acquisitions which have contributed to strong growth in revenues, a marked improvement in margins, and a more diversified business. Since 2009 the company has paid down around £150 million of debt and increased its cash reserves by £125 million giving it a stronger balance sheet and less drag on its cash flow. Aberdeen's core expertise is in emerging markets equity and fixed income products and has had particularly strong success with its Global Emerging Markets equity strategy, which is likely to contribute to continued growth in margins in the future. The company has significant scope for further growth by taking the success of its emerging market products to investors in the US where it currently has relatively little penetration. The company has grown its dividend every year since 2004 and in April announced that it would increase this year's dividend by 16%.

Proctor and Gamble announced a 7% increase in its dividend, which makes it the 56th consecutive year it has upgraded its dividend. The company has had a number of issues in recent years, including having been a little slow in their drive to take market share in emerging markets and earnings results missing or coming in at the lower end of their guidance. However, the company has consistently grown its dividend over this time as management focus is on delivering long-term cost savings rather than short-term fixes to improve quarterly earnings numbers. On this basis management and the board feel confident to increase their dividend. We wrote in our *Why Dividends Matter* white paper (available at **guinnessfunds.com**) that the average holding period for NYSE-listed companies between 1950 and 1970 was approximately six years, while today it is only one year, highlighting that these shorter holdings periods are a reflection of many market participants' obsession with short-term results. This provides us with opportunities to invest in objectively high quality companies at attractive valuations, and we certainly consider Proctor and Gamble to be one of these.

**Dr. Ian Mortimer & Matthew Page**

**Co-managers**

**Guinness Global Equity Income Fund**

**May 2012**

## PORTFOLIO (30.4.12)

### Fund top 10 holdings

| | |
|---|---|
| Aberdeen Asset Management | 3.3% |
| Meggitt | 3.2% |
| Coca-Cola | 3.2% |
| Abbott Laboratories | 3.2% |
| Halma | 3.2% |
| Pfizer | 3.1% |
| Danone | 3.1% |
| Willis Group Holdings | 3.1% |
| China Mobile | 3.1% |
| Unilever | 3.0% |
| % of fund in top 10 | 31.5% |
| Total number of stocks in fund | 34 |

### Geographic allocation

| | |
|---|---|
| United States | 47.6% |
| Great Britain | 30.5% |
| France | 8.6% |
| Hong Kong | 3.1% |
| Netherlands | 2.9% |
| Australia | 2.8% |
| Germany | 2.7% |
| Spain | 2.5% |
| Cash | -0.6% |
| | 100.0% |

### Sector analysis

| | |
|---|---|
| Consumer Staples | 32.6% |
| Health Care | 15.1% |
| Financials | 14.8% |
| Industrials | 12.0% |
| Telecommunication Services | 8.5% |
| Information Technology | 6.2% |
| Consumer Discretionary | 6.0% |
| Energy | 5.4% |
| Cash | -0.6% |
| | 100.0% |

## PERFORMANCE

### Discrete years' % total return

| 12 months to month end: | Apr '08 | Apr '09 | Apr '10 | Apr '11 | Apr '12 |
|---|---|---|---|---|---|
| **Guinness Global Equity Income Fund** | - | - | - | - | 0.4 |
| **MSCI World Index** | -1.5 | -18.9 | 32.6 | 8.5 | -2.0 |
| **IMA Global Equity Income sector average** | -4.9 | -17.6 | 28.4 | 11.4 | -0.9 |

### Cumulative % total return

| 30/04/2012 | 1 month | 3 months | 6 months | 1 year | From launch |
|---|---|---|---|---|---|
| **Guinness Global Equity Income Fund** | -1.7 | 1.0 | 3.2 | 0.4 | 3.7 |
| **MSCI World Index** | -2.7 | 2.1 | 6.9 | -2.0 | 0.5 |
| **IMA Global Equity Income sector average** | -1.4 | 1.9 | 3.8 | -0.9 | 1.6 |

### Risk analysis - Annualised, month end, from launch on 31.12.10

| 30/04/2012 | Index | Sector | Fund |
|---|---|---|---|
| **Alpha** | 0 | 0.99 | 2.45 |
| **Beta** | 1 | 0.86 | 0.73 |
| **Information ratio** | 0 | 0.16 | 0.51 |
| **Maximum drawdown** | -14.06 | -10.95 | -10.76 |
| **R squared** | 1 | 0.76 | 0.83 |
| **Tracking error** | 0 | 5.65 | 4.75 |
| **Volatility** | 11.25 | 11.06 | 9.05 |

**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, C class shares, GBP. Launch date: 31.12.10.

## IMPORTANT INFORMATION

This report is primarily designed to inform you about the Guinness Global Equity Income Fund, including recent activity and performance. For regulatory purposes it falls within the legal definition of a financial promotion. Please therefore note the risk warnings below and the following statements: it contains facts relating to equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report. It is 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 content of the document should not therefore be relied upon. It should not be taken as a recommendation to buy or sell individual securities.

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 the Fund's portfolio changes daily and can be affected by changes in currencies, interest rates, general market conditions and other political, social and economic developments, as well as specific matters relating to the companies in whose securities the Fund invests. Investment in the Fund carries with it a degree of risk and investors should read the risk factors section in the prospectus before investing.

The full Fund documentation contains more complete and detailed information of risk, fees, charges and expenses that are to be borne by an investor. The documentation should be read carefully before investing. The full documentation needed to make an investment, including the Prospectus, the Simplified Prospectus and the Application Form are available, free of charge, from the Manager: Capita Financial Managers (Ireland) Limited, Montague House, Adelaide Road, Dublin 2 Ireland or the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA. **Documentation is also available from the website guinnessfunds.com.** This document should not be distributed to Retail Clients who are resident in countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful. THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.

The Guinness Global Equity Income 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. The Fund has been approved by the Financial Services Authority for sale in the UK. The Company and the Fund have been recognised in the UK by the FSA pursuant to section 264 of the FSMA. Guinness Asset Management Ltd is authorised and regulated by the Financial Services Authority. The prospectus for Switzerland, the simplified prospectus for Switzerland, the articles of association, the annual and semi-annual reports, as well as the list of the buying and selling transactions 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, Fax: + 41 22 705 11 79, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland. Telephone calls to Guinness Asset Management may be recorded.

## GLOSSARY

### Alpha

Alpha is a measure of a fund's over or underperformance by comparison to its benchmark. It represents the return of the fund when the benchmark is assumed to have a return of zero, and thus indicates the extra value that the manager's activities have contributed.

### Beta

Beta is a statistical estimate of a fund's volatility by comparison to that of its benchmark, i.e. how sensitive the fund is to movements in the section of the market that comprises the benchmark. A fund with a Beta close to 1 will move generally in line with the benchmark. Higher than 1 and the fund is more volatile than the benchmark.

### Information Ratio

An assessment of the degree to which a manager uses skill and knowledge to enhance returns, this is a versatile and useful risk-adjusted measure of actively-managed fund performance. It is calculated by deducting the returns of the fund's benchmark from the fund's overall returns, then dividing the result by its Tracking Error. In this way, we arrive at the value, per unit of extra risk assumed, that the manager's decisions have added to what the market would have delivered anyway.

### Maximum Drawdown

Represents the worst possible return over a period, e.g. buying at the highest price over the period and selling at the lowest.

### R-Squared

The R-Squared measure is an indication of how closely correlated a fund is to an index or a benchmark. It can be treated as a percentage, showing what proportion of a fund's movements can be attributed to those of the benchmark. Values for R-Squared range between 0 and 1, with 0 indicating no correlation at all, and 1, rarely, showing a perfect match.

### Tracking Error

This statistic measures the standard deviation of a fund's excess returns over the returns of an index or benchmark portfolio. As such, it can be an indication of "riskiness" in the manager's investment style. A Tracking Error below 2 suggests a passive approach, with a close fit between the fund and its benchmark. At 3 and above the correlation is progressively looser: the manager will be deploying a more active investment style, and taking bigger positions away from the benchmark's composition.

### Volatility

Standard deviation is a statistical measurement which, when applied to an investment fund, expresses its volatility, or risk. It shows how widely a range of returns varied from the fund's average return over a particular period. Low volatility reduces the risk of buying into an investment in the upper range of its deviation cycle, then seeing its value head towards the lower extreme.

GUINNESS FUNDS
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