Guinness Global Equity Income Fund

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

INVESTMENT COMMENTARY - December 2012

Fund size (30.11.12) **£15.2m**

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."

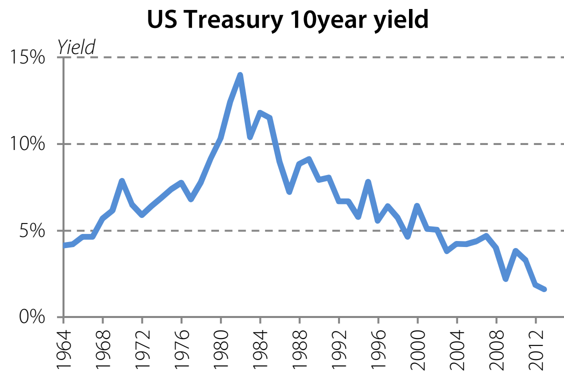
Some thoughts on equities and bonds

Equity markets in 2012 have been a volatile affair; rising sharply in the first quarter, giving up most of those gains in the second, and moving higher in the third quarter. Investors have had many challenges to contend with, not least the continued European crisis, rising tensions in the Middle East, natural disasters, the change in the Chinese leadership, and the US presidential election. The fact that most of these were either impossible to predict (natural disasters) or were highly dependent on the actions of relatively few individuals who in turn had complex relationships and agendas to satisfy (politicians in Europe in particular) made the task of quantifying investment risks particularly troublesome.

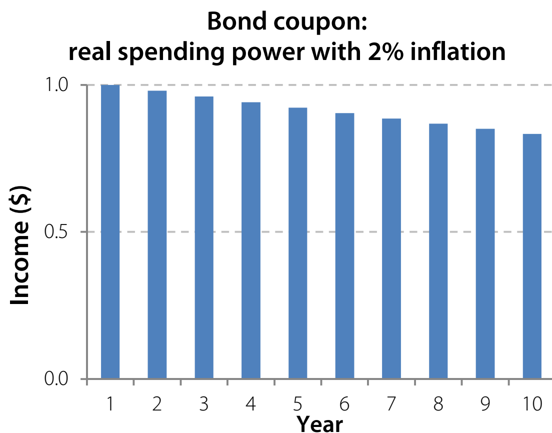
Perhaps it's no wonder, then, that investors have been looking for perceived safety. Specifically, it appears that many investors shunned equities and instead moved their investments into fixed income. Just looking at the Investment Management Association retail sales of unit trusts and OEICs over the twelve months from September 2011 to September 2012 shows that equity funds had net inflows of just £59 million, versus net inflows of £6,223 million for fixed income funds.

So, in the last twelve months retail investors appear to have decided to avoid the pain of short-term volatility in equities and instead invest in the 'guarantee' of a return of their invested capital in the future and an agreed coupon payment in the interim. But what risks are investors actually taking? We are all too aware that there is no such thing as a 'free lunch'. In its most simple form equity investment risk is often thought of as volatility, whereas fixed income investment must take account of credit, duration, and potentially leverage depending on portfolio construction. We believe the most important measure of risk, however, is the risk of a permanent loss of capital in real terms.

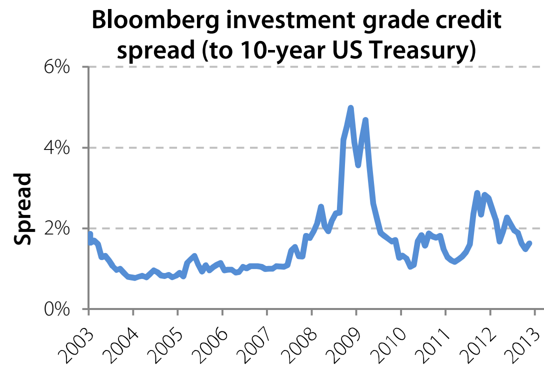
In the current environment of low interest rates and high demand for safe investments, bond yields have dropped to historically low levels. For example, the 10 year US treasury yield is now trading at 1.6%, down from 1.9% in 2011, and 3.3% in 2010. Such meagre income is unlikely to provide a sufficient return for most investors. Many are reaching for yield via lower credit-rated corporate bonds, or bonds with longer duration; both of these increase the inherent risk of investment. Currently short-dated corporate bonds might only have a yield of 1 to 1.5%, but longer-dated, 20-year high grade corporates might yield anything up to 4%. The risk of an interest rate rise to the market value of the long-dated bond, however, could be severe; a 2% interest rate rise on a hypothetical 20-year bond yielding 4% would be greater than 20%. The investor would not necessarily have to crystalise this loss if they could hold the bond to maturity, but such large moves in market value may surprise those who believed they were purchasing an asset with lower 'risk' than an equity investment.



Investors aiming to hold long-dated bonds to maturity will also suffer a loss of purchasing power due to the compounding impact of inflation over time on both the principal and income stream (as the coupon payments and principal value remain fixed in nominal terms). In an inflationary environment of just 2%, a hypothetical 10-year bond paying an annual coupon of $1 will see the value of that coupon, and the principal, decline by 17% in real terms over the life of the bond.

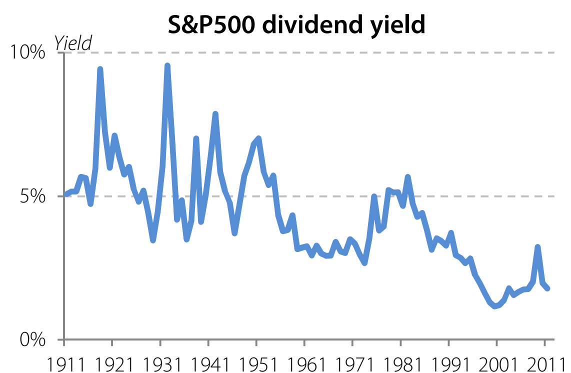


The beneficiaries of unusually low rates and investor demand for safe sources of income have been the corporations themselves. Unsurprisingly they have been happy to issue longer-dated debt and in turn lock-in low borrowing costs; for example, Microsoft recently sold $750 million of 10-year bonds with a coupon of 2.125%, and $900 million of 30-year bonds at 3.5%. Considering 10-year US government treasuries are currently trading with a yield of 1.6%, this implies a credit spread of just 0.525% for Microsoft's 10-years bonds. If we look at all investment grade corporate bonds in aggregate (using the Bloomberg Active Investment Grade Bond Index as a proxy) we see that credit spreads have been contracting since the start of 2012 and are now at approximately 1.5%, only 0.5% higher than the 1% average over the more economically stable 2003 to 2007 period. This either implies the market believes economic conditions have improved significantly since the start of the year, or inflated demand for higher-yielding investment grade credit has pushed prices above their intrinsic value. Only time will tell but we fear the driving factor is more likely the latter, which may leave investors who arrived 'late to the game' particularly exposed.



So where can investors find yield? We believe in the current environment that equities offer a good balance of risk and reward for investors looking for income. In the short term we are likely to continue to experience volatile markets, but for the long-term investor this should in fact provide opportunities.

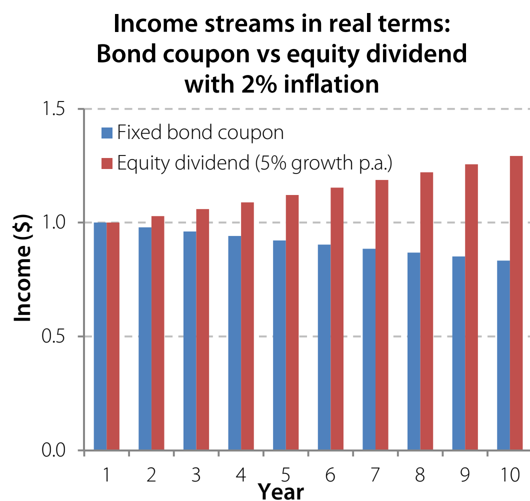
Equities have not been immune to the gradual decrease in yields over the last few years, as companies have been bolstering their balance sheets and conserving cash, and share prices have been rising. The S&P500 yield, for example, currently stands at a paltry 1.8%, versus an average of 3.1% over the last 50 years.



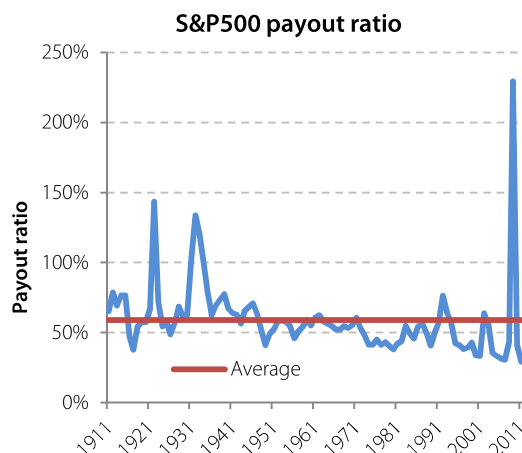
So why would you take on the volatility of the S&P500, which has been as high as 1465 and as low as 1022 in the past 3 years, for an extra 0.2% yield versus the US treasury 10-year bond? The main reason is the ability of companies to grow their earnings over time, and in turn grow their dividend payments; this means the purchasing power of the income generated is not diminished over time as it would be for a static coupon received on a bond.

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

Indeed, over the past 50 years the compound annual growth rate of dividends from the S&P500 has been just shy of 5%. If we compare the hypothetical 10-year bond with an annual $1 coupon to that of an equity with a $1 annual dividend that is growing at 5% per year, we see that in a 2% inflationary environment the dividend of the equity will have grown 29% in real terms - versus the 17% decline seen in the bonds coupon payment. A well-run company should also be able to grow its equity value over time which should result in capital appreciation of the investor's principal investment, again offsetting the effects on inflation over the longer term.



We also believe there are many companies who have the ability to increase their income payments quite significantly in the near future. Many corporations have been holding back cash and keeping it on their (ever expanding) balance sheets. For example, the payout ratio of the S&P500 is currently running around 30%, which is well below the average payout ratio of 50% over the last 50 years, and leaves a lot of head room for companies to boost their dividend payments.



The discussion above only considers the S&P500 index as a whole, of which 20% of companies pay no dividend whatsoever and thus drag down the overall yield quite dramatically. The S&P500 also only consists of US-listed companies. If we instead focus only on those companies that pay a dividend, and look at all stocks listed globally, then it is possible to find many more companies that pay a reasonable yield, but more importantly a yield that is significantly higher than that of government treasuries or short-dated corporate bonds. Our aim is to refine this search further; looking for companies which can generate significant cash flows, which can invest those cash flows in high return projects, that don't have stretched balance sheets, that have long histories of paying a dividend and that we believe have a very high probability of growing those dividends in the future.

In conclusion, therefore, we believe the risks to investors chasing yields in the bond sector maybe misunderstood, or at least underestimated, and that well capitalised, cash generative companies with established and growing dividends may very well provide a better proposition for those people searching for income who are able to invest for the long term.

Guinness Global Equity Income Fund

Equity markets in November were a tale of two halves; declining sharply in the first half of the month, before rallying in the second half to just above where they began. In November the Fund delivered a total return of 1.15% (in GBP), versus the MSCI World Index total return of 1.81% (in GBP). The Fund therefore underperformed the index by 0.66% over the month; our relative underweight allocation to information technology companies versus the index and our continued bias towards quality companies held the Fund back slightly as markets rallied sharply into the end of the month.

Dr. Ian Mortimer & Matthew Page

Co-managers,
Guinness Global Equity Income Fund

December 2012

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

PORTFOLIO (30.11.12)

Fund top 10 holdings (%)

Holding	%
Aberdeen Asset Management	3.8%
VF Corp	3.8%
Wal-Mart Stores	3.6%
Reynolds American	3.5%
H & R Block	3.5%
Meggitt	2.8%
Willis Group Holdings	2.8%
ENI	2.7%
Reckitt Benckiser	2.7%
Mattel	2.7%
% of Fund in top 10	31.9%
Total number of stocks in Fund	36

Geographic allocation (%)

Country	%
United States	51.4%
Great Britain	28.0%
France	5.3%
Italy	2.7%
Netherlands	2.7%
Hong Kong	2.7%
Australia	2.6%
Germany	2.6%
Cash	2.0%
	100.0%

Sector analysis (%)

Sector	%
Consumer Staples	28.3%
Financials	17.2%
Health Care	13.1%
Industrials	10.7%
Consumer Discretionary	10.0%
Energy	8.1%
Telecoms	5.4%
Information Technology	5.2%
Cash	2.0%
	100.0%

PERFORMANCE

12 months to month end:	Nov '08	Nov '09	Nov '10	Nov '11	Nov '12
Guinness Global Equity Income Fund	-	-	-	-	8.0
MSCI World Index	-24.0	23.2	11.7	0.5	11.5
IMA Global Equity Income sector average	-24.4	23.5	12.2	0.2	13.5

Cumulative % total return

30/11/2012	1 month	3 months	6 months	1 year	From launch
Guinness Global Equity Income Fund	1.2	1.0	6.7	8.0	8.5
MSCI World Index	1.8	2.4	8.3	11.5	4.9
IMA Global Equity Income sector average	0.9	2.0	9.3	13.5	7.0

Annualised % total return from launch 30/11/2012

	30/11/2012
Guinness Global Equity Income Fund	4.32%
MSCI World Index	2.53%
IMA Global Equity Income sector average	3.60%

Risk analysis - Annualised, weekly, from launch on 31.12.10

30/11/2012	Index	Sector	Fund
Alpha	0	1.74	2.16
Beta	1	0.76	0.76
Information ratio	0	0.18	0.32
Maximum drawdown	-18.26	-15.50	-16.40
R squared	1	0.80	0.90
Tracking error	0	7.16	5.58
Volatility	15.99	13.62	12.75

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

Source: Financial Express, bid to bid, total return, 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 KIID 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.

Telephone calls to Guinness Asset Management may be recorded.

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.

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.