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 - May 2013

Fund size (30.04.13) **£18.4m**

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."

Performance

In April the Fund generated a total return of 1.15% (in GBP), compared to its MSCI World Index benchmark return of 0.63%. The Fund has returned +17.66% year-to-date, versus +16.06% by the Index.

One man's "quality"…

"The risk of paying too high a price for good quality stocks – while a real one – is not the chief hazard... Observation over many years has taught us that the chief losses to investors come from the purchase of low quality securities at times of favourable business conditions."

Benjamin Graham

Over the first four months of the year the market has rewarded the type of companies that we look for – high quality companies. "Quality", used as a description of a company, appears to have quite a broad variety of meanings, depending on who you speak to. Sometimes quality is simply used to describe large, established companies with strong brands. Some even argue that any company that pays a dividend is a quality company. Others maintain it is any company in traditionally defensive sectors, such as consumer staples and pharmaceuticals, which have low growth prospects and whose share prices have low volatility. Perhaps if you combine all those elements together you get the consensus idea of a quality company: a well-known, large, old, low-growth, consumer staple company that pays a dividend, such as Coca Cola or Wal-Mart.

Using our own objective measure of quality (see below, and our Investment Process white paper), many of the companies that fit the above description might well be "quality" companies. But what is it about these types of companies that make them high quality? We believe a company's "quality" status is not dependent on its market cap, where it is listed, what sector it is in, and whether it pays a dividend. We believe quality companies are those that can consistently create value at all points through a business cycle.

Quality equals consistent value creation

Our initial quality screen selects companies that have achieved a cash flow return on investment (CFROI) over 10% each year for the last ten years. 10% is almost twice the average real cost of capital, and ten years is longer than the average business cycle. Using this screen we identify a broad universe of companies that is well diversified across sectors, size, geography, growth prospects etc. What we are looking for, first and foremost, is best-of-breed companies, irrespective of all other characteristics.

We then narrow this list down to a portfolio of 35 stocks that we find attractive on valuation, have a reasonable dividend yield and the ability to grow the dividend over time. Our focus on quality therefore leads us to a portfolio that is unlikely to be a "high yield" portfolio relative to other portfolios one could construct, but is more focused on providing a reasonable level of dividend income today with potential for growth in that dividend and capital appreciation over time.

An example of Guinness quality

A company that fits our quality definition (but maybe not others') is Aberdeen Asset Management. It's not a large cap (it's market cap at the beginning of the year was $6.6 billion), it doesn't have particularly high brand recognition outside of professionals in the finance industry, it's in the financial sector not the consumer staples sector, it is listed in London but it's true economic exposure is global with an emphasis on emerging markets, it's not a particularly old company (established 1983) and revenue and profits have been growing quite quickly recently. If you asked 100 people on the street to name a quality company it is unlikely they would name Aberdeen Asset Management.

Aberdeen has consistently generated high returns on capital for each of the last ten years; it is, by our definition, a quality company. Before we even consider the idiosyncrasies of any individual company our analysis suggests that companies like this – that achieve our quality definition – are statistically highly likely to continue to achieve these high returns on capital in the near future.

The company recently reported a good set of results, with revenues up 25%, and pre-tax profits up 52% (relative to the same period last year). The company also announced a 36% increase in the interim dividend.

It is worth noting that our process also identifies quality examples of large cap, blue chip companies, and we have owned quite a number of them in the portfolio. However, largely on valuation grounds, we have been gradually reducing our large cap exposure; we sold Pepsico and Wal-Mart within the last six months.

Dodge the value traps: quality over yield

Arguably, we could start with companies offering a reasonable yield, and then try and identify which are good quality, and end up with a similar list of companies. However, this approach would put us at risk of being blinded by an attractive yield and trying to convince ourselves the company was of sufficient quality. It's very easy to fall into this trap, especially if you set an absolute yield target for your portfolio. We prefer to be sure of the quality first and then look under the bonnet to understand if the current valuation can provide reasonable upside.

Our "quality" is particularly important when investing in dividend-paying companies: sustainable value creation enables a company to pay a dividend that can be grown and sustained into the future. With interest rates at all-time lows, quantitative easing providing liquidity, confidence improving, and commodity prices falling, the existing environment could be described as "favourable business conditions". In these conditions weak companies can superficially seem like quality companies as their share prices rally with the rising tide.

In a period of strong demand for income, companies that are trading on higher dividend yields are likely to be attractive to investors. However, the problem with targeting a specific absolute yield is that, as markets rally, you are forced into potentially more and more companies that are likely to be distressed. As valuations of equity markets rise and the force of mean reversion gets stronger, distressed companies are likely to be a painful place to be in any subsequent fall in equity markets.

A company with a high dividend yield normally signals one of two things. It could be that it's distressed, suffering from competitive pressure, a weak balance sheet, poor customer demand etc. Or it's simply out of favour, at a low point in its sentiment cycle as the market focuses on near-term transient issues. Distinguishing between the two is clearly critical.

Companies on attractive valuations that pass our initial quality screening process are more likely to be out of favour than distressed. If we identify an attractive new investment on a high yield, and after thorough due diligence we are comfortable that it's more likely out of favour than distressed, it would be tempting to add the stock to our portfolio with a high weighting, perhaps 5%, 7% or even 10%, in order to boost the yield. However, we realise that not all our decisions will work. The crux of successful investing is in identifying probabilities that skew in your favour, not deterministic outcomes. Even then there are unpredictable events, such as BP's Horizon oil spill. In these scenarios the only way to limit the threat to the portfolio is to restrict the size of the position which we can own in any one company. We want to limit the potential downside of being wrong or unlucky, and we therefore equally weight all our positions at 3%.

It is often tempting, when analysing many stocks for potential investment, to feel that your latest idea is your highest conviction, as the facts and thesis behind the investment are most clear in your mind. It is therefore tempting to give the position a higher weighting in the portfolio and let other positions drift. In our equally weighted portfolio we have no discretion on the size of the position – we either own it or we don't. Ultimately it will be up to the whim of the market to decide when a company's share price might match our own valuation estimate, and this could take some time. Your latest idea won't necessarily be the first to come good.

Latest quality find

Our most recent purchase was Northrop Gruman. We think the company is out of favour rather than distressed due to concerns last December over the fiscal cliff. Its valuation is incredibly attractive, ticking our three boxes of being cheap in absolute terms, cheap relative to its valuation history, and cheap relative to its peers. Its percentage pre-tax profit-to-enterprise value (a metric we particularly like) is in the high teens, and it has recently announced it is going to repurchase 25% of its own stock.

It certainly feels like our highest conviction position right now, but we have applied the same scalable analysis to all our holdings before purchase: like all of those that came before, we only allocated 3% of the portfolio to this company.

We believe our definition of quality identifies a basket of proven, cash-generative businesses, and that buying these companies at the right value should deliver reasonable, long-term returns in a range of market conditions.

Dr. Ian Mortimer & Matthew Page

Co-managers,
Guinness Global Equity Income Fund

May 2013

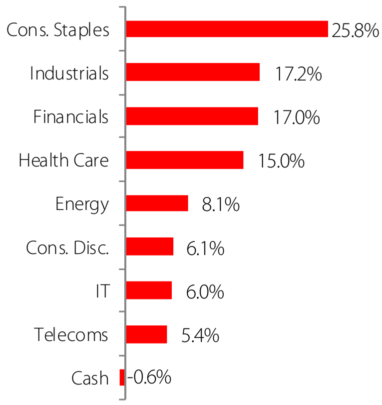
PORTFOLIO (30.04.13)

Fund top 10 holdings

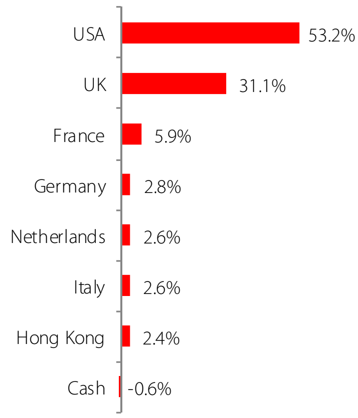
Abbvie	3.4%
Aberdeen Asset Management	3.3%
Mondelez International	3.2%
Microsoft	3.2%
Johnson & Johnson	3.1%
Mattel	3.1%
Danone	3.1%
Northrop Grumman	3.1%
Vodafone	3.0%
Meggitt	3.0%

% of Fund in top 10	31.4%
Total number of stocks in Fund	35
AUM	$30m

Sector analysis



Geographic allocation



PERFORMANCE

12 months to month end:	Apr '09	Apr '10	Apr '11	Apr '12	Apr '13
Guinness Global Equity Income Fund	-	-	-	0.4	21.2
MSCI World Index	-18.9	32.6	8.5	-2.0	21.8
IMA Global Equity Income sector average	-17.6	28.4	11.4	-0.9	21.6

Cumulative % total return

30/04/2013	1 month	3 months	6 months	1 year	From launch
Guinness Global Equity Income Fund	1.2	9.8	17.2	21.2	25.7
MSCI World Index	0.6	7.7	18.7	21.8	22.3
IMA Global Equity Income sector average	1.4	6.9	16.6	21.6	23.6

Annualised % total return from launch

	30/04/2013
Guinness Global Equity Income Fund	**10.29%**
MSCI World Index	**9.02%**
IMA Global Equity Income sector average	**9.52%**

Risk analysis - Annualised, weekly, from launch on 31.12.10

30/04/2013	Index	Sector	Fund
Alpha	0	2.71	3.14
Beta	1	0.75	0.76
Information ratio	0	0.11	0.25
Maximum drawdown	-18.26	-15.50	-16.40
R squared	1	0.81	0.90
Tracking error	0	6.80	5.33
Volatility	15.34	12.87	12.36

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. 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.

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, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland or the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA. **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 Conduct 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 Conduct 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.

GUINNESS
FUNDS
Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

Tel: +44 (0) 20 7222 5703
Email: info@guinnessfunds.com
Web: guinnessfunds.com