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 - November 2013

Fund size (31.10.13)	**£43.8m**

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.

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

The Fund generated a total return of 3.56% (in GBP) in October, compared to its benchmark MSCI World Index total return of 4.74%, thereby underperforming by 1.18%. The Fund has returned +24.54% year-to-date versus the Index return of +23.32%.

Update

In our last few monthly reviews we have been noting our caution on some of the holdings in the portfolio that had performed particularly well relative to the market, and especially those where we have seen share price rises dominated by multiple expansion rather than earnings growth. We have also noted for some time the benchmark-overweight exposure of the Fund towards Consumer Staples, which we have slowly been reducing from a weighting of just over 30% in late 2012 to just under 25% as of last month.

In October we made a number of changes to the portfolio to take profits on companies that had done well, and initiate new positions in companies with cheaper valuations, offering better margins of safety, and more attractive dividend yields. Up to this point we had only made three changes to companies held in the portfolio since the start of 2013 (sales of Metcash, Walmart, and VF Corp, and purchases of Northrop Grumman and BAE Systems in the first quarter) so our preference for low portfolio turnover remains. We expect turnover to be around 25% for the full year.

We sold five companies in October and replaced them with five new purchases. Our approach has always been to have a portfolio of thirty-five companies, all equally weighted. This means any decisions we make are as much relative as absolute. That is, we may well sell a company we own if something specific (positive or negative) occurs but if we identify a company that we like that we want to include in the portfolio, then we must look through our current holdings for a candidate for sale. We don't just keep adding companies in ever smaller position sizes. Our bottom-up approach therefore often leads us to areas of the market that have been out of favour and are trading on lower multiples, and moves us away from areas of the market that have been performing well and are trading at higher multiples. Getting this timing right is the art, and an art we don't profess to have mastered, but we think a company's valuation history can often be a good indicator as to when the market has reached an overly extreme view of its prospects, which may represent an opportunity. At what point the valuation will revert back to the mean is uncertain, but by taking a longer-term view and

having holding periods of two to three years we hope to have given ourselves a reasonable timeframe.

Sales

The sales this month can be split broadly into three categories:

1. taking profits on companies which are trading on multiples that are at historic highs;
2. taking profits on companies which are close to or at fair value and are in sectors and regions that have also done well relatively; and,
3. selling companies where our investment thesis has changed and we no longer expect the re-rating or earnings growth we had expected.

In the first category were sales of Halma and Pfizer. Halma, the UK-listed industrial safety equipment company, is a position we have held since we launched the Fund back in December 2010. It has been one of the best performing stocks we have had in the portfolio, with a total return of almost 70% since purchase. It has also provided the Fund with a steadily rising dividend stream with dividend growth of around 7% per annum. The company has barely put a foot wrong, with good top and bottom-line growth and consistently high returns on capital. The market has recognised this, though, and the company now trades on a PE multiple of 22 times, which is very close to the maximum multiple it has achieved over the last ten years. Having reached such a rich valuation we found it difficult to justify to continue holding it in the portfolio compared to other, cheaper opportunities, and therefore sold the position.

We bought Pfizer, the US-listed global pharmaceuticals company, in the summer of 2011 when we made changes to the Fund to reflect our worries regarding the outlook for Europe at that time. Pfizer, and the global pharmaceutical companies in general, were very unloved at the time – the market sold them down because of the expected impact of patent cliffs. When we purchased the stock it was trading on a PE multiple of 7.9 times and had a share price of $18. When we sold it the stock was trading on a multiple of 13.5 times with a share price of $29. Earnings growth for the company was limited during the period we held it, meaning the majority of the share price performance was due to the multiple expansion. When we think about the return we might achieve from a company, we note it can be split into three main components, (a) dividends, (b) earnings growth and (c) multiple expansion. In the case of Pfizer we think we have captured the majority of the multiple expansion; combined with the relatively low dividend yield and our cautious outlook for earnings growth, this meant we sold the position.

In the second category of sales – taking profits on companies close to or at fair value in sectors that have also done well relatively – we sold our holdings in Kraft Foods Group and Mondelez International, the two companies that emerged from the re-organisation of the original Kraft Foods in October 2012. Kraft Foods Group took the North American grocery business and Mondelez the global snack business, in effect clearly delineating the slower growth, more stable grocery side and the faster growth emerging market-focused snack side. Both companies, however, are US-listed and sit in the Consumer Staples sector. The performance of both companies has been enviable, with good revenue and earnings growth combined with a good tailwind from US stock market performance generally and the US Consumer Staple sector specifically. With PE multiples of 19 times for Kraft Foods Group and 21 times for Mondelez, and dividend yields of 3.7% and 1.6%, respectively, we felt it an opportune time to take profits and instead buy companies offering better upside potential and that also reduced our exposure to the US and to the Consumer Staples sector.

The final sell we made in October was that of AstraZeneca, which we have put in the bucket of sells induced by a change in investment thesis – we no longer expect the re-rating or earnings growth we had originally envisaged. We have owned AstraZeneca since we launched the Fund

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.

in December 2010; it was part of a basket of pharmaceutical companies that we purchased at the time which we believed had been unfairly sold down. Indeed, when we first bought the stock it was trading on a PE of just 6 times. Since purchase the total return for the Fund has been just under 40% as the PE multiple has expanded to 10 times today, despite a headwind of decreasing earnings over the period as a whole. Today we think the outlook has turned even more negative, and on many indicators we follow our investment thesis no longer stands up. Analyst earnings expectations are sharply lower, the free cash flow dividend cover stands at only 1.5 times, and on the latest earnings call Pascal Soriot, the CEO, indicated that the cost cutting and reorganisation of the business he has been spearheading since he joined in 2012 will not improve margins as much as hoped. So, despite the company offering a high dividend yield and a lowly valuation, we think this might well reflect the true outlook for the business over the next few years. Indeed, the cash flow return on investment is expected to fall from 10.4% to c.7% in 2014, which means the company is very likely to fall out of our investible universe next year. The possibility of a dividend cut also looms, which could be a trigger for share price weakness. With all these thoughts in mind we decided to take our profit and sell the position.

Purchases

Now we have covered the sales, we can concentrate on the future and the companies we've bought. The new companies in the portfolio all share a common theme in that they all pass our initial screen of a ten year history of consistently high returns on capital, a market capitalisation of greater than $1bn, and a debt/equity ratio of less than 1. They all have a good history of paying a dividend and, importantly, a dividend distribution that has been growing over time. Four of the five purchases can be classified as quality companies that we have identified as offering good value, and one is probably better classified as 'deep value' because the market sentiment is almost universally negative.

The four companies in the 'quality at a good price' group are:

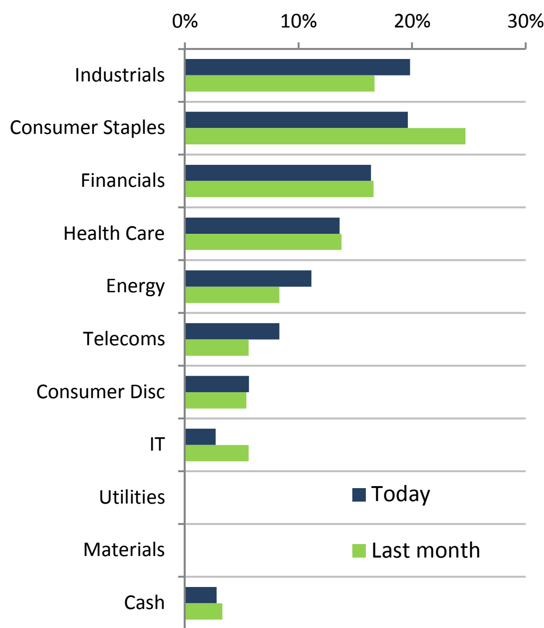
- Schneider Electric, the French-listed electrical component manufacturer;
- Sonic Healthcare, an Australian-listed medical diagnostics company;
- Vodacom, the South African-listed telecoms company;
- CNOOC, the Hong Kong-listed Chinese state oil company.

What immediately jumps out about this group is that none are listed in the UK or US (regions that have performed well relatively) and they are in the more cyclical sectors of the market (which have relatively underperformed the more defensive sectors over the last three years). This is not necessarily reflective of a 'top-down' view, but reflects our 'bottom-up' analysis which focuses purely on valuations of individual stocks regardless of which sectors or regions they are in. They all trade on valuation multiples well below their historic highs and, importantly, offer good prospects for earnings growth. The latter is something we are increasingly focusing on in the portfolio as we have seen the market multiple expand so much since the lows after the financial crisis.

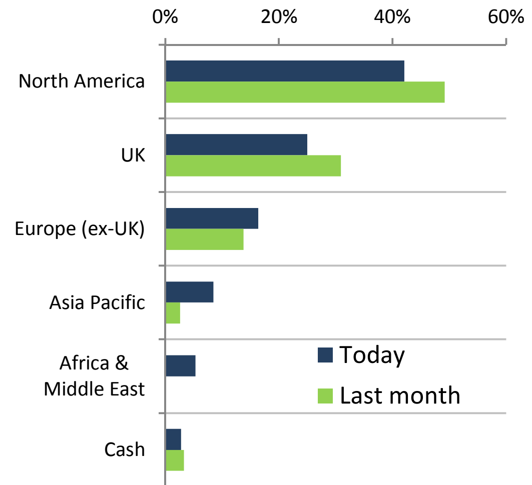
The final company we purchased was Teva Pharmaceutical, the US-listed generic drug manufacturer based in Israel. The company has been a consolidator of generic drug manufacturers and also generates a large portion of its revenues from a multiple sclerosis drug for which it owns the patent. Ironically it is the threat of generic competition to this drug next year, when it comes off patent, that has been a drag on the company. At just over 7 times 2014 expected earnings, however, it ranks in the bottom decile of its industry peers and almost 2 standard deviations away from its median multiple over the past 10 years. Earnings expectations have fallen over the past year but we feel this may have bottomed and the market has oversold the stock based on an overly pessimistic view. Again, we cannot pinpoint when sentiment and/or the share price may start to recover, but with sentiment at extreme levels and the stock already at such lowly valuations, we feel there is good upside potential over the longer term and a lot of bad news already priced in.

So, overall, we have taken profits in some US and UK-listed companies that were trading at very rich multiples and with low dividend yields, and replaced them with cheaper companies based outside the US and UK with better dividend yields. We have also continued to sell down our Consumer Staples stocks – we now have just under 20% in this sector. The charts below illustrate how the portfolio exposure has changed since we made the changes outlined above.

Portfolio sector weights (%)



Portfolio geographic weights (%)



We feel the portfolio is therefore well placed to continue its good performance and now stands at a discount to the MSCI World Index of 7% (based on 2014 PE estimates) with a dividend yield some 15-20% higher.

Dr. Ian Mortimer & Matthew Page

Co-managers,
Guinness Global Equity Income Fund

November 2013

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PORTFOLIO (31.10.13)

Fund top 10 holdings

Holding	%
Northrop Grumman	2.9%
L-3 Communications	2.9%
CNOOC	2.9%
ENI	2.9%
Coca-Cola	2.9%
Reynolds American	2.9%
Mattel	2.8%
China Mobile	2.8%
Unilever	2.8%
Meggitt	2.8%
% of Fund in top 10	28.6%
Total number of stocks in Fund	35

Sector analysis

Sector	%
Industrials	19.8%
Consumer Staples	19.6%
Financials	16.4%
Health Care	13.6%
Energy	11.1%
Telecoms	8.3%
Consumer Disc	5.6%
IT	2.7%
Cash	2.8%

Geographic allocation

Country	%
US	42.1%
UK	25.0%
France	8.2%
China	2.9%
Italy	2.9%
Hong Kong	2.8%
Australia	2.8%
South Africa	2.7%
Netherlands	2.6%
Germany	2.6%
Israel	2.5%
Cash	2.8%

PERFORMANCE

12 months to month end:	Oct '09	Oct '10	Oct '11	Oct '12	Oct '13
Guinness Global Equity Income Fund	-	-	-	6.7	24.1
MSCI World Index	16.1	16.2	0.8	9.7	26.1
IMA Global Equity Income sector average	21.8	14.9	3.5	8.3	22.7

Cumulative % total return

31/10/2013	1 month	3 months	6 months	1 year	From launch
Guinness Global Equity Income Fund	3.6	-1.5	5.9	24.1	33.0
MSCI World Index	4.7	0.8	6.3	26.1	30.0
IMA Global Equity Income sector average	4.9	2.4	5.2	22.7	30.1

Annualised % total return from launch 31/10/2013

	31/10/2013
Guinness Global Equity Income Fund	10.58%
MSCI World Index	9.68%
IMA Global Equity Income sector average	9.72%

Risk analysis - Annualised, weekly, from launch on 31.12.10

31/10/2013	Index	Sector	Fund
Alpha	0	2.07	2.90
Beta	1	0.77	0.78
Information ratio	0	0.00	0.20
Maximum drawdown	-18.26	-15.50	-16.40
R squared	1	0.81	0.90
Sharpe ratio	0	0.47	0.58
Tracking error	0	6.40	5.04
Volatility	14.68	12.48	12.08

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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 KIID 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.

Sharpe ratio
This is a commonly-used measure which calculates the level of a fund's return over and above the return of a notional risk-free investment, such as cash or Government bonds. The difference in returns is then divided by the fund's standard deviation - its volatility, or risk measurement. The resulting ratio is an indication of the amount of excess return generated per unit of risk.

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.