

# Guinness Global Equity Income Fund

INVESTMENT COMMENTARY – December 2018

## About the Fund

The Guinness Global Equity Income Fund is designed to provide investors with global exposure to dividend-paying companies.

The Fund is managed for income and capital growth and invests in profitable companies that have generated persistently high return on capital over the last decade, and that are well placed to pay a sustainable dividend into the future.

**Fund size** £542m

**Launch date** 31.12.10

**Managers** Dr. Ian Mortimer, CFA  
Matthew Page, CFA

**Analysts** Sagar Thanki  
Joseph Stephens

## Performance 30.11.18

	1 year	3 years	From launch
<b>Fund</b>	7.7	45.8	126.1
<b>Index</b>	6.2	50.7	130.0
<b>Sector</b>	1.5	36.1	91.0

### Annualised % gross total return from launch (GBP)

<b>Fund</b>	10.9%
<b>Index</b>	11.1%
<b>Sector</b>	8.5%

**Benchmark index** MSCI World Index

**IA sector** Global Equity Income

**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. Y Class 0.99% OCF. Please refer to 'Performance data notes' for full details



## Summary performance

In November, the Guinness Global Equity Income Fund produced a total return of 2.39% (in GBP) versus the MSCI World Net Total Return Index return of 1.28% (in GBP). The fund therefore outperformed the index by 1.08% in the month.

Since the beginning of the third quarter, the fund has outperformed the Index by 1.80% with a return of -2.39% versus the index return of -4.22% (in GBP).

Year to date, despite the volatility and uncertainty we have witnessed, the Fund has continued to perform well and returns are ahead of both the MSCI World Index and the IA Global Equity Income sector average.

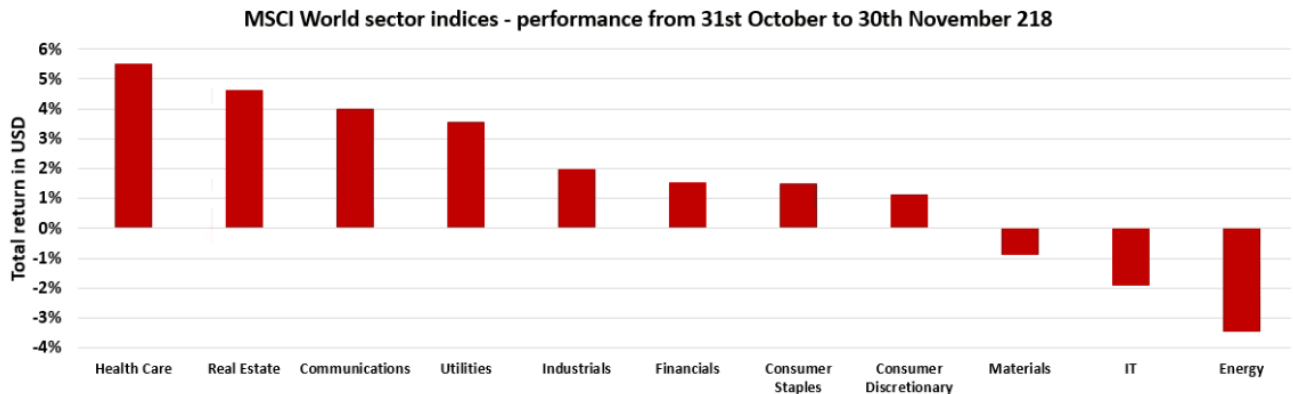
It is pleasing to see that both the short and long-term performance of the fund's strategy remain very strong; ranked by performance the fund currently sits within the 1<sup>st</sup> quartile across each of the time periods in the table below.

	YTD	1yr	3yr	5yr	Since Launch*
<b>Fund</b>	5.50	7.65	45.79	66.28	126.08
<b>Index</b>	4.75	6.24	50.70	77.31	130.01
<b>IA sector average</b>	0.16	1.53	36.09	48.44	90.95
<b>Rank vs peers</b>	8/54	4/54	5/45	9/37	3/19
<b>Quartile</b>	1st	1st	1st	1st	1st

Source: Financial Express. Cumulative Total Return in GBP as of 30 November 2018

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## Performance drivers



Source: Bloomberg. As of 30<sup>th</sup> November 2018

Over November, performance of the fund was aided by our overweight allocation to Health Care and underweight allocation to Energy, IT and Materials. Health Care stocks continued their strong run of 2018 and were the strongest performers after many surpassed analysts' earnings and revenue growth expectations. Energy was the weakest performing sector in the month and was affected by the falling oil price; WTI Crude Oil has fallen from a peak of \$76 in early October to \$51 at the end of November. This has mainly been attributed to supply side changes such as the huge increase in US production, higher production in Saudi Arabia, and the introduction of exemptions on Iranian sanctions. By nature of our stringent screening for quality companies – with a focus on persistently high cashflow returns on investment – we hold only one company within the Energy space (Royal Dutch Shell), thus limiting our exposure to oil price swings.

Technology stocks also faced a poor and volatile month, led lower by Apple. Concerns that the company's iPhone sales were falling stemmed from key suppliers guiding for lower volumes of orders. Apple then disappointed with its outlook for the critical holiday shopping season and stirred concerns about transparency as it announced that it would stop reporting unit sales of its devices. Concerns that the trade tensions between the US and China could drive down global demand and disrupt supply chains for major technology companies were also renewed, although this pressure eased towards the end of November. Apple's decline – alongside many names in its supply chain – contributed to Microsoft reclaiming the title of the 'world's most valuable company' in terms of market capitalisation. It has been almost two decades since Microsoft was previously in the top position. (We do not own Apple in the fund; we do own a position in Microsoft).

## Portfolio update

**We made no changes to the portfolio in the month.**

The fund's strongest performer in November was **AbbVie** (+21.1% in USD). The pharmaceutical giant focuses on producing drugs for specialty therapeutic areas such as immunology, chronic kidney disease, hepatitis C, oncology, and neurology. We have owned the company since the end of 2012 and over the holding period it has returned 235%. Its recent surge in price came after earnings beat consensus analyst estimates and company guidance for 2018 was raised for the third time this year. A key driver of this growth has been the Humira drug, which makes up 60% of total revenue. It has been described as the 'world's best-selling drug' and is an injectable therapy used to treat several autoimmune diseases, predominantly related to arthritis.



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**Vodacom** (+11.0% in USD) also performed well in November. The South African company provides a cellular telephone network and has further operations in Tanzania, Mozambique, Lesotho and the Democratic Republic of Congo. The company has been able to take advantage of its large market share (c.60% in South Africa) and expand its active subscriber base year over year. Initiatives to cut the cost of mobile data have increased smartphone penetration and led to both customer growth and increased mobile usage.

Gross margins have remarkably been increasing year on year for a decade, and the company has been able to generate a consistent cashflow return on investment of above 14% for the past 18 years. The group has a strong balance sheet and attractive dividend yield of 6.7%. Capital expenditure has been directed to improve the company's network, which has reached 80% 4G population coverage and 99% 3G population coverage. Its gains in the month point to macro issues in South Africa, specifically a stronger currency. The US dollar lost ground against a basket of emerging market currencies, with the South African Rand appreciating strongly. The country also pulled out of a 'technical' recession.



The worst-performing stocks in November were **British American Tobacco** (-19.0% in USD), followed by **Imperial Brands** (-6.7% in USD). We hold three companies in the tobacco industry, the third being **Japan Tobacco** (-3.4% in USD). The market's confidence in the industry was dented by news that the US Food and Drug Administration plans to pursue a ban on menthol cigarettes. The US is the industry's largest and most profitable market, and increased regulation would be expected to affect sales in the country.

With our bottom-up selection process, we focus on the fundamentals of a company. We look to identify company characteristics and trends that we believe reflect the philosophy of the fund: particularly quality, value, and the dividend. The tobacco industry's enviable cash generation, high barriers to entry and commitment to returning income to shareholders have therefore attracted our attention.

- In quality terms, each of our three companies has a high cashflow return on investment consistently around 20% and above for the last 10 years. This is significantly higher than the real cost of capital and has contributed to significant outperformance of the industry over the long term.
- Value: 2-year forward PE multipliers currently stand at 11.3x, 9.4x and 12.6x respectively for British American Tobacco, Imperial Brands and Japan Tobacco. For each, this is around the historical 10-year average and below the historical 7-year average.
- We believe that these companies are attractively valued given that each of them is expected to grow earnings in the high single digits for the next two years and has increased its dividend every year for at least the last 20 years and at an annualised rate of close to 10%.
- The current dividend yields are market-leading at 5.3%, 6.6% and 5.0% for British American Tobacco, Imperial Brands and Japan Tobacco respectively.
- Another compelling aspect of their valuations is that these companies have been able to sustain very high gross margins and grow year-on-year revenues for the last three years. This is despite the numerous concerns outlined below which we believe have been overplayed in the market.

### Regulatory Pressure

In an increasingly hostile regulatory environment over the past few decades, tobacco companies have survived negative headlines, advertising restrictions and even smoking bans - proving their model for

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profit and cash generation to be resilient under pressure. Recent threats from the US FDA are aimed at reducing nicotine levels in traditional cigarettes and the banning of menthols. We believe this could take many years to implement and the impact could well be limited by the considerable investment in new technology already taking place.

### **Government Pressure/Activism**

2017 witnessed a higher than average increase in excise duties across several developed markets prompting concerns regarding sales and consumption of tobacco. History demonstrates, however, that tobacco majors can recoup lost revenues through above-inflation price hikes, while industry consolidation adds to pricing powers.

Government tax revenues also stand to counter significant policy change: in the UK, 2017 revenue from levies on tobacco sales was £9.5 billion (source: HM Revenue and Customs). Any meaningful measures taken to price consumers out of cigarettes would squeeze government revenue.

### **Rising Interest Rates**

As Fed rates rise steadily, there is concern over the impact on high-yielding Consumer Staples such as tobacco stocks, which are often seen as being more sensitive to the bond market. However, we believe the notion of ‘bond proxies’ lacks substance; a crucial differentiator lies in the fact that bond coupons are fixed whereas tobacco dividend payments can grow and have been growing substantially in the last few years. Further, sentiment has priced in much of the negativity of interest rate changes, and the companies we hold have a long history of performing well against a variety of bond market scenarios.

### **Competition from substitute tobacco products**

Consolidation in the industry (e.g. BATS’s acquisition of Reynolds American being the most recent high-profile example) alongside the high barriers to entry means competition is limited and that these large players are the best placed to drive R&D in new products. Recent underperformance in Q3 2018 came from slower-than-expected adoption of Philip Morris’s non-combustible IQOS in Japan which caused concerns over adoption of the product worldwide. The slower adoption has not, however, affected the long-term growth forecasts.

## **November in Review**

*“It was the rise of Athens, and the fear that this instilled in Sparta, that made war inevitable.”*

Thucydides: History of the Peloponnesian War

Thucydides’ Trap – named after the ancient Greek historian and coined by Harvard Professor Graham Allison – is the theory that when a rising power threatens a ruling power, the result is often war. The phrase has recently been used with reference to the rising tensions between the US (as the supposed ruling power) and China (as the supposed rising power). These tensions have attracted attention over much of 2018 and November was no different. On the metaphorical battlefield, correcting trade imbalances seem to be the goal and tariffs seem to be the weapon of choice. However, the deeper underlying issues revolve around Chinese access to, and utilisation of, advanced American technologies. US Trade Representative Robert Lighthizer completed a seven-month investigation into China and intellectual property at President Trump’s direction in early 2017. US officials were said to find strong evidence that China uses foreign ownership restrictions to compel American companies to switch technology to local firms and that China supports and conducts cyberattacks on US companies to access trade secrets. The US currently stands as the ruling power in sophisticated technological development, although China has made tremendous strides over the last 20 years. It is therefore of significant importance for the US to protect its advanced technologies and restrict Chinese access.

At the 2018 G20 summit in Buenos Aires which concluded in the last weekend of November, President Trump and President Xi Jinping agreed not to impose any new tariffs for three months to allow

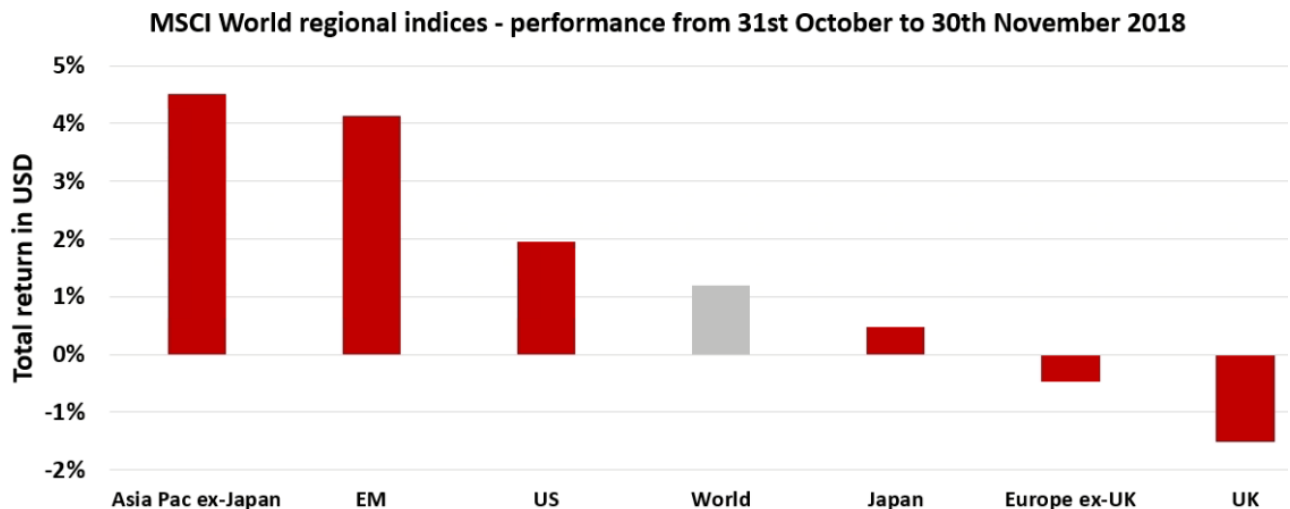
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## Guinness Global Equity Income Fund

negotiations to continue. This ceasefire delays the ramp-up in the US tariff rate from 10% to 25% that was scheduled for 1<sup>st</sup> January 2019 (impacting \$200 billion of Chinese imports). The agreement also stalls Trump's threat of new tariffs against the final \$267 billion of imports from China. In response, China "will agree to purchase a not yet agreed upon, but very substantial" amount of US exports.

With geopolitical concerns continuing to dampen risk appetite, global stock markets were unable to entirely bounce back after the sizeable declines registered in October though they did register modest gains driven by hopes of a US-China trade truce. This led to positive performance seen by Asia Pacific ex-Japan, Emerging Markets and the US, with Brexit uncertainty continuing to weigh on UK equity markets.



Source: Bloomberg. As of 30<sup>th</sup> November 2018

Global equities were also supported by more dovish comments from US Federal Reserve Chairman Jay Powell, who said that "interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy — that is, neither speeding up nor slowing down growth". The comments contrasted to October when the Fed rate was "a long way" from neutral; the change in rhetoric was taken to suggest that the Fed's tightening cycle may be drawing closer to the end.

In the US, November also saw the mid-term election results come in broadly as markets expected. The Democrats took control of the House of Representatives and the Republicans increased their majority in the Senate. With the Democrats unlikely to back further tax cuts, one of the key implications of the election was reduced fiscal support for the US economy.

In the rest of the world, there were also plenty of other political events for investors to digest in November. Some progress was achieved on Brexit as a withdrawal agreement was agreed between the UK and the EU, although amid considerable criticism from both the Conservative and Labour parties, it remains to be seen in December whether Prime Minister Theresa May can pass the deal through UK Parliament. The uncertainty surrounding the Brexit strategy continues to negatively impact the UK market, which was the worst-performing over November.

Tensions between Brussels and Italy also persist. The European Commission rejected the Italian budget after no significant changes were made to the first spending proposal under the new government. It is unclear whether the Italian government will alter its stance or face an 'excessive deficit procedure'. Towards the end of November, however, discussions did seem to have become more constructive between the Italian government and the EU, which could suggest the possibility of a compromise.

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## Guinness Global Equity Income Fund

European equities overall experienced a difficult month as economic data suggested slower growth. The flash composite purchasing managers' index for November came in at 52.4, a 47-month low, and worries around the sustainability of global growth, trade wars and corporate profits continued to build. On a country basis, Spanish and Italian indices delivered positive returns, rebounding a little from more pronounced October weakness, while French and German stock markets were negative over the month.

Asia ex Japan equities rebounded in November amid optimism over a more gradual pace of interest rate hikes in the US. Positive corporate earnings news also provided support, while the plunge in crude oil prices boosted gains for net oil importers such as India and Indonesia. Trade negotiations between the US and China continued to dominate sentiment, as for much of 2018, and helped Chinese equities rebound in November.

We thank you for your continued support and wish you a Merry Christmas!

### **Portfolio Managers**

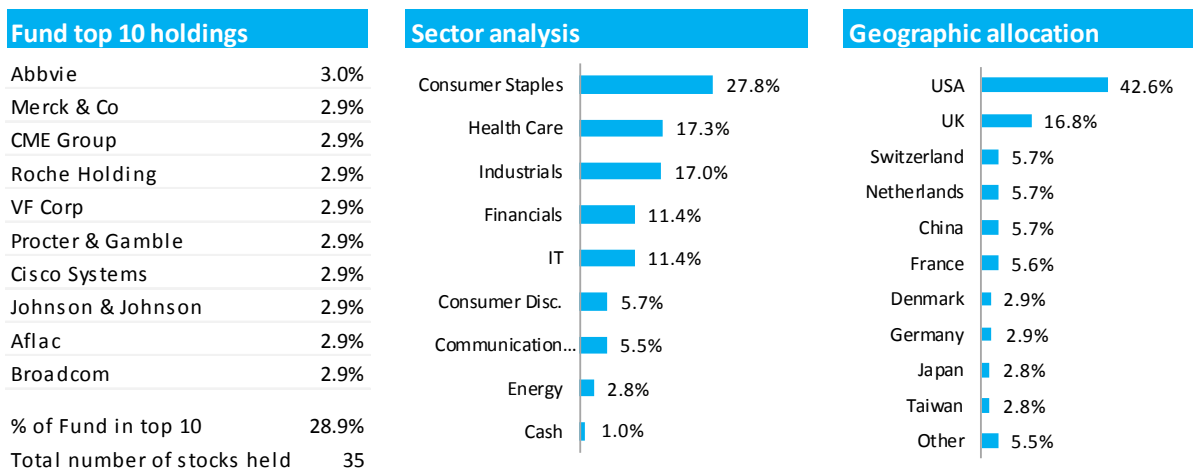
Matthew Page, CFA  
Dr Ian Mortimer, CFA

### **Analysts**

Joseph Stephens  
Sagar Thanki

**PORTFOLIO**

30/11/2018



**PERFORMANCE**

30/11/2018

**Annualised % total return from launch (GBP)**



**Discrete years % total return (GBP)**

	Nov '14	Nov '15	Nov '16	Nov '17	Nov '18
Fund (Y class, 0.99% OCF)	13.6	0.4	23.5	9.7	7.7
MSCI World Index	14.5	3.9	25.0	14.8	6.8
IA Global Equity Income sector average	8.9	0.1	18.8	12.8	1.5

**Cumulative % total return (GBP)**

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (Y class, 0.99% OCF)	2.4	5.50	7.65	45.79	66.28	126.08
MSCI World Index	1.3	4.75	6.24	50.70	77.31	130.01
IA Global Equity Income sector average	1.6	0.16	1.53	36.09	48.44	90.95

**RISK ANALYSIS**

30/11/2018

Annualised, weekly, from launch on 31.12.10, in GBP	Index	Sector	Fund
Alpha	0	0.15	1.20
Beta	1	0.76	0.86
Information ratio	0	-0.38	-0.05
Maximum drawdown	-18.26	-15.50	-16.34
R squared	1	0.80	0.89
Sharpe ratio	1	0.44	0.60
Tracking error	0	6.05	4.42
Volatility	13.83	11.39	12.19

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Source: Financial Express, bid to bid, total return. Fund launch date: 31.12.10. Fund Y class (0.99% OCF): Composite simulated performance based on actual returns of E share class (available from Fund launch), calculated in GBP.

**Performance data notes**

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1) The performance numbers displayed on the previous page are calculated in GBP (Sterling). Please note: The Fund's Y class was launched on 11.03.15. The performance shown is a composite simulation for Y class performance being based on the actual performance of the Fund's E class, which has an annual management charge 0.75%, and has existed since the Fund's launch. The Fund's E class is denominated in USD but for the purposes of this performance data its performance is calculated in GBP.

## 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 Guinness Global 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 Global 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. 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](http://www.guinnessfunds.com), or free of charge from:-

- the Manager: Link Fund Administrators (Ireland) Ltd, 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.

### 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.

### Switzerland

The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports 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, [www.carnegie-fund-services.ch](http://www.carnegie-fund-services.ch). The paying agent is Banque Cantonale de Genève, 17 Quai de l'Île, 1204 Geneva, Switzerland.

### 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

**GUINNESS**

ASSET MANAGEMENT

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