Guinness Global Innovators Fund

INVESTMENT COMMENTARY - March 2016

About the Fund

The Fund is a large cap. growth fund designed to provide exposure to companies benefiting from innovations in technology, communication, globalisation or innovative management strategies. The Fund holds a concentrated portfolio of large and medium-sized companies in any industry and in any region.

Fund size	£51m
AUM in strategy	£160m
Fund launch date	31.10.14
Strategy launch date	01.05.03
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA

Performance **31.01.15**

Cumulative %	**1 year**	**3 years**	**5 years**
Strategy*	-3.3	48.8	78.2
Index	-1.3	27.2	48.4
Sector	-3.7	17.7	31.2
Position in sector	**132** /250	**7** /227	**6** /195

Annualised % total return
from strategy inception (GBP)

Strategy*	11.38%
Index	8.44%
Sector	7.74%

Strategy	Guinness Global Innovators*
Index	MSCI World Index
Sector	IA Global

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.
***Composite simulation of performance. Guinness Global Innovators Fund (UCITS) launched on 31.10.14. Performance data prior to this date is based on the actual returns of a US mutual fund managed by the same team using the same investment process as applied to the UCITS version.** Source: Financial Express, bid to bid, total return, in GBP.

Fund review

In February the fund was up 2.90% (Z class in GBP) compared to the MSCI World Index which was up 1.03%. The fund therefore outperformed the benchmark by 1.87%.

This reverses the underperformance of the fund versus the benchmark seen in the first month of the year. Year-to-date the fund is down 1.08% (Z class in GBP), 0.23% ahead of the benchmark which is down 1.31%.

The positive market performance in February as a whole masks more volatile trading during the month itself. In the first two weeks of February the market sold off sharply and at the low on February 11th the MSCI World Index was down over 7% (in GBP) from the close at the end of January. The index then rallied into the month end recovering all losses, and more. It is notable that that the oil price and US 10-year Treasury bonds traced the same path, bottoming on the same day near the middle of the month.

With such volatile trading, markets were more focussed on earnings announcements. Indeed we witnessed extreme price movements post results for many companies – even if results were only marginally better or weaker than expected. We try not to read too much into short term data points but the overarching sentiment change was that of reduced expectations. For example if we look at the US market, analyst consensus estimates for the S&P500 Index 2016 earnings dropped considerably over January and February. Generally speaking the analyst community always starts the year in bullish mood and predicts earnings rises of 10%+. This year was no different. These high expectations were cut quickly through January and February, however, dropping from an expectation of over 12%

growth year-on-year to less than 8% at the end of February.

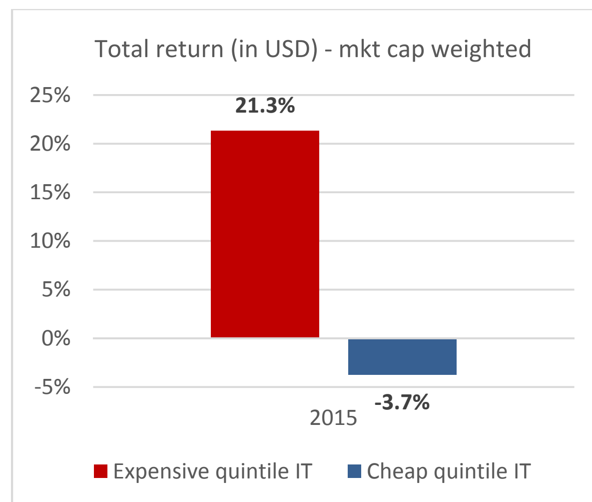
Over the past months we have discussed the divergence between value and growth styles that has evolved over the last 18 months or so – with growth indices significantly outperforming value indices over that period. In this month's update we look more closely at how this performance difference has manifested in the information technology sector, an important part of the portfolio today. Specifically we look at IT companies listed in the US.

We take as our dataset all IT companies in the MSCI US Index with a market capitalisation over $1bn as at 31/12/2014. We will use the end of 2014 as the start point of our analysis in this case.

This group is comprised of 360 companies. We can simply then split this group into quintiles by valuation, using PE multiples based on consensus forward twelve month earnings. We denote the top quintile group as 'expensive IT' and the bottom quintile group as 'cheap IT'.

The first thing to note is the dramatic difference in valuations between the cheap and expensive groups. The expensive quintile group has an aggregate PE ratio of 45X (with top 10 most expensive having an aggregate 178X multiple). Whereas the cheap quintile has an aggregate PE ratio of just 11.6X.

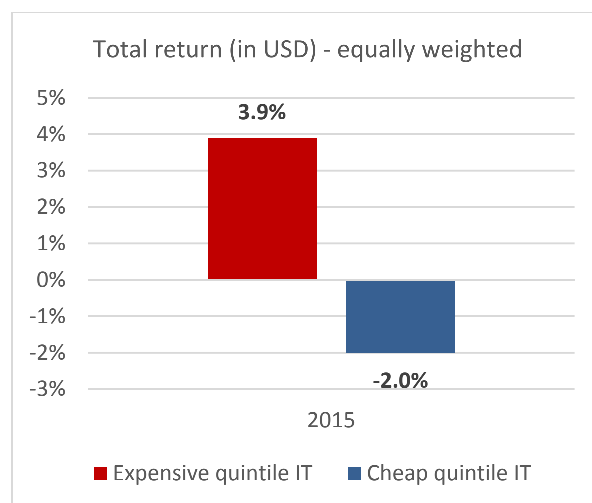
The chart below shows how these two groups fared over the following year, 2015.



Source: Guinness Asset Management, Bloomberg

The outperformance of the expensive IT companies in 2015 is dramatic: 25% relative.

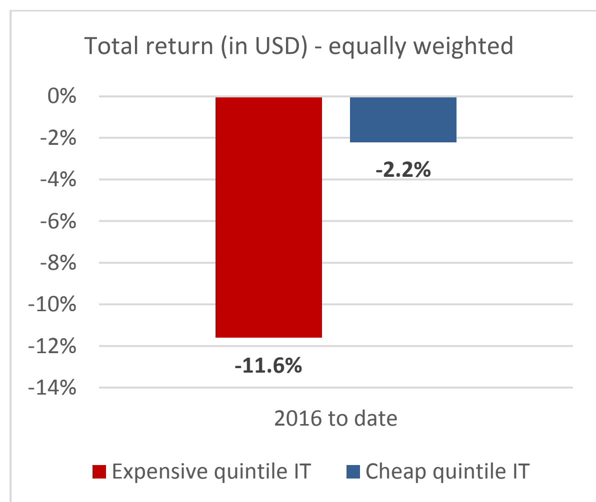
However, if we look more closely at the data set we can see that Facebook skews the results for the expensive IT quintile dramatically. The median market cap of the expensive quintile is $3.4bn (and the cheap quintile is $4.0bn). Due to Facebook's far greater size it makes up over 40% of the market capitalisation weight. This combined with its good performance in 2015 (up 34%) accounts for almost half of the expensive quintile total return. If instead we look at the same data set but instead take an equally-weighted approach, we still see a large outperformance from the expensive quintile (5.9% relative) but without the outsized gain from Facebook skewing the overall numbers.



Source: Guinness Asset Management, Bloomberg

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 as a result of market and currency fluctuations.

If we then take the same groups of companies we can see how their performance has evolved through 2016 so far, and we look once more on an equally weighted basis.



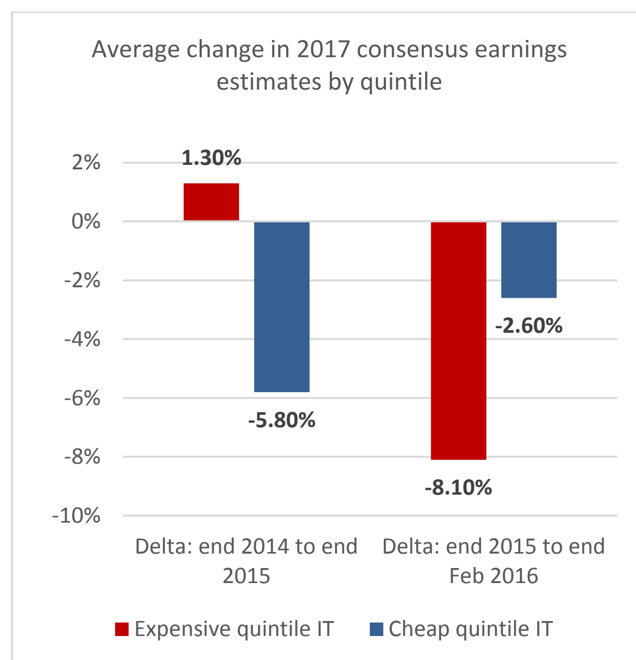
Source: Guinness Asset Management, Bloomberg

In the first two months of 2016 the cheap quintile IT companies, although posting negative returns in absolute terms, is 9.4% ahead of the expensive quintile companies. This a big turnaround versus the market consensus seen through 2015. It is also worth putting this in the context of the wider US market in 2016; the S&P500 was down 5.09% year-to-date.

Our belief is that high expectations for growth priced into expensive companies often does not come through and therefore that paying up for these types of business carries a high risk. This is why we always try to employ 'value discipline' to looking at growth companies. Essentially we like to see some prospect of a re-rating of a company's multiple, whether versus the broad market, its peers, of its own historic multiple. This helps us to avoid chasing 'hot' sectors or getting caught up in the 'hype cycle' of the Next Big Thing.

We can look at how expectations have changed for our two quintiles by assessing how analyst consensus estimates changed over the periods we are considering.

There are many ways to do this, but we have taken point in time snapshots of estimates for the 2017 earnings. So we can look how the average estimates for the 2017 earnings changed for the underlying companies from the end of 2014 to the end of 2015. And then how these changed over the last two months by taking a snapshot at the end of February. The chart below illustrates this data.



Source: Guinness Asset Management, Bloomberg

The chart shows that through 2015 analysts were getting more pessimistic about the cheap quintile companies (on average reducing their earnings estimates for 2017 by 5.8%) whereas they were getting more optimistic about the expensive quintile (on average increasing their expectations by 1.3%). In January and February this year, however, this optimism for the expensive companies reversed quickly – and analysts cut their expectations by 8.1% on average. The cheap companies were not immune to these downgrades, and their earnings expectations were reduced once more, but by a comparatively benign 2.6%.

One way to assess the expectations priced into a company is to split its value into three parts: one that represents the value of the business today if it were to run with no further investment for growth (so just re-investing for maintenance essentially); one that represents

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 as a result of market and currency fluctuations.

non-depreciable assets such as cash and land; and one that represents the growth of the business in the future.

This is obviously not an exact science, but if you can estimate the first part to a reasonable degree with sensible assumptions, you can know exactly the value of the cash holdings, then the final part you can 'back out' of the current price. Essentially getting an idea of what proportion of the current value the market is ascribing to the growth opportunities the company has (the so called 'present value of growth opportunities' or PVGO). The Credit Suisse HOLT database calculates a estimate for the PVGO of each of the companies it covers and it is this data point we will use here.

It is a truism that the higher the value the market ascribes to the growth a company might achieve in the future, then the harder it is for that company to match those expectations. But empirically it is observed that if a company has a PVGO much greater than 40% its overall value then it is more likely than not to miss these expectations. As the data above shows, this can have a significant effect on that company's share price in the near term – because the market does not like disappointment and that company may have been bid up in the run up as sentiment drove expectations higher and higher.

If we look at the average PVGO priced in to our two quintile of IT companies we see that the expensive companies have an average of 45%, whereas the cheap companies have an average of -15%. So the market has expectations for the expensive companies that are (historically at least) very hard to achieve, and for the cheap companies saying they will actually shrink in the future. The latter, we would suggest, is a far easier target to exceed.

If we now consider the fund in this context we see that it is trading on a PE ratio of 14.7X 2016 expected earnings, the 11 IT companies we own that reported in January and February all beat earnings expectations (at an average of 8.3%), and today the average PVGO of companies in the portfolio is 7%. We have seen the style of our approach be out of favour through 2015 as the market chased high growth at any price, but we sense that this may be starting to turn. We feel the portfolio is well placed to benefit from any change in sentiment towards the types of business we favour, but we cannot predict the timescale over which this may occur. In the meantime we will continue to look for better opportunities to improve the quality, value, or growth prospects of the fund.

Thank you for your continued support.

Dr. Ian Mortimer & Matthew Page
Co-managers, Guinness Global Innovators Fund

March 2016

Data sources

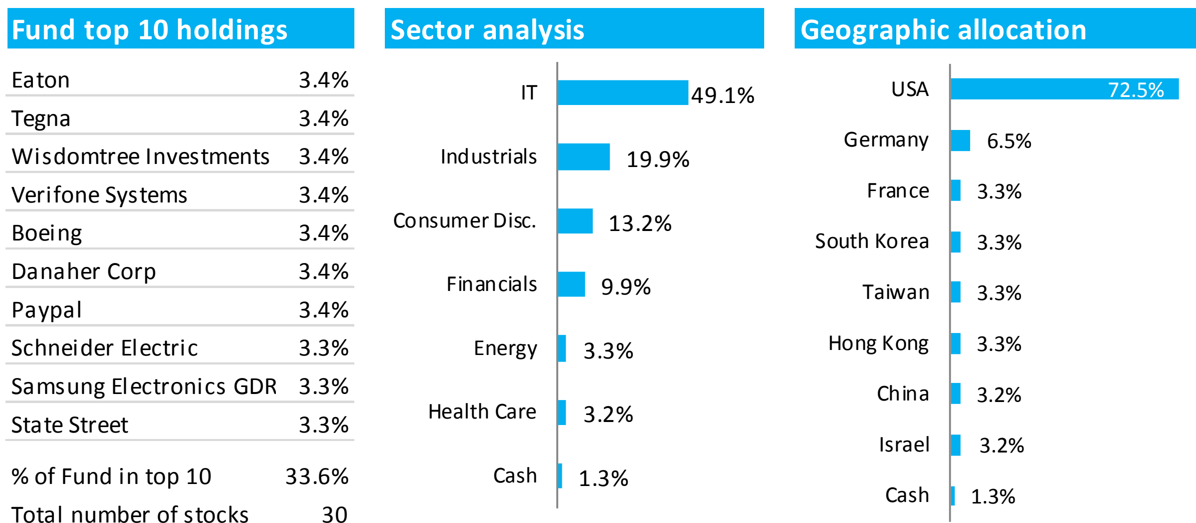
Fund performance: *Financial Express, total return in GBP*

Stock performance: *Bloomberg*

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 as a result of market and currency fluctuations.

PORTFOLIO

29/02/2016



Fund top 10 holdings

Holding	%
Eaton	3.4%
Tegna	3.4%
Wisdomtree Investments	3.4%
Verifone Systems	3.4%
Boeing	3.4%
Danaher Corp	3.4%
Paypal	3.4%
Schneider Electric	3.3%
Samsung Electronics GDR	3.3%
State Street	3.3%
% of Fund in top 10	33.6%
Total number of stocks	30

PERFORMANCE *(composite simulation - see below)*

29/02/2016

Annualised % total return from strategy inception (GBP)

Guinness Global Innovators strategy*	11.38%
MSCI World Index	8.44%
IA Global sector average	7.74%

Discrete years % total return (GBP)

	Feb '12	Feb '13	Feb '14	Feb '15	Feb '16
Guinness Global Innovators strategy*	0.2	19.5	25.8	22.3	-3.3
MSCI World Index	0.1	16.5	10.2	17.0	-1.3
IA Global sector average	-0.4	11.9	9.3	11.8	-3.7

Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years
Guinness Global Innovators strategy*	2.9	-1.1	-3.3	48.8	78.2
MSCI World Index	1.0	-1.3	-1.3	27.2	48.4
IA Global sector average	3.7	-1.9	-3.7	17.7	31.2

RISK ANALYSIS

29/02/2016

Annualised, weekly, 5 years, in GBP	Index	Sector	Strategy*
Alpha	0	-1.35	3.15
Beta	1	0.81	1.11
Information ratio	0	-0.45	0.62
Maximum drawdown	-18.26	-17.61	-22.64
R squared	1	0.80	0.88
Sharpe ratio	0.35	0.14	0.54
Tracking error	0	6.40	6.05
Volatility	14.15	12.86	16.77

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.
***Composite simulation of performance. Guinness Global Innovators Fund (UCITS) launched on 31.10.14. Performance data prior to this date is based on the actual returns of a US mutual fund managed by the same investment team using the same investment process as applied to the UCITS version. The past performance of the US mutual fund is not indicative of the future performance of Guinness Global Innovators Fund.**
Source: Financial Express, bid to bid, total return, in GBP.

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 as a result of market and currency fluctuations.

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 Innovators 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 Innovators 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.

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 , or 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.

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. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

Telephone calls may be recorded and monitored.