# Guinness Global Innovators Fund

## Innovation | Quality | Growth | Conviction

## INVESTMENT COMMENTARY – December 2017

### About the Fund

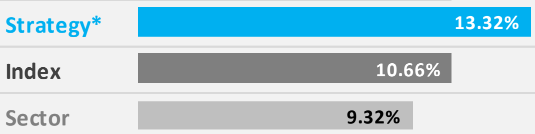
The Fund is a global growth fund designed to provide exposure to companies benefiting from innovations in technology, communication, globalisation or innovative management strategies. The Fund holds a concentrated portfolio of large and medium-sized companies in any industry and in any region.

| | |
|---|---|
| **Fund size** | $146m |
| **AUM in strategy** | $371m |
| **Fund launch date** | 31.10.14 |
| **Strategy launch date** | 01.05.03 |
| **Managers** | Dr. Ian Mortimer, CFA<br>Matthew Page, CFA |

### Performance **30.11.17**

| **Cumulative %** gross total return (GBP) | 1 year | 3 years | 5 years | 10 years |
|---|---|---|---|---|
| **Strategy*** | 24.3 | 56.0 | 170.2 | 252.7 |
| **Index** | 14.8 | 49.0 | 112.2 | 155.9 |
| **Sector** | 15.7 | 41.0 | 86.8 | 103.4 |
| **Position in sector** | 14 /277 | 41 /245 | 4 /218 | 3 /147 |

**Annualised % gross total return**
**from strategy inception (GBP)**




| | |
|---|---|
| **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, gross total return, in GBP.

## Summary performance

In November, the Guinness Global Innovators Fund produced a total return of -1.0% (in GBP), versus the MSCI World Index return of 0.3%. The Fund therefore underperformed the index by 1.3% in the month.

Year-to-date the Fund is now up 20.9%, outperforming the MSCI World Index, up 10.8%.

Over a one-year period to the end of November, the Fund is ahead of the benchmark, up 24.3% (in GBP) versus the MSCI World Index return of 14.8%.

## November in Review

Equity markets over the past year have persistently defied the sceptics, who have pointed to political dysfunction, monetary policy uncertainty, and potential geopolitical crises as reasons for woe. November marked the one-year anniversary for President Trump's time in office; he has consistently touted the stock market as well as taken credit for its steady ascent since the U.S. presidential election on 8th November 2016.

How much President Trump has contributed to stock market gains will remain debatable. However, it is not 'fake news' that his initial proposals were in fact pro-business. These included lower corporate taxes, a repatriation tax holiday (a tax break on overseas profits), huge infrastructure spending, and financial deregulation. Although the proposals faced significant hurdles, November finally saw some traction with tax legislation being passed through the Senate. The bill now must be reconciled with the House version before the President gets the opportunity to sign it into law. This boosted U.S. equity markets late in November, and the S&P 500 index reached the $2,600 mark for the first time. The index is in its second-longest bull market in history without a 20% correction. It's the 10th longest streak without a 10% correction; the 4th longest streak without a 5% pullback; and the longest streak in history without a 3% pullback. The climb so far has largely been attributed to optimism about economic growth and company earnings, in an environment characterised by loose monetary policy.

In terms of macroeconomic news, third quarter GDP growth was revised upwards – it climbed at an annualised rate of 3.3%, up from the previously reported 3%. The nomination of Jerome Powell as the new chairman of the Federal Reserve (Fed) could have created some uncertainty, but was seen as the choice for continuity. Strong economic data and encouraging comments from current Fed chair, Janet Yellen, increased the likelihood for a December interest rate hike, as she told the Joint Economic Committee: "The economic expansion is increasingly broad based across sectors as well as across much of the global economy". The S&P 500 Index gained 3.1% (in USD) in November, taking the year-to-date return to 20.5%.

In Europe, November saw the return of political uncertainty, involving Germany, Italy and Spain. Election and coalition apprehensions were possibly key reasons for the correction of the MSCI Europe (ex-UK) Index, which ended the month with a -2.0% (in EUR) return (although it is still up 12.7% year-to-date). From a macroeconomic viewpoint, the 'goldilocks' tale continued. Strong growth and modest inflation – the 'just right' environment – was broad-based across the Eurozone economies. The 19-nation bloc has also seen the unemployment rate drop to 8.8%, the lowest in almost nine years. Policymakers continue to express confidence that GDP growth and falling unemployment will eventually feed through to prices as the slack in the economy wanes. The latest manufacturing survey data (by IHS Markit) show signs that a mounting order backlog in the Eurozone is putting upward pressure on both input and output prices for goods, and this could eventually be reflected in inflation figures.

In the UK, the equity market fell in November as continued uncertainty in domestic politics weighed on confidence in the UK's economic outlook. At the start of the month, the Bank of England implemented the first interest rate rise in a decade, up from 0.25% to 0.5%, as third-quarter GDP growth was confirmed at 1.5% and inflation remained unchanged at 3.0%. The Autumn Budget revealed a slower pace of fiscal tightening to support the economy through the Brexit negotiations.
The FTSE 100 closed with decline of 1.8% (in GBP), marginally reducing the year-to-date return to +6.6%.

## Market Movements

Towards the end of the month, there was some notable sector rotation – perhaps a healthy way for the market to consolidate some gains without the overall market suffering to any significant degree. U.S. tax reform prompted a rotation out of technology stocks, the year's best performing sector, and into firms seen to benefit the most from a potential reduction in the corporate tax rate, such as banks. Technology companies are expected to see little boost, as the industry's average effective tax rate of 18.5% is already lower than the new level of 20% proposed by Republicans.

The tables below compare S&P 500 sector performance over two specific time periods: the year to November 27th; and the brief period between November 27th and December 1st. November 27th is chosen since this marked the swift deposition of tech stocks from their leadership perch, among other notable sector reversals.

| S&P 500 Sector Performance, 2017 | | | |
|---|---|---|---|
| Sector | 31/12 - 27/11 | Sector | 27/11 - 01/12 |
| IT | 39.0% | Telecoms | 6.3% |
| Healthcare | 18.6% | Financials | 5.2% |
| Materials | 17.1% | Energy | 3.7% |
| Consumer Discretionary | 16.2% | Industrials | 2.7% |
| Utilities | 14.8% | Consumer Staples | 2.3% |
| Financials | 12.3% | Consumer Discretionary | 2.0% |
| Industrials | 12.0% | Healthcare | 1.8% |
| Real Estate | 8.7% | Materials | 1.0% |
| Consumer Staples | 6.1% | Utilities | 0.4% |
| Energy | -10.8% | Real Estate | -0.2% |
| Telecoms | -16.0% | IT | -2.0% |

Source: Bloomberg. GICS sector price returns, in USD.

It should be highlighted that the 'correction' time-period is very short, and comes in year in which technology stocks have performed very strongly (the Fund is overweight IT). The Information Technology sell-off appeared to be driven by concerns raised in a Morgan Stanley analyst report that the cycle was peaking for memory chips. Chip manufacturers and equipment makers led the sell-off. The Philadelphia Semiconductor (SOX) index was down 5% in the week while the S&P500 was up 1.8% (total return in USD, week ending 30-November). This then led to other Information Technology companies selling off (such as Facebook and Alphabet), although this didn't appear to be driven by any fundamental changes. End of year profit-taking has been suggested as an explanation for the fall. In context the SOX was up 50% before the sell-off, vs S&P500 up 18% (total return in USD, year-to-date ending 24-November). The sell-off was most prevalent in Emerging Markets.

The Global Innovators Fund's current overweight position in Information Technology contributed negatively to its performance over the month of November. Over the year, however, Information Technology remains the biggest contributor to positive total attribution of the Fund.

## Portfolio update

Individual stock performance in the month followed, in general, the market movements described above. Key stock movements are highlighted below.

Stocks held in the Fund that were directly impacted by the sell-off in semiconductors (in the week ending November 30th) were Samsung Electronics (-8%, total return in USD), Applied Materials (-9%), Nvidia (-8%) and Infineon (-6%). However, this must be seen in the context of the very positive year to date performance for these four stocks, which were up on average 83% (total return, in USD) to November 24th.

More positive performance in the month came from Nike and AAC Technologies.

Nike (+9.9% total return in USD) was added to the portfolio in November 2016. It has all the characteristics we seek in a business: a strong balance sheet, good returns, and good capital allocation discipline that shows the company as selectively and profitably re-investing cash flows. Nike has been attempting to cut out the middleman and sell direct to customers. The threats of increased competition and inventory overhang and the question of whether future lines are well received remain, but Nike's focus on robotics and price segmentation is an example of the company's ability to innovate in both technology and business. Nike has collaborated with Flex, the high-tech manufacturing company, to roll out innovations such as laser-cutting and automated gluing across Nike's supplier base. The shift to automation has the attraction of driving down costs and delivering innovative designs more quickly, commanding a premium.

AAC Technologies (+9.3% total return in USD), is a HK-listed company that is a market leader in the design and manufacture of various components for consumer electronic components. It historically specialised in acoustic parts, most notably speakers and microphones for smartphones and tablets, but has been diversifying into non-acoustic parts such as haptic vibrators and RF antenna. Like many Asian technology companies, its client base is concentrated, with companies such as Apple and Samsung accounting for significant proportions of overall revenue - which poses obvious risks. However, unlike many other product manufacturers AAC has consistently managed to maintain high operating margins of around 30% and has a strong balance sheet. AAC did see some pullback after the iPhone 8 went on sale in late September, but with the launch of the iPhone X and reports of healthy sales, AAC's stock performed well in November.

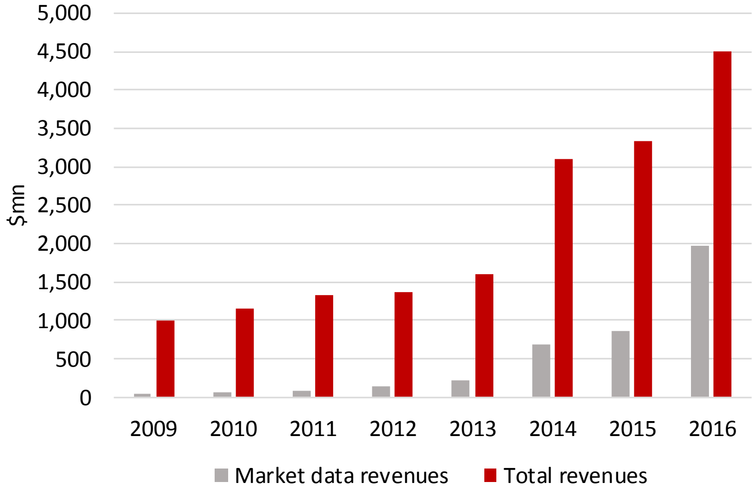
We made no changes to the portfolio in November.

**Accessing innovation in other companies and other sectors**

The Guinness Global Innovators Fund does include some well-known, obvious innovators such as Facebook (owned since August 2017), Alphabet (August 2015) and PayPal (July 2015). All three of these companies are in the Information Technology sector, but there are also many good opportunities to access innovative themes in other companies and in other sectors, as highlighted in the following three examples.

**Consumer Discretionary sector:** New Oriental Education provides educational services in China, such as foreign language training, test preparation for Western university admissions, primary and secondary education. The stock was added to the Guinness Global Innovators portfolio in October 2016 on a 25x forward PE. It is currently a market leader with sales growth exceeding 20% per year. Asset growth has been between 10-20% a year and return on capital has been steadily increasing. The drivers of this growth have been the use of a scalable platform to accelerate its market share growth. In 2017 the company started a collaboration with Tencent and Digital China for 'smart campus', an online AI-based education platform.

**Financials sector:** Intercontinental Exchange (ICE) operates 12 exchanges, six clearing houses and a data business. ICE was included in the Fund in September 2009 on a 20x forward PE basis. The company has grown organically and through acquisitions (for example the NYSE) and now has more than 50% of its revenues generated on a recurring basis. The business works on a 'virtuous cycle' from selling data to improve trading, and subsequently generating more data from the clearing of trades.




The market data segment has grown from $54m of revenue in 2009 to almost $2bn in 2016, now accounting for over 40% of overall revenues. Key themes the company is focussing on include big data, automation and AI.

**Industrial sector:** Boeing, which specialises in commercial jet aircraft, was purchased for the Fund in August 2014 on a 15x forward PE basis. Sales have grown 4-6% on average per year and we have seen operating margins increase 200bps last year. Asset turnover, a measure of a company's efficiency and productivity, has also increased by more than 25%. One key improvement to the business has been the adoption of planes being assembled on a moving assembly line (52 aircraft per month expected in 2018 vs 31 in 2005), concurrent with the adoption of lighter, smarter materials and the increasing use of robotics and automation in the assembly process.

## Outlook

The Fund has always sought to provide exposure to many of the exciting innovation growth themes that exist and this year the market has begun to react to the potential of many of these themes. Recent earnings results from many of the large technology companies suggest that the growth opportunities continue to expand, and we are pleased with the way that our holdings have been executing on their growth plans as well as with their share price performance. We hold better quality companies than the broader market. The current portfolio has, on average, more cash than debt on the balance sheet and a cash flow return on investment of 18%, which is 60% higher than the broader market.

We do not attempt to predict the future direction of the market, but we feel confident that the strong balance sheets and superior return on capital of the businesses held in the portfolio will serve the Fund well over the long term.

Thank you for your continued support.

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

**Analysts**
Joshua Cole
Sagar Thanki

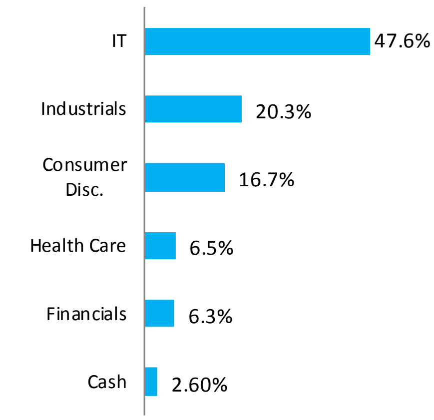
## PORTFOLIO

30/11/2017

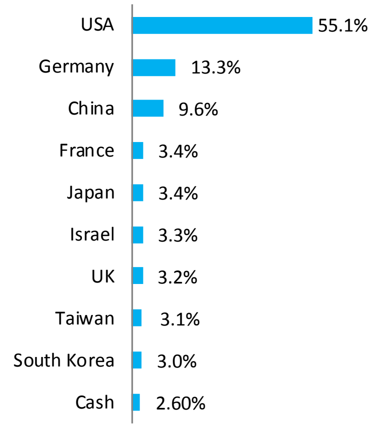
### Fund top 10 holdings

| | |
|---|---|
| Paypal | 3.6% |
| Nike | 3.5% |
| Intercontinental Exchange | 3.5% |
| Continental | 3.5% |
| Comcast Corp | 3.4% |
| Schneider Electric | 3.4% |
| Boeing | 3.4% |
| Roper Industries Inc | 3.4% |
| Fanuc Corp | 3.4% |
| Cisco Systems | 3.4% |
| % of Fund in top 10 | 34.4% |
| Total number of stocks in Fund | 30 |

### Sector analysis

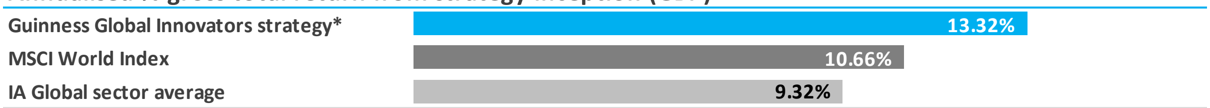



### Geographic allocation




30/11/2017

### Annualised % gross total return from strategy inception (GBP)




| Discrete years % gross total return (GBP) | Nov '13 | Nov '14 | Nov '15 | Nov '16 | Nov '17 |
|---|---|---|---|---|---|
| **Guinness Global Innovators strategy*** | 40.3 | 23.6 | 2.7 | 22.2 | 24.3 |
| **MSCI World Index** | 24.4 | 14.5 | 3.9 | 25.0 | 14.8 |
| **IA Global sector average** | 21.8 | 8.7 | 2.1 | 19.3 | 15.7 |

| Cumulative % gross total return (GBP) | 1 month | Year-to-date | 1 year | 3 years | 5 years | 10 years |
|---|---|---|---|---|---|---|
| **Guinness Global Innovators strategy*** | -1.0 | 20.9 | 24.3 | 56.0 | 170.2 | 252.7 |
| **MSCI World Index** | 0.3 | 10.8 | 14.8 | 49.0 | 112.2 | 155.9 |
| **IA Global sector average** | -0.1 | 12.2 | 15.7 | 41.0 | 86.8 | 103.4 |

## RISK ANALYSIS

30/11/2017

| Annualised, weekly, 5 years, in GBP | Index | Sector | Strategy* |
|---|---|---|---|
| **Alpha** | 0 | 0.85 | 4.74 |
| **Beta** | 1 | 0.81 | 1.11 |
| **Information ratio** | 0 | -0.35 | 1.14 |
| **Maximum drawdown** | -14.03 | -17.08 | -17.14 |
| **R squared** | 1 | 0.80 | 0.87 |
| **Sharpe ratio** | 0.99 | 0.89 | 1.32 |
| **Tracking error** | 0 | 5.51 | 5.39 |
| **Volatility** | 12.30 | 11.11 | 14.62 |

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Source: Financial Express, bid to bid, gross total return, 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 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: Link Fund Manager Solutions (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. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 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** may be recorded and monitored.