Guinness Global Innovators Fund

Innovation | Quality | Growth | Conviction

INVESTMENT COMMENTARY – December 2018

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	$187m
AUM in strategy	$374m
Fund launch date	31.10.14
Strategy launch date	01.05.03
Managers	Dr. Ian Mortimer, CFA Matthew Page, CFA
Analysts	Sagar Thanki Joseph Stephens

Performance 30.11.18

Cumulative % total return (GBP)	1 year	3 years	5 years	10 years
Strategy*	-3.3	46.8	86.3	391.1
Index	6.2	50.7	77.3	238.0
Sector	2.7	41.8	57.5	192.6
Position in sector	**256** /294	**99** /262	**30** /235	**4** /163

Annualised % total return from strategy inception (GBP)	
Strategy*	12.17%
Index	9.81%
Sector	8.89%

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 0.99% OCF, bid to bid, total return, in GBP.

Summary performance

In the month of November, the Guinness Global Innovators Fund provided a total return of 1.54% against the MSCI World Index return of 1.28% (in GBP). Hence the fund outperformed the benchmark by 0.26%. Over 2018 to 30th November, the fund has produced a total return of -4.20%, against the MSCI World's 4.75% (in GBP).

Having weathered the October sell-off – the worst since October 2011 – it is useful to reflect on the fund's investment strategy. During periods of volatility, such as the current shake out, it is important to avoid poor quality companies which can lead investors to suffer a permanent loss of capital. Poor quality companies make low levels of profitability, have stretched balance sheets, are often in declining industries and have a low market share due to a lack of competitive strength. The underlying quality of the companies that we own is extremely high: on average our companies earn a return on capital which is double that of the MSCI World Index, and they collectively have more cash than debt. Not only that but our companies are growing their revenues and earnings faster than the MSCI World and yet our companies are cheaper when measured by free cash flow yield.

Performance drivers

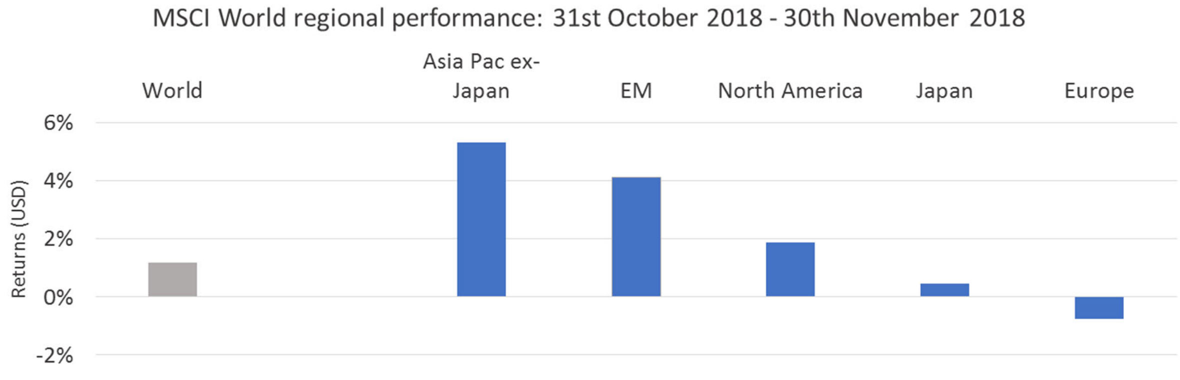

Chart 1. Source: Bloomberg, as of 30th November 2018

The fund's allocation to China and the US were the biggest contributors to the outperformance over the month. Our overweighting to China (c.15%) contributed positively to asset allocation relative to the MSCI World as Asia and Emerging Markets rebounded on softer trade talk. With the portfolio slightly underweight North America, asset allocation was a slight drag with the US performing well on trade talk and a possibly easing of interest rate increases. However, strong stock selection more than offset this with our lack of exposure to Apple (down 18%) also boosting relative performance.

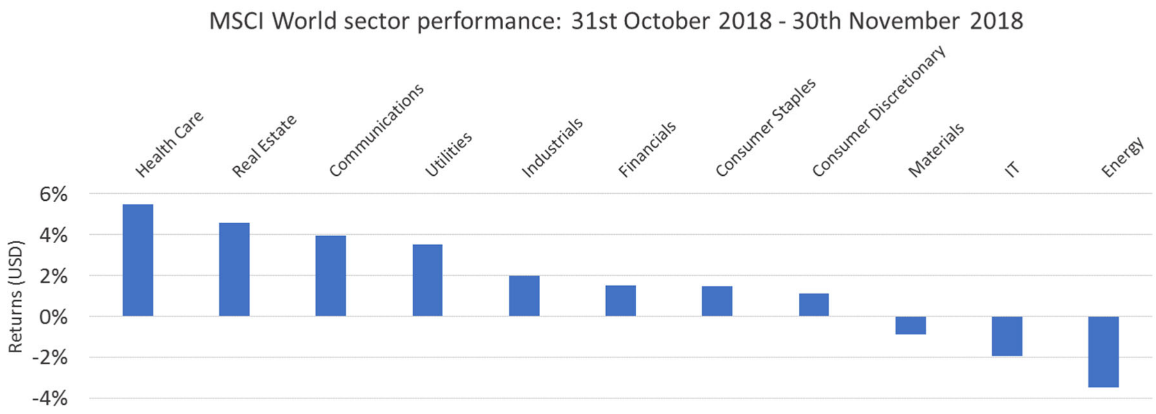

Chart 2. Source: Bloomberg, as of 30st November 2018

Our underweight exposure to Health Care was a slight drag over the month, although our stock selection in Danaher (up 10.2% in USD), our sole Health Care stock, offset some of the negative contribution. IT, which continued its sell-off, was a positive contribution to the portfolio even with our c.36% overweighting relative to the MSCI World. This reflected strong performances from semiconductor names such as Applied Materials and Lam Research, as well as the exclusion of Apple.

Semiconductors on the rise

In the last month we have seen stronger performance from semiconductor names such as KLA Tencor and LAM Research. Semiconductor stocks have historically been more volatile and cyclical than other parts of the IT sector. However, looking through the short-term noise, the outlook for semiconductor stocks continues to look very favourable, driven by numerous innovation themes from Artificial Intelligence and Machine Learning to Augmented Reality and Autonomous Vehicles, among others.

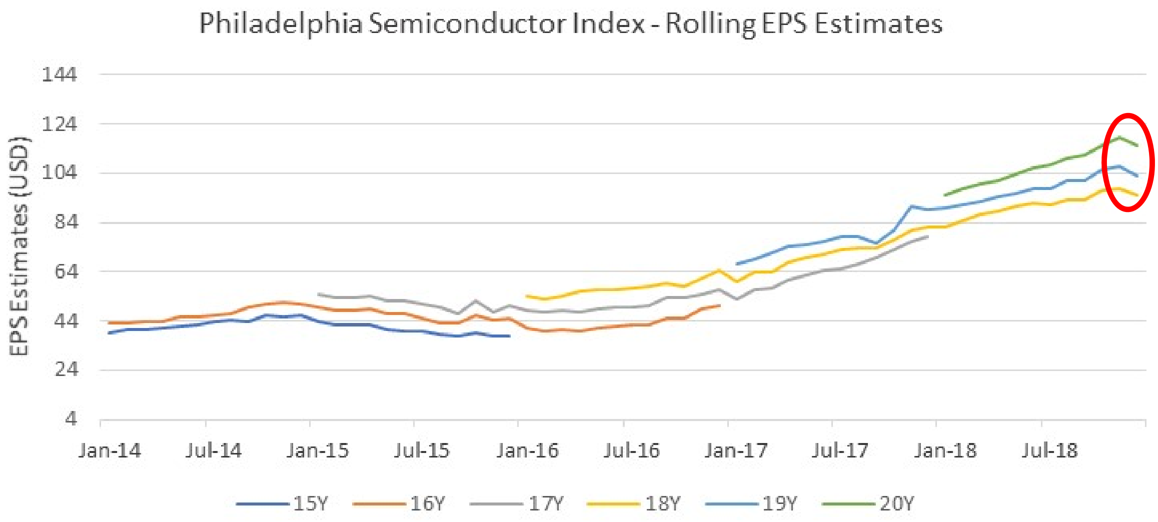

Chart 3. Source: Bloomberg, as of 30st November 2018

From Chart 3 it can be observed that, based on the Philadelphia Semiconductor Index, EPS revisions have risen strongly over the past few years with a slight tick down in recent months. However, this still prices in an 8% growth rate between 2018 and 2019 and 12% between 2019 and 2020.

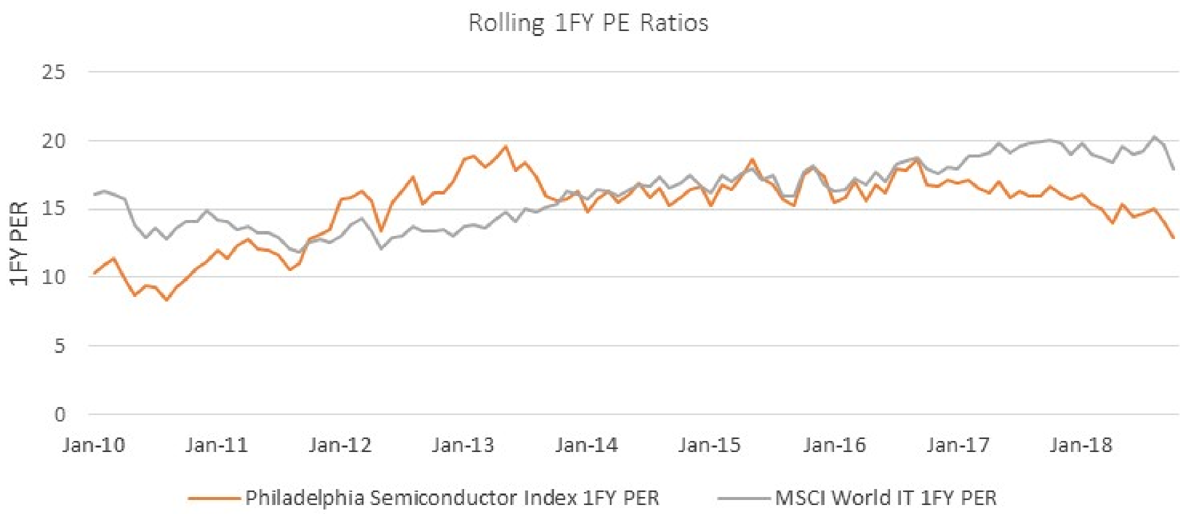

Chart 4. Source: Bloomberg, as of 30th November 2018

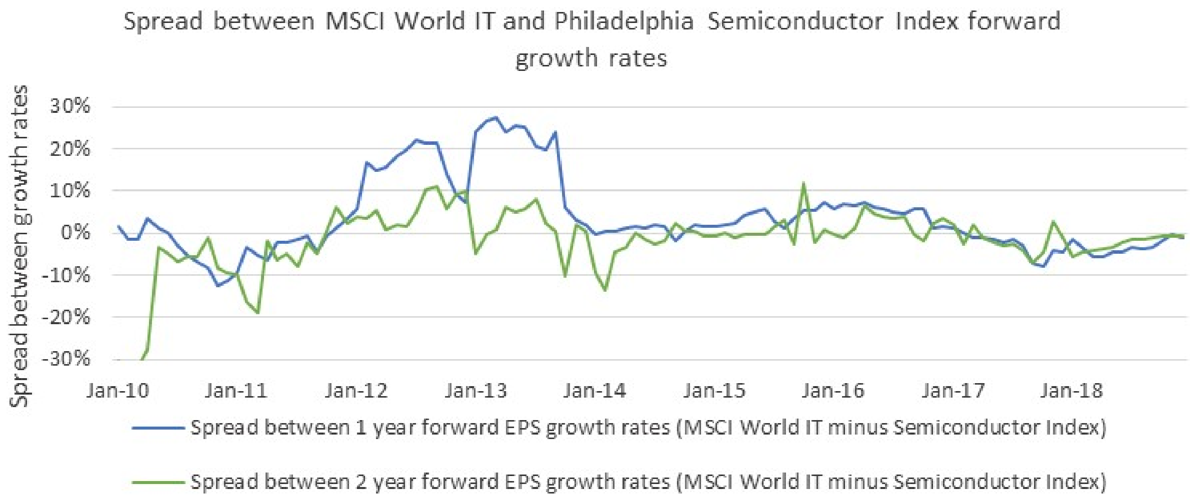

Chart 5. Source: Bloomberg, as of 30th November 2018

When compared against the MSCI World IT index, the Philadelphia Semiconductor index exhibits a c.26% valuation discount (chart 4), but crucially is being priced with similar growth rates over one and two-years (chart 5). This presents a very attractive opportunity to own companies of growing influence in a technologically advancing society at a substantial discount to alternative areas of IT.

Portfolio update

Individual companies that performed well over the month included Tencent Holdings Ltd (17.11% in USD) and Applied Materials Inc (14.03% in USD).

Tencent 腾讯 APPLIED MATERIALS®

Tencent is the Chinese conglomerate with an ecosystem of businesses from video games and social media platform WeChat to music streaming and payment services. Tencent posted Q3 profit growth of 31% as the video game ban in China was offset by increased revenue from online advertising, mobile payments and cloud services. Tencent's gaming revenue has been falling as a proportion of total revenue over recent quarters as China continues to ban new games from being released. However, Tencent's diverse portfolio of businesses has benefited it greatly, with online advertising rising 47% – the mobile app WeChat has over 1bn active users – and a doubling of cloud-service revenues. Having bought Tencent in Q3 after a sell-off of around 35%, we continue to see upside potential from the individual businesses' competitive moats and integration into almost every aspect of the consumer's life.

Applied Materials brushed off concerns of weaker guidance from management than expected to produce strong returns as part of the general rebound in semiconductor names. Management reiterated its view of a stronger 1H19 compared to 2H18, led by growth in foundry/logic segments offsetting some declines in its memory segment. We believe fears surrounding semiconductor cycles could soon diminish as global demand for semiconductor chips continues to expand into diverse areas. As of the end of November, Applied Materials traded on c.10.7x 1FY PER – a sizable discount to historical valuations – so we believe Applied Materials has strong potential for future re-ratings.

Individual companies that underperformed over the month were NVIDIA Corp (-22.40% in USD) and Catcher Technology Co Ltd (-14.77% in USD).

Nvidia, the market-leading producer of GPU chips, gave weaker guidance than expected after a collapse in demand for their chips from cryptocurrency miners. While the slowdown in demand from this segment has been fairly well flagged, it was surprising to see the significant build-up in inventory which management are now taking quick action to clear. We believe this is short-term noise, and it does not change our outlook for the company. Indeed, cryptocurrency has always been a small part of Nvidia's revenues and we are far more excited about the steady cash generation, growth of the gaming business and higher growth potential from data centres and artificial intelligence applications. Despite these, since the end of September the share price halved before starting to recover two weeks ago. We have owned Nvidia for a very long time and our equally weighted portfolio construction methodology has meant that we have been reducing our exposure as the share price has rallied and we have been able to take advantage of recent volatility to rebalance our position and buy more at a considerable discount.

Catcher has suffered from the broader sell-off in Apple supply chain names over fears of weaker Apple product demand. In its recent earnings report, Apple announced it would no longer provide unit sales data going forward and there were also reports of weaker demand for the new iPhone XR, Apple's discounted version of the premium XS for which Catcher produces the majority of casings. Whilst the mobile phone casing market is moving away from metal casings – an area Catcher is best known for – and into glass panels, there is still a need for metal structures within mobile devices to house the glass panels. Innovations around better heat dissipating structures and 5G network antennas also present the need for continued premium casings. Catcher is a leader in its industry and has maintained a gross margin of c.40%, which is significantly above that of its competitors and indicates Catcher's continued competitive advantage.

November in review

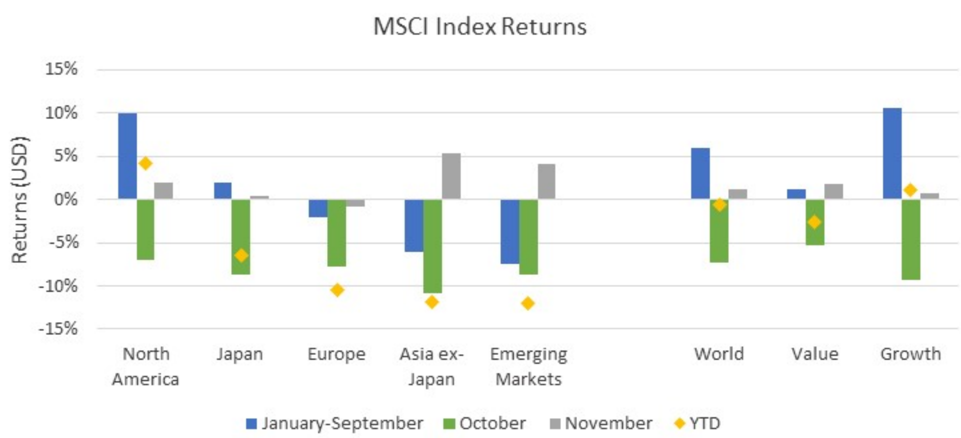

Chart 6. Source: Bloomberg, as of 30th November 2018

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Having weathered one of the worst months for equity markets since October 2011, markets realised some recovery across most regions in November. In an unfamiliar development, Asia and Emerging Markets produced the highest returns after increasingly positive exchanges between the US and China and a possible slowdown in US interest rate hikes, giving some additional relief as the US dollar pulls back.

All eyes were on Donald Trump and Xi Jinping at the G20 summit in late November as the two met for the first time in over a year. Markets had some relief to hear the US and China in agreement on a two-month trade tariff pause that sees the proposed increase in tariffs from the US postponed until 1st March to allow the two parties to reach further agreements. Equity markets also rallied as Jay Powell, the Federal Reserve chairmen, indicated US interest rates were closing in on “neutral levels”, raising the possibility of a slow-down in the Fed’s rate-hiking programme.

China continued to release weaker economic data with credit growth at its slowest pace on record and manufacturing PMI falling to 50 – suggesting government’s attempts to stimulate the economy have thus far been muted. However, there was a brief rally on G20 talks which left the CSI 300 index at 0.85% (in USD) over the month. The market’s positive reaction to talks between the US and China – in which only a pause has been agreed – raises the prospect of additional larger reactions if negotiations yield more promising outcomes.

Brexit negotiations had the appearance of a breakthrough as Theresa May and the EU agreed on a proposed exit agreement. However, May still faces an uphill battle as discontent for the proposal remains. The biggest hurdle – rallying MPs to push the agreement through parliament – is still to come.

Oil entered bear market territory during November on worries of over-supply. This came as the US re-imposed sanctions on Iran but handed select countries waivers for an extended adjustment period. Additional data showed US oil production surged to new records, causing additional fears regarding global over-supply. Saudi Arabia faces pressure from both sides as the US push for sustained supply levels, but oil prices at current levels may cause larger economic headwinds.

Thank you for your continued support.

Portfolio Managers

Dr Ian Mortimer, CFA
Matthew Page, CFA

Analysts

Joseph Stephens
Sagar Thanki

Data sources

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

Index and stock data: *Bloomberg*

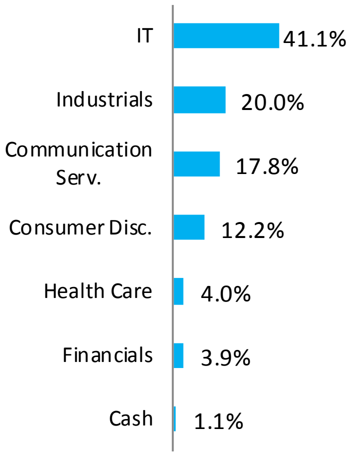
PORTFOLIO

30/11/2018

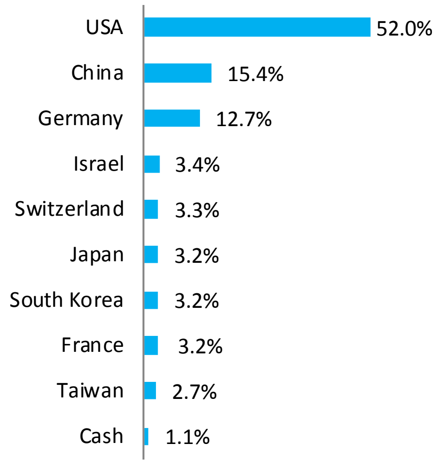
Fund top 10 holdings

Comcast Corp	4.2%
Danaher Corp	4.0%
Roper Industries Inc	3.9%
Intercontinental Exchang	3.9%
Cisco Systems	3.9%
Paypal	3.7%
Tencent Holdings	3.7%
Alphabet	3.5%
KLA-Tencor	3.5%
Siemens	3.4%
% of Fund in top 10	37.7%
Total number of stocks	30

Sector analysis

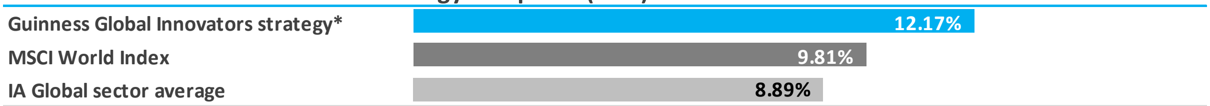


Geographic allocation



30/11/2018

Annualised % total return from strategy inception (GBP)



Discrete years % total return (GBP)	Nov '14	Nov '15	Nov '16	Nov '17	Nov '18
Guinness Global Innovators strategy*	23.6	2.7	22.2	24.3	-3.3
MSCI World Index	13.9	3.3	24.2	14.1	6.2
IA Global sector average	8.7	2.1	19.3	15.7	2.7

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	10 years
Guinness Global Innovators strategy*	1.5	-4.2	-3.3	46.8	86.3	391.1
MSCI World Index	1.3	4.8	6.2	50.7	77.3	238.0
IA Global sector average	1.6	1.1	2.7	41.8	57.5	192.6

RISK ANALYSIS

30/11/2018

Annualised, weekly, 5 years, in GBP	Index	Sector	Strategy*
Alpha	0	0.02	-0.30
Beta	1	0.81	1.14
Information ratio	0	-0.38	0.17
Maximum drawdown	-14.03	-17.08	-17.14
R squared	1	0.79	0.86
Sharpe ratio	0.70	0.55	0.64
Tracking error	0	5.88	6.11
Volatility	12.67	11.51	15.57

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Source: Financial Express, bid to bid, 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) 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.

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.