

# Guinness Global Innovators Fund

Innovation | Quality | Growth | Conviction

## INVESTMENT COMMENTARY – October 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.

<b>Fund size</b>	\$215m
<b>AUM in strategy</b>	\$435m
<b>Fund launch date</b>	31.10.14
<b>Strategy launch date</b>	01.05.03

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

**Analysts** Sagar Thanki  
Joseph Stephens

### Performance 30.09.18

Cumulative % total return (GBP)	1 year	3 years	5 years	10 years
<b>Strategy*</b>	8.8	78.1	113.9	347.3
<b>Index</b>	14.4	70.0	93.6	210.7
<b>Sector</b>	11.6	61.8	72.2	167.3
<b>Position in sector</b>	213 /293	33 /261	19 /232	4 /159

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

<b>Strategy*</b>	12.86%
<b>Index</b>	10.23%
<b>Sector</b>	9.35%

<b>Strategy</b>	Guinness Global Innovators*
<b>Index</b>	MSCI World Index
<b>Sector</b>	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 September, the Guinness Global Innovators Fund provided a total return of -3.13% (in GBP) against the MSCI World Index rise of 0.23%. Over the quarter the fund produced a total return of 0.38% (in GBP) against the MSCI World Index's rise of 6.28%, hence an underperformance of 5.90%.

Despite the weaker performance over Q3, the medium and long-term performance of the strategy remains very strong versus both the index and the IA Global Sector; its performance versus the sector places it in the top quartile over three, five and ten years.

	1yr	3yr	5yr	10yr
<b>Fund</b>	8.84%	78.10%	113.89%	347.38%
<b>Index</b>	14.44%	70.02%	93.56%	210.72%
<b>IA sector average</b>	11.63%	61.82%	72.19%	167.27%
<b>Rank vs peers</b>	212/292	32/260	18/231	3/158

**Figure 1: Global Innovators strategy total return in GBP. Source: FE (as at 30.09.2018)**

### Quarter in review

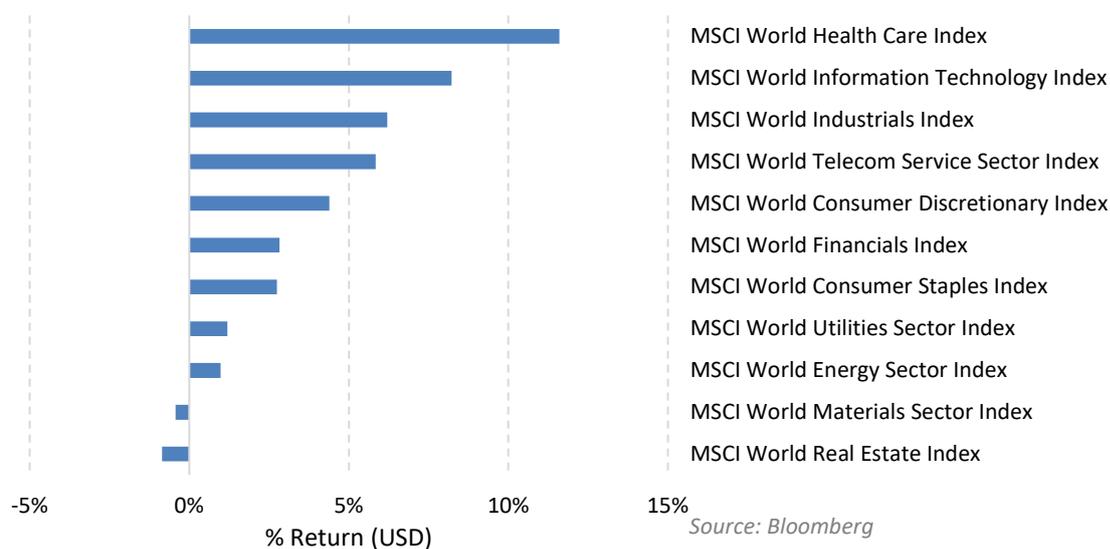
The quarter began with Donald Trump following through with his tariff threats on China by imposing a 25% import tariff on US\$34 billion of Chinese goods with further tariffs increasingly likely. However, this was largely shrugged off as earnings season produced strong positive results across most sectors, with 82% of the fund's constituents reporting positive surprises. Elsewhere, the UK government published its

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proposed terms for leaving the EU in its Chequers plan. The proposal was met with a negative reception from the EU and members of the Conservative Party as the Irish border remained a substantial sticking point.

August saw further depreciation in emerging market currencies, led by the Argentinian Peso, Turkish Lira and South African Rand. On-going concerns regarding current account deficits and rising inflation, coupled with a strengthening of the US dollar, continued to put pressure on political and monetary authorities to stem outflows. In the US, trade tariffs continued to make headlines as Trump imposed the second round of proposed tariffs at 25% on an additional \$16 billion of Chinese goods. In addition, the US reached a tentative agreement with Mexico for the revamp of NAFTA. The agreement imposes stricter rules on the percentage of car components manufactured in the US and raises minimum wages for Mexican auto manufacturers to deter further relocation of business for cheaper labour.

September saw increased trade tensions with the prospect of renewed discussions between the US and China set back as Trump imposed a 10% levy on a further \$200 billion of Chinese goods. This took the total to \$250 billion of US imports affected. Canada reached an agreement on the revamped NAFTA, under the new name USMCA, narrowly meeting the deadline as Mexico prepares for a change of president. The US Federal Reserve continued its steady path of rate rises with the third hike of the year. Europe saw continued uncertainty regarding the UK's exit from the EU and Italy's budget proposal, which could see the budget deficit rise to 2.4% of GDP, increasing its use of debt further in breach of EU rules.



**Figure 2: Sector performance in Q3 2018 (all TR in USD)**

Figure 2 illustrates the individual sector performance of the MSCI World Index over Q3 2018. Energy continued to gain as oil prices rose. Health Care and IT both performed strongly, with only Materials and Real Estate reporting negative returns.

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As shown regionally in figure 3, the MSCI World was led by North America and Japan, which has reversed losses experienced in the previous quarter when it was down 3%. Emerging Markets and Asia ex Japan continue to underperform.

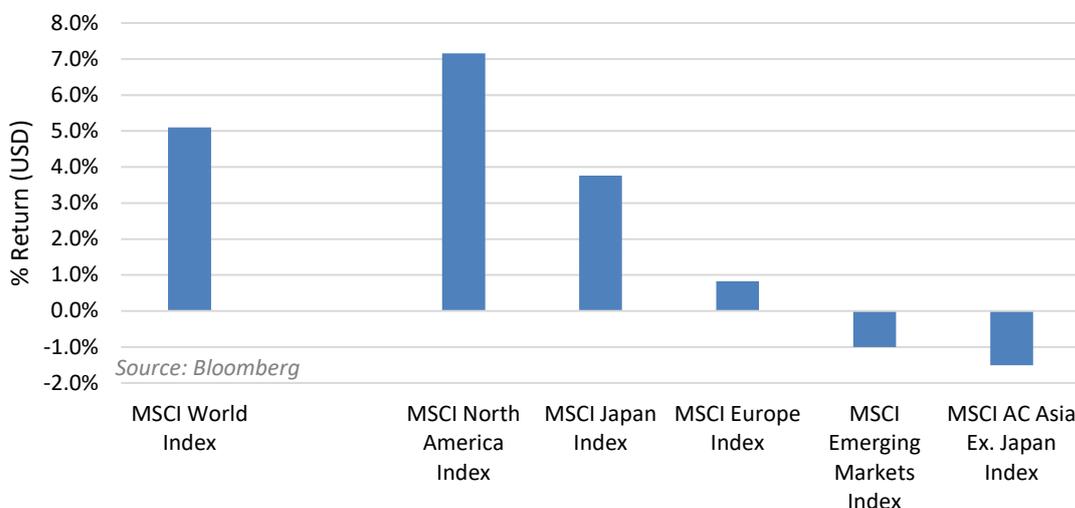


Figure 3: Regional performance in Q3 2018 (all TR in USD)

### Performance drivers

Our overweighting of 36% to the Information Technology sector provided a positive contribution to the portfolio. However, our stock selection was a drag, particularly within the IT and Consumer Discretionary sectors where strong performances from companies such as Checkpoint Software (+20.46% USD) and Nvidia (+18.69% USD) were offset by underperformers including AAC Technologies (-25.88% USD) and Continental (-23.72% USD).

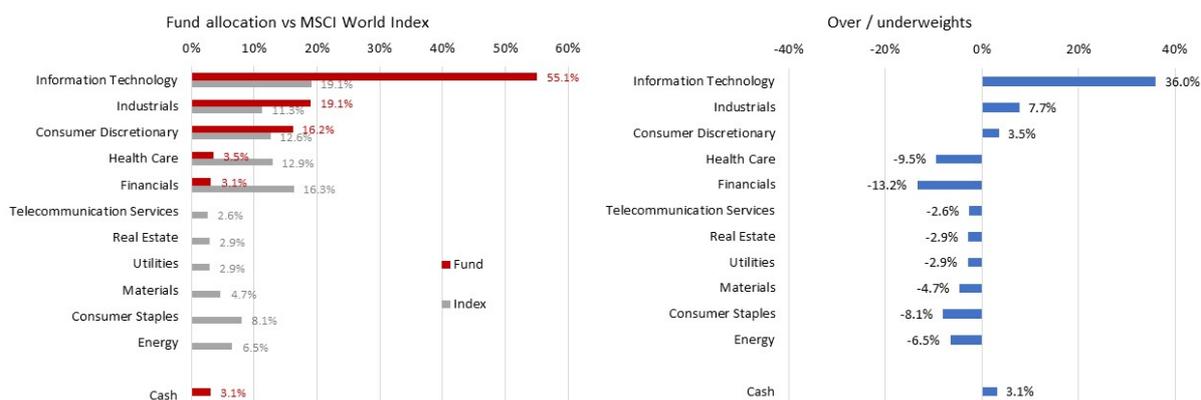
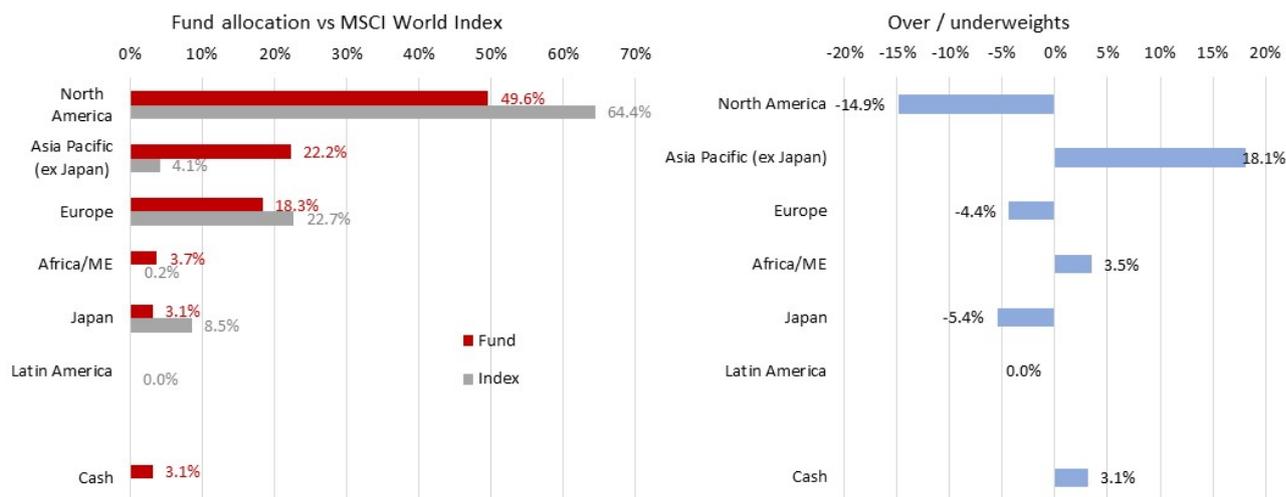


Figure 4: Sector breakdown of the fund versus MSCI World Index. Guinness Asset Management, Bloomberg (data as at 30.09.2018)

Regionally, the portfolio’s overweighting to Asia Pacific ex Japan was a drag on the portfolio, with exposure to China accounting for 1.84% (USD) of the fund’s underperformance. Additionally, our underweighting to the United States, coupled with strong performance by a few large-cap stocks which we do not own (such as Apple), provided further negative contributions to the portfolio relative to the benchmark.

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## Guinness Global Innovators Fund



**Figure 5: Geographic breakdown of the fund versus MSCI World Index. Guinness Asset Management, Bloomberg (data as at 30.09.2018)**

Some of the stocks that have sold off the most in the portfolio (AAC, for example) continue to show good earnings, and revenue growth and operating margins remain robust – suggesting sentiment played a large role in the negative returns, whether due to tariff worries or views on the Asia/EM regions. If the upcoming earnings season suggests company fundamentals are not softening as fast as the market has priced in, then we see the potential for strong gains from these ‘over-sold’ stocks.

Individual stock performance over Q3 2018 (total return USD)

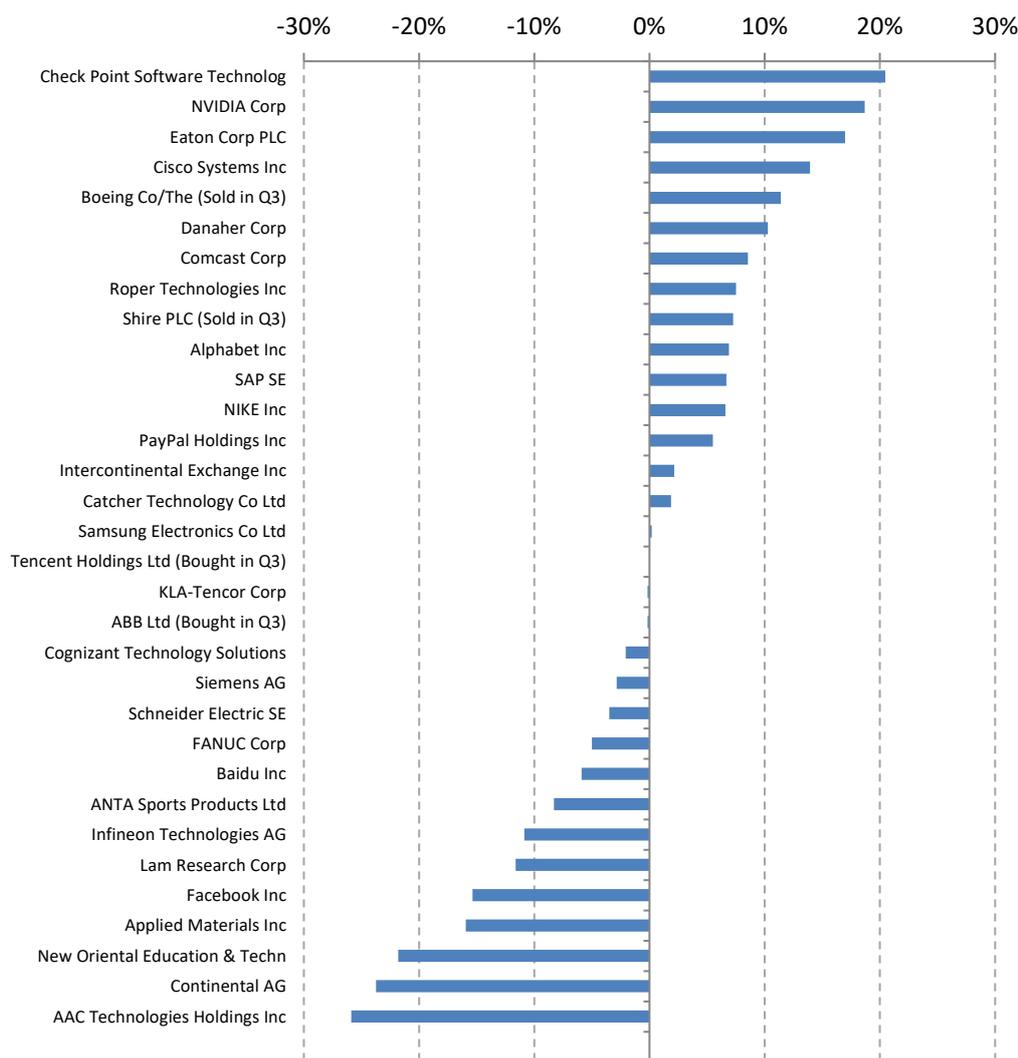


Figure 6: Individual performances of fund constituents. Guinness Asset Management, Bloomberg (data as at 30.09.2018)



Individual companies that performed well over Q3 were Check Point Software Technologies (+20.46% total return in USD) and Nvidia (18.69%).

Check Point, the Israeli software provider, is a leading company in the cyber security space, providing network security, gateway solutions and endpoint solutions. The stock outperformed after strong Q2 results and increased Q3 expectations. In particular, the results indicated a turnaround in US sales growth and stronger-than-expected operating margins. This resulted in upgrades in analysts' recommendations including from JP Morgan, who raised their target price by around 20%. This was welcome news following a period of underperformance beginning Q3 2017 which saw the stock drop around 18% on slowing growth prospects.

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Nvidia, the semiconductor manufacturer which creates graphics processing units (GPUs) for video games and more recently AI-related technologies, was the portfolio's second-largest gainer, up 19% (USD) for Q3. Nvidia shook off market worries around the steep drop in revenues associated with bitcoin mining to post strong earnings results in August, citing a 52% increase year-on-year in revenues from its gaming division and an 83% increase YoY in its data centre unit.



Individual companies that performed poorly over Q3 were AAC Technologies (-25.87% total return in USD) and Continental (-23.73%).

The largest underperformer over the quarter was AAC Technologies, which manufactures smartphone lenses and miniaturised components for acoustics. As a supplier of speaker components for Apple, AAC has faced slowing demand as the smartphone market softens and trade tariffs imposed by the US create further headwinds. We still view AAC as a strong long-term investment which is experiencing temporary headwinds.

Continental's underperformance was driven by profit warnings signalled by management in August, citing lower expected sales and increased costs. It was an indication of softening demand in the automotive sector as interest rates rise, trade tariffs increase costs and consumers change preferences to vehicles such as SUVs. Continental continues to be a quality company and we continue in our belief that its automotive segment, which includes tyres and chassis technology, can benefit from the changing automotive landscape to the electric car and autonomous vehicle.

### Changes to the portfolio

Over the quarter we made two changes to the portfolio, replacing our positions in Shire and Boeing for new positions in ABB and Tencent Holdings.



Shire, the biotech company which researches and develops medicines for rare diseases, was bought in the fund in September 2016. We had previously owned the stock in 2013, selling after the (ultimately failed) bid for the company by AbbVie. Shire operates in a highly lucrative industry, which is reflected in its high margins. However, having come off around 25% to lows in March 2018, Shire was subject to M&A speculation from larger rivals including Japanese firm Takeda, whose US\$62 billion bid is now subject to EU regulatory approval in November. The stock gained 44% after the bid was first proposed and with additional regulatory hurdles to still to overcome, we took the opportunity to sell.

Boeing has been a very strong holding for the portfolio, returning 245% in USD since purchase in 2014. One of the less obvious holdings in the Global Innovators Fund, Boeing was bought as we believed it driving efficiencies by drastically reducing construction time on airlines and using 3D printing for some non-critical components to drive down costs. However, the valuation of the company had increased significantly and this drove our sell decision.

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ABB is one of the leading manufacturers of industrial robots as well as providing electrification products and power generation solutions. We believe ABB is set to benefit from the increasing demand for industrial robots as companies strive to improve efficiencies through factory automation. ABB may also benefit from proposed talks on splitting off its power grid business. After it sold off around 14% from highs in January, we took the opportunity to buy a company offering strong growth prospects and rising returns on capital at a reasonable valuation.

Tencent, the Chinese conglomerate and largest gaming company in the world has subsidiaries including WeChat, the social media platform which boasts over one billion active monthly users and offers a platform for activities ranging from payment making to ordering a taxi; JD.com, China’s answer to Amazon; and Tencent Music Entertainment (TME), which has four times the users of Spotify. However, Tencent has underperformed in 2018, selling off around 35% from highs in January. This was a result of trade tariff concerns, Chinese intervention in the gaming industry and headlines surrounding its e-commerce holding JD.com. Tencent may still not appear cheap relative to the market, although with returns on capital around 20% and growth prospects above 20% p/a, we believe the higher valuation is warranted and Tencent is set to benefit from continuous R&D in its new and existing channels.

## Portfolio characteristics

The chart below shows the geographic weighting of the portfolio by domicile and by source of revenue.

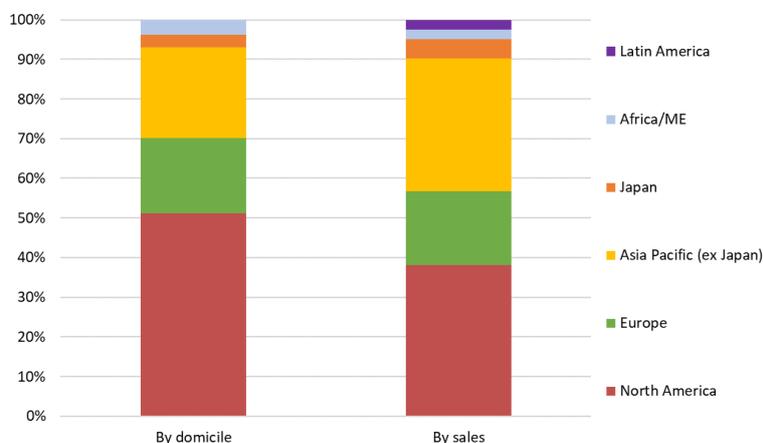
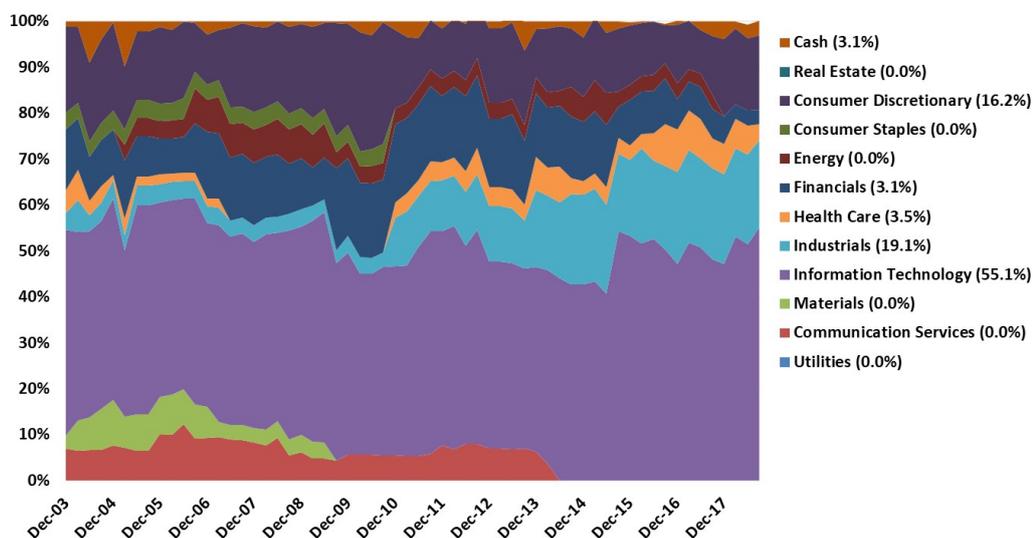


Figure 7: Geographic breakdown of the fund. Guinness Asset Management, Bloomberg (data as at 30.09.2018)

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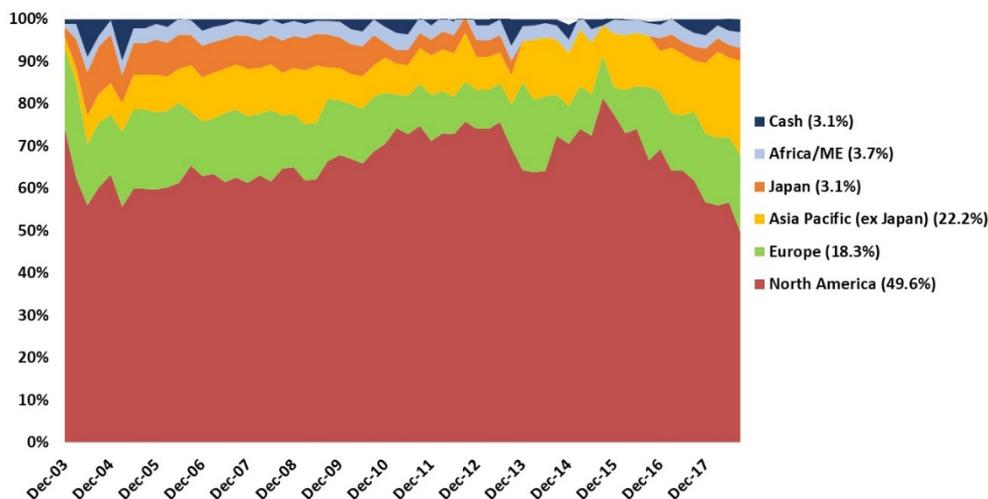
## Guinness Global Innovators Fund

The two charts below show how the exposure of the fund has evolved since we launched the strategy in 2003. We continue to hold no exposure to Real Estate, Energy, Materials and Utilities. Technology remains our largest exposure, split between three sub-sectors: semiconductors; software and services; and technology hardware.



**Figure 8: Portfolio sector breakdown. Guinness Asset Management, Bloomberg (30.09.2018)**

Our exposure to North America continues to decrease as we find increasingly attractive positions in Asia, particularly in the IT sector.



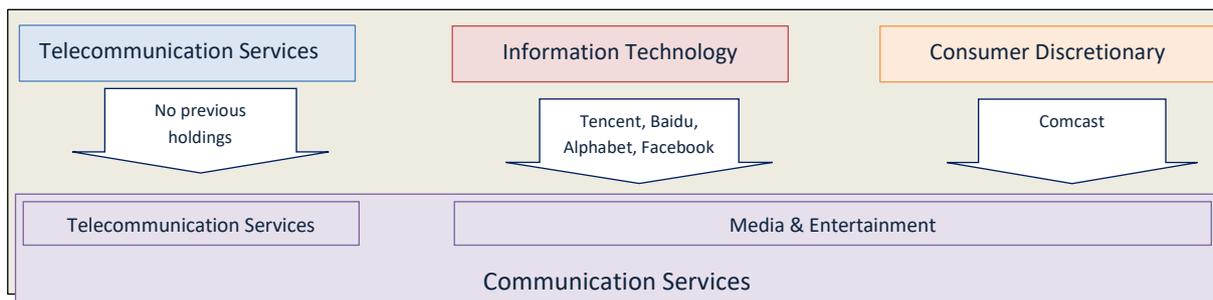
**Figure 9: Portfolio geographic breakdown. Guinness Asset Management, Bloomberg (30.09.2018)**

## Portfolio characteristics under new GICS reclassification

On 28<sup>th</sup> September, MSCI and S&P implemented a reclassification of the Telecommunications sector under the new name of Communication Services. The new classification will encompass content providers and advertising, entertainment and social media platforms, grouping FAANG constituents Netflix, Facebook and Alphabet together and greatly increasing the sector's index weighting.

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The changes affect the following constituents of the Guinness Global Innovators Fund:



The following summaries the changes to the fund and MSCI World sector weightings:

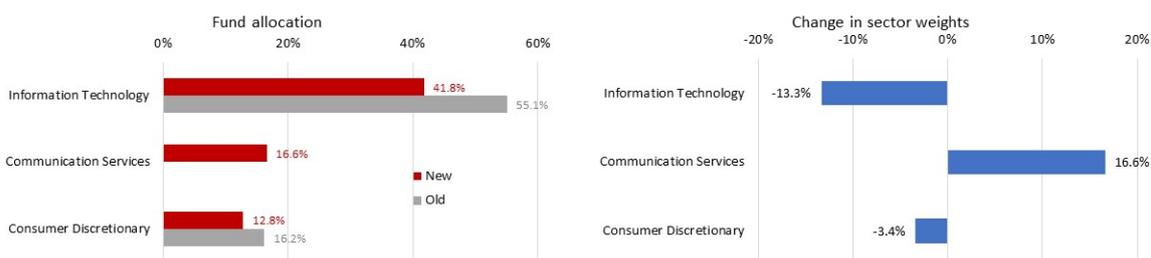


Figure 10: Portfolio sector weights before and after GICS reclassification of Telecommunication services. Guinness Asset Management, Bloomberg (30.09.2018)

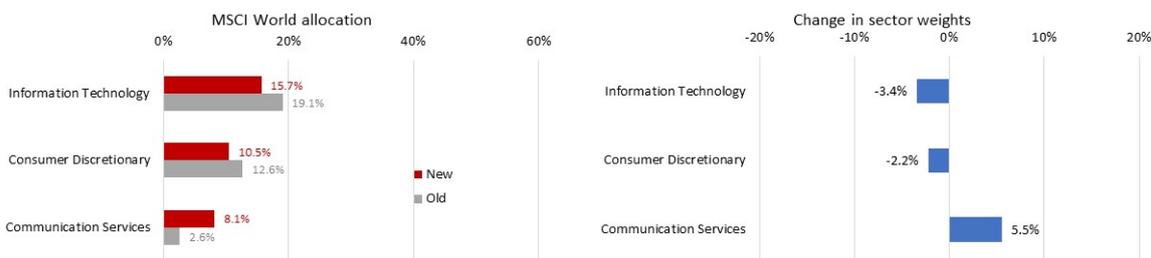


Figure 11: MSCI World sector weights before and after GICS reclassification of Telecommunication services. Guinness Asset Management, Bloomberg (30.09.2018)

The reclassification gives the following new allocations against the benchmark:

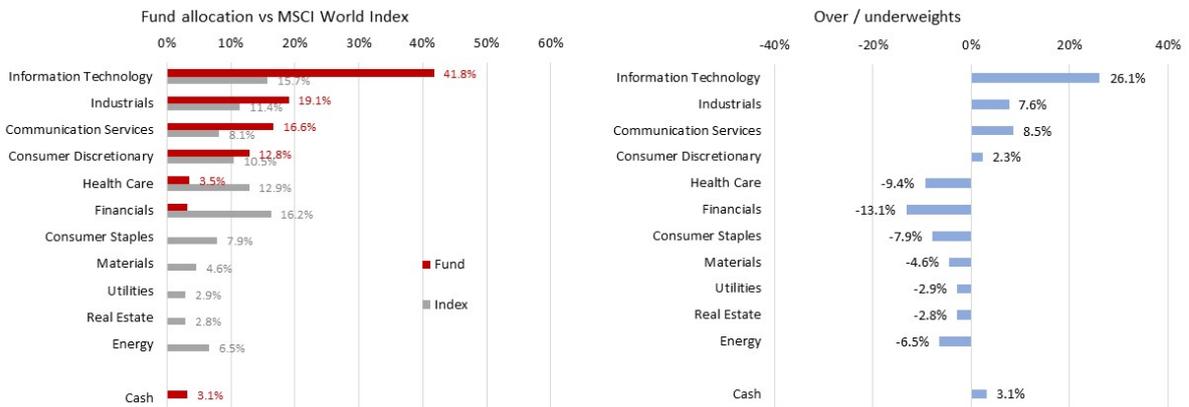


Figure 12: Sector breakdown after GICS reclassification of Telecommunication services. Guinness Asset Management, Bloomberg (30.09.2018)

## Key fund metrics today

The four key tenets to our approach are innovation, quality, growth, and conviction.

		Fund	MSCI World Index
Innovation	R&D / Sales	8%	6%
	CAPEX / Sales	6%	9%
Quality	CFROI (median 2017)	16%	9%
	Weighted average net debt / equity	-13%	64%
Growth (& valuation)	Trailing 3-year sales growth (annualised)	15%	6%
	Estimated earnings growth (2019 vs 2018)	9%	9%
	FCF yield	4.7%	4.1%
	PE (2018e)	17.0	16.5
Conviction	Number of stocks	30	1190
	Active share	94%	-

Figure 13: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 30.09.2018)

As the table above shows, the Global Innovators Fund displays characteristics in line with this philosophy: higher spend on R&D; less capital intensiveness; substantially higher returns on capital; all whilst trading at a modest premium to the benchmark.

## Outlook

The fund is now trading at an 3% premium to the broad market on a PE ratio basis (fund 17.0x 2018 expected earnings vs MSCI World Index 16.5x). The longer-term premium of the fund versus the

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broader market has been in the 10-20% range, and so we still believe the portfolio offers good value relative to the market today. We also note the FCF yield of the fund is higher than the benchmark (4.7% vs 4.1%). From a long-term perspective, the portfolio invests in highly efficient companies (median CFROI 2017 16% vs 9%) whose innovative nature differentiates them from competitors and consequently should drive demand for their products.

We 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*

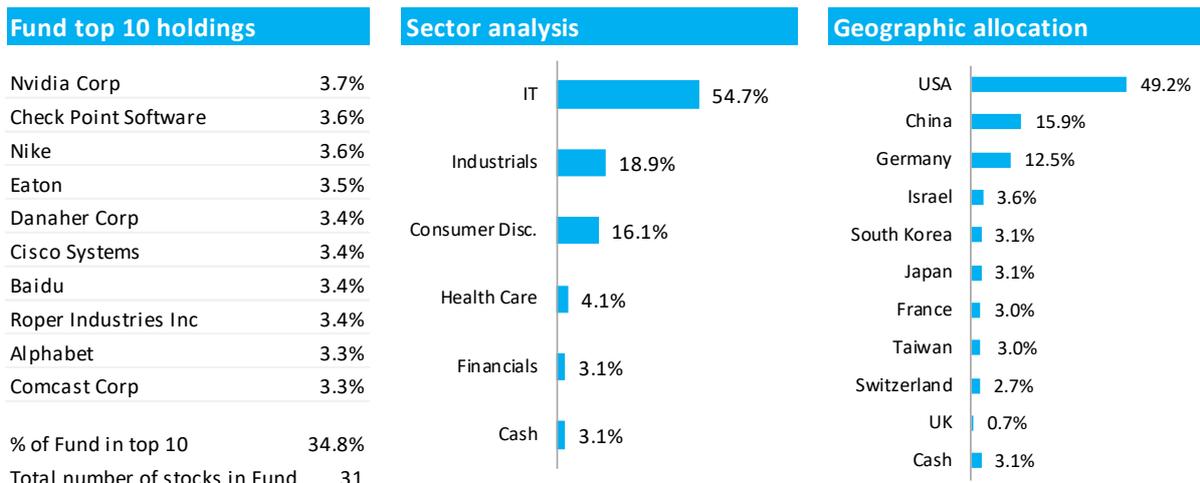
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## Guinness Global Innovators Fund

**PORTFOLIO**

**30/09/2018**



**30/09/2018**

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

Guinness Global Innovators strategy*	12.86%
MSCI World Index	10.23%
IA Global sector average	9.35%

### Discrete years % total return (GBP)

	Sep '14	Sep '15	Sep '16	Sep '17	Sep '18
Guinness Global Innovators strategy*	22.6	-2.0	31.8	24.1	8.8
MSCI World Index	12.1	1.6	29.8	14.4	14.4
IA Global sector average	7.9	-1.4	26.1	14.9	11.6

### Cumulative % total return (GBP)

	1 month	Year- to-date	1 year	3 years	5 years	10 years
Guinness Global Innovators strategy*	-3.1	3.3	8.8	78.1	113.9	347.3
MSCI World Index	0.2	9.4	14.4	70.0	93.6	210.7
IA Global sector average	-0.4	6.4	11.6	61.8	72.2	167.3

### RISK ANALYSIS

**30/09/2018**

Annualised, weekly, 5 years, in GBP	Index	Sector	Strategy*
Alpha	0	0.46	0.60
Beta	1	0.79	1.13
Information ratio	0	-0.38	0.36
Maximum drawdown	-14.03	-17.08	-17.14
R squared	1	0.77	0.87
Sharpe ratio	0.85	0.71	0.85
Tracking error	0	5.88	5.66
Volatility	12.27	11.07	14.87

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\*Composite simulation of performance. Guinness Global Innovators Fund (UCITS) launched on 31.10.14.

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Source: Financial Express, bid to bid, total return, in GBP

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## 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](http://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](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

Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

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