# Guinness European Equity Income Fund

## INVESTMENT COMMENTARY – November 2018

| | |
|---|---|
| **Launch date** | **19.12.2013** |
| **Team** | **Ian Mortimer** (manager)<br>**Matthew Page** (manager)<br>**Nick Edwards** (analyst) |

### Aim

The Guinness European Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Europe ex UK region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

### Performance

31.10.18

| | |
|---|---|
| **Fund** | European Equity Income |
| **Index** | MSCI Europe ex UK |
| **Sector** | IA Europe ex UK |

| | 1 year | 3 years | From launch |
|---|---|---|---|
| **Fund** | -3.1 | 40.5 | 45.2 |
| **Index** | -6.2 | 32.1 | 39.5 |
| **Sector** | -7.0 | 31.5 | 42.0 |

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


**Risk analysis** (annualised, weekly, from launch)

| | Index | Sector | Fund |
|---|---|---|---|
| **Alpha** | 0.0 | 1.1 | 1.6 |
| **Beta** | 1.0 | 0.9 | 0.9 |
| **Info ratio** | 0.0 | 0.1 | 0.2 |
| **Max drwdn** | -18.0 | -15.0 | -16.5 |
| **Tracking err** | 0 | 5 | 5 |
| **Volatility** | 13.8 | 13.0 | 13.0 |
| **Sharpe ratio** | 0.2 | 0.3 | 0.3 |

**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, Z class 0.74%, bid to bid, total return.

## Summary performance

In October, the Guinness European Equity Income Fund produced a total return of -3.12% (in GBP) versus the MSCI Europe ex UK Index return of -6.08%. The fund therefore outperformed the Index by 2.96% in the month. It is pleasing to see that both the short and long-term performance of the fund's strategy remain ahead versus IA Europe ex UK peers.

| | 1 Month | 3 Months | YTD | 1 Yr | 3 Yrs |
|---|---|---|---|---|---|
| **Fund** | -3.12% | -4.60% | -2.42% | -3.05% | 40.51% |
| **Index** | -6.08% | -7.81% | -4.88% | -6.17 | 32.05% |
| **IA sector average** | -7.05% | -8.92% | -6.24% | -7.02 | 31.48% |
| **Out / Under performance vs Sector** | 3.97% | 4.32% | 3.82% | 3.97% | 9.03% |

Source: Financial Express 0.74% OCF. Cumulative Total Return in GBP as of 31 October 2018

Outperformance in the month came from both stock-specific alpha and sector allocations. Both of our holdings in the IT sector, **Tieto** and **Inficon**, outperformed following better-than-expected numbers against a backdrop of large sector declines. The IT sector was the worst-performing sector in Europe with -9% for the month. The fund also benefitted from having no exposure to Materials, the second-worst-performing European sector, returning -8.5% over the month. In Industrials, down -8.2% in October and a c.7% overweight sector for the fund, both **Schneider Electric** and **Konecranes** rose sharply after better-than-expected Q3 earnings. In the Consumer Discretionary sector, **Continental AG** also came out with better-than-expected numbers. In short, several stocks reported quite robust results against a backdrop where the market has jumped to some quite negative conclusions driven by the loud noise around trade wars, Italian populist coalition posturing and Brexit.

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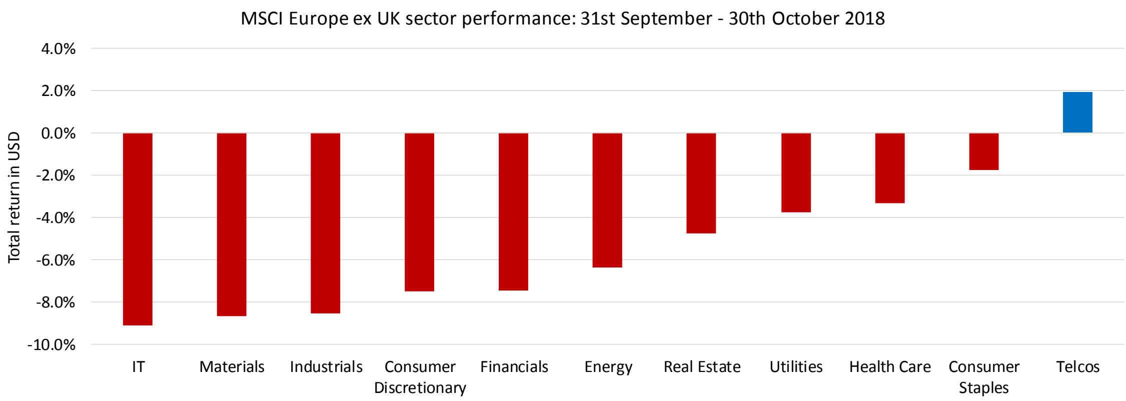
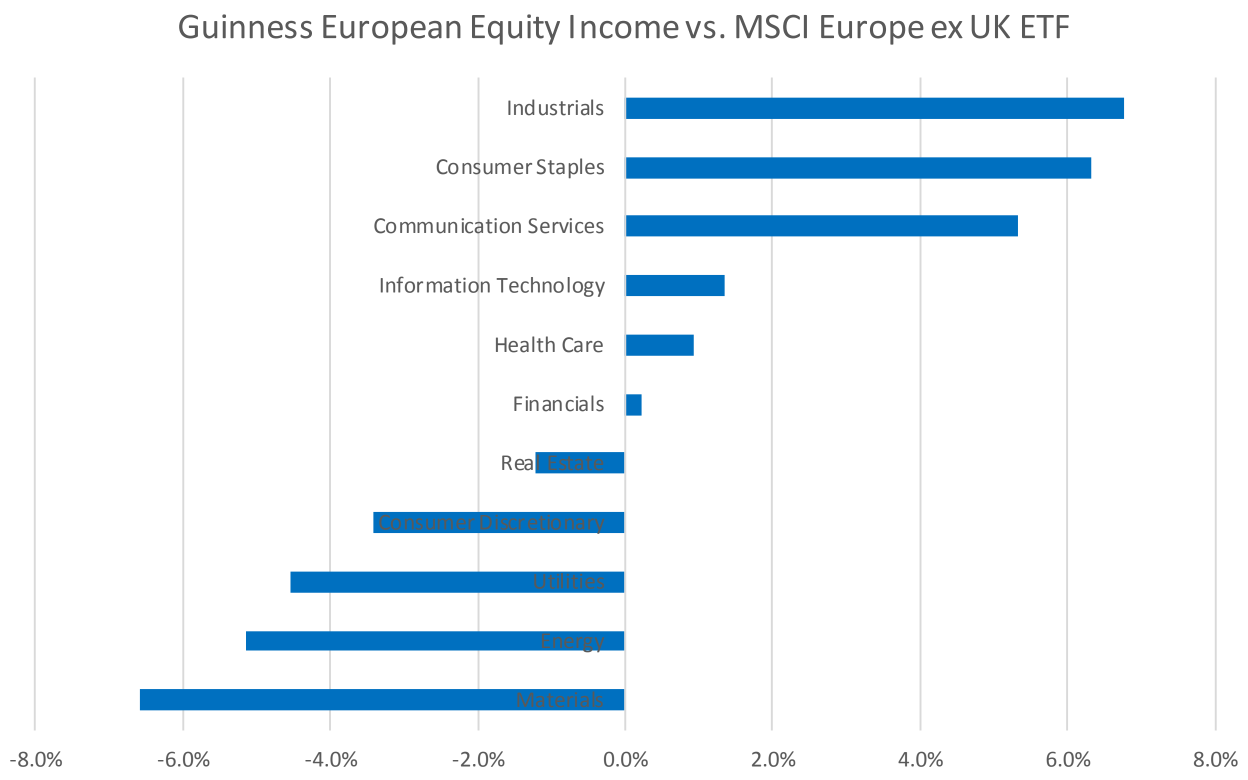
At the other end of the spectrum, our large 6.5% overweight position in Consumer Staples and 1.2% overweight in Healthcare helped fund performance**. Unilever, Nestle** and **Danone** all reported Q3 earnings in October and in aggregate traded higher, helped by positive commentary from P&G. Sales and price growth was looked upon favourably by the market and was ahead of rising input costs. Danone reminded us that no one can twiddle thumbs given increased local small-brand competition, enabled by the direct-to-consumer nature of internet marketing. This sector has an excellent track record for passing on inflation. We are watchful of ratings given the likely upward direction of real rates after nearly two decades of declines, which have been helpful for long-duration stocks.

Telecoms was the only sector in Europe to see positive returns over the month, which was a headwind for the fund. The prospects for the sector have improved, in our view. The French regulator Arcep and others have turned face after years of focusing on costs to the consumer ahead of the need to invest. With the requirement to invest in 5G now paramount, consolidation is being actively encouraged and pricing power seems likely to improve.



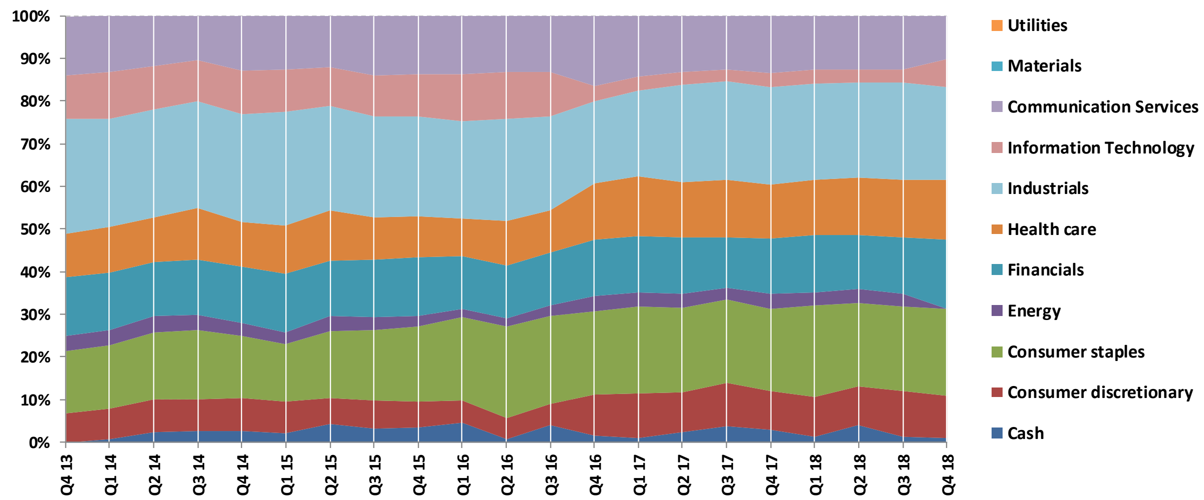

Source: Bloomberg. As of 31st October 2018

We continue to hold none of the stocks in the Materials, Real Estate or Utilities, many of which do not make it into our universe due to our focus on quality and persistent returns. Industrials, Consumer Staples and Communications Services remain our significant sector overweight holdings.




Source: Bloomberg data, Guinness data.

**We made three portfolio changes in the month of October. Euronext, Continental AG** and **Inficon** were bought, replacing JM AB, Tecnicas Reunidas and Freenet. Our exposure to the Information Technology sector doubled as a result of the Inficon purchase, while Financials moved to a small overweight with the Euronext purchase. Consumer Discretionary exposure remained flat as Continental replaced JM AB. Communications Services exposure fell as Freenet left the portfolio and we now have no exposure to Energy after the sale of Tecnicas Reunidas. Departures had all seen a combination of rising debt or stalling dividend growth.




Source: Guinness Asset Management. As of 31st October 2018

**Euronext** operates cash and derivatives exchanges in Europe along with fund and debt listings and custody and settlement services. Euronext is a good fit for the portfolio, offering an attractive combination of capital growth and yield. The 3.25% dividend yield is accompanied by a strong balance sheet with a net cash position. Euronext has generated consistent high and rising margins along with eight-year cash flow returns on investment averaging c.35%. The company has a very strong position in its core European markets (Paris, Amsterdam, Brussels, Lisbon and Dublin), with c.66% market share in cash equities and number one market positions in debt and funds listings. Barriers to entry are high and stem from both network effects and regulation, a combination which should see the moat continue to widen for years to come. A maintenance capex to sales ratio of just 3% means that there should also be ample room for the company to continue to invest for growth and consistently increase cash returns to shareholders.

The medium-term backdrop looks supportive for Euronext, with European consolidation likely to drive M&A related listing fees, while Brexit plays to Euronext by pushing marginal business to Dublin, Paris and Amsterdam. Volatility is usually good news for exchanges and turmoil in October should prove to have been good for business. On the cost side, there should be on-going savings to come and synergies from the recent Irish Stock Exchange acquisition. After the collapse of the LSE and Deutsche Boerse merger in 2017, consolidation could continue to be a theme for this attractive oligopoly. Euronext represents good value and trades on a PE of 15.6x while generating a return on equity of 35%. Deutsche Boerse, meanwhile, trades on 19x and generates a c.20% return on equity.

**Continental AG** has a robust track record, averaging over 10% cash return on investment for the last eight years, and occupies leading market positions in all three business segments. In our view this is a company where management are firmly on investors' side. A decentralised capital allocation structure means that segment managers think and act like owners, while an incentive package based on return on capital employed is well aligned with investors. Group R&D spend averages an impressive 7% of sales, keeping the company at the leading edge of innovation.

Thanks to Donald Trump and fears around trade wars with China, the market offered up some attractive prices in the shares of Continental and some other high-quality cyclicals over the last month. Indeed, at their October lows the shares were pricing negative growth in perpetuity based on an 8% discount rate. This was a timely opportunity in our view, as the next couple of years look set to bring a lot of change to the group which should highlight the value of its parts. Continental is in the process of putting all the internal combustion engine (ICE) and hybrid-related operations into a new Powertrain division ahead of its IPO next year. The year after that, management have signalled potential to spin off Rubber (global no.4 of an oligopoly), which could very possibly merge with Michelin (global no.2) given the active direction Europe is taking to scale up to compete globally. The remaining new Automotive division will hold the attractive high-IP longer-term assets (Autonomous Driving Technologies and Vehicle Networking Technologies).

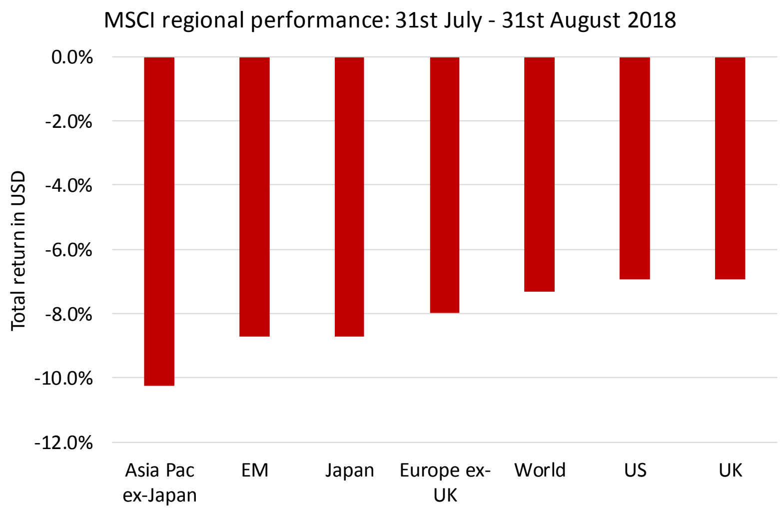
On just 9.6x earnings and generating a return on equity of approximately 20%, Continental offers great value and is trading at 10-year valuation lows. The shift from 'conglomerate' to scalable and capital-light as Powertrain and Rubber are spun off should be supportive for the rating, while the structural tailwind from rising tech content in autos and electrification plays to Continental's strengths.

**Inficon** is an enabler of productivity and efficiency gains across advanced industries ranging from semiconductors through to air conditioning, refrigeration, life sciences and lithium ion battery manufacturing. Products include vacuum-based instrumentation for gas analysis, measurement and control, critical sensor technologies and advanced process control software. Market-leading positions in vacuum leave Inficon well placed to continue to dominate an attractive niche, and R&D spend approximating to 8% of sales maintains its edge. The company has a history of generating consistently high cash returns on invested capital. It is conservatively run and has c.€80m of net cash on the balance sheet. Employee satisfaction is high, and crucially, management think and act for the long term.

Thanks to recent concerns over trade tariffs between the US and China, the market offered some attractive prices for shares of this high-quality compounder in October. On 18x earnings and generating a return on equity of some 32%, the shares look good value and offer a near-4% dividend yield to boot. Modest maintenance capex requirements of 3% of sales leave plenty to fund growth and rising returns to shareholders. A structural tailwind from the continuing trends towards digitalisation, increased complexity, miniaturisation and rising demand for intelligent sensors across IoT, automation and environmental markets should continue to drive demand for Inficon's cutting-edge products for a long time to come. With new products and designs set to come through over the coming few years alongside rising technology capex, we think there should be good news in store for shareholders. This is a business that shareholders can feel good about owning for the long term.

## October in Review

October saw markets finally capitulate amid a confluence of factors that had been weighing on investor psychology for some time. Trump and trade tariffs, Italian populists, Brexit, Saudi concerns, German local elections, auto emissions bottlenecks, rising inflation and higher bond yields (but not breakeven rates) all took their toll. Most global indices fell in the range of 6.5% - 11%, with Europe ex. UK falling 8% in local currency and in USD according to Bloomberg data. In Europe, cyclicals such as banks, tech and rate-sensitive Consumer Discretionary stocks were hit hardest. Some indices, such as the Italian MIB, are now pricing in recession in our view, although evidence on the ground looks quite a long way away from suggesting that.




Source: Bloomberg. As of 30th October 2018

It is the case that some European leading indicators including PMIs and industrial and service sentiment showed signs of softening following earlier falls in global indicators such as new export orders. It is also the case that the new Italian coalition government is posturing in an attempt to live up to its populist election pledges. The government now has until November 13th to reply to the EU with a new budget proposal after the EU rejected its initial 2.4% budget deficit target. We suspect that a compromise will be reached. After all, the alternatives – of capital controls, which would put more pressure on T2 balances – aren't attractive to either party, nor to the support base of the Northern League (the larger coalition party focused on immigration) which is in the wealthy north of Italy. Similarly, with Brexit, the most likely outcome is that some sort of compromise will be reached.

**Valuations in some parts of European markets are discounting recession, trading at multiples not far off those seen in the Euro crisis or even prior to that in 2008. Meanwhile, the recent Q3 EU Bank Lending Survey highlighted rising loan demand across all categories and easier credit standards for loans to enterprise. Risks look to the upside, and notably so if compromises are found on Italy and Brexit in the coming months.**

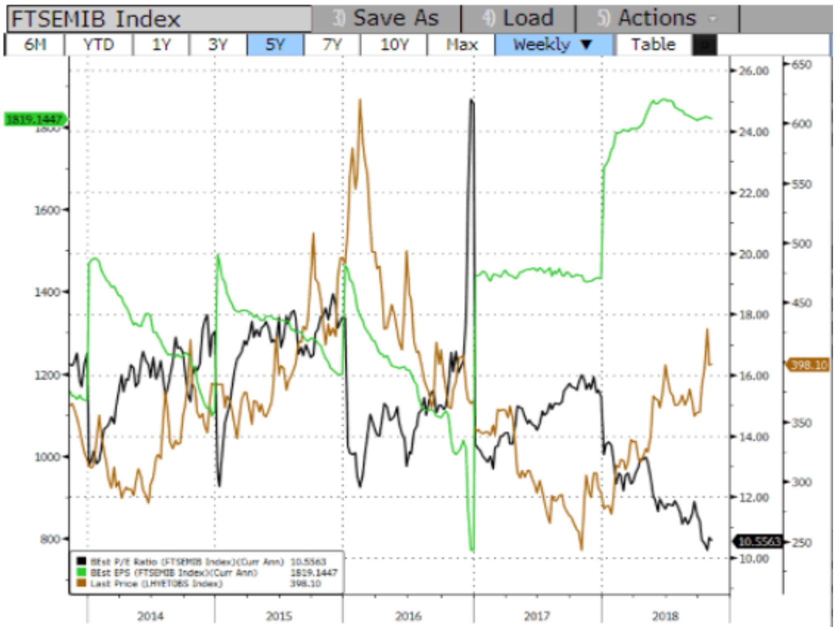
(net percentages of banks reporting tightening credit standards or positive loan demand)

| | Enterprises | | | | | | House purchase | | | | | | Consumer credit | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Credit standards | | | Demand | | | Credit standards | | | Demand | | | Credit standards | | | Demand | | |
| Country | 18 Q2 | 18 Q3 | Avg. | 18 Q2 | 18 Q3 | Avg. | 18 Q2 | 18 Q3 | Avg. | 18 Q2 | 18 Q3 | Avg. | 18 Q2 | 18 Q3 | Avg. | 18 Q2 | 18 Q3 | Avg. |
| Euro area | -3 | -6 | 9 | 16 | 12 | -2 | -8 | -2 | 6 | 23 | 5 | 4 | -3 | 1 | 4 | 25 | 22 | 1 |
| Germany | -3 | -3 | 4 | 25 | 10 | 4 | -7 | -3 | 2 | 21 | 3 | 8 | -3 | 3 | -1 | 38 | 6 | 10 |
| Spain | -10 | -10 | 10 | 0 | -20 | -3 | -11 | 0 | 15 | 22 | 22 | -9 | -20 | -10 | 6 | 60 | 40 | -7 |
| France | 0 | 0 | 6 | -3 | 4 | -10 | -2 | -2 | 2 | 17 | -22 | 8 | 0 | 0 | -1 | 14 | 36 | 0 |
| Italy | -10 | -10 | 14 | 10 | 30 | 4 | 0 | 0 | 1 | 20 | 10 | 15 | 0 | 0 | 7 | 30 | 20 | 15 |
| Netherlands | 0 | -26 | 10 | 45 | 43 | -1 | -50 | -34 | 13 | 51 | 49 | -1 | 0 | 0 | 13 | -18 | 32 | -16 |

**The Q3 2018 EU Bank Lending Survey, showing rising loan demand and looser credit standards.**

Behavioural psychologists should be interested; we see an excessive reaction to current information that does not match an apparently stable outlook for cash flows and dividends. With the pain of losses associated with the Euro crisis and 2008 still fresh in investors' minds, it has been far easier to sell than risk another round of the same. Over the month Bank of Italy data showed that outflows of Italian government and bank debt by foreigners is already at a higher level than in July 2011, Feb 2012 and December 2016, highlighting quite how nervous market sentiment is towards Italy.

The Guinness European Equity Income Fund only holds one company with any direct exposure to Italy, the asset manager Azimut, which has around 3% direct equity exposure to domestic Italian equities. However, you should not be surprised if exposure to high-quality cyclicals (like Continental and Inficon) is increased further given the glaring valuation differential between cyclical value and long-duration quality. The following chart of the Italian MIB Index sums it up well, with PE valuation back near 10-year lows while earnings estimates for next year remain upgraded. Note that on 10.5x earnings the PE of the MIB Index is below where it was when credit spreads were some 50% higher.




**Bloomberg data. FTSE MIB BEST P/E ratio (black), EPS (green), CS High Yield Credit Spread over benchmark (brown).**

Similarly, Stoxx 600 EPS have improved over the last five years, and credit spreads have risen recently but the Stoxx 600 PE is trading at five-year lows, below where it was when credit spreads were some 50% higher. Meanwhile, price to book valuations of unloved Stoxx 600 sectors such as banks and autos, good proxies for domestic and trade sensitive companies, are back near to 2011 and 2008 lows.

The good October fund performance saw your Guinness European ex UK Income Fund move up the rankings into second place for the year to 31st October among peer Europe ex-UK income funds, outperforming the MSCI Europe ex UK Index over one year, three years and since launch.

| Year to date | |
|---|---|
| Polar Capital European (EX UK) Income | -2.27 |
| Guinness European Equity Income Z Dis | -2.42 |
| Allianz European Equity Income C Inc | -2.45 |
| Montanaro European Income | -2.58 |
| Waverton European Dividend Growth L Inc | -3.52 |
| L&G European Equity Income | -4.56 |
| Argonaut FP Argonaut European Income Oppo | -6.13 |
| BlackRock Continental European Income | -6.28 |
| Invesco European Equity Income | -6.58 |
| Legg Mason IF Martin Currie European Equity I | -6.59 |
| Liontrust European Income | -7.85 |
| Standard Life Investments European Equity In | -7.99 |
| Liontrust European Enhanced Income | -8.06 |
| GLG European Alpha Income | -8.36 |
| Quilter Investors Europe (ex UK) Equity Income | -8.72 |
| Jupiter European Income | -8.75 |
| Schroder European Alpha Income | -8.84 |
| F&C European Growth & Income | -9.04 |
| **Sector : IA Europe Excluding UK** | **-6.24** |

| 1 year | |
|---|---|
| Polar Capital European (EX UK) Income | -0.90 |
| Waverton European Dividend Growth L Inc | -1.43 |
| Montanaro European Income | -1.54 |
| Argonaut FP Argonaut European Income Oppo | -2.95 |
| Guinness European Equity Income Z Dis | -3.05 |
| Allianz European Equity Income C Inc | -3.43 |
| Invesco European Equity Income | -7.24 |
| BlackRock Continental European Income | -7.33 |
| F&C European Growth & Income | -7.35 |
| Legg Mason IF Martin Currie European Equity I | -7.55 |
| Liontrust European Enhanced Income | -8.50 |
| Liontrust European Income | -8.60 |
| Standard Life Investments European Equity In | -9.11 |
| Jupiter European Income | -9.63 |
| Quilter Investors Europe (ex UK) Equity Income | -10.00 |
| Schroder European Alpha Income | -10.10 |
| **Sector : IA Europe Excluding UK** | **-7.02** |

| 3 Years | |
|---|---|
| Waverton European Dividend Growth L Inc | 52.93 |
| Montanaro European Income | 50.04 |
| Guinness European Equity Income Z Dis | 40.51 |
| Polar Capital European (EX UK) Income | 38.80 |
| Allianz European Equity Income C Inc | 33.89 |
| Schroder European Alpha Income | 32.87 |
| F&C European Growth & Income | 32.52 |
| Invesco European Equity Income | 30.10 |
| BlackRock Continental European Income | 29.15 |
| Standard Life Investments European Equity In | 27.32 |
| Jupiter European Income | 26.41 |
| Legg Mason IF Martin Currie European Equity I | 22.04 |
| Liontrust European Income | 19.67 |
| Liontrust European Enhanced Income | -1.02 |
| **Sector : IA Europe Excluding UK** | **31.48** |

| From launch (19.12.13) | |
|---|---|
| Montanaro European Income | 63.32 |
| Waverton European Dividend Growth L Inc | 59.88 |
| Schroder European Alpha Income | 53.24 |
| BlackRock Continental European Income | 50.84 |
| F&C European Growth & Income | 46.21 |
| Guinness European Equity Income Z Dis | 45.15 |
| Invesco European Equity Income | 42.39 |
| Allianz European Equity Income C Inc | 38.55 |
| Standard Life Investments European Equity In | 38.51 |
| Jupiter European Income | 36.35 |
| Liontrust European Income | 36.26 |
| Liontrust European Enhanced Income | 31.10 |
| Legg Mason IF Martin Currie European Equity I | 28.18 |
| **Sector : IA Europe Excluding UK** | **42.00** |

**Source: Financial Express, IA Europe Equity Income sector**

We thank you for your continued support.

**Dr Ian Mortimer, CFA** and **Matthew Page, CFA** (portfolio managers)
**Nick Edwards** (analyst)

**Data sources**

Fund performance: *Financial Express, total return*

Index and stock data: *Bloomberg*

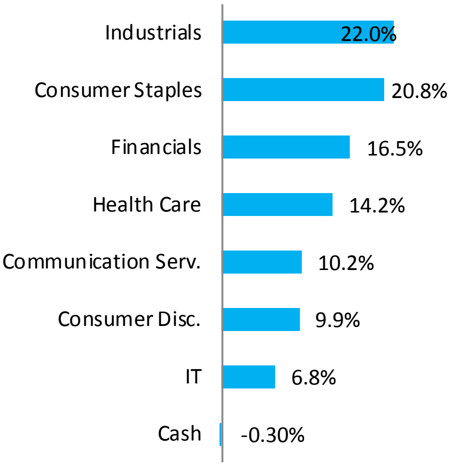
## PORTFOLIO

31/10/2018

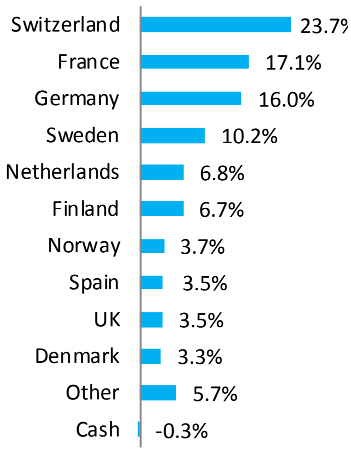
### Fund top 10 holdings

| | |
|---|---|
| Sanofi | 3.8% |
| Salmar | 3.7% |
| Novartis | 3.6% |
| Helvetia Holding | 3.6% |
| Roche Holding | 3.5% |
| Mapfre | 3.5% |
| Nestle | 3.5% |
| Unilever | 3.5% |
| Publicis Groupe | 3.5% |
| Continental | 3.4% |
| % of Fund in top 10 | 35.5% |
| Total number of stocks | 30 |

### Sector analysis




### Geographic allocation




## PERFORMANCE

31/10/2018

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


| Discrete years % total return (GBP) | Oct '14 | Oct '15 | Oct '16 | Oct '17 | Oct '18 |
|---|---|---|---|---|---|
| **Fund** | - | 1.3 | 28.9 | 16.1 | -3.1 |
| MSCI Europe ex UK Index | 5.6 | -1.6 | 20.0 | 21.5 | -6.2 |
| IA Europe ex UK sector average | 4.0 | 3.6 | 18.4 | 21.9 | -7.0 |

| Cumulative % total return (GBP) | 1 month | Year-to-date | 1 year | 3 years | 5 years | From launch |
|---|---|---|---|---|---|---|
| **Fund** | -3.1 | -2.4 | -3.1 | 40.5 | - | 45.2 |
| MSCI Europe ex UK Index | -6.1 | -4.9 | -6.2 | 32.1 | 36.6 | 39.5 |
| IA Europe ex UK sector average | -7.1 | -6.2 | -7.0 | 31.5 | 39.5 | 42.0 |

## RISK ANALYSIS

31/10/2018

| Annualised, weekly, from launch on 19.12.13, in GBP | Index | Sector | Fund |
|---|---|---|---|
| Alpha | 0.00 | 1.09 | 1.57 |
| Beta | 1.00 | 0.88 | 0.89 |
| Information ratio | 0.00 | 0.07 | 0.18 |
| Maximum drawdown | -17.99 | -14.98 | -16.49 |
| R squared | 1.00 | 0.87 | 0.88 |
| Sharpe ratio | 0.21 | 0.25 | 0.29 |
| Tracking error | 0.00 | 5.05 | 4.74 |
| Volatility | 13.78 | 13.01 | 13.03 |

**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 (0.74% OCF). Fund launch date: 19.12.2013.

# 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 equities and equity markets invested in by the Guinness European 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 Europe 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. The Fund invests only in stocks of companies that are traded on European stock exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. 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, 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** will be recorded and monitored.