Guinness European Equity Income Fund

INVESTMENT COMMENTARY – December 2018

Launch date	**19.12.2013**
Team	**Ian Mortimer** (manager) **Matthew Page** (manager) **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 30.11.18

Fund	European Equity Income
Index	MSCI Europe ex UK
Sector	IA Europe ex UK

	1 year	3 years	From launch
Fund	-2.6	39.7	44.6
Index	-5.1	30.2	38.8
Sector	-6.8	28.2	40.6

Annualised % total return from launch (GBP)

Fund	7.7%
Index	6.9%
Sector	7.1%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	1.1	1.8
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	13.7	13.1	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 November, the Guinness European Equity Income Fund produced a total return of -0.41% (in GBP) versus the IA Europe ex UK net TR Index return of -0.50% (in GBP). The fund therefore outperformed the index by 0.09% 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	QTD	YTD	1 Yr	3 Yrs
Fund	-0.41	-3.48%	-2.83%	-2.64%	39.73%
Index	-0.50	-6.55%	-5.36%	-5.09	30.18%
Out / Under performance vs Sector	0.09%	3.07%	2.53%	2.45%	9.55%

Source: Financial Express 0.74% OCF. Cumulative Total Return in GBP as of 30 November 2018

Outperformance in the month came both from stock-specific alpha and from sector allocations. Three out of four of our holdings in the **Healthcare** sector, Roche, Novo Nordisk and Novartis, outperformed their sector aggregate which rose 1.9%. All reported positive results from drug trials. Hennes & Mauritz continued to rebound, rising some 7% against declines for the wider **Consumer Discretionary** sector (-3.4%), as management added to stock holdings. The fund benefitted from its complete lack of exposure to the Energy (-6.3%) and Materials (-5.5%) sectors, which fell sharply amid deteriorating macroeconomic data.

Our overweight position in the **Consumer Staples** sector (which rose 2.7%) was a tailwind to performance as Nestlé, Unilever and Danone led their sector higher. Nestlé continues to benefit as its first external CEO refocuses the company at the intersection of food, health and science. It remains to

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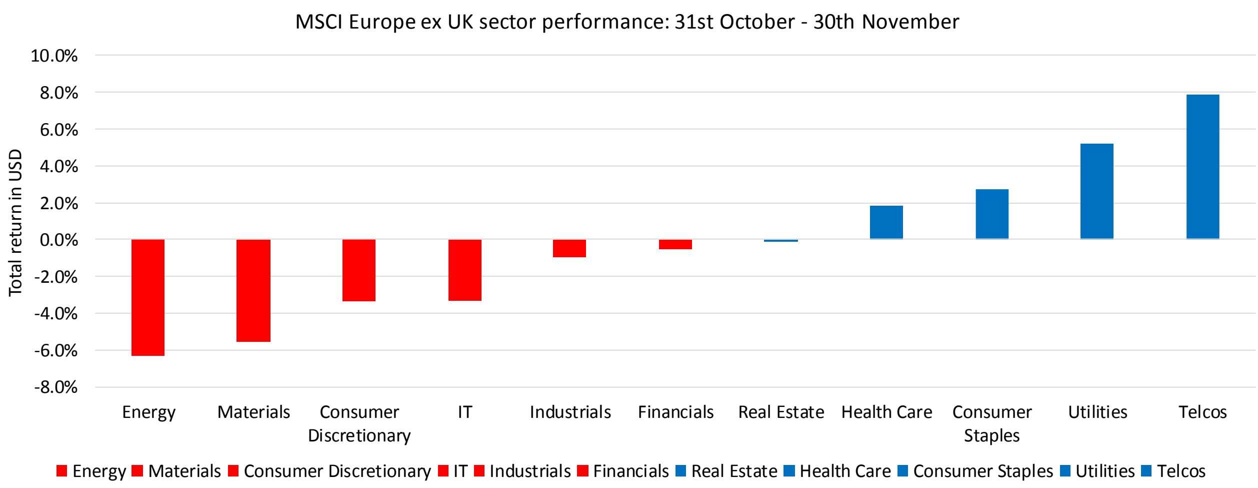
be seen if the new (internal) CEO at Unilever can have a similar impact.

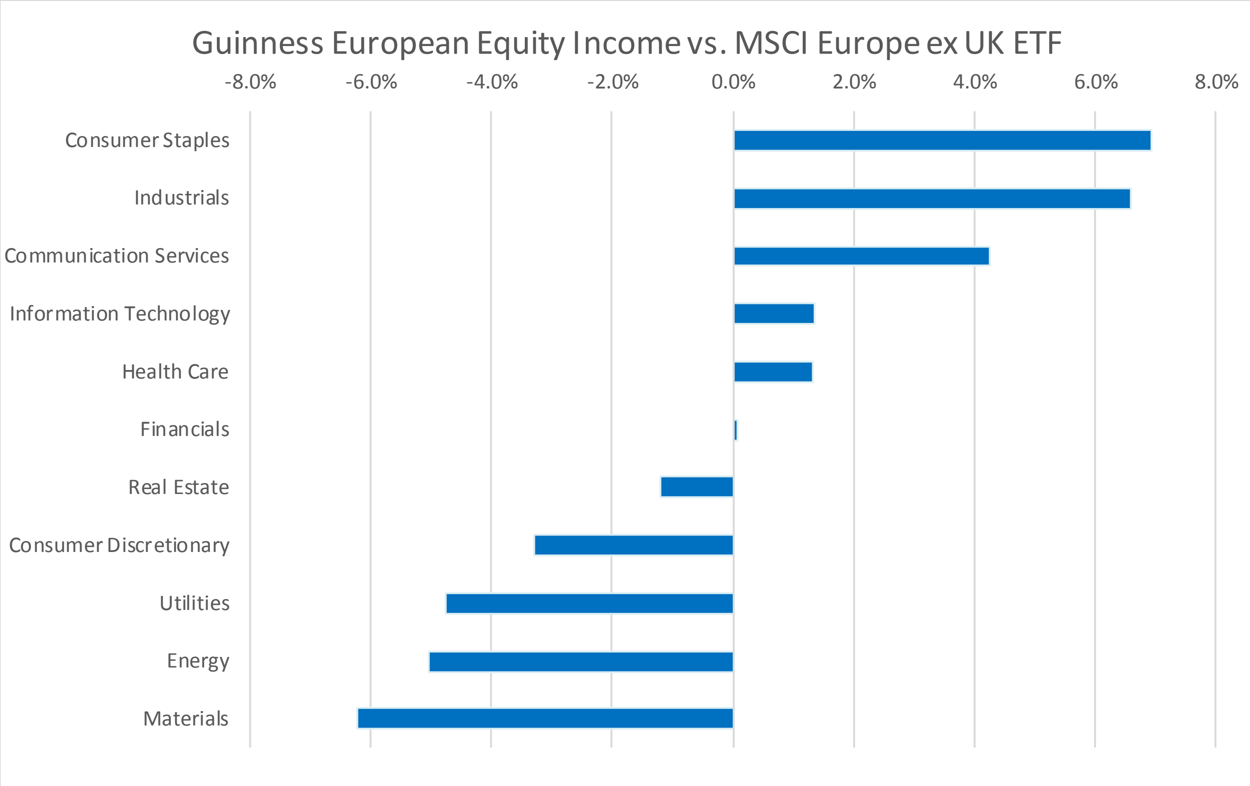
Our other significant sector overweight, **Industrials** (-0.9%), was a drag on performance as continued concerns around global trade saw Andritz and KoneCranes trade lower, despite recent upbeat results from the latter. Continental also suffered as the auto sector remains at the epicentre of these concerns, trading at a price which suggests no future value creation (based on an 8% hurdle rate).

Telecoms remained a thorn in our side by remaining the top performing sector for a second month while we have no exposure to it. There is a strong capital cycle argument for exposure to the sector given returns that look unsustainably low if the European industry is to invest in 5G and compete on a global stage; something that European politicians are keen to see. If the EC regulator approves the merger of T-Mobile and Tele2 AB it will confirm a new direction of travel for the sector, namely consolidation, which will bring increased pricing power, returns and the ability to invest, as opposed to the concern for consumer prices which has dominated over the last few years. This would represent a positive read for other pending deals and signal the return of potential M&A in the French Telco sector. Our focus on quality and persistent returns precludes many names in the telecoms sector, and reliance on a regulator to access such returns is never ideal, but there are some names in the sector that do make the (returns) grade.



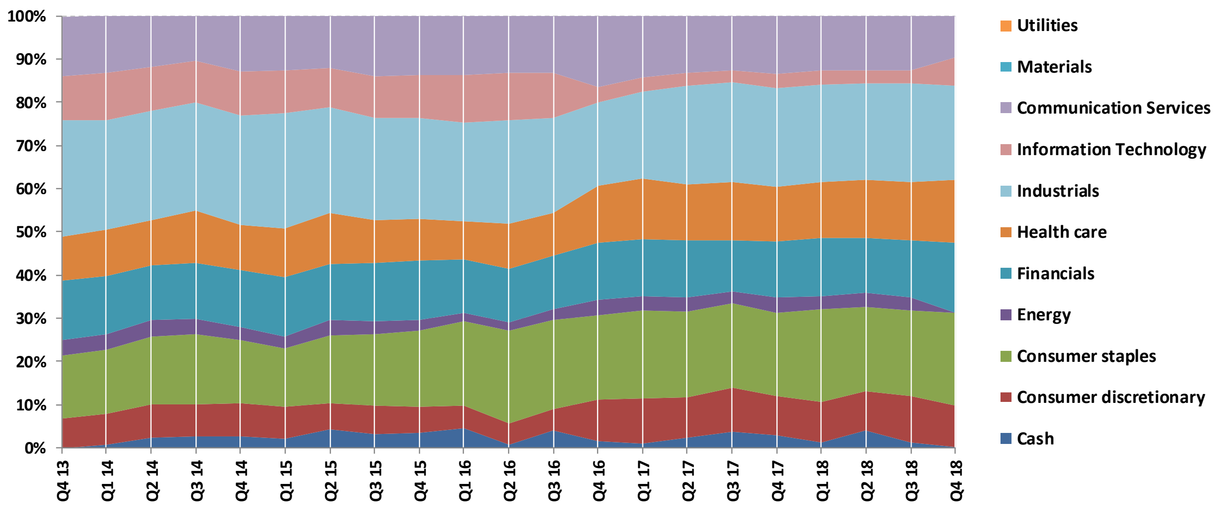
Source: Bloomberg. As of 30th November 2018

The fund has no exposure to Materials, Energy, Utilities or Real Estate stocks, many of which do not make it into our universe due to our criteria for quality and returns. Industrials, Consumer Staples and Communications Services remain our significant sector overweight holdings.



Source: Bloomberg data, Guinness data.

We made no portfolio changes in November. As a result, sector weightings remained broadly the same as for October, when we added Inficon, Continental and Euronext to the portfolio, replacing JM AB, Technicas Reunidas and Freenet.



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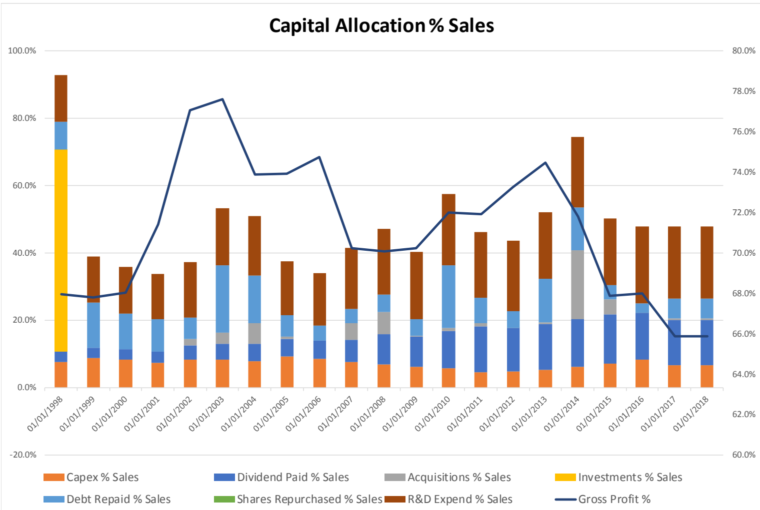
Roche (+6.7% Nov) was the top performing stock in our portfolio in the month. Roche is the world's largest biotech company and global market leader in in-vitro diagnostics (IVD) with a c.20% global market share, ahead of Abbott at around 12%. In oncology, Roche boasts some 26% market share. The good share price performance comes after seven quarters of near consistent YoY improvement in sales growth from c.3% back up to 7%, near to a five-year high. This increase in organic sales growth has been largely driven by new pharma products (CHF+2.3bn YTD 2018), handsomely offsetting attrition in biosimilar (CHF-758m YTD). It is good to see that sales gains have been driven not just by the oncology franchise but notably by Ocrevus, Roche's new multiple sclerosis drug – perhaps a sign that Roche's innovation DNA is bearing new fruit. Roche's deep understanding of molecular biology and focus on integration of its pharmaceuticals and diagnostics capabilities leave the company well placed to innovate for the long-term as we move into the age of the genome.

We are fully aware of on-going pressure on drug pricing, particularly with the Democrats having regained control of the House or Representatives in the US. However, the ultimate driver of returns in this industry is innovation combined with the ability to understand and deliver (diagnostics). Roche estimates that IVDs influence over 60% of clinical decision making, while accounting for just 2% of total healthcare spending, taking no account of saved costs associated with right treatment. A useful measure of near-term potential on the pharma side is the number of new molecular entities (NMEs) at pivotal stage; at Q3 2018 Roche reported 49 NMEs vs. 32 in 2015. For a longer-term measure of potential, a glance at the capital allocation graph for Roche below highlights a high, steady and rising share of sales for R&D expenditure (dark red bar), averaging 21% for the last ten years vs. 17% for the preceding ten years (1998 – 2009). In our view there is plenty of life left in this old income champion (yielding 3.4%), and it's one that shareholders can feel good about owning.

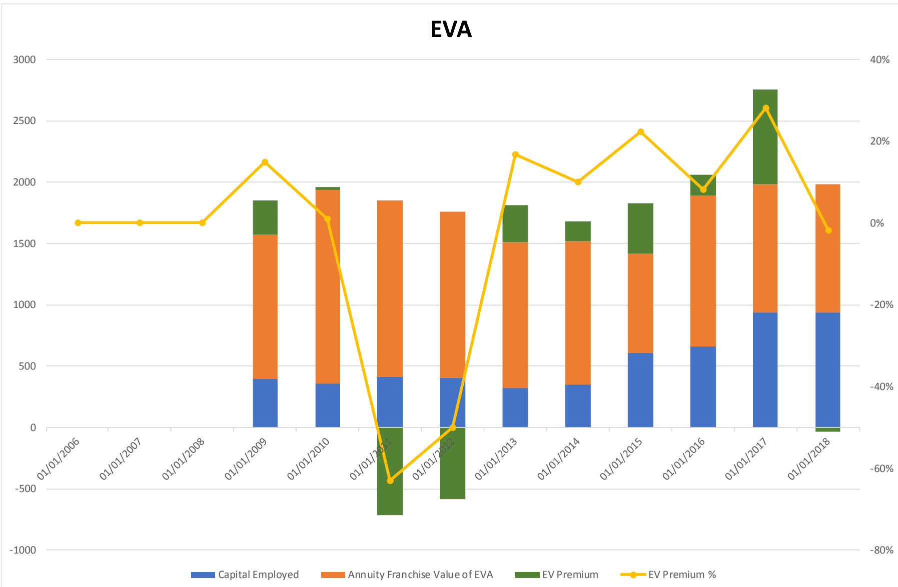


Source: Guinness, Bloomberg data.

M6 Metropole Television (-8.4% Nov) is the third-most watched television network in the French speaking world after TF1 and is 48.35% owned by Belgium's RTL. In 2017 M6 recorded a +3.4pp gain in its free-to-air net TV ad market share, rising to 25.4%. M6 has also gained channel audience share versus TF1 in recent years, rising to 71% of TF1 in 2017 vs. 52% in 2007. Whatever the results on a quarterly basis, these are reassuring statistics. Over the last six months, M6 share price and earnings multiple has compressed back to near Euro Crisis levels, falling from €23 to €15 in absolute terms, or from 11.5x EV/EBIT to a 7.7x multiple. Meanwhile return on equity (RoE) has risen over the last few years to a ten year high of 23%.

It hasn't been a good market for domestic French equities in the last few years and concerns over internet-led competition for TV content producers and broadcasters in general have grown. Soft results from European domestic peers including ProSiebenSat and ITV have been a factor in the derating, as was the announcement that Netflix will increase content production in Europe by some 30% next year. However, there is scant evidence that M6 itself is under any real pressure. Indeed, we would argue that M6's position is quite well protected from US platform competition compared to English language producers by its French-speaking audience and exposure to growth on the African continent. Recent nine-month 2018 numbers support this view, with sales growth of 12.5% and EBITDA growth of 12.4%. We also note that ad pricing has been rising in France, and at H1 2018 overall hours watched per month were up 0.9% to 45m across TV, PC, mobile and tablet, while advertising revenues were up 18.4%.

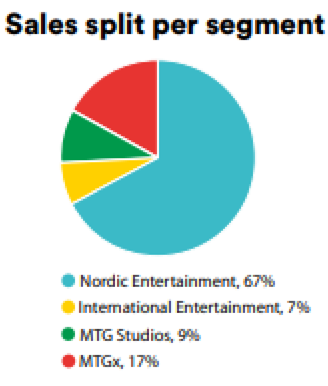
With 5Y average capex/sales of c.1% in 2018, lagging the prior 5Y average of 1.6%, set against ROCE of 25% vs. >50% five years ago, there appears to be an argument for sector consolidation. M6 has recently been divesting non-core assets and has net cash on the balance sheet, while majority shareholder RTL has been under pressure due to some market share losses. With its 6.4% dividend yield 2.4x covered by cash flow and net cash on the balance sheet, we think this 'petite boite' has quite a lot of returns still to give. Our economic value added (EVA) profile highlights nothing in the price for future value creation at an 8% hurdle rate, while Holt sees 73% upside.

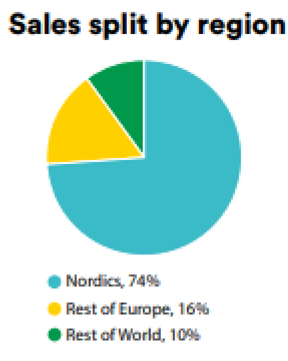


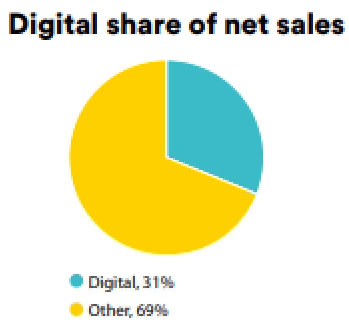
Source: Guinness, Bloomberg data.

Modern Times Group (-8.7% Nov) was our worst-performing holding last month impacted by wider market concerns over media sector dislocation and the sell-off in technology shares in general. Modern Times Group (MTG) started out life thirty years ago as operator of Scandinavia's first commercial TV channel, TV3. Change and a focus on digital have since been a constant. MTG's strategy has been to 'follow the eyeballs' by making the required investments to capitalise on the consumer shift to online entertainment. First came linear TV, radio and content production, and then streamed TV enabled by investment in streaming services Viaplay and Viafree. Next came investment into esports and online gaming, represented by the MTGx division. Key gaming acquisitions have included 51% of InnoGames and 100% of cross platform games publisher Kongregate, funded by the sale of traditional Czech, Baltic and Bulgarian TV assets. MTG has also invested heavily in its esports franchise including European Sports League (ESL) and DreamHack, both now global brands. Both free-to-play gaming and esports have compelling structural growth drivers, with the latter having become a mainstream market and the entertainment format of choice for many millennials.

The established pay and free TV channels and streaming assets that make up Nordic Entertainment (67% 2017 sales), along with MTG Studios (9% 2017 sales) and Splay Networks have been earmarked for spin-off in early 2019 by way of a distribution to MTG shareholders, who will be left holding the smaller but fast-growing esports and online gaming business MTGx. Similarly to M6 Metropole (above), we think cash-generative, dividend-paying Nordic Entertainment and MTG Studio assets, which look set to be spun out, remain attractive. Characterised by good use of technology and streaming services alongside a leading Scandinavian market position, these assets should prove attractive in the consolidating media landscape. Meanwhile, the remaining MTG gaming assets hold the potential to scale very well (as highlighted by 37% organic growth in 2017) given the global nature of their brands and their low capital intensity. Share price weakness ahead of the potential distribution strikes us as an opportunity.





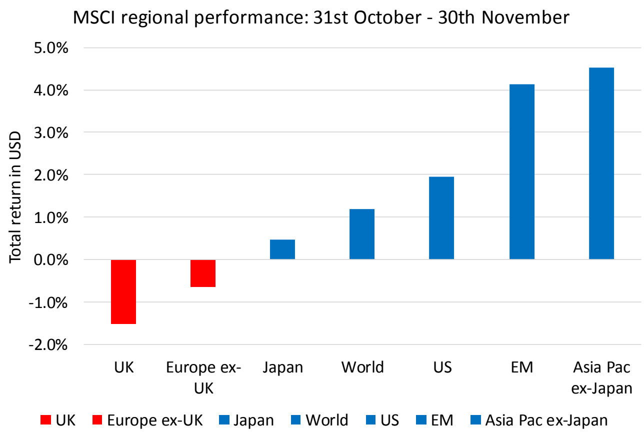


Source: 2017 Modern Times Group annual report

November in Review

November saw many equity markets rebound from recent lows, while Europe ex UK fell by 0.5% as negative sentiment continued to spill over from the Italian coalition government's proposed high 2019 budget deficit target. The tone of 'negotiations' softened over the course of the month, with the coalition government initially offering to make the high budget deficit target contingent on GDP growth.

Suggestions later came that the whole target looks likely to be reduced to around 2% from 2.4% of 2019 GDP, a level that might just be acceptable to the European Commission if accompanied by some contingencies in case of lower growth than expected. The European Central Bank, for its part, is keen not to repeat the mistakes made in Greece, which led to large-scale capital flight. The Italian 10Y yield has now come back to 3.1% from highs of 3.7% in mid-November. We remain of the view that the situation in Italy will muddle through given the alignment of incentives (see Q3 note).

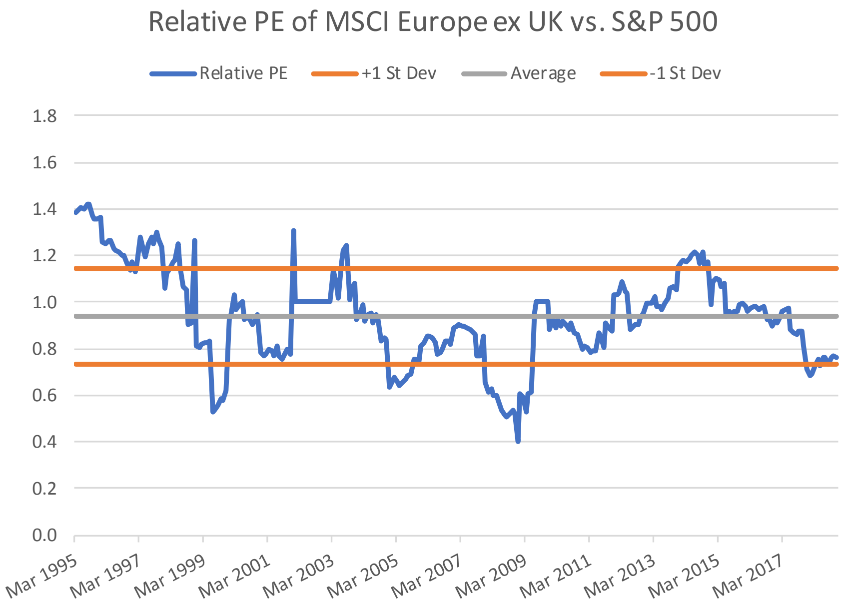


Source: Bloomberg. As of 31st November 2018

Party elections for Angela Merkel's CDU resulted in the confirmation of Annegret Kramp-Karrenbauer (AKK) as her successor as party leader. Both AKK and her rival for the leadership Friedrich Merz represented something of a shift to the right for German politics and should result in net voter attrition for Alternative for Deutschland, although AKK has not come out as strongly in favour of a tougher line on immigration as Merz, Merkel's old rival and Chairman of Blackrock Germany. On European integration, AKK is expected to push ahead in the measured manner of Merkel – whereas Merz was more strongly in favour of Macron's ambitious proposals. Brexit is the main outstanding near-term risk variable for Europe in our view. However, with an apparent majority in the House of Commons in favour of something close to continued single market access and or a second referendum we could have more visibility within a few months.

In the meantime, European equity valuations are looking attractive. MSCI Europe ex UK PE relative to the S&P 500 is trading around one standard deviation below its long-run average and not far off 2008 and Euro Crisis lows. Domestic, trade-related and Italian stocks look particularly out of favour. Meanwhile, leading indicators are holding up better than many gloomy articles in the press would have you believe. German November manufacturing PMIs were weighed down by one-off factors relating to discounting of older auto models ahead of the advent of new emissions standards in September. Lending to European non-financial companies accelerated in October, the Belgian Business Indicator remained robust in November and EC consumer and manufacturing confidence data surprised to the upside.

There is also quite a good chance, in our view, that the Euro has now bottomed against the Dollar. As parts of the US yield curve invert and with European QE slowing, we may have passed the peak spread in US vs. EU interest rates. Meanwhile Europe, in stark contrast to the US, continues to boast both a current account and trade surplus.



Source: Guinness, Bloomberg data.

Good November fund performance saw your Guinness European Equity Income Fund move up the rankings into third place over one year against a peer group of Europe ex UK income funds, outperforming the index over one year, three years and since launch.

Year to date		1 year		3 Years		From launch (19.12.13)	
Polar Capital European (EX UK) Income	-0.79	Polar Capital European (EX UK) Income	-0.98	Waverton European Dividend Growth L Inc GB	46.13	Montanaro European Income	59.66
Allianz European Equity Income C Inc	-1.48	Allianz European Equity Income C Inc	-1.86	Montanaro European Income	41.83	Waverton European Dividend Growth L Inc GB	57.45
Guinness European Equity Income Z Dis GBP	-2.83	Guinness European Equity Income Z Dis GBP	-2.17	Guinness European Equity Income Z Dis GBP	40.40	BlackRock Continental European Income	52.05
Montanaro European Income	-4.76	Waverton European Dividend Growth L Inc GB	-3.43	Polar Capital European (EX UK) Income	39.14	Schroder European Alpha Income	51.52
Waverton European Dividend Growth L Inc GB	-4.98	Montanaro European Income	-3.48	Allianz European Equity Income C Inc	34.19	Guinness European Equity Income Z Dis GBP	44.55
BlackRock Continental European Income	-5.52	Argonaut FP Argonaut European Income Oppo	-4.02	Schroder European Alpha Income	30.81	Invesco European Equity Income (UK)	42.91
L&G European Equity Income	-6.13	BlackRock Continental European Income	-6.28	Invesco European Equity Income (UK)	29.40	Allianz European Equity Income C Inc	39.91
Invesco European Equity Income (UK)	-6.24	Liontrust European Income	-6.5	BlackRock Continental European Income	27.37	Liontrust European Income	38.23
Argonaut FP Argonaut European Income Oppo	-6.45	Invesco European Equity Income (UK)	-6.64	Standard Life Investments European Equity In	25.15	Standard Life Investments European Equity In	37.96
Liontrust European Income	-6.52	Legg Mason IF Martin Currie European Equity I	-6.84	Jupiter European Income	25.11	Jupiter European Income	36.12
Legg Mason IF Martin Currie European Equity I	-6.71	Liontrust European Enhanced Income	-7.66	Liontrust European Income	21.02	Liontrust European Enhanced Income	31.90
GLG European Alpha Income	-6.82	Standard Life Investments European Equity In	-8.36	Legg Mason IF Martin Currie European Equity I	20.72	Legg Mason IF Martin Currie European Equity I	28.01
Liontrust European Enhanced Income	-7.49	Quilter Investors Europe (ex UK) Equity Income	-9.46	Liontrust European Enhanced Income	-1.58		
Standard Life Investments European Equity In	-8.36	Schroder European Alpha Income	-9.59				
Jupiter European Income	-8.90	Jupiter European Income	-9.65				
Quilter Investors Europe (ex UK) Equity Income	-9.79						
Schroder European Alpha Income	-9.86						
Sector : IA Europe Excluding UK	**-6.24**	**Sector : IA Europe Excluding UK**	**-7.02**	**Sector : IA Europe Excluding UK**	**31.48**	**Sector : IA Europe Excluding UK**	**42.00**

Source: Financial Express, all income funds from the IA Europe sector

The value of an investment and the income from it can fall as well as rise as a result of market and currency movement; you may not get back the amount originally invested. Past performance is not a guide to future performance.

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*

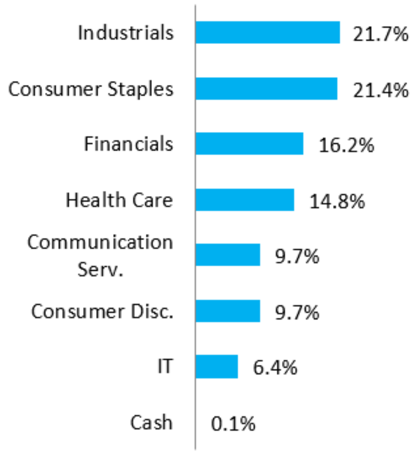
PORTFOLIO

30/11/2018

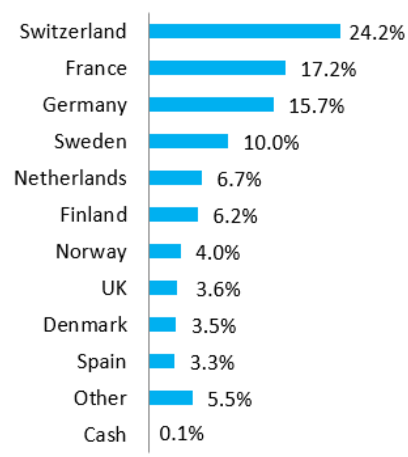
Fund top 10 holdings

Salmar	4.0%
Sanofi	3.8%
Novartis	3.8%
Roche Holding	3.7%
Helvetia Holding	3.6%
Unilever	3.6%
Hennes & Mauritz	3.5%
Danone	3.5%
Publicis Groupe	3.5%
Novo Nordisk	3.5%
% of Fund in top 10	36.6%
Total number of stocks	30

Sector analysis



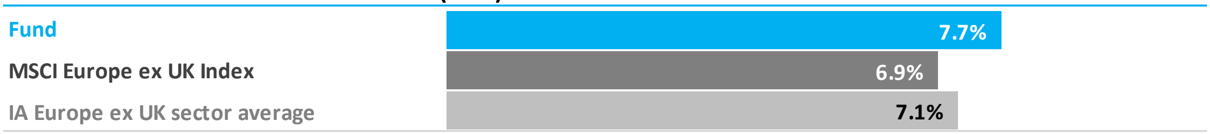
Geographic allocation



PERFORMANCE

30/11/2018

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Nov '14	Nov '15	Nov '16	Nov '17	Nov '18
Fund	-	1.3	28.9	16.1	-2.6
MSCI Europe ex UK Index	5.6	-1.6	20.0	21.5	-5.1
IA Europe ex UK sector average	4.0	3.6	18.4	21.9	-6.8

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	-0.41	-2.83	-2.64	39.73	-	44.55
MSCI Europe ex UK Index	-0.50	-5.36	-5.09	30.18	36.87	38.81
IA Europe ex UK sector average	-0.97	-7.15	-6.77	28.22	38.63	40.62

RISK ANALYSIS

30/11/2018

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	1.07	1.75
Beta	1.00	0.89	0.89
Information ratio	0.00	0.06	0.21
Maximum drawdown	-17.99	-14.98	-16.49
R squared	1.00	0.86	0.88
Sharpe ratio	0.23	0.27	0.33
Tracking error	0.00	5.07	4.74
Volatility	13.72	13.06	13.00

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Source: Financial Express, bid to bid, total return (0.74% OCF). Fund launch date: 19.12.2013.

Important information

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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.

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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
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Telephone calls will be recorded and monitored.