Guinness Global Money Managers Fund

A high conviction equity fund managed by Will Riley and Tim Guinness investing in quoted companies in the asset management sector.

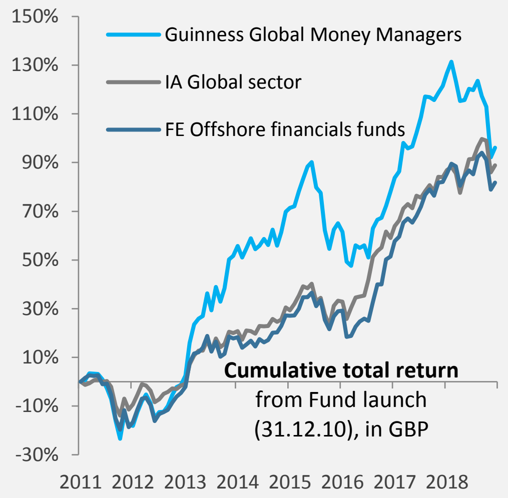
INVESTMENT COMMENTARY – January 2019

Aim

The Fund aims to deliver long-term capital growth by capturing the strong returns that successful asset management companies can deliver to shareholders.

We expect asset managers to outperform the broad market over the long term, primarily due to the ability of successful managers to grow their earnings more rapidly than the broad market.

Performance **31.12.2018**



Index	**MSCI World Index**
Financials Index	**MSCI World Financials Index**
Fund launch	**31.12.10**

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 (X class, 1.24% OCF), bid to bid, total return.

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2015: BEST FUND OVER 3 YEARS
EQUITY SECTOR BANKS & OTHER FINANCIALS

Asset management sector

In this month's update, we review the asset management sector and our Fund performance in 2018, and consider the outlook for 2019 and beyond.

The Global Money Managers Fund (class X, in GBP) in 2018 produced a total return of -22.7%. This compares to the return of the MSCI World Index of -3.0% and the MSCI World Financials Index of -11.8%.

After a period of strong performance in 2017, the money management sector suffered a torrid year. Weakness in broader equity and fixed income markets acted as a drag on the sector, since nearly all participants are operationally geared to rises and falls in the market. But it was the concern of ongoing active-to-passive rotation that compounded the weakness for many asset managers. Active equity management in the US again saw net outflows, although active fixed income funds reported net inflows.

With the exception of stock exchanges, all subsectors within money management performed very weakly in 2018. As a group, mid-cap asset managers were the worst hit, with some of the European names seeing outflows after several years of net inflows. Large cap managers were not much better. In general, and in common with the last five years, we observed that some active providers reacted to the threat from passive products better than others, distributing products that were clearly differentiated from passive products, or that were sufficiently competitively priced.

Sentiment towards larger US active asset managers took a knock in September with Fidelity's announcement that they were launching four zero fee index mutual funds. Fidelity's new funds are only available to their own customers, as part of a wider package of services. Nonetheless, the move caught the imagination of the market and lead to underperformance from nearly all asset management companies in the US that specialise in listed equities.

Alternative asset managers proved to be a relative safe haven, although most were still down over the year. Most private equity firms achieved net inflows in 2018, and have been able to defend margins more successfully than public equity and fixed income oriented managers.

The best performers in the fund over the year (on a total return basis) were: AllianceBernstein (+20.9%), Liontrust Asset Management (+16.1%) & Nasdaq (+8.2%).

A number of factors worked in Alliancebernstein's favour in 2018. Fund performance was strong, and the company's bias towards fixed income proved a better place to be than active equities. Versus its peers, Alliancebernstein also demonstrated a greater focus on operating margin improvement, with the aim to exceed 30% by 2020, versus 27% currently. The company's research arm also performed better than expected, with revenues down only slightly despite the introduction of MiFID2 in Europe.

Liontrust, which we purchased for the fund in 2012, has enjoyed a transformational period. AuM moved over £11bn in 2018, thanks mainly to (organic) net inflows and the acquisition of the Sustainable Investment Team from Alliance Trust. The Sustainable Team joined Liontrust with assets of £2.3bn, and finished the year managing over £3.3bn. With the company's Economic Advantage team managing over £5bn, the addition of Sustainable Investments creates a healthy degree of diversification in the business, which has been well received. Further diversification in assets has come with the addition of an experienced new global fixed income team, joined from Kames Capital.

Nasdaq was successful in expanding its market share in all key trading markets, despite increasing competition. Non-transaction based business now represents more than 70% of the company's revenues. Growth was particularly strong in market technology and information services, whilst on the transaction side, US cash equity exchange volumes were up nearly 10% versus the previous year.

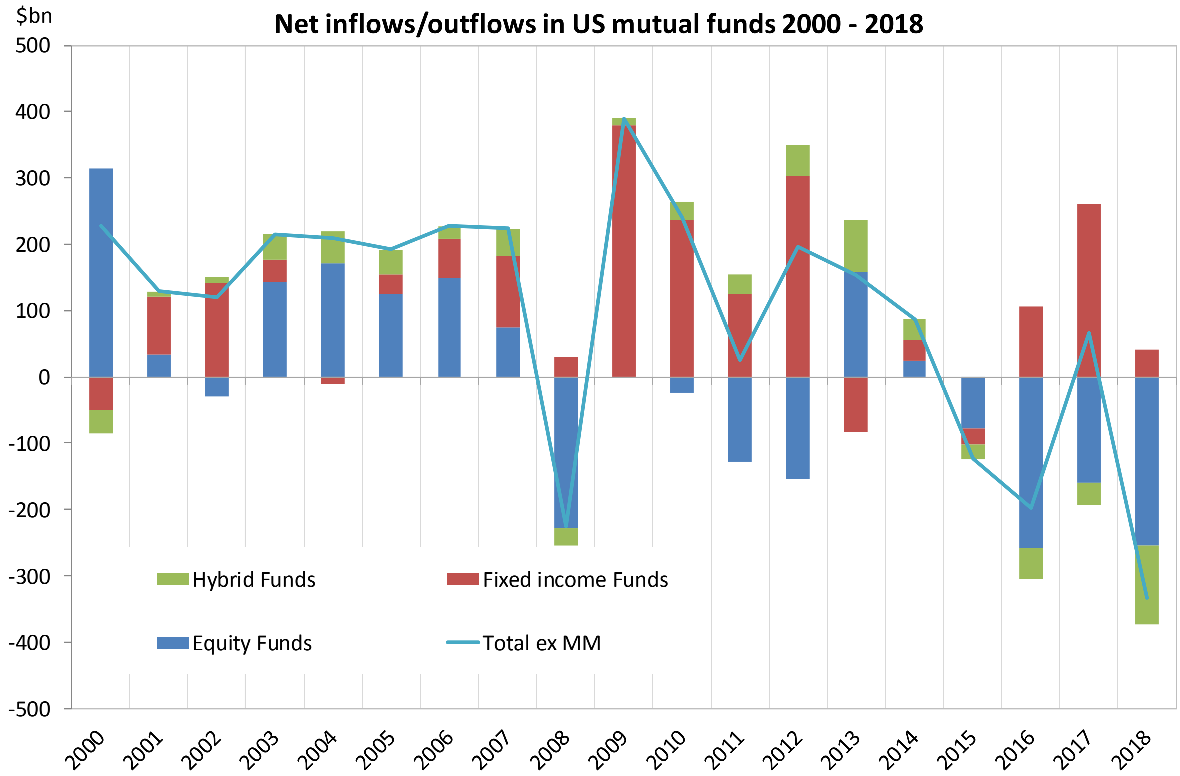
The worst performers in 2017 were: GAM Holding (-74.8%), Jupiter Asset Management (-52.6%) and Invesco (-50.0%).

GAM experienced an exceptionally difficult year. In July, the company announced the suspension of key fixed income fund manager, Tim Haywood, after concerns arose around risk management procedures. By August, GAM announced that it was liquidating Haywood's absolute return bond funds (ARBF), involving the return to clients of around CHF11bn which had been in the strategy. In December, the company pre-announced 2018 results, with underlying profits before taxes expected to be around 27% lower than 2017. The company also announced a suspension of the dividend for 2018, as capital is redirected towards a restructuring plan, involving the consolidation of various investment teams.

Jupiter, which we have held since the inception of the fund, suffered in the market downturn but also reported relatively large net outflows in the second half of 2018, after a succession of net inflow years. The bulk of the outflows came in the company's fixed income strategy, which has been a sharp underperformer over the last year or so.

Invesco also struggled with the scale of outflows, which accelerated into the end of the year. Outflows were particularly acute in its mutual fund range, particularly in its diversified dividend and equity income strategies. Operating margins at the company were also depressed in 2018 thanks to a rise in the company's core expenses, driven by several significant acquisitions (ETF providers Guggenheim & Source, digital platform Gemstep).

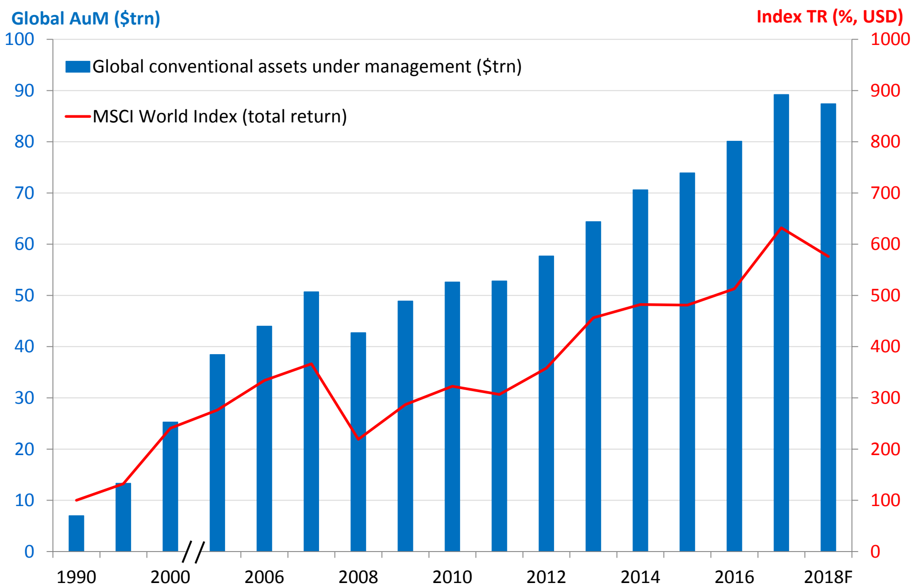
Within the asset management sector, data for US mutual fund flows (which we treat as a proxy for global flows) indicated record outflows from equity funds in the fourth quarter of 2018, surpassing the outflows seen at the end of 2016. The picture for active bond & income funds was also negative, with net outflows of $84bn, though net flows for bond & income were positive overall during the year. It was an environment where few prospered.



Source: ICI; Bloomberg; Guinness Asset Management

Outlook

Assets under management in the money management industry globally remained close to their highs in 2018, driven by the secular forces of wealth creation, expansion in the breadth of investible assets, and demographic shifts. It was an environment where many firms achieved record profits. And yet, the challenges of weaker market conditions, active to passive rotation in equities, and associated fee pressures, combined to leave sentiment toward the sector at a decadal low.



So, how do these countervailing trends play out?

We have said for some time now that the money management sector is developing into the haves and the have-nots. Simplistically, it would be easy to think of the 'haves' as those who can crack the issue of scale: 'trillionaire' firms managing the largest pool of assets in an efficient, profitable fashion. This is part of the answer. As we see it, however, investment quality remains the key facet when defining a successful asset manager, and will continue to manifest itself in various ways.

We define investment quality as "the ability of a manager to consistently meet stated and relevant objectives". For a smaller traditional asset manager, it may still mean the provision of high active share, alpha-generating portfolios. For a passive provider, investment quality might be measured by the delivery of easily accessible, very low tracking-error, low cost ETF products. For an alternatives provider it might mean the consistent delivery of differentiated absolute returns. If investment quality is sustained, it will drive the growth of a successful asset management business.

The most obvious 'have-nots' in the industry today are the weaker traditional asset managers who continue to overcharge for undifferentiated products. Some companies in this category are reaching interesting 'value' territory, such was the magnitude of share price declines in 2018, but many will remain value traps: leaking assets and lacking the vision to redesign investment products or client distribution models.

As investors in the space, we of course need to identify the good-value 'haves' and traverse our way past the expensive 'have-nots'. To summarise by sector, we expect outperformance from the following participants in the sector:

- **Effective, outperforming, active management.** Managers who can successfully offer products that outperform their benchmarks will continue to be the sector's most attractive revenue opportunity. These products will likely have a high active share (if compared to benchmarks), have a high tracking error. Firms must be able to demonstrate performance quality and investment process quality (isolating skill from luck). 2018 was a poor year for active manager outperformance (only 30% of active managers were ahead of their benchmark on a three year rolling basis), illustrating the importance of investing in the 'right' active manager.

- **Cost-efficient beta (ETFs/passives).** There will be significant growth in the use of easily-accessible passive products, notably ETFs. We expect the global ETF market to triple in size over the next five years. Broadly speaking, this divides into low-cost 'beta delivery' operations (e.g. Vanguard, BlackRock iShares) which rely on scale, and innovative beta products (e.g. Wisdom Tree and Invesco Powershares). Increasingly, the winners in the ETF/passive world are those achieving significant scale, so maximising their operating leverage.

- **Alternative asset managers**. 'Alternative' asset managers, such as private equity and hedge funds, face less threat from passives than large low active-share traditional managers, and therefore sit well placed to continue to grow assets as investors seek differentiated returns. Many alternative managers are seeing record fundraising activity, whilst some US managers are likely to follow KKR's lead and convert from publicly traded partnership structure into a C-Corp structure, driven by US corporate tax reforms. This would expand their ownership bases with passive and active-only equity managers, some of whom are unable to own partnership structures.

- **Wealth management consolidators.** The wealth management industry in many developed countries remains a fragmented market with many subscale operators. However, consolidation is taking place, as pricing pressures, low interest rates and additional regulation prompt companies to scale up and exploit potential cost savings. We are attracted towards those wealth managers we think can consolidate effectively, seeing particular opportunities in the UK and continental Europe.

- **Ancillary services to the industry (e.g. custody banks; stock exchanges).** Whilst change is occurring to the composition of assets under management, it remains the case that the total level of AuM is growing at a faster pace than the growth in underlying returns. Since 1990, new investable companies and increasing household wealth have helped grow conventional assets under management by around 12x, versus world equity returns of around 6x. We expect this trend to continue. An expanding pool of assets provides an attractive environment for sectors such as stock exchanges and custody banks.

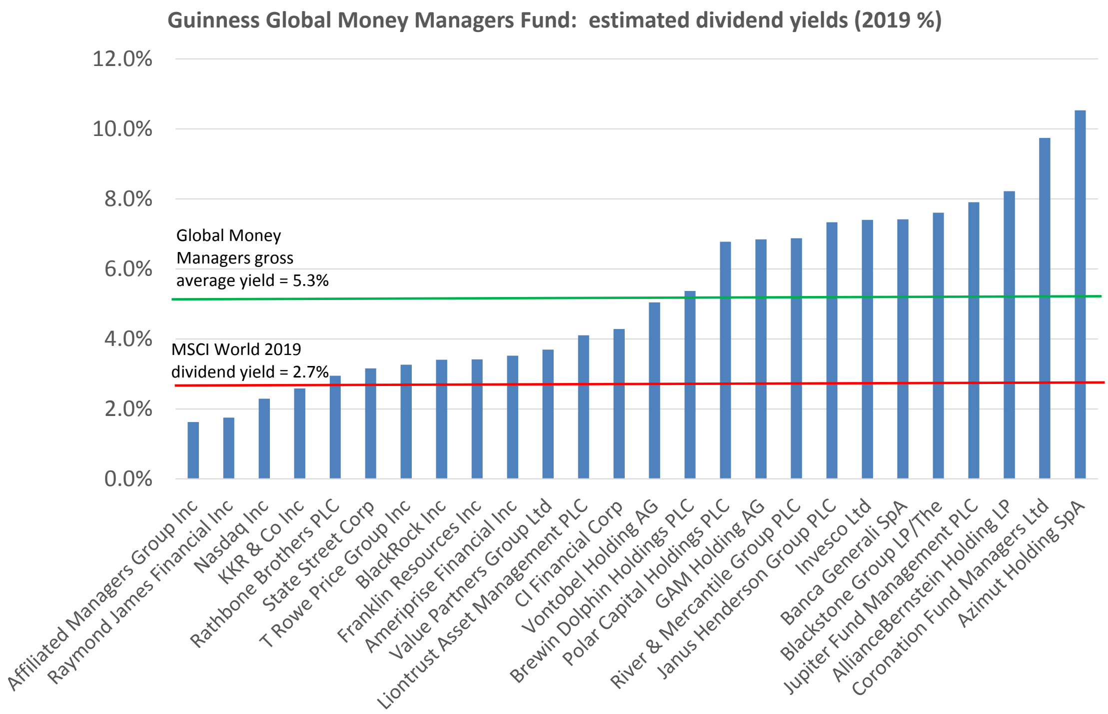
Combining these themes with our stock selection process, which allows us to identify the equities of managers whose products are succeeding, leads us to the following portfolio positioning, expressed by theme (as at 31st December 2018):

	Theme	Example holdings	Weighting (%)
1	High active share		26.1%
2	Alternatives		8.7%
3	Growth of ETFs/passive distribution		6.7%
4	Wealth management		16.4%
5	Traditional value		18.4%
6	Support services		7.6%
7	Asset management consolidators		3.3%
8	Secular shift in Europe to equities		11.1%
9	Other (incl cash)		1.8%

Despite headwinds for the sector, return on capital remains as high today as it was in the years leading up to the 2008-09 financial crisis, at a level far exceeding average returns across the broad market. Indeed, median cashflow return on investment (CFROI) for the portfolio in 2019 is estimated to be around 19%, which compares to a broad market average of around 8.5%. This puts asset management returns comfortably in the top decile of all GICS sub-sectors.

Dividends and valuation

An important component of returns generated by money management firms is their dividend. Companies in this sector tend to generate significant excess cash, and usually, Boards are willing to return the cash to shareholders in the form of dividends. At 31 December 2018, the portfolio showed an average gross dividend yield for 2019 of 5.3% (n.b. this is rolled up in the fund rather than paid out), well ahead of the MSCI World at 2.7%.



It is of course important to consider the sustainability of the portfolio's yield, as well as the yield itself. At 31 December 2018, the median dividend cover (defined as the ratio of estimated 2019 net earnings to dividends paid to ordinary shareholders) of the fund stood at 1.9x, with all companies owned achieving at least 1x cover. By comparison, the MSCI World's dividend cover stands at around 2.5x. Arguably, asset managers should have a higher dividend cover, due to the greater volatility of their earnings versus the broader index, but we still take comfort that the 'affordability' of portfolio's dividends remains high. Indeed, despite the dividend yield for the portfolio being as high as c.5%, the payout ratio is in line with the portfolio average for the last ten years.

At 31 December 2018 the P/E ratio of the Fund was 10.7x 2018 earnings and 10.1x 2019 earnings. This sits at a significant discount to the broad market, with the S&P 500 trading on a 2018/19 P/E ratio of 16.0/14.7x earnings. Earnings for the portfolio are expected to grow by 6% in 2019.

Fund P/E ratios versus the S&P 500 Index (31.12.18)

	'16	'17	'18	'19
Fund P/E	16.8	8.9	**10.7**	**10.1**
S&P 500 P/E	23.6	20.1	**16.0**	**14.7**
Premium (+)/ Discount (-)	-29%	-56%	**-33%**	**-31%**

Source: Standard & Poor's, Guinness Asset Management.

In the longer term we expect asset managers as a sector (and therefore the Fund) to outperform the broad market, due primarily to the ability of successful asset management companies to grow their earnings more rapidly than the broad market.

The Fund remains positioned to capitalise on the increasing value of successful companies in the sector.

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Will Riley, Tim Guinness & Mark Hammonds
January 2019

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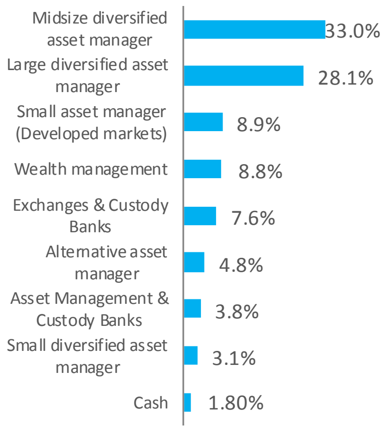
PORTFOLIO

31/12/2018

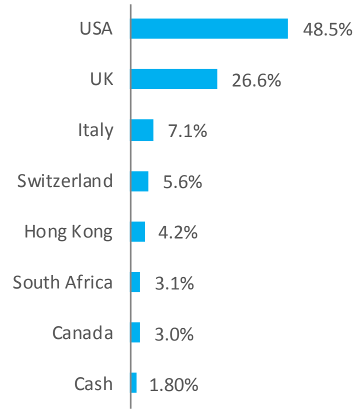
Fund top 10 holdings

Liontrust Asset Management	4.9%
AllianceBernstein	4.8%
Brewin Dolphin	4.5%
Blackstone Group	4.5%
Rathbone Brothers	4.2%
Value Partners	4.2%
Raymond James Financial	4.1%
T Rowe Price	4.1%
Polar Capital	4.1%
Nasdaq	4.0%
% of Fund in top 10	43.4%
Total number of stocks in Fund	29

Sector analysis



Geographic allocation



PERFORMANCE

31/12/2018

Annualised % total return from launch (X Class, in GBP)

Cumulative % total return (X Class, in GBP)	1 year	3 years	5 years	From launch
Guinness Global Money Managers Fund	-22.7	8.5	12.6	73.8
MSCI World Index	-3.0	39.0	62.5	112.9
MSCI World Financials Index	-11.8	32.7	48.6	88.6
Financial Express - Financial Sector average	-8.9	23.5	32.5	58.0

Discrete years (X Class, in GBP)	Dec '14	Dec '15	Dec '16	Dec '17	Dec '18
Guinness Global Money Managers Fund	10.0	-5.7	13.7	23.4	-22.7
MSCI World Index	11.5	4.9	28.2	11.8	-3.0
MSCI World Financials Index	9.6	2.2	34.2	12.1	-11.8
Financial Express - Financial Sector average	6.7	0.5	17.0	16.0	-8.9

RISK ANALYSIS

31/12/2018

X Class, in GBP, annualised, weekly, from launch on 31.12.10, relative to the MSCI World Index	MSCI World	MSCI World Financials	Fund
Alpha	0	-1.93	-3.15
Beta	1	1.10	1.14
Information ratio	0	-0.19	-0.27
Maximum drawdown	-18.26	-28.87	-29.47
R squared	1	0.84	0.79
Sharpe ratio	0.49	0.32	0.24
Tracking error	0	6.56	8.25
Volatility	13.55	16.24	17.45

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Performance data note

The performance numbers displayed on the previous page are calculated in GBP (Sterling). Please note: The Fund's X class was launched on 15/02/2012. The performance shown is a simulation for X class performance being based on the actual performance of the Fund's E class, which has the same annual management charge as the X class, and has existed since the Fund's launch. The Fund's E class is denominated in USD but for the purposes of this performance data its performance is calculated in GBP. Hence the Fund's E Share class is used here to illustrate the performance of a GBP-based clean-fee (RDR-compliant) share class since the Fund's launch on 31.12.10.

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 recent developments in the asset management sector invested in by the Guinness Global Money Managers Fund. It may also provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to investment 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 Money Managers 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 companies involved in asset management and other related industries; it is therefore susceptible to the performance of that one sector, and can be volatile. Details on the risk factors are included in the Fund's documentation, available on our website.

Documentation
The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available from the website www.guinnessfunds.com, or free of charge from:-

- the Manager: Link Fund Manager Solutions (Ireland) Ltd, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

Residency
In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients. **NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.**

Structure & regulation
The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

Switzerland
The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

Telephone calls will be recorded and monitored.