Guinness European Equity Income Fund

INVESTMENT COMMENTARY – February 2019

Launch date	**19.12.2013**
Team	**Ian Mortimer** **Matthew Page** **Nick Edwards**

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.

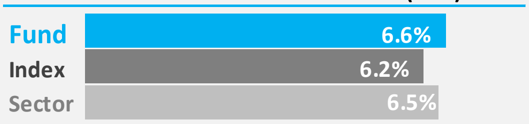
Performance

31.01.2019

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

	1 year	3 years	From launch
Fund	-6.5	36.2	38.8
Index	-8.2	31.8	36.2
Sector	-10.3	30.3	38.1

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	1.0	1.2
Beta	1.0	0.9	0.9
Info ratio	0.0	0.1	0.1
Max drwdn	-18.0	-15.0	-16.5
Tracking err	0	5	5
Volatility	13.7	13.1	13.0
Sharpe ratio	0.2	0.2	0.2

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.

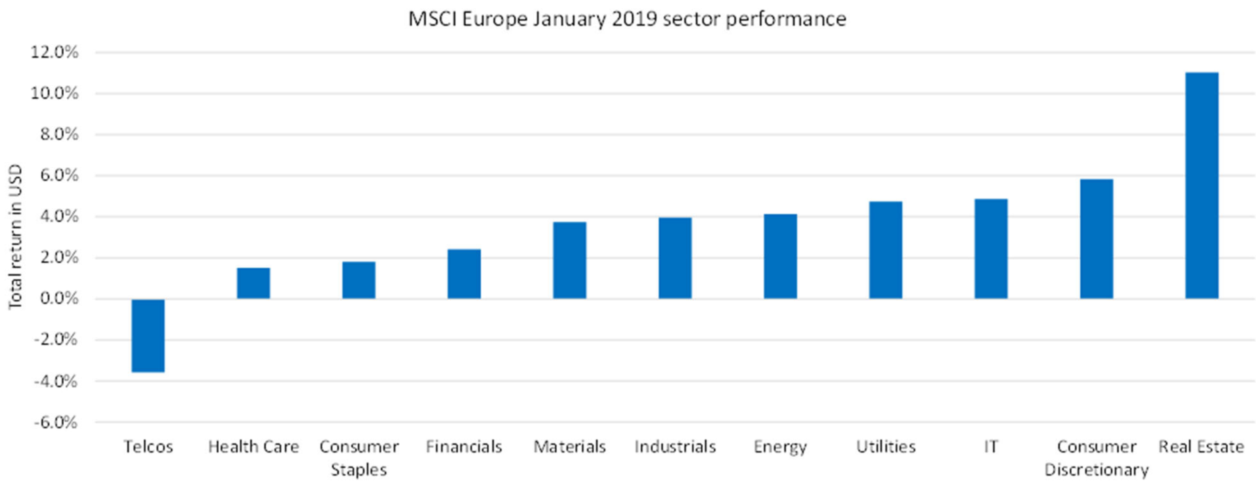
Summary performance

In January, the Guinness European Equity Income Fund produced a total return of +1.99% (in GBP) versus the IA Europe ex UK net TR Index return of +3.02% (in GBP). The fund therefore underperformed the index by 1.03% over the month. It is pleasing to see that both the short and long-term performance of the fund remain ahead versus IA Europe ex UK peers.

	1 Month	YTD	1 Yr	3 Yr
Fund	1.99%	1.99%	-6.49%	36.21%
Index	3.02%	3.02%	-8.20%	31.80%
Out / Under performance vs. Sector	-1.03%	-1.03%	1.71%	4.41%

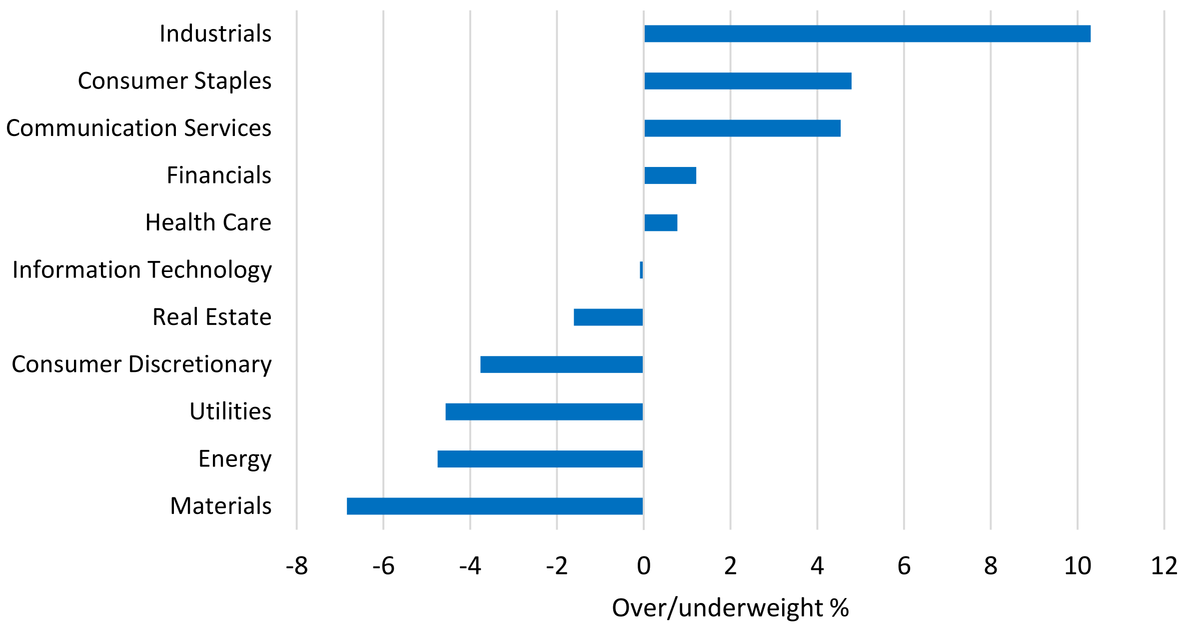
Source: Financial Express 0.74% OCF. Cumulative Total Return in GBP as of 31.01.2019

The fund's modest underperformance over the month was a result more of what we do not hold than what we do. Notably, the MSCI Europe ex UK Real Estate sector posted a strong performance (as expectations for interest rate increases slumped), followed to a lesser extent by the Utilities and Energy sectors, to which we have no exposure. Our smaller overweights in Financials and Communication Services outperformed, while our larger overweight positions in Industrials and Consumer Staples underperformed a touch. Stand-out performers included Azimut +12.95% (in GBP) which rebounded after publishing a new fee structure, Konecranes (+11.2%) following a better-than-expected update, Continental (+10.9%) on confirmation of its plans to separate its Powertrain division in 2019 along with better sentiment towards global trade, closely followed by Deutsche Boerse (+7.7%) and Atlas Copco (+6.3%). At the other end of the spectrum, M6-Metropole Television (-7.3%) continued to de-rate on the back of concerns around US internet-led competition, something we feel is overdone in the case of this very French broadcaster. Unilever fell -4.3% on results which were weighted down by emerging market currency and demand weakness.



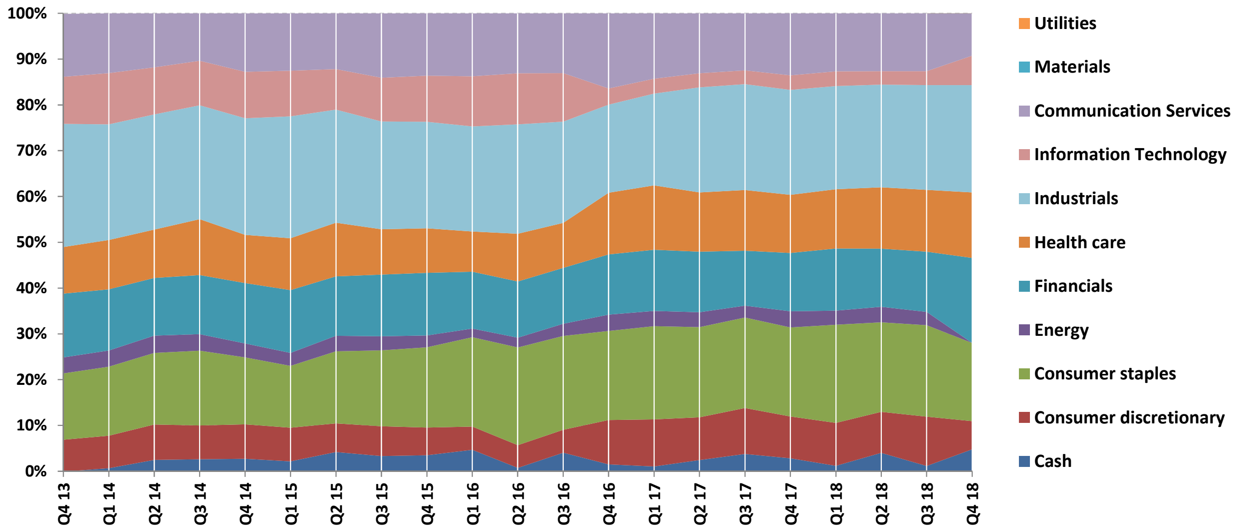
Source: Bloomberg. As of 31st January 2019

We hold no Materials, Energy, Utilities and Real Estate companies, many of which do not make it into our universe due to our focus on quality and returns. Industrials, Consumer Staples and Communications Services remain our significant sector overweight holdings, followed by Financials (excluding banks) and Health Care.



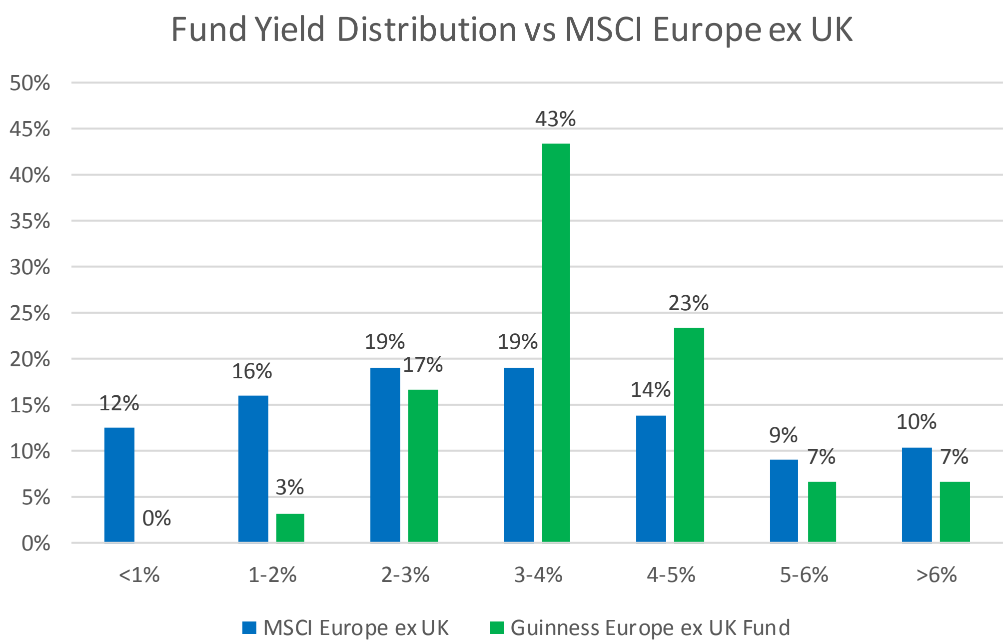
Source: Bloomberg data, Guinness data.

We made no portfolio changes over the course of January. As a result, sector weightings remained broadly the same as at year end.

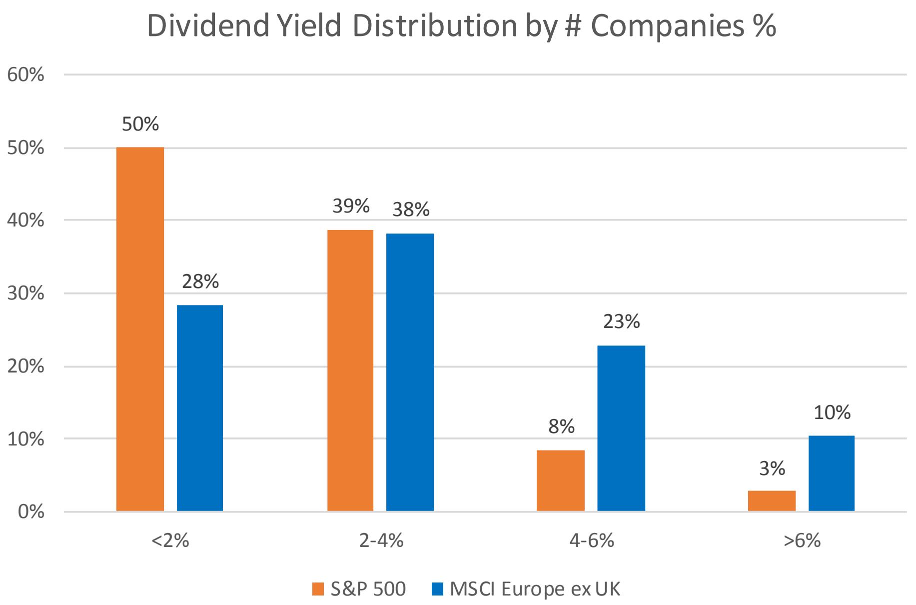


Portfolio Analysis

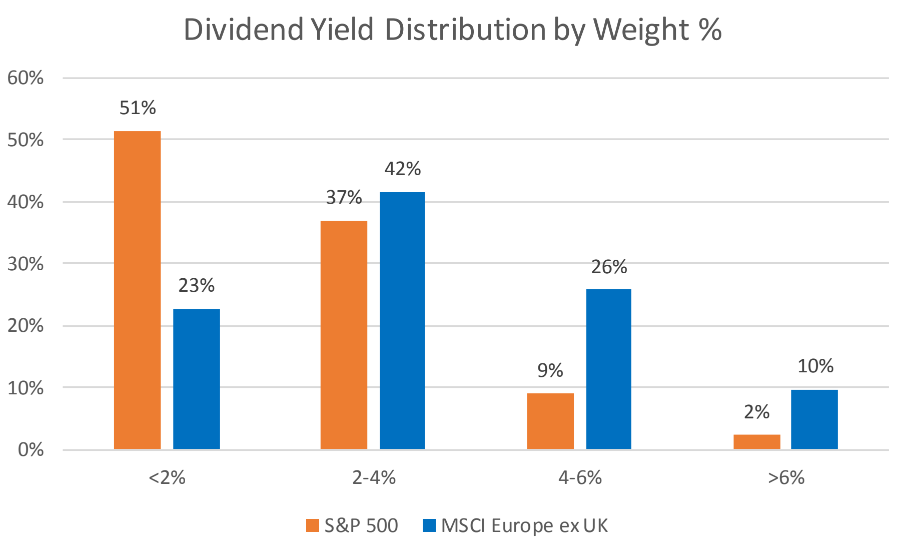
In January we updated our work on yield analysis versus the benchmark which resulted in some reassuring observations. The fund's yield composition is, as one would expect, heavily overweight vs. MSCI Europe ex UK Index companies in the 3% - 4% dividend yield range, with 43% of the portfolio in that bracket vs. 19% for the benchmark. A further 23% of our exposures have yields in the 4-5% range vs. 14% for the index. Conversely, we are materially underweight in the <2% range and most importantly in the >5% area, where research shows that the probability of dividend cuts and associated share price underperformance is markedly higher.



European equities offer superior yield opportunities vs. the US with a dividend yield for the MSCI Europe ex UK Index of 3.6% vs. 2% for the S&P500. However, some 33% of MSCI Europe ex UK equities are found in the higher (>4%) yield bracket vs. just 11% for the S&P500. Buyers of European indices therefore have significantly higher exposure to potential dividend cutters. The Guinness European Equity Income process shields investors from these risks by focusing on those companies that can generate persistent high cash returns, which we find are a strong predictor of dividend growth and in turn share price performance.



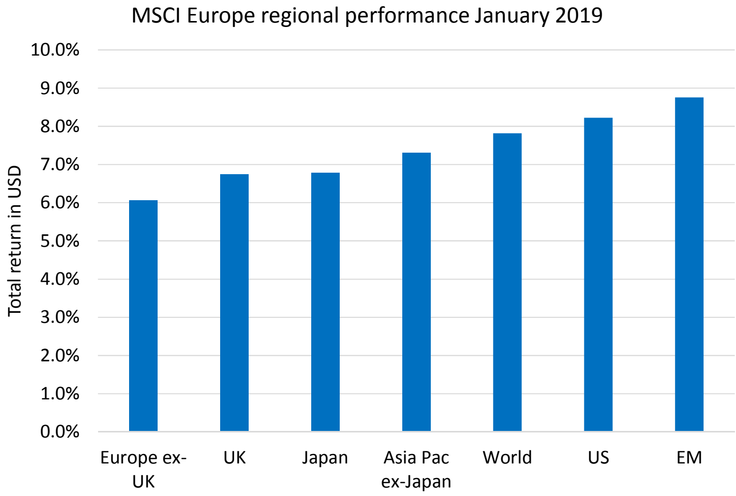
The dividend yield distribution by index weight, shown below, shows a very similar distribution to the analysis by number of companies shown above. This of course is very different to the UK market, where the larger weights tend to have significantly higher dividend yields than US or Continental European indices.



January in Review

January saw European equity markets rebound from the December lows as global sentiment improved along with hopes for some resolution around the US-led trade dispute with China. Meanwhile domestic Eurozone risk premiums inched lower as Italian 10Y spreads continued to fall after resolution of the 2019 budget deficit with the EU (at quite some cost to Italian Q3 and Q4 GDP growth, as the country fell into recession). French 10Y yields remained stable at 0.69%, close to one-year lows despite Les Gilets Jaunes.

German 10Y yields recorded new one-year lows, below 0.15%, as export data deteriorated due to external factors (namely the US-China trade dispute).



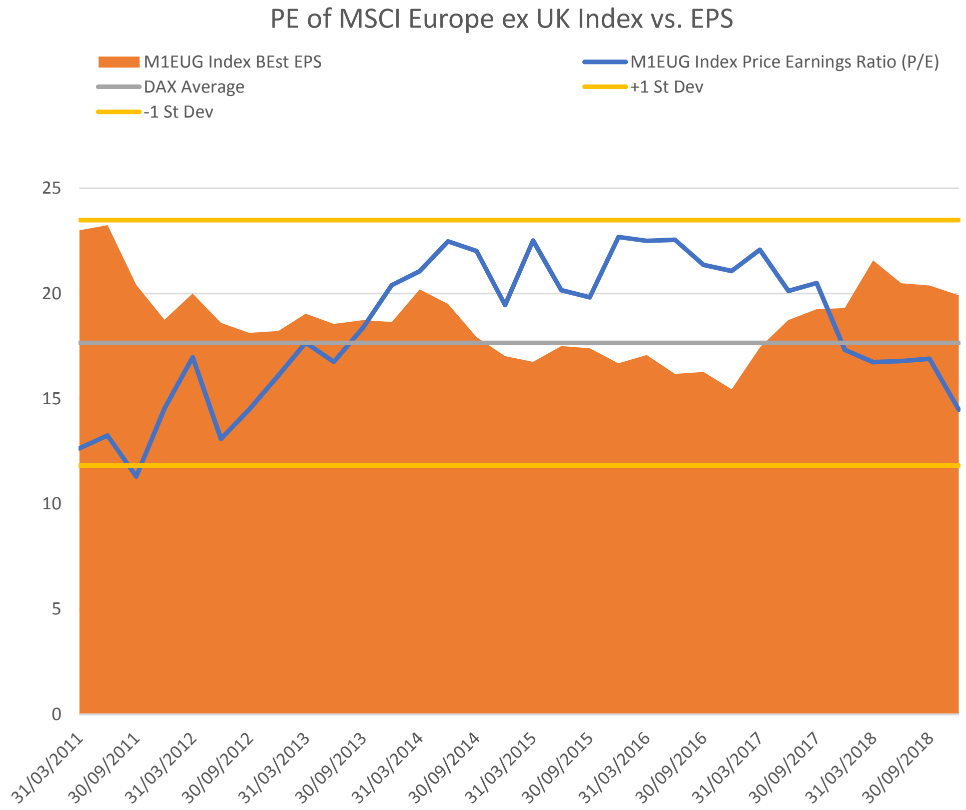
Source: Bloomberg. As of 31st January 2019

The spread between deteriorating external trade and still largely resilient domestic indicators was apparent in the sharp decline of the German IFO Expectations index vs. a much more resilient reading from the Belgium Business Confidence Index. Despite weak German export data and low inflation expectations (as expressed by 10Y yields and breakeven rates) Eurozone unemployment continued to fall, to 7.9%, and wage growth accelerated to 2.8% YoY. Given a slim output gap there is scope for depressed rate expectations to rebound over time, in our view. Later in the month the ECB's Q4 Bank Lending Survey added support to the view that the domestic economy remains resilient in the face of weak external data. Indeed, loan demand from corporates across the Eurozone remained positive and household demand increased.

The Euro remained resilient in the face of the ECB's downgrade to growth expectations (as the spread between short dated US treasuries and German 2Y narrowed after the Fed reined in expectations of further rate hikes). Expectations for Q3 2019 rate hikes were pushed out to Q4 2019. ECB president Mario Draghi highlighted that proceeds of QE will continue be reinvested even after rates rise. However, no update was given on the potential for new targeted longer-term refinancing operations (TLTROs) ahead of the expiry of the old, although action does seem likely at some point this year. Regarding the near-term outlook the ECB's Klaas Knot commented "we'll see a couple of quarters with somewhat slower growth, and that's mostly due to external trade, but domestic demand is still holding up".

Another notable development over the month was the continued tailwind behind the European effort to compete against China and the US on the global stage. The importance to European industry and jobs of global competitiveness and collaboration over national ideology and backyard protectionism is now well understood by most politicians and by businesses. The Federation of German Industries (BDI) announced far-reaching plans in January to take on China and improve global competitiveness by four means: 1) mergers, to allow European companies to bulk up into 'european champions'; 2) reciprocity, in tenders for big public procurement contracts like roads and railways; 3) matching clauses, allowing EU countries to offer state aid to investors to keep business in Europe by matching rival subsidies offered by the likes of China and Mexico; and 4) giving lawmakers the ability to limit foreign shareholdings to 10% vs. 25%.

While the European Competition Commissioner Margarethe Vestager hesitates over the Siemens Alstom rail merger, we have no doubt that this dynamic towards consolidation will continue to benefit a number of companies in our European portfolio. The reaction to the suggestion that the ECC might rule against the merger was marked; Manfred Weber of the European People's Party said, "we need to change the rules" while others including Le Maire, the French Finance Minister, voiced his support for change.



Source: Guinness, Bloomberg data. MSCI Europe ex UK PE vs. EPS (orange).

European equities have de-rated significantly since Q3 last year and price in a pessimistic scenario with multiples now not far off Euro crisis levels in many cases, in contrast to earnings estimates which remain relatively robust (see chart above). We believe we are a long way away from another Euro crisis, but what chance of a meaningful shift in sentiment towards Europe? The two big risk variables in Europe remain the two most likely sources of improving sentiment. We should have greater clarity over the form that Brexit will take within the next quarter or two, while the infighting in the Italian coalition looks increasingly likely to come to a head, perhaps around the european elections in May. Senior coalition partner The Northern League has seen its expected share of the vote rise to over 30% while support for Five Star has fallen into the mid-teens. A sharp shift in market sentiment towards Italy could occur if the coalition were to split and Matteo Salvini's immigration-focused but business-friendly Northern League were to prevail alone. Such an event could also have a meaningful effect on the balance of power in Europe, putting Matteo Salvini on a more equal footing with Emmanuel Macron and Angela Merkel.

Dr Ian Mortimer, CFA, Matthew Page, CFA and **Nick Edwards**

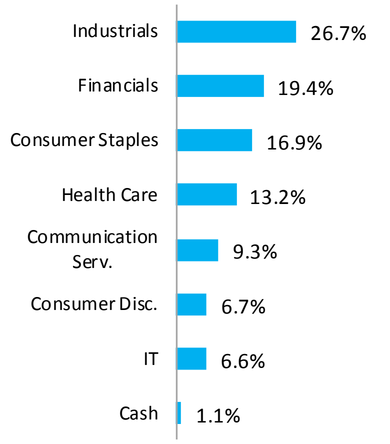
PORTFOLIO

31/01/2019

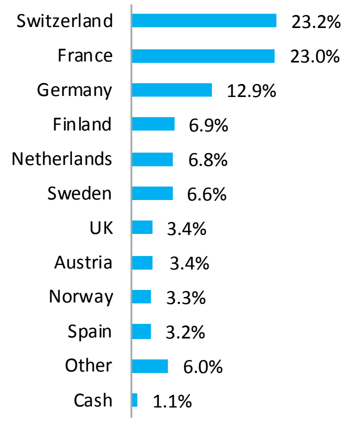
Fund top 10 holdings

Schneider Electric	3.5%
Kering SA	3.5%
Konecranes	3.5%
Unilever	3.4%
Helvetia Holding	3.4%
Danone	3.4%
Tieto	3.4%
Andritz	3.4%
Euronext	3.4%
Heineken	3.4%
% of Fund in top 10	34.4%
Total number of stocks in Fund	30

Sector analysis



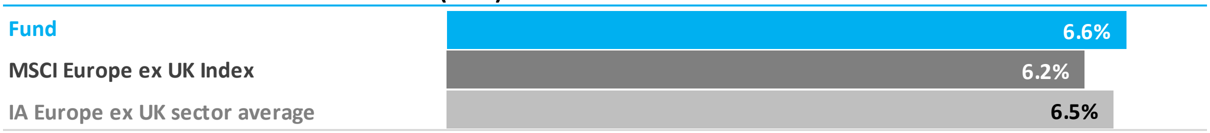
Geographic allocation



PERFORMANCE

31/01/2019

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Jan '15	Jan '16	Jan '17	Jan '18	Jan '19
Fund	-	1.3	28.9	16.1	-6.5
MSCI Europe ex UK Index	5.6	-1.6	20.0	21.5	-8.2
IA Europe ex UK sector average	4.0	3.6	18.4	21.9	-10.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	2.0	1.99	-6.49	36.21	40.62	38.84
MSCI Europe ex UK Index	3.0	3.02	-8.20	31.80	37.10	36.19
IA Europe ex UK sector average	3.8	3.77	-10.30	30.33	39.11	38.05

RISK ANALYSIS

31/01/2019

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	0.96	1.21
Beta	1.00	0.89	0.89
Information ratio	0.00	0.06	0.12
Maximum drawdown	-17.99	-14.98	-16.49
R squared	1.00	0.86	0.88
Sharpe ratio	0.18	0.21	0.23
Tracking error	0.00	5.09	4.73
Volatility	13.71	13.10	12.99

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.