Guinness European Equity Income Fund

INVESTMENT COMMENTARY – April 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.

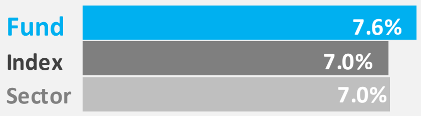
Performance

31.03.2019

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

	1 year	3 years	From launch
Fund	4.2	38.1	47.5
Index	2.2	33.8	42.7
Sector	-1.2	29.1	43.1

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	0.9	1.5
Beta	1.0	0.9	0.9
Info ratio	0.0	0.0	0.2
Max drwdn	-18.0	-15.0	-16.5
Tracking err	0	5	5
Volatility	13.7	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 Q1 2019 the Guinness European Equity Income Fund produced a total return of 8.21% (in GBP) versus the MSCI Europe ex UK net TR Index return of 7.95%. The fund therefore outperformed the Index by 0.26% over the quarter. It is pleasing to see that both the short and long-term performance of the strategy remains ahead versus IA Europe ex UK peers.

	1 Yr	3 Yr	5 Yr	Since Launch
Fund	4.2%	38.1%	41.6%	47.5%
Index	2.2%	33.8%	35.7%	42.7%
Sector	-1.2%	29.1%	35.5%	43.1%
Out/Underperformance vs Sector	5.4%	9.0%	6.1%	4.4%

Source: Financial Express 0.74% OCF. Cumulative Total Return in GBP as of 31.03.2019

Quarter in review

European markets continued to rebound in March amid further signs of progress in US-China trade talks towards the end of the month. This worked to the benefit of Industrials, our largest sector overweight. At the same time, economic releases continued to show greater-than-expected weakness in German manufacturing and export data. The press remains quite pessimistic, providing extensive coverage of Germany's export-led woes, but has given little colour on much more positive domestic European leading indicators. Manufacturing output is slowing but not by as much as was priced into Germany's DAX Index three months ago when we increased our holdings in high-quality cyclicals and the Index traded at multiples close to Euro crisis levels. Looking ahead, when it comes to US trade talks with the EU, Donald Trump may try once more to use the threat of tariffs as leverage. However, it is not a one-way street; the EU can play the same game on steel and aluminium.

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We suspect that again a compromise will be found here.

Despite recession in Italy and the soft PMI data in Germany, in March equity risk premiums continued to fall along with European high-yield credit spreads. The reality is that this is not another Euro crisis. March saw the Belgian Business Confidence Index (otherwise known as La Courbe Synthétique) rebound, highlighting the relative resilience of the domestic European economy in the face of weak external data and chiming with recent better-than-expected IFO Expectations data. German unemployment dropped to from 5% to 4.9%, its lowest rate since reunification in 1990. M3 rose 4.3%, ahead of the 3.9% increase that was expected and 3.8% prior, demonstrating improved liquidity. Italian, French and German services PMIs all came in ahead of expectations, as did French business confidence. Meanwhile, lending to non-financial businesses in the Eurozone increased 3.9% YoY in February, characterised by strength in Germany and France while lending growth in Italy and Spain remained subdued.

China's meetings with Italy (regarding signature to its Belt and Road Initiative (BRI)) and Eastern European countries put pressure on the European Union take a tougher line with China. One official commented "It has finally sunk in… while we were absorbed in our own crises for ten years, the GDP of China soared and Trump was elected. We entered a different game." The EC's proposal of an international procurement instrument (IPI) is a sensible one that should help level the playing field, allowing it to penalise bids for EU public contracts from foreign companies in sectors where their own governments have blocked access to public tenders. Simultaneously the theme of European Champions received a push from German economy minister Peter Altmaier and Emmanuel Macron citing China's growing technological prowess as one of the main reasons Europe needs a new European industrial strategy. Margrethe Vestager may have vetoed the Siemens-Alstom deal due to prohibitively high domestic market shares in signalling, but it looks likely that regulatory attitudes towards consolidation will continue to soften. This will allow higher market shares and returns, and in turn, increased investment into innovation with which to counter growing Chinese technological advancement. A number of our portfolio holdings look likely to benefit from this dynamic.

Are we moving past peak political paralysis? The recent bitter debate within the Italian governing coalition about signing up to China's Belt and Road Initiative and the future of the Turin-Lyon rail link in March highlighted just how divided it is. As we head into the European elections in May this a factor to watch. Salvini's business-friendly but immigration-focused League party now commands a significant majority over Di Maio's populist Five Star party. Were the coalition to split in the months ahead and Salvini's League party to prevail in one form or another, perceptions of Italy as a source of risk to the European Union could take a more favourable turn. There is also of course scope for more visibility on Brexit, the other main source of significant political risk in Europe, over the coming months. Regarding the European elections, populist parties look set to make headway (towards 15% - 20% of seats) but not to the extent that they gain control, and none – from any country – is arguing to leave the Euro. Meanwhile their progress is driving a rethink on attitudes towards immigration, in turn resulting in gains by centre right parties like Germany's CDU over AFD.

The ECB's introduction of its new bank refinancing operation TLTRO III, while ill-received in Q1 as it coincided with a sharp downgrade to European growth, should help steady the financial sector (where we have a small overweight position) going forwards. News that the ECB is working on the impact of negative rates on the banking system and is considering waiving negative deposit rates for banks is also a potential positive for the region. Peter Praet's replacement as ECB chief economist by Phillip Lane suggests that central bank policy will become more targeted on specific regions and sectors as the proceeds of QE are reinvested. While the leader of Germany's CDU party Annegret Kramp-Karrenbauer's focus on banking union underlines what seems to be a real desire at EU level to progress towards common bank regulation and an insurance deposit scheme. We also think there is a clear understanding in Germany's leading CDU party that Germany needs to and will give more as the largest beneficiary of the common currency.

Whatever the political and economic weather in Europe, which as a region accounts for just over 50% of fund holdings' sales, we think the Guinness European Equity Income Fund is well placed due to its exposure to companies characterised by high levels of self-determination – namely, leading market positions with a proven track record of generating persistent high cash returns, widening moats, aligned interests and long runways for growth. We hold no positions in sectors characterised by high levels of regulation (Telecoms, Utilities and Banks) or cyclicality (Materials and Energy).

Please see Holdings Performance Analysis below for Q1 single stock performance and reviews.

Performance Drivers

MSCI regional performance

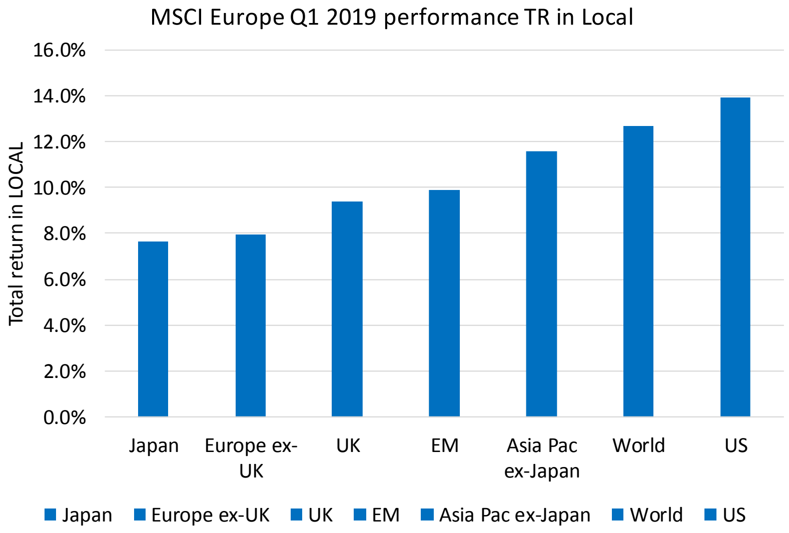

Chart 1: MSCI World Index geographic total return breakdown for Q1 2019, in Local. Source: Bloomberg

Sector performance was broadly spread in Q1, with Communication Services and Financials the main laggards in the Europe ex UK region. The former was held back by media sector disintermediation and the latter by large downgrades to GDP growth estimates. Bond proxies and long-duration equities such as Real Estate and Consumer Staples did well as declining inflation expectations resulted in lower risk-free rates. Information Technology performed well along with the rebound in US technology majors and as the Federal Reserve took a more dovish turn. Industrials did well, particularly in March as US-China trade talks showed material progress, despite still weak manufacturing data coming out of export-led economies like Germany.

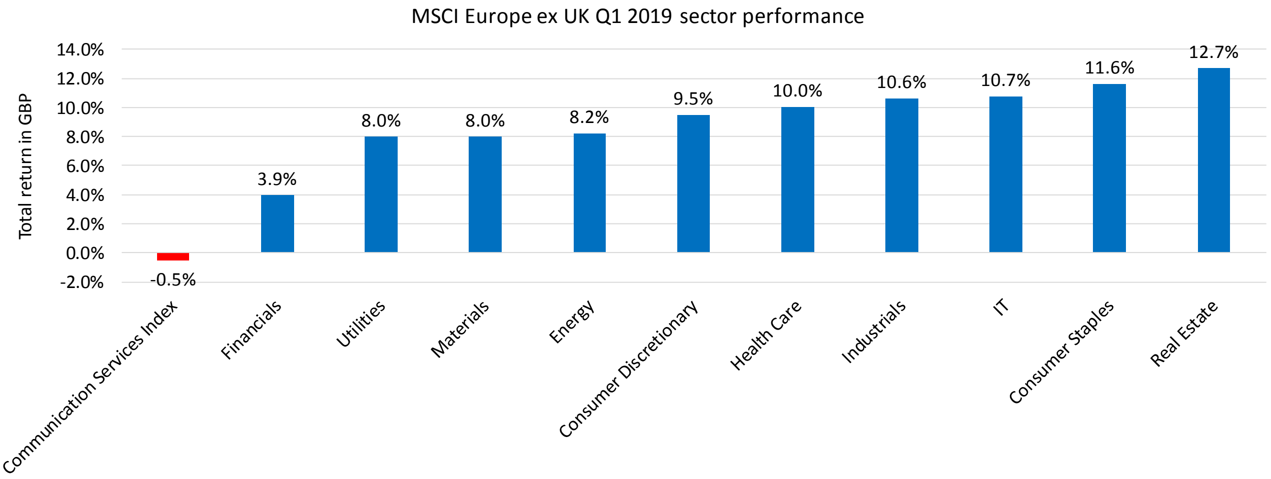

Chart 2: MSCI Europe ex UK Index sector total return breakdown for Q1 2019, in USD. Source: Bloomberg

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Positioning

Your fund holds no exposure to highly cyclical sectors such as Materials and Energy or regulated ones including Utilities and Telecoms. It is also has no exposure to the high street, with a significant underweight in Consumer Discretionary, and within Financials we hold no banks. Few companies from these sectors make it into our universe due to our focus on quality and returns. Industrials, Consumer Staples, Communications Services and to a lesser extent Financials remain our sector overweight holdings, as shown in the tables below. For a sector breakdown of the fund since launch, please see our 2018 Annual Review.

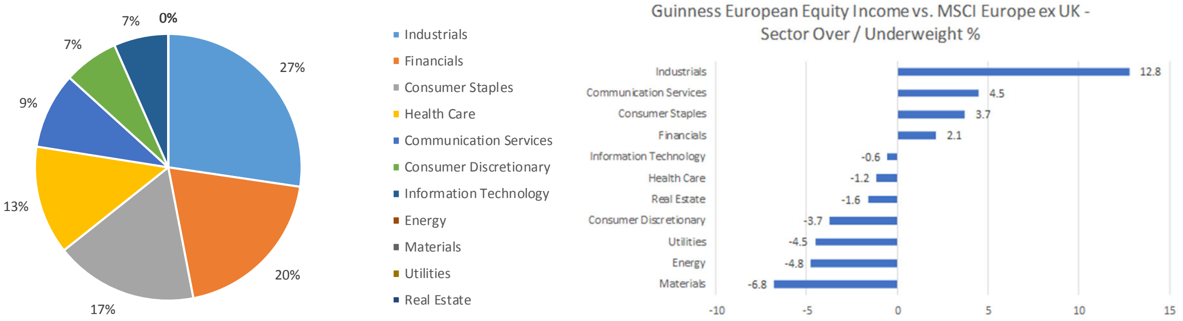

Chart 3: Left: Sector weightings, Right: Sector overweight / underweight vs. MSCI Europe ex UK.

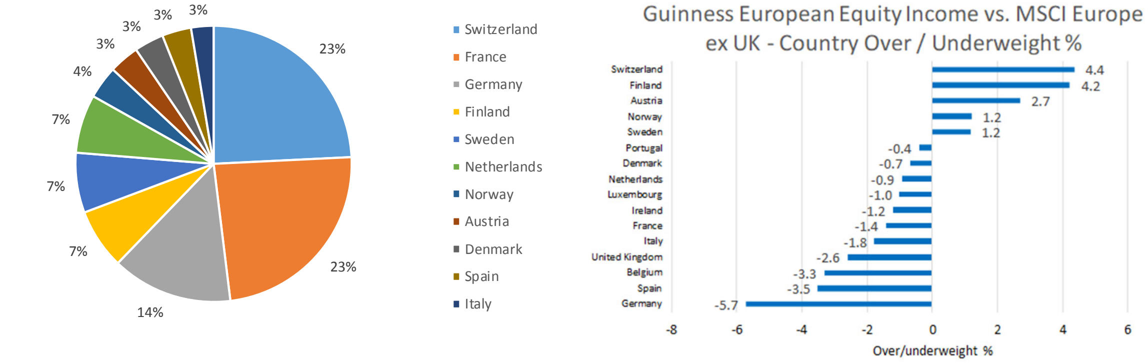

Chart 4: Left: Country weightings, Right: Country overweight / underweight vs. MSCI Europe ex UK.

By country we are overweight Switzerland, Finland, Austria, Norway and Sweden. This results from two factors. First, we find more high-quality companies in Switzerland and Scandinavia, and secondly, with the exception of Switzerland (the second-largest country index weight after France) these countries represent quite low weights in the MSCI Europe ex UK Index. Conversely, our 5.7% underweight to Germany is less than the weight of two positions versus the third-largest country index weight.

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Holdings Performance Analysis

We made no portfolio changes over the course of Q1 2019. Sector weightings remained broadly the same as for December, when we last made changes, adding Amundi, Kering and Atlas Copco to the portfolio to replace Hennes & Mauritz, Hugo Boss and Axfood.

Individual companies that performed well in Q1 that we have not written about over the previous six months or are not under review included **Konecranes, Tieto Oyj** and **Deutsche Post**. On the same basis, companies that posted weaker performance included **Andritz AG** and **Salmar ASA**.

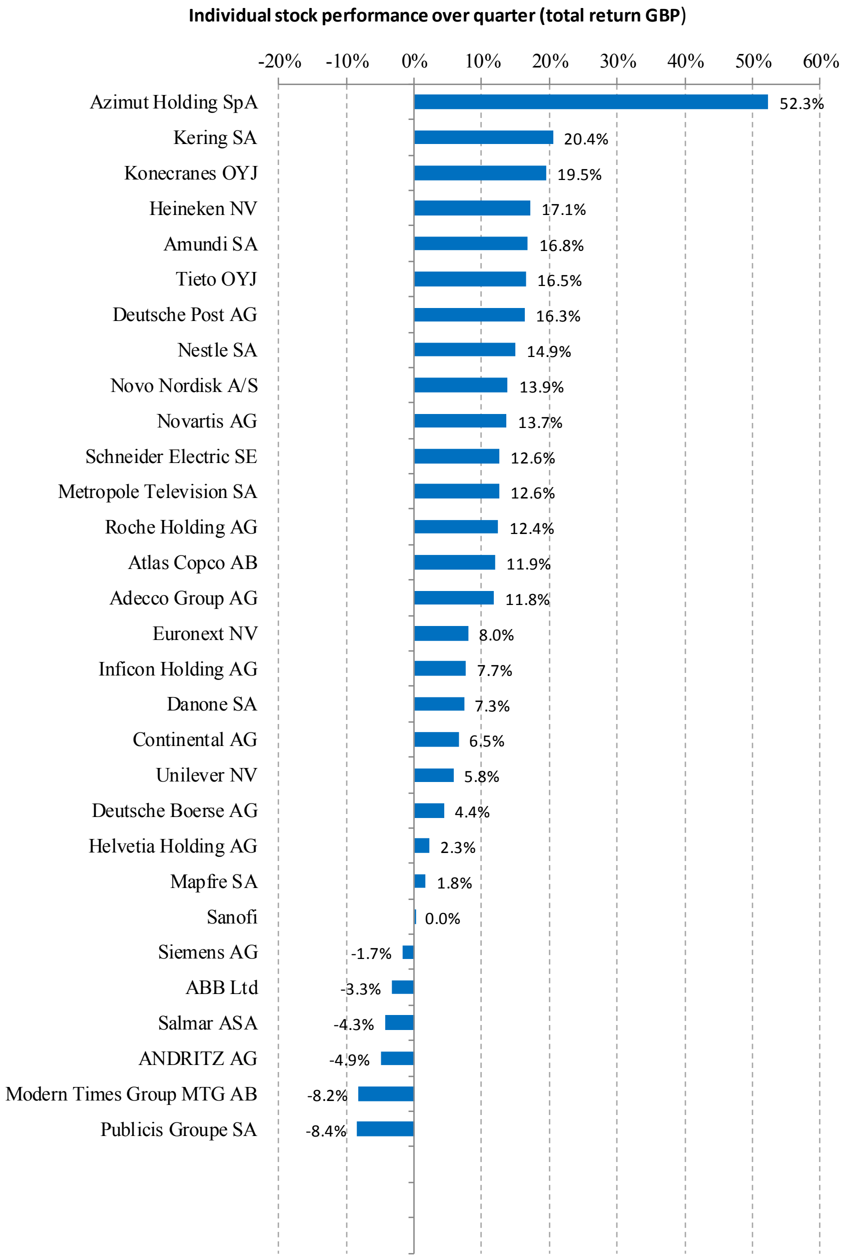

Chart 5: Individual stock performance over the quarter, in GBP. Source: Bloomberg data

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Konecranes (+19.5% in GBP) outperformed the Industrials sector in Q1 as the tone of US-China trade talks became more constructive. Konecranes is the global market leader in industrial cranes and ranks first to third in the market in all lifting product categories for ports and container terminals. The company's global service branch network is unique, and there is no global or regional competition in industrial crane maintenance. Rising global demand for automation is driving demand for Konecranes' flow solutions and automation systems. In addition, advancements in technology and sensors are helping Konecranes increase its higher margin service revenue as remote surveillance of client equipment increasingly enables pre-emptive action and repair. Demand is robust and margins are improving. Across Service, Industrial Equipment and Port Solutions divisions, order intake rose 5.3%, 5.5% and 5.3% respectively in 2018. We see strong growth potential in Service with the expansion of service to the acquired Demag installed based. Further, the more recent acquisition of MHPS in the US has extended Konecranes' lead in the industrial lifting and port solutions markets and its ability to offer comprehensive solutions and complementary products and services to clients. A total of €140m of annual synergies at the EBIT level are foreseen in 2019 along with €130m in one-off costs. Further upside to margins looks set to come from platform rationalisation as Konecranes expects to move to 11-14 global platforms from 20 in 2018 and 30 in 2017. Konecranes is a company where management is focused on value creation and has a good history of capital allocation. The presence of multiple active owners on the shareholder register acting in long-term shareholder interests, including Chairman Stig Gustavson (2.8%), Hartwall Capital (10%) and Solidium (6.9%), is reassuring in this respect. High share price correlation to global trade, capacity utilisation and PMIs means that the shares will suffer highs and lows, but this is a company that we like and which looks set to deliver for shareholders over the longer term.

Tieto Oyj (+16.5%) performed well in Q1 as demand for its IT services in Finland and Scandinavia including project services, outsourcing and R&D software engineering continued to rise. Tieto is the market leader in Finland and number three in Sweden. Barriers to entry are apparent in high switching costs, local economies of scale and sector-leading technical expertise. Signs that Tieto's moat continues to widen include continued success in rolling out its software roadmap for Lifecare, Payments and Healthcare sectors, driving above-market growth. Related to this is a stable high gross margin and widening EVA margins. The presence of long-term active shareholders Cevian (14.9%) and Solidium (10%) on the shareholder register is supportive of long-term value creation. Meanwhile, the relatively fragmented nature of the IT services industry in Europe combined with Tieto's strong balance sheet (30% net debt / equity) highlights potential opportunities from both bolt-on acquisitions and sector consolidation. Tieto's shares continue to price in little by way of value creation based on an 8% discount rate.

Deutsche Post (16.3%) did well in Q1, coming off a low valuation amid strong DHL shipment volume increases and an improving tone in US-China trade negotiations. Deutsche Post is a European dividend champion offering a yield in excess of 4% alongside good potential for future growth. Deutsche Post occupies some attractive market positions. DHL Express's core product Time Definite International (TDI) holds the global No.1 position with 38% market share of premium cross-border parcel and document delivery. DHL eCommerce Solutions benefits from the growing trend towards internet-led delivery in Europe and the US and holds a No.1 market position in Indian B2B Express. DHL Global Freight Forwarding occupies a No.1 position in air freight, No.2 in ocean freight and No.3 in road freight. Deutsche Post's supply chain business is the global No.1 with 6% market share. Except for TDI, these are fragmented

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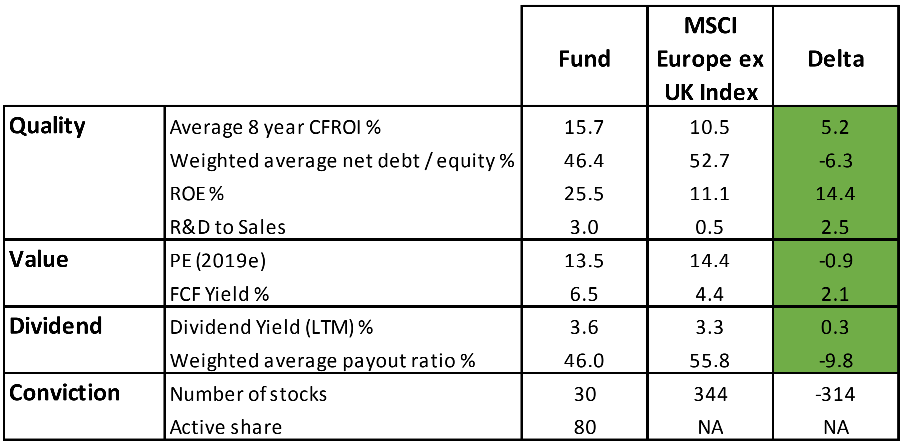
markets that are in the process of consolidation, leading to higher market shares and higher returns, supporting Deutsche Post's steadily widening EVA margins. The recent bid for Panalpina by DSV is a case in point that should have a knock-on benefit to sector returns. It is also noteworthy that regulators and politicians in Europe are becoming more tolerant of consolidation and the creation of European champions as Europe looks to compete with China and the US on the global stage. The shares continue to price in little by way of future value creation based on an 8% hurdle rate.

Andritz (-4.9%) is the global market leader in medium-sized hydro equipment with 23% global market share. The shares had a poor quarter; demand for hydro equipment remained low as global subsidies for wind continued to keep hydro on the side-lines. However, we are quite optimistic regarding Andritz's long-term prospects. Although 2018 sales only rose 2%, overall order intake rose 19%. The majority of the rise in order intake was accounted for by the Pulp & Paper and Metals segments; but given that hydro power is still the cheapest form or renewable energy at c.$5c/kwh vs. onshore wind at c.$7c/kwh ex subsidy, and carbon price risk looks to be on the upside, we believe that this key division also has a bright future. Thinking about the top line, in 2009-2011, when order growth last exceeded sales growth by a wide margin, Andritz went on to post strong revenue growth for the five years through 2015. Meanwhile, at the margin we think that technology is increasing Andritz's moat and enabling efficiency gains out of its large installed base. Remote monitoring enables pre-emptive maintenance to the benefit of both Andritz and its customers. In terms of the shape of the broader market, there is also scope for accretive acquisitions and sector consolidation, particularly in the Pulp & Paper and Metals segments where markets are more fragmented, and Andritz's conservative balance sheet (16% net debt / equity) leaves it well placed in this respect. Thinking long-term, Andritz's focus on being a technology and quality leader is reassuring, and management interests are well aligned with those of shareholders given CEO Wolfgang Leitner's 25.77% stake in the company and Andritz's 2.8% holding in its own stock. Our long-term positive view on Andritz remains; we recently increased our holding in the shares on flows, bringing the position back to a 3.3% equal weight, in line with our equal weighted, high-conviction portfolio structure.

Salmar has been a strong performer for the fund but softened in Q1 amid an EC price-fixing investigation that includes Salmar's joint venture with Leroy Seafood Group, Scottish Sea Farms. The investigations are at an early stage, but in a worst-case scenario fines could be levied up to 10% of global turnover, representing a $132m risk for Salmar, equating to about 24% of FY 2019e EBIT or 2.3% of EV or 10% of equity shareholders' funds. Given that the SSF joint venture is co-owned, the worst case may in fact be half of that. We continue to like the sector for its attractive supply and demand outlook, with the latter driven by rising standards of living and population growth and the former by the limited number of sites with water temperatures suitable for salmon farming. Salmon's superior feed conversion efficiency ratio versus other animal products makes it the fastest growing source of animal protein. We continue to like Salmar specifically within the sector for its superior growth profile and sector-leading investment in new technology and innovation. The company is conservatively run, with Gustav Witzoe, the son of the founder, owning 52.2% of the shares and having a firm eye on the long term. To this point the company has a sound balance sheet with a net debt / equity ratio of just 16%. Following the recent news of the price fixing investigation, share price multiples (14x FY1 PE) have fallen back towards their 10Y average while ROE of 33% remains well above its prior 5Y average of c.26%. If nothing comes of the investigation we are happy owners at the current price, and in the event that it does prove to have basis and the share-price reacts negatively we would be happy to follow our equal-weight strategy and bring the position back to portfolio weight.

Key Fund Metrics Today

The four key tenets to our approach are quality, value, dividends, and conviction. We follow portfolio-level metrics to make sure we are providing what we say we will. At the quarter end, we are pleased to report that the portfolio continues to deliver on all four of these measures relative to the benchmark MSCI Europe ex UK Index.



		Fund	MSCI Europe ex UK Index	Delta
Quality	Average 8 year CFROI %	15.7	10.5	5.2
	Weighted average net debt / equity %	46.4	52.7	-6.3
	ROE %	25.5	11.1	14.4
	R&D to Sales	3.0	0.5	2.5
Value	PE (2019e)	13.5	14.4	-0.9
	FCF Yield %	6.5	4.4	2.1
Dividend	Dividend Yield (LTM) %	3.6	3.3	0.3
	Weighted average payout ratio %	46.0	55.8	-9.8
Conviction	Number of stocks	30	344	-314
	Active share	80	NA	NA

Chart 6: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 31.03.2019)

Outlook

An equal-weighted, high-conviction portfolio of high-quality companies trading at reasonable valuations and paying moderate to high and growing dividends is an attractive profile in a low-growth volatile environment. Your fund offers significantly higher return characteristics and balance sheet metrics compared to the wider index, while trading at a small price-earnings discount. In general, our portfolio companies exhibit strong levels of self-determination, characterised by market leadership positions, widening moats, aligned interests and significant market opportunities for growth. We believe that whatever the weather this is a good place to be.

We thank you for your continued support.

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

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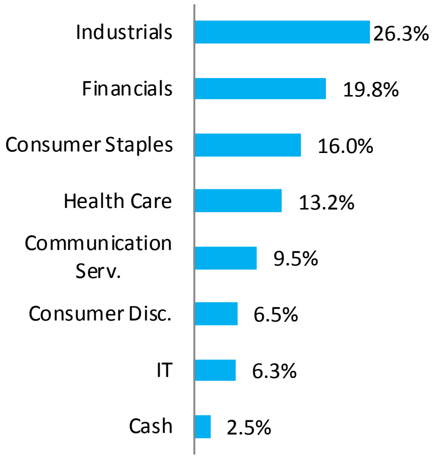
PORTFOLIO

28/02/2019

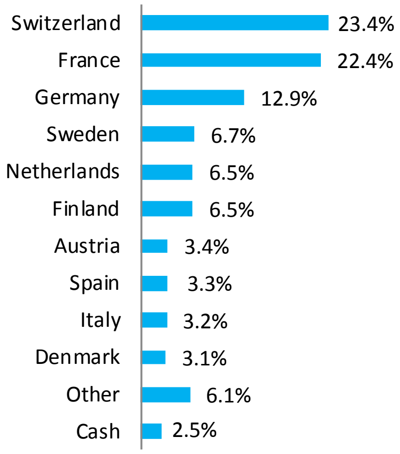
Fund top 10 holdings

Roche Holding	3.5%
Amundi	3.5%
Helvetia Holding	3.5%
ABB	3.5%
Nestle	3.4%
Andritz	3.4%
Novartis	3.4%
Modern Times Group	3.3%
Atlas Copco	3.3%
Deutsche Post	3.3%
% of Fund in top 10	34.0%
Total number of stocks	30

Sector analysis



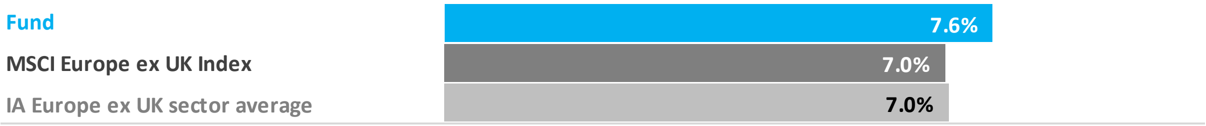
Geographic allocation



PERFORMANCE

31/03/2019

Annualised % total return from launch (GBP)



Discrete years % total return (GBP)	Mar '15	Mar '16	Mar '17	Mar '18	Mar '19
Fund	-	1.3	28.9	16.1	4.2
MSCI Europe ex UK Index	5.6	-1.6	20.0	21.5	2.2
IA Europe ex UK sector average	4.0	3.6	18.4	21.9	-1.2

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	4.1	8.4	4.2	38.1	41.6	47.5
MSCI Europe ex UK Index	2.5	8.0	2.2	33.8	35.7	42.7
IA Europe ex UK sector average	1.8	7.6	-1.2	29.1	35.5	43.1

RISK ANALYSIS

31/03/2019

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	0.89	1.54
Beta	1.00	0.88	0.89
Information ratio	0.00	0.02	0.17
Maximum drawdown	-17.99	-14.98	-16.49
R squared	1.00	0.86	0.88
Sharpe ratio	0.24	0.26	0.32
Tracking error	0.00	5.13	4.68
Volatility	13.65	12.99	12.98

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

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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 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
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.