Guinness European Equity Income Fund

INVESTMENT COMMENTARY – October 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

30.09.2019

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

	1 year	3 years	From launch
Fund	9.8	27.9	64.4
Index	5.9	30.3	57.2
Sector	2.2	26.9	56.1

Annualised % total return from launch (GBP)

Fund	9.0%
Index	8.1%
Sector	8.0%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	0.9	1.8
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	13.4	12.8	12.7
Sharpe ratio	0.3	0.4	0.4

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 0.35%, bid to bid, total return.

Summary performance

At the end of Q3 2019, your fund had returned 20.3% year-to-date (in GBP) in comparison to a return of 18.9% for the MSCI Europe ex-UK Index. The fund returned 0.5% (in GBP) over the third quarter, which was 1.2% behind the MSCI Europe Ex UK Index, which rose +1.7% over the quarter.

European equities, a significant underweight in most global portfolios, performed in line with most main regions over the quarter in USD and outperformed all main regions in EUR terms except Japan.

The main driver of returns over the quarter was once again a declining risk-free rate, leading to strong performance from bond proxies such as Utilities and Real Estate (where we have no exposure) and long duration sectors like Consumer Staples (a small overweight for the fund).

Your fund has outperformed its benchmark the MSCI Europe ex UK Net Return Index over most main timeframes (one and five years and since inception) whilst at the same time delivering on its mandate to provide a rising income stream to investors.

	1 month	YTD	1 Yr	3 Yr	5 Yr	Since Launch
Fund	1.8%	20.8%	9.8%	27.9%	67.1%	64.4%
Index	1.0%	18.9%	5.9%	30.3%	53.9%	57.2%
Sector	0.4%	17.3%	2.2%	26.9%	55.6%	56.1%
Fund performance vs Sector	1.4%	3.5%	7.6%	1.0%	11.5%	8.3%

Figure 1 source: Financial Express 0.35% OCF. Cumulative Total Return in GBP as of 30.09.2019

Quarter in review

Perhaps the most striking feature of the third quarter in Europe was the discord surrounding Mario Draghi's penultimate ECB meeting as president and the related reintroduction of quantitative easing. A total of nine out of 25 members of the ECB Governing Council voted against the move. Klaas Knot went as far as publishing his views on the Dutch central bank website, where he questioned the effectiveness of negative rates and QE, emphasised their role in the increasing unaffordability of housing as an asset class and associated rise in inequality, and highlighted risks to pension pay-outs. His statement was followed by the resignation of Sabine Lautenschlaeger, Germany's representative and the only female member of the ECB's governing council. The Austrian and French central banks also expressed opposition to the move. A more recent memo published by a group of ECB hawks cited "suspicion that behind this measure lies an intent to protect heavily indebted governments from a rise in interest rates is becoming increasingly well founded… like other central banks the ECB is threatened with the end of its control over the creation of money." Related research published in August by economists from the US Treasury, the University of Bath and several other universities found "robust" evidence that bank lending growth was weaker in countries with negative interest rates.

Mario Draghi's move may prove to have been a smart one – at once putting all of the issues on the table ahead of Christine Lagarde's arrival and highlighting to the fiscally prudent, largely northern European countries the alternative if they don't step up and implement growth-enhancing fiscal policies. The Dutch response was swift: a €50bn infrastructure-focused investment programme aimed at locking in ultra-low rates, the detail of which will be announced in early 2020. Meanwhile, Germany, bound by internal borrowing limits (for now at least), announced a €50bn climate package that may be funded via a carbon levy. These are small steps in the right direction and may gain momentum in 2020 when Christine Lagarde takes over as president of the ECB on November 1st 2019. One country moving to lock in ultra-low rates can potentially become self-reinforcing as the others also look to lock in similarly attractive rates before the opportunity fades.

For markets the implication is significant, shifting stimulus away from "top down" (asset price targeting and related trickle-down effects) to "bottom up" (through infrastructure and wages). If one then considers the potential for a more market-friendly attitude to trade from the US ahead of elections, reduced free movement of labour and increasing new debt issuance (in the US due to the deficit and in Europe due to increasing bank regulation and rising fiscal expenditure), the ingredients are there for a more reflationary tone and a related shift away from growth towards value.

First and foremost, the Guinness European Equity Income Fund's stock picking is bottom up; but your fund should nevertheless be well placed to navigate such a shift were growth to become less scarce, with our large overweight in Industrials standing to benefit from increased infrastructure spend and our insurance overweight from any reflation that makes its way back into the system. As we said in our last quarterly update, our holdings in incumbents would also benefit from any right-sizing of the capital pecking order, with less free money available for weaker players.

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

Performance Drivers

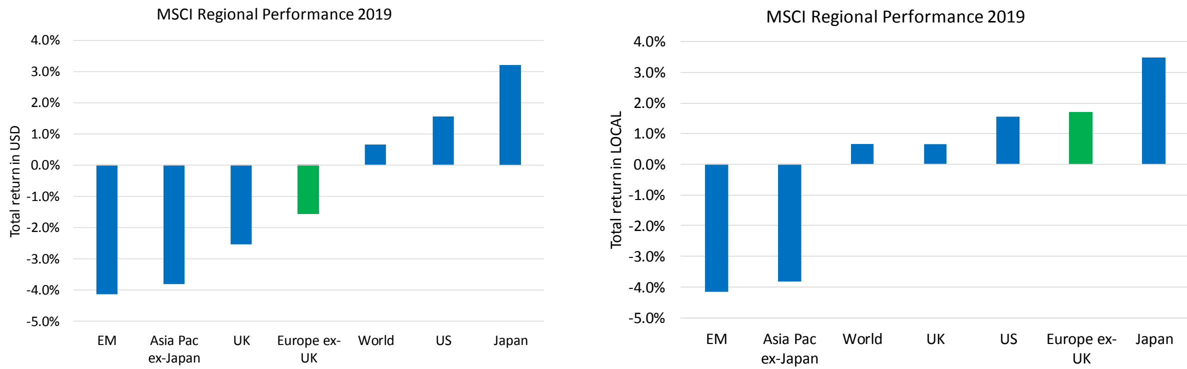

Figure 2: MSCI World Index geographic total return breakdown for Q3 2019, in USD (left) and Local currency (right). Europe ex UK in green. Source: Bloomberg data

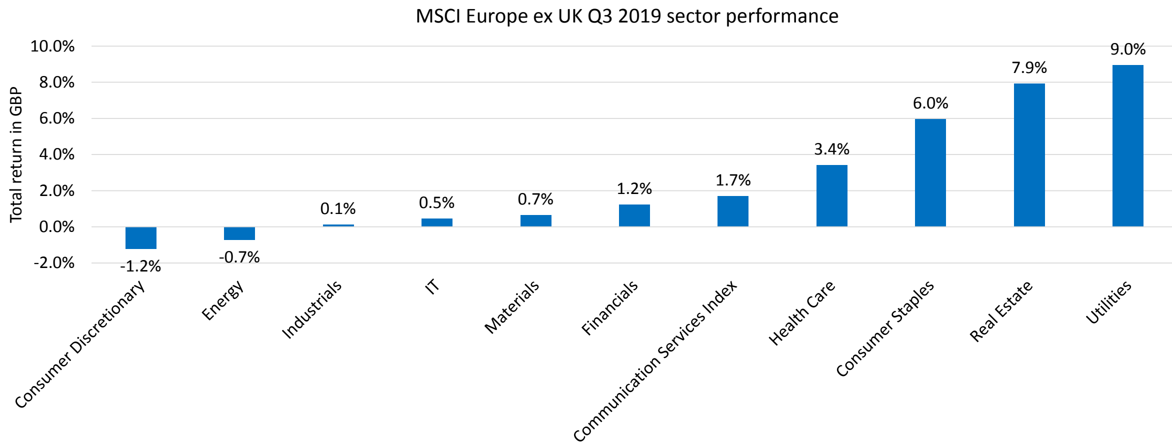

Figure 3: MSCI Europe ex UK Index sector total return breakdown for Q3 2019, in GBP. Source: Bloomberg

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

Positioning

The Guinness European Equity Income Fund is characterised by a high 82% active share against the Europe Ex UK benchmark. Our focus on companies with good track records that are in charge of their own destiny and have the potential to deliver high and rising returns for a long time to come means the fund has no exposure to cyclical and regulated sectors like Materials, Utilities, Real Estate, Energy and Banks. Conversely, sectors like Industrials, Financials, Consumer Staples and Communication Services, in which your fund is overweight, hold many high-quality and scalable companies.

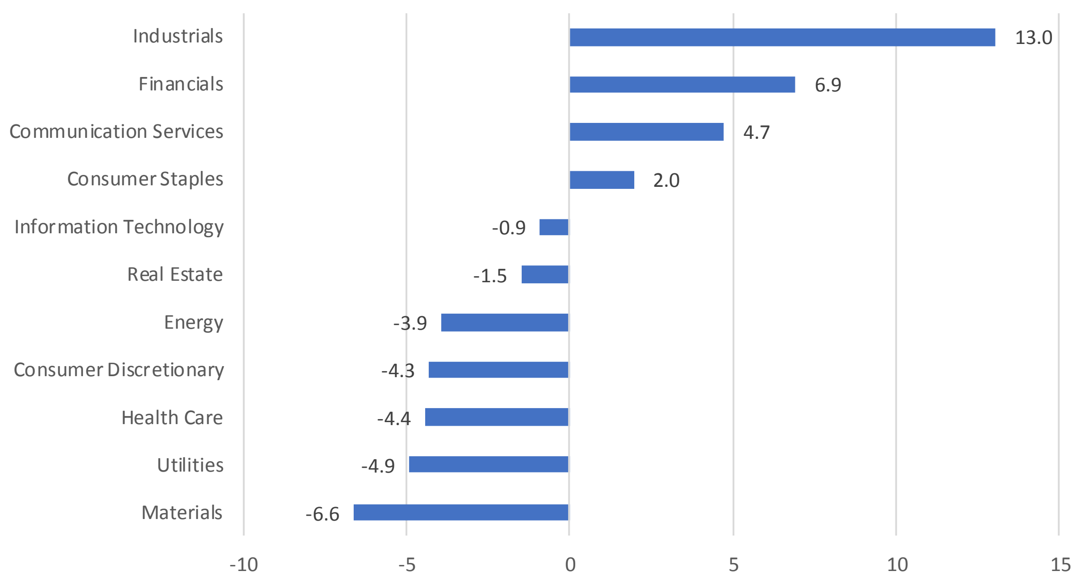

Figure 4: Sector over/underweight % breakdown of the fund versus MSCI Europe ex UK Index. Guinness Asset Management, Bloomberg (data as at 30.09.2019).

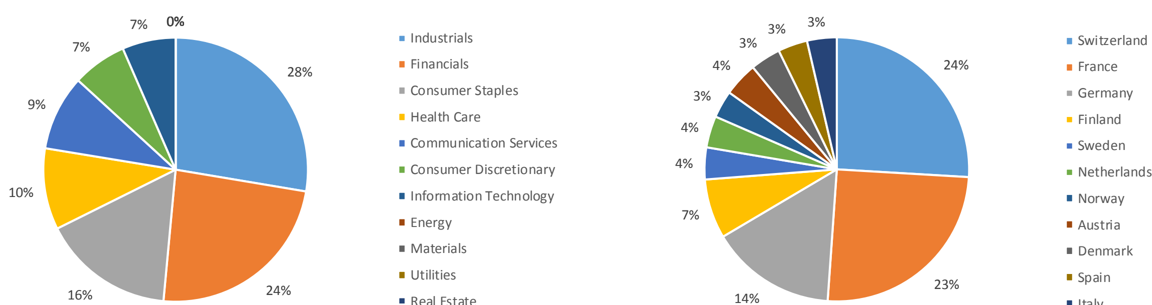

Figure 5: Sector and regional breakdown of the fund. Guinness Asset Management, Bloomberg (data as at 30.09.2019)

The Guinness European Equity Income Fund's country over and underweight positions result from a pull between two factors. Naturally France and Germany represent high absolute weights in the index at 24.5% and 18.4% respectively, but we simply find a greater number of high-quality companies with strong prospects in "high IP" markets with good corporate governance like Switzerland and parts of Scandinavia.

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

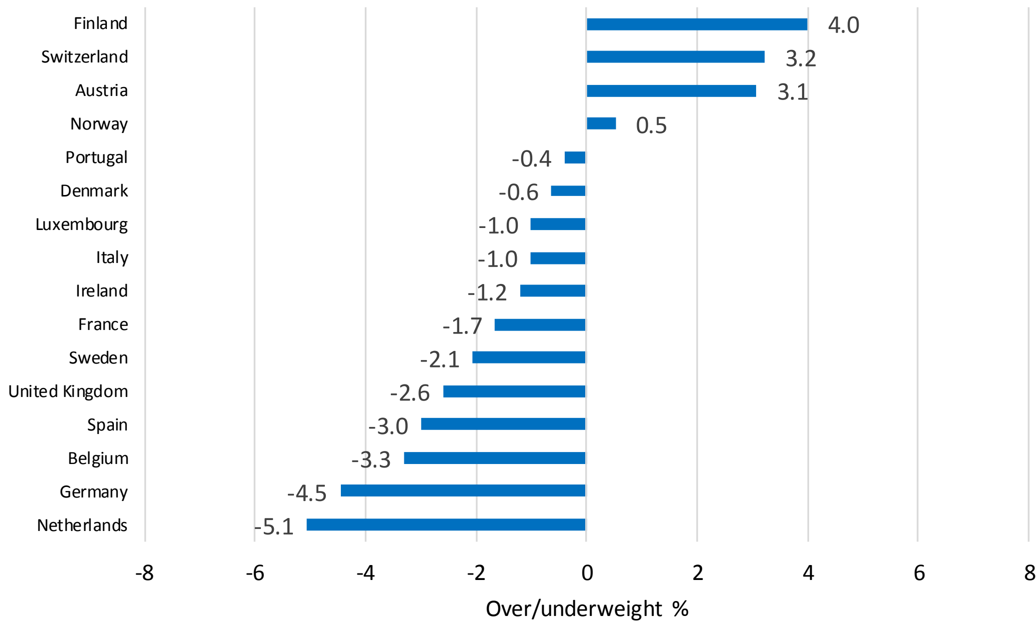

Figure 6: Regional breakdown of the fund versus MSCI Europe ex UK Index on a geographic basis. Guinness Asset Management, Bloomberg (data as at 30.09.2019)

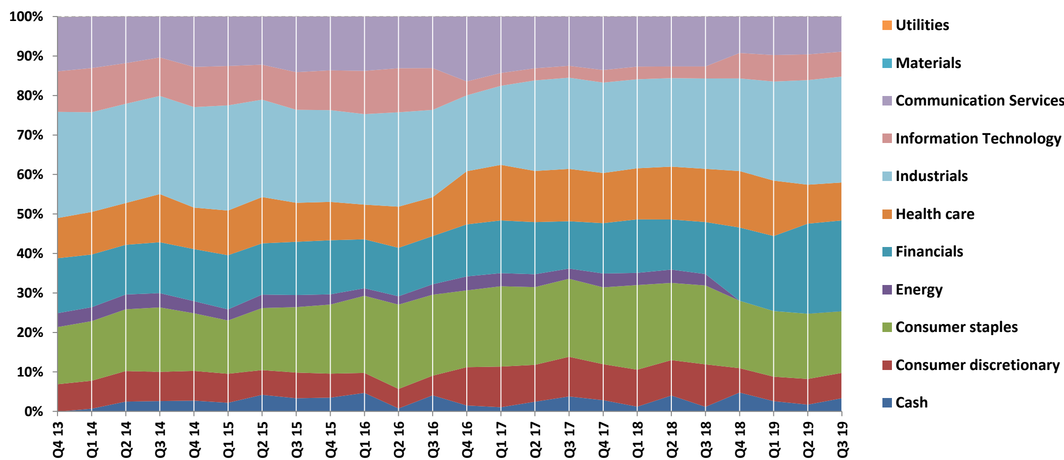

Figure 7: Portfolio sector breakdown at end Q3 2019

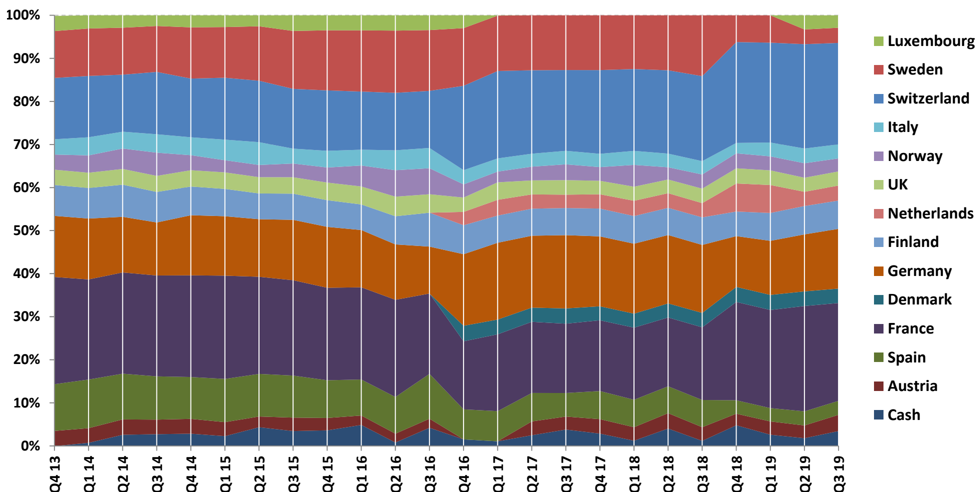

Figure 8: Portfolio geographic breakdown by domicile at end Q3 2019

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

There were no changes to underlying holdings during Q3 2019.

Individual companies that performed well in Q3 were **Deutsche Boerse AG** +15%, **Helvetia Holding AG** +15%, **Andritz AG** +13%, **Euronext NV** +13% and **Inficon Holding AG** +11%. Companies that detracted from performance in Q3 were **Konecranes Oyj** -12%, **Kering SA** -10%, **Millicom Int. SA** -10%, **Tieto Oyj** -10% and **Metropole Television SA** -10%.

Newsflow from our portfolio companies was light over the last couple of months ahead of Q3 reporting season later in October. However there were some developments worthy of comment.

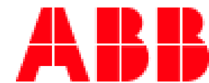

ABB has been out of favour for a while, partly due to its end markets being held back by the US-China trade war and as the costs of rationalisation and restructuring have weighed on the P&L. However, news during September added to our conviction that potential continues to build behind the scenes. According to press reports, new CEO Björn Rosengren (ex Sandvik CEO) may seek a sale of the Electrification business when he takes the helm next year, making the company purely focused on the Industrial Automation & Robotics and Motion segments. Also noteowothy were reports that ABB is considering appointing Sandvik Chairman Johan Molin as a board member. ABB is already in the process of selling 80.1% of its Power Grids division to Hitachi, due H1 2020, which looks set to result in a large c.$7.7bn one-off return of capital to investors. A sale of Electrification would represent another step up for the group margin and leave it predominantly focused on innovative, higher-IP, higher-growth industries. The appointment of Rosengren and Molin reads well for ABB's transition towards a more agile and decentralised business model. Johan Molin spent nearly twenty years at Atlas Copco, and played a part along with Investor AB (the largest shareholder in both Atlas Copco and ABB) in shifting the businesses to a more local and flexible decentralised structure. Compared to ABB's current vertical structure, the benefits of a more local, customer-focused model, where divisions are incentivised at unit level, should with time pay dividends for ABB shareholders. Atlas Copco was recently at pains to point out the advantage afforded it by its global-local position as trade barriers rise. The market may continue to worry about the cost of ABB's restructuring, its exposure to manufacturing industry and a China slowdown. If so, we will be happy to follow our process and reweight our position back up to portfolio weight. After all, with a dividend yield of 4.5% and a significant special dividend to come, we are paid to wait.

Siemens continues to develop in a similar way to ABB, albeit at a more advanced stage on its journey towards a higher-return and more agile company, having already spun out its wind, health and lighting divisions and scaled up Siemens Wind through the merger with Gamesa to be a (European) global champion with a no.1 market position. Healthineers was separately listed, putting it in a position where its management is free to allocate capital effectively. The spin-out of the lighting division, Osram, saw Siemens exit a company where barriers to entry were arguably too low. As for rail, it seems unlikely we will see a rerun of the failed Alstom merger after EC competition authorities ruled on excessive market power.

News over the month that Siemens may replace the head of its Gas & Power unit ahead of a planned listing next year would see Siemens significantly reduce its exposure to its lowest-return, most volatile

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

and arguably least sustainable division. It would put the G&P division in a stronger position to create value and simultaneously make Siemens a more focused entity, better able to allocate capital and resources across Smart Infrastructure, Digital Industries and Mobility (rail). This is a company on a journey towards higher returns – a view which is supported by the recent change in management incentive structure to include return on capital employed (ROCE at a 15% hurdle rate) alongside individual targets. It is also notable the new share plan has resulted in some 80% of Siemens' 300k employees being shareholders vs c.30% under the 2015 share plan. All of this is supported by the fact that Siemens, like so many of our industrial holdings, has identifiable barriers to entry, namely switching costs in the form of a large installed base of equipment woven into and across its client assets which requires regular servicing. With the company offering a c.4% dividend yield we are happy to wait for developments to feed through into to higher returns.

Roche performed well in September following its investor day, which highlighted a large and growing pipeline comprised of 21 new molecular entities (up 62% vs 2010) and 149 late stage projects by therapeutic area (up 148% vs 2010). Roche has an impressive 20Y sales CAGR of 9%, much of which can be attributed to its prowess in announcing breakthrough therapy designations (BTDs). However, the market is only forecasting top line growth of around 3% per annum through 2022, whereas Roche itself is targeting new sales of $25bn from 16 "pivotal readouts" through to the end of 2020; which, all else equal, would equate to a total increase in sales of c.40%. Clearly it is the pace of biosimilar attrition to existing oncology drugs like Avastin, Rituxan and Herceptin in combination with follow-through from the above pipeline that will determine the outcome. The relatively recent introduction of Perjeta and Kadcyla suggest that Roche is well placed to keep expanding its oncology franchise, while sales of MS drug Ocrevus beat all initial forecasts (rising to c.$7bn). Market expectations seem quite lowly if past form is anything to go by; expecting erosion of not far off 40% to existing portfolio sales, set against an earnings multiple of under 15x vs a historic range of 10-20x.

As we push on into the 21st century and medicines become increasingly personalised and data driven, it looks likely that there will be fewer but bigger winners in the pharmaceutical space. Roche as a global market leader in vitro diagnostics (20% global mkt share) and biotech and oncology (30%) looks particularly well placed to be amongst the winners. With R&D as a percentage of sales up at 21%, and an unparalleled position in diagnostics, which influence over 60% of clinical decision making but account for just 2% of cost (taking no account of saved costs associated with right treatment), Roche (and its Genentech division) look best-in-class in terms of innovation and barriers to entry. Further biologics, which comprise over 80% of Roche's pharma sales, tend to be harder to replicate and therefore suffer less generic competition compared to other classes of drugs. With a 2020e dividend yield of 3.2% and RoE of 42% vs a PE multiple of just 14.3, the Guinness European Equity Income Fund remains a happy holder of Roche for the long term.

Millicom's lead shareholder Kinnevik updated on plans for its 37% stake in the company in September, announcing that it will divest the entire stake to shareholders by year end 2019. Millicom, which is listed in Sweden and was founded by Kinnevik some 30 years ago, no longer fits Kinnevik's profile, which has shifted its focus to early-stage technology ventures. In the short-term this means that Millicom has been and may continue

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

to be under pressure, the shares having fallen by some 10% over Q3. However, in the longer term it should be good news, removing an overhang and speculation that has been in the market for some months. The move could also create the conditions for John Malone to return to the table, after Millicom walked away from a deal with Malone's Liberty Latin America Ltd valuating Millicom at about SEK710/shr back in January 2019 (vs today's price of about SEK450/shr).

Deal or no deal, we continue to think that Millicom (the market leader in Central America for cable and 4G) represents an attractive quality income profile given its long runway for growth and dominant market positions; its markets being characterised by high GDP and population growth, along with rapidly growing middle classes (around +6% per annum) and low broadband penetration rates. Further, starting cable/data packages are small while fibre roll-out is of developed market quality, meaning that Millicom has plenty of room to increase price and volume down the line. Headline PE multiples are elevated due to high deprecation rates, but EV/EBITDA multiples of just c.4x are well below those of closest peer Liberty Latin America (on 6.7x). The biggest risk for us as income investors would be a cut to the dividend driven by the amount of investment opportunities the company has on offer – not a problem we normally encounter among European Telecoms operators.

Key Fund Metrics Today

The four key tenets to our approach are: quality, value, dividend, and conviction. We follow these metrics at the portfolio level 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 debt / equity %	72.0	177.0	-105.0
	ROE %	23.0	11.0	12.0
	R&D to Sales	3.0	0.5	2.5
Value	PE (2019e)	14.9	15.0	-0.1
	FCF Yield %	6.4	5.0	1.4
Dividend	Dividend Yield (LTM) %	3.4	3.4	0.0
	Weighted average payout ratio %	54.0	60.0	-6.0
Conviction	Number of stocks	30	344	-314
	Active share	82	NA	NA

Figure 9: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 30.09.2019)

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

Outlook

Following recent declines in government bond yields, the market has continued to reward the shares of high-quality European listed global growth companies with historically high valuations, while shares of domestic and more capital-intensive companies remain far lower-rated. Our sense is that at this juncture we should continue to tilt towards the value end of our quality universe of persistent high-return companies. If an increased focus on fiscal policy in Europe joins excess stimulus into a tightening labour market the rotation away from growth towards value could be meaningful.

Uncertainty over political decision making and terms of trade looks likely to continue to cloud the European investment landscape. The other side of the coin is that scepticism and underweight allocations create value opportunities, and Europe is a region rich in intellectual property and knowhow. Your fund invests in companies characterised by high levels of self-determination, namely: identifiable barriers to entry, strong market positions, widening moats, aligned interests and long runways for growth.

Based on the table above, our high-conviction fund holds companies which are better quality at better value versus the index. We will continue to work hard to deliver long-term capital growth and a steady, growing income stream.

We thank you for your continued support.

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

Past performance should not be taken as an indicator of future performance. The value of investments and any income arising from them can fall as well as rise as a result of market and currency fluctuations.

PORTFOLIO

30/09/2019

Fund top 10 holdings

Holding	%
Andritz	3.7%
Helvetia Holding	3.5%
Deutsche Boerse	3.5%
Atlas Copco	3.5%
Siemens	3.5%
Euronext	3.4%
Nestle	3.4%
Schneider Electric	3.4%
Continental	3.4%
Amundi	3.4%
% of Fund in top 10	34.5%
Total number of stocks	30

Sector analysis

Sector	%
Industrials	27.1%
Financials	23.3%
Consumer Staples	15.8%
Health Care	9.7%
Communication Serv.	9.0%
Consumer Disc.	6.5%
IT	6.4%
Cash	2.2%

Geographic allocation

Country	%
Switzerland	23.1%
France	22.3%
Germany	13.6%
Finland	6.4%
Sweden	6.3%
Austria	3.7%
Netherlands	3.4%
Denmark	3.3%
UK	3.2%
Italy	3.2%
Other	9.2%
Cash	2.2%

PERFORMANCE

30/09/2019

Annualised % total return from launch (GBP)

	%
Fund	9.0%
MSCI Europe ex UK Index	8.1%
IA Europe ex UK sector average	8.0%

Discrete years % total return (GBP)	Sep '15	Sep '16	Sep '17	Sep '18	Sep '19
Fund	1.3	28.9	16.1	0.4	9.8
MSCI Europe ex UK Index	-1.6	19.9	21.5	1.4	5.9
IA Europe ex UK sector average	3.6	18.4	21.9	1.9	2.2

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	1.8	20.8	9.8	27.9	67.1	64.4
MSCI Europe ex UK Index	1.0	18.9	5.9	30.3	53.9	57.2
IA Europe ex UK sector average	0.4	17.3	2.2	26.9	55.6	56.1

RISK ANALYSIS

30/09/2019

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	0.85	1.81
Beta	1.00	0.88	0.89
Information ratio	0.00	-0.02	0.20
Maximum drawdown	-17.99	-14.98	-16.49
R squared	1.00	0.86	0.88
Sharpe ratio	0.34	0.35	0.43
Tracking error	0.00	5.06	4.63
Volatility	13.42	12.78	12.74

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 (0.35% 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 European 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, 18 Smith Square, London SW1P 3HZ.

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.