GUINNESS

European Equity Income Fund

Annual review

2019

GUINNESS
ASSET MANAGEMENT

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

31.12.2019

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

	1 year	3 years	From launch
Fund	24.2	26.4	69.0
Index	20.0	25.3	58.6
Sector	20.3	24.0	60.1

Annualised % total return from launch (GBP)

Fund	9.1%
Index	8.0%
Sector	8.1%

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	1.1	2.1
Beta	1.0	0.9	0.9
Info ratio	0.0	0.0	0.3
Max drwdn	-18.0	-15.0	-16.5
Tracking err	0	5	5
Volatility	13.3	12.7	12.7
Sharpe ratio	0.4	0.4	0.5

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.

Performance

In 2019 your fund rose +24.3% (in GBP) over the year, ahead versus the MSCI Europe Ex UK Net Return Index, which rose +20.0% (in GBP). The fund therefore outperformed the index by 4.3% over the year and was best in class vs income peers in the IA Europe ex UK Sector.

On a relative basis Q4 was a good period for the fund, which outperformed the MSCI Europe Ex UK Net Return Index's 0.9% rise by 1.7%. Over the year performance benefitted from the fund's focus on high-quality companies with widening moats and long runways for growth trading at attractive valuations.

Your fund has outperformed its benchmark, the MSCI Europe ex UK Net Return Index, over most main timeframes: one year, five years and since inception, whilst delivering on its mandate to provide a growing income stream to investors.

	1 month	YTD	1 Yr	3 Yr	5 Yr	Since Launch
Fund	2.1%	24.2%	24.2%	26.4%	69.9%	69.0%
Index	1.0%	20.0%	20.0%	25.3%	56.2%	58.6%
Sector	1.5%	20.3%	20.3%	24.0%	57.7%	60.1%
Fund performance vs Sector	0.6%	3.8%	3.8%	2.4%	12.2%	8.9%

Figure 1 source: Financial Express 0.35% OCF. Cumulative Total Return in GBP as of 30.11.2019

Dividends

Our focus on companies that offer the potential for dividend growth rather than simply a high dividend yield means we have managed to grow the dividend distributed by the Fund every year since we launched the fund in December 2013. This year the Fund grew the dividend by 4.1% (X-class, in EUR), while the annualised growth rate over the last six years has been 6.3%. The current fund dividend yield based on last year's pay-out is 3.2% post withholding tax, in line with the MSCI Europe ex UK Index 2019 dividend yield.

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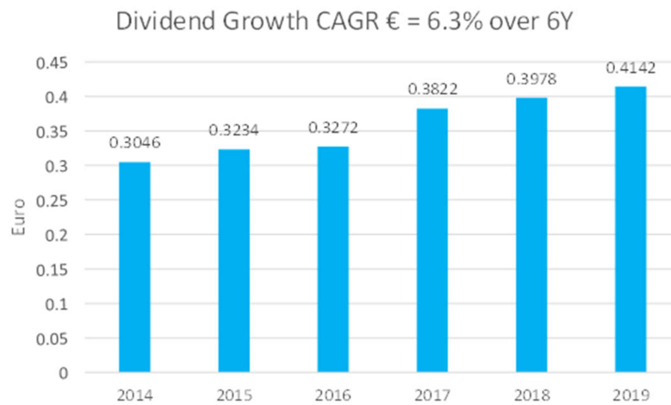

Figure 2: Dividends paid since launch (19.12.2013). Source: Guinness Asset Management

Investment Backdrop

European and global equity markets climbed a wall of worry through 2019 following the setback of Q4 2018. The twin panacea of rate cuts and renewed unconventional monetary stimulus more than offset concern over rising trade tariffs, although the latter did make themselves felt in export-led and manufacturing segments of European markets. The service sector and the consumer, however, held up well in Europe, supported by ongoing robust bank lending growth and falling political risk premia as concern over the Italian political debacle evaporated as quickly as it had arrived. In the final quarter of 2019 sentiment improved as the market began to sniff out an improving policy mix, culminating in mid-December in an initial 'phase one' trade deal between the US and China alongside reduced probabilities of an ugly Brexit. This was good news for Europe, and particularly Germany, given its position as a large net exporter.

As we enter 2020, European sovereign yields have bounced off their lows (with the German 10Y yield rebounding to -0.2% from around -0.8%), while Sweden even raised benchmark rates back to 0% in a nod to an improving outlook. This also highlights increasing awareness of the impact of negative rates in Europe, including reduced pension pay-outs, unaffordable housing and increasing inequality, an impaired banking system, alongside reduced incentives for those with cash to spend and for CEOs to increase capital expenditure over buybacks. Despite this there are signs that the latest round of ECB-led stimulus is having a positive effect (albeit at diminishing returns). M1 and M3 (cash and near-cash measures of money in circulation) are up sharply over the last quarter, suggesting a pickup in PMI manufacturing data ahead, arguably with potential to run given low capex/deprecation levels versus history. Whilst some of this upcoming pick up has been priced, it remains good news for our ongoing significant overweight in European industrials and more cyclical areas of the market.

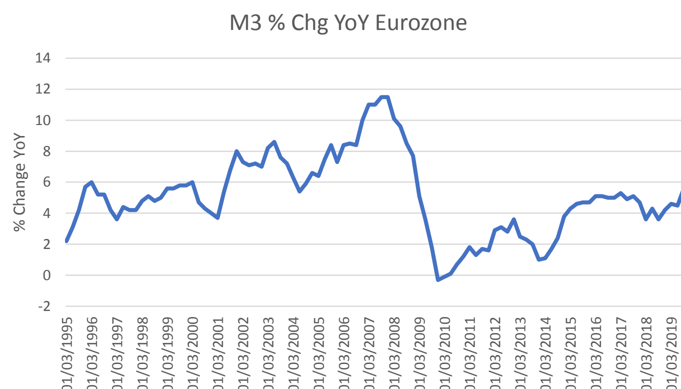

Figure 3: M3 % Chg YoY Eurozone. Source: Bloomberg data.

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In our December European equity outlook, we highlighted structural drivers supporting our fundamental quality value long-term stock picks, particularly with reference to our overweight in Industrials. This sector looks set to benefit from long-term shifts towards increased levels of green investment and potential for higher fiscal spending across conservatively financed European countries displaying large current account surpluses (collectively incentivised to increase fiscal spending through their dislike of QE). We also discussed potential for continued consolidation both at the company level (as Europe looks redress the balance vs growing US and Chinese industrial might) and at the political level as Europe looks to take advantage of Brexit to consolidate its own markets – pushing ahead with banking union, creation of a single asset, an insurance deposit scheme and playing a more outward role in the world. The latter could be supported by increased defence cooperation and export of European environmental and regulatory standards in exchange for market access. The moves towards financial consolidation, coupled with an improving economy, should support our other large sector overweight, Financials.

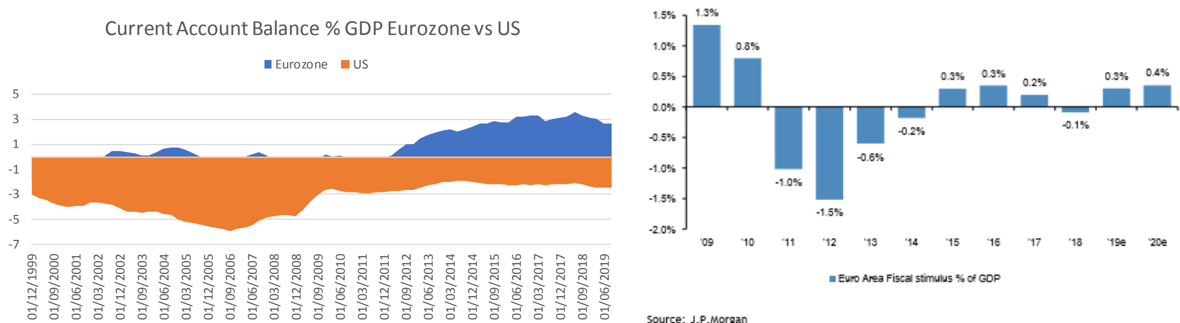

Figure 4: LHS: Current Account Balance, Europe (blue), US (orange). Source: Bloomberg data. RHS: Euro Area Fiscal stimulus % GDP. Source: JP Morgan.

Regarding the potential for fiscal stimulus, the quantum will likely prove reflexive and inverse to the direction of the economy. However, the good news in Europe is that if things did deteriorate again (not our base case as the dual drags of the trade war and Brexit fade somewhat) Europe has something of a put option. Having significantly more firepower for stimulus than the US and other regions thanks to a superior funding advantage some 200bps below US 10Y yields, and a markedly better fiscal position with an aggregate Eurozone current account surplus of c.3% of GDP vs. the US's -3% of GDP, all supported by a greater likelihood of low inflation growth in the form of higher labour slack at c.7.5% unemployment vs. 3.5% in the US. There is also significant political will to meet upgraded climate targets which makes green fiscal expenditure almost certain whatever the weather.

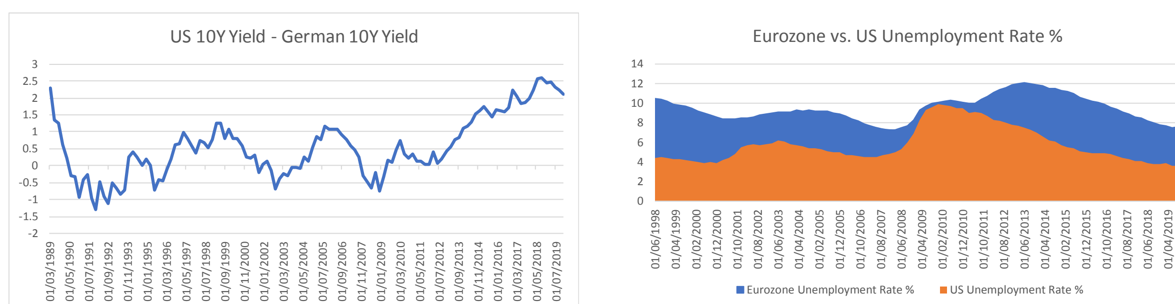

Figure 5: LHS: Europe's funding advantage, US 10y Yield – German 10Y Yield. Source: Bloomberg data. RHS: Eurozone (blue) vs. US unemployment rate (orange). Source: Bloomberg data.

Overall, European equities look fair value compared to history and attractive versus the US and bonds. It becomes more nuanced, however, when one considers intra-sector and regional valuation and performance

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disparities versus history, and skews by years of declining rates, QE and political interference. This is a setup that calls for a continued emphasis on value within our usual quality/value focus. Low growth, QE and ultra-low rates have pushed value to generational lows vs. growth. Markets have been skewed towards long-duration, bond proxies and international growth equities and away from their domestic counterparts as GDP growth slowed and rates fell. Meanwhile, the Euro is at lows against the dollar (ahead of likely consolidation of the European financial framework alongside a difficult election in the US). Capital-intensive has been handicapped versus capital-light amid near-unlimited, near-zero-cost capital. But if the tonic does shift from top-down QE towards bottom-up direct fiscal stimulus, we may find ourselves in a new, more reflationary regime increasingly favouring value, domestic and capital intensive over growth, high asset prices and trickle-down effects.

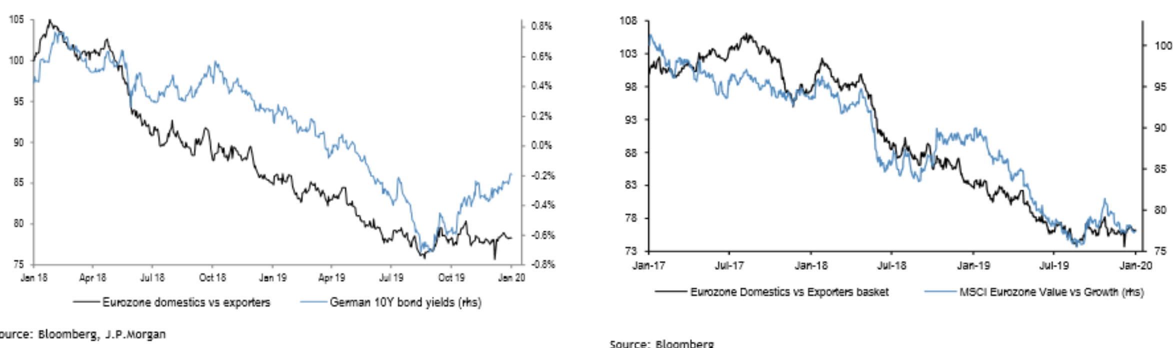

Figure 6: LHS: Eurozone domestics vs. exporters relative (black) vs. 10Y German bond yields (blue). Source: Bloomberg data, JP Morgan. RHS: MSCI Eurozone Value vs. Growth relative (blue) vs. Domestics vs Exporters relative (black). Source: Bloomberg data.

It doesn't seem too far-fetched to imagine that Europe might manage to forge a path and consolidate its position (having surprised on the upside in 2019), while taking advantage of its superior funding options and exporting its higher environmental standards. The US could, from a higher starting point, suffer uncertainties relating to election outcomes and its growing deficit - the 'net net' being that growth becomes a bit less scarce amid reflation and improved confidence in domestic Europe (helpful for sectors like financials, industrials and infrastructure). In the event that this did happen it could, of course, also suggest upside for the Euro.

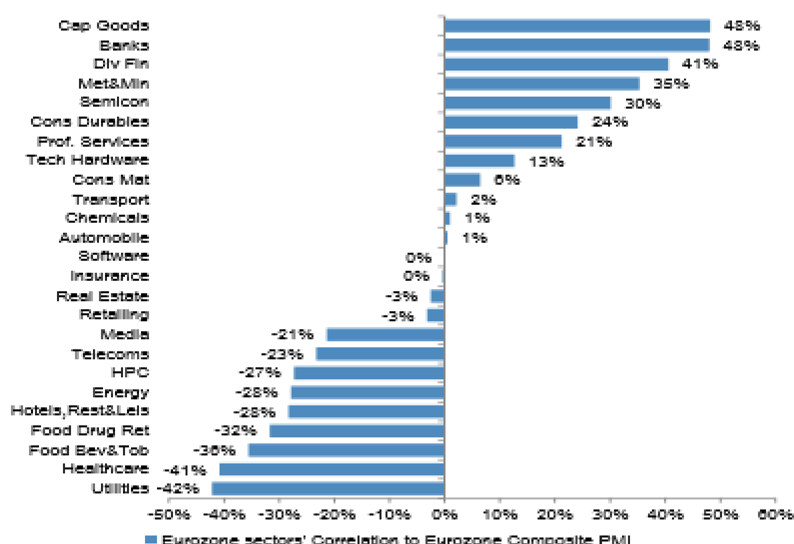

Figure 7: Eurozone sectors' correlation to Eurozone PMI (and interest rates). Source: Bloomberg data, JPM.

In our view, the outperformance of the fund in both Q4 and over the course of 2019 was predominantly driven by two factors. First, our overweight positioning in high quality cyclicals, notably Industrials and Financials. These

sectors hold many high-quality companies that are both good value and positioned to capture any reflation that softening in trade and Brexit concerns alongside nascent European fiscal stimulus may bring. Second, our focus on companies with identifiable barriers to entry, leading market positions (no.1, 2 or 3 or dominates a niche), widening moats, aligned interests and long runways for growth.

Atlas Copco, our top-performing Industrial over the year (+77.7% in EUR) and in Q4 is a great example of this. The company is the global market leader in one big niche, compression technologies. Identifiable barriers to entry are abundant, due not just to the company's scale and technological lead, but also due to the amount of kit that the company has installed across its client base which requires regular servicing. This means that the company benefits from both high switching costs and higher-margin, scalable repeat service revenue. On the basis of fundamentals over valuation we remain comfortable and confident holding the stock because we can see that the company has a widening moat. Evidence of this includes ongoing market share gains, high levels of investment in R&D and new product introductions. Further, a review of the supply side shows no new entrants into the market and relatively depressed capex/sales levels vs history. We also feel confident holding the shares because interests across management, employees, customers and shareholders are aligned. The guiding hand of Investor AB (23.18% of shares outstanding) lends valuable advice and support to group companies, and management also have plenty of "skin in the game' and are incentivised on a returns basis (ROCE). The decentralised and locally focused company structure enables employees to have a real focus on and understanding of their local markets. This means customer service is excellent and, importantly, Atlas Copco is delivering product that makes the world a better place, much of its equipment having significant resource efficiency benefits to its clients and the world at large. This is a company where aligned interests are apparent across shareholders, management and company impact. We also have confidence that the company isn't going to run out of opportunities any time soon given the long runway for growth apparent across its end markets, characterised by high exposure to young and growing industries like semiconductors, electric vehicles and buildings efficiency.

The six changes we made to the portfolio in Q4 2018 increased our exposure to high-quality industrial cyclicals and financials. The five changes we made in 2019 were in a similar vein with an increasing emphasis on value and domestic. Portfolio additions in 2020 will continue to be characterised by our definition of quality, namely persistent high returns, and will remain focused on companies trading at attractive valuations.

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Performance Drivers

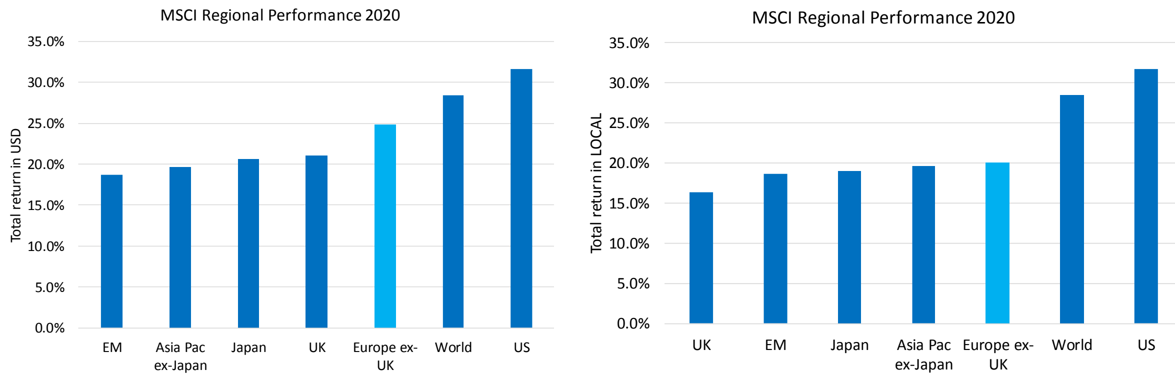

Figure 8: MSCI World Index geographic total return breakdown for 2019, in USD (left) and Local currency (right). Europe in light blue. Source: Bloomberg data

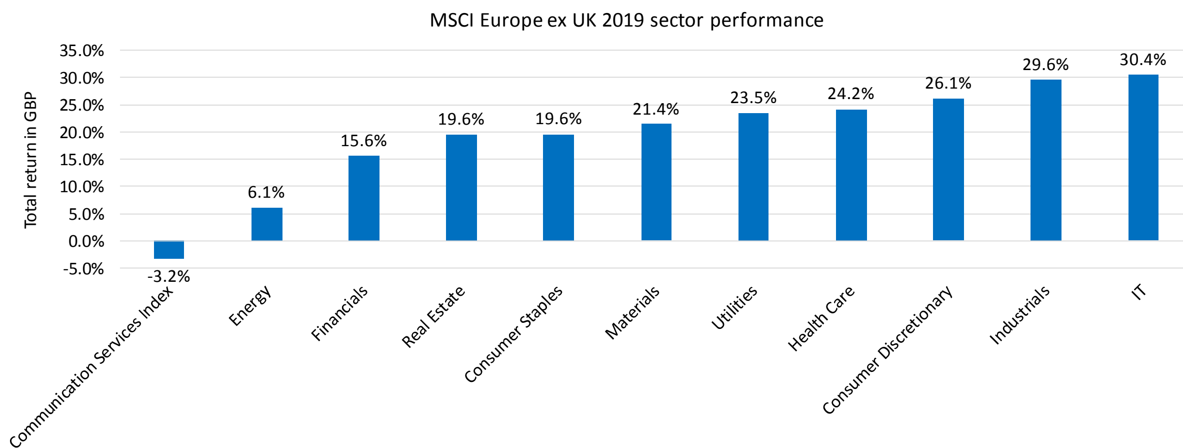

Figure 9: MSCI Europe ex UK Index sector total return breakdown for 2019, in GBP. Source: Bloomberg

In USD terms the MSCI Europe ex UK Index rose 25% in 2019. Sector performance was driven by four key factors, namely tepid levels of underlying economic activity accompanied by declining interest / discount rates alongside increased optimism on trade towards the end of the year. At the lower end of the performance spectrum was **Communication Services**, driven by a fourth factor, continued internet-led disintermediation of traditional communications companies across media and advertising. Our holding in Metropole Television remained on a low multiple due to related concerns, whilst growing market share and surprising to the upside as French viewers remained loyal to their local French language media. Publicis also suffered as FMCG clients took out less traditional media advertising in favour of new direct-to-market routes provided by Amazon and others. Here the moat is not widening, but a combination of restructuring, reorientation towards digital and sector consolidation may yet provide a respectable conclusion. Meanwhile the telecoms sector remained weak, where we thought we might have started to see sector consolidation as the regulator begins to lend increased support towards European champions and higher levels of innovation via increased R&D expenditure and investment; something that may still be on the cards for 2020.

Energy, where we have no exposure (in common with the other commodity sectors), was pressured by the soft economy backdrop and higher-than-expected supply. We also had no exposure to the weakest component of **Financials**, namely banks, which in Europe suffered another crushing year amid the backdrop of negative interest rates. Our holdings in exchanges and asset managers such as Euronext and Azimut, however, had good year.

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Staples, a small overweight for the fund, were key beneficiaries of lower interest rates and some accelerated performance through restructuring and business model optimisation. Meanwhile the impact of increased internet-led direct to consumer brand competition continued to make itself felt. Our FMCG holdings, including Danone and Nestlé, have been some of the most aggressive in the sector on investment and transitioning to sustainable and premium-focused business models.

Healthcare performed well despite the upcoming US election where drug pricing will be a key topic. We reduced sector exposure to drug pricing over the course of 2019.

Consumer Discretionary and **Industrials** came top of the table after **IT**, boosted by increased confidence around trade and Brexit in the fourth quarter. Irrespective of short-term macroeconomic factors we continue to favour industrials with large installed bases and resilient, scalable, higher-margin repeat service revenue, simultaneously on low to reasonable ratings due to the concern around global growth and trade. In the IT sector, continued investment in cloud and the internet of things saw an early stage recovery in semiconductor spending, notably logic, with signs that memory is set to follow, to the benefit of both Atlas Copco and Inficon.

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Positioning

The Guinness European Equity Income Fund is characterised by a high 85% active share against the MSCI 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 virtually no exposure to commodity and regulated sectors like Materials, Utilities, Real Estate, Energy and banks. Meanwhile, sectors like Industrials, Financials and Communication Services, in which your fund is overweight, hold many high of the high-quality and scalable companies which we find attractive.

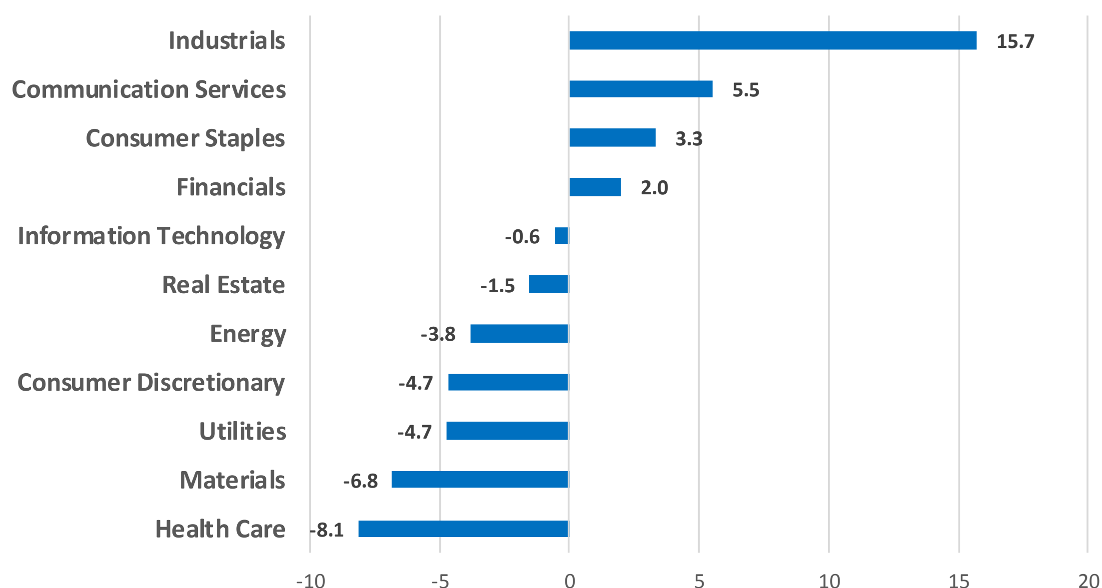

Figure 10: Sector over/underweight % breakdown of the fund versus MSCI Europe ex UK. Guinness Asset Management, Bloomberg (data as at 31.12.2019).

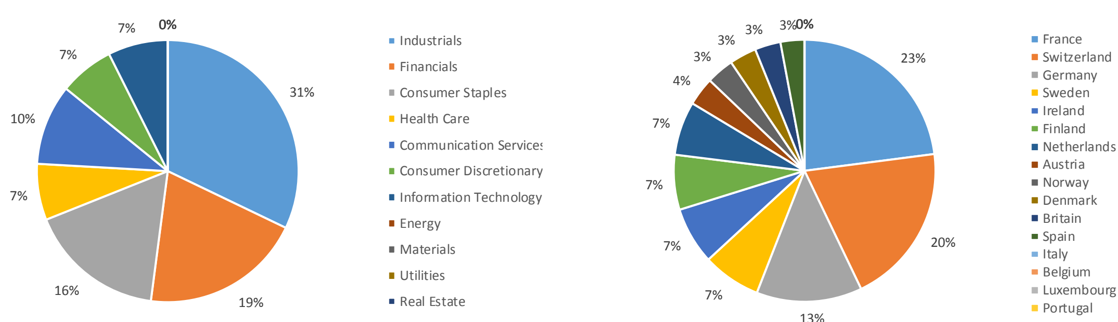

Figure 11: Sector and regional breakdown of the fund. Guinness Asset Management, Bloomberg (data as at 31.12.2019)

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 18.5% respectively, but it is also the case that we simply find a greater number of high-quality companies with strong prospects in 'high-IP' markets with good corporate governance including Scandinavia and Switzerland.

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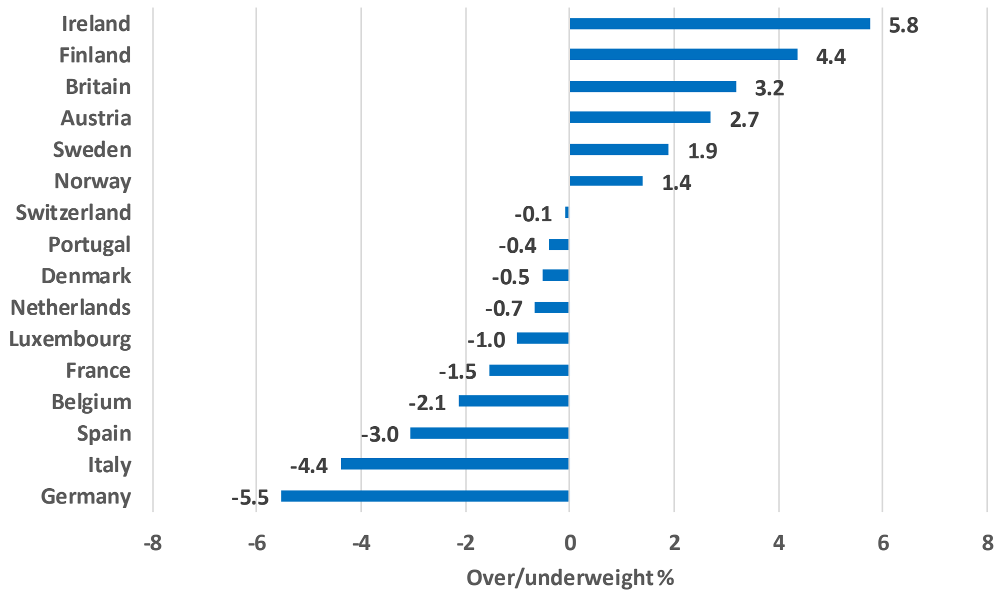
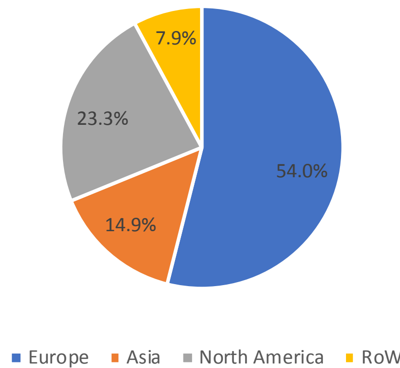


Figure 12: Regional breakdown of the fund versus MSCI Europe ex UK Index on a geographic basis. Guinness Asset Management, Bloomberg (data as at 31.12.2019). *Britain exposure represents Unilever which is domiciled in UK but listed in the Netherlands.

The Guinness European Equity Income Fund's company holdings represent a mixture of domestic and global exposures, with domestic European sales amounting to 54% of total portfolio sales. If the euro does strengthen against the dollar in 2020 the Guinness European Equity Income Fund is conservatively positioned, with more than half of fund sales derived from domestic Europe.

Guinness EEI Fund - Geographic Sales



Europe Asia North America RoW

Figure 13: Sales exposure of fund holdings on a geographic basis. Guinness Asset Management, Bloomberg (data as at 31.12.2019)

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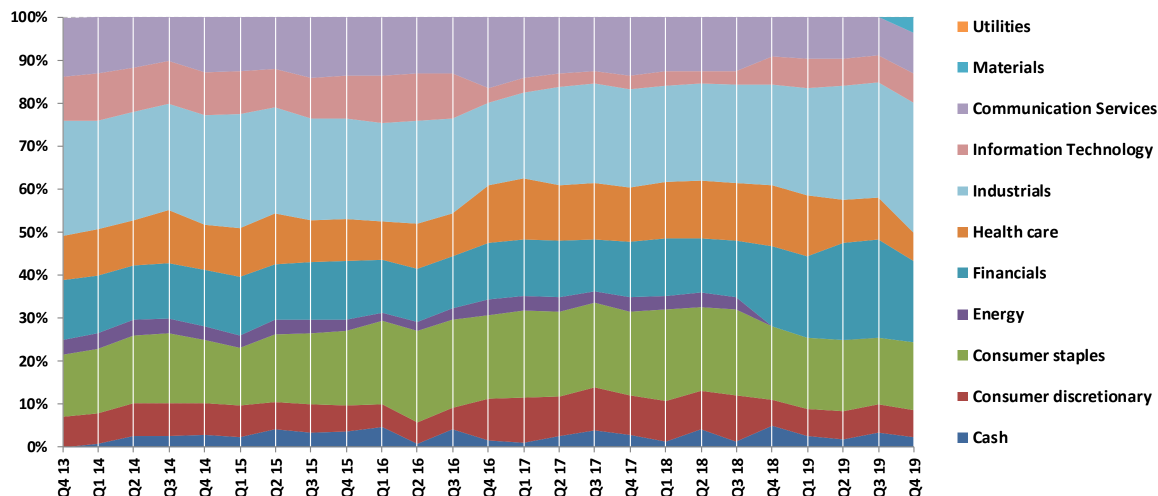

Figure 14: Portfolio sector breakdown at year end 2019

Our overweight to Industrials rose sharply, driven by sector holdings outperformance and one net new purchase. Our exposure to Materials rose from zero to 3.3% as we acquired a sustainable packaging producer which we discuss later in this note. Meanwhile our exposure to Healthcare fell sharply as we found higher-conviction ideas to replace Novartis and Sanofi, where cash returns have been falling; a move that could work to our advantage if there is a pickup in concern over political interference on drug pricing ahead of the US election.

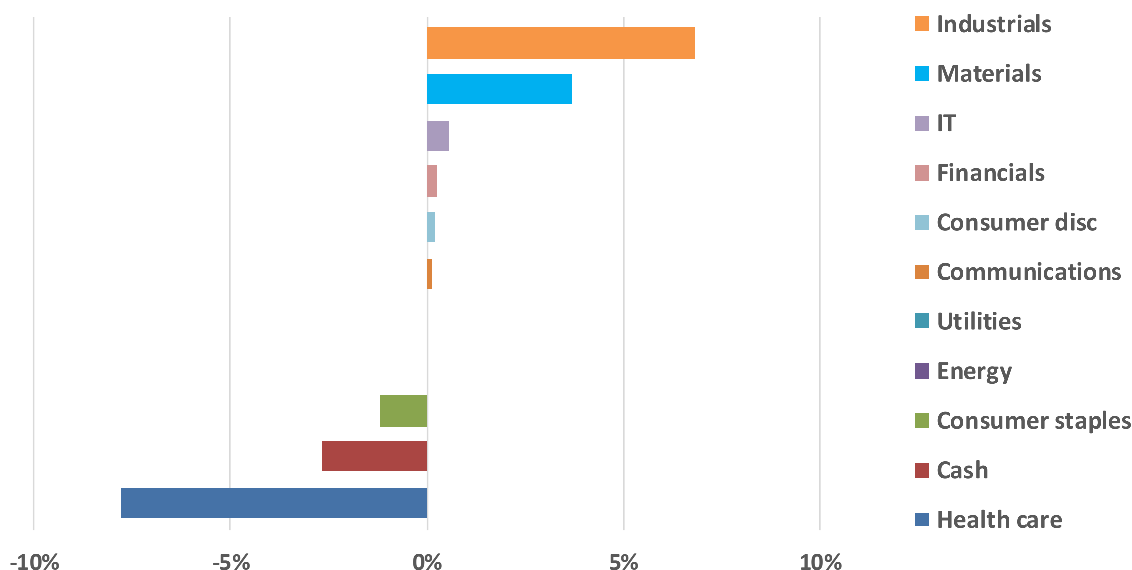

Figure 15: Year on year change in sector breakdown

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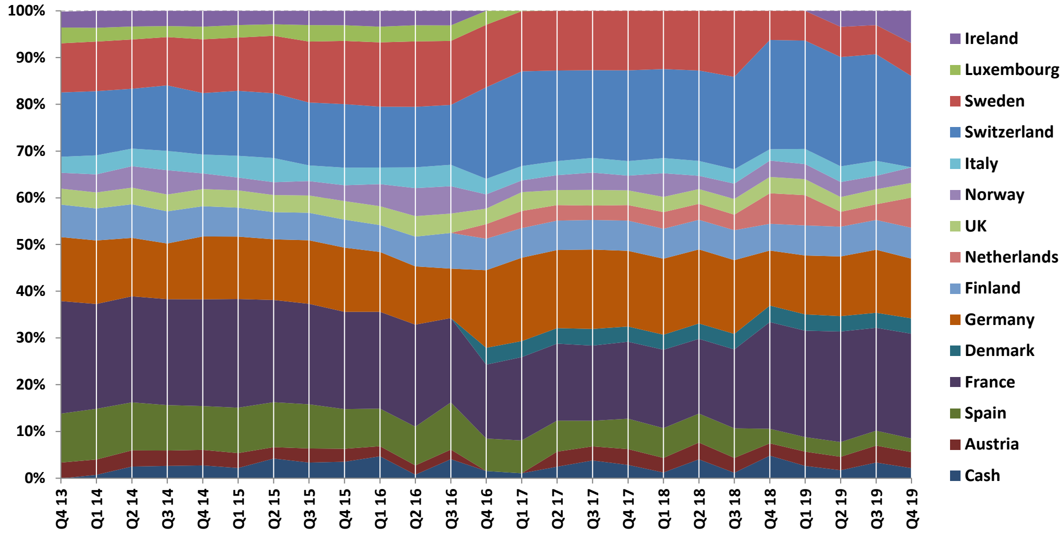

Figure 16: Portfolio geographic breakdown at year end 2019

Two new positions were added in Ireland for no other reason than that they are high-quality, largely domestically-focused companies with an attractive opportunity set trading at very reasonable valuations.

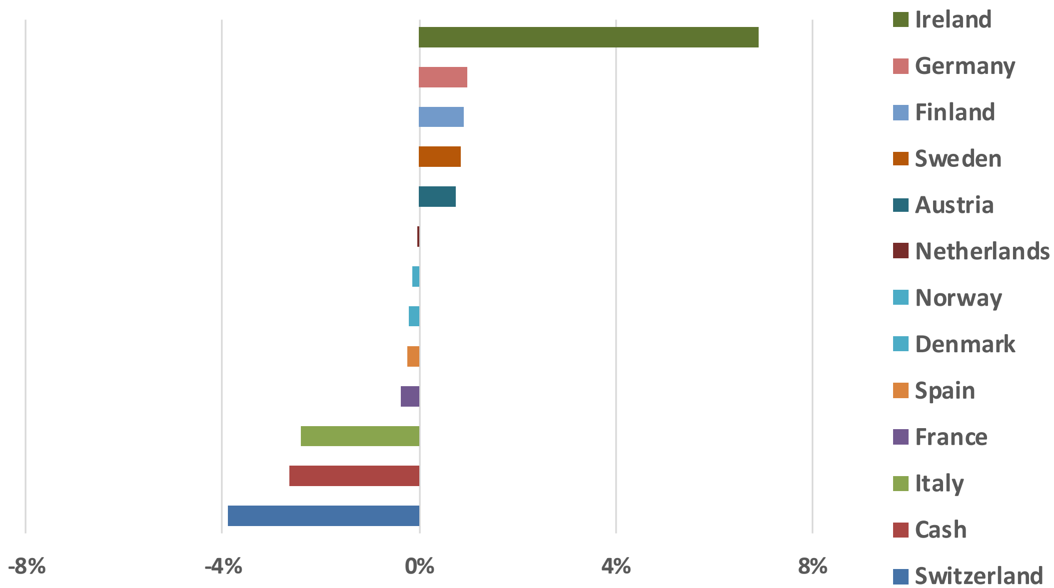

Figure 17: Year on year change in geographic breakdown

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Individual Holdings

Individual companies that performed well in Q4 2019 were Atlas Copco, Smurfit Kappa, Kering, ABB and Inficon. Companies that fared less well included Publicis, Danone, Konecranes, Unilever and Euronext.

Best 5 performing stocks Q4	Total return
Atlas Copco AB	28%
Smurfit Kappa Group PLC	25%
Kering SA	25%
ABB Ltd	19%
Inficon Holding AG	19%

Worst 5 performing stocks Q4	Total return
Publicis Groupe SA	-11%
Danone SA	-9%
Konecranes Oyj	-7%
Unilever NV	-6%
Euronext NV	-3%

Figure 18: Best and worst five performing shares in Q4 2019 in EUR. Source: Bloomberg data. *Smurfit Kappa acquired 30th October, return to the fund 13.9% in Q4.

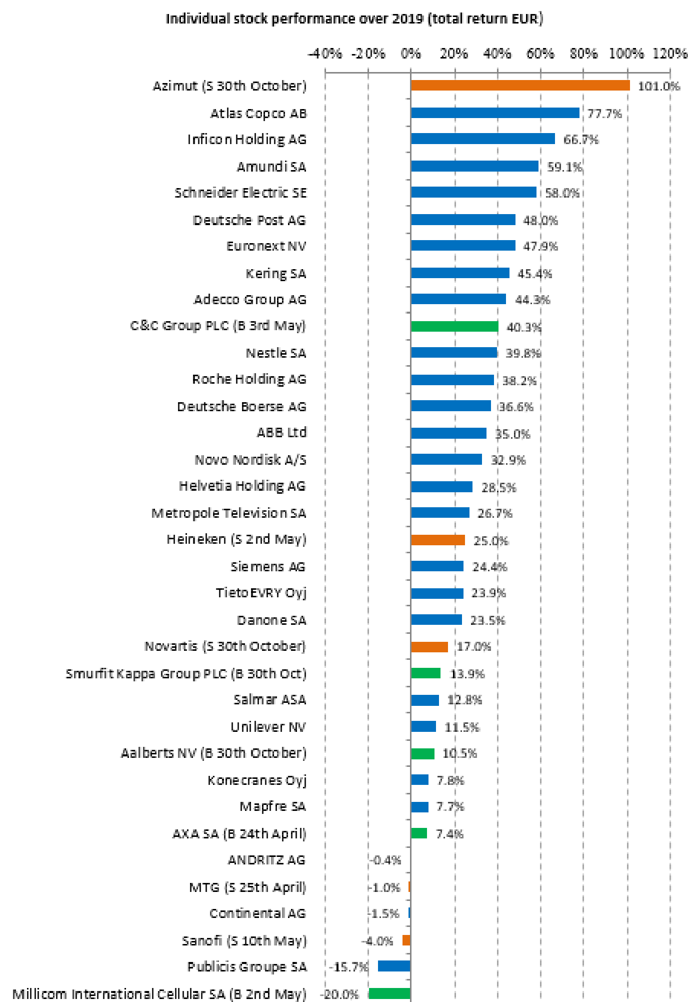

Figure 19: Individual holdings performance over 2019 in EUR. Orange = Sold. Green = New Holding. Source: Bloomberg data.

Changes to the portfolio

In 2019 we sold 5 positions and bought 5 new positions. There were three switches in the second and two in fourth quarters of the year, leaving the portfolio with 30 equally weighted positions at the end of the year.

In April we bought **AXA Group SA** to replace **Sanofi SA,** which had fallen out of our universe amid declining cash flow returns on investment.

AXA is a lowly-rated insurance company that is nearing the completion of a transformation from predominantly Life & Savings product provider to an insurer c.80% focused on technical risk, represented by Property & Casualty, Health and Protection. This is a good transition which should, with time, warrant a higher multiple (as there is limited differentiation in Life), moving the company away from financial risk to technical risk and from 'payer to partner'. Technical risk is characterised by high-frequency customer contacts, quality service and superior technical expertise – in short, giving Axa greater opportunity to build stronger customer relationships, trust and demonstrate best-in-class knowledge and advice. Following on from the sale of AXA Life Europe and purchase of XL Group in the US and the remaining 50% of Axa Tianping (making Axa the No.1 foreign P&C insurer in China, a market it sees a growing 8% p.a. through 2025), this transition will be completed by the ongoing sale of Axa Equitable Holdings in the US. This will leave Axa as the global No.1 and leader in P&C Commercial lines insurance and reinsurance. The acquisition of XL Group will allow Axa the chance to lead in growth areas related to the challenges of globalisation including cyber insurance and climate change. All of this should translate into a stronger and more differentiated business, and higher returns to shareholders. Importantly, there are also ample signs of a widening moat, suggested by high levels of innovation and new technical product offerings.

Axa, like all our portfolio companies, is well capitalised, with a Solvency II ratio of 190%, leaving it in a good position to weather storms and take market share. Employees own 5.34% of group equity and the remuneration of members of the management committee and the CEO are well aligned with shareholders' best interests, being based on group metrics that include return on equity as well as individual performance. Axa's focus on health and climate insurance chimes with its emphasis on the wellbeing of its stakeholders as well as shareholders and the importance of good environmental and social governance. In short this is a company that shareholders can feel good about owning. Axa trades on a 2020 earnings multiple of just 8.9x, a P/B ratio of 0.92x and at the current price offers a dividend yield of 6.1% in 2019 rising to near 6.5% in 2021, based on a 50% - 60% pay-out ratio as long as the Solvency II ratio (currently over 190%) remains between 170% - 220%. In addition to the current backdrop of low interest rate expectations, the purchase could also prove to be well timed after returns were depressed by high catastrophe claims which are now resulting in an improved outlook for premiums.

In May we bought **C&C Group** to replace our longstanding position in **Heineken**. Also in May, we acquired a new position in **Millicom** and sold our holding in **MTG Group** after the company split in two, one side taking the unprofitable gaming operations and the other cash generative side assuming all the debt, leaving us unable to hold either.

We acquired **C&C Group** on 12x PE and a 4.6% dividend yield and sold Heineken after it rerated to 20x from mid-teens, offering a 1.8% dividend yield. Cheap stocks can turn out to be value traps, and switching from a global player to a predominantly domestic operator focused on the UK & Ireland might raise eyebrows, particularly when it comes to growth. However, in the case of C&C Group

the relatively low multiple is accompanied by a widening moat. The recent acquisition of **Matthew Clark** (MC) and **Bibendum** represents a step change in earnings power for the group. As the incumbent player in distribution in Ireland and Scotland, C&C group understands the space very well, and the purchase of Matthew Clark out of receivership from Conviviality means that C&C group is now the gateway and largest final mile distributor of alcohol and other drinks to the on-trade not just in Ireland and Scotland but the whole of the UK.

With a new owner MC is finally in the right hands. The original founder management of both Mathew Clark and Bibendum see the potential and have returned to help turn the businesses around. C&C Group now has a large new distribution channel through to some 2000 on-trade corporate customers and some 19,500 outlets in the UK. The price looks favourable as C&C Group believes that after significant costs have been extracted their purchase price will fall in the area of £70m (vs the £200m that Conviviality paid). They also see the potential to increase UK own-brand sales by some three times current levels by pushing existing brands like Magners down the Matthew Clark channel. On top of this MC represents a great platform to develop and launch new own-brands (such as premium lagers Menabrea and Heverlee) and to work with and distribute for larger players such as ABI in the UK. C&C Group is now effectively kingmaker, with the ability to determine success for new smaller brands trying to enter the UK on-trade; and success in the on-trade tends to lead to well received launches in the off-trade. The Bibendum acquisition is less transformational but nevertheless gives the company a stronger footing at the premium end of the market in high-end third-party wines and spirits. This in turn represents a good platform from which to sell and market C&C Group's own premium products.

One could say more about other potential positives including the enhanced ability of the group to capture and utilise UK-wide data, the move to a more decentralised model which should improve groupwide operational agility, or the acquisition of a stake in Admiral Taverns, giving the group another channel down which to push own product. The market is assuming the that 21% EPS growth slows to 9% in 2020 and mid-single digit growth thereafter. We think there is a very real chance this proves conservative. If correct, there is plenty of rerating potential with the shares still trading on low multiples, not to mention a healthy dividend while we wait.

Our new holding in **Millicom** got off to a soft start as main 40.9% shareholder Kinnevik changed its strategy to focus solely on early-stage internet investment and tried to flush out bids for its entire holding in Millicom. In January 2019 Millicom had walked away from interest by John Malone's Liberty Latin America (Lilac) reportedly in the area of SEK715/share vs around SEK460/share today. The current CEO Mauricio Ramos used to work for Malone at Lilac and its Chilean business VTR. There are several ways this situation can work itself out, the most likely being a placing of Kinnevik's holding, but whatever the result we think the overhang will go and this is a strong business with a bright future. Millicom has been selling off non-core tower and mobile operations in Africa and reinvesting in its market-leading cable TV, internet, wireless and data business across Central America. A 'Central American Virgin Media' is a good analogy for those familiar with that business. The runway for subscriber growth at Millicom is significant, with overall low levels of fixed broadband and 4G penetration across Central America. The upside for pricing and returns (the latter obscured by current capex) are also strong given that starting broadband packages are generally less than 10bmps and cable installation costs a fraction of that in North America. Additional upside optionality comes from ownership of Tigo Money, Latin America's largest online payments company, and also a large data centre portfolio, both of which could arguably command meaningful standalone valuations. On the latter point we were pleased to see **Millicom** recently announced a JV with **Schneider Electric** for infrastructure monitoring of its data centres. Millicom shares trade at a large EV/EBITDA discount to peer Liberty Latin America and to recent transaction bids by America Movil across the region. The idea might seem a little far away from home, but the growth profile and regulatory backdrop make a refreshing contrast with European telecoms, where the only route forwards seems to be consolidation.

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In October, we made two more portfolio changes, acquiring **Aalberts Industries** to replace **Azimut** (+111% YTD at sale), and buying **Smurfit Kappa** to replace **Novartis**, which had fallen out of our universe.

Aalberts Industries is a 'magic ingredient' type of company, that designs, manufacturers and services critical components and technologies that are vital to the functioning of a much larger product but only represent a small fraction of its total cost. This means that the company tends to have excellent pricing power, allowing it to continue to reinvest in future growth while paying an attractive growing income stream to shareholders in the form of dividends. A good analogy for those familiar with the UK market is Halma Plc, except Aalberts currently trades on half the price-earnings multiple. Aalberts dominates niches across areas including flow control, surface technologies and advanced mechatronics; enabling productivity gains in areas such as heating, air conditioning, additive manufacturing, electric vehicles, robotics and semiconductors (ASML being its largest customer in the latter segment). Whilst the multiple is depressed vs company history, in large part due to the weak manufacturing backdrop in Europe, long-term structural drivers are more plentiful than one might imagine. By end market, buildings (HVAC) and Europe represent the largest exposures with over 50% of sales. With just 3% of European building stock now estimated to meet European buildings efficiency targets vs historic levels of 10 – 20%, and European fiscal policy increasingly pointing in a green direction, this represents an unexpectedly exciting runway for growth that should supply Aalberts Industries and its shareholders with growing dividends for a long time to come.

Aalberts is a great fit for the fund having many of the characteristics we look for across the Guinness quality equity income strategies. It has a strong balance sheet (net debt to equity of 35%) and low pay-out ratio (c.30%), set against good cash conversion and persistent high and improving returns. Importantly, management have an excellent track record for capital allocation and the company culture is one that feeds off shared knowledge and close customer relations. The recent 2018 five-year plan should result in lower long-term operating costs through increased investment in efficiency measures alongside improved agility and innovation stemming from an increasingly decentralised business model. The guiding hand of Aalberts Investments, Aalberts Beheer B.V., with ownership of 13.27% of company shares, represents a strong long-term support for shareholders, offering company management increased market insight, long-term thinking and strategic support. Aalberts is an investment that shareholders can feel very comfortable with and has the potential to generate high excess long-run returns alongside a positive external impact.

Smurfit Kappa (SKG ID, €8bn) offers a significant potential improvement in portfolio return on capital employed compared to Novartis, including a higher dividend yield off a lower earnings multiple, set against a long and sustainable runway for growth and returns. Identifiable barriers to entry exist in both local economies of scale, and Smurfit Kappa's customer-focused innovation (exemplified by the group's Better Planet Packaging initiative and the opening of 26 innovation centres across Europe and the Americas in four years). In Europe Smurfit Kappa is the market leader in sustainable (corrugated) packaging and "smart shelf" solutions, and the only large-scale pan-regional player in the Americas. Fast moving consumer goods (FMCG) companies account for some 70% of sales, which means that earnings growth is well anchored and volatility tends to be low. It also means that the moat is widening; Smurfit is in a great position to provide sustainable solutions to global FMCG companies desperate to reduce high reliance on single-use plastic packaging. Smurfit Kappa is historically a good company, characterised by persistent high cash flow returns, and EVA margins and returns (19.3% 2018 ROCE vs. 15% in 2017 and 12% historically) are widening compared to history, while the market has yet to reward the structural nature of this shift. The recent Q3 trading update underscored the point, speaking to rising demand and upward pressure on pricing against a broadly weak economic backdrop in Europe. Vertical integration, from owned and sustainably managed forest assets and recycled fibres through to client-focused innovative solutions, means that Smurfit is well placed to manage its supply chain and that price rises tend to

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drop to the bottom line. On the other side of the input equation the cost of debt continues to fall, with the company recently conducting one refinancing round at 1.5% vs. 4.1% prior.

Capital allocation is critical to long-run returns, and Smurfit Kappa has a good track record, with management and employee interests well aligned with those of shareholders and stakeholders. Notably, Anthony Smurfit, grandson of the founder, now CEO and with the company for over 30 years, owns €38m or 0.5% of Group equity. Management are incentivised based on return on capital employed (ROCE) and free cash flow (FCF) as well as earnings per share and total shareholder return metrics. The group's strong focus on innovation and sustainability factors, as well as the employee inclusion, diversity and retention, mean that shareholders of Smurfit Kappa are well placed to benefit from a business owner culture that should continue to drive superior returns for the long term.

Portfolio today and outlook

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 and 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
	Debt / equity %	77.0	187.0	-110.0
	Net debt / Equity %	52.0	68.4	-16.4
	ROE %	22.4	11.0	11.4
Value	PE (2020e)	14.9	15.0	-0.1
	FCF Yield %	6.5	5.0	1.5
Dividend	Dividend Yield (LTM) %	3.2 (net)	3.2 (gross)	0.0
	Weighted average payout ratio %	54.0	60.0	-6.0
Conviction	Number of stocks	30	344	-314.0
	Active share	85	NA	

Figure 20: Portfolio metrics versus index. Guinness Asset Management, Credit Suisse HOLT, Bloomberg (data as at 31.12.2019)

Conclusion

Whatever the economic weather in 2020, we believe our focus on quality companies that generate persistent high cash returns supported by strong balance sheets will serve investors well for the long term. Guinness European Equity Income Fund holdings are characterised by high levels of self-determination, namely, identifiable barriers to entry, leading market positions, widening moats, aligned interests and long runways for growth. As we noted in our December 2020 outlook, many of our fund holdings, notably Industrials, look well supported by structural drivers. The metrics above also show that we have a high-conviction fund with companies which are significantly higher quality and better value versus the index.

From where we stand at the beginning of 2020, the investment backdrop is full of contradictions but also significant opportunities, in our view. We will continue to work hard to deliver long-term capital growth and a steady, growing income stream. Your fund offers an attractive mix of high-quality international companies supported by structural growth drivers and attractive growth profiles, and many more domestically-focused companies, shielded from the risks of trade and currency wars, where returns and ratings have potential to benefit from a mixture of self-help, improving domestic demand and market consolidation.

We thank you for your continued support.

Matthew Page, CFA
Dr Ian Mortimer, CFA
Nick Edwards

Portfolio managers, Guinness European Equity Income Fund
January 2020

All Index and performance data source: Bloomberg, except Fund performance data, which is sourced from Financial Express and Guinness Asset Management.

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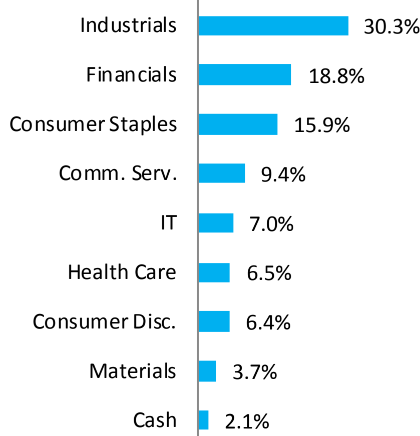
PORTFOLIO

31/12/2019

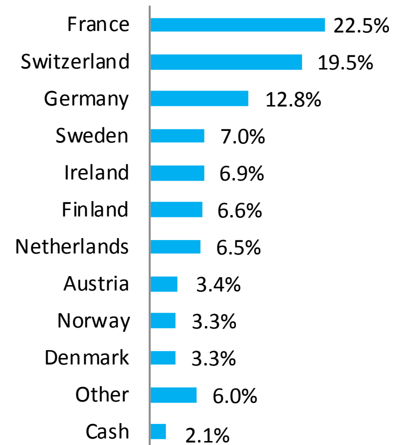
Fund top 10 holdings

Holding	%
Smurfit Kappa Group	3.7%
Millicom International Ce	3.5%
Inficon Holding	3.5%
Deutsche Post	3.5%
Schneider Electric	3.5%
Aalberts	3.5%
Tieto	3.4%
Andritz	3.4%
Atlas Copco	3.4%
Kering SA	3.3%
% of Fund in top 10	34.7%
Total number of stocks	30

Sector analysis



Geographic allocation



PERFORMANCE

31/12/2019

Annualised % total return from launch (GBP)

Fund	9.1%
MSCI Europe ex UK Index	8.0%
IA Europe ex UK sector average	8.1%

Discrete years % total return (GBP)	Dec '15	Dec '16	Dec '17	Dec '18	Dec '19
Fund	4.1	29.1	11.2	-8.5	24.2
MSCI Europe ex UK Index	5.1	18.6	15.8	-9.9	20.0
IA Europe ex UK sector average	9.3	16.4	17.3	-12.2	20.3

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	2.1	24.2	24.2	26.4	69.9	69.0
MSCI Europe ex UK Index	1.0	20.0	20.0	25.3	56.2	58.6
IA Europe ex UK sector average	1.5	20.3	20.3	24.0	57.7	60.1

RISK ANALYSIS

31/12/2019

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	1.05	2.07
Beta	1.00	0.88	0.90
Information ratio	0.00	0.02	0.26
Maximum drawdown	-17.99	-14.98	-16.49
R squared	1.00	0.86	0.88
Sharpe ratio	0.35	0.37	0.47
Tracking error	0.00	5.01	4.67
Volatility	13.29	12.68	12.72

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.
Fund returns are for share classes with a current Ongoing Charges Figure (OCF) stated above; returns for share classes with a different OCF will vary accordingly. 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

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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.