Guinness European Equity Income Fund

INVESTMENT COMMENTARY – May 2020

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 30.04.20

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

	1 year	3 years	From launch
Fund	-13.7	-6.7	34.5
Index	-8.0	0.1	36.7
Sector	-7.2	-0.6	39.1

Annualised % total return from launch (GBP)

Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0.0	0.7	0.2
Beta	1.0	0.9	0.9
Info ratio	0.0	0.0	0.0
Max drwdn	-25.0	-24.4	-30.3
Tracking err	0	6	5
Volatility	15.4	14.4	15.1
Sharpe ratio	0.1	0.1	0.1

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, Z class 0.35%, bid to bid, total return.

Summary performance

In April, the Guinness European Equity Income Fund produced a total return of 4.76% (in GBP) versus the Index return of 4.38% (in GBP), meaning the fund outperformed its benchmark by 0.38%.

	1 month	YTD	1 Yr	3 Yr	5 Yr	Since Launch
Fund	4.8%	-20.4%	-13.7%	-6.7%	24.4%	34.5%
Index	4.4%	-13.9%	-8.0%	0.1%	21.8%	36.7%
Sector	7.2%	-13.1%	-7.2%	-0.6%	24.4%	39.1%
Fund vs Sector	-2.5%	-7.3%	-6.4%	-6.1%	0.0%	-4.6%

Figure 1: Performance data. Source: Financial Express 0.35% OCF. Cumulative Total Return in GBP as of 30.04.2020

The largest positive contributors to performance over the month of April (in EUR) were **Konecranes Oyj** +27%, **Aalberts** +19%, **Salmar** +18%, **Deutsche Boerse** +15% and **Amundi** +13%.

At the other end of the spectrum the biggest detractors from performance were **Thales** -9%, **Millicom** -6%, **Kering** -3%, **Assa Abloy AB** -3% and **Epiroc AB** +1%.

In April the MSCI Europe ex UK Index rebounded 4.38% (in GBP), with Information Technology and Healthcare among the leaders and highly cyclical and regulated sectors such as Energy, Utilities and Telecoms among the laggards. As the Q1 reporting season got underway, we were happy to see many portfolio holdings updating the market on ways in which they have been able to positively address the crisis. These included **Roche**, of course, with its Cobas diagnostic testing equipment, and **Schneider Electric** providing critical infrastructure to data centres essential to health and communications infrastructure. There were also names one might not have expected: **Smurfit Kappa** highlighted that it is making flexible paper office dividers, masks and temporary beds alongside its usual mainstay of sustainable packaging solutions to FMCG clients; **Aalberts** announced that it had increased manufacturing capacity of medical oxygen pressure regulators and valves for breathing equipment, used in hospitals, ambulances and home care; **CapGemini** and **Tieto** both highlighted that they expect a long sustainable tailwind of business related to cloud, mobile and digital health related services. There was also some irony for **Unilever**, which on one side gained from hand washing but lost out to consumers foregoing deodorant and razors. Meanwhile **Nestlé** saw a large 13% uptick in the Pet division alongside strong gains in prepared dishes and health science. In short, the core of the portfolio is in good shape.

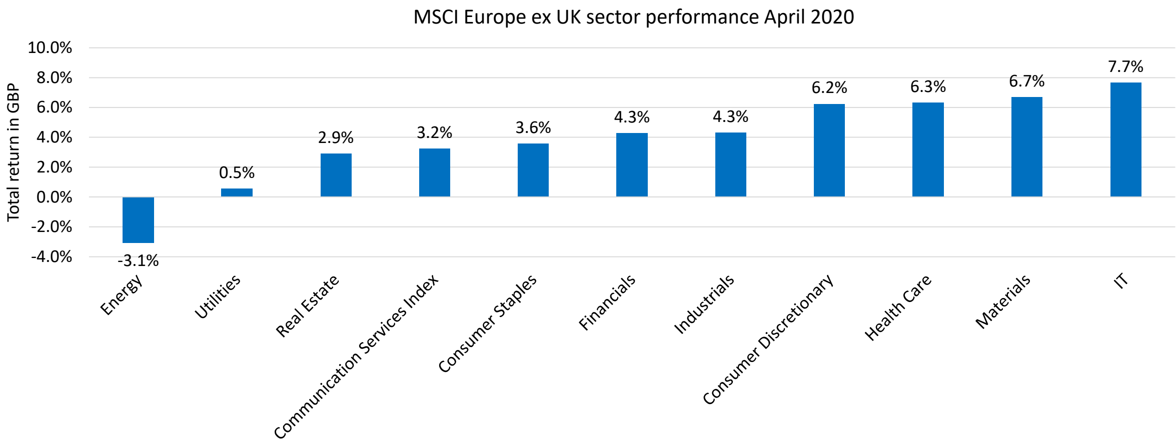


Figure 2: MSCI Europe ex UK sector performance data for April 2020 in GBP. Source: Bloomberg.

On the other side, we moved to address the handful of names where the ratio of risk to reward had deteriorated, including some where we had lost a dividend. As we said at quarter end, the most important thing is that at any one time the portfolio holds our best European dividend-paying ideas on a three to five-year view. Second to that, if there were opportunities to move up the quality curve following the sell-off (and pick up a lost dividend) we would do so. The net result of this rare bout of activity is five portfolio changes in the month of April, resulting in a slightly higher multiple portfolio at 15x 2020 earnings (still a c.10% discount to market) and a lower headline yield of around 3.7%, alongside a lower payout ratio and higher topline and dividend growth.

Sales

- **C&C Group** – When we bought C&C Group we could not have imagined that the entire on-trade market could be shut down, let alone for the best part of a year. With 70% net debt/equity and a c.6% net margin we see a chance of permanent capital loss (i.e. dilution) if a soft lockdown persists into 2021.

- **Cerved**'s sale of its credit marketing division fell through due to the crisis in Italy, thereby meaningfully capping the upside potential.

- **Adecco**, a holding we were already reviewing, having paid its 2019 dividend appears a candidate which may not pay its 2020 dividend in 2021 amid a sizeable impact on the temporary staffing industry.

- **Metropole Television** and **Publicis** had always looked too cheap (alongside offering sizeable dividends) relative to modest ad industry digital attrition. What we simply failed to envisage was the possibility of an environment where ad capex could become entirely discretionary. In hindsight we should not have had exposure to these names.

Buys

The buys are all positioned to lead us out of this crisis into the mid-2020s and beyond, being high-quality enablers of resilience and or job creation; namely enablers of communications, automation and infrastructure, including health infrastructure.

ASML is unique and sets the bar for long-term thinking, having built up its market-leading position in advanced lithography over the past 20 years. This has resulted in a large installed base of cutting-edge EUV equipment (extreme ultraviolet micro patterning equipment, now the key enabler of increased semiconductor efficiency) at the world's major logic (foundry and integrated device manufacturers) and memory (NAND and DRAM) chipmakers. At the most tangible level, the company aids the transition to sustainable transport and energy, digital health, efficient agriculture and bridging the digital divide (5G, IoT and AI). To give an idea of runway, ASML estimates that by 2025 around 75% of enterprise-generated data will be created and processed outside a traditional centralised datacentre or cloud versus about 10% today. We can't say that there isn't scope for short-term supply-chain bottlenecks given the recent gyrations in the global economy, but events strongly suggest that communications and digital capex growth will only accelerate in the next few years, likely aided by COVID-19 response and fiscal packages, many of which look likely to focus on 5G capex. Headline multiples don't look optically cheap on c.25x 2021 earnings nor the dividend high at a 1% yield, but this is a franchise with prospective top line and dividend growth of around 20% per annum, alongside a large net cash position and R&D/Sales of 17%. The coming years will also see resilient higher margin service revenue develop, which shorter-term market estimates often don't capture and tend to command stubbornly higher earnings multiples (as demonstrated by the elevator industry). This is a company that looks set to both pay rapidly growing dividends and continue to have a large positive impact on the global communications landscape.

Sika is the global market leader and innovator in the fragmented and relatively low-tech construction chemicals industry. Sika holds around 9% market share in an industry where the top ten players hold about 40% market share. Key drivers range from tightening enviromental regulations, helping sales of Sika's sealants and lightweight bonding and waterproofing products, to increasing demand for digital intelligence on construction sites, setting Sika apart with its industrial-scale 3D concrete printing. The company has over 1100 employees in its R&D function across 21 global technology centers. A widening moat can be seen in both market share gains and the 25% of sales generated from products released in the past five years. Being decentralised across its global customer base offers it an advantage, both in terms of understanding and working closely with customers, and the ability to transfer techniques across markets. Sika enables its clients to minimise resource consumption and carbon footprint with average reductions in CO_2 emissions per ton of c.12% through 2023. If, as we strongly suspect and already see evidence of, the response to COVID-19 results in a green job-enabling infrastructure and building boom for as long as low rates last, Sika is in pole position. Like ASML, earnings multiples aren't optically cheap and a near-2% dividend yield may not appear to be in 'bargain basement' territory, but that needs to be seen in the context of potential for a double-digit sales and dividend CAGR. In a fragmented industry it generally pays to own the scale and innovation leader (as demonstrated by DSV in logistics and Ashtead in machine hire).

Fresenius SE had been excessively priced down by the market due to concerns around the coronavirus outbreak but retains solid long-term potential, with market-leading positions and high levels of recurring sales of consumable products off a large installed base. It is further supported by an innovative culture where R&D represents nearly 7% of sales. The largest of the four units, accounting for c.50% of sales and EBIT, stems from its majority-owned and listed holding in Fresenius Medical Care (FMC), which is the European and US market leader in dialysis care and services with a market share of 36%. In the US, FMC is a supplier to the number-two player DaVita Health, and the recent acquisition of NxStage looks set to drive growth in at-home care. Fresenius's Kabi division accounts for just over 25% of EBIT and specialises in intravenous drug delivery, clinical nutrition and infusion therapy and biosimilar drug development. The division is characterised by scale advantages which in turn lower costs for customers while generating attractive repeat sales of consumables relating to pumps. The Helios division is Germany and Europe's largest operator of hospitals accounting for just under 20% of EBIT and has arguably been the key source of recent share price discrepancy. We can't predict how long the disruption to hospital operations relating to COVID-19 will last, but we can say that government current and longer-term financial support for hospitals and health infrastructure in Germany looks strong. Similarly, the smallest division Vamed, which specialises in health infrastructure solutions, looks well placed for the long-term as governments respond to the crisis. The Else Kroner foundation owns 26% of Fresenius stock and is in our view a reassuring shareholder support, thinking conservatively and for the long term.

Epiroc supplies productivity and efficiency solutions to capital-intensive industries including mining and infrastructure and claims some 45% market share of the hard rock drilling equipment market, which requires large quantities of consumables. Key drivers of sales include emissions regulations, declining ore grades and global infrastructure spend. Aftermarket recurring revenue is high with service revenue representing 39% of total sales in 2019 and consumables (tools and attachments) 27% of revenue – key drivers of persistently high c.30% return on capital employed. Counter-cyclicality is quite high too, as service benefits when customers defer new capital expenditure. The remainder of revenues are accounted for by machine sales, where Eprioc is the market leader in clean electric mining and drilling equipment. From a COVID-19 point of view, most mines (which are increasingly automated) have been deemed critical by governments and have therefore bypassed much of the shutdown. There will of course be some shutdowns at the higher end of the cost curve, but other than in the very short-term, clean infrastructure and climate, which require increased quantities of high-value metals like copper and nickel (not to mention gold from a QE response point of view), look like very strong candidates to be part of long-term policy response and recovery packages (as per discussions to apply sustainability requirements to European fiscal packages). Consequently we feel that this is a company with both a solid competitive position and scope for a c.10% sales CAGR stretching out through the 2020s.

Assa Abloy, like all these names, uses technology well, being the global market leader in electronic lock systems. It is also highly resilient, with two thirds of sales stemming from the aftermarket, namely upgrades, components, software and virtual or digital key card issuance all spanning a building's lifetime. Barriers to entry are characterised by high switching costs enhanced by strong relationships with installers and security systems experts. A good analogy is the electrical industry, where electricians are very loyal (through training) to a specific brand, and once one type of system is installed it is extremely expensive to switch. Assa Abloy has a long runway for growth driven both by emerging markets and by market share gains. Mechanical locks still make up around 30% of Assa Abloy's sales, and with smaller traditional lock brands generally lagging in the technology required for electrotechnical locking systems, Assa Abloy is often able to purchase such operators at reasonable multiples of earnings and enjoy a long runway upgrading clients to digital, whilst also assimilating complementary products or services. Regardless of what happens over the next few quarters, Assa Abloy, with its strong balance sheet and high levels of cash conversion, looks well placed by way of longer-term response to this crisis. With some 70% of sales relating to corporate expenditure, Assa Abloy is both one step removed from a downturn, but also exposed to sustainable buildings infrastructure investment – something that looks likely to be high up on agendas as governments seek to get economies moving again, create jobs and make sure that fiscal packages are put to good use.

Portfolio metrics

Following these changes, the key metrics for the portfolio by which we monitor our commitment to quality, value, dividends and conviction are presented below.

		Guinness European Income Fund	MSCI Europe ex UK Index
Quality	Average 8 year CFROI %	16.0	10.5
	Debt / equity %	79.0	210.0
	Net debt / Equity %	51.3	68.4
	ROE %	20.0	7.0
Value	PE (2020e)	15.2	16.8
	FCF Yield %	5.6	5.0
Dividend	Dividend Yield (2020e) % gross	3.7	3.5
	Weighted average payout ratio %	50.0	75.0
Conviction	Number of stocks	30	344
	Active share	85	NA

Figure 3: Portfolio statistics data as of 30th April 2020 in GBP. Source: Guinness Asset Management, Bloomberg)

The portfolio's sectoral and geographic positioning is as follows.

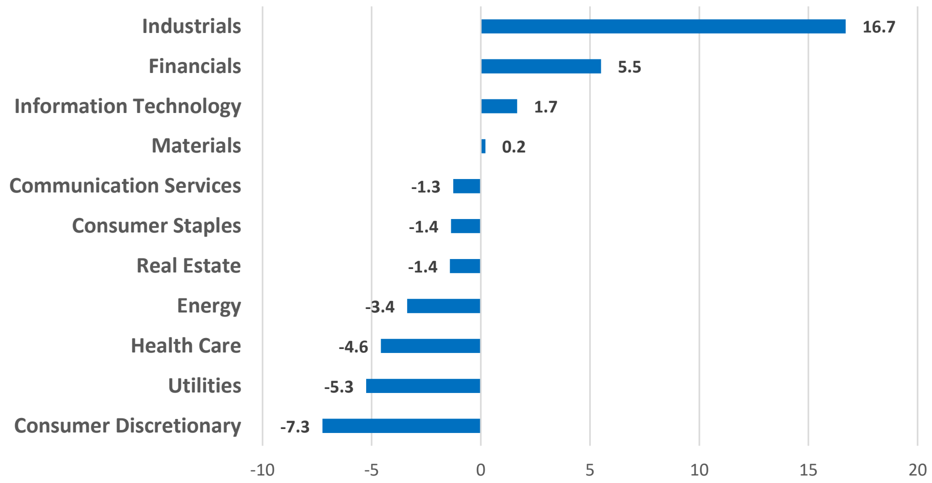


Figure 4: Sector over and underweights as of 30th April 2020 in GBP. Source: Bloomberg

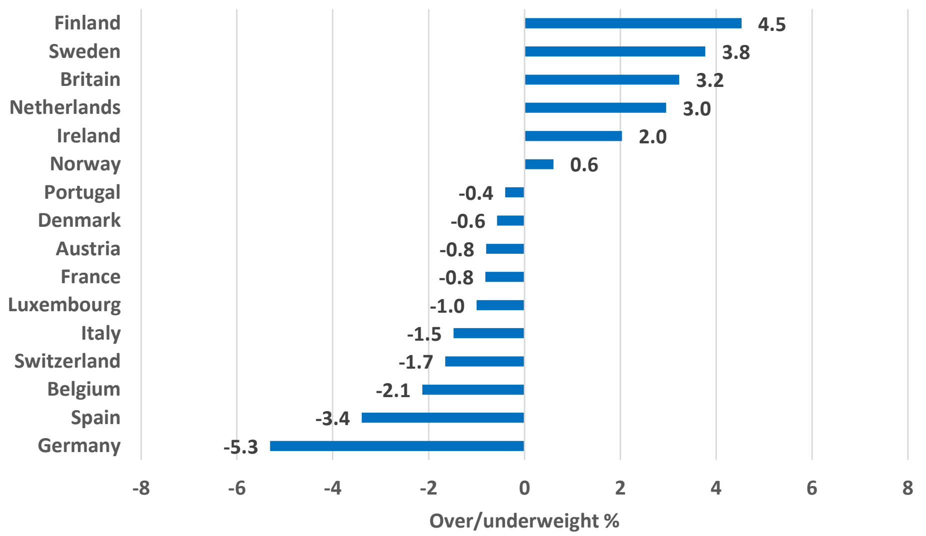


Figure 5: Country over and underweights as of 30th April 2020 in GBP. Source: Bloomberg.

We thank you for your continued support.

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

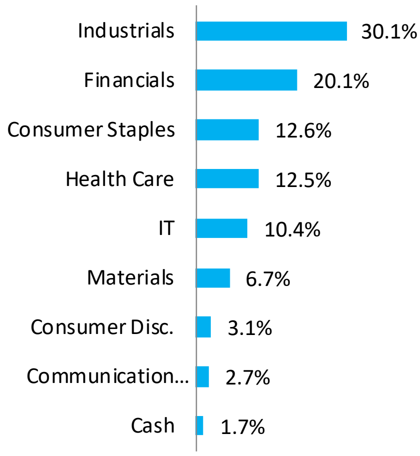
PORTFOLIO

30/04/2020

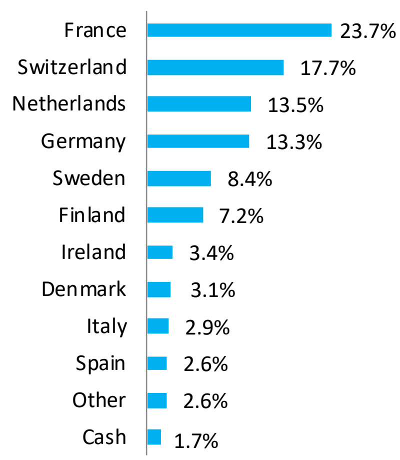
Fund top 10 holdings

Schneider Electric	4.0%
Helvetia Holding	3.9%
Aalberts	3.7%
Nestle	3.7%
Konecranes	3.6%
Tieto	3.6%
Deutsche Boerse	3.5%
Capgemini SE	3.4%
AXA	3.4%
Roche Holding	3.4%
% of Fund in top 10	36.2%
Total number of stocks	30

Sector analysis



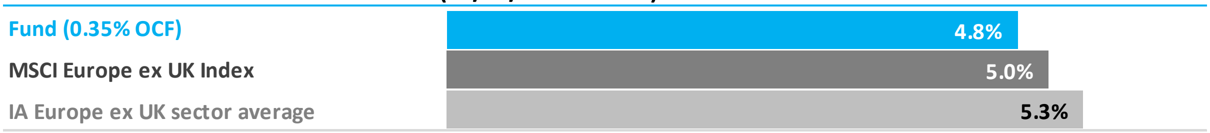
Geographic allocation



PERFORMANCE

30/04/2020

Annualised % total return from launch (19/12/2013 in GBP)



Discrete years % total return (GBP)	Apr '20	Apr '19	Apr '18	Apr '17	Apr '16
Fund (0.35% OCF)	-13.7	5.9	2.1	34.6	-1.0
MSCI Europe ex UK Index	-8.0	2.3	6.3	27.9	-4.9
IA Europe ex UK sector average	-7.2	-0.3	7.5	26.1	-0.7

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund (0.35% OCF)	4.8	-20.4	-13.7	-6.7	24.4	34.5
MSCI Europe ex UK Index	4.4	-13.9	-8.0	0.1	21.8	36.7
IA Europe ex UK sector average	7.2	-13.1	-7.2	-0.6	24.4	39.1

RISK ANALYSIS

30/04/2020

Annualised, weekly, from launch on 19.12.13, in GBP	Index	Sector	Fund
Alpha	0.00	0.70	0.21
Beta	1.00	0.87	0.92
Information ratio	0.00	0.02	-0.04
Maximum drawdown	-25.02	-24.43	-30.29
R squared	1.00	0.87	0.88
Sharpe ratio	0.07	0.08	0.06
Tracking error	0.00	5.53	5.29
Volatility	15.41	14.35	15.08

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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.

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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.**

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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.

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Singapore

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Telephone calls will be recorded and monitored.