

GUINNESS

Global Equity Income Fund



10 Golden Rules for Global Income Investing

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There is no disputing the power of *dividends*.

That **dividends and dividend reinvestments constituted over 90% of the S&P 500's total return from 1940 to 2011** testifies to the potent contribution they can make to the size of any long-term equity investor's portfolio.

Yet **chasing companies with high dividend yields is more likely to hinder long-term growth prospects than generate superior returns**. This is because:

- The highest-yielding stocks also tend to be the most distressed, and businesses undergoing structural decline are liable to cut their dividend at any point.
- In plumping for the highest-yielding companies on a global basis, one would necessarily have to exclude a vast number of US stocks, since US businesses tend to favour share buybacks which can result in lower dividend pay-outs. It goes without saying that disregarding a large proportion of the global equity market – not to mention one of the most robust economies in the world – would leave a gaping hole in any investor's global portfolio.
- Sectors with the highest yields are often highly regulated, as is the case with utilities; or cyclical, as with commodities and financials. By restricting one's choice of sector on a high yield basis, one would struggle to diversify out of overcrowded, economically sensitive areas.

The following 10 rules have been formulated to help combat the high-yield trap to which every global income investor is susceptible. They lay out how the ever-elusive balance between yield, quality, and diversification may be struck.



A handwritten signature in black ink that reads "Ian".

Dr Ian Mortimer, CFA

Co-Manager



A handwritten signature in black ink that reads "Matt".

Dr Matthew Page, CFA

Co-Manager

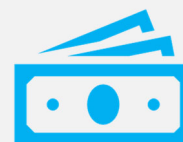
1 Opt for quality companies with moderate, sustainable, growing dividends

Screening solely for yield is a perilous business, particularly given the disconcerting correlation between high-dividend yield and high risk of a future dividend cut. That's why **we do not chase yield, but instead seek out capital and dividend growth**, focussing solely on quality, well-run, profitable companies. **Dividend payers outperform in the long term; quality dividend growers, even more so.** Having a moderate dividend yield makes it easier for a company to hike its dividend, for the simple fact there is more room to grow. By investing in quality companies with moderate dividends, our Global Equity Income Fund has managed to grow its fund dividend payment every year since inception, with a compound annual growth rate of 5.6% over 8 years (31.12.2010–31.12.2019).



2 Target companies that have persistently generated high cash-flow returns on investment (CFROI)

CFROI is a solid metric for determining a company's ability to pay a healthy and growing dividend long into the future. Hence why **the only companies included in our investment universe are those which have achieved at least a 10% return on capital** – well above the average real cost of capital at 6% – **in each and every year over the last 10 years.** History shows that for companies which have seen a decade of high returns on capital, there is a 95% chance that these companies will achieve a return on capital over 10% the following year, and an 80% chance they'll still be doing it 4 years later. It is an exceedingly rare achievement for a stock to meet this criterion; on average, a mere 3% of global listed companies make the cut. We believe this reflects the **truly quality nature of those few companies that do meet or surpass our threshold.**



3 Look for strong balance sheets

If a company's balance sheet is stretched, it is liable to be compelled by the market to cut its dividend in order to pay off its debt. **A strong balance sheet means a company is less likely to cut its dividend.**



4 Hold a value-bias...

The investor who holds high-quality companies which are valued like mediocre ones can rest as easy as anyone with an equity portfolio – particularly if these holdings also produce a steady rising income stream. We follow an investment process that is fundamentally driven from the bottom up, and endeavour to identify companies that are cheap versus the market, peers, and their own history.



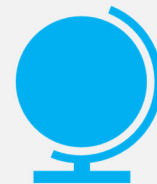
5 ...But don't fall for value-traps!

At heart, **we're growth-at-reasonable-value investors**. We seek to identify good businesses whose long-term profitability – bolstered by competitive advantage and capital discipline – is undervalued by the market. **We realise, however, that some companies may be cheap for good reasons**. It is important to buy quality companies – ones that have generated a minimum 10% return on capital over the last 10 years – at attractive valuations, rather than companies that are merely inexpensive.



6 Go global

We do not limit ourselves to investing in stocks from any one region, and **have no benchmark-driven constraints on our regional and sector weightings**. That's because **we recognise that there are rich dividend payers domiciled all over the globe**, and wish to invest in a diverse range of companies – from high profile blue-chip stalwarts, to companies that are perhaps less well-known, and located outside the traditional dividend-paying regions and sectors.



7 Construct a concentrated, high-conviction portfolio

We believe **the sweet spot** in terms of balancing the need for diversification to limit stock-specific risk, whilst still having sufficient weight in one's positions so that any appreciation will have a meaningful impact on the portfolio is achieved when you get to a level of **30 to 40 positions**. At 30 positions, your maximum potential loss to the portfolio from an individual position is 3.33%, while at 40 positions it is 2.5%. Adding additional position to a portfolio always has a diminishing effect on reducing stock specific risk, but beyond 40 positions the additional benefit is negligible.



8 Equally weight

At first, the notion of splitting a portfolio into a number of equally weighted positions seems to sit at odds with the idea of a high conviction portfolio as outlined in the previous rule. Shouldn't a high-conviction portfolio contain some large weights to one's favourite companies? We believe, however, that **investing equally in c.35 stocks displays our conviction in every position we hold**, and is **certainly indicative of a higher degree of conviction than holding larger weights in a few companies and small weights in the rest**. Not to mention that **having an equally weighted portfolio mitigates one's stock-specific risk**, keeping it to a reasonable level. Index-weighted portfolios will have higher weighting in large-cap companies, and thereby possess higher stock-specific risk.



9 Buy (well) and hold

To quote the famous advertising strapline of one esteemed beverages business, 'Good things come to those who wait'. The Guinness Global Equity Income Fund has a **low turnover rate**; with an average 3–5 year investment horizon, our c.35 stock portfolio has an average yearly position turnover of 5. Some of the positions in our fund – Microsoft, Procter & Gamble, Johnson & Johnson, to name a handful – have been there since its inception in 2010. This is because **we recognise the damage that excess activity can inflict upon a portfolio**, with short-term trading both losing value and burning up money via trading costs. **Buying well and holding is a far superior approach for any long-term investor.**



10 Think like a physicist

Having both studied advanced degrees in Physics at the University of Oxford, we have come to learn – albeit via a rather oblique route – that **when it comes to investing, it is prudent to let the numbers do the talking**. Our natural preference for good metrics rather than good stories means we can avoid being unduly influenced by market sentiment. **By always hanging our hat on the numbers, we are able filter out much of the noise and hype that often surround companies, and can pinpoint the true signals that drive company valuations.**

It also doesn't hurt to appreciate that **what goes up, must go down**. **Dividend-paying companies** really come in into their own through the way they are able to – over the long term – **provide a hedge** against inflation. This is because dividend income grows in line with – or often at a higher rate than – inflation. Yet another reason why quality income stocks are a no-brainer for inclusion in any long-term equity investor's portfolio: they often lead to better risk-adjusted performance by offering protection on the downside, whilst simultaneously being able to sustainably grow their businesses.



Bonus In order to strike upon good dividend-paying companies, don't look at the dividend

Our Global Equity Income Fund is designed to invest in the best global dividend-paying companies all around the world, yet **we prefer to select companies on the basis of quality rather than yield**. As it happens, our screening inevitably identifies an abundance of companies with attractive dividend yields. On average, since 2000, over 50% of the companies in our investment universe have yielded over 2% – higher than the global market average. This means we can rest easy, knowing that **we are in the unique position to build a judicious portfolio, made up of high-quality companies whose ability to keep generating high ROC provides the solid backing for a sustainable, growing dividend.**





Case Study

As an example of our process in action, take the Swiss-Swedish conglomerate ABB – currently a holding in the Guinness Global Equity Income Fund. ABB manufactures products used in electrical grids and transmission, industrial automation, and production line robotics. It has a wide mix of product lines, and customers in many sectors – from data centres to food and drink. While it has an interesting business, the company is in a period of change as it undergoes a reorganisation – something which has gone down well at other industrial companies such as Atlas Copco. ABB is growing its services revenue, which is below average for its peers, and constitutes a more valuable cashflow stream than relying on customers' capital expenditures, which are more cyclical. As well as meeting our quality criteria, ABB is expected to grow its earnings by double digits in 2020, giving the dividend a secure backing and offering the investors both avenues of return. Meanwhile the dividend yield stands at 3.6%.

By the Portfolio Managers of the Guinness Global Equity Income Fund

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Matthew Page, CFA



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Guinness Global Equity
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Dr Ian Mortimer joined Guinness Asset Management in 2006, and is co-manager of the Guinness Global Equity Income Fund, Guinness Global Innovators Fund, and the Guinness European Equity Income Fund. Prior to joining Guinness, Ian completed a D.Phil. in experimental physics at Christ Church, University of Oxford, and graduated in 2006. He graduated from University College London with a First-Class Honours Master's degree in Physics in 2003. Ian is a CFA charterholder.



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more**

How we manage the Fund

Read how we invest and why in our *Investment process* paper



Keeping you updated

Detailed portfolio and performance analysis



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The Guinness Global Equity Income Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. 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.

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