Guinness Atkinson
Dividend Builder eBrief
Manager's update

A review of 2014

2014 was perhaps unlikely to be a repeat of 2013's very strong returns for global equities, particularly given the broader macro concerns that existed at the beginning of the year. While it turned out to be a positive year for global equities, it was not a smooth ride, particularly over the last six months.

Emerging market equities generally underperformed due to the strengthening US dollar and implications for slower GDP growth in these countries. The falling oil price was another major macro factor that affected equities both positively and negatively in the second half of the year and will likely to continue to shake out winners and losers through 2015.

1. Performance

Global equity markets were positive despite a poor start and end to the year; the MSCI World Index had a total return of 5.64% over the year. The Guinness Atkinson Dividend Builder Fund had a total return of 4.99% over the same period, thereby underperforming the MSCI World Index by 0.65%.

Performance table of Fund vs benchmark

	1 year (actual)	3 years (annualized)	5 years (annualized)	10 years (annualized)	Since launch (annualized)
	12/31/2013	12/31/2011	12/31/2009	12/31/2004	12/15/1998
	12/31/2014	12/31/2014	12/31/2014	12/31/2014	12/31/2014
Fund	12.55%	25.14%	16.48%	10.58%	7.05%
MSCI WORLD	5.64%	16.26%	10.94%	6.76%	5.38%

Source: Bloomberg, Guinness Atkinson Asset Management
Gross Expense Ratio: 5.47%
Net Expense Ratio*: 0.68%

Performance data quoted represent past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. For most recent month-end and quarter-end performance, visit gafunds.com or call (800) 915-6566.

**The Advisor has contractually agreed to reimburse expenses (excluding Acquired Fund Fees and Expenses, interest, taxes, dividends on short positions and extraordinary expenses) in order to limit the Fund's Total Annual Operating Expenses to 0.68% through March 31, 2016.*

Our focus on high return on capital companies that have the potential to grow their dividends means we have managed to grow the dividend income distributed by the Fund by 4.7% compared to 2013.

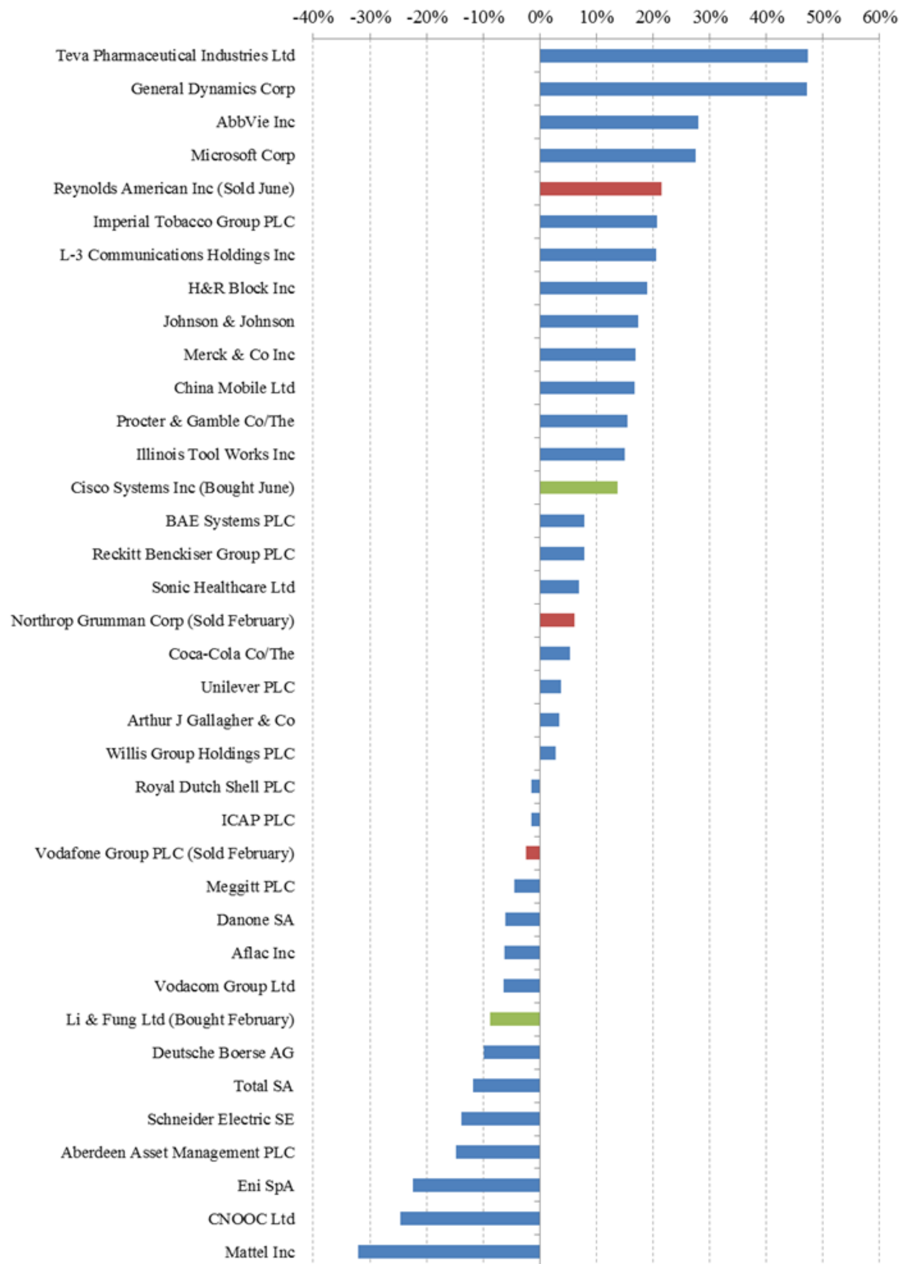
	2012	2013	2014
Q4	11.0	11.0	12.1
Q3	10.0	12.0	12.0
Q2	10.0	11.0	12.0
Q1	-	11.0	11.0

Inception date = 3/30/12
Source: Bloomberg

2. Attribution and asset allocation

The performance of each individual company held in the fund throughout the year is shown in the table below. Where a company was held intra-year, the purchase or sale date is highlighted in brackets.

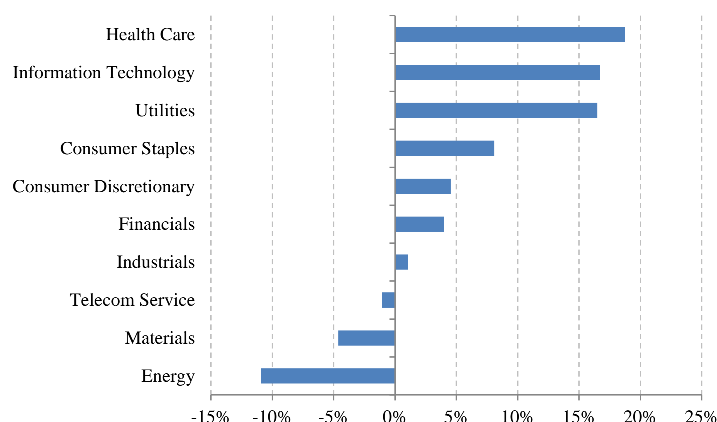
GUINNESS ATKINSON FUNDS



Source: Bloomberg, Guinness Atkinson Asset Management

If we look at how the different sectors in the MSCI World Index have performed over 2014 we can see there has been a very wide dispersion. The best performing sector, healthcare, was up 18.7% versus the worst performing sector, energy, down 10.9%.

MSCI World Index: Sector performance in 2014



Source: Bloomberg, Guinness Atkinson Asset Management

Looking at specific holdings, we saw particularly strong performance in Teva Pharmaceutical which we had bought towards the end of 2013. The Healthcare sector was the best performing global sector in 2014 after a number of high profile acquisition attempts led to higher multiples. The sector was up 18.7% over the year. All our Healthcare holdings provided a positive total return with Abbvie, Johnson & Johnson and Merck all contributing meaningfully to performance.

Teva Pharmaceutical was extremely unloved when we bought it. The company has been a consolidator of generic drug manufacturers and also generates a large proportion of its revenues from a multiple sclerosis drug for which it owns the patent. Ironically, it is the threat of generic competition to this drug when it comes off patent that had been a drag on the company before we bought it. At just over 7 times 2014 expected earnings, however, it ranked in the bottom decile of its industry peers and looked very attractively valued relative to the company's historical valuation range. Earnings expectations had fallen over 2013, but we felt this may have bottomed and the market had oversold the stock based on overly pessimistic view. We felt there was good upside potential over the longer term, and a lot of bad news already priced in.

This was a classic example of buying a company that was attractively valued but where no obvious "catalyst" existed. We never know how long negative sentiment will persist and whether it will become more negative before it improves, but this has turned out to be a fairly quick turnaround.

After strong performance in 2013 General Dynamics went on to have another good year in 2014, producing a total return only just shy of Teva Pharmaceutical. The company has been growing its dividend at 10% per year for the last 5 years, and we believe this strong dividend growth is likely to continue.

The poor performing positions in 2014 were generally either affected by the falling oil price or their exposure to emerging markets. The halving in the oil price over the last 6 months of the year hurt the valuations of our energy companies. We were modestly overweight in the energy sector, but the positions we held within the sector were the more defensive integrated names, which have generally held up well relative to the broader energy sector.

Positions exposed to emerging markets generally underperformed due to the strengthening US dollar and implications for slower GDP growth in these countries.

3. Buys and sells

Portfolio turnover was particularly low in 2014, even by our own historical standards - we only made two purchases and three sales, leaving the portfolio with 34 holdings by the end of the year.

In February we sold our position in Northrop Grumman and replaced it with Li & Fung.

We had bought US defense contractor Northrop Grumman in March 2013. When we looked at the valuation multiples back then we found the company was trading at the lower end of its ten year range, with a 2014 P/E of 9x. We appreciated the concerns surrounding defense spending cuts, but ultimately, we thought that the valuation multiples had gone too far.

When we initiated the position, the source of return we felt most confident about was the dividend stream; the company had grown its dividend for the last ten years, the payout ratio was very modest at 30%, and we expected the impact from earnings declines to be slower than the market was forecasting. Share price overreaction on the downside and our willingness to be patient also gave us some confidence that we could derive a return from a re-rating (multiple expansion). Finally, earnings growth was clearly quite uncertain. We decided to sell it in February this year as sentiment had turned quite rapidly. The total return over the holding period was 80.3% (in USD). Given the relatively short holding period, the proportion of total return from dividends was only 2.5%, while 75.9% came from price appreciation. Of this price appreciation, more than half came from multiple expansion, and the remainder from earnings forecast growth.

To replace it we bought a position in Hong Kong-listed Li & Fung, which is a global outsourcing company. It's an interesting example of a company that is listed in Asia but derives the bulk of its revenues from outside Asia (88%, derived mainly from the US and Europe). Just like Northrop Grumman, it was trading at the low end of its ten year valuation range when we bought it. This was partly due to general fear surrounding China and emerging market-listed companies, and partly because the holiday season in the US the previous year was a little disappointing. They also took a restructuring charge on the US arm of their business. So, there were reasons why the valuation was attractive, but we have to remember this is another company that has a ten year history of generating top quartile return on capital, and it weathered the financial crisis extremely well.

Our levels of confidence in terms of the sources of total return was the same as Northrop Grumman. Dividends, then multiple expansion, and finally earnings growth. But we may well have to wait considerably longer than we did with Northrop Grumman.

In February we also sold our position in Vodafone after Verizon's acquisition of Vodafone's stake in Verizon Wireless. Vodafone was a company whose return on capital was already in a state of decline, and we concluded that once the Verizon wireless stake was gone, the return on capital was likely to fall below our threshold level.

In June we decided to sell our position in tobacco company Reynolds American and bought Cisco.

The consensus bear case on tobacco companies over this period has always focused on falling volumes because of campaigns against smoking, the threat of plain packaging, and the tax burden on consumers. We don't disagree with any of these specific threats, but we did also observe that tobacco companies in general were able to offset falling volumes with an increase in price.

When you look at Reynolds American specifically, the expectation for revenues in 2014 was only around 2% lower than the company's reported revenues in 2010. Over this period the company has also managed to grow gross, operating and net margins quite substantially, leading to a healthy growth in cash flow. Net income has grown by 23% (in USD) over our holding period. When combined with an 8% reduction in shares outstanding through share buybacks, this translates into 33% earnings per share growth.

In the end we decided to sell the position largely on the rerating of its valuation, which has coincided with merger and acquisition activity in the sector. The risks to the business remain the same as when we bought it, but the potential for upside from here was, in our opinion, much reduced, despite the prospect for a steady dividend (but with likely lower growth going forward).

In place of Reynolds American we bought a position in Cisco. Cisco only started paying a dividend in 2011 and is an interesting example of what has historically been considered a growth company morphing into more of a steady state. Like many large-cap IT companies, Cisco is awash with cash and short-term investments – over $50 billion, which compares to the company's market capitalization of $126 billion (when we initiated our position). We also like the company's geographic diversification, with 59% of revenues coming from North America, 25% from Europe and 16% from Asia-Pacific.

Revenue has been growing modestly over the last few years, and margins have been stable. Acquisitions have been a significant part of how Cisco has managed to maintain its edge over the last 10 years, and it has largely financed these through free cash flow generation. Given the amount of cash on the balance sheet and the steady, but not spectacular growth prospects, we believe there is scope for a very reliable dividend, with potential growth. The payout ratio is around 35%, and the company offered a prospective yield for 2015 of 3.2% when we initiated the position.

Most importantly, the valuation was attractive, with the company trading on a one-year forward P/E ratio of 12.1x, which was certainly cheap relative to its historical range, its peers, and the broad market.

Time will tell where the total return from this position will come from. But we feel very confident that if we look back in three years' time we will have received a very healthy proportion of the total return from the dividend. The multiple looks attractive, even when you take the cash into consideration, and there is still opportunity for earnings growth, but how the proportion of any future total return will split between these two is uncertain.

4. Looking forward

At this point we might provide some kind of macro outlook, but I'm sure you are receiving plenty of those, from people far more qualified to produce them than us. As interested as we are in the macro environment, we don't spend any time trying to make big macro forecasts and therefore don't have any particularly interesting views to share with you. We prefer to prioritize our time on the three core pillars of our investment process: Quality, value and growing dividends, as we believe these will ultimately drive our returns.

Over the last year our focus on quality has meant that the median 10 year cash flow return on investment of our positions is more than twice as high as that of the MSCI World Index. Our focus on valuation means that the fund remains at a P/E valuation discount of 7% relative to the index. Our focus on dividend growth has produced a dividend distributed by the fund that was 7.5% greater than the previous year, and provided a dividend yield of 3.25% (based on the unit price at the beginning of the year). As of 12/31/14, the Fund's 30 Day SEC Yield was 2.86% (subsidized) and 0.98% (unsubsidized).

This will continue to be our priority in 2015 and beyond.

Portfolio managers
Dr. Ian Mortimer, CFA
Matthew Page, CFA

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice.

Mutual fund investing involves risk and loss of principal is possible. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. These risks are greater for emerging markets countries. The Fund also invests in medium and smaller companies, which will involve additional risks such as limited liquidity and greater volatility. The Fund may invest in derivatives which involves risks different from, and in certain cases, greater than the risks presented by traditional investments.

Securities mentioned are not recommendations to buy or sell any security. Current and future portfolio holdings are subject to risk

Top 10 Holdings as of 12/31/14

1.AbbVie Inc	3.70%
2.General Dynamics Corp	3.54%
3.ICAP PLC	3.47%
4.Procter & Gamble Co	3.40%
5. China Mobile Ltd - ADR	3.38%
6.Illinois Tool Works Inc	3.35%
7.H&R Block Inc.	3.20%
8.Willis Group Holdings PLC	3.18%
9.Cisco Systems Inc.	3.15%
10.Microsoft Corp	3.15%

Investment performance reflects fee waivers in effect. In the absence of such waivers, total returns would be reduced.

This information is authorized for use when preceded or accompanied by a prospectus for the Guinness Atkinson Global Innovators Fund. The prospectus contains more complete information, including investment objectives, risks, charges and expenses related to an ongoing investment in The Fund. Please read the prospectus carefully before investing.

Diversification does not assure a profit nor protect against loss in a declining market.

Dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Earnings Growth is a measure of growth in a company's net income over a specific period, often one year.

Earnings per share growth is calculated by taking the total earnings divided by the number of shares outstanding

Free cash flow represents the cash that a company is able to generate after laying out the money required to maintain or expand its asset base.

MSCI World Index is a capitalization weighted index that monitors the performance of stocks from around the world.

P/E Ratio reflects the multiple of earnings at which a stock sells.

Payout ratio is the percentage of net income that a company pays out as dividends to common shareholders

Return on capital is a return from an investment that is not considered income. The return of capital is when some or all of the money an investor has in an investment is paid back to him or her, thus decreasing the value of the investment

Return on investment or ROI, is the most common profitability ratio. There are several ways to determine ROI, but the most frequently used method is to divide net profit by total assets.

Earnings growth is not a measure of the Fund's future performance.

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