

# Davy Discovery Fund

from New Ireland

## Quarterly update Q3 2019

This fund is provided by New Ireland Assurance plc and is managed by Davy Asset Management.

For Investment Professionals Only

Performance	1 Month (%)	Q3 2019 (%)	1 Year (%)	3 Year (P.A.) (%)	5 Year (P.A.) (%)
Davy Discovery Fund* (Gross of Fees)	4.18	1.28	2.85	10.48	12.36
MSCI World Small And Mid-Cap Index (Total Return)	3.07	3.84	3.93	9.46	10.54

Source: New Ireland (\*Discovery Fund Series 6, performance is quoted gross of taxation and fund management charge) and Bloomberg as at 30th September 2019. The fund management charge and product charges will vary depending on the terms and conditions of your policy. The MSCI World SMID Cap Index captures mid and small cap representation across 23 Developed Markets (DM) countries. With 5,250 constituents, the index covers approximately 28% of the free float-adjusted market capitalization in each country.

### Fund overview

The aim of the **Davy Discovery Fund** (the 'Fund') is to achieve long-term capital growth by investing in shares of small and medium sized companies on a global basis. These companies demonstrate growth potential and represent attractive investment opportunities. Investing during the early stage of a company's life cycle can lead to higher than average investment returns.

### Market comment

Global equity markets rose by 5.02% in a volatile third quarter dominated by slowing growth, tumbling bond yields, political drama in the UK and rising trade tensions. The MSCI World Index has now risen by an impressive 23.32% in euro terms in the first three quarters of 2019. Some central banks have been active in recent weeks, with the European Central Bank and the Federal Reserve cutting rates in the face of weakening sentiment. While the initiation of impeachment process against the US president grabbed the headlines late in the quarter, the trade war and rate cuts remain the main movers of markets.

### Fund performance

The Fund returned 1.28% during the quarter, having risen by 24.48% year to date, outperforming the MSCI World SMID Index by 1.36%, in euro terms. During the quarter Stock Selection, Currency and Asset Allocation negatively affected performance, the Fund's Quality bias partially offset these effects.

The top five contributors to relative performance were Teradyne, CTS Eventim, Man Wah, Descartes Systems and CoStar. While Micro Focus, Covetrus, Moncler, H&R Block and Hostelworld were the top five detractors during the period.

**Teradyne**, the robotics and automated testing equipment company, performed strongly during the period returning 26.47%. The company delivered strong 2Q19 results and raised FY19 guidance. Semiconductor test revenue is growing faster than expected due to 5G, networking and memory test which is more than offsetting lower demand from automotive. Management believe this sector will continue to grow faster than GDP, as average selling prices for

Cobots are still rising. In fact, prices could double when visualisation capabilities are added over the next twelve months.

**CTS Eventim**, the online ticketing company performed strongly during the quarter returning 26.34%. The company's revenues have grown 24.6% over the last 12 months. Most of this growth is organic, as there is limited potential for acquisitions. Initially, they build their presence in a market organically or if they can, they make a suitable bolt-on local acquisition. In the last quarter, they have agreed to combine their French operations with France Billet, creating a local leader. We expect this to continue, slowly consolidating the European market and positioning them as the only direct competitor to Ticketmaster.

**Micro Focus**, the legacy software provider detracted from performance returning -41.85%. The headwinds the firm faced in 2018 have persisted in 2019 as the integration of Hewlett Packard Enterprise has proved to be harder to integrate than prior deals. Management's ability to successfully restructure and integrate legacy assets has been called into question and the firm is now undergoing a strategic review to optimise its portfolio of products. We expect non-core businesses will be divested and cash returned to shareholders, for example.

**Covetrus**, the software producer for veterinarians detracted from performance returning 49.44%. Since being spun-out of Henry Schein in 1Q19, it has missed guidance twice as a combination of higher CAPEX, weakness in North American distribution, Brexit and currency negatively affected business performance. There are several factors at play, one of which is customers buying more products online rather than from their vet, highlighting a possible weakness in Covetrus's business model. Consequently, we have decided to exit this stock despite the attractiveness of this sector.

### Sample portfolio transactions

Over the period, the Fund invested in taxation software provider H&R Block and the Japanese game manufacturer Capcom, which is well positioned to benefit from Apple's new gaming platform, Arcade. These positions were funded by the sales of Hostelworld, Helmerich & Payne and L Brands as they no longer fit our investment criteria.

### The QQE Perspective

As noted in the last of our working series, Quality Matters – Asymmetric Returns, outperforming the market during Down markets is favourable to outperforming in Up markets, due to the long-term effect of compounding returns. If an investment outperforms in a Down market, it has less to recoup and will then be ahead over a longer period, assuming it performs in-line with the market as it rebounds – a simple case of compounding.

During the quarter, we took a deeper dive into the four individual sub-pillars making up the DAM QUALITY model – Profitability, Persistence, Protection, and People – we believe that these four pillars are essential

to achieving better positive asymmetric returns. We found that whilst three of the four sub-pillars of QUALITY provide asymmetric returns, none do so to the same extent as QUALITY, highlighting that QUALITY is more than the sum of its parts.

Future analysis of QUALITY and its four sub-pillars will extend to include a wider universe to better understand the nuances.

**Details of our analysis can be found in the insights section of our website <http://www.davyassetmanagement.com/insights>**

Calendar Year Performance	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)
Davy Discovery Fund* (Gross of Fees)	-9.05	15.32	10.58	14.17	15.91
MSCI World SMID Cap Index (NTR, EUR)	-8.88	8.35	13.7	11.71	18.55
MSCI World Index (EUR)	-4.11	7.51	10.73	10.42	19.50
Teradyne	-24.37	66.16	24.29	5.72	13.38
CTS Eventim	-14.82	33.20	-17.24	51.90	35.08
Man Wah	-55.99	47.19	20.02	47.78	15.79
Descartes Systems	0.81	24.83	2.84	61.39	21.39
CoStar	13.60	57.54	-8.81	12.56	-0.51
Micro Focus	-42.48	19.61	39.20	52.77	41.49
Covetrus <sup>1</sup>	-	-	-	-	-
Moncler	11.73	59.08	29.16	16.98	-29.03
H&R Block	0.52	18.14	-28.43	1.29	18.89
Hostelworld	-45.09	83.32	5.72	-	-

Source: New Ireland (\*Discovery Fund Series 6, performance is quoted gross of taxation and fund management charge), MSCI and Bloomberg as at 30th September 2019. The fund management charge and product charges will vary depending on the terms and conditions of your policy. Performance is quoted in local currency unless otherwise stated.

<sup>1</sup> Given Covetrus Inc. was established in February 2019, no performance data are available yet.

The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (DM) countries. With 1,650 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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**Warning: Past performance is not a reliable guide to future performance.**

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