DAVY

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# Davy **Defensive Equity Income** Strategy

## **Quarterly update** Q3 2019

For Investment Professionals Only

| Performance | 1 Month (%) | Q3 2019 (%) | 1 Year (%) | 3 Year (P.A.) (%) | 5 Year (P.A.) (%) |
|---|---|---|---|---|---|
| Davy Defensive Equity Income Strategy* (Net of Fees) | 3.28 | 4.28 | 9.94 | 5.46 | 5.40 |
| MSCI World Index** | 3.16 | 5.02 | 8.49 | 11.33 | 10.39 |

Source: Davy Asset Management (Class B Eur) and Bloomberg as at 30th September 2019.

* The Davy Defensive Equity Income Fund was launched on 22nd July 2015. Investors should note the Davy Defensive Equity Income Fund (UCITS) is newly established. The past performance reflects past performance data relating to the Davy Defensive High Yield Fund (UCITS) which merged with the Davy Defensive Equity Income Fund (UCITS) (the "Merger"). Prior to the Merger the investment policy, strategy and portfolio composition were largely the same. In the circumstances, the past performance data included in this document is believed to be an appropriate reference for investors.

** The benchmark index shown above does not include fees or operating expenses and you cannot invest in it. 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.

### Fund overview

The aim of the **Davy Defensive Equity Income Fund** (the 'Fund') is to provide long-term capital growth, with reduced levels of volatility compared to global equity markets. The Fund aims to reduce risk by investing in large global companies that pay out above average dividend yields and employs an options strategy to provide some downside protection against significant market falls.

### 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 4.28% during the period and is up 16.20% year-to-date. Stock Selection was the main driver of returns during the quarter as the equity portfolio outperformed the MSCI World Index during the period. In a rising market the Options Strategy detracted from performance, Asset Allocation also took from relative performance during the period.

Stock Selection contributed positively to performance during the third quarter. The top five contributors to relative performance were Taiwan Semiconductor Manufacturing Company (TSMC), UPS, Procter & Gamble, JP Morgan and Ferrovial. While Pfizer, Apple (not held), Rio Tinto, Altria Group and L Brands, were the top five detractors during the period.

**TSMC**, the world's largest semiconductor foundry, outperformed during the quarter returning +24.84%. The company is benefiting from a dominant position in the latest generation of semiconductors and is likely to gain market share in the roll-out of fifth-generation wireless technology. In July the company released earnings that exceeded expectations and calmed market nerves about falling chip demand in light of the slowdown in smartphone sales. TSMC will raise capex in 2020 to meet demand for its high-powered chips.

**Proctor & Gamble**, one of the world's largest consumer goods companies, outperformed during the quarter returning +19.25%. The company reported robust organic sales growth of +5% in the quarter vs 4.5% market expectations and raised the full year sales guidance to +4%. PG also raised its adjusted free cash flow productivity guidance to at least 100% (greater than 90% prior) for FY19 and expects to pay over $7 billion in dividends and repurchase approximately $5 billion of common shares.

**Pfizer**, the US pharmaceuticals company, underperformed during the quarter returning -12.55%. Pfizer announced that it would combine its Upjohn business, which includes its off-patent branded products with generics drugs maker Mylan, to form a $20bn off-patent business. Pfizer will own 57% of the new company. The move was greeted with caution by some rating agencies who downgraded the company's debt as the Upjohn business's cash flow exits Pfizer.

**Rio Tinto**, the international mining company, underperformed during the quarter returning -9.13%. The company reported during the quarter and despite earnings being in line, the iron ore division, which contributes over 50% of sales, has seen price declines due to the increase of supply into the market.

### Sample portfolio transactions

There have been no transactions within the Fund this quarter.

## 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 Defensive Equity Income Strategy (net of fees) (EUR) | -3.46 | -2.29 | 6.61 | 6.88 | 13.06 |
| MSCI World Index (EUR) | -4.11 | 7.51 | 10.73 | 10.42 | 19.50 |
| Taiwan Semiconductor Manufacturing Company | -3.57 | 42.31 | 31.14 | 4.94 | 31.15 |
| UPS | -15.48 | 7.14 | 22.71 | -10.93 | 8.67 |
| Procter & Gamble | 3.62 | 12.69 | 9.37 | -9.96 | 15.42 |
| JP Morgan | -6.65 | 26.73 | 34.57 | 8.37 | 9.88 |
| Ferrovial | -2.58 | 15.63 | 15.26 | 31.25 | 21.79 |
| Pfizer | 24.82 | 15.88 | 4.46 | 7.10 | 5.30 |
| Apple | -5.39 | 48.48 | 12.48 | -3.02 | 40.62 |
| Rio Tinto | 0.44 | 21.36 | -0.69 | 15.80 | 13.54 |
| Altria Group | -27.09 | 9.45 | 20.46 | 23.10 | 34.52 |
| L Brands | -54.23 | -3.86 | -27.27 | 15.76 | 45.68 |

Source: Davy Asset Management (Class B Eur) and Bloomberg as at 30th September 2019. Performance is quoted in local currency unless otherwise stated.

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

**Warning: Neither past experience nor the current situation are necessarily accurate guides to the future growth in value or rate of return of the Fund. The value of the investment can reduce as well as increase and, therefore, the return on the investment will also be variable. Changes in exchange rates may have an adverse effect on the value price or income of the product.**

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