DAVY

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Davy **Low Carbon Equity** Strategy

Quarterly update Q3 2019

For Investment Professionals Only

Performance	1 Month (%)	Q3 2019 (%)	YTD (%)	1 Year (%)	3 Year (P.A.) (%)
Davy Low Carbon Equity Strategy* (Net of Fees)	3.44	6.97	26.28	13.22	-
MSCI World Index**	3.16	5.02	23.32	8.49	11.33

Source: Davy Asset Management (Class AA Acc in EUR) and Bloomberg as at 30th September 2019. Davy ESG Ex-Fossil Fuels Strategy changed its name on the 12th July 2019 to the Davy Low Carbon Equity Strategy.

*The Davy Low Carbon Equity Fund (previously named the Davy ESG Ex-Fossil Fuels Fund) is a newly established (UCITS) fund and was launched on 26th April, 2018. As such there is currently insufficient data to provide any useful indication of past performance to 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 Low Carbon Equity Fund** (the 'Fund') is to achieve long-term capital growth. We aim to achieve this by investing in a portfolio of "blue chip" global companies chosen based on carbon emissions criteria. The Fund favours corporate practices that have actively embraced carbon emissions reduction relative to peers. The Fund does not invest in companies which explore, extract and/or profit from the burning of fossil fuels.

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 outperformed the MSCI World Index during the quarter by 1.95%, returning 6.97% net of fees in euro terms. The Fund is now 2.96% ahead of the MSCI World Index year-to-date after returning 26.28%.

Stock Selection was particularly strong and the main driver of performance during the quarter. The top five contributors to relative performance were Alphabet, Medtronic, UPS, Smith & Nephew and Apple. While Prudential, International Flavours and Fragrances, Continental, Hang Seng Bank and Fresenius Medical were the top five detractors during the period.

Alphabet outperformed during the quarter returning +17.80%. The stock rose over the period, buoyed by Q2 earnings in July, which beat analyst expectations. The result was well received as advertising revenues returned to over 20% growth following a Q1 miss. All the long-term drivers remain in place such as machine learning, artificial intelligence, cloud computing and Other Bets such as Waymo (driverless car). Alphabet's mission is to make information accessible and useful to help people in their daily lives, e.g. Google Assistant. The stock remains a core holding.

UPS was another strong performer during the quarter returning +22.20%. UPS has been a divisive stock for many investors, based on their ambitious investment plans aimed at coping with the growth of ecommerce and increasing visibility in their business. UPS has started to see the green shoots of that investment as margins stabilised in Q2. In theory the investments made should allow UPS to handle increased ecommerce-driven traffic without negative impact on margins. The positive earnings delivered in July will hopefully kickstart margin and earnings development to match their impressive revenue growth.

Prudential, the UK life insurance company, was the worst detractor from performance returning -12.02%. The execution risk of the demerger of its UK business, poor sentiment for emerging markets, riots in Hong Kong and lower global bond yields contributed to the underperformance. With the UK demerger set for Q4 2019, focus will return to Prudential's Asian life business. This is a massive opportunity given higher growth economies and an emerging middle class. The shares remain a core holding within the insurance sector.

Fresenius Medical Care, the world's largest dialysis provider detracted from performance returning -10.63%. The stock fell based on disappointing earnings and an announced shift in policy regarding kidney care in the US. On July 10, an executive order was signed which aimed to support kidney care by promoting home dialysis and kidney transplants. Fresenius had disclosed to us previously that reform was on the cards and this was the justification for their purchase of home dialysis company NxStage in 2017. Fresenius also produced a frustrating set of earnings where they delivered material improvement in their North American business, which had been the root of their issues in 2018 but disappointed in their European dialysis products business, which was viewed as more dependable. The change in approach from the US government reflects a significant structural shift in Fresenius's core business and will be assessed to determine its potential impact on the company's investment thesis.

Sample portfolio transactions

During the quarter we made a number of changes to improve the overall QUALITY of the Fund, while also removing some companies with inferior carbon emissions profiles. Continental, the tyre manufacturer, was sold on the basis of their carbon intense core business, which, when multiplied by their deteriorating fundamentals, made the stock unsuitable for our portfolio, in spite of a seemingly attractive valuation. Newell Brands, the owner of Rubbermaid and Yankee Candles, has suffered from a deteriorating fundamental as they seek to rectify their strained balance sheet. With no major turnaround catalyst and a mediocre climate change response, we opted to sell the stock. BNP Paribas, the French bank, was also sold in the belief that there were other more attractive opportunities which better meet our QUALITY and climate change criteria.

Unilever was added to the Fund in September after successfully passing through our investment process. Unilever is an exceptionally high-Quality business with high returns and margins, a strong balance sheet and a generous shareholder return policy. A call with the company emphasised their commitment to sustainability. Singapore Exchange was another stock added to the portfolio in September. Singapore Exchange stood out in terms of their Quality, as per our model, and further research, including a company call, reinforced the defensive aspects of their business. From a carbon emissions perspective, Singapore Exchange operate a very carbon-light business model.

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 Low Carbon Equity Strategy* (Net of fees) (EUR)	-	-	-	-	-
MSCI World Index (EUR)	-4.11	7.51	10.73	10.42	19.50
Alphabet	-0.80	32.93	1.86	46.61	-5.39
Medtronic	15.19	15.89	-5.44	8.62	28.13
UPS	-15.48	7.14	22.71	-10.93	8.67
Smith & Nephew	15.97	7.50	3.05	3.49	40.57
Apple	-5.39	48.48	12.48	-3.02	40.62
Prudential	-24.40	20.15	10.38	5.05	14.25
International Flavours and Fragrances	-10.11	31.96	0.40	20.20	19.94
Continental	-45.25	25.04	-16.59	29.88	11.77
Hang Seng Bank	-6.07	39.66	4.33	18.63	7.37
Fresenius Medical	-34.68	10.34	4.63	26.93	21.49

Source: Davy Asset Management (Class AA Acc in EUR) and Bloomberg as at 28th June 2019. Performance is quoted in local currency unless otherwise stated Davy ESG Ex-Fossil Fuels Strategy changed its name on 12th July 2019 to the Davy Low Carbon Equity Strategy.

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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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