DAVY ASSET MANAGEMENT

FOR INVESTMENT PROFESSIONALS ONLY

# DAVY DISCOVERY EQUITY STRATEGY

## Q1 2018 UPDATE

| PERFORMANCE | 1 MONTH (%) | Q1 2018 (%) | 1 YEAR (%) | 3 YEARS P.A (%) |
|---|---|---|---|---|
| DAVY DISCOVERY EQUITY STRATEGY* (NET OF FEES) | -3.0 | -1.8 | 4.2 | 6.1 |
| MSCI WORLD SMALL & MID-CAP INDEX (TOTAL RETURN) | -1.1 | -2.8 | 0.7 | 4.3 |

Source: Davy Asset Management (Class A Acc Eur) and Bloomberg as at 29th March 2018.

*On 19th April 2013, the previously proposed changes to the fund strategy were implemented. For more information please contact Davy Asset Management.

The Davy Discovery Equity Fund was launched on 12th December 2014. Investors should note the Davy Discovery Equity Fund (UCITS) is newly established. The past performance reflects past performance data relating to the Davy Discovery Equity Fund (non-UCITS) which merged with the Davy Discovery Equity Fund (UCITS) (the "Merger"). Prior to the Merger when the Fund was not authorised as a UCITS, 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.

### FUND OVERVIEW

The investment aim of the **Davy Discovery Equity 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.

### FUND PERFORMANCE

The Fund delivered robust performance for the quarter versus its benchmark MSCI World SMID outperforming by 1.07% with returns driven principally by Stock Selection. A very strong start to the year was slightly tempered in March as the increased risk to global growth began to appear in styles as volatility increased. The winning styles were "Low Beta" (Quality) and "Smaller Size", this is contra to popular belief that small caps underperform in down markets as both outperformed, indicating the market rotation turned more defensive. Value struggled most over the quarter, particularly in March as the yield curve remained flat, but it rebounded towards the end as Growth sold off following the Facebook scandal, Trump's attack on Amazon and Tesla's self-driving car crash. It has been our firm view for the past year that the perceptions of "expensive markets" have been driven by the crowded larger growth companies rather than in smaller ones (which are more reasonably valued) and we have seen this play out in March.

The top contributing stock was **Bakkafrost** whose FY2017 results and positive outlook statement has seen the stock perform strongly in 1Q2018. Compared to peers, Bakkafrost harvests its fish at larger sizes which enables them to command a price premium, usually 11% to 33% higher, depending on the fish's weight. This means they set the pace for the industry when it comes to profitability, double that of Marine Harvest, and this is likely to remain the case. Why? The unique marine environment of the Faroe Islands and the stricter operating environment under the Faroese veterinary model help to keep the fishes healthier, yielding a greater weight. Given its strong performance of late, we have taken some profits.

**CyberAgent's** strong performance continues in 1Q2018. A major growth area over the last 18 months has been e-sports where multiplayer video games are played competitively for spectators, typically by professional gamers. The games fall into four genres - fighting games, first person shooter, real time strategy and multiple online battle arena games. CyberAgent has been involved setting up a new pro league in 1Q2018, called 'RAGE Shadowverse Pro League,' which is being set up for Shadowverse video gamers to compete in a RAGE e-sports contest. It will be jointly run by CyberAgent and Avex. The league begins in May with games being held weekly and broadcast live on AbemaTV (Cyber's TV Channel) and OPENREC.tv (a game video platform). Players will be paid a minimum monthly salary of ¥300,000 which may prove to be a way to pull in professional players rather than offering prize money. We have taken profits in this stock as appropriate over the quarter.

Asset Allocation made a positive contribution to performance over the quarter too but the effect of Stock Selection was three times greater and only two sectors Consumer Discretionary and Information Technology, made negative contributions. This was due to idiosyncratic stock risk with **L Brands** having disappointing numbers and **Micro Focus** profit warning twice. The stock reacted harshly on the day of the surprise news announcement, dropping 50% at the open, while we have since talked to management and concluded the core business remains intact and is operating as expected, the firm needs to deliver over the coming months if the stock is to recover. Using various valuation methodologies, the stock now is extremely undervalued and management needs to communicate more frequently with the market to give comfort that the business is back on track. We have traded the stock well, halving our position after its acquisition of HPE, given the often complicated nature of acquisitions. We have continued to hold it, as we believe there is value to be had, once management begin to execute well on the integration. We took advantage of weakness in the stock in January to increase our position marginally but were taken off guard, as most were, when the stock sold off as it did. Believing the selloff to be overdone, we bought into it as did most Micro's senior management and the stock has since rebounded 20% from its lows.

## SAMPLE PORTFOLIO TRANSACTIONS

The Fund made two new purchases over the quarter – Sonic Healthcare and Anta Sports. Anta produces affordable sportswear for low to middle income consumers in China. It's vertically integrated from design to manufacturing and sells its products to distributors who sell directly to consumers through 7,340+ franchise stores in China. Sonic is the 3rd largest laboratory services company in the world, it's the only global player with labs in the US, Europe and Asia. These positions were funded through the sale of our remaining position in Tenneco the auto OEM whose returns and margins had begun to decline and the reduction of the Fund's positions in companies whose quality, valuation and growth metrics were no longer as attractive as they once had been.

The Fund continues to perform strongly in 2018, even though volatility has picked up as a number of idiosyncratic macro events have occurred, given the unpredictable nature of these affairs we prefer to focus on what we can better control i.e. Stock Selection. This is supported by our research which shows that during periods of uncertainty owning quality stocks can help to protect asset values from market gyrations. To date this has been proven when the Fund's quality style bias swung into action enabling the fund to outperform.

| CALENDAR YEAR PERFORMANCE | 2017 (%) | 2016 (%) | 2015 (%) | 2014 (%) | 2013 (%) |
|---|---|---|---|---|---|
| Davy Discovery Equity Strategy (NET OF FEES) | 14.2 | 10.0 | 13.5 | 14.7 | 20.9 |
| MSCI World Small and Mid-Cap Index (Total Return) | 8.4 | 13.7 | 11.7 | 18.6 | 24.9 |
| CyberAgent Inc | 53.9 | 15.8 | 12.0 | 7.6 | 145.0 |
| Bakkafrost | 5.5 | 35.3 | 62.2 | 85.4 | 61.5 |
| L Brands | (3.9) | (27.3) | 15.8 | 45.7 | 34.4 |
| Micro Focus | 19.6 | 39.2 | 52.8 | 41.5 | 38.0 |

Source: Davy Asset Management (Class A Acc Eur) and Bloomberg as at 29th March 2018. 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.**