Q2 2022 Update

IQEQ

Davy ESG Equity Fund

For Investment Professionals Only

Performance	1 Month (%)	Q2 2022 (%)	1 Year (%)	3 Years P.a. (%)	5 Years P.a. (%)
Davy ESG Equity Fund (net of fees)	-5.62	-8.17	-0.09	11.40	10.98
MSCI World Index[1]	-6.41	-10.80	-2.83	10.09	9.56

Source: IQ EQ Fund Management (Ireland) Limited (Class A Acc in EUR) and Bloomberg as at 30 June 2022.
[1] The MSCI World 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 ESG Equity Fund** (the 'Fund') is to achieve long-term capital growth. We aim to achieve this by using both quantitative and fundamental research that should result in a portfolio of high-quality companies that exhibit strong environmental, social and governance characteristics.

Market comment

The equity market correction which began in early January continued through the second quarter, with the MSCI World Index falling by 10.80% in euro terms. This brought the year-to-date return to -13.53%. Euro-based investors benefited somewhat from a rally in the dollar which supported the euro value of US asset prices during the period.

Market direction during the quarter was dictated in large part by inflation data and increasingly hawkish comments from central bankers about the need for higher interest rates. There was also growing evidence towards the end of the quarter of the negative impact that inflation expectations are having on consumer and business sentiment as evidenced from surveys in major developed economies. Recession risk resulted in a renewal of the traditional performance relationship between bonds and equities: as equities weakened in response to the rising risk of recession, bonds began to rally.

The war in Ukraine is also exacerbating inflationary pressures, particularly in the areas of food and energy. Nevertheless, most measures of broad commodity prices ended the quarter lower as recession fears grew. Meanwhile, China's zero-Covid strategy was in full effect during the quarter, with extended lockdowns in some major cities such as Shanghai driving down China's GDP growth expectations for 2022.

Within the equity market, the second quarter pattern followed that of the first as Technology and Consumer Discretionary stocks underperformed while Energy and Consumer Staples outperformed. The Energy sector was alone in producing a positive return during the second quarter, driven higher by energy prices.

Fund performance

The **Davy ESG Equity Fund** outperformed the MSCI World Index in the 2nd Quarter by 2.63%. The strategy declined -8.17%, net of fees, compared to the MSCI World Index return of -10.8%, In fact the strategy outperformed each month as markets adjusted to concerns regarding inflation, high commodity costs, Covid-19 in China, supply chain bottlenecks and the pace and extent of interest rate rises and whether that would lead to a soft landing or recession. Quality, as a style, to which the Fund is aligned continued to underperform. Stock Selection was the key driver of performance particularly within Technology (Shimadzu, ADP) and Consumer Discretionary (Home Depot, TJX Companies). Selection was weakest within Communication Services (Alphabet) and Financials (American Express, State Street). Asset Allocation took from performance, principally for being underweight the Healthcare sector which outperformed and by being overweight the Technology sector which underperformed. The more defensive sectors such as Healthcare and Consumer Staples outperformed in the down market. Energy was the only sector to post a positive return. Currency also took from performance, mainly due to being underweight the US dollar. The top contributors to return in the quarter were Merck, Loblaws and Total Energies. The Davy ESG Equity Fund is ahead of the MSCI World Index year to date and over 1,3 and 5 years and since inception.

The top five equity contributors to relative performance during the quarter were Merck & Co Inc, Loblaws, Total Energies, Pepsi Co, Unilever NV. The bottom five equity detractors to relative performance during the quarter were Alphabet, American Express, Boliden, State Street Corp, Nike.

Merck & Co Inc. was the top contributor to returns in the quarter outperforming both the market and the Healthcare sector as you would expect in a down market. The US healthcare company is best known for its cancer drug Keytruda, diabetes drugs Januvia and Janumet, and HPV vaccine Gardasil. Q1 results reported in April were better than expected and saw guidance raised for 2022. Merck leads its peers in initiatives to improve access to healthcare, particularly in developing countries where they have pricing policies based on affordability for 40 products in over 120 countries. Merck's ESG performance improved last year following a favourable end to alleged tax issues. Product liability remains a major risk for the sector. However Merck remains a core holding as we see a solid outlook for the company with solid top line and bottom line growth driven by their high margin products Keytruda, Gardasil and animal health.

Loblaws was also a top contributor to returns. The Canadian food and pharmacy retailer reported strong Q1 results early in May as earnings grew a respectable +20%. Although the quarter began with some Covid-19 related lockdowns, sales growth accelerated through the period. We believe Loblaws is well positioned in a time of high inflation as ~60% of their grocery sales come from discount formats which benefit from shoppers trading down. Indeed, their grocery Discount division and hard discount No Frills and Maxi stores experienced strong sales growth in the quarter. Loblaws also released their 15th annual ESG Report. New targets are: to be net zero by 2040 for Scope 1&2 emissions and Scope 3 by 2050, to reduce plastic waste by making all control-brand and in-store packaging recyclable or reusable by 2025, to send zero food to landfill by 2030, to ensure that all cotton sourced in their Joe Fresh apparel division is sustainable by 2025 and that at least 20m plastic hangers become reusable by 2023. We like Loblaws for its defensive qualities in the current macro environment.

Alphabet the global technology giant is a high-quality stock focused on search, advertising, Android and YouTube. The shares declined over -16% in the quarter and was the main detractor to returns. The shares had held up well in the first 3 months of the year. However, positive results in February were undone by mixed Q2 results in April. Search remained strong driven by a recovery in retail and travel and Cloud continued to grow by 44%. However, Youtube revenue growth of 14% disappointed investors. Although YouTube was facing a tough comparable period and pressure from rival TikTok, brand advertisers in Europe also reduced spending post the Ukraine invasion. A new share repurchase plan of $70bn authorised by the company indicates that management remain upbeat and confident. We continue to like the valuation of the business and the long-term growth in their search and cloud businesses. Alphabet is a leader in many areas such as privacy & data security and opportunities in clean technology. However the company remains under the microscope regarding anti-trust, content integrity and workforce diversity where improvements can be achieved.

American Express (AXP), the global payments company, was also a main detractor to returns in the quarter as the shares declined almost 21%. Q2 results reported towards the end of April beat market estimates and showed that travel and entertainment spend had progressed through the quarter and indeed was back to 2019 levels in March. Earnings guidance for the year was also maintained. For 2022 revenues are expected to grow 18%-20% and in excess of 10% thereafter. The weakness in the shares is due to recessionary fears which have being factored into the card companies. This is despite credit growth and loan growth trending better than expected. We continue to like their core business trends and the tailwinds from the recovery in travel and entertainment. AXP is a strong performing ESG company. Given the company handles significant volumes of customer data they must follow stringent data and privacy regulations. The company also has robust cyber security initiatives and training to handle any data security incidents. AXP have also committed to net-zero emissions by 2035 in alignment with the Science Based Target Initiative.

Sample portfolio transactions

We initiated a new position in Iqvia,a leading US-based global provider of advanced analytics, technology solutions and clinical research services to the life sciences industry. They gather health information such as patient records, prescription and promotional data which delivers powerful insights that allows their customers such as pharmaceutical and medical device companies to accelerate the clinical development and commercialization of their products. Iqvia is a high-quality company and we believe that its unique offering can drive sustained growth above the market. The name has been on our watchlist for some time and the pullback in the valuation gave us the opportunity to initiate a position. In terms of ESG issues Iqvia is a leader in protecting individual patient privacy. They also lead their peers when it comes to product safety and quality and have had fewer regulatory warnings also.

The QQE perspective

Last quarter we noted that despite falling equity and bond prices, and the uncertainty generated by the war in Ukraine, investors, by and large, remained confident in the resilience of the economic cycle. This was reflected in the superior performance of the People pillar of our proprietary Quality model. Our Quality model guides stock selection within our equity portfolios. It assigns a quality rank to each stock in a broad universe based on four pillars of Profitability, Persistence, Protection and People.

That confidence was evident through the second quarter as the People pillar continued to perform strongly at a time when Quality, as a style, was out of favour. Towards the end of the quarter, there was some evidence that investors were starting to lose faith in the economic cycle and starting to price in a recession. The most obvious sign was the rally in bonds late in the quarter while equities remained under pressure.

It will be interesting to follow the relative performances of the four pillars of our model in the months ahead as we go through another earnings season in which company managements will describe the current and future business environment. Uncertainty about future economic growth often tempts investors back into Quality companies that can deliver profitable growth for investors. It is this area of the market that we, as bottom-up investors, focus our attention.

Calendar year performance	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)
Davy ESG Equity Fund (net of fees) (EUR)	32.7	7.5	31.1	-1.6	7.1
MSCI World Index (EUR)	31.1	6.3	30.0	-4.1	7.5
Merck & Co Inc	1.8	-7.2	22.3	40.0	-1.5
Boliden	25.2	21.2	36.5	-28.5	20.4
Total Energies	35.5	-22.6	10.8	5.4	-0.3
Pepsi Co Inc	20.54	11.71	27.37	-4.81	17.81
Unilever NV	-1.56	0.03	11.52	3.69	24.65
Loblaws	67.9	-4.4	11.6	13.5	-2.2
Alphabet Inc	65.2	31.0	29.1	-1.0	35.6
State Street Corp	31.1	-4.8	29.3	-34.0	27.8
Nike Inc	18.7	41.0	38.1	19.9	24.7
American Express	36.9	-1.2	32.5	-2.6	36.2

Source: IQ EQ Fund Management (Ireland) Limited (Class A Acc in EUR) and Bloomberg as at 31st December 2021. Performance is quoted in local currency unless otherwise stated.

Warning: Past performance is not a reliable guide to future performance. 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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The Davy ESG Equity Fund (previously the Davy Ethical Equity Fund) is a sub-fund of Davy Funds plc, an open-ended umbrella investment company with variable capital and segregated liability between sub-funds incorporated with limited liability under the Companies Acts 2014, authorised by the Central Bank of Ireland as an Undertaking for Collective Investment in Transferrable Securities (UCITS). The Prospectus, Supplement and Key Investor Document for the fund are available in English from Davy Global Fund Management, Davy House, 49 Dawson Street, Dublin 2, Ireland or https://iqeq.com/ucits. Investors should be aware that some of the Directors of the Company (Davy Funds plc) are also employed by the Investment Manager, Promoter and Distributor. Further information in relation to the management of potential conflicts of interest is available upon request.

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The MSCI World Quality Index is based on MSCI World, its parent index, which includes large and mid cap stocks across 23 Developed Market (DM) countries*. The index aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. The MSCI Quality Indexes complement existing MSCI Factor Indexes and can provide an effective diversification role in a portfolio of factor strategies.

About us*

We are IQ-EQ, a leading investor services group employing over 4,000 people across 24 jurisdictions worldwide. We bring together that rare combination of global expertise with a deep understanding of the needs of our clients. We have the know how and the know you to support fund managers, global companies, family offices and private clients.

*Information correct as of 3 February 2022

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