Q2 2022 Update

IQEQ

Davy Strategic: Global Quality Equity Fund

For Investment Professionals Only

Performance	1 Month (%)	Q2 2022 (%)	Year to Date (%)	1 Year (%)	3 Year (%)
Davy Strategic: Global Quality Equity Fund[1] (net of fees)	-5.57	-10.69	-17.20	-4.19	14.22
MSCI World Index[2]	-6.41	-10.80	-13.53	-2.83	10.09

Source: IQ EQ Fund Management (Ireland) Limited (Class A Acc Eur) and Bloomberg as at 30 June 2022.
[1] Investment Management of the Davy Strategic Global Equity Fund was assumed by Davy Asset Management during the month of September 2018 and subsequently by Davy Global Fund Management in November 2019. On 31 May 2019 the Davy Strategic Global Equity Fund implemented its current investment strategy. For more information please contact IQ EQ Fund Management (Ireland) Limited. On 10 July 2020 the Davy Strategic Global Equity fund changed its name to the Davy Strategic: Global Quality Equity Fund.
[2] 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 investment objective of the **Davy Strategic: Global Quality Equity Fund** is to provide long-term capital growth by investing in global quality equities with consideration given to ESG criteria. The Fund adopts a Quantamental (quantitative and fundamental) approach to select and manage the investments.

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 Strategic: Global Quality Equity Fund** returned -10.69% (net of fees) during the quarter. The strategy outperformed its benchmark MSCI World NDTR in 2Q 2022, in what have been challenging market conditions. Since the start of 2022, markets have been negatively affected by inflation, war in Ukraine and China's recurring lockdowns. The market is laser-focused on inflation levels and likely policy responses by central banks. These concerns were exacerbated in late June when Federal Reserve Chairman Powell responded to questions about inflation as if the Fed had made a policy mistake. This is probably why the ECB, and the Bank of England, have delayed their policy responses, while the FOMC had opted for a more aggressive pre-emptive strike. For our part, we anticipate self-correcting forces will win out and will soon begin to push inflation rates lower as this is a supply-side shock caused by the resumption of the normal course of business activities post lockdown, resulting in fewer rate hikes than currently anticipated. From a style perspective the power of quality as a style was reinforced this quarter with profitability as a factor positively contributing to performance. During periods of uncertainty we believe patience is key which is why we have taken advantage of market conditions in quality ESG stocks whose valuations have become increasingly attractive.

The top five equity contributors to relative performance during the quarter Eli Lilly & Co, Merck & Co. Inc, Johnson & Johnson, Colgate-Palmolive Companies, American Tower Corporation. The bottom five equity detractors from relative performance during the quarter were Alphabet, Apple Inc, NVIDIA Corporation, Microsoft Corporation and Rio Tinto Plc.

Eli Lilly & Co (LLY) has one of the best growth profiles in the US pharma sector due to its new products. It offers products across four core therapeutic areas: diabetes/obesity, oncology, immunology and neuroscience. Its pipeline is well diversified across all core areas with no reliance on any single product which makes the business very attractive and less prone to failures of any drug. Over the next few years LLY, is expected to launch several new drugs addressing its large end markets such as diabesity (Tirzepatide), Alzheimer's (Donanemab), cancer (Verzenio). Analysts expect two of these could achieve sales more than $5bn by 2030. Nonetheless, as a biotech firm it is exposed to high levels of scrutiny, particularly relating to product safety and quality, which the firm manages well. To summarise it is a high-quality stock with a strong drug pipeline and little debt but it needs to improve its product safety and quality from an ESG perspective.

Merck & Co. Inc. is a high-quality US healthcare company best known for its cancer drug Keytruda, diabetes drugs Januvia and Janumet, and HPV vaccine Gardasil. Its 1Q 2022 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.

Alphabet Inc. is a high-quality stock with an BBB MSCI ESG rating. It is a holding company composed of Google and a collection of businesses called Other Bets. Its internet sites are amongst the most visited internet properties in the world, led by visits to its core search engine. Its online advertising platform continues to take share from traditional offline formats, as it is continually developing new offerings, which is helping it deliver growth despite a large base. Though Alphabet's ad business is exposed to an economic slowdown, it is sustaining healthy engagement across its search and YouTube offerings, giving it a stronger buffer than social-media rivals. We continue to like the valuation of the business and the long-term growth in search and cloud, delivering revenue growth of 23% y-o-y, including significant capex and talent investment. Although a leader in many areas such as privacy & data security, with opportunities in clean technology. Alphabet is continuously under the microscope regarding anti-trust, content integrity and workforce diversity where improvements can be achieved.

Apple Inc. is a high-quality stock with its own ecosystem of software and mobile hardware devices with an A ESG rating from MSCI, reflecting the strength of its data security. It is the integration of product + software + service which makes Apple unique. Additionally, Apple sets itself apart with innovative hardware and has increasingly extended this differentiation into chip design, software and applications throughout its entire product offering. Annual reports show it derives 50% of its revenues from iPhone, with 10% iPad, 10% PCs, 20% Services (incl. iCloud, Apple Music, Apple Pay), 10% Wearables, Home and Accessorises. The growth of its installed base helps to drive demand in future years and provides revenue visibility. It is attractively valued with excellent revenue diversification, unique product + service set and strong cash flow generation. Apple, like many stocks in the technology sector, has seen valuations fall YTD and its decision to pare iPhone production amid persistent supply-chain issues is expected to effect full-year revenues.

Sample portfolio transactions

The Fund exited positions in Best Buy Company, Snap-on Inc and West Fraser Timber to fund purchases in higher quality stocks such as Novartis AG over the period.

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 Strategic: Global Quality Equity Fund (net of fees)	36.3	16.0	30.6	-8.6	8.1
MSCI World Index (EUR)	31.1	6.3	30.0	-4.1	7.5
Rio Tinto Plc	0.6	30.6	35.4	0.3	31.5
Microsoft Corporation	34.6	82.3	89.0	-5.4	48.5
NVIDIA Corporation	125.5	122.3	76.9	-30.8	82.0
Merck & Co. Inc.	1.8	-7.2	22.3	40.0	-1.5
Apple Inc	34.6	82.3	89.0	-5.4	48.5
Eli Lilly & Co	66.1	31.0	16.2	40.4	17.8
Alphabet	65.2	31.0	29.1	-1.0	35.6
American Tower Corporation	32.9	-0.5	47.8	13.3	37.7
Colgate-Palmolive Companies	2.1	27.2	18.6	-19.2	17.9
Johnson & Johnson	11.4	10.9	16.2	-5.1	24.4

Source: IQ EQ Fund Management (Ireland) Limited (Class A Acc 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 Strategic: Global Quality 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 Information Document for the fund are available in English from IQ EQ Fund Management (Ireland) Limited, Davy House, 49 Dawson Street, Dublin 2 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.
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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

Reference: TC364_18072022_1

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