

# Davy Discovery Equity Fund

For Investment Professionals Only

Performance	1 Month (%)	Q4 2023 (%)	1 Year (%)	3 Years P.a. (%)	5 Years P.a. (%)
Davy Discovery Equity Fund (net of fees)	7.83	7.24	9.42	1.07	8.57
MSCI World Small & Mid Cap Index' (total return)	6.92	7.40	11.70	6.62	10.70

Source: IQ EQ Fund Management (Ireland) Limited (Class A Acc EUR) as at 29 December 2023.

'The MSCI World SMID Cap Index shown above does not include fees or operating expenses and you cannot invest in it. The MSCI World SMID Cap Index captures mid and small cap representation across 23 Developed Markets (DM) countries. With 5,250 constituents, the index covers approximately 28% of the free float-adjusted market capitalization in each country.

## 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 tend to 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.

the year at 3.9%. Investors are now expecting a 0.25% cut in US interest rates by the end of March 2024.

The US was the best-performing equity region during the year, driven by a strong performance by the so-called 'Magnificent Seven' stocks – Microsoft Corp., Apple Inc., Amazon.com Inc., Tesla Inc., Meta Platforms Inc., Alphabet Inc., and Nvidia Corp. While their contribution faded somewhat in the fourth quarter, the performance of these stocks accounted for 48.3% of the total return of the c. 1,500-stock MSCI World Index during 2023 – an unusual level of performance concentration in such a broad index.

## Market comment

After marking time during the third quarter of 2023, global equity markets reached all-time highs during the fourth quarter, rising by 6.79%. The year-end rally erased all of 2022's losses and brought the return for 2023 to 19.60%. Equity markets were buoyed by rapidly falling bond yields, with the benchmark US 10-year yield falling from a 16-year high of 5.0% in October to finish

Many of the seven stocks are seen as probable winners in the development and implementation of Artificial Intelligence ("AI"). Nvidia Corp., which designs and develops processors that are integral to the advancement of AI, was among the best performers in 2023, rising by 228%. These stocks are represented within the Technology, Communications Services and Consumer

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Discretionary sectors, which were the best performers during 2023.

The Energy sector was the worst performing sector in the fourth quarter as the Brent oil price fell from \$97.4 at the beginning of the quarter to end the year at \$77.0. The price fall was driven by overt disagreements among OPEC+ members about voluntary production cuts to support the oil price. The Consumer Staples sector also suffered as tepid demand and increasing costs resulted in profit downgrades throughout the sector.

## Fund performance

The **Davy Discovery Equity Fund** rose by 7.24% in the fourth quarter underperforming the MSCI World SMID by -0.16%. The relative performance was driven by positive Asset Allocation and Currency. The best performing sectors were Health Care (Sonova) and Information Technology (Endava, Nemetschek) where the Fund is overweight, while the Energy sector contributed too due to the fall in oil prices as the Fund is underweight this sector. Markets rallied strongly in the final quarter driven by speculation that the interest rate cycle has peaked and that a cut in interest rates is possible by mid-2024. This change in sentiment was positive for smaller companies and resulted in them outperforming large caps for the first time in several quarters. Despite this rally, smaller companies are still attractively valued relative to history and to large cap stocks on an earnings basis, trading around 15.8X. We continue to take advantage and invest in attractively valued, quality ESG businesses.

The top five equity contributors to relative performance during the quarter were: Endava Plc, Nemetschek SE, Pinnacle Financial Partners, Sonova Holding AG, and Masco Corporation. The bottom five equity detractors from relative performance during the quarter were: Fox Factory Holding Corporation, Capcom Co Ltd., Energy Recovery Inc., JDE Peet's NV, and Steris Plc.

**Endava Plc (Endava)** assists firms' digital transformation, highlighting the pace and importance of digital transformation. It is exposed to discretionary IT spending, as proof-of-concept

engagements with existing clients, increases the stickiness of client relationships, creating tailwinds to drive margins and growth. Strong quarterly results, beat market expectations as sales momentum and improved client decision-making resulted in a better bottom line number. This led to a rebound in the stock price. Its sales pipeline remains healthy and Endava believes demand is starting to normalize to pre-pandemic levels. Although we are positive on this stock given its expertise in next-gen technologies combined with low exposure to traditional / legacy IT, we took some profits over the period.

**Nemetschek SE (Nemetschek)** specialises in Building Information Modelling ("BIM") software used in the Architecture, Engineering and Construction markets. BIM software optimises the design and building of structures and reduces waste. The BIM market is forecast to grow 9% annually to \$13.2bn by 2027. Nemetschek differentiates itself from competitor Autodesk due to the interoperability of its software with other applications. This enables it to grow its footprint with existing customers and win new users. The stock rose over the quarter when 3Q23 earnings beat market expectations, as management raised their 2023 guidance and seemed confident about business momentum into CY24. This resulted in a recovery in NEMs valuation multiple as investors regain optimism in the move of its business model to SaaS and the greater associated revenue stream visibility.

**Fox Factory Holding Corp. (Fox Factory)** manufactures performance ride dynamics products. These are used in bicycles, side-by-side vehicles, on/off -road vehicles, trucks, all-terrain vehicles, and snowmobiles etc. Products are distributed to Original Equipment Manufacturers ("OEMs") and to consumers through the aftermarket channel. It was one of the worst performers over the quarter as management announced a bombshell 3Q23 earnings report; revenues fell 17% but adjusted EPS was only down ~5%. This soft third quarter was attributed to strikes by the United Auto Workers Union ("UAW") and inventory de-stocking effects in the bicycle channel. However, these negative results were coupled with the surprise announcement of an acquisition in an unrelated vertical, Marucci Sports, a manufacturer of highly engineered

premium baseball bats. We suspect the decline in the share price mostly relates to the Marucci deal as it is expensive and had jolted investors' confidence in managements business focus.

**Capcom Co. Ltd. (Capcom)** is a Japanese producer and distributor of computer games, with franchises such as Resident Evil, Street Fighter and Monster Hunter World. Despite being one of the gaming industry's original players it still has some of the fastest growing intellectual property ("IP"), due to continual investment in its hit franchises. This has led to high earnings visibility and profitability, supporting its valuation. While Capcom looks set to sustain FY2023's double-digit sales growth into 2024, the market is anticipating a softer pipeline over the next 12 months and tougher year-on-year comparable numbers will result in slower growth over the next 12 months. This is why the stock underperformed over the quarter despite strong free cash flow generation.

## Sample portfolio transactions

There were no significant transactions during the quarter.

## The QQE perspective

We have been observing a remarkably high degree of performance concentration within the equity market during 2023. By the fourth quarter it had a name – the 'Magnificent Seven'. These, mostly US-based AI-related shares were driving global equity market performance to a degree not seen in the past. At one point in October these seven shares were contributing 60% of the total year-to-date return of the MSCI World Index.

By and large, the Magnificent Seven companies had strong consistent cash flows or, in the case of Tesla Inc., growing cash flows. Microsoft Corp., Apple Inc. and Alphabet Inc. had also shown earnings resilience through downturns in the past and all scored highly on our Quality model, which is comprised of four sub-pillars reflecting the attributes that we believe will drive long-term performance for our clients: Profitability, Persistence, Protection and People. Investors had been paying up for growth and consistency during the year, which drove the performance of our Profitability and Persistence pillars. However, the Magnificent Seven do not score well on valuation, due in part to the dearth of dividends from the group and relatively high PEs.

We had observed a hiatus in the momentum of these stocks in Q3 of 2023 as our People pillar outperformed for the first time in 2023.

Things changed somewhat in the third quarter when the People pillar, which represents companies that manage their capital well and reward shareholders with distributions, recovered some performance. Sectors such as Financials, Healthcare and Energy are represented within the pillar and these performed strongly during the third quarter before much of that relative performance was given up again as the Magnificent Seven surged again in October and into November. However, in the weeks of the year-end rally the People pillar has held its own. This may be an early sign that the performance concentration which we have seen in 2023 may not be such a feature in the year ahead.

Calendar year performance	2023 (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)
Davy Discovery Equity Fund (net of fees) (EUR)	9.4	-26.0	27.5	9.9	32.9
MSCI World SMID Cap Index (NTR, EUR)	11.7	-13.6	25.6	6.2	29.2
MSCI World Index (EUR)	19.6	-12.8	31.1	6.3	30.0
Capcom Co Ltd.	9.7	57.8	-18.2	123.6	41.6
Endava Plc	1.8	-54.4	118.8	64.7	-
Energy Recovery Inc.	-8.1	-4.7	57.6	39.3	45.5
Fox Factory Holding Corporation	-26.0	-46.4	60.9	51.9	18.2
JDE Peet's N.V.	-7.5	2.4	-25.8	-	-
Masco Corp.	46.6	-32.1	29.6	15.8	66.3
Nemetschek SE	65.6	-57.5	87.7	3.2	85.3
Pinnacle Financial Partners	20.5	-22.3	49.5	2.0	40.4
Sonova Holding AG	27.5	-37.8	57.1	4.5	39.7
Steris Plc	20.2	-23.4	29.5	25.5	-

Source: IQ EQ Fund Management (Ireland) limited (Class A Acc EUR) and Bloomberg as at 29 December 2023. Performance is quoted in local currency unless otherwise stated.

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\*Information correct as of 24 February 2023

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