

FOR FINANCIAL ADVISORS ONLY

# Davy Discovery Fund *from New Ireland*

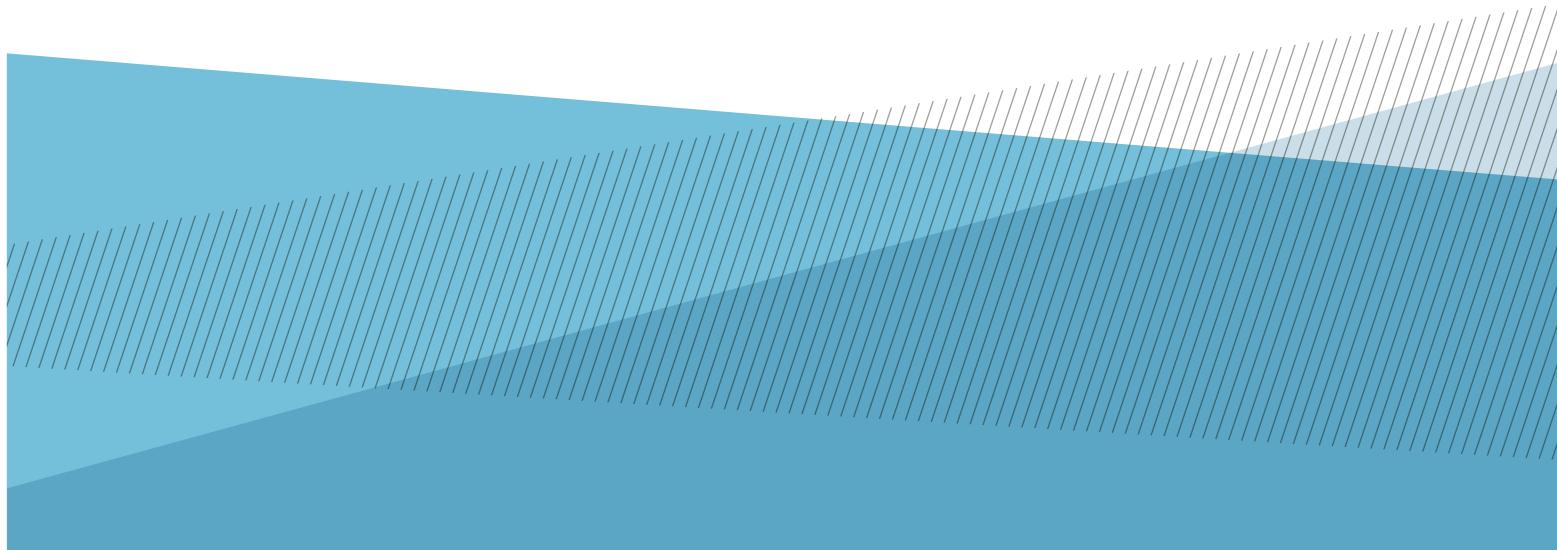


*Davy Asset Management Limited, trading as Davy Asset Management, is regulated by the Central Bank of Ireland.*

A large, stylized graphic in the background. It features a close-up of a compass rose with cardinal directions (N, S, E, W) and intermediate markings. Superimposed on the compass is a line graph representing a stock market index, with numerical values like 11,000, 10,000, and 10,000 visible along the right side. The overall color palette is a cool blue.

Generating **long-term capital growth** by investing in a **diversified portfolio** of medium-sized companies throughout the world.

The investment objective of the fund is to generate **long-term capital growth by investing in a diversified portfolio** of medium-sized companies throughout the world that are growing strongly and represent attractive investment opportunities.



## Fund Overview

### **Investment Objective**

The investment objective of the Davy Discovery Fund (the 'Fund') is to achieve long-term capital growth by investing in a diversified portfolio of **medium-sized** companies throughout the world that are growing strongly and represent attractive investment opportunities.

### **Active Fund Management**

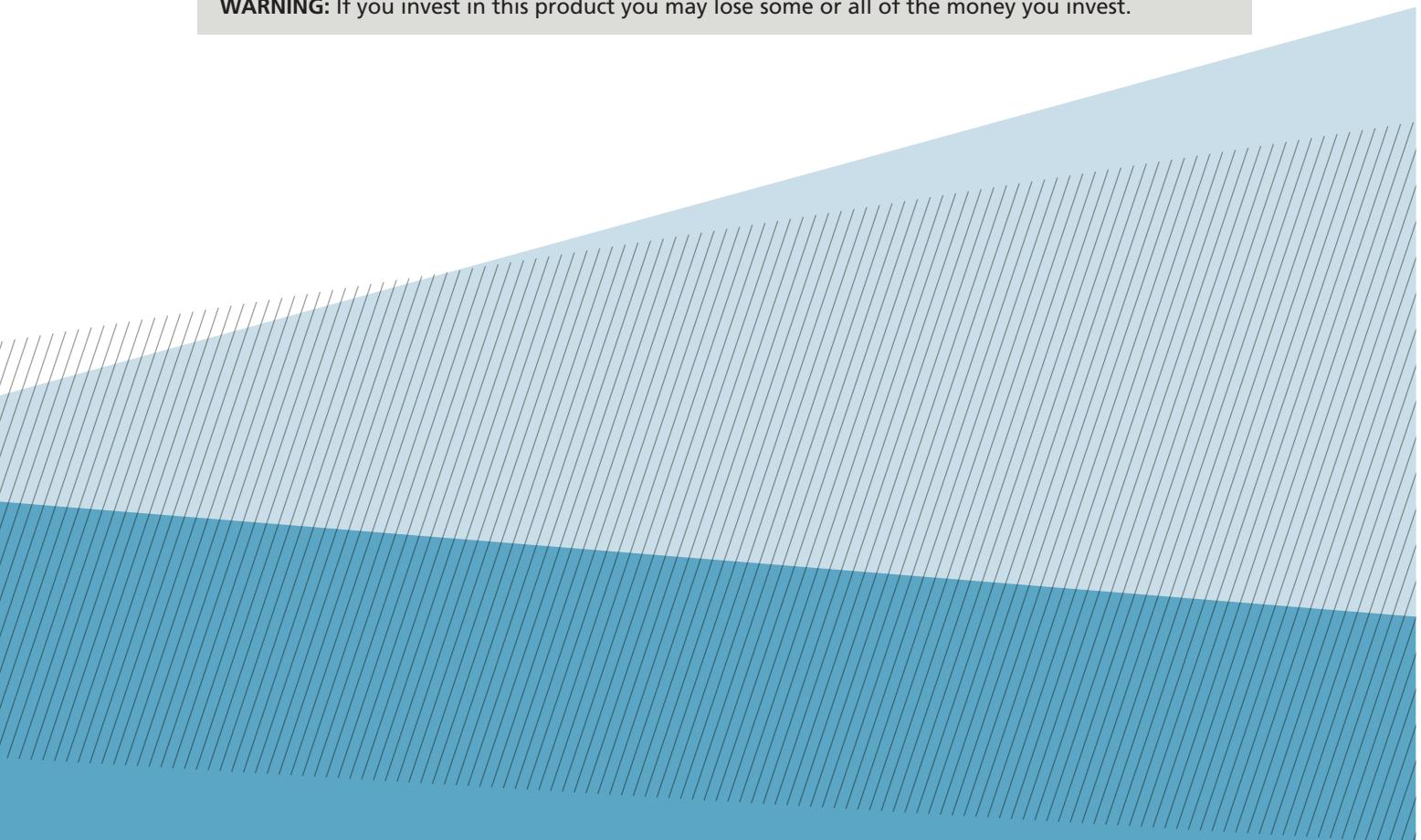
The investment team aims to identify high quality, medium-sized companies that have established profitability early in their life cycle and then to stick with them through their core growth phase. The team utilises a structured investment process to identify companies with the following characteristics:

- *Medium-sized businesses that are established, profitable and growing strongly;*
- *Niche businesses with sustainable competitive advantage; and*
- *Entrepreneurial management teams that are experienced with proven track records.*

### **Conviction with Diversification**

The Fund typically invests in 50 to 70 medium-sized companies. The Fund provides the potential for return enhancement and diversification benefits within an overall equity allocation by investing in a segment of the equity market that typically does not attract as much in-depth research coverage as large capitalisation stocks.

**WARNING:** If you invest in this product you may lose some or all of the money you invest.



# Why Invest in Global Mid-cap Stocks?

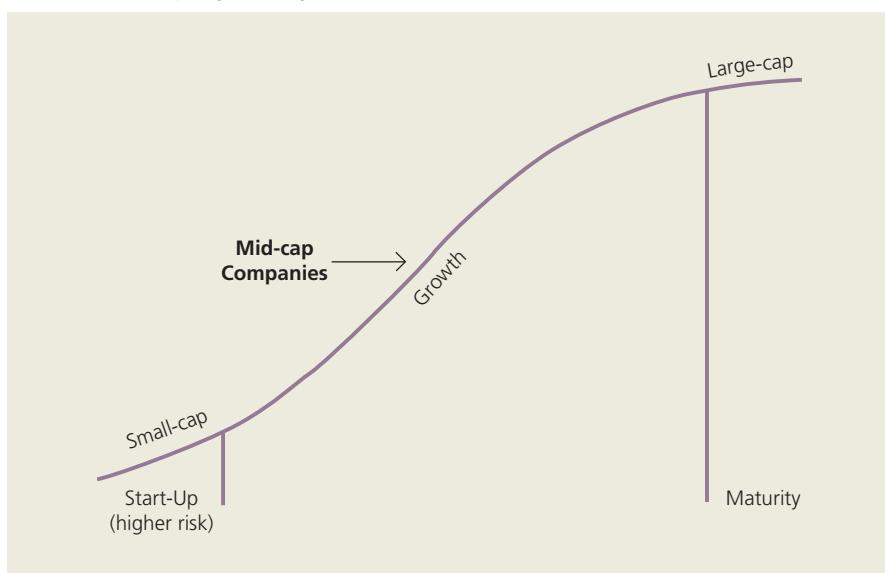
## 1.1 What is a Mid-cap Company?

As consumers, we tend to be very familiar with the products and services offered by medium-sized companies (for example, Paddy Power, Easyjet and Puma). However, evidence<sup>1</sup> suggests, that as investors we generally tend to have limited exposure to the mid-cap segment of the equity market within equity allocations.

Mid-cap companies are companies that have successfully made it past the initial start-up phase, where many companies falter but have not quite made the transition into the high profit stage yet. Investing in these companies just before they become more successful can be a very rewarding and profitable experience. In general we describe mid-cap companies as those stocks that have a market capitalisation between €200 million and €7.5 billion.

In many cases, mid-cap companies are as financially stable as their larger counterparts, yet unlike large-caps, they tend to offer greater growth potential as their businesses continue to develop from less-established entities to more mature companies.

**FIGURE 1: Company Life Cycle**



Source: Davy Asset Management

## 1.2 Why Mid-caps?

**The 'Neglect Effect':** We believe the under-researched mid-cap universe creates an opportunity to potentially identify companies with high returns through detailed fundamental research. The mid-cap segment of the equity market represents a universe of stocks that is frequently overlooked by other fund managers. In addition, analyst research coverage in this segment tends to be lower than in the large-cap space. For example, in the UK, the average analyst coverage for the large-cap space (as represented by the FTSE 100) is 25. However, the average analyst coverage for the mid-cap space (as represented by the FTSE 250) is 12<sup>2</sup>. This 'Neglect Effect' presents an opportunity for return enhancement via stock selection as the universe is currently much larger, with less comprehensive analyst coverage than the large-cap space.

<sup>1</sup> Mid-caps account for 28% of the US equity universe, yet the asset class accounts for only 15% of equity mutual fund assets, according to Morningstar.

<sup>2</sup> Source: Bloomberg.

**Better Growth Potential:** Mid-cap companies typically offer higher earnings / cash flow growth potential than comparable large-caps as their businesses continue to develop from less-established entities to more mature companies.

**More Frequent Merger & Acquisition ('M&A') Activity:** Mid-cap companies tend to present more unique investment opportunities and, due to their size, are more likely to be takeover candidates.

1

On 8<sup>th</sup> December 2014, drug giant Merck said it would buy Discovery holding Cubist Pharmaceuticals for a +37% premium to Cubist's closing level on 5<sup>th</sup> December 2014.

Cubist has said it plans to introduce four new drugs by 2020 to combat bacterial infections that are resistant to other treatments because of overuse. The rising threat of drug-resistant bugs has spurred public health authorities to urge companies to invest in new antibiotics, a field drugmakers had largely abandoned to focus on more profitable therapeutic areas such as cancer or hepatitis C.



2

On 3<sup>rd</sup> November 2014, Laboratory Corp. of America Holdings agreed to buy Discovery holding Covance Inc. for approximately \$6.1 billion, creating a business that performs an unusual combination of routine medical tests and research for drug companies.

The offer represented a +32% premium above Covance's closing price on 31<sup>st</sup> October 2014.



3

On 12<sup>th</sup> September 2014 Danfoss A/S offered to buy Vacon Oyj, a Discovery Fund holding and a Finnish producer of A/C drives.

The offer price was a +13.1% premium to Vacon's closing price on 11<sup>th</sup> September 2014. Danfoss made the offer to ensure its "strategic focus on creating profitable growth." Vacon is a "good match" to this ambition and Danfoss will combine the two companies' AC drive units.



Source: Davy Asset Management, Bloomberg.

The benefits of having exposure to M&A activity are highlighted by empirical performance studies. Studies that look at stock returns before and after merger announcement dates have concluded that targets gain approximately 30%<sup>3</sup>.

While it's important to note that the Fund does not try to identify stocks which are likely to participate in M&A, the metrics used by the fund manager for screening would include several used by professionals operating in the M&A environment.

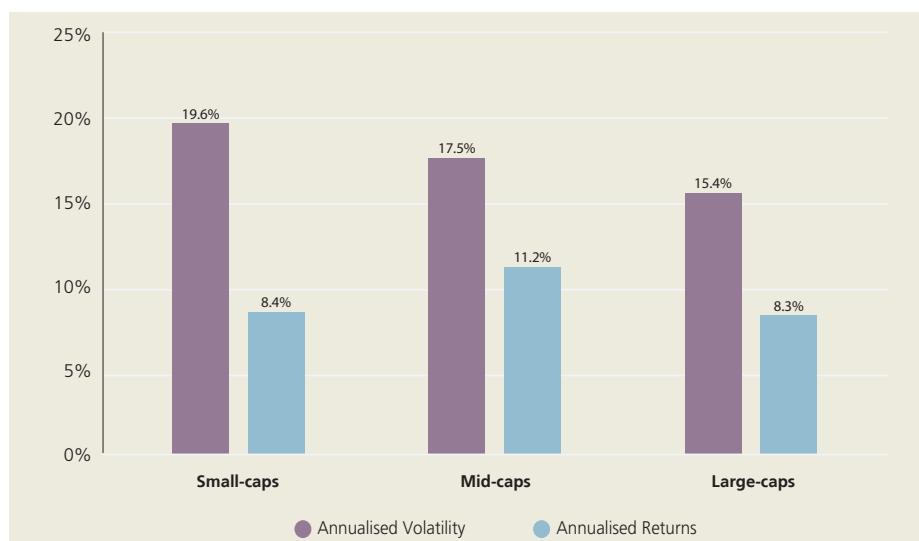
<sup>3</sup> Reference: J. Fred Weston and Samuel C. Weaver, *Mergers & Acquisitions* (New York: McGraw-hill,2001) pp. 96-116.

**Return Enhancement:** In our view, mid-cap stocks sit in a ‘sweet spot’ between large-cap and small-cap. In the 20 years from 1992 through the year ended 2012, the performance of mid-cap stocks, represented by the S&P 400 Midcap Index, was better than that of large and small-cap stocks in the S&P 100 Index and Russell 2000 Index respectively<sup>4</sup>. The risk displayed by the mid-cap index over the period, as measured by the annualised volatility of returns, was lower than the small-cap index but not significantly higher than the large-cap index as illustrated in Figure 2 below.

**WARNING:** Investments in mid-sized companies may involve greater risks than those in larger, more well-known companies. Mid-cap equities generally tend to be less liquid than their large-cap peers and therefore the share price performances of mid-cap equities may be more volatile than that of large-cap equities.

**FIGURE 2: Comparison of returns and standard deviation**

*Mid-caps: better returns than small and large-caps, less risk than small-caps*



Source: Davy Asset Management / Bloomberg, December 1992 – December 2012.

**WARNING:** Past performance is not a reliable guide to future performance.

<sup>4</sup> Please refer to Section 7 ‘Appendix’ for 5-year performance data.

## The Investment Process

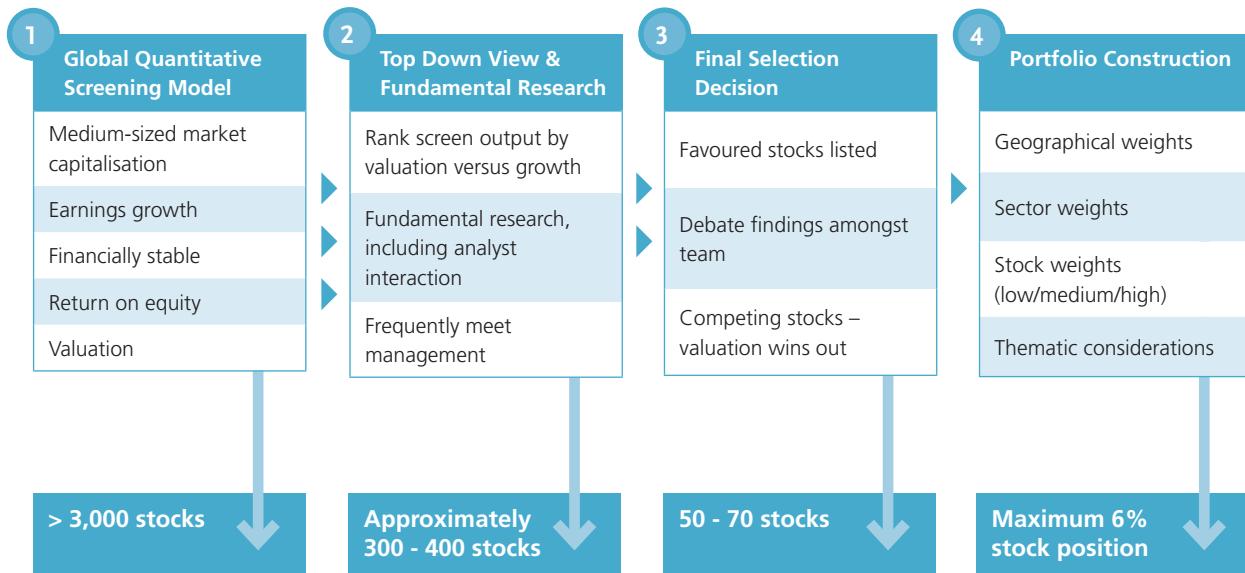
### 2.1 Investment Management Process

Davy Asset Management implements a ‘bottom-up’ stock selection strategy combined with a broad ‘top-down’ input. Our investment approach utilises a combination of both quantitative and fundamental analysis. The Davy Discovery Fund is managed using a strong, disciplined and structured investment process as outlined below.

In broad terms, the Investment Manager is looking to identify the following:

- Stocks which are undervalued relative to future growth prospects
- Stocks which have the potential to maintain valuation levels but deliver upside growth surprises

**FIGURE 3: Davy Discovery Fund Investment Process**



**WARNING:** Please note the factors listed are neither comprehensive nor exhaustive. There may be other factors that influence the investment process.

### 2.2 Global Quantitative Screening

The initial stage of our investment process involves the utilisation of a quantitative screen. The screen is used to filter the broader equity universe into a sub-set of stocks which represents the investable universe for the investment style. The use of the screen provides the team with a focused universe of stocks to research. It also imposes a structure and discipline on the process, ensuring repeatability over time.

Effectively, this screening process narrows the universe to a sub-set of stocks which broadly display the following characteristics:

1. Medium-sized market capitalisation;
2. Established profitability;
3. Not overly expensive in absolute valuation terms;
4. Attractive medium term earnings growth; and
5. Financially stable.

The list of stocks which pass the criteria are then ranked according to valuation and growth potential, which helps the Investment Manager to prioritise names of interest to research.

Following this process, we will have an investable universe of around 300 to 400 stocks.

### **2.3 Fundamental Research**

The investment team undertakes fundamental research on the candidates within the investable universe. This involves industry/sector research, company analysis and valuation work. The team looks to identify the key growth drivers of the sector and business, the competitive landscape, the strategic outlook for the company and the potential risks. Frequently the team will also look to meet company management, competitors, suppliers, etc. Valuation analysis is performed in order to identify a fair value for potential investments.

### **2.4 Stock Selection & Portfolio Construction**

Following the quantitative and fundamental analysis, we endeavour to construct a balanced global portfolio of 50 to 70 stocks. The portfolio is primarily built using an active, bottom-up approach. Whilst it is structured from the stock level up, we would describe ourselves as 'benchmark aware'. Geographic and sector weightings are regularly reviewed to ensure that the Fund remains suitably diversified from a risk perspective.

**FIGURE 4: Examples of Global Mid-cap Growth Stocks**

Sector	Stocks
Consumer Discretionary	 
Technology	 
Industrials	 
Healthcare	 

*Source: Davy Asset Management. This information is provided for illustrative purposes only.*

## 3 Investor Suitability & Risks

The New Ireland policy documentation will contain information on the relevant risks. Potential investors should read this documentation carefully and seek independent financial advice based on their personal circumstances prior to any investment decision.

**WARNING:** The value of your investment may go down as well as up.

**WARNING:** If you invest in this product you may lose some or all of the money you invest.

## 4 Fund Structure

The Fund is a unit linked fund of New Ireland Assurance Company plc and is available through a life assurance policy. The value of an investor's policy is linked to the performance of the Fund. The Fund is available through New Ireland, via its website, [www.newireland.ie](http://www.newireland.ie).

The Davy Discovery Fund is available via the following products:

- *Smart Funds*
- *FutureSave*
- *Trustee Investment Plan*
- *Personal Retirement Bond*
- *Personal Retirement Plan*
- *Executive Retirement Plan*
- *Approved Retirement Fund ('ARF')*
- *Approved Minimum Retirement Fund ('AMRF')*
- *PRSA (non-standard)*

## 5 Summary of Investment Rationale

- The Fund offers investors exposure to a universe of mid-cap equities. Frequently these types of stocks are neglected by other fund managers.
- The investment team is looking to identify quality medium-sized quoted companies that have established profitability early in their life cycle and to stick with them through their core growth phase.
- The strategy offers exposure to attractive secular growth themes such as Energy, Technology, Basic Resources, Healthcare and Environmental Services.
- Mid-cap equities are attractive because they offer the opportunity for both return enhancement and diversification within the equity space.
- Mid-cap companies are attractive for a number of reasons:
  1. a larger universe of stocks to pick from versus large-cap equities;
  2. less comprehensive analyst coverage (the neglect effect);
  3. generally higher growth potential versus large-cap equities; and
  4. more frequent Merger & Acquisition ('M&A') activity.

## 6 Contact Details

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## 7 Appendix

	<b>SPTRMDCP INDEX</b>	<b>SPTR100 INDEX</b>	<b>RU20INTR Index</b>
	<b>Mid-cap</b>	<b>Large-cap</b>	<b>Small-cap</b>
2014	9.8%	12.7%	4.9%
2013	33.5%	30.4%	38.8%
2012	17.9%	16.1%	16.4%
2011	-1.7%	3.2%	-4.2%
2010	26.6%	12.5%	26.9%

*Source: Bloomberg*

**WARNING:** Past performance is not a reliable guide to future performance.



## **IMPORTANT INFORMATION**

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