Baillie Gifford™

International Concentrated Growth Q2 investment update

July 2024

Investment specialists Paul Taylor and Katie Muir give an update on the International Concentrated Growth Strategy covering Q2 2024.

Your capital is at risk. Past performance is not a guide to future returns.

Katie Muir (KM): Hello and welcome to the second quarter update for the International Concentrated Growth Strategy. I'm Katie Muir and I'm joined today by my colleague Paul Taylor and we're both investment specialists for the strategy.

Today, we're going to provide an update on some of the recent performance drivers for the strategy, as well as talk about some of the changes that have been made to the portfolio's positioning.

As a reminder, the International Concentrated Growth Strategy is an active, long-term, high growth focused strategy. We are looking for outliers and the companies that can deliver those types of returns are rare.

So therefore, we focus on finding and building a portfolio of between 25 and 35 of the most exceptional growth businesses we can find in international markets, with latitude to invest up to 15 per cent in US listed companies. And our style of investing can add a lot of value over the long term and you can see that in the strategy's track record.

So Paul, global equity markets reached new highs again during the quarter, and this was [again] led by the US and by some of the big tech companies. Three months is a very short period for our strategy, which has a five-to-ten-year time horizon. But what have been some of the positive performance drivers or contributors to performance more recently?

Paul Taylor (PT): So it's hard to not talk about NVIDIA these days. All roads in generative AI currently lead to NVIDIA but what we've seen during the first quarter - or the first quarter reporting [period] shall I say - is that a lot of the large cloud providers, the hyper scalers as they're being called, the Amazons, the Googles, the Metas, are increasing their capital expenditure by about 40 per cent this year.

So in total, they'll be spending about $190bn. And a lot of that will be dedicated towards purchasing NVIDIA's GPUs for generative AI. This has driven NVIDIA to compete with the likes of Microsoft for the moniker of world's largest company. And it continues to make some really strong contributions to the portfolio's performance.

You mentioned our limit on US equity holdings. We've been having to reduce NVIDIA quite a bit during the quarter to remain within that risk constraint.

KM: OK, thanks. And how about the long term for NVIDIA? How are we thinking about it?

PT: I think it's really important to highlight how we think about stocks rather than how the market generally thinks about stocks.

So we are conscious that NVIDIA is in a very very strong position at the moment with a big supply-demand imbalance. But we're also very conscious that it operates in a cyclical market and that situation is unlikely to last forever.

And there will become a point where NVIDIA will be one where are coming on to talk to clients and that it's featured on the negative side of the performance ledger for one quarter, maybe longer. But we're also thinking that each peak in these demand cycles will be higher than the last.

And our skill set isn't in timing these trades around these cycles. What we aim to be is good long-term holders of great growth businesses. So whilst we've been taking some capital out of NVIDIA, we think it's going to remain a significant feature of the portfolio for some time.

KM: NVIDIA and broader enthusiasm for AI has certainly been a big focus for many. And we've also seen that benefit some other portfolio holdings, ASML and TSMC, semiconductor holdings. And we've been adding to TSMC more recently.

Outside of those companies, what else would you highlight as positive drivers to performance?

PT: Yes, so Spotify's for a very different reason. Over the last two years, Spotify has transformed itself from growing its cost base twice as quickly as it was growing revenues in 2022 to now delivering comparable growth, but much more profitably.

They've, [in] 2023, cut out a lot of layers of management. They’re now much more nimble. They refer to that as ‘removing the work around the work’ and the stock is now up more than 300 per cent over the past couple of years.

But what we're monitoring now is that have they maybe taken a little bit too much off the table? So growth slowed to albeit 19 per cent active users in the first quarter but we've been speaking to management and we're confident that they're taking this very seriously and that they're having to match this balance in terms of cost reduction without sacrificing the long-term opportunity that they've got in front of them. So that's something that we'll be looking at over the coming quarters.

KM: Great so that's some of the positives. What about some of the areas of weakness during the most recent quarter?

PT: So Adyen stands out as being quite volatile over the past year particularly. The first quarter results that they provided to the market showed processed volumes up to $300bn, growing just over 40 per cent. So the growth in terms of the usage is remarkable.

But what they also delivered was revenue growth around the 20 per cent mark. So the question the market's currently asking is, is there a race to the bottom in terms of take rates? We don't think there is.

It's somewhat ironic that they've only just started disclosing quarterly results to help the market better understand their business. But they [their financial results] will be volatile on a three-month basis. And what's happened in the first quarter is that a contract that was signed years ago has only just started to ramp now - this is with Block’s Cash App, particularly in the US.

So they're not having to compete to win business on a short-term basis it's just the phasing of when different revenue streams which had different take rates attached to them ramp. So, we'll be monitoring, [and] our expectation is that as other parts of the business that are higher structurally margins grow, that the take rate will move up again.

KM: Great, thanks. So maybe turning to portfolio activity now, we made a new purchase during the quarter, BYD, which is a Chinese maker of electric vehicles. What are we excited about [with] BYD and its growth prospects over the long term?

PT: Put that into context, BYD is, we think, the leading Chinese EV manufacturer. As a strategy, we've had a long and successful track record of investing in the transition away from the internal combustion engine. We were early investors in Tesla.

And until more recently, we've had NIO in the portfolio, one of the other Chinese EV manufacturers. We've had NIO for about five years. We sold it in March. And it had grown very well over the holding period.

But looking at the structure of the Chinese EV market, it's a pretty tough place to operate at the moment and we had some concerns around their capital allocation decisions and didn't think they were best equipped to weather that storm.

BYD is really, really well suited to winning in this environment. They are vertically integrated, take care of their own battery technology. So they're positioned to deliver the best technology very quickly to customers.

And that's just in the domestic Chinese market. We think there's huge opportunities for them to internationalize as well. Maybe not into the US, where we've seen tariffs of over 100 per cent on Chinese EVs. So that's probably cut off for them. But certainly the European market and we think much of the global south will be a really good hunting ground for them.

KM: Great. So, to summarize, the world needs cheap EVs if it's going to decarbonize. And we think BYD is an important part of the answer there.

PT: Absolutely. Looking at some statistics recently, about one in 10 cars sold in the US is currently an EV. That's one in four in Europe, but it's around 50 per cent in China. But if we're serious about decarbonizing, it's not just those markets that need to shift, it's everybody.

And looking at other large markets, India, Brazil, penetration rates are still low single digit and a lot of that demand we expect to be met with supply from China of which BYD will probably be a significant beneficiary.

KM: Great, thanks Paul. So to summarise we remain focused on the long-term prospects of your portfolio's holdings and on finding the next exceptional growth businesses to add to the portfolio.

Competition for space in the portfolio remains fierce and we're finding some interesting ideas. BYD is a good example of that in some new areas. And we're also very conscious that where growth over the next 10 years may come from may be very different to where it's come from over the last 10 years.

So we remain very open-minded in our hunt. Thank you for watching today and we look forward to updating you again soon.

International Concentrated Growth

Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
International Concentrated Growth Composite	45.2	60.7	-46.4	21.6	10.3
MSCI ACWI ex US Index	-4.4	36.3	-19.0	13.3	12.2

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
International Concentrated Growth Composite	10.3	10.9	11.6
MSCI ACWI ex US Index	12.2	6.1	4.3

Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

Past performance is not a guide to future returns.

Legal notice: MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Risk factors

This communication was produced and approved in July 2024 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited (‘MUBGAM’) is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a “wholesale client” within the meaning of section 761G of the Corporations Act 2001 (Cth) (“Corporations Act”). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a “retail client” within the meaning of section 761G of the Corporations Act.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas Limited is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com