US EQUITY GROWTH: WEBINAR HIGHLIGHTS

Investment Managers Tom Slater, Gary Robinson, Kirsty Gibson and Dave Bujnowski share their thoughts on the investment environment, explain why they believe there is scope for upside from here, and discuss their search for transformational growth companies.

All investment strategies have the potential for profit and loss, capital is at risk.

This communication was produced and approved in May 2022 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.

Ben James (BJ): Hello, everyone, and welcome to this highlight video of a recent webinar we recorded for the US Equity Growth Strategy at Baillie Gifford.

The video features the four managers, Tom Slater, Gary Robinson, Kirsty Gibson and Dave Bujnowski, discussing the long view for US growth in the face of the current environment. In the video, we talk about valuations, some specific stocks, inflation, interest rates and so on, as well as talking about why we remain excited for the long term in US Growth. I hope you enjoy.

Dave Bujnowski (DB): I'd actually like to start any reflections by maybe going back even further than a year to March of 2020 when we convened as a team in what I'd describe as an emergency meeting of sorts. It was a notably calm emergency meeting, but an emergency meeting nonetheless.

The world had just locked down because we'd just come face-to-face with a situation that would deeply disrupt every aspect of our lives as well as the operations of the companies we invest in. And our team met effectively to assess the fitness of the portfolio; how might the fortunes of our companies be affected by the pandemic?

How we went about addressing the challenge then, in March of 2020, is very similar to what we've done over the past year and what we continue to do confidently today.

We're dealing with complex systems, from humanity itself to the economy to the virus. How such systems respond to a once-in-a-century shock is far from clear.

Twelve months ago, we had very little interest in reconstructing the portfolio to benefit from any reopening, nor did we make significant changes to avoid the volatility that might come with that. Again, our focus was on the long-term shifts and outlier opportunities that looked deeper into the future.

Regrettably, this has led to weak performance over the past year, and we feel and share that pain. While fundamentals have remained strong, valuations across the portfolio have fallen considerably and violently.

Fundamentals may be strong now, but are those long-term structural shifts we found so grounding in the March of 2020 and which bolstered our confidence in the long view still in place, or are there changes afoot that will mitigate their strength?

The answer, and I don't mean to be cheeky here, is both. There are absolutely new challenges and uncertainty to contend with, and to be frank, many important questions we don't yet have the answers to.

But the long view, the broad picture, leaves us very enthusiastic about the current portfolio. Amazon remains a top five position with AWS, and we've been increasing our exposure to other pure plays in software, like Snowflake, Cloudflare, HashiCorp, Datadog, Twilio.

But the message I hope to leave you with is that even in unpleasant, troubling times, easily the most challenging in my 25 years of investing, given the fundamental picture we see in this long view, there's still a lot to be excited about as long-term growth investors.

Kirsty Gibson (KG): We commissioned our risk team at the beginning of 2021 to do a review of the academic literature with regard to rising rates and the potential impacts on our portfolio. And what they found was really interesting.

So over the short term, inflation surprises can be negative for great stocks, but over the long term, the evidence is actually inconclusive. And this makes perfect sense because we are investing in real assets.

Most of the value for a growth stock is based upon future cash flows, and under inflationary conditions, those are now discounted at a higher rate. But in the long run, inflation also drives the cash flows themselves higher. However, this is only possible if the companies that you invest in can pass on that inflation.

We believe our portfolio is positioned quite well in this regard, as the businesses we invest in tend to be selling high-value products with high gross margins. And some of the businesses we invest in are able to pass some of this inflation on automatically, for example, Shopify, who make money based upon a take rate of the economic activity flowing through their platforms.

So in the short term, in all honesty, who knows how this is exactly going to play out? But our hypothesis is that over the long run, five to ten years and beyond, inflation is far less important than the structural changes.

We fully expect commerce to keep shifting online, the financial sector will continue to see the unbundling of products, the transportation and energy sector will continue to shift to cleaner and greener technologies, and genomics will continue to drive the personalisation of medicine.

We can also look at the fundamentals of our portfolio. And for the most part, fundamentals have been strong. In terms of revenue growth in 2019, 52 per cent of firms in the portfolio were growing revenues faster than 25 per cent year on year.

In 2020, the year of lockdown, that increased to 60 per cent of the portfolio. And then last year, in 2021, this increased further to 78 per cent of the portfolio. So fundamentals are not just strong. They've been exceptional for many businesses.

But we do recognise that there is a lot of short-term uncertainty right now, and it's not comfortable for anybody. But we have to keep a level head, and we remain very excited about the long-term prospects for the companies that we own in this portfolio.

Tom Slater (TS): There has been a big reset in valuations. If you look at the operating performance of most of the businesses in the portfolio, it has been really strong.

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You had exceptional years in 20 into 21 because of COVID and some of the COVID-related restrictions. But even as these companies are coming up against those tough comparables, they're continuing to deliver really quite attractive growth rates.

For a number of the companies, we're seeing upgrades to estimates, and yet the share prices have come back substantially. So there's very clearly been a reset in the way these companies are being valued.

And if you look at the long-run outcomes, it seems to us that in a number of cases, we really have developed a lot more conviction over the past two or three years in the ability of these companies to execute on those opportunities.

KG: I think it's fair to say that the pandemic drove quite a few companies in the portfolio to grow their revenues at very high rates and that it's fair to say that we expect that these growth rates will normalise as the world returns to a more normal level.

I think at its peak, Shopify was growing over 100 per cent year over year. And in all honesty, that's simply not sustainable over any time frame.

But we have a lot of businesses now that are lapping these tough comps that they faced. But we do believe that these businesses can continue to grow faster than the average company and it's just that they are seeing slightly slower rates than they did during the pandemic.

And I think almost every sector that we invest in is affected by technology-led change right now. And we've talked about this before, but this was going on prior to the pandemic and it was accelerated by the pandemic.

And we believe that it will continue after the pandemic, but that it's not going to necessarily be a straight road. There will be bumps along the way, particularly as companies start to lap those tougher comparisons.

And I think it's fair to say that the environment that we're in now, that when they do come up against the tougher comparisons, that the market can overreact to changes in growth rates. But we believe that over the long term, the conditions are still very favourable for these innovative growth companies.

Gary Robinson (GR): So the healthcare sector is very large. It's very inefficient and it hasn't changed much for the last 50 years. And so it would seem like an area that's ripe for disruption.

I think we might be on the cusp of some sort of generational companies emerging on both the drug development side of the sector and on the tools side of the sector.

So fast-forward to today and we're seeing a new type of drug development company emerge, built on foundational technology platforms.

And Moderna would be one example of one of those sorts of companies, where they have this underlying technology that has broad applicability and they can take the learnings from a single use case, like producing a Coronavirus vaccine, and then apply those learnings across lots of different areas like cardiovascular disease or rare diseases or even cancer.

And so we're very excited about Moderna, not because of the opportunity within COVID, we think it's been wonderful for the company because it's enabled them to invest in the broader platform, but because just of the breadth of opportunities ahead and the potential for increasing returns to scale in the business because of that genuine platform of mRNA technology that it’s built.

DB: I like looking for things that might seem obvious but that are underappreciated. And I think the digital transformation is something that’s very easy to underappreciate.

The term itself, digital transformation, begs one to think of a world that’s migrating from point A to point B, point A being analogue, point B being digital. And I think this can lead one to think that when point B is reached, the transformation is complete. It’s a finite migration. As in, okay, we’ve moved to the cloud, glad that’s done, now on we go.

But this misses the biggest point, which is the magic of this point B, this digital place that you end up in, it’s not an end state. It's really just the beginning.

The digital world, unlike the analogue world, is a world with new, infinitely scalable tools, like data and software and all those things that plug into human ingenuity, that a software developer can tap into to create amazing new innovations that can be put to you in infinitely scalable ways. So I’m really excited about that.

TS: I think one area that’s really interesting is those companies that are applying the tools of modern healthcare that Gary talked about to industrial applications, so the field of synthetic biology.

We took a new holding in Ginkgo Bioworks towards the end of last year. And I think what they’re doing in terms of bringing in a new era of using biological processes to make modern materials could ultimately have a transformational impact on the global economy.

GR: I hope what you’ll take away from this webinar is the excitement that we all collectively have for the opportunities ahead.

There’s lots of uncertainty in the world right now, but we remain really confident in the businesses that we own. And in aggregate, they’re performing well and they’re still very early on in penetrating the growth opportunities ahead of them.

Now, that hasn’t translated into strong share prices recently. Volatility is inevitable in investing though, and it’s how you respond to it that really matters over the long term.

I hope you take comfort from the fact that you know we’re responding to this in our usual way, by staying focused on the fundamentals of the businesses that we own and being patient and trusting that the strong fundamental performance of the businesses will be reflected in share prices in the long term, as is usually the case.

BJ: I hope you found that highlight video insightful. And we’d be delighted to talk to you more about it. So please get in touch if you have any further follow-ups.

In the meantime, please look out for our recent publication, *The Long View*, in which the investment team puts forward what they think are the most important factors driving the next decade of opportunities. Thank you for watching and have a good day.

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Annual Past Performance to 31 March Each Year (Net per cent)

	2018	2019	2020	2021	2022
US Equity Growth Composite	37.6	16.5	1.8	144.2	-28.2
S&P500	14.0	9.5	-7.0	56.4	15.6

Annualised returns to 31 March 2021 (per cent)

	1 Year	5 Years	10 Years
US Equity Growth Composite	-28.2	23.4	17.4
S&P 500	15.6	16.0	14.6

Source: Baillie Gifford & Co and S&P Dow Jones Indices LLC. Net of fees. US Dollars. Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. All investment strategies have the potential for profit and loss.

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