Baillie Gifford™

International Concentrated Growth Q3 investment update

October 2024

Investment manager Paulina McPadden and investment specialist Katie Muir give an update on the International Concentrated Growth Strategy covering Q3 2024.

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Katie Muir (KM): Hello, and welcome to this International Concentrated Growth Strategy update. I'm Katie Muir and I'm an investment specialist for the strategy, and I'm joined today by Paulina McPadden, one of the portfolio managers. In this update, we'll talk about recent performance and some of the drivers of it, and we'll also provide an update on what we've been doing from a portfolio perspective and share some of the new ideas that have been coming in.

But first, a reminder of the strategy. We invest in a concentrated portfolio of exceptional growth companies that are driving transformational change across societies and industries around the world. Our investment horizon is five to ten years in order for that change to translate into financial success.

Paulina, thanks for joining me today. So, starting with performance, the strategy has delivered very strong absolute and relative returns both over the summer months and for the year-to-date. While that's a very short period for us, in the context of our long-term philosophy, what have been some of the drivers of that performance?

Paulina McPadden (PM): Well, you're right. It is a very short period. So, I think it's worth taking a step back and mentioning that over ten-year and five-year time horizons, the strategy performance has also been very strong. Where it has failed a little bit is over a three-year time horizon, we recognize that that's not what we would have wanted to happen.

We have learned some lessons there around things like managing the lifecycle of holdings, thinking about unexpected correlations in the portfolio as well, particularly as a result of the pandemic. But it's worth reiterating that this is a strategy about the next five or ten years of the world's changing. And patience is something that is rewarded if you think in those time periods. Ultimately, we want to own the businesses that are capable of delivering exceptional returns and there are always going to be difficult times when we're looking for that kind of company.

So, two that I would draw your attention to would be MercadoLibre. It's one of the largest holdings in the portfolio and it's been continually bumping up against our 15 per cent limit, so we've been having to actively reduce it over time. It's now back to an all-time share price high, having gone down something like 60 per cent since the pandemic. And that's on the back of the market finally recognising that profitability is up fivefold since Covid. And we've had these sorts of periods with MercadoLibre in the past. For example, when they were heavily investing in logistics, there was deep competition with Amazon for a period of time. But we've continued to have patience and wait for management to realise their vision.

The second company that I would probably mention here is Spotify. And again, shares were down 75 per cent after 2021, but are again at a new peak more recently. That is also on improving profitability, particularly on more recent efficiency measures. The founder, Daniel Ek, is very careful not to call this cost-cutting, because for him it's not about cutting cost, it's about recognising that what really matters is doing the work, rather than the work around the work, and therefore he's removed layers of management effectively. It's also about success in recent initiatives like podcasting and audiobooks, and a recognition that alongside continued growth in monthly average users, there's probably quite a lot of pricing power to this platform. Some of us spend significantly more than 50 hours a month on Spotify, and yet we only pay $10 for it. So, it's really a good benefit for consumers, but Spotify can probably up prices a bit there.

KM: Yes, I have to admit I'm a very happy Spotify customer and didn't mind paying a dollar or a pound more for the service.

Okay, thanks. So, that's some of the positives more recently and year-to-date. What about turning to some of the areas of share price weakness more recently? ASML features this quarter and ASML has been one of the strategy's long-term winners, so really exemplifies the asymmetric returns we look for. Can you provide an update on ASML and how the team's been thinking about position sizing there?

PM: Yes, it's been a very large holding for a very long time. And as a reminder, ASML is a manufacturer of lithography machines, which are pretty much the most complicated equipment on the planet. And they have a monopoly on this technology. And over the last decade-plus, the share of semiconductor capex going towards lithography spending has been increasing as that equipment has become more critical and continuing to push Moore's Law forward, improve computing power, and maintain the pace of change in the world.

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Now, I take a step back and mention that a key part of our process is looking for insight outside the typical financial sources. So, not just sell side reports, but also speaking to experts in the field. And we found our engagement with IMEC, which is an institute based in Belgium that does some foundational research in semiconductors, particularly helpful here. Because over the last year or so, they've been telling us that, increasingly, Moore's Law is probably going to need to be pushed forward by a combination of technologies rather than just one.

And so while lithography remains very important and ASML's position is unassailable effectively, we wonder whether some of that capex spend is going to be going to packaging technologies, for instance. That, combined with recent management change, has led us to start reducing the position and put those funds into TSMC instead.

KM: Great, thank you. And I've spotted your NVIDIA mug there, Paulina. We can't do one of these updates without talking about NVIDIA. So, it's been a very strong contributor to performance and relative performance over the past few years. This quarter, again, it's one of those companies that's had a bit of a drawdown. Can you talk about what's been going on there and how you're thinking about it?

PM: Well, we've held NVIDIA for some time now, and it's been a bumpy ride to get to where we are with $3tn in market cap and multiple periods in the past where I've thought something may have gone off the rails – for instance, with the Bitcoin boom a few years ago.

But I think what the company has created in terms of nearly a monopoly in the foundational technology for generative artificial intelligence. And this virtuous cycle where they have a pool of developers that are used to working with NVIDIA technology in a time when companies like Microsoft and Google need to be pushing forward as quickly as possible. Nobody really has time to train on anything else. And that means that NVIDIA has gotten so big that it's able to put way more money into R&D and finding new use cases for its products than anyone else. I think it's interesting that its main competitor, AMD, is probably loss-making in this particular segment, for example.

Having said that, it's still a hardware company. It's still probably viciously cyclical in the future. So, we don't know when the next drawdown is coming, but it will come. And I mentioned lifecycle management of holdings at the start of our talk, and this is one where it applies particularly well. Over the last 12 months or so, we've been quite active in taking money out of NVIDIA. We've probably taken out about 5 or 6 per cent from the company in recognition of the fact that it's very exciting, it still has a long growth runway, but there will be a period when the hardware cycle turns.

KM: Brilliant, thanks, Paulina. So, maybe moving on now to talk about the portfolio and the positioning and where we've been finding new ideas. We had a couple of new holdings this quarter, Nu Holdings and SEA. What's special about those businesses?

PM: So, Nubank is a Latin American neobank. They've managed to pretty much organically get about half of Brazil's [adult] population using their bank. And they've achieved a two-striker, which I think is really impressive – their costs are 85 per cent lower than incumbent banks and yet they're also significantly more profitable, which is just a really, really good place to be. Lawrence went out to see them earlier this year and came back with renewed enthusiasm, even though the shares have done very well over the last year or two. So, that's a new position in the portfolio.

And SEA is a Southeast Asian ecommerce company with a history in gaming. And there, we've again followed this company since IPO about five years ago, but we're very impressed by the speed of execution, the recognition by management when some things aren't working out and being willing to take a step back. The core gaming business is relatively stable, but they're also exploring opportunities in financial services, for example, which again extends the opportunity set for them going forward. And they're starting to make investments in logistics, which should provide a durable edge in the future.

KM: Great, thank you. And then on the funding side, just to touch on those quickly, we've been trimming some of the larger positions which have been some of the longer-term winners. We also sold a couple of holdings, Genmab and Zalando. What was the rationale there?

PM: So, Genmab is a company that has an approaching patent cliff in 2030-2031 for its main blockbuster drug, Darzalex, and it has a really interesting pipeline of future antibody drugs coming up. However, the timing of those two probably doesn't coincide as we would like it to, and so we've decided to sell that holding.

And then Zalando is a company where we waited for a long time. We felt that the pandemic boom in demand for their platform was very exciting, but perhaps presaged a future that could be just as exciting. Unfortunately, it seems that this is a company that's more mature than we would have expected, and there's just not as much growth to go for in fashion commerce in Europe as we might have hoped.

KM: Great, thanks, Paulina. And thanks for joining us today. So, we've provided an update. The strategy continues to deliver really strong performance both in absolute and relative terms. We've got a couple of new holdings in the portfolio and look forward to updating you again next time. Thank you.

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International Concentrated Growth

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

	2020	2021	2022	2023	2024
International Concentrated Growth Composite	81.5	28.4	-48.9	14.6	41.2
MSCI ACWI ex US Index	3.4	24.4	-24.8	21.0	26.0

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	10 years
International Concentrated Growth Composite	41.2	14.0	13.3
MSCI ACWI ex US Index	26.0	8.1	5.7

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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