CHINA GROWTH TRUST MANAGER INSIGHTS

Joint manager of the China Growth Trust Sophie Earnshaw reflects on the macro drivers of performance for Chinese equities over the last two years, gives an update on the portfolio and explains why the team remains excited about growth opportunities in China.

As with any investment, capital is at risk. Past performance is not a guide to future returns.

This film was produced and approved in June 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

For a Key Information Document for the Baillie Gifford China Growth Trust, please visit our website at www.bailliegifford.com

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I'm Sophie Earnshaw, joint manager of the Baillie Gifford China Growth Trust.

This has been another volatile year for Chinese growth equities. Looking backwards, the returns we have delivered to shareholders over this period have been disappointing. But looking forwards, we feel increasingly optimistic about the asset class, our existing portfolio companies, and the new opportunities available to long-term growth investors in China.

Now, there are thousands of listed companies in China. But for the Baillie Gifford China Growth Trust, we're focused on a portfolio of just 60 of the very best. And by best, we mean those that participate in disruptive and secular trends, and therefore, we believe, are likely to deliver strong growth over the next 5-10 years.

Now, our focus on individual growth companies, and on the long term, means that we think very differently to the market, and we aim to perform very differently to it.

But the key drivers of performance in the last two years have been macro events rather than individual companies.

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Performance

The aim of the China Growth Trust is to outperform our benchmark over rolling 5-year periods. For the year to the end of January 2023, the NAV return was -5.7 per cent, whilst the benchmark return was -2.2 per cent. Our share price return was -7.9 per cent. This follows very weak returns in the year prior. Now, while we expect periods of underperformance on the road to capital appreciation, we are keenly aware that this has been a painful period for our shareholders.
We believe there are three main macro drivers behind the weak performance of Chinese equities:

1. Zero-Covid;
2. The regulatory clampdown; and
3. Geopolitical tensions.

But fast forward to today, and two of these negative drivers have been resolved, while some of the market's worst fears about investing in China have been disproved.

The government has completely dismantled zero-Covid and ended the regulatory clampdown. In addition, it's put forward a markedly pro-growth agenda, reiterated its commitment to wealth creation and its support for the private sector.

Economic growth is rebounding, sentiment towards the asset class has improved and the stage has been set for a strong period of domestic growth.

In terms of relative performance, I'd say it's been a tough time for growth investors in China. The types of companies that did well in share price terms, such as state-owned enterprises, or oil companies, don't fit with our investment philosophy.

But importantly, the companies that we do own have delivered strong operational performance and we believe it is only a matter of time before this strong operational performance is rewarded by strong share price returns.

A good example is Asymchem. It's grown its earnings by over 200 per cent over the last two years, but features as one of our top detractors. The market is overlooking this exceptional operational performance for regulatory reasons that we think don't matter.

So, China is in a good place both cyclically and structurally, the companies we own are performing well operationally, and we therefore think this positions us well for the long run.

That being said, drawdowns and periods of market volatility are the norm rather than the exception for Chinese equities. Indeed, the propensity for volatility has likely been heightened by the increasingly competitive relationship between China and the US. As such, this remains an asset class with big risks and big opportunities, and one that is only suitable for those with the appropriate risk tolerance and long-term time horizon.

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Portfolio update

One of the reasons we're confident in our future performance is that the opportunities for growth investors in China have remained remarkably consistent during this period of volatility.

We believe the China Growth Trust portfolio is geared into these long-term opportunities, and represents a selection of the best and most innovative public and private Chinese growth companies on offer.

Now, these include our investments in:

- companies such as Longi, the world's largest solar manufacturer;
- companies such as Inovance, that are contributing to China's ambition to advance its manufacturing capabilities in robotics and automation;
- 'little giants' such as SG Micro, that are developing technology in strategically important industries such as semiconductors;
- software-related companies, such as Yonyou, that are helping traditional industries become more efficient;
- leading domestic brands, such as Li Ning, that have the scope to challenge foreign brands within China and abroad;
- compounders within the platform economy that continue to add value to consumers' lives;

in short, companies that we believe are likely to contribute to China's development over the next decade.

Now, over the year, we've bought a range of companies that are exposed to these themes, such as Dongguan Yiheda in automation, or Jiangsu Azure in batteries. We've added to a number of stocks on valuation grounds, including Alibaba and China Merchant's Bank. And we've sold a number of our lower conviction holdings, including Tencent Music and Bilibili.

Outlook

To conclude, I want to say thank you for your support. While we know this period has been difficult, I hope I've been able to convey the excitement that we still see in China, and the opportunities open to growth investors there.

We continue to believe that China offers an attractive mix of risk and reward for those investors with the appropriate risk appetite and long-term time horizon.

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Annual Past Performance to 31 March Each Year (%)

	2019	2020	2021	2022	2023
Baillie Gifford China Growth Trust	4.1	-3.2	53.0	-32.7	-12.8
MSCI China All Shares Index*	2.4	-7.4	27.3	-20.5	-0.2

Source: Morningstar and MSCI. Share price, total return, sterling.
*Changed from MSCI AC Asia ex Pacific index to MSCI China All Shares Index on 16/09/20

Please note, Baillie Gifford was appointed by the board to manage what was the Witan Pacific Investment Trust as of September 2020

Past performance is not a guide to future returns.

Important information and risk factors
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.

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The specific risks associated with the Baillie Gifford China Growth Trust include:

- The Trust invests in overseas securities. Changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.

- Baillie Gifford China Growth Trust invests in China, where potential issues with market volatility, political and economic instability including the risk of market shutdown, trading, liquidity, settlement, corporate governance, regulation, legislation and taxation could arise, resulting in a negative impact on the value of your investment. Investments in China are often through contractual structures that are complex and could be open to challenge.

- The Trust's risk could be increased by its investment in private companies. These assets may be more difficult to sell, so changes in their prices may be greater.

- The Trust can borrow money to make further investments (sometimes known as "gearing" or "leverage"). The risk is that when this money is repaid by the Trust, the value of the investments may not be enough to cover the borrowing and interest costs, and the Trust will make a loss. If the Trust's investments fall in value, any invested borrowings will increase the amount of this loss.

- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.

- The Trust can make use of derivatives which may impact on its performance.

- Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.

- The Trust's exposure to a single market and currency may increase risk.

- Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.

- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.

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