

Manager Insights: US Growth Trust

September 2024

Investment manager Gary Robinson shares insights on the trust's performance, strategic shifts towards growth, and the impact of generative AI on the portfolio.

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

Gary Robinson: Hi, I'm Gary Robinson, the co-manager of the Baillie Gifford US Growth Trust.

The trust rose strongly in the year to the end of May. The net asset value was up by 16 per cent, and the share price rose around double this amount as the discount narrowed. Unfortunately, this was behind the benchmark. The S&P 500 index rose by 25 per cent over this period.

We're disappointed to have underperformed the benchmark. In an ordinary year, a 16 per cent net asset value return would have been a pretty good outcome. But the market's been exceptionally strong over the last year. It's also been exceptionally concentrated, with a handful of mega-cap stocks driving the return and mid and smaller companies lagging.

We take comfort from the strong fundamental performance of companies in the portfolio. The aggregate revenue growth rate for the portfolio was well in excess of the market during the period. We know that over the long term, share prices follow fundamentals. This strong fundamental performance hasn't come at the expense of profitability.

Indeed, we've seen a shift in emphasis in companies in the portfolio over the last year, from growth alone to a more balanced approach, incorporating both growth and profitability. You can see this coming through in the numbers. At the end of Q1, over two thirds of the portfolio had either positive free cash flow or positive earnings per share. And this compares to just under half a year ago.

Indeed, we think that the companies in the portfolio coming out of this post-Covid period are a lot stronger than they went into it. Not only have they rationalised their cost bases, they've also evolved their strategies, their organisational structures and their processes.

Take Shopify as an example. Shopify came out of the pandemic with negative free cash flow margins. However, following a period of reorientation, Shopify's free cash flow margins are healthily positive again, and they may even exceed the peak level this year.

Amazon's another example, which was unprofitable coming out of the pandemic in its retail business. However, it's back to being healthily profitable again. And these companies aren't just more profitable than they were. Following their reorganisations, they're a lot leaner, more agile than they were. And this is absolutely critical at this juncture because we're going through a big transition at the moment with the new technological paradigm that's come along in the form of generative AI.

ChatGPT, which was launched at the end of 2022, threw generative AI into the spotlight. And we think this attention is warranted. This is one of the most important technological developments in the last century. Generative AI is already exceeding humans in certain tasks, and it's improving at a remarkable rate. We think it's got the power to transform large swathes of the economy.

There are many companies in the portfolio which are looking to incorporate generative AI into their business models to improve their products or become more efficient in their cost structures. Shopify, again, has launched a new product called Sidekick, which is like an assistant for merchants that helps them to navigate the product and run their businesses better.

Social media platform Meta is using AI to improve its advertising tools and to hone its content recommendation algorithms. And language learning app Duolingo has launched a new AI-powered subscription tier, which is enabling its customers to have spontaneous foreign language conversations with AI chatbots.

It's not just in the application layer that we've made investments into companies that are using AI. We also invest in some of the infrastructure providers that are powering the AI revolution, such as NVIDIA, the chip provider, and Amazon, through its Amazon Web Services division, which is powering some of these AI models.

Portfolio update

Portfolio turnover remains low, and it's consistent with our long-term time horizon. For a full list of transactions, please see the annual report.

To give you a sense, we bought a new holding in Block. Block owns the merchant software company Square and the consumer financial services app Cash App. It's always been a great product company, but historically it's been run with a lack of financial support. However, this appears to be changing.

Under the leadership of founder Jack Dorsey, the business has become a lot more focused and has been run to much more stringent financial targets. It now has an employee cap in place, and it's really focusing its business around just a few core tasks. As a result of this, Block has become a lot more adaptable and a lot more innovative, and ultimately we think it's going to become a lot more profitable as a business.

We also added a few other names to the portfolio during the period. We bought a new holding in Insulet, a provider of pumps for diabetics; Guardant Health, a provider of molecular tests for cancer; and Yeti, the consumer brand that makes durable coolers and drinks containers.

To fund these purchases, we made several sales. These include Twilio, the communications provider. Zoom, the video conferencing app. We also reduced some larger holdings in the portfolio, like Shopify and NVIDIA, which had an exceptionally strong run in their share prices.

Looking forward

The market backdrop remains volatile and the future is still very uncertain, as always. But we are continuing to do what we've always done with this fund, and that's to try and identify and own the exceptional growth companies in America.

One of the features that exceptional growth companies have in common is adaptability. That's because if a company's going to thrive over the long term, it needs to be able to navigate the market challenges and technological transitions that will inevitably come along the way.

In this context, the transitions that we've seen at the likes of Shopify, Meta, and Block are very encouraging in this regard. They've come out of these transition periods stronger and more adaptable, which positions them well for the future. We think this characteristic of adaptability will be found in the exceptional growth companies of the future, and we believe we own many of these types of companies in the portfolio today.

We also still firmly believe that America is the best place to find such exceptional growth companies. The US is the innovation capital of the world. In previous technology waves like internet and mobile, it was the US companies that drove us forward. And it's the US companies that are driving us forward this time again in new areas like artificial intelligence and space.

We own many companies in the portfolio with exposure to these themes, and we believe that they have the potential to deliver exceptional returns over the long term if they execute on these opportunities.

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

	2020	2021	2022	2023	2024
Baillie Gifford US Growth Trust (Share price)	51.4	66.3	-57.5	2.8	31.2
Baillie Gifford US Growth Trust (NAV)	46.9	67.9	-46.5	6.5	17.7
S&P 500 Index	10.7	25.9	1.7	14.2	25.3

Source: Morningstar, S&P. Total return in sterling.

Past performance is not a guide to future returns.

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The specific risks associated with the 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.
- Unlisted investments such as private companies, in which the Trust has a significant investment, can increase risk. 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.
- The aim of the Trust is to achieve capital growth and it is unlikely that the Trust will provide a steady, or indeed any, income.

Further details of the risks associated with investing in the Trust, including a Key Information Document and how charges are applied, can be found in the Trust specific pages at www.bailliegifford.com, or by calling Baillie Gifford on 0800 917 2112.

Definitions:

- Free cash flow (FCF): a company's available cash repaid to creditors and as dividends and interest to investors.
- Earnings per share (EPS): a company's net income subtracted by preferred dividends and then divided by the number of common shares it has outstanding.
- Aggregate revenue growth rate: the total growth rate of income generated from business operations for all companies in the portfolio