Baillie Gifford™

# Global Income Growth Q4 investment update

January 2024

**Investment manager James Dow and investment specialist Seb Petit give an update on the Global Income Growth and Responsible Global Equity Income strategies covering Q4 2023.**

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**Seb Petit (SP)**: Hello and welcome to this investment update on the Baillie Gifford Global Income Growth Strategies. I'm Seb Petit, I am an investment specialist and I'm joined today by James Dow, portfolio manager and head of the Global Income Growth Team.

So, James, the year 2023 ended on quite a strong note and on market highs, particularly as investors got excited about the prospect of interest rates starting to be cut by the central banks over the coming months.

Our portfolio has had a strong uplift in the quarter and performed in line with global equity indices. Can you talk a little bit about performance in the quarter and what has driven those returns?

**James Dow (JD)**: Yes, I can. I would say you're absolutely right, that markets ended the year quite strongly, and I agree, I think it was some of the sentiment around equities and [the] prospects for future growth improved with inflation dissipating and so forth. And the strongest returns in the portfolio came from the more economically sensitive parts of the portfolio.

So, the industrial companies like Atlas Copco, Fastenal, the US industrial distributor or Partners Group, the Swiss private equity manager, which is a little bit economically sensitive as well.

Those types of business, as folks perhaps cheered up a bit... There was a lot of malaise around “we're going to have a terrible hard landing in the economy” and actually, it looks now like we may be able to avoid that. Inflation is receding, and as that lifted spirits, some of those economically sensitive names in the portfolio performed particularly strongly. People remembered that they're actually rather good businesses and they've got good fundamentals ahead of them.

Now, on the flip side, I will say that there were some names in the portfolio which performed less strongly. The more defensive names that suddenly weren't so exciting, the ‘consumer staples’ holdings we have, like Procter and Gamble, for example, or L’Oréal, that kind of name.

[I would] also pick out the China-related holdings. The market is still very agitated by the risks around geopolitics in China. Those names were less strong, but I think that's as you would expect over such a short time period in a diversified portfolio. There were some parts of the portfolio that did rather well, there were others that did less well.

**SP**: Thank you. Now, in terms of transactions, this was a relatively quiet quarter. The sale of a Chinese company, Want Want, and a reduction in Novo Nordisk, the Danish pharmaceutical company, which remains a large holding, but where we reduced the position. What were the rationales for those two?

**JD**: So let's start with Want Want. This was an investment we made about ten years ago. And when we invested in the company… it's the top brand in Rice Crackers, which is a big category for consumers in China, and also in beverages. So we invested in this leading company ten years ago and our expectation at the time was very much double-digit revenue and profit growth for many years to come.

And it just hasn't happened. It has grown a bit, but it's never reached the heights that we thought it would and that compound result that we look for. For a while, we thought that this was largely [due to] some sort of cyclical factors and channel changes in the market going on. Management were taking some positive actions and we thought we'd just give it time and be patient.

But the reality is, as we've monitored it, the growth just continues to be a bit underwhelming. I think the honest answer is that the market is just quite saturated for these products in China and got quite competitive. And I'm not sure that the innovation strategy of the company is as good as it could be. It's a bit scattergun.

So, Ross went out, as part of a number of companies he visited in China at the end of last year, [and] had more meetings with them. We discussed it further and decided we should just be able to do better than this in the portfolio and it was time to move on and reinvest the proceeds elsewhere.

So that was one. Novo Nordisk [is] a much simpler explanation. The company has continued to deliver strong results and guidance. It raised its revenue guidance once again recently on new products selling very strongly, and the shares responded very positively to that. And once again, it has gone through the risk limit that we have. We value diversification in the portfolio and we won't let anything become more than 5 per cent of capital or income.

And so, I think it's the third time in the year that we trimmed it back a little bit just to bring it back below that guideline. [We are] still very keen on it, [we] still think it has great prospects for years to come, [it's] still our biggest holding, but we reduced it a bit to recycle some of the gains into other holdings elsewhere in the portfolio.

**SP**: Thank you. I want to take a slightly longer perspective now and look at the full year 2023, which started with low expectations but turned out to be quite a good year for equities. Global indices were up more than 15 per cent in sterling. Our strategy slightly lagged but delivered strong absolute returns. How do you reflect on 2023?

**JD**: Well, I guess we always try to bring it back to: "what are we trying to do for clients?". And the answer to that is: with these strategies, we're trying to grow our clients' capital and income sustainably over long periods of time. So that starts by looking back on any year [and asking]: which of the holdings delivered on that, did they deliver the kind of steady growth that we look for in earnings, which we think will drive capital growth and dividends over the year?

And looking back on the year, in the vast majority of cases, the answer to that was yes. Of our 50-something holdings, I think about 40 of them delivered solid profit growth during the year. There were another dozen, I would say, where profit was down year on year.

When we look through those, [for] a lot of them, it was due to strong trading during Covid. For example, lab testing companies saw a lot of business during Covid, [so did] transportation companies. So those that saw profits fall, I think in many cases, it was just a sort of normalisation or a cyclical effect.

So, there's probably about half a dozen names in the portfolio where, looking back on 2023 and recent results, we've got a bit of a question about the long-term growth there and whether they [are] really delivering. Those are a priority for our research in 2024.

But the vast majority of the holdings that we own are delivering on that remit, we're confident about that continued steady progression of earnings and dividends and [are] happy with those.

**SP**: Thank you. Now we know some clients come to us and invest in our strategies for the total return approach. Some others come to us for the income growth we deliver. [What will] that income growth look like for the year 2023?

**JD**: So, the accountants, as we speak, are still triple-checking the numbers at the end of the year on this. But it looks like, in ballpark terms, the ordinary dividends of the company – the sort of regular, repeated dividends of the company that we track – are going to be up somewhere around the low-to-mid single digits year-on-year. That [kind of] growth rate.

The thing that stands out to me, from last year, is the special dividends that we get paid. And remember, most of the companies we own are very cash generative, and [have] an abundance of cash flow that pay out these dividends. [So], often we get additional special dividends; one-off dividends from them. But those were actually very low last year.

They're typically about 5 per cent of portfolio income, but they really dropped away last year. I think just a coincidence of timing rather than anything else following a strong year before. But what that means is that the ordinary dividend growth was [in] the same mid-single digits range.

The distributions that we make during the year will probably be about flat due to the absence of those special dividends. But the underlying progression remains pretty good.


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For the year ahead, my expectation would be that we'll start to see a few of those specials come back and the ordinary will continue marching on, and so we would expect 2024 to get back into that sort of typical 5 to 10 per cent income growth range.

**SP**: Thank you. Changing tack slightly now and talking about ESG. Is there any piece of engagement or research you'd like to highlight for the last quarter?

**JD**: Well, one that sticks in my mind is TSMC, the semiconductor company, because that's a company where, as you're probably aware, manufacturing semiconductors is quite an energy-intensive process and therefore the emissions from the electricity generation can be quite high. And particularly for TSMC, which, being based in Taiwan and the particular resource endowment on that island, is quite fossil-fuel dependent.

And so, we've been quite keen to see TSMC get ambitious in its targets to decarbonise its operations. Not least because we think that it could be a really important competitive advantage for the company in the long term, because a lot of its customers are looking for their suppliers to green their supply chain and to decarbonise their own operations.

We spoke to a lot of academics in Taiwan trying to understand the nuances of the issues there, and we spoke quite a lot with the company about that. When we saw the CFO, for example, during the year, we were encouraging the company [to] please spend the money on doing this. We think this is really a worthwhile investment. And that's exactly what we've seen over the over the course of the year.

The company [is] installing new solar capacity, generally working really hard and ambitiously to decarbonise. And in fact, towards the end of the year, we actually saw them bring forward their net zero target by ten years and significantly up their interim targets for emissions reductions. And I bring that one up just because it's really great when we can see the sort of win-win of reducing emissions, making customers happier [and] improving your competitive advantage.

We love to see our holdings really get on the front foot with that and take advantage of that. So that was good to see.

**SP**: Thank you. Now the last question is about the year ahead. 2023, as I said, started with rather low expectations [but] turned out to be good for equities. This year, what [are] you [looking] forward to? Where do you see most opportunities going forward?

**JD**: Yes, this is always the time of year when people say: "what's the macro going to do?" and [I'd] say: "well, you tell me". The central banks have reams – vast armies [even] – of forecasters, who can never predict what's going to happen. And it's a tough one, [to know] what's going to happen.

But what I would say is this: focus on what you own. That's certainly what we're doing. Focus on the businesses in your portfolio.

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Do you think that they are financially strong, well-managed companies with great growth opportunities ahead of them? Where could you find more of those? Are there some that are lagging a bit and are there opportunities to upgrade the portfolio and buy even stronger businesses?

So, I'm not quite sure what 2024 will bring in terms of economics and so forth, but I'm pretty confident that we've got a good portfolio already. We're working on five or six names really actively right now, which we're genuinely intrigued and excited by. That could come in and potentially make the portfolio even better during the course of the year.

I think whatever happens with the macro backdrop, we know that this is a pretty resilient portfolio. It's been stress tested a number of times, not least during Covid. So, whatever pans out that way, [it] should be fine. Optimistic would be one way to sum it up, with the holdings that are already there, [and] the opportunities that we see.

**SP**: Thank you, James, for this update. Three key messages I retain: positive performance in the last quarter of the year caps a year of strong absolute returns for our strategies.

The second message is that the vast majority of our holdings have continued to deliver solid earnings and dividend growth this year.

And the last message is about macro economy and the fact that whatever happens, we are confident that the portfolio is composed of companies that can deal with a lot of different situations.

Thank you for listening and thank you, James again for your time.

## Global Income Growth (including Global Income Growth and Responsible Global Equity Income strategies)

### Annual past performance to 31 December each year (net%)

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Global Income Growth Composite | 27.8 | 18.9 | 19.2 | -17.1 | 20.0 |
| Responsible Global Equity Income Composite* | 28.7 | 18.0 | 20.7 | -17.4 | 22.5 |
| MSCI ACWI Index | 27.3 | 16.8 | 19.0 | -18.0 | 22.8 |

### Annualised returns to 31 December 2023 (net%)

| | 1 year | 5 years | 10 years | Since inception |
|---|---|---|---|---|
| Global Income Growth Composite | 20.0 | 12.5 | 8.0 | N/A |
| Responsible Global Equity Income Composite* | 22.5 | 13.2 | N/A | 13.2 |
| MSCI ACWI Index | 22.8 | 12.3 | 8.5 | 12.3 |

*Inception date: 31 December 2018.
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.

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