Today we're talking with Lee Qian, comanager of the Keystone Positive Change Investment Trust. My name is Richard Lander of Citywire and I'm going to be talking to Lee for about 20 to 25 minutes about how he and comanager Kate Fox run the trust. So welcome, Lee, how are you?

I'm very well, thank you, Richard. It's good to be here.

It's a good time to talk to you because it's just about three years since you and Kate Fox and indeed, Baillie Gifford took over running the trust. So how would you describe the changes you've made since taking over responsibility for this trust?

Yes. So, a quick reminder for everyone about the philosophy for Keystone Positive Change. Our aim is to satisfy two objectives. One is to generate attractive long-term investment returns. Then the second objective is to contribute towards a more sustainable and inclusive society. On the investment objective, when we say attractive, we define that as outperforming the global equity benchmark by 2% per year over rolling five year periods. When it comes to sustainability, we are focusing on investing in businesses that are delivering products and services needed for a more sustainable future. Examples of that include Moderna, which are leveraging on new medicine technology to deliver vaccine and a range of novel therapeutics.

Companies like Duolingo, which is improving language learning and education with their smartphone app and Northvolt, Europe's leading battery startup that is contributing towards expanding the supply of batteries. A critical component of a clean energy future. So, when we took on the trust, there was three changes we made. First, we moved the trust from one that focuses on UK companies, to a global investment trust. So, we can invest in companies across the world, no matter where they are, from the east coast of China, to the west coast of US and indeed, anywhere in between. So, we are opening up exciting investment opportunities to the trust shareholders. Second, we are focusing on companies that are contributing towards a sustainable future.

We think this also helps to enhance our ability to deliver the financial objectives because companies that are contributing to a better world, that are creating products and services needed for a sustainable future are more likely to be met with stronger demands for their products and services.

They are also more likely to have loyal customers and more motivated employees so they'll have a stronger competitive advantage. Then the third change is, we have increased the investments in private companies. We've used the closed-ended structure of the Keystone Positive Change as a unique ability to invest in private companies that are also making a positive impact on society. So today, we have invested in five private companies with around 6% of the trust's assets dedicated to private companies.

Excellent. So that is quite a radical makeover you've given the trust in the three years in charge. You've talked a lot about those two, those twin criteria that you're looking for, which is one is great for your investors, one is great for the rest of us. The big question is, how do you go about finding those because they're quite rare companies that can fulfil both briefs?

They are to an extent, rare, but also, encouragingly becoming more common as well. We are seeing more and more companies, especially some of the startups today, that are very mission focused and it gives us optimism both about the future and our ability to invest in them. So, in terms of how we go about and find companies that satisfy both of the objectives, we start off with the idea generation. For Keystone Positive Change there are four impact themes which help us to focus our attention in terms of searching for new companies on areas where businesses can have a positive impact. So, the first impact theme is social inclusion and education, where we are looking for companies that are creating a fairer society with a focus on access to information, education and improving living standards in a sustainable and inclusive way.

The second impact theme is environment and resource needs, where we are looking for companies that are reducing the negative environmental impact of human activities, as well as those companies that are improving access to basic resources like food and water. The third impact theme is health and quality of life, where we are looking for companies, including like Moderna, that are contributing to novel ways to improve how we are diagnosing and treating diseases. Finally, the last impact theme is base of the pyramid. Where we are looking for companies that are meeting the basic and aspirational needs of people on low income across the world. So those are the four areas which the trust focuses on and those four impact themes or lenses help us to focus on research on areas that were more likely to meet our two objectives.

So that's the first part. Then the second part is our research process, which we think is very robust and differentiated. When we do our research, there is a dedicated investment research process and, also, a dedicated impact analysis. Those two research help us to analyse in-depth, a company's ability to deliver financial success, as well as their contribution towards a more sustainable future. The two research are done by two separate people to ensure there is objectivity in the analysis.

Then those reports are presented to the team. Those are robustly debated and we make sure that the investment and impact thesis are well tested before we make our investment decisions.

So, you mentioned in the introduction, companies like Duolingo, Mercado Libre and, also, Remitly, which has done very well for you in the last year. All those companies have done well. What is the single common thread that you see running though companies like that?

I think one common thread across those three companies is their mindset around disrupting their industry. They are all managed by passionate founders who saw an opportunity and to use technology and innovation to improve how customers are served. So, use Remitly as an example. This is a business that is improving remittance services for migrant workers across the world. So traditionally, if you want to send money back home to your family and friends, you have to go to a Western Union or a MoneyGram, one of those offline branches hidden away in a corner shop. You have to give them cash. They take your cash and it can often take a couple of days before your family actually receives the money.

Because the whole process is offline with different middlemen in between, it's also quite expensive. On average, 6% of the money is taken as a fee. So, for every $100 that's being sent, the recipient only gets about $94. What Remitly has done is using smartphone and mobile app to digitalise the whole experience. So, people no longer have to go to an offline branch. Everything can be done on a smartphone app. This is much quicker and most [marker 0:10:00] of their customers receive the payments in hours, not days. It's also cheaper relative to the fees of Western Union. Remitly's fee in half of that. So, a significant saving for customers.

So, I think those are companies where there are opportunities to leverage on technology, to provide a service that's fundamentally and significantly better than the status quo. All of those companies are successfully taking market share away from incumbents and legacy providers that are less well positioned to satisfy customer demand.

Obviously, it's great for you and Kate when companies come out with good news flow and growth and getting towards profitability or being profitable like some of those. Less great when you have someone-, we had the shock with Orsted this year. A brilliant company trying to install wind power across the world. Terrible shocks about installations in the States and Europe. The share price fell. What do you do in a case like that? Do you double down? Do you get out? How do you decide whether to carry on the investment in a company like that, after a bad news event?

One company faces an obstacle, which inevitably, it happens to a lot of businesses. Our approach is to revisit the fundamentals of the company. Go back to our core investment thesis and analyse them, to see what has changed. So, for Orsted, what we did last year, when the bad news came out, we arranged calls with the company to find out the exact causes of the challenge. As we found out, quite a lot of that was happening in the US, where their projects were getting delayed due to permitting difficulties and in an environment of high inflation and supply chain challenges, this is causing a negative valuation impact on those assets. So, we try to understand, in as much depth as possible, the exact causes of challenge.

Then, trying to see whether those are near-term blips or an indication of much bigger problems that might derail our investment thesis. So, for Orsted, we reviewed the long-term fundamentals, the long-term growth opportunity. We are still convinced that building more offshore wind is necessary for us to meet our sustainability target and expand access to clean and renewable energy. So, we think the growth opportunity still exists. Where we then had much more questions are around capital allocation of the company. Why did the business keep investing in a lot of money in the US project and have committed capital to that supplier, when they knew there were delays and difficulties with those projects?

So, our confidence and conviction on the management team able to continue to allocate money sensibly have diminished significantly. On the back of this review, we did exit the position for Orsted because we have lost conviction on capital allocation. So, there was a very robust research process behind it, to review the investment case. It's not a decision that's taken lightly. We are not reactive to news flow, but when the investment updates give us reason to believe that the investment case has broken, we would move on and redeploy the capital to more attractive opportunities elsewhere.

Just to stay on that for a second, you've left Orsted, but you still have faith in the offshore wind sector. Are you looking at new investments there?

We continue to look for opportunities in the transition towards a renewable future. We think there are investible opportunities. A good example, we briefly mentioned Northvolt, the battery manufacturer based in Sweden, but is expanding rapidly in other regions and countries as well. We think the buildout of a renewable energy system will mean significant investment will go into this sector. We think that there will be attractive investment opportunities like Northvolt, for example.

Let's go back to some good news and talk about great investments. What is your favourite company right now in the portfolio?

One of my favourite companies and one that might not be widely appreciated is Autodesk. Autodesk is a leading provider of design and construction software for the architecture, engineering, and manufacturing end-markets. The construction and building industry is very inefficient and there is a lot of waste every year. At the same time, buildings need to become more energy efficient as well so that they use less energy and are responsible for less emissions as well. Autodesk helps to meet both of those objectives. Its design software is increasingly incorporating AI and machine learning to help architects to design more energy efficient buildings, to select materials that are more sustainable and to reduce the environmental footprint of the buildings they design.

At the same time, Autodesk is also releasing a range of construction related software that helps people who actually put up the buildings to communicate and collaborate more effectively. This helps to reduce errors and reduce waste and as a result, reduce a lot of the negative environmental impact of the construction activity. This is a very high-quality business with strong profitability and very attractive return on capital and that are continuing to use innovation and technology to help customers to do more and meet their environmental and sustainability obligations. So, we think the growth opportunity over the long-term is very attractive.

You mentioned the phrase ‘artificial intelligence’. We had to get it in there. So apart from Autodesk, where else are you seeing interesting applications of AI in the companies in your portfolio?

We do see it very widely and, sometimes, in places you might not expect. So, we are seeing it in the agricultural area as well. So, one of our investments in the portfolio is John Deere, which is the leading tractor and agriculture equipment manufacturer. It’s increasingly using AI to improve the functionality of their equipment and embedding precision agriculture functions. To give one example, they recently released a product series called See & Spray. So those are massive sprayers that are applying pesticides or insecticides onto crops. Those obviously help to improve crop health, but using loads of insecticide has obvious negative environmental impact.

What the company do is that in front of the sprayer, there are now cameras and the cameras, combined with the computer chip and AI algorithm on the sprayer, are able in real-time, as the sprayer’s going over the field, spot which one is a weed and which one is a crop. Then the insecticides or the pesticides are only sprayed onto the weeds and not onto the crop. By doing that, they are able to reduce pesticide usage by 70%. So, an incredible amount of saving, which is good for farmer profitability, also great for the environment as well. So, this is an example where AI is being used in probably, an area that you might not expect.

There are also a lot of software companies that are using it. Duolingo is using AI, for example, to create a new subscription offering. Higher priced that allows [marker 0:20:00] learners to leverage on AI to understand where they are making mistakes with their language learning and help them to improve feedback and get better at the language they are learning as well.

It's interesting, you mentioned both John Deere and Autodesk. These are both very old companies. One would think they're subject to disruption. So, it does seem like long-established companies can adapt, can fight off potential disruption in their sectors.

Yes, that's right. We do have a few companies which have very long operating records and very impressive records as well. You're right, a lot of the time incumbents are at the risk of disruption. We have seen it in the automotive industry where Tesla and EV startups are becoming a real threat to the incumbent automakers like Volkswagen or Ford or GM. Occasionally, we do see incumbent companies that, for various reasons, are very innovative and that are long-term thinking and often, that long-term horizon is really important. They are willing to invest significant amounts of assets and resources into research and development, to come up with products and services that continually meet the future needs of their customers.

So, there are not just optimising for profitability or near-term returns, they are really thinking about creating long-term values. In those circumstances, they can be great long-term investments as well and have a positive impact on society.

Very interesting. So, one striking thing in your recent update was obviously, the era of easy money is over. 0% interest rates are gone and most people would see that as a setback for growth companies such as the ones you invest in. You took a more positive spin on it, in terms of shutting other people out.

Yes. I think the move to higher interest rates, the immediate impact that we see is a clear multiple contraction and derating of growth equities because they tend to have more of their cashflow will be coming from future activities that might be five or ten years in the future. So, they are being discounted much more aggressively with higher interest rates. This is a near-term impact. I think there is actually, a very interesting longer-term impact of higher interest rates. That with capital being more expensive, companies are forced to be much more rational around their business decisions and capital allocation.

You no longer see companies that are able to raise billions of dollars with a nice PowerPoint and then use that money to acquire customers with heavy subsidies and promotions. Companies actually need to start making profits and be financially sustainable in an era of higher interest rates. So, what that leads to is more rational competition, which favours businesses with strong competitive advantage. They are able to leverage their cost advantage or other superiorities and then, able to gain market share and grow their profit and cashflow on the back of that. We have seen that in some of our companies. Mercado Libre is a good example.

This is Latin America's largest ecommerce and fintech platform and previously, you had a lot of new entrants into the market that are using aggressive promotions and subsidies to try and take market share. Now they are leaving the market or putting up their prices to try to make a profit and Mercado Libre, it's now taking market share away from those smaller, less competitive players. So last year, Mercado Libre is able to gain market share and grow revenue and expand its profitability as well and delivered a very good investment return. We think that those longer-term impacts of higher interest rates, which will benefit high quality growth companies that we invest in.

Just before we move to questions from the audience, let's talk a bit out the private companies in your portfolio. Makes up about 6% as you said. You've talked about Northvolt. What do you look for in private businesses and perhaps, as you mentioned Northvolt, just maybe what are those other companies that you feel very happy about investing in?

We invested in a range of private companies. In addition to Northvolt, we also invested in Climeworks, which is a Swiss carbon removal company that's taking CO_2 out of the air and burying that underground. We're investing in Boston Metal, which is commercialising a green steel technology that uses electricity rather than coal to produce steel. We're also investing in Spiber, a Japanese synthetic biology company and PsiQuantum, a quantum computing company. So those are the five private companies in the portfolio. In general, we are looking for companies with more disruptive potential here and they do tend to be a bit earlier stage than the listed companies in the portfolio.

They tend to be much more innovative or radical in what they are pursuing. We're looking for private companies which can be adding something additional to the portfolio that our listed equity holdings don't have exposure to. So, for example, with carbon removal, there is no pure listed companies that are offering that. With green steel, this is still a fairly early-stage concept, where there's no public companies that are producing green steel. So, we want to allocate a part of the trust into those companies which could have very disruptive potential in the future and support those businesses as they try to commercialise their technology.

We're going to move on to some readers' questions and we've had a few come in. One is obviously, you're not the only investment trust to be trading at a discount, it's very common at the moment. So, this audience member asks, "What ways might you be looking at to narrow that discount?"

I think there's two things. One that is near-term and one that is longer-term. So near-term, we are doing a little bit of share buybacks because we do feel the discounts on the trust and to the underlying NAV is very attractive. We are able to buy essentially, shares in companies that we are excited about at a discount by buying back shares. We think that is sensible capital allocation for the trust to do that. So, we are doing a bit of share buybacks to help to manage the discount. Over the long-term, the discount will be driven by the demand for the trust. I think what's really important is demonstrating the long-term investment and impact outcome of Keystone Positive Change.

Since we took on the investment trust, we have undergone a very volatile period with conflict and higher interest rates and that has been, as mentioned, very negative for growth equities. Also, as mentioned, we think that over the long-term, the opportunity for those businesses can be very attractive. So, we're continuing to focus on identifying and investing in great businesses over the long-term. As we prove the investment and impact objectives of Keystone, we believe that should help to attract more shareholders to the trust and that should help to narrow the discounts as well.

Someone says, "No one doubts the need for companies to keep the planet cool and no one doubts your commitment to that. Is it not the case that the commitment [marker 0:30:00] amongst investors at large, to ESG concerns is waning a little and people are seeking more immediate returns?"

I think investment interest in the near-term can always be volatile and fluctuate. Depending on macroeconomic circumstances, on peoples' risk appetite, what is the investment flavour of the month or the year might change quite radically. Something really in favour today, might be out of favour tomorrow. We just don't know. What we do know is that if we want to have a habitable planet in the future for ourselves, for our children and if we want to see a more fairer and equal society where everyone can flourish and do well, then we need to start addressing the challenges that we see today. We need to invest in renewable and clean energy. We need to invest in innovation so that we can better prevent ourselves from a pandemic like COVID again.

We need to invest in upskilling and education so more people have the skillset that's necessary for a rapidly changing work environment. We believe over the long-term, the need to do that will create large investment opportunities for companies and we continue to focus over those long-term prices and look for companies that are committed to tackle those.

This one that's just come in, "You've got a number of holdings in the biotech sector, which has had a tough time in recent years, what are your views on the outlook for biotech?"

Indeed, the biotech sector has been challenging over the last 18 months. Part of it after COVID and some of the COVID benefits have rapidly weened off and diminished. What we are really excited about is the underlying innovation that is going on in the biotech sector. New technologies, including mRNA gene editing and even improving antibody therapies. Those are able to help us come up with treatments for previously unmet diseases. There are loads of very talented scientists and entrepreneurs that are looking to convert knowledge coming out of academia into the real world, into new drugs and new treatments that are curing cancer or helping us to prevent the next pandemic.

So, we are excited by the underlying technology innovation that's happening and we believe in the long-term, as people are working on that new and better treatment and diagnosis will come through and that will create enormous amount of fortune for successful companies. We saw it last year with Novo Nordisk for example, when they had their GLP-1. That really is able to create a lot of value for that company and we think there will be other examples in the biotech sector in the coming years.

So, you're excited about biotech. We'll wrap up with a final question. "What are the other sector that particularly excite you about the future?"

I think there are many sectors that are exciting and, in some way, we are almost spoilt for choice. Whether it's to think about the energy transition or healthcare or digital innovation or financial inclusion, there are just so many exciting investment opportunities. I think what's actually more important for making sure we do a good job for our shareholders in the long-term, is to focus on the business fundamentals to make sure the companies that we pick are the likely winners that have a competitive advantage or have the realistic prospect of building a business model that has competitive advantage so they can actually earn economic profits and attractive return on their investments.

So, I think that is the common thread that we are really focusing on and I think if we can really pick those companies that have the competitive advantage and can be the future winners, there are just so many sectors and themes and trends out there which will provide attractive investment prospects.

On that optimistic note, I'm afraid we've got end there. So, thank you very much for your time and your insights, Lee. We do have more sessions like this coming up. So please do keep an eye out for those if you find today's meeting useful. Until the next time, goodbye.

Annual past performance to 31 December each year (Net %)

	2019	2020	2021	2022	2023
Keystone Positive Change Investment Trust plc	23.3	-0.8	-4.8	-33.6	9.4
*MSCI ACWI Index (GBP)	22.4	13.2	20.1	-7.6	15.9

Source: Morningstar, MSCI, share price, total return in sterling.

*MSCI ACWI Index (GBP). Changed from FTSE All Share Index on 10/2/2021. Data chain-linked from this date to form a single index.

Past performance is not a guide to future returns.

The specific risks associated with the Trust include:

- The Trust's risk is increased as it holds fewer investments than a typical investment trust and the effect of this, together with its long-term approach to investment, could result in large movements in the share price.
- The Trust invests in companies whose products or behaviour make a positive impact on society and/or the environment. This means the Trust will not invest in certain sectors and companies and the universe of investments available to the Trust will be more limited than other funds that do not apply such criteria. The Trust therefore may have different returns than a fund which has no such restrictions.
- 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.

- 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.
- The Trust invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.
- The Trust's risk could be increased by its investment in private companies. These assets may be more difficult to buy or sell, so changes in their prices may be greater.
- 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.
- 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.

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.