Baillie Gifford™

Sustainable Growth Q3 investment update

October 2024

Investment manager Toby Ross and investment specialist Alasdair McHugh give an update on the Sustainable Growth Strategy covering Q3 2024.

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

Alasdair McHugh (AM): Hello, and welcome along to this update on sustainable growth. I'm Alasdair McHugh, an investment specialist on the strategy, and I'm joined today by Toby Ross, who's one of our two decision makers. As a reminder, in Sustainable Growth, we aim to build a portfolio our clients can be proud of. Proud of for its financial returns, but also proud of for the value that it creates for society.

This quarter in our investor letter, we focus on the theme of kind and wicked learning environments, very much in reference to a book that we found useful lately by the author David Epstein. And it's definitely been a wicked learning environment for investors over the summer with some pretty extreme bouts of volatility. We saw global markets fall 3 per cent in a single day at the start of August, for example.

So, it's pleasing to be able to report that your Sustainable Growth Strategy has delivered positive returns against that pretty nervy backdrop. So in sterling terms, we're up about 4 per cent in the quarter, and that's ahead of a benchmark which is up less than a per cent. And for the year to date, we're up a pretty healthy 8 per cent now in sterling terms again, but still slightly shy of that very concentrated and narrow index return that we've seen this year of 13 per cent.

So, Toby, I wonder if you could start by talking about one contributor to that strong outcome over the recent quarter?

Toby Ross (TR): Yeah, very happy to. As ever, disclaimer, a quarter is a short period, but there have been a few companies where there's been a kind of notable strategic development over the quarter that's led them to deliver strong returns. A good example of that is DSV, the Danish freight forwarder and logistics company. We own DSV because they've got this fantastic track record of making acquisitions and operating them better, so making them run the DSV way, and in the process helping make global supply chains more efficient. In September, they announced their largest ever acquisition of a German company called Schenker. That will nearly double the size of the company. We think that's a great acquisition for them. It provides many years of opportunity, and we supported it on behalf of our clients in a recent placing.

AM: Okay, and so in these really wicked learning environments, what is it that you and the team focus on?

TR: Yeah. Well, it's important to go back to what it is you're trying to do for your clients. And as you said at the start, our aim is to find companies that can sustain strong earnings growth over genuinely long periods. So, we're looking for 10 per cent plus earnings growth over a 10-year period.

So, what we do is track operational performance against the expectations that we have. We have a very clear hypothesis for every company we invest in. And as time goes by, we try and focus on, okay, is DSV tracking against the hypothesis that we initially set out or not? And that's really where our focus is.

AM: And so, we've said in the past that 90 per cent or more of the portfolio has been in line with or ahead of our expectations operationally. If anything, that's increased over the past three months. But there's still that little bit of the portfolio that's in the worry bag, if you like.

Do you want to tell us a little bit about what's in there at the moment?

TR: Yes. And so, as you say, it's a small number of names which, for actually quite idiosyncratic reasons, have just been a bit behind our operational expectations.

So, a good example of that would be Starbucks, the coffee chain. So, they've had weak traffic in the US earlier this year. And results there and in China have really been much lower than we were hoping for. However, a common theme around the worry bag is that we've started to see some green shoots operationally coming through over the last little while. So, in the case of Starbucks, they appointed a new CEO. We think he's really credible and actually has got a lot of skills that should be really relevant to the company. So actually, it's had a bit of a recovery. And I think that's the thing we're then going to be focusing on for those companies is, OK, we've seen some green shoots. Will those be sustained over the coming months, years.

AM: Okay, so one we're sticking by there. There have been some changes in the portfolio over the past three months. Do you want to give us the highlights there?

TR: Yes, very happy to. So, the one that's maybe gotten the most attention is that we, after a very long and successful run, we've sold NVIDIA. It's a company we admire greatly for their strategic vision and the quality of execution. And their growth has really been driven by the growth of AI and huge numbers of their GPUs being put into data centres.

Now, we believe in the trend of generative AI having a big impact on the global economy over time. But NVIDIA is a really very focused bet on that. And it's very sensitive to how much money people are spending on data centres, and in particular, their chips in those. So we've decided to actually have a more diversified exposure to that theme by investing in Microsoft.

So, Microsoft will enable the use of AI by people like you and me through their software. But they also, through their Azure data centre business, are a huge beneficiary of just companies moving more of their, moving more of their workloads into the cloud. So, we think they'll benefit from that trend and the AI will accelerate that trend. So, it represents a more, I think, resilient and durable way to benefit from AI.

AM: Okay. Two very large companies you've mentioned there. Do you want to tell us a little bit about how we get companies of different sizes into the portfolio?

TR: Yes, it's a good point because, as I said earlier, the aim is to find companies that can sustain strong levels of growth over long periods. And the important thing is to be looking at companies in many different sectors and of many different sizes. So, we've bought Microsoft, $3tn market cap, but we've also bought BioMérieux with an $11bn market cap. And I think it's fair to say that, overall, recently we've been finding the valuations in that kind of mid-sized company range more attractive.

BioMérieux is a fascinating company. They're a French diagnostics business focusing on infectious diseases. And they've got this really interesting structure. So, the company is majority owned by the Institute Mérieux, whose focus is on improving healthcare outcomes globally. That's helped them give the sort of strength to invest really heavily in R&D. And we think, over the next few years, that's going to really pay off into accelerating organic growth. And that's a company that maybe people haven't heard of, it's not Microsoft or NVIDIA, but that's the company where we think the prospects for growth are really attractive and underpriced.

AM: Yeah, and you've said that valuations have been attractive in this sort of mid-cap part of the spectrum for some time now, and we have seen that trend of mega-cap outperformance reverse a little bit in the last quarter, haven't we?

TR: Yes, that's right, and I guess you could also say if you put your macro hat on, well, we've also started to see rates falling finally in the US, the Eurozone, the UK. And I think that potentially sets up an environment where companies that have got greater duration of growth, maybe starting from a slightly smaller base than some of the mega caps, could be positioned to do really quite well. So, you know, we continue to look across the market cap spectrum, but I think that potentially sets up quite a favourable environment for us as growth stock pickers.

AM: Yes, I think that's a really optimistic note to end on.

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So, in recent quarters, we've talked about our desire to maintain a diversified portfolio with a range of growth drivers present within it. We've seen a contribution from non-US companies, from non-technology related companies and from some of the non-mega cap companies in the most recent quarter. So that is beginning to play out. The favourable rate environments could be a tailwind rather than a headwind going forward.

So, we hope that this hints at a more sustained improvement in absolute and relative returns going forward. We'll update you on that next time around. Thanks again for listening today and see you in three months.

Sustainable Growth

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

	2020	2021	2022	2023	2024
Sustainable Growth Composite	66.9	21.7	-46.4	13.1	29.9
MSCI ACWI Index	11.0	28.0	-20.3	21.4	32.3

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	Since inception*
Sustainable Growth Composite	29.9	9.8	11.1
MSCI ACWI Index	32.3	12.7	11.6

*Inception date: 31 December 2015.
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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