

Sustainable Growth Q2 investment update

July 2025

Investment manager Katherine Davidson gives an update on the Sustainable Growth Strategy covering Q2 2025.

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

Katherine Davidson:

Hello, I'm Katherine Davidson and I co-manage the Sustainable Growth Strategy here at Baillie Gifford. Today I want to talk to you about three topics. Firstly, how the portfolio has fared in a volatile quarter. Second, our continued efforts to enhance resilience. And lastly, why we remain convinced that sustainability is a source of long-term outperformance.

So when we meet company management teams, they're sometimes surprised by the topics we want to discuss. We're longer term and bigger picture than most investors they meet with. But it is worth keeping an eye on the questions asked in company earnings calls so that we can understand what the market's currently obsessing about and make sure our views are still different. Now, it'll come as no surprise that words like tariff, geopolitics and trade deficit have featured prominently this year. Tariff-related discussions really surged during April as management teams scrambled to re-ensure investors following President Trump's Liberation Day announcements.

So global equities fell more than 10 per cent in the subsequent week. Now, as long-term investors, it's tempting to dismiss all this as noise, especially given that trade tensions have calmed down since April and the market has recovered. However, the universal 10 per cent tariff does remain in place and combined with existing levies on steel, aluminum in China, the average effective tariff rate now sits around 15 per cent, which is actually the highest since 1937. And after benefiting from decades of globalisation, companies now face the scenario of permanently higher costs and complexity. Perhaps even more pernicious has been the lack of visibility and the impact that this has had on business confidence. This has come through in all our meetings with companies this quarter and informed our decision to reduce the portfolio's weight in CapEx-sensitive industrial holdings.

While we've been discussing trade war scenarios since the November election, the magnitude still surprised us. The good news is that sustainable growth entered this latest crisis in the best possible state after two years spent improving our resilience and diversification. This shows up in concrete

metrics. Our debt-to-equity levels are around a quarter of the broader market and our growth margins are about a third higher. The upshot of this greater resilience is that the strategy outperformed the index by more than 1 per cent this quarter.

We've analysed company-specific impacts of tariffs through supply and demand risk lenses. And it's worth noting that AI has allowed us to do this much faster by passing company filings and call transcripts. You can have a look at the quarterly letter for a discussion of how we're using AI in our research process.

So one company that has been harder hit is Yeti, which manufactures drinkware primarily in China for the US market. Now, initially, each 10 per cent increase in the tariff meant an additional \$10mn of costs for Yeti. But management is moving quickly to diversify sourcing and expects to have minimal China exposure by year end. So we're comfortable with our holding. For the most part, though, we consider the portfolio to be pretty well insulated.

Nearly half our holdings we consider to be low risk on both the supply and demand sides. MSA, which makes safety equipment for firefighters, exemplifies this. Their production is local for local and demand is extremely resilient given the essential nature of the products. Plus, it's worth remembering that more than half of the portfolio companies sell services rather than physical goods, so tariffs have a limited impact.

Turning to performance, TSMC was one of our best performing holdings in the quarter, displaying impressive resilience despite its reliance on international trade. In fact, even President Trump couldn't challenge its dominance in advanced semiconductors, exempting the industry from tariffs rather than risk falling behind in the AI race. While TSMC is benefiting from AI spending, it's well diversified across mobile phones, automotive and other end markets. And its April results showed more than 40 per cent revenue growth and 60 per cent earnings growth year over year. It's actively addressing geopolitical risks too by building three new fabs and an R&D center in Arizona.

We've also added new holdings that we think will actually benefit from this uncertain environment. Canaxis is a Canadian company that helps large manufacturers to create efficient, flexible supply chains through its Maestro software. So supply chain planning used to take weeks, using Excel spreadsheets primarily, but Maestro can model scenarios in as little as 30 minutes. And after years of supply chain disruptions from pandemics to trade wars, the incentive to modernise these systems has never been greater.

So tariffs have featured in plenty of our on-desk discussions, as you can probably tell, but our research remains very focused on the long term. Trending topics on Baillie Gifford's research library include weight loss drugs, energy storage solutions, and cybersecurity, all areas where innovation addresses society's most pressing challenges. It can be easy to get distracted by the 24-hour news cycle, but our experience shows that long-term investing rewards patience and discipline. And this is even more true when it comes to sustainable investing, where performance of many strategies has been disappointing recently.

We want to reiterate that for us, sustainable investing isn't a passing fad or a regulatory tick box. Rather, it's a disciplined framework for identifying well-governed, adaptable businesses that are positioned to benefit from powerful secular shifts. We expect it to be a source of long-term outperformance, as these companies that are addressing real-world problems deliver market-

leading growth and longer competitive advantage periods. So, with your support, we'll continue looking beyond the headlines, staying patient through the noise, and building a portfolio that's resilient, forward-looking, and aligned with a more sustainable future.

Sustainable Growth

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

	2021	2022	2023	2024	2025
Sustainable Growth Composite (gross)	-	-	-	9.1	13.1
Sustainable Growth Composite (net)	-	-	-	8.5	12.4
MSCI ACWI Index	-	-	-	19.9	16.7

Annualised returns to 30 June 2025 (net%)

	1 year	5 years	Since reorganisation*
Sustainable Growth Composite (gross)	13.1	-	15.7
Sustainable Growth Composite (net)	12.4	-	15.1
MSCI ACWI Index	16.7	-	20.7

*31 December 2022.

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.

Past performance is not a guide to future returns.

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