Hello and welcome to this programme from Baillie Gifford, the latest in a series of webinars where we talk to the managers of the business' different investment trusts. Today, we're talking to investment specialist Rosie Rankin. My name is Natalie Breen from Citywire and I'll be talking to Rosie about Keystone Positive Change Investment Trust's portfolio performance, company research and opportunities for the year ahead. Rosie, thank you so much for joining me here today.

We've certainly been feeling the effects of the permacrisis of 2022 and following through into the beginning of this year, but as ever, you guys remain long-term conviction managers. So how have you been able to look beyond all of the noise and the media anxiety and what themes are you exploring for this year?

You're right, Natalie. It certainly felt like a real permacrisis since the start of 2022 and I think what has been really helpful for us is just remaining firmly focused on our dual objectives. So, within Keystone, we are seeking to invest in that small number of companies who can generate attractive returns and who can contribute towards a more sustainable and inclusive world. And I'm pleased to say that the pipeline of ideas for the company remains really rich. So, for example, within our environment and resource needs them, we're exploring opportunities in the energy transition, the electrification of transport, carbon capture. Within healthcare there are lots of exciting ideas in areas of increasing our understanding of biology or treating diseases. Then, within social inclusion and base of the pyramid, we're looking at companies that can either provide access to basic services or can help to build people's financial resilience and financial health.

Super. We're definitely going to dig into some of these themes throughout the course of the next 20 minutes or so, but can we start, perhaps, by looking at how performance has been so far to-date and some of the contributors to this performance?

Really happy to do that. In terms of performance, Keystone has just released its interim results and I'm pleased to say that over the last six months, performance has been positive. So net asset value has increased by just over 14% and share price total return by just over 9%. Both ahead of the index. I'm very conscious that it's just six months performance. We were appointed managers of the trust two years ago, in February 2021. We're really conscious that over that time period, performance has been behind the index. Of course, overall, our investment time horizon is five years plus and we do aim to outperform by 2% per annum over those five-year periods. So yes, just wanted to put that short-term positive performance into that longer-term context.

What have been some of the contributors to the short-term performance, in particular?

I think it's helpful to look at both sides of the coin in terms of some of the companies that have detracted from performance and some that have really contributed. Just looking at that six-month time horizon, Tesla has been one of the detractors from performance over that period and seen weaker share price performance. I think, as the market reacted to concerns about increasing competition in the electric vehicle market. Also, whether Elon Musk's acquisition of Twitter was proving a distraction for him. Now, competition has definitely increased in the EV market, both from electric vehicle startups and from traditional car manufacturers, but we're really confident in terms of Tesla's strong competitive position.

In terms of looking at those EV startups, many of them have managed to raise billions of dollars over the past few years, to start help production begin, but funding is becoming harder to come by. We can see many of the newer EV competitors starting to scale back their growth plans. Of course, on the traditional car manufacturer side, they're often struggling to be profitable on their electric vehicles because they've got the challenges of their legacy manufacturing sites and scales of their workforce, but we're really pleased that Tesla has managed to consistently reduce its production costs. It's got very good vertical integration and a real emphasis on efficiency. It aims to produce two million cars this year, which is quite incredible, thinking that a decade ago they just produced 10,000. Then there's the energy division, which is growing at a really decent clip as well, over 148% growth in the last quarter. So, I think lots to be optimistic about there, despite the recent share price weakness.

When you have a company within your portfolio, you've got a long-term view on it, but how long does it take until you start monitoring one of these underperforming companies and what's the process like for then moving them on? You're a low turnover portfolio anyway, but could you talk to us a little bit about how that process actually plays out?

I think you're right. We want to be patient. We want to be perseverant and we want to be long-term, but we don't have infinite patience or perseverance. I think for us, the key differential is whether a company is having some short-term weakness. Either due to market sentiment being against it or some short-term operational difficulties. In which case, we want to be supportive of that company, providing it's staying true to its long-term vision. However, if we think that a company's challenges are deeper routed, that perhaps it's got really persistent operational challenges or that it's changed strategic direction, then we will move on. A really good example is a company that we sold from the portfolio in the autumn of last, a company called Berkeley Lights.

Early-stage biotech business, made machines that allowed clinical researchers to do single cell analysis. A really interesting and innovative technology, but the company were really struggling to commercialise that technology. Actually, we felt that their struggles around that and some quite concerning levels of management churn within the company as well, were really indicators to us [marker 0:10:00] that it was time to move on from that company and we sold that in October of last year.

The flipside to that is, how long does it take to onboard a new company and have you added any new names to the portfolio recently?

Yes, absolutely. Almost the answer to that is, how long is a piece of string because sometimes, it takes years of getting to know a company and to build up our knowledge and conviction. At other points, it can be a relatively quick process. So, we have added two new names to the portfolio since we last spoke. One is in base of the pyramid, a company called Remitly and the other is in environment and resource needs, a company called Autodesk. Really happy to give you a bit more information about those if that's of interest.

Yes, please do.

In terms of, first of all, Remitly, we've been looking at this company for a couple of years. What they do is, they provide a means of people to remit money. Now, what do I mean by that? Well, their core customer would typically be a migrant worker who has perhaps, moved to Europe or the US to work and wants to remit money back to relatives or friends in their home country. Now, the size of the remittance market is huge. It's estimated it's about $600 billion that is remitted globally every year. Now, that is more than the total amount of government aid that is given to developing countries. What these remittances are typically used for by the recipients is to pay for housing costs, food costs and interestingly, about 25% of remittances go towards paying for education. So, it's a really powerful way of capital being deployed to improve living standards and educational prospects in emerging markets.

Remitly is a mobile remittance platform, it allows people to transfer money much more quickly and easily and more transparently that traditional providers of remittance services such as Western Union. So, we're quite excited about the impact case and the advancement potential. We looked at Remitly, interestingly, at the time of their IPO, which was about 18 months ago, but we just felt it was quite richly valued at that point. Now, since then, their share price has come off about 17%, which made it much more attractive from an investment point of view and they were also showing that they were building up that business and building up their user numbers. So, we were able to have greater conviction that it was the right investment for the portfolio. So invested in Remitly just at the very end of 2022.

That was Remitly. In contrast, the other company that we bought, Autodesk. Completely different company. It's within our environment and resource needs' theme. If anybody participating on the call today has a background in design or public design, they've perhaps, used Autodesk. It's computer aided design software. Now, why on earth do we like this from a Positive Change perspective? Well, there's two main reasons. One is Autodesk is a core piece of software used in the construction industry and the construction industry is an incredibly wasteful industry. It's estimated that a about 40% of landfill is occupied by excess materials from the construction industry and anecdotally, it's said that for every four houses that are build in the UK, a fifth ends up in the skip.

So, Autodesk's construction cloud platform allows architects, designers, builders, project managers to communicate in a much more efficient way and hopefully, reduce that waste. The other aspect that we really like it for is in terms of its artificial intelligence aided design. Which allows architects to be much more conscious of the environmental footprint of the buildings that they're designing. The software can suggest ways of improving environmental efficiency and reducing carbon intensity of those buildings. So, two completely different companies, but both ones that we're excited about.

Now, I know I said I would be taking questions at the end, but I've seen one that just popped up, which is very relevant to what we've been talking about here, so I might turn to it quickly. One of the viewers asks, "Are the new names coming up, is there any cross pollination between different Baillie Gifford teams?" Is that an area of research for you and, in particular, they mention the global discovery team. Are you working in collaboration to find names across the themes that you're looking at?

Yes. Colleagues can be a rich source of ideas for us within Positive Change. So, to give some idea, about 90% of companies in the portfolio are owned somewhere else at Baillie Gifford. It might be in a regional strategy or a global strategy. The highest single amount of overlap is in a strategy called Long-Term Global Growth, which is about a 25% overlap. You could expect that size of overlap to endure because we share one of our two objectives with all of our equity colleagues that are seeking attractive growth companies. So, we do a lot of collaboration across the investment teams in terms of idea generation. It's not just on the listed side, it's also with our private companies' team, of course. Within Keystone, we can invest in private companies. So, working with our colleagues within the private companies' team is a rich source of ideas as well. So great question and yes, we do a lot of work with colleagues.

As you touched on there, obviously, you're growth investors and it's a tough time to be growth investor. How resilient are the portfolio holdings against this challenging inflationary backdrop?

You're right, it's a tough time to be a growth investor. Of course, whilst we're thinking about the long-term and we're wanting the companies in the portfolio to really thrive over the long-term, they need to survive in the short-term, which is why resiliency is important. When we think about resiliency, we're thinking about it at the individual company level. So, when we're looking at our companies within the portfolio, we're thinking about elements such as how resilient are these companies to rising interest rates for example? Now, within the portfolio, across the portfolio, the level of net debt is about half of that of an average index company. So, levels of debt are quite low across the portfolio, but we want to be really conscious about the rising cost of debt to companies within the portfolio and explore any vulnerabilities there.

We also want to think about resiliency to inflation. Recognising that companies are seeing increasing costs in terms of inputs. We want to think about whether companies have the pricing power to enable them to withstand those inflationary pressures. So, we've seen a number of companies across the portfolio raising their prices over recent months. Whether that's Christian Hansen, the Danish bioscience business or Ecolab, a US chemicals business. Of course, we want to see companies exercising pricing power responsibly within Positive Change. So, whilst we want to see them remaining profitable, we don't want to see them being egregious in terms of the pricing increases that they're putting through.

I think thirdly and maybe this is the most important point in thinking about resiliency, is this is a portfolio of companies that are doing something very important for society and the environment. They are generally companies that people really value and so, generally, their demand is quite resilient in the face of macroeconomic pressures. They're generally companies that people value and need.

On that then, how resilient are they to geopolitical factors and how have they been faring this year with rising tensions between China and the US and [marker 0:20:00] not least, the war going on. How has that played out amongst your holdings?

You're absolutely right. Sadly, there are, there does seem to be rising geopolitical tensions in a number of areas of the world. I think firstly, it's important to say that we're not macro investors, so we don't take a top-down view of the portfolio. Also, we're very diverse in terms of geographic exposure. We have companies in over 16 different countries. I think again, similar to how we're thinking about resiliency in terms of the inflationary backdrop, we think about geopolitical resilience in terms of individual company exposure. So, for example, when we're thinking about rising tensions with China, if we're looking at a European or US domiciled company that exports a significant amount to China, we then want to think about how will their business be effected if those exports become limited in future? So, we want to think about it in that individual company context.

Of course, sometimes, geopolitical tensions provide opportunities because the companies we invest in are solving some challenges relating to them. A great example is Deere, the manufacturer of agricultural equipment, which was a very strong contributor to performance over the course of 2022 as their precision agricultural machinery allowed farmers to reduce their input costs in the face of rising costs associated with the Ukraine war. So, we do see companies helping to mitigate some of the risks associated with geopolitical tensions.

Let's move on slightly and look at engagement. Everybody says that they do engagement nowadays, but what does it mean to the Positive Change team and what does it mean to do engagement properly?

It is really important to us to do it properly. I think it's important at the outset to say that within Keystone, we invest in 40 or so companies that we really like. They are generally, in our view, exceptional companies that are doing something very positive for the world. So how can we add value through our engagement? What we want to do is offer supportive engagement to encourage companies to pursue their positive strategic direction. Of course, we will challenge companies where we feel that things could be improved. It's useful to give you a quick example of what do I mean by supporting a company in their positive direction. So, we invest in Nubank, which is a Brazilian bank. It's now, in just a number of years, the world's largest digital bank. It has 60 million customers in Latin America and it's really pleasing to see the financial inclusion that they've facilitated.

We were starting to wonder, whilst it's a very positive thing to include people financially, how has that actually affected their lower income customers? Has having access to a credit card and a bank account actually improved their financial health? We commissioned a consultancy in Brazil to do some work exploring that very question and then we engaged with Nubank and sat down with them and the Brazilian central bank to discuss the results of the findings. In terms of encouraging them to think about that lower income segment of their customer base and how their products and educational initiatives can really continue to help them and improve their lives. Now, we didn't change Nubank's strategic direction, but we've hopefully supported it, provided some additional food for thought and that is the kind of engagement that we think, over the long-term, can add real value.

How do you then translate all of that work that you've been doing with the companies, how do you then actually communicate that to clients and show the meaningful impact that you've had on those 40 companies that you invest in?

We produce an annual report, it's called Keystone Positive Conversations. The most recent report came out in February of this year. It covers the whole of 2022 and yes, it covers every single engagement that we've had within the portfolio and, also, explores aspects of companies' business practices, such as their attitude towards the environment and their approach to governance. So, a really comprehensive report, which hopefully, is of use to shareholders.

Another resource that you have available is a great series of podcasts, which I was listening to in anticipation of this interview. Something really struck me that Kate Fox, one of the lead portfolio managers said. She talks about the second deep transition, which I thought was a really articulate way of describing where we're at in the globe and the global transition at the moment. Could you talk to us a little bit about what she means by 'second deep transition' and the impact that that has on the portfolio?

Glad you enjoyed that podcast. The deep transitions project is a project that we're involved in, it's being led by some Dutch academics and bringing together a range of asset owners and managers thinking about this deep transition. What do we mean by that? Well, looking back, the last deep transition was really the industrial revolution. Now, that has had many positive benefits for living standards and longevity and the way that we live today, but there have been some unintended negative consequences, not least our reliance on fossil fuels. Thinking about the deep transition that needs to come next, it's really about writing many of those wrongs of the first deep transition, in terms of the industrial revolution. It's recognising that we're on an unsustainable path currently, in terms of our energy usage. Our usage of the world's resources and the social inequalities that we're creating.

So, it's really thinking about what is required in terms of transforming our systems. It's also exploring the two concepts of whether you want to just invest in companies that optimise your current system or really transform a system and I'll give you a quick example there. I've already talked about Tesla and electric vehicles. Now, electric vehicles optimise the current system of everybody owning and driving their own car as a better way of internal combustion engines. Systems transformation would be moving to autonomous vehicles, where you don't own a car at all, but use cars as a service. So, it's just thinking about those really deep-rooted transformations that will change the way that we live.

Perhaps a final few points from this formal part of our interview before we turn to some audience questions. What areas of system transformations has the team been researching and have you been able to be out in the field accessing any of these new companies? Could you talk to us a little bit about that?

We're researching such a range of different opportunities at the moment. For example, the team have been out to India to think about the companies that we're researching there, we're mainly in the areas of financial inclusion, but also, in the areas of Indian healthcare. Recognising as India's now the world's most populous country. It also has now, an aging population and sadly, lifestyle diseases are also becoming more prevalent. So how will India cope with the demographic challenges and the healthcare challenges associated with that? So, thinking about that. We've got a trip coming up to China, to explore different companies involved in various aspects of the energy transition. Interestingly, we've been doing some work—now it sounds very mundane, on HVAC. So heating, ventilation and air conditioning.

Now, sadly as the world's temperature increases and weather becomes more extreme, our need [marker 0:30:00] to heat and cool our homes and our businesses goes from being a luxury to an absolute essential. So, we're looking at companies that are enabling us to do that in a very energy efficient way. So, a real range of different companies that we're looking at. Some are more at the systems transformation edge and some are more at the optimisation. Both will have a place in the portfolio.

Shall we turn to some audience questions. Some follow on directly from that, from your trip to China. Somebody asks, "Do you own any Chinese companies at the moment?"

No, we don't own any Chinese companies at the moment. That's not a decision to be ex-China at all. It very much continues to be part of our research universe. We have to be ensured that the companies that we find to invest in there, will meet both of our objectives. When we think about meeting the world's challenges, if we think about something like climate change, it's recognising that China really has to be part of driving that global solution if we're thinking about big global challenges like that.

Hopefully, your newest research trip will uncover some great companies for you there. Something that you touched on at the beginning. You talked about the base of the pyramid investing. Can you explain a little bit more about what this approach is?

Yes, really happy to. So, it's the theme within the portfolio where we're looking for companies that are helping those at the very bottom of the global income ladder. We define that as the four billion people who are on less than $3,000 a year. So, it's looking for companies that are helping to give them access to basic products and services or to help them participate financially or improve their prospects. It is a difficult theme to find investable companies because we want companies that have the potential to be profitable and generate attractive investment returns, but at the same time as providing those critical services or products to those on the very lowest of incomes.

Turning to healthcare as a theme that you're exploring and accessing. Somebody's asked here, "What's your view of Moderna when perhaps, the market's moving away? What's your long-term take on it?"

I think that's absolutely right. Moderna has been weaker in share price terms recently and I think that's the market recognises that demand for COVID vaccines will decrease over the coming years. The reason behind us investing in Moderna was never the COVID vaccine. We invested in Moderna back at their IPO at the end of 2018 and the reason that we liked Moderna was the potential of their mRNA platform in that ability to develop a whole new class of drugs and therapeutics. Now they have almost 50 different therapeutics and vaccines and different stages of clinical trials in their pipeline. Most encouragingly is recently, they have announced very encouraging progress on their personalised vaccine trials, which are currently in phase two trials. Those will be moving to phase three trials, we think, in the summer.

The potential there, in terms of being able to develop personalised cancer vaccines, in terms of societal impact, but also, in terms of investment returns are really exciting. So yes, we would agree that we would expect revenues from the COVID vaccine to decline over the near-term, but it's that long-term potential of the other therapeutics and vaccines that really excites us.

Staying within healthcare. The rest of the new areas that you're exploring are predominantly in India, is that right?

It's a real mix. So, we've been looking in India. That's mainly candidates for base of the pyramid and, also, social inclusion. Many of the companies that we're looking at in terms of the energy transition are in the US and, also, Europe. So, a real mix of, I guess, geographic locations and different types of companies contributing to different themes.

We've got quite a few questions here, about being growth investors, which obviously, we've touched on in the main body of the interview but somebody asks here, "Do you feel like, sometimes, not enough emphasis is given to value investing?"

It's interesting, I'm hesitating because I have got such a strong bias towards growth investing. It's what we spend all our time doing at Baillie Gifford and I think over the long-term, that's what really excites us is that potential to generate investment returns through the growth of companies in the portfolio. Maybe one comment, it doesn't directly answer the question, I think perhaps because I feel unqualified to do so, but in terms of thinking about growth investing. I think often people associate growth investing, particularly from Baillie Gifford, with those very early stage, high growth types of names that maybe there's a lot of uncertainty associated with the outcome. Don't get me wrong, we do invest in those types of companies and have seen much success from that, but we also have an appreciation for other types of growth companies.

So, within positive change for example, we have companies which offer a very different style of growth in terms of that steady, compounding growth. So, whether that's a company such as Deere, the manufacturer of agricultural machines that I mentioned or Xylem, a manufacturer of water infrastructure systems. Those are growth companies, but a very different style of growth company to something like Moderna. I think it's important to recognise those different flavours of growth.

On that somebody asks, "Can you explain why growth companies perhaps, like Keystone, at the moment are undervalued?"

So, we saw a huge selloff in growth companies right back at the start of 2022. It was really the market recognising that in an environment of rising interest rates and inflation, that growth companies were less attractive. Particularly, long-duration growth companies whose earnings were far into the future. They were particularly penalised by the market. So certainly, at the start of last year, we saw a really marked disconnect between the operational progress that we were seeing from some of the companies in the portfolio and their share price performance. We're pleased to see that link between operational progress and share price performance is starting to be re-established, but it's undoubtedly been a painful period for growth investors and very much appreciate, for our shareholders as well.

Let's look at investment into private companies. "Could you comment on the four private companies and what is the percentage made up of the portfolio? Are there any more in the pipeline perhaps?"

Private companies are an area that we really want to invest in, in the portfolio. I think particularly given our dual objectives, we feel that by providing primary capital to private companies, that's a way of us providing additional impact as well. In terms of those private companies within the portfolio, they are a relatively small proportion of the portfolio just now. So, there are four companies. In combination, they're about 5% of the portfolio. Looking out over the longer-term, we have the ability to invest up to 30% of the portfolio in private companies. So, it's definitely an area over the coming years that we hope to see that weighting increase. Now, in terms of the current private companies within the portfolio, there's a really different range. There is Northvolt, the battery manufacturer. There is PsiQuantum, which is a manufacturer of quantum computing systems.

There is Spiber, which is a Japanese company which uses synthetic biology to manufacture alternatives to materials such as cashmere or fabrics that have [marker 0:40:00] more petrochemical basis. So, a circular economy there and forgive me, but the fourth company has completely escaped my mind at the moment. Climeworks, which is the most recent private company addition to the portfolio, we just added that into the portfolio last year. That is a company that is active in the area of carbon capture. So that technology where you can suck in air into a large piece of machinery. It extracts the-, it uses sorbents to extract the carbon and then you end up with a solidified piece of carbon that you can then-, so basically, that technological ability to extract CO_2 from the air.

Another question here is asking about, "What level of gearing are you at, at the moment and do you anticipate this changing?"

So, we tend to have structural gearing in place. At the moment it's around 10%. There're no plans to change that in the near-term.

We've got some country specific questions here and one gentleman asks, "What is your view on Japan as a growth market at the moment?"

I think in terms of thinking about opportunities within Japan, it's again for us, just on that company specific basis. So, we have in terms of the listed space, a company such as M3, which is a Japanese medical platform or Spiber which I mentioned, the private company that does synthetic biology materials. It's a Japanese company as well. So, we are finding opportunities there, but we don't really think of geographies in terms of that top-down where are the geographic opportunities. It's much more about where are the individual company opportunities. We are certainly finding opportunities in Japan.

Staying on that theme then, do you think that the pipeline for Positive Change companies overall, is that pipeline still there? Have the recent years of uncertainty hindered the growth in these areas?

I don't think the recent years of uncertainty have hindered the growth. In terms of we're seeing lots of-, whether it's relatively early-stage companies with that ambition to have a positive impact or more established companies that are recognising that either they need to strategically adapt their businesses to have more of a positive impact. We see opportunities on both sides. I think one area that has been slower over the last year though, would be in private companies in terms of that deal flow that we're seeing coming through. There was much more muted fundraising in terms of private companies over the course of 2022 and thus far, this year. We would regard that as a temporary condition rather than something that will be enduring over the long-term.

Rather than something structural, yes. That makes sense. Perhaps a few comments to close. Would you mind just giving in summary, some of the things that you're looking forward to for the year ahead and some of the themes that you and the team are most exciting to carry on exploring?

I think to give it a final summary is that our desire to identify those companies who are going to grow and who are going to have a positive impact is our absolute north star within Positive Change. That just is our unwavering focus within the team. When we look at what we call our research radar and the range of opportunities that are afforded there, I think that gives us real cause for optimism against what can be quite a depressing macro and news flow backdrop. So yes, remain really focused on those areas that I talked about. Whether it's energy transition, helping the very poorest in the world or exploring some of those really exciting healthcare innovations.

Rosie, thank you so much. That's all we've got time for in today's session. So, I look forward to being able to speak with you again, perhaps towards the end of the year.

Yes, looking forward to it as well. Thank you, Natalie.

This is one of many of these Baillie Gifford Invest Trust Webinar series, so if you've enjoyed today, please do keep an eye for one coming in the future.

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

	2019	*2020*	*2021*	*2022*	*2023*
Keystone Positive Change Investment Trust plc	*-3.2*	*-26.9*	*34.9*	*-10.2*	*-13.3*
**MSCI ACWI Index (GBP)*	*6.4*	*-18.5*	*22.2*	*12.9*	*-0.9*

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.*

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