Baillie Gifford™

US Equity Growth
Q4 investment update

January 2025

Investment manager Tom Slater and investment specialist Patrick Stapleton give an update on the US Equity Growth Strategy covering Q4 2024.

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

Patrick Stapleton (PS): Hello and welcome to this Q4 2024 update for the US Equity Growth Strategy. My name is Patrick Stapleton. I'm an investment specialist here at Baillie Gifford and I'm joined today by one of the strategy's four decision makers, Tom Slater. Now, Tom, for background, also is a partner here at the firm. He also analyses companies day to day, just as he did when he joined the firm.

So what we're going to talk to you today about are three key areas, one being the portfolio in relation to the broader macro environment. We'll talk about the portfolio then in a little bit more detail while talking about some of the trading activity that we've been doing over the last three months. Now, as a reminder, the US equity growth strategy is a concentrated strategy, 30 to 50 of what we believe to be some of the most exceptional growth businesses in America. We're looking for companies that can grow among the top quintile of companies in the United States for long periods of time. And we believe that it's the fundamental growth of these businesses that drives share price returns in the long term. So, Tom, hello.

Tom Slater (TS): Hi.

PS: So, looking then to the macro environment, we're seeing a slowing of interest rate decreases, by the Federal Reserve. And this is joined by talk of relatively high market valuations, and then talk of potential for inflation being brought about by the upcoming US President. So, taking all of those factors in sum, what is your feeling about how this plays with how you're developing the portfolio and the strategy over the coming years?

TS: I think that there are some big question marks in the broader picture. You have the new administration, and we've had some hints about what they're going to do, but we don't know the

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extent of it. Some aspects of the agenda will probably work against each other. So to take an example, if there are tariffs, import tariffs, on goods coming to the US, then that will be inflationary. However, if the Department of Government Efficiency knocks $2 trillion off annual federal spending, that will be highly deflationary. And we don't know what the net of those two things will be. So even for a headline number like inflation, there's quite a high degree of uncertainty.

Now, you mentioned market valuations. The market valuation has increased. But I often think these comparisons are not helpful. It's better to break it down by sector. And so the market overall has increased in value as measured by the short-term price earnings multiple. But that's because the high price earnings multiple sectors have become a larger part of the market. So you have to be slightly careful with those sort of aggregate statistics. And so given the uncertainty around some of these areas and the dangers of relying too much on headline numbers, what I would emphasize is looking for businesses that are resilient and adaptable in this environment, that have pricing power, that can flex their business model to deal with the changing circumstances. Because I think those qualities are going to be most important over the next two or three years. And those qualities are nothing necessarily to do with growth, but they're much more to do with the way a company's managed and its position in the marketplace.

PS: Right. So I think probably fair to characterize it that regardless, we're going to focus on finding exceptional growth companies, companies that can deliver really outstanding growth over the next five years and beyond. And actually, with that in mind, if you look at the last two years, if I may, the portfolio's performance has been very strong. So 2023, 2024 actually saw outperformance versus the S&P 500 in, I would say, exceptionally strong performance years for the for the S&P benchmark itself. But we're also seeing profitability for the portfolio evolve. So higher levels of profitability at the portfolio level. And then we're also seeing reinvestment well ahead of the market at the portfolio level in that time. So what matters for the companies we invest in over the next five years and beyond?

TS: Yeah. So yes, the past two years have been strong. We would always encourage people to look at the longer-term numbers, albeit they are distorted by the strong period in Covid and the weak period coming out of Covid at the moment. But I think what's encouraging from my standpoint is that you've seen real improvements in the fundamentals of the companies that we invest in. You've seen continued strong growth at a time where these companies have got a lot more efficient. So they've been looking at headcount coming out of Covid, where the pace of hiring has been quite high, and they've been thinking about how do you use those resources more effectively. And I think they've been able to drive margins and keep a handle on costs at the same time as growing that top line. And I think it's that combination of ingredients which has been really important for driving the performance of our portfolio. And if I sort of look out the way, I do think that actually the potential profitability of these companies has increased as a result of, so for example, AI has improved developer productivity. And so companies are not having to hire as many engineers in order to deliver products.

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So I think there's real tangible benefits of some of these technology shifts that we're seeing. And you see that in big holdings, companies like Amazon. Or in some of the more mid-market players, so in Shopify, which makes software for operating retail businesses. You've seen the number of employees relatively flat at that business, despite it experiencing pretty rapid top-line growth. That's been really helpful for profitability. It's been really helpful for cash flow generation. But we see it in other places as well. So take Duolingo, the language learning app. They're both benefiting from the greater productivity of engineers, but actually their product is getting better as a result of AI. It's providing a better experience for users more efficiently. So you can see these trends which still have some way to play out across the portfolio; driving profitability, driving cash flow, and I think that's what the market has been rewarding.

PS: So efficient growth for companies that can harness AI effectively there. And then turning to what we've been up to, so trades. And what is it about the companies we've invested in recently that are important for long-term growth investors?

TS: Well, so what we've seen is a combination of adding to some of the positions that we already have in the portfolio, and then some new holdings. So I'd flag something like CloudFlare, which is an IT business, it's a network business, which we think will be really important for delivering AI applications. We've had the holding for some time, but we see that the market is moving in its direction. We've been adding to the position. Something quite different, Wayfair, the online furniture retailer. They've been operating in a very tough market for some time. They have really improved the efficiency of that business. And when that market starts to come back, we think this will be a much more profitable business than anybody expects. We've taken a new holding in DraftKings. They do online sports betting. And we think this is a sector with huge potential as it moves from being a niche industry into the mainstream, as it's legitimized, as it's made legal in more and more states. So it's going to be the combination of growth in the existing states where it operates as the market matures and adding new states as this becomes more of a mainstream activity. And we think that the big players will only get stronger in that environment because the pace of product innovation is faster, because their customer acquisition costs are lower.

So there's plenty of new ideas. We've reduced Tesla. That's been a very longstanding and important holding for us. And there, we're looking at the significant increase in the price and saying, well, it's just becoming harder for us to make the case for the return over the next five or 10 years. And therefore, we want to proportionately lower the holding size. Albeit, we still think that's a business with huge potential as it hopefully brings out new lower-priced products through this year, as well as adding AI, which makes these products much more attractive to customers.

PS: That's very helpful, thanks. And so what gives you optimism for the next five and 10 years?

TS: Well, I think it's that a lot of the companies that we own are growing not as a result of just broad economic expansion, but changes in the marketplace. They're harnessing technology to access new opportunities to serve customers in different ways. And the fact that they're able to do this

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increasingly efficiently, generating higher margins, higher cash flows, I think is a real source of optimism if you look over that time horizon.

PS: Well, that's a great place to leave it. Thank you, Tom.

TS: Thank you.

PS: And thank you for everyone listening. Goodbye.

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US Equity Growth

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

	2020	2021	2022	2023	2024
American Equities Composite	128.3	-4.0	-55.5	46.6	30.6
S&P 500 Index	18.4	28.7	-18.1	26.3	25.0

Annualised returns to 31 December 2024 (net%)

	1 year	5 years	10 years
American Equities Composite	30.6	13.3	15.3
S&P 500 Index	25.0	14.5	13.1

Source: Revolution, S&P. 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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