Baillie Gifford™

US Equity Growth
Q1 investment update

April 2024

Investment specialists Fraser Thomson and Patrick Stapleton give an update on the US Equity Growth Strategy covering Q1 2024.

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

Patrick Stapleton (PS): Hello, my name is Patrick Stapleton. I'm an investment specialist here at Baillie Gifford and I work on the US Equity Growth Strategy. Now, as a reminder of the strategy, this is a strategy holding 30 to 50 companies, some of the most exciting businesses in America with exceptional growth opportunities. We look to hold companies for periods of five years, ideally longer, long enough that the fundamental characteristics of these businesses can play through into returns for our clients.

And I'm joined today by my colleague, Fraser Thomson, who is also an investment specialist and is a partner of the firm here at Baillie Gifford.

So, Fraser, let's jump right into it.

We're seeing rising trade tensions over the last several years. We're seeing persistently high inflation and interest rates and an upcoming presidential election. So is the US still a special place to invest?

Fraser Thomson (FT): Thanks, Patrick. That's a good place to start. So there are always things to worry about when it comes to investing, especially over the long term. And the things you've just mentioned are big and important events, but they are events principally, and I don't think they change the fundamental nature of what the US is as a place for companies to grow. I would contend that the US is still a very special place for growth investing for various reasons that just cannot be replicated by anybody else out there over any reasonable timeframe.

To give that a little bit of colour, I would say that having the world's biggest consumer economy on your doorstep is a really valuable thing for growth companies. It allows you to grow domestically to a pretty big size before you have to go out and take on the world beyond your borders. So that's a starting advantage for a kick-off. But in terms of being the innovation economy of the world, the US has some really big levers to pull. Since 2000, it's produced around about 1,500 billion dollar startups. That's more than the rest of the world combined. China's the next best at 350, so the US is very far apart from everybody else. And a lot of those companies are coming out of innovation hubs, so clusters of expertise like Silicon Valley on the West Coast or the biotech hubs of the East Coast. And that kind of expertise tends to build upon itself and get stronger and stronger the longer it's been there for. Things like venture capital systems or legal frameworks, business support networks build up around it and you get a better and better place to start your businesses. And of course, we know that the US has net migration, so people actually move into that country to start their business knowing what a great place it is to grow. So I think all of those are big, long-lasting advantages, and that's what makes it a great place for us to go looking for growth investing. But one level deeper than that, I would say, is actually the culture. The US is still the land of opportunity, and having that mindset is different and I think does set it even further apart.

PS: So that makes the US really this kind of global center of excellence for creating new, exciting growth businesses. And among those businesses, it won't have escaped you, the Magnificent Seven did very well last year, and now we're looking at increased concentration in the market. There's even talk of an emerging Fab Four. So how has performance been considering this?

FT: Yeah, well, it's certainly a feature. These are very big entities. And as you point out, they are pretty big components of any reasonable index you care to look at. I would caution against getting too caught up with it, though. Newspapers are great at catchy monikers. As you said, the Magnificent Seven is already changing to the Fab Four. And if you look at the 1960 movie, only three of the Magnificent Seven actually survive all the way to the end of the film. So I guess what I would say there is it's important to be selective when it comes to picking your investments and not get pulled in one direction or the other because of what an index is telling you. So we will hold big companies in our portfolio where we think there's a sufficient opportunity for future growth. That can be simply because the market is so big that even starting now, there's a tremendous opportunity for growth.

An NVIDIA, for example, would be a really good example of that. Potentially, computing is getting retyped onto an accelerated model, which NVIDIA's chips will help power. And that's a really exciting demand environment. Or you take something like Meta, for example, which we have been adding to over the past year and a half or so to become quite a big part of the portfolio. And that's because Meta's scale gives it an edge over other advertisers. So in a post-Apple privacy world, it's quite hard to get intelligence from your third-party data.

And Facebook may be unique in having the engineering scale to rebuild tools, primarily on AI, that give advertisers that visibility back and make that platform so much more valuable than anything else out there. We think that will drive all kinds of growth for Facebook and Meta's other social media platforms. And that's tremendously exciting. So something being big now doesn't mean it can't get bigger later, but it does mean that you should be really selective about what you're picking.

Against that backdrop, our performance has actually been pretty strong over the past year or so. So far this year, we've been strong in absolute terms, so up 8 or 9 per cent, but a little bit behind the index. But I would characterize that more as the ebb and flow of a relatively small number of stock price moves.

PS: So performance of the strategy being driven by some large names, established businesses that are performing very, very well. Looking then back to the portfolio level, we're seeing a portfolio that is also quite robust, so a high proportion higher than last year have positive earnings or cash flows. We're seeing companies also reinvest in growth ahead of the market and we're seeing the portfolio grow ahead of the market as well.

So how well is the portfolio positioned for growth in this environment?

FT: We think it's positioned very well in this environment for growth. We should make no bones about it. We went through a difficult spell. So as you mentioned at the top of the discussion, interest rates have certainly been a feature of the investment environment. And that change from zero rates to a higher rate has been painful for some of our companies. They've had to make adjustments to their cost base to adapt to that new environment. And growth did slow as they looked inward and made those changes.

There's been a mindset shift, probably from a growth at all costs type approach to a more selective approach to where you place your investment dollars. But our companies are still placing those dollars at a very high rate, and that will power future growth. We take something like Shopify, which is an e-commerce platform owned in the portfolio. It has moved away from trying to develop a logistics business to sit alongside this e-commerce platform, so it's divested from that and it's reinvested in building AI (artificial intelligence) tools for its merchants because it thinks that's where it has the greatest opportunity to deliver value to its customers. And we completely back that. At the same time, Shopify has gone from burning cash to a free cash flow margin of over 20 per cent. And that kind of adaptability, that kind of progress is what we're looking for in our companies. So I would say we're looking at a really healthy place for the portfolio overall.

Looking at what that offers up in terms of opportunities, as well as it changing some of that decision making, it changes the competitive environment as well. So a higher rate investment environment means a more challenging one for funding generally. Only the best companies will secure that kind of funding. And if we own the best, we can actually find ourselves in a much easier competitive place than we'd previously expected. If we take DoorDash, for example in the portfolio, a local delivery business, primarily delivering takeaway food at the moment but has much grander ambitions. That's been a great market for volume, but it's been a horrible market to make money because entrants have come in, they've bought custom by operating below where their economic line is, and that's been a totally viable strategy in a low-rate environment. That doesn't work now. And DoorDash is different in that it's always focused on being a fundamentally profitable business. And as the environment has changed, DoorDash has found itself almost operating alone and able to grab a much bigger share of the market more quickly than we might have expected. And that's really exciting.

PS: So businesses that are focused on the fundamentals have done well. You're also saying that artificial intelligence is driving more efficiency, so helping companies in some cases save costs, but become more productive as well. And it seems you can't open a newspaper today without seeing the term artificial intelligence. But it's one of the many areas that we invest in, for example, electrification, cloud migration, genomics, there are other areas. So what are we most excited about this year and beyond?

FT: Well, we are also excited about artificial intelligence. I think that's a big deal. You can actually read a bit more detail in Tom Slater's paper on this, the AI paradigm, which I think sets out our thinking really well. But essentially, we agree that there could be rebuilding of compute on a faster, more productive platform than we previously expected. And the likes of NVIDIA may provide the foundational hardware for that to happen. So we're really excited about that.

We've actually reduced our NVIDIA position in light of very, very strong share price appreciation and the size that's ended up being in the portfolio. So we're still very enthusiastic about that as a long-term opportunity. But its current size means that we can both reduce that and maintain some significant exposure. And we can also invest in other exciting areas of the artificial intelligence value chain. The likes of an Amazon through its AWS is also providing that foundational technology. And there are analytical providers, the likes of a Snowflake or a Datadog. These are companies that provide tools that help you to make sense of your data. So organizing it in a way that makes it viable for productivity gains and intelligence. And that's becoming really important, too.

And then finally, there are just companies that own great data sets, making really smart use of them. Tesla might be one of them. It's collected millions of driving miles and is seeking to use that data set to help it create a viable self-driving software stack which it can sell to its customers. And there are other examples like Duolingo, the language learning application, which is using AI to both accelerate its product development, but also deliver more value to its customers. It's already charging more for the AI-enabled tier, which is far more personalized, far more conversational than the previous iterations of its applications. So really rapid progress in that kind of environment.

But as you said, it's much more than just that. We're looking for companies that can grow by two and a half times or more over the next five years, and they can get that in a great variety of ways. But if I was to pick one other area where we're really excited, it would be healthcare. There's a falling cost of data collection and storage. There's a greater understanding of the individual nature of people's genetic makeup and the genetic makeup of disease. And as those two things collide, we can get much better intelligence for a much lower cost in terms of what people are facing, how they're likely to react to treatments. And that opens up a whole new avenue of opportunity. And we don't think that the best opportunities will come from the existing large pharma companies. We think they're more likely to come from new entrants like Moderna which we've been adding to this year, or Guardant Health which is a liquid biopsy company that we bought late last year. Now, its tests are primarily used to help select therapies at the moment for cancer patients. But if we roll forward a few years, that technology could equally be used to screen people for a variety of health concerns at a very early stage. So the whole mindset shifts from treating people when they appear sick to keeping people healthy. And that is a very exciting and potentially very rewarding environment for growth investing.

PS: That is excellent. And lots of reasons, like you said, to be excited about the future of growth and that pace of progress accelerating as well. So thank you very much, Fraser. And thank you, everyone watching online. Fraser did mention Tom Slater's article on AI. You can access that and more insights about how we're thinking about the opportunities for growth investing in America over the long term. You can do that by searching Baillie Gifford, The Long View. So thank you again for watching and goodbye.

US Equity Growth

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

	2020	2021	2022	2023	2024
American Equities Composite	1.8	144.2	-28.2	-29.3	35.2
S&P 500 Index	-7.0	56.4	15.6	-7.7	29.9

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years
American Equities Composite	35.2	11.3	13.8
S&P 500 Index	29.9	15.0	13.0

Source: Baillie Gifford & Co and S&P 500. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

Past performance is not a guide to future returns.

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