Baillie Gifford™

International Smaller Companies Q1 investment update

April 2025

Investment manager Charlie Broughton and investment specialist Eoin Anderson give an update on the International Smaller Companies Strategy covering Q1 2025.

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

Eoin Anderson (EA): Hello and welcome to this Q1 2025 investment update for the International Smaller Companies Strategy. My name is Eoin Anderson. I'm an Investment Specialist on the Strategy and today I am joined by Charlie Broughton, who's one of the portfolio managers. As a reminder, International Smaller Companies, or ISC, is a small cap strategy that looks to invest in a broad portfolio of small, exciting, and most importantly, growing businesses from within the international equity universe.

So, Charlie, we're three months into the new year, but I think it's fair to say it's been something of a roller coaster so far. I wonder if, to begin with, you want to just give us a few thoughts or bring us up to speed on what's been happening so far.

Charlie Broughton (CB): Yes, it's been eventful, to say the least. I think you know well that over the past few years, international equities in general have been under real pressure relative to their US counterparts. The valuation discounts have approached record highs and capital flows increasingly been out of international into the US. The quarter saw that reverse probably for the first time in a number of years and quite dramatically, for example, in the case of Europe, where the valuation outperformance was unprecedented. It's never happened at the rate it happened. We think this is probably twofold. We think some of the political manoeuvring and volatility of the last couple of months has, it's both served to maybe reduce investor confidence in the US economy, but it's also, I think, lit a fire under a number of governments outside of the US acting as a somewhat harsh reminder that they can no longer necessarily rely upon the US to do the heavy lifting politically and economically. And we've seen this manifest in a number of ways. Probably Germany's the most striking, where, as you'll have seen, they removed their longstanding debt ceiling. And this opens the door there for significant fiscal spending on things like defence and infrastructure, which has led to a real uplift in valuations across those sectors. So yeah, busy times, exciting times.

EA: So how has this impacted your positioning, if at all? Obviously, long-term growth investing, you're looking far, far longer. But amidst this, has it had an impact on your thinking or the shape of the portfolio?

CB: Yeah, I think it's had a very clear short-term impact. One of the unfortunate side effects of capital leaving an asset that's perceived as being too risky or fleeing uncertainty, if you will, is they tend to move towards less risky assets and that said, or assets that benefit from some of the momentum from all the volatility happening. In the case of the past quarter, that's meant banks, ex-US banks, and it's meant defence companies, because I think people have realised that you can no longer necessarily rely upon the US to support its historic allies. As you know, we are long-term growth investors. We want to find companies with exceptional competitive advantages, generating healthy returns that they can compound over many, many years by normally addressing big opportunities. This has historically kept us a little bit away from banks, where we think there's very rarely the edge or the opportunity in place to get past the commodity nature of banking. And simultaneously with defence, I think we've always struggled with customer concentration and maybe a lack of competitive advantage outside of the US. So, what that's meant is that we are underexposed to those areas, which has created some headwind over the quarter. That said, we are still seeing a lot of really exciting opportunities out there.

We've added to a number of positions in your portfolio, companies like Tonies, where this is a German toy company that's expanding rapidly into the US, growing extremely quickly, hitting their operational KPIs, but seeing valuation come down. We took a new holding in a a remarkable business called Cover in Japan, which is a very hard company necessary to describe to those who aren't initiated in the world of VTubing. But Cover is the world's largest VTubing talent agency. VTubing sees influencers and musicians perform online, and increasingly live as well, using virtual avatars. So they appear as a virtual character. As a medium, it's growing incredibly quickly. We see a lot of analogies with how K-pop emerged maybe 10, 15 years ago. Cover are the leader, they're growing their revenues at 40 per cent plus a year, and these are returns on capital in excess of 50 per cent. So it's an incredibly profitable business. And we believe if this can emerge as a global entertainment medium, the upside is incredible. So we're seeing really exciting things out there.

EA: Thank you. That's really helpful. It's given some of the broader context and a couple of stock examples, including a new purchase. But is there anything else in performance terms as a stock picker you want to pull out from the companies held within the portfolio?

CB: Yeah. It's funny, if you look at the attributions, you'd say, wow, you're really overweight Hong Kong or really overweight Switzerland. And of course, we are, but not because we have a huge macro view on Switzerland and Hong Kong. This is a result of having really high conviction ideas that we hold at size in our portfolio in those countries.

And I guess for us looking at this past quarter in Hong Kong, we have a business called Johnson Electric. They make tiny robotic motors and actuators. These historically were used in industry and in automotive and the big boost over the past kind of six months has been the emergence of businesses looking to find ways to take AI and apply it to robotics. So you take your chat GPT and you put it in a physical body and let it help you, you know, carry your stuff around the house. Obviously, still very speculative, still in early days, but I think the market has appreciated that there's a bunch of players in the value chain here whose standard benefit should this become mainstream and Johnson Electric are very much one of them.

Sensirion, this is a Swiss sensor business, quite a big holding for us. They've had a terrible couple of years. They make environmental sensors and its very kind of CapEx driven and They struggled with supply chain challenges over 2022 and 2023. At first, they couldn't service their customers because they couldn't get the pieces. And then when they could, customers overordered. And hence, there was this big inventory hangover. What was striking is that throughout that period, Sensirion continued to invest and invest and invest in R&D and CapEx, very much proactively looking at the opportunities over the next five or 10 years. And we added to the position based on this, what we felt was very counter-cyclical, forward-looking approach by management. I guess it's been really encouraging to see Q1 of this year, see some of that demand start to come through and some of those investments pay off. So on the positive, those are good examples.

On the negative, we've been hurt by Japan. Again, capital flowing out of the US is flowing into more defensive, maybe value-orientated assets in Japan, and Japan has a big portion of their index taken up by more mature industrial companies. We very much are focused at the lower end of the index on the fast-growing young companies, and they've underperformed over the quarter. Taiwan is maybe the most striking example of evaluation mismatch. We're very overweight, Taiwan. We're very much focused there on the semiconductor industry, which we believe remains the most important industry in the world today in terms of how it will reshape our world over the next five, ten years. Obviously, a lot of that's based around TSMC. We know TSMC very well. We have a good relationship with them within Baillie Gifford, and we speak to them regularly and they are explicit that the demand for semiconductors has never been stronger. They cannot meet the demand their customers, they can't make enough chips to service their customers. And these are customers across industries from AI is the obvious one, but also electric vehicles and cryptocurrency and Internet of Things. The demand is almost endless. And yet their suppliers and partners and their ecosystem around them, many of whom we own in your portfolio have seen themselves underperform over the past six months. So, that's a good example where we think the short-term valuation mismatch is really striking and it's unfortunate to see it hold us back over the period, but we're very, very optimistic with your holdings there.

EA: Okay, last question from me, but a fairly big one and quite an important one, given some of the external noise that we've spoken about in the environment at the moment. What at the moment is giving you real, real confidence in your long-term philosophy, process, your stock picking, where does that confidence come from?

CB: Yeah, I mean, it's not easy in hard periods, but I think probably the greatest joy of being long-term growth investors is that we are positioning ourselves in businesses where we believe they have this incredible opportunity to grow and compound through cycles. And we think, again, assets will come and go out of vogue, flows will come and go, there'll be cycles. But ultimately, for small companies that are able to compound and grow into big companies, the cash flows that are generated in doing that can't be ignored. And really, time is on your side in that scenario. And I think that conviction in the long term makes it much easier to ride out macro volatility. Looking more short-term, probably the great hope here is that investors have been reminded that there is a world outside of the US. There are companies operating on either side of both oceans, exciting, fast-growing, competitively strong companies. And I guess the hope is that after the initial flight maybe to the more stable, slow-growing assets, investors realise that there are companies there that are genuinely competitive on a global stage, growing quickly and trading at valuations that remain even now, you know, at an unprecedented discount to anything else in the market. So I think having that kind of leads to a lot of optimism about your portfolio going forwards.

EA: That's great. Thank you, Charlie. And thank you very much for joining us. Should you have any questions at all, please don't hesitate to get in touch with us here at Baillie Gifford. Thank you again and goodbye.

International Smaller Companies

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

	2021	2022	2023	2024	2025
International Smaller Companies Composite	86.3	-13.7	-12.3	0.6	-1.6
MSCI ACWI ex US Small Cap Index	70.4	0.4	-9.9	13.4	2.4

Annualised returns to 31 March 2025 (net%)

	1 year	5 years	Since inception*
International Smaller Companies Composite	-1.6	6.9	3.2
MSCI ACWI ex US Small Cap Index	2.4	12.3	5.9

*Inception date: 28 February 2019.
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.

Legal notice: MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Risk factors

This communication was produced and approved in January 2025 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial Intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a "wholesale client" within the meaning of section 761G of the Corporations Act 2001 (Cth) ("Corporations Act"). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a "retail client" within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas Limited is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Singapore

Baillie Gifford Asia (Singapore) Private Limited is wholly owned by Baillie Gifford Overseas Limited and is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence to conduct fund management activities for institutional investors and accredited investors in

Singapore. Baillie Gifford Overseas Limited, as a foreign related corporation of Baillie Gifford Asia (Singapore) Private Limited, has entered into a cross-border business arrangement with Baillie Gifford Asia (Singapore) Private Limited, and shall be relying upon the exemption under regulation 4 of the Securities and Futures (Exemption for Cross-Border Arrangements) (Foreign Related Corporations) Regulations 2021 which enables both Baillie Gifford Overseas Limited and Baillie Gifford Asia (Singapore) Private Limited to market the full range of segregated mandate services to institutional investors and accredited investors in Singapore.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com