

Blue Sky & Base Rates: 10 Years On

Tom Slater & Lawrence Burns, hosted by Hamish Maxwell
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Your capital is at risk. Past performance is not a guide to future returns.

Hamish Maxwell (HM): Hello, I'm Hamish Maxwell, an investment specialist with Scottish Mortgage, and welcome to this session on *Blue Sky and Base Rates*.

Since 1909, Scottish Mortgage has lived through oil shocks, dot-com bubbles, financial crises and pandemics. One lesson stands out in particular. While the short term can sometimes feel overwhelming, real value is built over the long term.

Ten years ago, Scottish Mortgage manager Tom Slater, indulging his inner maths geek, which I hasten to add are his words, not mine, published his study *Blue Sky and Base Rates*. By analysing historic returns of the market, Tom explored how often stocks rose significantly in value over five-year periods. This revealed patterns in returns and base rates, or the likelihood of certain outcomes based on past performance.

It showed that just a few companies create most of the market's wealth, and that exceptional operational performance is key to success. That analysis has now been revisited, and its lessons could not be more relevant.

Tom and Lawrence joined me to discuss the findings, and how patience, imagination, and a willingness to back transformative companies, even through uncertainty, can shape long-term success.

Tom, Lawrence, thanks for joining the discussion.

Tom Slater (TS): Thank you for having us.

HM: Tom, I'll start with you. A week can sometimes feel like an eternity in markets. So how do you shift the focus from that narrow perspective to the 5-to-10 years that really matters?

TS: I think you're right. A week can feel very painful. But it doesn't equate to real big business progress. Rome wasn't built in a day. It wasn't built in a week. And

actually, you have to look over longer time horizons than that. So, all the work we do is looking to underwrite an investment case over 5 to 10 years.

And then what we're monitoring is the signs of progress towards that vision, whether it's the development of the addressable market, it's the competitive position of the company, and how it's moving towards that goal.

And it's in doing that and maybe distancing ourselves from the noise and the inevitable volatility along the way that we can remain resolutely focused on actually the developments in the business, not the volatility in the stock price.

HM: Lawrence, when you back companies building something genuinely new, progress can be uneven. So, what's the investing lesson in the fact that growth is never in a straight line?

Lawrence Burns (LB): I think it's that you have to remember that the price for pursuing outliers is volatility. That almost all of the great companies, because they've been trying to do something that has never been done before, there have been times where people have questioned that path, that progress, and the journey has been bumping.

And so, I think for us, it's going in with that mentality up front, that this isn't a bug of a few companies' journeys. This is a feature of how great companies are built, that there are periods of stock market volatility on that journey.

And I think for us, the more recent and most poignant example of this is, NVIDIA has been a huge stock market success. It's near a \$4.5 trillion valuation. The trust has done very well. It's made 100 times returns since its initial investment.

If you look at the share price graph, it looks very attractive, but people forget the journey was a lot more difficult than it appears. If you go back to 2022, the share price fell 60-70 per cent. You wouldn't have ever been able to get that outlier return if you decided to give in at that point, if you sold out.

And so, for us, it's just reminding ourselves that a company going through difficulty does not mean that they don't go on to be incredibly successful. And you see that again and again. Apple's had two drawdowns of over 70 per cent in its history. Amazon's had three of over 45 per cent, the worst being over 90 per cent.

This is a feature of the path that great companies go through.

HM: Yes, keeping that in mind that it's not a bug, it's a feature of the long-term progress.

Tom, you've remarked before that only one in 10,000 companies survives to be 100 years old, and Scottish Mortgage and of course its manager, Baillie Gifford, are among that small cohort. So, what have stability and adaptability meant in practice for the Trust?

TS: Stability is at the core of the culture of the Trust. It's about long-termism. It's about having an independent board. It's about acting in the best interests of shareholders. And adaptability is how we work within that culture and refresh our growth themes, search for new ideas, reassess the way the world is going.

And I think stability without adaptability is stasis, but adaptability without stability is just drift. So, it's being resolutely long-term, staying true to the core pillars that support the trust that have led to that 100-year history, but using that stability to embrace risk, to accept the volatility that Lawrence was referring to in that pursuit of outlier growth companies.

HM: Yes, indeed, the foundations to avoid the stasis and drift. Thank you.

Lawrence, back to you. On the one hand, headlines and on the other hand, structural growth. How do you keep the focus on the latter?

LB: Bill Clinton used to have a saying, follow the trend lines, not the headlines. And I think that's true in investing.

So how do you keep that focus? I think one part of it that's really important is just being very clear about what you do and what you don't do. Being clear with yourself, being clear with your colleagues, and most importantly, being clear with shareholders.

We're here to optimize returns over periods of five years or more. And I think if you're very clear about that, it reduces any temptation to focus on the headlines, to focus on short-term fluctuations.

I think the second thing that psychologically helps with it is not to spend all of your time in the office, not to spend all of your time watching a screen with the news headlines, with share prices, but to get out, meet companies, meet founders who are actually driving the structural change.

That is incredibly important that you are there having those conversations, seeing that structural change and focusing on what matters, which is the long-term fundamentals.

HM: Yes, it's difficult, but so, so important.

I'd like to go back to the origins of the piece of work we're talking about, Tom. So, let's go back to 2014. And [with] *Blue Sky and Base Rates* originally, what was your intention and what did you hope to reveal?

TS: Well, it quantified, I think, what experience told us, which is that a small proportion of companies generate a disproportionate amount of the value.

So, you see that about 20 per cent of companies create half of all stock market returns. And about 5 per cent of companies go up at least fivefold in any five-year period. And that has big implications. It reframes how you think about risk, because you can only ever lose that initial investment. But if you're right about something, then 5 per cent of the time, you can make more than five times your money.

And it shapes also, I think, thinking on portfolio design. If the returns are driven by a small number of big winners, how do you maximise the chances of owning those big winners? What are their characteristics?

And where you find companies that have that potential, how do you hold onto them for long enough without that temptation to trim, without that idea that, just because something has become a big holding, it's become more risky that you actually capture the full return of those most impactful stocks.

HM: And if I can stick with you for a moment longer, Tom, that was 2014. So why refresh now? What did we hope to reveal in the recent work?

TS: Well, the last decade has had some real periods of stress. We've gone through Covid, we've gone through the pandemic, we've seen the impact of social media. I think we live in a much more uncertain geopolitical environment.

So, we wanted to go back and say, well, does that thinking still apply? And not just opine on that, but actually look at the numbers, look at the data and say, well, 'is this still the world we live in?' And that was the trigger to go back and rerun the numbers.

The first time we did it, we looked only at US stocks. So, this time we looked at a global universe over the more recent timeframe.

HM: Of course, thanks. Time for a couple more questions. Lawrence, we aim to benefit from the extraordinary rather than the average. So how has the ongoing presence of skew shaped portfolio construction?

LB: So if you look at the Trust's top 10 holdings, they account for about 40 per cent. And I think that is reflective of the skew and what Tom was just talking about. That

what you see in equities as an asset class is this small number of companies drive returns, and you see that with our portfolio as well.

And there we're very comfortable of letting those companies run. I think there are two mistakes you can make that are the largest when pursuing outliers. The first is to miss an outlier entirely.

The second is that you've actually done the hard work of identifying and owning it, but then as it goes up, you're constantly trimming it. Investing in outliers when you're trying to get a five-or-10 times return, you're not going to get that if halfway through you halve the holding after it's doubled. And so that's what ends up sort of driving all the portfolio construction of these large holdings.

And at the same time, it's about keeping the bar low to the next idea that could be the outlier. And so you'll then see a number of small holdings that have to operationally validate themselves and improve over time. But we want to keep that bar low for the next generation of winners coming through as well.

HM: Sure. We could talk about this all afternoon, but unfortunately, we have just time for one more question. So, I might just come back to Tom then to underline the importance of patience, because I've heard you say often one of the most underused advantages in investing is time. So, can we just dig into quickly how you steel yourself for the buy and hold?

TS: Well, I think you are bombarded by information. And the headlines implore you to act. Something's going wrong at this company, this piece of economic news. You should do x.

But I think what's centrally important is knowing, in your own mind, why you own a stock. And then using that as a framework to judge the news. And if a company's gone up in stock price, well, on its own, that doesn't tell you very much.

Let's stick with the example of SpaceX and what Commander Hadfield was saying, that position has grown in value for Scottish Mortgage. Well, should we trim it? Well, think about what he said. He said that they've moved on very substantially over the past seven years in the capabilities that they've delivered, and they're pulling away.

So, to my mind, that opportunity has got bigger and the likelihood that they capitalise on it has got greater. So, it makes sense to have a larger holding. And, so, viewing the positions through that lens, I think, informs how we construct the portfolio.

HM: That's so interesting. And thank you very much, both of you, for your answers to these questions. We are coming up on time now.

Over a century, our edge has been simple. Focus on what matters and keep learning. Markets change, but our principles of patience and growth do not.

Despite short-term challenges, Scottish Mortgage has turned resilience, stability and adaptability into long-term success. We back excellence and innovation because history shows that a few exceptional companies drive most of the returns.

Looking ahead, we'll continue to nurture those outliers for the long-term benefit of shareholders.

Scottish Mortgage Annual Past Performance To 30 September each year (net %)

	2021	2022	2023	2024	2025
Share Price	44.5	-45.0	-13.9	25.6	36.5
Net Asset Value	39.4	-36.3	-5.9	16.8	33.3
Benchmark*	22.7	-3.6	11.1	20.2	17.4

Performance figures appear in GBP. *FTSE All World Index (GBP) TR.

Performance source: Morningstar and relevant underlying index provider, total return.

Past performance is not a guide to future returns.

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