Baillie Gifford™

Global Alpha
Q4 investment update

January 2025

Investment manager Spencer Adair and investment specialist Jon Henry give an update on the Global Alpha, Global Alpha Ethically Restricted, Global Alpha Paris Aligned and Global Alpha Paris Aligned Ethically Restricted strategies covering Q4 2024.

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

Jon Henry (JH): Hello, and welcome to this quarterly Global Alpha update. My name is Jon Henry, and I'm a specialist on the Global Alpha Strategy, and I'm delighted to be joined by Spencer Adair, one of the portfolio managers for Global Alpha. Hi, Spencer.

Spencer Adair (SA): Hi, Jon.

JH: As a reminder on Global Alpha, the strategy is a diversified global growth approach. And by growth, we mean earnings growth, because that's what we believe drives share prices over the long run.

And we embrace that earnings growth potential in companies by investing across three different growth types: compounders, disruptors and capital allocators. And the output of that process is a diversified, balanced and resilient growth portfolio that seeks to outperform the MSCI, All Country World Index, over rolling five-year periods.

In terms of what we're going to cover with Spencer today, we plan to talk about performance, the positioning of the portfolio, what we've been up to recently, and then we'll touch on why we're confident about the portfolio's positioning and characteristics as we look forward.

So if I bring Spencer in now on performance, Spencer, the last quarter of 2024 brought to a close another eventful year, perhaps no more eventful than in November with the US elections. But overall, global equity markets have been strong, up 18 per cent or thereabouts in US dollar terms. I think given a significant leg up by large cap US tech stocks as a result of the excitement around artificial intelligence and its potential.

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Now, the Global Alpha Strategy has delivered a really healthy absolute return but has ended the year a handful of percentage points behind the index. Perhaps you could share some perspectives on that.

SA: Yeah. So we're happy with the absolute returns. We're unhappy with the relative returns and we appreciate that we are paid to outperform. We've not done that. So what have we been doing? Well, we've been adjusting our holdings to have more capital invested in companies which have got higher risk adjusted upsides.

We've been taking advantage of share price moves to reallocate. That may mean broadening out the base of the portfolio generally with new growth ideas and drivers that are not represented in the portfolio. But also within areas like artificial intelligence or infrastructure, we've been widening out the holdings within those. So broadening and widening the base of the portfolio is what we've been up to.

But what's hurt, why have we underperformed? The number one headwind has come from healthcare, and two companies in particular. Elevance, which is a US health insurer. It quite often underperforms in election years. This has happened as well. It's also had some... [its] margins have fallen a bit. We've spoken to the management team there. They're fixing the margin. And we think that it will really come through quite strongly in the next few years. So we're really quite excited about that one being a coil spring ready to rebound.

The other headwinds in healthcare was Novo Nordisk, the Danish company that's leading in the new obesity treatments that are all over the news, and also in diabetes care. They've made really good fundamental progress on revenue, on building out these drugs. They are becoming more and more popular. They're getting recommended. And what's really exciting is that people are taking these drugs for longer. So, it's becoming a really long-duration asset.

The disappointment came just the end of the year, where their very latest generation of obesity drugs, they thought they would reduce your weight by about 25 per cent. It ended up reducing it by between 22 and 23. A good result, but not quite as good as the high expectations of the market.

JH: Thanks Spencer. I think it'd be helpful just to tease out the point on broadening out the base for growth in the portfolio. I mean, it feels like at the moment, the competition for capital in the portfolio is coming from a range of different places, often unfashionable places, sectors, parts of the economy.

We could look at something like Builders First Source, which we purchased earlier in the year, the building supplies business for the US retail housing sector, we've added to that this quarter.

[We’ve] also added to AutoZone in car park retailing, not necessarily areas you would associate with growth. But we have added a new position in Brookfield Corporation. in the latest quarters. Perhaps you could tell us a bit about what Brookfield Corporation does and ultimately how it fits into the portfolio.

SA: Yes, so we love finding unfashionable, out of favour growth stories that have got long term structural growth but there's something holding the market back and some of your examples there are prime examples of that.

But Brookfield is an alternative asset manager. It develops and owns and runs real assets, usually very large assets. That could be commercial real estate, it could be power infrastructure and generation, so a really broad mix of real assets.

It provides another way of funding the infrastructure growth that we've been so excited about for some time. It really fits into that. It's very well financed. It's continuing to raise new funds. And we think it's poised to compound its earnings at 10 to 15 percent for the very long run.

The shares trade though at a discount to its intrinsic value. You can add up, you can sum up the value of all these assets. It trades at quite a big discount to those. It also trades at a discount in terms of PE to the broader market, despite probably superior long-term growth prospects. Now, the complexity may be putting some people off. There's a lot going on here.

But also, there's some cyclical pressures, particularly in commercial real estate. But we weigh those up against the really strong structural growth rates the company has delivered and should be capable of delivering, but also a really superb record of smart capital allocation. And therefore, we're happy to take a holding and let it compound for years to come.

JH: That's really interesting, Spencer. I think it's worth stepping back, actually, when we look at the portfolio as a whole. And what we're talking about is perhaps a more unfashionable, less recognised areas of growth.

But actually, portfolios tilted a little more towards disruptors in the portfolio. Now, that includes NVIDIA and large tech businesses that we own, but also a range of other companies that are doing really fantastically in terms of revenue and free cash flow growth.

And here, I think we're talking about the likes of the trade desk and programmatic advertising and Shopify, where we've reduced and taken profit recently. But we've also added to our position Block, which firmly fits in as one of our faster growing holdings. So perhaps you could tell us a little bit about Block and why our conviction in this business is growing.

SA: Yeah. So Block is a fintech company. At its core, it's increasing access to financial services and products. It's got several different divisions that help either small business owners or the underbanked.

Both of those businesses, they're adding new products continually, new software products, so their product's getting better, and the customers are getting stickier, and so they're growing at a very good clip. High teams growth rate.

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Previously, the only thing that the management team cared about here was the high growth rate. That's what they're prioritizing. In the last 12 months or so, they've really started to focus on more balanced growth and particularly on profit growth, profitable growth as well.

And so we've seen a really big inflection or change. A year ago, this was making operating losses and net losses. Today, it's making operating and net profits. So it's really swung from losses to profit. And the next five years should see continued strong top line growth and continued building up of that margin.

So why did we add to it? Well, frankly, it was underpinned by valuation. We're buying this company on a modest discount to the market over the next 12 months, but a massive discount on the 12 months after that as the growth comes through. So the market hasn't priced in that tipping point, that inflection point to block.

JH: Well, that's really interesting. We're talking about inflection points in growth. And one of the last questions I wanted to ask you relates really to the the overall health on a fundamental level, the operational progress of the portfolio as a whole.

So could you share your perspectives on where you think the portfolio is today and how confident we are looking forward?

SA: Absolutely confident. So there's no inflection point here. This is a continuation of business as usual. So really solid foundations and those foundations if anything have been strengthening relative to the wider market.

Our companies are delivering faster growth. They are better free cash generation. They are reinvesting more into their business. They've got much lower levels of debt relative to the market. And yet, our relative valuation is now at the lowest level in five years. So the fundamentals have got stronger, and valuations have got weaker. And that's a great combination to start from.

I also take a lot of comfort, if you look over the last 12 months, most of our return has been driven by earnings per share growth. So the biggest component of our growth has been profits. The biggest component of the stock market growth, broadly, has been a re-rating, has been the PE, the price to earnings ratio, increasing. And so our approach to me feels inherently more stable and sustainable because it's driven by the fundamentals coming through, which is what we say we're going to do.

JH: Thanks, Spencer. That's really interesting. I think if we can then summarise, I think there's three key points I think we've covered here.

The first is that we're intentionally broadening the base of growth in the portfolio. And we may to some extent have ceded near-term returns versus the index in favour of longer-term returns, and we think that's a trade-off that we're willing to take at the moment.

The second is that the portfolio's exposure to disruptive growth, fastest growing growth companies in the portfolio remains meaningful and we've been adding where we've had the opportunity with the likes of Block.

And then thirdly, I think the foundations of the portfolio, the operational level of the portfolio is strong. So what you're suggesting here is that the earnings growth have been the majority driver of our share price return or returns over the course of 2024, which puts us on a sustainable footing for delivering outperformance in the future.

So I think that sums us up nicely. Thank you for your time, Spencer. And thank you all for watching. And we'll see you next time.

Global Alpha (including Global Alpha, Responsible Global Alpha, Global Alpha Paris Aligned and Responsible Global Alpha Paris Aligned strategies)

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

	2020	2021	2022	2023	2024
Global Alpha Composite	36.4	7.3	-29.1	19.5	11.1
MSCI ACWI Index	16.8	19.0	-18.0	22.8	18.0

Annualised returns to 31 December 2024 (net%)

	1 year	5 years	10 years
Global Alpha Composite	11.1	6.6	9.0
MSCI ACWI Index	18.0	10.6	9.8

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.

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