

# International Smaller Companies Q4 investment update

April 2025

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

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**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 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.

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