Baillie Gifford™

Global Income Growth Q2 investment update

July 2024

Investment manager James Dow and investment specialist Seb Petit give an update on the Global Income Growth and Responsible Global Equity Income strategies covering Q2 2024.

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Seb Petit (SP): Hello and welcome to this quarterly investment update on the Baillie Gifford Global Income Growth Strategies. I'm Seb Petit, I'm an investment specialist and I'm joined today by James Dow, head of the team.

As a reminder, our strategy is to invest in high-quality long-term compounders, companies that we expect to deliver attractive rates of growth in earnings and dividends and with truly resilient business models across cycles. So, we aim for above-market growth with below-market volatility.

James, after a strong start to the year, global equity markets were up about 3 per cent in the second quarter. Our portfolios were up about 1 per cent. What is your high level take of the quarter?

James Dow (JD): Well, you're right, Seb. Another strong quarter for equities, investors in enthusiastic fettle, a brilliant mood. I think [of] a couple of key driving trends the past few months. One has been the continued enthusiasm around artificial intelligence and that's propelled a small number of stocks to rather giddy heights over that period as people look ahead to AI.

Another one a bit less talked about, [is] probably the prospect for interest rate cuts, particularly in the US in the second half. And that's led to some cyclical names that were quite bombed out on fears about [the cycle] last year [that] have bounced, US banks and so forth. And those things combined have really propelled stock markets to new highs.

In terms of the portfolio, also positive returns, [but] not quite as strong as the market. I think that's probably to be expected because of our focus on durable long-term compounding in these hot markets. Then the portfolio tends to be a little bit behind. But generally positive momentum, investors [are] enthusiastic, the world economy looking quite strong.

SP: Thank you. And if we look at the portfolio in the quarter, which stocks have driven that performance, you know, good and bad?

JD: Novo Nordisk [was] certainly a big contributor. That's a large holding for us and [thanks to] continued good news flow around the company and its products. For example, [the] authorization of Wegovy, one of its flagship medications in China, propelled the shares to new highs.

TSMC [is] riding on the coattails of AI as the manufacturer of most of NVIDIA's chips, NVIDIA a big name in the AI space. TSMC has also done very well. Similar story at Atlas Copco, which serves the semiconductor industry, Schneider Electric and data centres. So, multiple beneficiaries of some of those strong trends within the portfolio.

On the negative side of the ledger, Fastenal having hit record highs in the first quarter has come off a bit, a bit of cyclicality there [in] the past few months. B3, Partners [Group], a couple of other holdings, I would characterize most of those as sort of cyclical noise rather than we think there's anything wrong with them, all continue to deliver long-term strong growth. So, some puts and takes both sides.

SP: Thank you. Now stepping away from the quarterly moves in share prices, I know in the second quarter usually you sit down with the team to analyse the long-term earnings growth of companies in the portfolio. What have you done this year? What are the lessons you took from this year's exercise?

JD: Yes, that's right. That's a big exercise for us every year. And an important one, to sit down and process all of the annual results from the holdings in the portfolio and really making sure that they are on track with the investment cases that we've laid out for them.

You know, at a high level, we expect companies in the stock market broadly to grow their earnings around 5 per cent a year. We're looking for a higher rate of growth from that, more like 10 per cent a year, [that] is the benchmark that we set for holdings in the portfolio. And over [the] long term, that should deliver outperformance.

So, we sit down every year and clean up all the numbers, go through the financial statements, [and] see if the companies are indeed on track. And the good news from having done that exercise over the past couple of months for the holdings is that the portfolio is very much on track.

The average across the portfolio is a little bit more than 10 per cent earnings per share growth over the past five years, including the latest financial year. And so, that's good to see, that the portfolio is delivering the growth that we're trying to deliver to clients.

Now, within that there's a range, as you might expect. There's a sort of central core of the portfolio maybe about 60 per cent of the portfolio is indeed continuing to deliver that 10 per cent growth year in year out. So, for example carsales.com, which is the dominant place to buy and sell used cars in Australia. Having processed more results from that [holding], we can see that [for the] past five years, it's on track. It's delivering that 10 per cent a year growth now, and we've had good returns out of the shares.

So that's the core of the portfolio. [There are] a few where we've noted disappointing results, sort of sub 5 per cent growth over the past five years, [after] updating for the latest numbers. An example there would be Want Want, which we've recently sold, where the growth hadn't really come through. So, as you can imagine, we're doing work on all those names checking the investment cases, why aren't they performing the way we thought?

And then finally, [at] the top end of the portfolio, some really strong results from a number of companies. About 20 per cent of the portfolio where we've seen over 15 per cent a year growth. So, for example, Microsoft would be in that bucket. In fact, [it is] more than 20 per cent a year growth we've had out of Microsoft the past five years.

Long story short, the portfolio is on track and the headline is it is it's delivering that 10 per cent growth that we're looking for, [we are] looking at some of the few names that have disappointed [and] some names have done extremely well.

SP: Thank you. Now, in terms of transactions in the quarter, we really had two complete sales: Dolby and Kering, was that the result of this analysis you've done?

JD: Yeah, related to that. So Dolby is one that has shown up over the past few years as disappointing against our growth expectations, [it] has not met that 10 per cent hurdle. We reviewed the company, met the management again, did a lot of research around it and felt that actually, some of the headwinds in that business, particularly on pricing, they're unlikely to overcome those. And so, we divested.

Kering, a little bit different because although it has been a very strong, [it has] been a good investment for us since 2016, we're sort of getting [on] that early after a difficult 12 months for the company, looking at it, a lot of research into it. Our feeling is the change of strategy that has been a big one at the company is difficult for them to pull off. And so, we decided to exit that because we don't expect those good rates of growth going forward.

SP: Thank you. Now, changing tack a little bit and moving to ESG, can you highlight maybe a piece of engagement or research that the team has done last quarter?

JD: Probably the main result I'd highlight there is around Anta Sports, the apparel company (trainers and so on) in China, where we've been engaging with the company for a long time on picking up the pace of audits of their supply chain.

We think that's really important to audit their supply chain independently and frequently. And the company's responded to that, and just in the last few months, they've confirmed to us they're really escalating the pace of that. Happily so far, all of those audits have come back well, clean, no problems to report, but that's a good example where engagement for a higher standard, which we think is important has paid off in action by the company.

SP: Thank you. Now we just passed, you know, we're halfway through the year, can you give us a little bit of an outlook for the second half of this year? How do you see, you know, equity markets developing?

JD: There's quite a few noisy events coming up, elections around the world and so forth. Maybe we'll finally get those interest rate cuts that everyone's been hoping for so long.

I think for us, the core focus is sort of bottom up, on the portfolio. We're looking for that durable long-term compounding to carry on for the next five, ten years, and business models that shouldn't be disrupted by whatever happens in the second half of this year.

So, that very much seems to be the case with the portfolio we've got, but we'll continue that work of testing the investment cases, looking for new ideas if they could potentially upgrade the pace of growth. And that should see us good, we think, through the rest of the year.

SP: Thank you, James, for this review of the quarter. Three key messages I retain. The first one is it was a positive quarter in terms of returns for the portfolios.

The second key message is the annual review of results by the holdings has shown that the vast majority of them is showing growth above or around the 10 per cent per annum that we expect from them.

And the third message is that the quality growth tilt of the portfolio has not changed, and that provides resilience in more volatile environments.

Thank you, James, for your time, and thank you, everyone, for listening.

Global Income Growth (including Global Income Growth and Responsible Global Equity Income strategies)

Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
Global Income Growth Composite	4.4	39.0	-14.2	17.7	9.7
Responsible Global Equity Income Composite*	4.9	38.0	-13.6	19.6	11.6
MSCI ACWI Index	2.6	39.9	-15.4	17.1	19.9

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years	Since inception
Global Income Growth Composite	9.7	10.0	7.9	-
Responsible Global Equity Income Composite	11.6	10.8	-	13.0*
MSCI ACWI Index	19.9	11.3	9.0	13.3

*Inception date: 31 December 2018.
Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

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