Baillie Gifford™

Global Alpha Investor Forum

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

Jon Henry (JH): Ladies and gentlemen, good afternoon, and welcome to our investor forum. We're delighted to see you all here this afternoon in such great numbers. My name is Jon Henry, I'm a Director in Baillie Gifford's Clients Department, and I'm delighted to be joined by the portfolio managers for the Global Alpha Strategy, Malcolm MacColl, Spencer Adair and Helen Xiong.

Now, we're here in the Haberdashers' Hall, which belongs to the Worshipful Company, you guessed it, of Haberdashers, one of the City of London's Great Twelve Livery Companies. Now, as the name suggests, the company's roots lie in the regulation of silk and velvet merchants many, many years ago, and it really is a shining example of longevity, having been founded over six and a half centuries ago. That really is the sort of longevity that we can only aspire to at Baillie Gifford.

So what do we have planned for you this evening? Well, you'll hear a presentation from the portfolio managers, during which we'll outline why we remain convinced about the merits of long-term growth investing, why we're confident about the positioning of your portfolio, and importantly, why we're increasingly optimistic about the future.

Now, following that, we'll have around half an hour of Q&A, so your chance to put your questions to the portfolio managers. And I should say for the purposes of this session that it's being recorded on the camera at the back there. But after that, we'll mix things up, and you'll attend two break-out sessions touching two of the themes for the research agenda from this year, copies of which you have on your tables in front of you, hot off the press.

Following the conclusion of those break-outs, after which I'm sure you'll have heard plenty from us, we'll be delighted if you could join us for a drinks and canapes on the ground floor, just as you came in there. So on that note, I think enough from me. You'll hear from each of the managers in turn here, beginning briefly with Malcolm, before then moving on to Helen and Spencer. So with that note, Malcolm, over to you.

Malcolm MacColl (MM): Okay, thanks very much indeed, Jon. I'll add my own welcome to you all. It really is excellent to see such a large body of our clients here today. We very much appreciate your time.

As you'll be aware, the last three years have been very challenging for us with regards to the investment backdrop. You'll understand that, as well, the delivered volatility and the results are not those that you were looking for, and they're not the results that we were seeking to deliver ourselves.

We know that we've tested your patience, and we are very much aware that we are fortunate to have a body of clients with a long-term perspective and also a body of clients with very much a strong set of underlying relationships.

I'd like to be clear, that whilst we remain strongly committed to our reward-seeking growth philosophy, we've also worked hard to learn lessons from this period, from the last three years, and to take forward lessons that we can put into practice within our portfolio and portfolio construction, for example, reinforcing our risk overlays with a view to ensuring a high degree of balance within the portfolio. This is one of the areas that Helen is going to come on and talk a little bit more about later this evening.

Before this though, I wanted to focus on two critical points. First is a reminder, as Jon has already said, of why we strongly believe in growth, in the growth philosophy and why that will deliver for yourselves. And the second point is to stress why I am particularly excited about where we are today with regards to the underlying portfolio.

So, why growth? Well, ultimately, we believe that it's compounding, the powers of compounding that deliver long-term wealth creation, that it's those growth companies that can actually deliver over the longer periods of time which create that wealth for individuals and for underlying shareholders.

There's a slide here that we've shown with regards to the proof statement around growth. And we've shown this before at this gathering, but I think it's very important and therefore worthwhile focusing on once again. What you can see here is, if you focus your eyes towards the right-hand side of the slide, you can see the highest quintile of growth. That's the top 20 per cent of growth companies and what that has delivered in terms of underlying share performance over the past, I think this is 34 years.

And you can see here, there's a very nice correlation between higher growth rates, as we go from the left-hand side up to the right-hand side, and higher excess returns for stocks. So these companies on the right-hand side, the top quintile, have delivered 9.3 per cent per annum outperformance, excess return, over the market over that period of 34 years. This matters, and I think it's very important as again an underpinning aspect of our philosophy. Growth works.

Okay. But are we invested in the right growth companies for yourselves? So you're going to hear about a lot of exciting individual stocks from Helen and from Spencer and also, as Jon was mentioning, within the break-out later on, or the break-outs later on. But it's actually when I look at the portfolio in the round that I get the most enthused just now. I think it's when I look at things in aggregate that I can see a very clear picture and a picture which gives me a lot of confidence.

You can see here aspects relating to, I think, the qualities of the portfolio. You can see here, on the left-hand side, where we are with regards to profitability. We've got one metric here showing our gross margins versus the index. And you can see that we are more than 10 per cent higher than the market average with regards to the margin profile within the portfolio. You can see that our levels of indebtedness are significantly lower. So the balance sheets that we have within the portfolio are very, very strong relative to the broader market.

And then you can also see on the far right-hand side here that we've got very good cash flow characteristics within our company. So there's a very strong degree of resilience across all of these businesses. So this is one thing, the underlying quality of the companies that we're owning for yourselves. But actually much more important than this is the level of growth that we think that they are going to go on to deliver.

So if we look here at the growth profile of our businesses and compare them with the underlying market, what you can see with the blue line at the top, that's the Global Alpha portfolio and the three-year forward expected growth rates. So these are third party numbers. They actually come from one of the data providers, FactSet, independently verified. This is the growth rates that people are expecting for our companies into the future.

And you can see the orange line beneath that, here, which is showing us the market's growth rates. And what really interests me today, what I think is very important for us all, is that you can see that the portfolio growth rate has actually expanded away from the market growth rate over the recent period here, again, on the right-hand side. The jaws are widening at present.

These numbers underlying, it's a little bit over 2 per cent, almost 2.5 per cent superior growth over the next three years which is expected from our companies, again independent stats, versus the market growth rates. And the numbers underlying that, it's a little bit over 14 per cent compound growth, 14 per cent per annum against, I think, six and a bit, just over six and a bit.

Importantly, you're also not having to pay a significant premium relative to history. So the premium that we are paying for this growth is roughly in line with the ten-year average that we've paid within the Global Alpha portfolio. So we think that we're very well set up with regards to the growth profile, increasingly moving away from the market's growth profile, expanding away from it, yet we're not being disadvantaged with regards to the starting prices.

So just to pause and reflect on this slide for one moment more before I hand over to Helen, I think also one of the things which will likely be going through your minds as underlying clients is, what periods does this work, and why have we had this period of dislocation, this tough period within the Global Alpha performance? It's much more volatile than I had expected during that period.

So if you look at this section here, you can see that this is where our growth profile was well ahead of the market, and the delivered returns during this period were actually very strong, pretty much throughout that six-year period that we can see there.

Then there was a period where the market growth rate to some degree, not wholly, but to some degree boosted by inflationary pressures, boosted by what was going on with the snapback and what was happening at the banks and energy companies, and to some degree actually a function of our own companies being in a less strong relative position… We struggled, because the growth was not in our favour, linking it back again to that initial slide saying that high growth typically does well if you get the right businesses.

But now we're here. And this is what fills me with confidence, thinking we're in a better place now. We can't guarantee what the smooth pattern will be forwards, or we can't guarantee, rather, a smooth pattern forwards, but we're very confident that we're in a place to deliver from this starting point.

So I like the portfolio a lot. You're going to hear more interesting aspects about individual names. But I think that putting that portfolio context into place for you is also hopefully something which will give you a high degree of interest and comfort. And with that, I'll pass over to Helen.

Helen Xiong (HX): Good afternoon, everyone. So Malcolm, Spencer and I, when we were comparing notes on what we wanted to talk about today, found that we were all broadly addressing the same topic, which is, why growth, and why now? It's a question that's front of mind for many of us, and there's a very good reason.

We are undoubtedly in a very different macroeconomic regime than the one we had over the last 15 years. Global growth is slowing, and there's a looming threat of a US recession, interest rates have risen, which has affected the valuations of growth companies disproportionately, and inflation is higher, which is creating cost pressures for many of the companies that we own.

And instead of the globalisation tailwind that we've had over the last two decades, we now have a looming threat of rising geopolitical tensions. But we have a tendency to link stock market activity with economic variables. But if we step back from the apparent short-term correlations, you'll find that the long-term link is tenuous at best.

Since the 1920s, the US has had around 17 recessions, including the Great Depression, it's had numerous wars, including a world war, and now also a global pandemic. Yet over the last 100 years, the S&P [index] has delivered around 10 per cent per annum every year.

Now, we believe there are far stronger forces driving change in society over the long term, forces that are unaffected by the economic winds of change. Joseph Schumpeter, the famous economist, said: "The fundamental impulse that sets and keeps the capitalist engine in motion comes from new consumer goods, the new methods of production or transportation, the new markets and the new forms of industrial organisation that capitalist enterprise creates."

And it is in the creation of the new services that we see companies like DoorDash, operating in a highly discretionary area, grow 27 per cent even in a weak consumer environment; the new technologies that enable [The] Trade Desk, an advertising company, to grow four times faster than the advertising market; and in the new products that has propelled Li Auto to grow over 100 per cent last year, while significantly improving its profitability.

Now, the growth of many of these companies, particularly in the disruptive growth profile, is underpinned by long-term currents. These currents flow regardless of the way that the wind blows. We will be talking more about artificial intelligence in the break-out. AI is an emerging current that we believe has the potential to write a new chapter in growth investing. Now, when we think about the long term, we're looking to ride these currents, much like the sea turtles in *Finding Nemo*. They have the advantage of being stronger and far more predictable.

Now, growth is also not fragile. Malcolm has already talked about a lot of the growth statistics. But why do they matter? Well, if you're worried about inflation, it matters that the companies in your portfolio have ten-percentage-points higher gross margins, because that's a very good proxy for pricing power.

If you're worried about interest rates, it matters that the companies in our portfolio have half the debt levels, because they're more robust in a rising interest rate environment. If you're worried about growth, it matters that 95 per cent of the companies are free cash flow positive, because it means their growth is self-financing. And importantly, it matters that the future earnings growth is high, because that's what's going to drive share price returns over the long term.

Now, as you can see, the companies in your portfolio are in robust financial health, and their operational performance is strong, but the volatility has been in excess of what we hoped to deliver for you. Malcolm mentioned that we've taken measures to address the balance of the portfolio. We have put in place additional guardrails that place limits on the growth profiles. Importantly, we've back-tested those limits, and those are limits that would have bitten twice in the last three years.

But volatility is not just a risk. It is also an opportunity. Price fluctuations provide us with opportunities to buy wisely. Over the last year, we've been taking money away from the compounders, whose valuations have held up relatively well, and deploying it in the disruptors and capital allocators' growth profiles, in companies whose share prices have been more economically sensitive, companies such as Texas Instruments and CATL, both leaders in their respective industries, both beneficiaries of long-term currents, and we believe we've positioned the portfolio for future success. And with that, I'll hand over to Spencer.

Spencer Adair (SA): Hello. I'm going to tell you about the growth drivers that are getting us excited, really excited when we think about the future. But let's look back before we look forward. I'm going to go back to one of Malcolm's slides. And this shows the growth profiles going back to, I think it was [19]89, until December last year. And you see that it's the fundamental progress of companies, it's fundamental growth that drives share price returns.

Now, just like the fashion from the late 80s, there are booms and busts in stock markets. There's hype and fashions. But the fundamental things, our long-term growth, that's what really matters. That's the prime bedrock of building long-term growth. Now, I will turn from the theory, which is this, and we'll look at the portfolio.

So this slide shows the growth in the Global Alpha portfolio since 2005. It's 19 years of data. You can see that in general, growth has been from bottom left to top right. You can see that it's not delivered entirely smoothly, this was the GFC, but also that there's a bit of a pattern in that we have perhaps three or four years of strong growth and then a period of consolidation and another burst, and it looks like steps. Over the long run, though, our companies have been successful. They've been growing. They've been expanding their scope. That's exactly what we hope they do.

Now I'm going to overlay the overall return that clients have received. And you see that this line is more volatile. So rather than two steps forward and then pause, two steps forward, this goes three or four steps forward, three or four steps back. The dance is a little wilder. But overall, it's in the same direction, and it's driven by the fundamentals.

There are times, like here, where the returns are in excess of what the fundamentals are doing, and then there are times, like this more recent period, where the fundamentals are really strong but the share prices have been a bit weaker. And that coils up for future outperformance.

We've seen that pattern several times in the past, where you've had weak share prices, strong fundamentals, and then you see things can bounce back really quite quickly. So we feel very good about where we are. The key question is the pace of that orange line. That's what drives long-term returns. And the exciting bit is we think it's inflecting upwards again.

Now, one of those pieces of data that we have to get confidence in that inflection upwards is the fact that our companies are growing 2.5 times faster than the market. That's happened pretty quickly, it's happened in the last six to nine months, but that's really opened up for us. That's a good start. That's exactly where you want to be.

But we think there's three reasons. When we look at the portfolio, we see three pockets of that superior growth. First, we're seeing companies that are already growing suddenly accelerate even further. So they've been running at a certain pace, and then the pace increases.

One example. The shift to cloud and AI has meant that Microsoft grew its earnings 33 per cent last quarter. That shouldn't happen to a 48-year-old company. That shouldn't happen to a $3tn company. It's caught the tailwind. It's reaccelerated. The same things are happening at almost all of our semiconductor holdings, at almost all of our 'software-

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as-a-service' companies that are handling data, with a big acceleration in growth rates.

We're also seeing that same sharp acceleration in our 'renew, repair, replace' companies. These are perhaps enhancing the West's aging infrastructure or replacing the West's aging infrastructure, returning critical manufacturing onshore.

Now, I spoke to Comfort Systems at the end of last week, and this is a company of air conditioning and electrical engineers. They help build big buildings like the one we're sitting in. Skilled construction labour is under a real shortage in the US. That's the bottleneck for growth. For them, business is booming, because that's what they do.

Their earnings grew 65 per cent last quarter. The last 25 years, it's grown at 20 per cent, suddenly [its] 65 per cent. Massive acceleration. They've caught that serious tailwind in their sails. [The] same things are happening in lots of our construction repair, renew, replace companies. So reaccelerating growth is reason number one why I'm very optimistic.

Reason two is that several of our deeply ingrained, long-term growth trends have fallen out of favour, we think temporarily. And that allows us to allocate more capital to things which we have got very high degrees of confidence in. I'll highlight two.

Healthcare is being shunned today in the stock market, yet the growth of healthcare revenues is almost demographically underwritten. A 90-year-old consumes ten times the amount of healthcare as a 45-year-old, someone half their age. As society ages, healthcare revenues will continue to grow, and there's very little we can do about that. Yet the industry had its worst year in two decades last year, relative to the broader market. It's trading at ten-year-low relative valuations. We've been slowly building up our holdings, building up our shopping lists, deploying incremental capital.

One example [is] Elevance [Health]; one of the leading US health insurers. Now, we've owned this since inception, [in] 2005, and it's grown earnings over that period at 12-13 per cent a year, compounded. Incredible returns. 12-13 per cent full return since inception. Whenever we look at our analysis and we see what they're doing with the company, we actually think that growth may accelerate. They're entering in some new areas [where] we think the growth could be even faster. Today, because it's an election year, it's trading on 13 times earnings. That is exactly what we want to own: in-size, out-of-favour structural growth companies.

A second example here would be emerging markets. Emerging markets have often got superior demographics. And that underwrites their economic growth. In the 19 years that we have been running money in this way, emerging markets have never been so out of favour. There is faster growth at radically lower valuations compared to their history or even compared to peers in different markets.

Now, we really like what we own in emerging markets, but we're also aware that this is an opportunity. So we are off. A couple of us are doing trips. Helen is going around Asia, prospecting for ideas, I'm going around South America. What's fascinating is that technology and the business models coming out of Korea, China, Brazil are world-class. They are superior companies trading at very big discounts to their Western peers.

I said there were three reasons. Those are two. And the third one, finally. As growth stocks themselves have fallen out of favour, the companies are responding. They are taking this personally. Now, that may be because they've all got share options, but they're taking it personally and they're reacting.

And it's that reaction which makes me really enthusiastic about the future. Particularly growth tech companies are cutting back on the frivolous and entering a period of more balanced growth, balancing ambition and profitability. A few years ago, it was all just ambition. Now they care about the bottom line. Meta, the social network, has really led the way here. It's been the influencer. It has led the pack in moderating its growth in order to boost earnings, and the share price has really been rewarded. Shares are up four- or fivefold from the bottom since the end of 2022.

That creates fast followers. Shopify, Spotify, Adyen, Block, a whole range of companies, and the list goes on, are now copying Meta and saying, I am going to show you the money, I am going to prove profitability. And that's in their own control. Additionally, competition is less cut-throat. So a lot of these areas, lots of these companies were going against each other. Now peace has broken out, and profits can soar.

Look, just as I end here, I know that we have tested, we all know that we have tested your patience over the past three years. We are hugely appreciative of your forbearance and your good grace. We've reflected, we've learnt several lessons, we've made some changes, but I want to leave you with the message that we are increasingly enthusiastic about what is being offered up to us now.

It feels like it's our time again. It won't be delivered smoothly every quarter, but the growth outlook is strengthening and broadening right across the portfolio. Multiple large growth drivers are working independently. Most, much of the portfolio has got exposure to these growing tailwinds, they're adapting well, they've got good operating momentum, and they've got this improving profitability. That's why growth's inflecting upwards. That's why the numbers have changed. So we think we're strongly placed to deliver growth, and we look forward to rewarding your patience. Thank you.

JH: Thank you, Spencer, Malcolm and Helen. So the plan now is to allow you to put your questions to the portfolio managers. Now, we have two roaming mics. So we have one on the right, as I'm looking at it, and another in the room. So please do just raise your hand if you'd like to ask a question. But whilst you sharpen your pencils, I thought I would just kick us off.

Perhaps just picking up on something Spencer said and maybe directing the question, Malcolm, to you, Spencer mentioned Meta. I guess big tech have been, well, in the headlines a lot throughout 2023. Spencer mentioned that Meta's pivoted towards being profitable. Can you give us a bit of a flavour in terms of what it is that's been driving that, what we see the opportunity is and how they've been turning around their operational performance?

MM: Yes, sure. So, just to clarify. So Meta's been extremely profitable for a long period of time. But what we've seen over the past two or three years is a situation whereby they pivoted to even more heavy levels of investment for the future, as they saw it, and then a realisation that perhaps they'd actually overstepped the mark somewhat there, maybe a little bit swept up with some of the euphoria that they had been seeing during the pandemic period. And now we've seen them actually starting to actually slightly shift gear there with regards to a little bit more modesty with regards to some of that expenditure.

But realistically, that business hasn't changed enormously over the past several years. It's still got the same underpinning growth engines. It's still got its enormous amount of reach, not just within the western world but also within parts of the emerging economy. It's got a huge advertising base which is still deploying larger amounts of capital to itself with regards to that secular tailwind of the move towards digital advertising.

And what we've seen is they've actually made some very shrewd investment decisions. They've put a huge amount of effort into areas such as artificial intelligence, something we'll come on to talk about a lot more later. They've used that to

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sharpen up the way in which their platforms are delivering content to probably most of ourselves in here. The thing that people talk a lot about is Reels, the video application within Instagram, for example.

They've done a lot to also change up their ad tech and the way in which they're delivering intelligence to underlying clients. There was a big move from Apple to close down a lot of the ability for people to see through advertising, and Facebook have had to work around that. But long-term thought and sensible investment has taken them to a much better place.

So I think, actually, it's a company which has been well run for a long period. They had to perhaps right the level of expenditure a little bit. The market, though, when Spencer was talking about the way in which you have these growth profiles going like this and that the market zigzags around this and the level of sentiment shifts around, the market can sometimes be a little bit schizophrenic.

But what's really changed at Meta is the narrative, from one of where... Mark Zuckerberg, two or three years ago or two years ago, let's say, he was in the doldrums. He was an idiot. He couldn't do anything right. He was spending too much money. He didn't care about anything other than his dreams about the metaverse. That wasn't true. He was doing a huge amount of good underneath the surface, and that's now coming through. Yes, I'm sure he would say that he'd made a few mistakes, but ultimately, he's made more good decisions than bad.

JH: Thanks, Malcolm. Okay, I'll open up to the floor then in terms of questions, so please do raise your hand, and we can... There's a question down here. Thank you.

Client 1: Given we all know about the demographics, can you explain why the performance of healthcare stocks has been so miserable?

SA: Yes. So, I think there's a number of things. Some of it was pandemic hangovers. So if you think about a company that maybe supplies hip replacements, you simply couldn't get that done. There were staffing shortages. There were long delays. The supply chains were interrupted. And we think that simply built up. So growth has slowed for some of those medical device companies, but we think that simply built up demand. The hips aren't going away. They still need replaced. And therefore, [I think] that's quite exciting.

Some of it, they've been crowded out. Eli Lilly and Novo Nordisk have developed an anti-obesity drug, the GLP-1s. And that's the only game in town for healthcare investing, and there's lots of fear has come out elsewhere. So we've looked at companies that are involved in diabetes care or sleep apnoea or heart disease. Those companies have all very sharply derated, because people think, well, if you've cured obesity, then we're going to cure everything else that goes with that. That's not true, because the obesity is a factor, but age is a bigger factor, and the aging part has not been cured yet.

And then finally, you've had some of the biotech companies and even the large pharma have headwinds. So the biotech companies, a lot of their funding was drying up. They couldn't tap into the stock market. And some of the large pharma companies, they had headwinds from more drug price controls in the US. So you put that together, and those forces have been pretty difficult for healthcare companies.

We understand them. We think a lot of them are temporary. We can see the way through, and we think that some of the reactions have been overdone. So we are slowly, carefully working our way through, trying to find the compounding long-term healthcare stocks we want to own and backing them. And we're happy with that. So that's why... those big

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factors all came at once, and it knocked the wind out of healthcare. I think it gave up ten years of relative performance in a year. It was fairly brutal for them.

JH: I think there was one down here. Thank you.

Client 2: I've got two questions which are very... They're separate, but slightly connected. I was at a conference last week which was headed *Why Value, Why Now*. So I asked them the obvious question. What would make you change your tune? So I'm going to ask you the same question. What would make you change your tune: why growth, why now?

And the second question, which is connected but is really to Helen. You mentioned about the risk overlay. Could you give a bit more detail into how you'd stay true to your philosophy of being growth but manage to... Not minimise, but to reduce the downside at times when growth is not in favour?

MM: I'll maybe take the first part and then let Helen take the second part there. So with regards to what would make you change your mind, I think is the question, or growth versus value as maybe an undercurrent to that. If we go back to the slide that was first up and the one that Spencer actually returned to, I have always been a strong believer that actually getting on the right growth trajectory is the primary thing you need to do to deliver value creation and to deliver outperformance within the stock market.

But the subtlety to it is that you have to pay the correct price. I am less convinced about the boxes that people try to put you in. I think that there are subtle differences between growth and value rather than a chasm. And I think that ensuring that the prices that you are paying for that growth, the starting point is correct, is vital.

Now, I think an important thing for ourselves, and this is then passing back to Helen for the second part of the question, is that I think that there are aspects of the portfolio which actually we were paying too high a price for that growth when we consider where we were two, three years ago.

And I think that that's the big lesson for ourselves, and that in running some of the winners and allowing those to become big parts of the portfolio, normally, in normal conditions, that is the perfect thing to do, because it's the outliers that drive a lot of the long-term performance for clients. But when things become so concentrated and the market starts to hoard around your stocks, that's a bad thing.

And I think that that drove the absolute valuations of some of the companies which we were working hard to hold onto into the wrong place. And it's been one of the factors which has led to the less good outcomes over the more recent times. So hopefully that captures the first part, that I believe deeply in growth, but you need to pay the right value.

HX: On your second question on how do we remain true to growth with these additional factors, it's something that we thought a lot about. And we didn't have to introduce any additional risk factors. It was an option to do nothing. And there was a very good reason to do nothing as well, because to your point, most of the time, we just want to let things compound. We don't want to interrupt that compounding.

We've been through a very, very unusual period in the last four years. We've been through both war in Europe which has led to the energy price rises, which led to the inflation and the interest rate rises, and then the global pandemic. There [were] two black swan events. And we could've explained it away by saying this is two black swan events, but then we also have to accept that the volatility that was delivered over the last two years has been far in excess of what we expected.

And so we thought a lot about this in combination with our risk team, and we came up with metrics that we back-tested over the last 15 years. And over that last 15-year period, these are metrics that would have flagged only in two distinct periods where, with hindsight, doing something would have been beneficial to us. So one of those periods was within the last three years. Now I can't remember when the other one was.

SA: I think it was just before the GFC, [in] 2007. So we [had] a signal that, if we'd listened to it, would've been very helpful.

MM: Yes. To my mind, risk controls should bite at periods of extreme. And that's where, again, you need to… It's a check and balance within the system. But I was having a conversation with a client earlier today, and they asked… the important part of the question for them was, "That doesn't mean that you're hunkering down now, does it?" Absolutely far from it. Our reward-seeking mentality remains fully intact. It's just that at those periods when the market is getting to a strange place, you want to have something which is ringing the bell to tell you to adjust things accordingly.

JH: Who would like to go next? There's a microphone coming behind you.

Client 3: Thank you. As I listened to you, I just put my mind back to the last of these meetings, which was, I think, two years ago. I think that it was at the foot of Regent Street. And some of my colleagues were becoming a bit restive. And I went back to them and said, don't worry. I said, the manager still believes in growth, earnings are still moving forward, cash flows are still very positive and they say, have faith. Now, my question is, that's more or less the same message that we've just been having. What's changed in the outer world that makes you think that it's more likely to come now than it has done over the last two or three years?

MM: So I think it's a very important question. So for me, the primary thing which has changed is the valuation of the businesses that we're in. And what we've seen, the primary thing which hurt us during that period, which is a thing that keeps me awake at night, is the extent to which longer duration assets, higher growth assets were punished in a higher rate environment. So I think…

Client 3: Actually, the multiples were the problem.

MM: Going back to the prior question, it was the starting multiples on the stocks. And in an environment where rates were extremely low, it made a lot of sense to be paying those types of multiples. But the sharpness of the change is the thing which caught us, I think, off-guard, and again going back to the adjustments that we have been making and the improved balance within the portfolio.

So I think that you're right to ask that question. But the starting point is different, and actually, the relative growth rates are different. They're better than they were at that point. Now, again, none of us can guarantee what's going to happen next, but it feels good to me. It feels like we're in that right place.

And Spencer was also at pains to point out that it's broadening out. There's different pockets. It doesn't feel like it's concentrated in just those very disruptive, new-age businesses. There are other things which are going on which I think are actually very complementary to our style. And that gives me a lot of encouragement, rather, for the future.

Client 3: Can I summarise by saying, the last time, it felt good, you're now saying it feels better?

MM: It feels better, for sure.

SA: Yes.

MM: And I think, again not wishing to labour the answers too much, that Spencer and Helen would tell you very openly that during that period, I was nervous about market valuations, not necessarily so much just where we were. I was very worried about market valuations. But I didn't know what it was that was going to change the landscape. I couldn't see where that was going to come from. Then, smack, we have these extreme events which are very challenging and have been difficult for lots of different reasons, more on a human level. But we're past that now, and we've had the reset, and I think we're in a good place. That's how I think about it.

JH: Yes, in the middle here, sir.

Client 4: Can you talk a bit about the business disruption side? At the end of 2019, money was very cheap. It was easy to finance these businesses. How are you seeing it now? How much emphasis… I saw your earlier chart where the number of your positions where there was cash flow issues is very low. So how are you bringing that in, and that discipline? And how do we get… It doesn't feel like business disruption is going to slow. In fact, it looks like it could speed up. I'd be interested in your thoughts. But how do you see the financing of those early-stage companies and whether you can be part of that?

MM: Do you want to…? Is DoorDash a good example of this, or…?

HX: Yes, so the companies in our portfolio, most of them, 95 per cent of them, are free cash flow positive. So that means they can finance their own growth. They are largely unaffected by the capital markets, [where] it's much harder to raise money now than it has been before. I think that's also one of the reasons that Spencer talked about why biotech companies have struggled a little bit, because biotech is very capital intensive at the earlier stages of the business.

But actually, a lot of the disruption that we've seen from businesses in the last recent while has come from companies that are not that capital intensive, head on. That might change in the future. We might get into the more capital-intensive companies. But we don't see the pace slowing. And in fact, the withdrawal of capital from the market in many cases is a good thing for those companies.

DoorDash is a very good example of that, where there was a lot of money in food delivery chasing very thin margins. And what has happened is a lot of competitors that were VC-funded, that didn't have a lot of discipline in showing profits because they didn't need it, because there was the VC sugar daddy, that has disappeared from the market. And so a lot of the companies that we have… Shopify would be another example where the competitive advantage has strengthened in this new environment. The companies we own are already free cash flow positive, and they're largely unaffected by the capital markets.

SA: I might give you an analogy to build on that. We're all from Edinburgh. And during the festival in Edinburgh, the town doubles, trebles in size. And suddenly, there's loads of very enthusiastic students handing you flyers when you're trying to walk to work. And growth investing felt like that two years ago, three years ago. Everyone was there. It was easy. Everyone was enthusiastic. If you had a slide deck, you could raise capital.

Now, it's 1 September. The students have gone home. I can walk to work. It's peaceful. No one's disturbing me. I've got my city back. We've got growth investing back, because all these tourists that came in when the times were easy have disappeared. And in companies, a lot of them are having to consolidate. The competitive heat has been significantly taken out of several industries. And they were really going hell for leather at each other, and now they're much calmer. And so we're seeing order be restored. The tourists have gone home, the frivolous is beginning to fade, the posters are being taken down, and we've got growth investing back. And that feels much better.

JH: More questions? Who has? Please do just raise your hand.

Client 3: Thanks. The other issue which I'd be interested in you talking about is China, which hasn't been easy. Very interested just in a few words as to how... A wee bit about history and a little bit about the future.

HX: I think the starting point is [that] our portfolio exposure to China has come down very significantly over the last four years, and it's actually very modest at present. My personal view is that we've almost come full circle in China. It's the second to largest economy in the world.

As Spencer was saying, it's home to some of the world-class companies, companies where there isn't necessarily a western equivalent. It manufactures entrepreneurs the way that other countries manufacture cars. And there's still a lot of innovation in the country, and it's on bargain basement valuations, many of those companies.

So we're definitely very interested. There's no doubt that investing in China has become harder, both because of the geopolitical tensions that we're seeing, which isn't something that is going to go away, but also because of the policy changes that are in China.

But it's a very good starting point. It's a market that global investors cannot ignore, both because of its size, because of the companies that are there, because it's home to some of the most formidable competitors to the companies that we own, and it's a very important market for many of the companies that we own as well. So I'm actually going to China next month for a month to investigate and look for ideas there. And I think we have been able to do very well in China in companies like Li Auto, where you're riding a very strong structural tailwind and where it is aligned with the government.

MM: Yes. So one of the ones that we've been buying recently would be CATL, which again either Helen or Spencer referenced earlier. It's the largest battery manufacturer in the world, lithium batteries for EVs [electric vehicles].

So this has only come into the portfolio in the last couple of quarters. This is one where it did have a huge multiple attached to it. That's crunched down now. It's trading at below a market average P/E on a near-term basis. We think the thing can compound at 20 per cent-plus for ten years potentially, and we think it has far superior technology and far superior scale to anybody else in the marketplace.

Now, if you want to imagine what it could be, the real bullish outlook for it is that this is the TSMC of batteries in the future. And you're not really being asked to pay anything for it. Could something happen geopolitically which knocks their ability to sell into the US market? Yes, it could. Is it valued as something which will be a big success in the US market? No, it's not.

So these are the things we're trying to remain open-minded to. It feels to me like we're nearly at, probably at, revulsion stage for the Chinese market. But equally, I'm very aware of the fact, or we are very aware of the fact that things can come

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from a policy perspective and hurt you badly, and you need to be sure that you're aligning yourself in the right manner.

The last thing to say is [that] I like picking up on soft factors. And one of the things I saw yesterday was that the level of buybacks in the Chinese A-share market last quarter was at the highest level… And I shared this with somebody else earlier today. This is at the highest level it's ever been historically. So the businesses themselves think they're cheap, and they're buying themselves back. And it's these things which say to me, just stay patient, but be very careful, and also be careful about how much of the portfolio you would put to work.

SA: Yes. Just to build on that, CATL, the battery manufacturer, it's got 37 per cent market share, absolutely dominant. This thing's a beast.

MM: Globally, yes.

SA: Globally. The growth we assume comes from China down into Southeast Asia, maybe into Brazil. We're not assuming growth is very successful in North America or Europe. Let's assume that geopolitically, that's off the agenda. But despite superior returns, big scale, lowest cost, best technology, it's trading, what, 13 times, something like that?

Now, the number two in the industry is Korean. It's based in Seoul. Much lower market share, perhaps a third lower in market share, lower returns on capital, lower scale, questionable technology. It's trading on three times the multiple, approximately. So the market's saying the Chinese discount is two-thirds. Now, I'm not sure Seoul is necessarily geopolitical risk-free. Something could happen there too. So it does feel that the disgust, the rejection of growth is really acute in emerging markets broadly, but China specifically.

JH: Thank you. There's a question at the back here. Yes?

Client 5: Yes. Hi. Thank you very much. So EM's cheap, healthcare's cheap. What's expensive?

SA: Safety, I think. So I think a lot of people are [thinking], what happens if there's a recession? And so we have been reallocating capital away from some of the compounders which are regarded as low economic risk. What else would you say?

MM: Well, I think that that is the primary answer right now. I think that we were in a period where… So compounding businesses with very stable outlooks were bid up by the market for an extended period, ten years at least, I think as a function of the fact there wasn't any income elsewhere.

And what you were getting from these businesses were reliable dividends. Well, I may as well buy those, because I'm getting a 2 per cent or 3 per cent dividend yield there, and I get nothing from investing for income in other securities. So they were bid up for that reason.

And then, into the more volatile period and with rates rising, they took a further lurch upwards. And that was a function of the fact that these are seen as shorter duration or more stable, more dependable, less risky, lots of fear, I'm going to go there.

So in a strange way, it's some of the more stable businesses which I think are perhaps maybe the less stable stocks right now. Now, there are obviously examples counter to that, and we're still finding some good opportunities in the compounding area. But as a body of stocks I think that's one area of relative valuation expense.

JH: So we have just a couple of minutes left, if there's any questions anyone would like to ask. No more hands going up. I thought we'd just, therefore, pose one last question just around what you've been looking at recently and what stocks and companies that you've been researching that's left you feeling really very optimistic and perhaps maybe just ask a couple of you to share some examples of recent research that's been particularly interesting and have made you feel like the opportunities are out there. Spencer, do you want to…?

SA: Okay.

JH: You looked like you were poised to answer that one. How about we start with you?

SA: I was trying to avoid eye contact, Jon. Look, I've been doing a bit of work around the need to replace and repair the grid that we have, the electrical grid. And it strikes me that we have to actually spend quite a lot of money to get things a bit back up to standards, partly because in the future, if there's a lot more solar and wind, the grid has to be a lot more flexible to accommodate that. And previously, we've had point and central and predictable generation, and now it's been much more diffuse and much less. So the requirement to upgrade becomes really critical.

And you start to work through all the bottlenecks. Is it the wires, is it the transformers, etc. And weirdly, and we haven't bought this, but I think it might be the actual wooden poles that holds the grid up. And so this weekend, in fact, I'm flying out to North America and Canada, and I'm meeting two companies. And between them, they've got 80 per cent market shares in these wooden poles in North America for grid replacement.

Now, I'm meeting them, so we're not going to conclude yet. But it's that kind of follow the growth, look for the niche, look for what people maybe aren't seeing. And the leading company there is trading on nine times EBITDA, which is maybe a third less than it normally does. So I see growth potentially being brighter, and I see valuations being quite depressed. I haven't met them. I may go to the meetings and hate it, but that's the type of thing.

JH: But there's significant potential for insight there…

SA: Yes.

JH: Which we think is really exciting. Malcolm, how about you?

MM: So I've got one that's more, I think, easy to grasp and exciting than wooden poles. So what I genuinely really latch onto from Spencer's work around this thing… It's called Stella-Jones, but we may or may not go anywhere near it. Who knows? But it's the fact that they've consolidated the market down.

I love businesses which consolidate a marketplace. It leads towards regional oligopolies, and therefore, the outcome is better pricing, better growth rates through the pricing and better returns on invested capital. I think this may have some of the hallmarks of that. Some of our most successful investments over the past five-ten years have actually been in that mould. The likes of Martin Marietta, which is an aggregates business, at first glance doesn't look exciting, but wow, it's powerful.

But the one that I was going to mention is a thing that many of you will be aware of, some of you will be less aware of, maybe depending on the demographic of your families and suchlike. But it's Roblox, which is a gaming business. It's an enormous, networked gaming business, where it's actually the players who generate the underlying content themselves. Now, again, we've not bought this. Some of our colleagues do own it in other funds within the firm.

But what really intrigues me about it, is the fact that not only is it already operating at a gigantic scale, but it's one of those businesses where I think the new wave of software which is being enabled by AI tools could make the creative angle on it and their ability to make new content as a user vastly better so it's no longer clunky. It's going to be a far better experience.

And so I can see that real-world example of where this might come into force. It's also one of these businesses where it was bid up to a very high multiple. That multiple has slammed back down again. They've been going through an investment phase, so the market doesn't like that. It's not making a lot of money right now. So I can see ways in which that could come back to life as a stock market story, not just a business. And the two things together could be very powerful.

JH: I think that's a really nice segue, the mention of AI. We've got lots of opportunity to tell you about more opportunities and exciting themes in the portfolio in the break-out sessions, which we'll move into now. We've got one on artificial intelligence and the other on infrastructure upgrade and the domestic champion in the US. So we have a roughly ten-minute break just now. There's teas and coffees in the main foyer there.

And the important bit, that I get this right, because our events organiser will be terribly annoyed with me if I don't, tables one to five, if you could go firstly to the AI session, and tables six to ten, if you'd go to the infrastructure upgrade session when you go out to the foyer there. So one to five is AI, six to ten, infrastructure upgrade. Grab yourself a tea or coffee. Thank you very much for all of your questions, [they're] much appreciated. We look forward to more in the break-out sessions. And thank you very much for your time. Thank you.

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

	2019	2020	2021	2022	2023
Global Alpha Composite	32.7	36.4	7.3	-29.1	19.5
MSCI ACWI Index	27.3	16.8	19.0	-18.0	22.8

Annualised returns to 31 December 2023 (net%)

	1 year	5 years	10 years
Global Alpha Composite	19.5	10.5	8.3
MSCI ACWI Index	22.8	12.3	8.5

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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