Baillie Gifford™

Global Income Growth Q1 investment update

April 2024

Investment manager Lucy Browne and investment specialist Seb Petit give an update on the Global Income Growth and Responsible Global Equity Income strategies covering Q1 2024.

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

Seb Petit (SP): Hello, and welcome to this quarterly investment update on the Baillie Gifford Global Income Growth Strategies. My name is Seb Petit. I'm an investment specialist, and I'm joined today by Lucy Browne, an investor in the team. As a reminder, we aim to invest in long-term compounders, well-established growth companies, which we expect to deliver earnings and dividend growth for the next 10 years.

Welcome, Lucy.

Lucy Browne (LB): Hi, Seb.

SP: So 2023, quite strong equity markets across the globe. That momentum has continued in the first quarter of 2024, with global equity markets up close to 10 per cent in sterling terms. Our portfolios have returned positive numbers, but somewhat lagged that benchmark. Can you tell us what happened?

LB: Sure. So we know that in periods of strong market rallies, our focus on resilient compounders can be a drag on relative performance, as other investors may chase more cyclical names or, as we've seen in the past few months, high-growth tech companies. And while we do own Apple and Microsoft in the portfolio, our aggregate lack of exposure to the ‘Magnificent Seven’ continues to be felt this quarter. And indeed, since the start of the year, that explains about a third of underperformance.

SP: So, if we put the Magnificent ‘Seven impact’ aside for a minute, what else has driven the portfolio returns this quarter?

LB: So I'll start with the contributors. Novo Nordisk was once again our leading contributor to performance, having posted very strong results for 2023 on the back of continuing strong demand for its obesity medication. Taiwanese chip manufacturer TSMC was our second largest contributor. Producing chips for the likes of NVIDIA has really benefited TSMC in terms of sales growth this quarter. And among the more cyclical names in the portfolio, we've had US distributor Fastenal and also French electric power equipment company Schneider Electric also contributing positively on the back of strong results. And then on the other side of the ledger, the main detractors to performance have been companies which are still feeling the effects of demand normalizing after experiencing a COVID-related boom. So, in that camp, we'd have logistics company Kuehne & Nagel, Australian lab testing business Sonic Healthcare and Swiss pharmaceutical Roche. In all cases, as excess demand has dropped out, there have been some cost overhangs which have temporarily weighed on profitability.

SP: In terms of portfolio activity, this quarter seemed relatively quiet, but maybe a bit of reshuffling in the pharmaceutical names. Can you tell us more?

LB: Sure. So as you say, it has been a fairly quiet quarter in terms of portfolio activity. We've only had one new name enter the portfolio. Our new buy is Epiroc, which is a Swedish company and a global leader in high value drilling equipment, which it sells to mining and construction companies.

We expect earnings growth to be driven by growing demand for metals linked to the decarbonization megatrend. And going back to our focus on really resilient business models, we particularly like that Epiroc has a very large installed base of equipment, which enables it to generate around 70 per cent of its sales from spare parts, tool attachments and servicing. And this more stable revenue stream allows it to pay an attractive dividend as well as reinvesting in growth.

And then, as you mentioned there, there's also been a bit of digging into our pharma holdings and some portfolio activity on the back of that, notably the complete sale of GSK, but also reductions to Roche and Novo Nordisk. So, if I take GSK first, essentially we've lost conviction in the pipeline replenishment investment case and decided to exit the position and move on. In terms of Roche, we do have conviction that the health of the R&D engine is still there. However, it's been a bit disappointing to see Roche lose its status as global number one in oncology. And the company is also undergoing a reorganization under a new CEO. So, we've decided it's appropriate to half the position size to reflect a bit more execution risk.

And it's a different story at Novo Nordisk. The decision to reduce there is more a reflection of our commitment to portfolio diversification discipline rather than any change in conviction in the investment case. And indeed, it remains as a top position. It's now the fourth time in the past 12 months that we've trimmed just as strong share price performance has pushed us up towards our 6 per cent maximum position size.

SP: Thank you. Now, in terms of research, what has kept you busy the last few months?

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LB: One thing I've been working on this quarter is revisiting the investment case for our lithium producer, Albemarle, and really going back and retesting some of our assumptions around lithium volume growth, demand growth and also lithium pricing. And the backdrop to that has been some pretty weak share performance across lithium stocks amidst softer EV sales and a sharp decrease in the lithium stock price.

However, we're reassured that the key drivers of lithium demand remain intact, predominantly as it relates to the continued adoption of EVs. And we think that presents a really exciting volume growth opportunity for Albemarle. And while I wouldn't pretend to have any special ability to predict commodity prices, we've also done work to test the economics of lithium production at various ore grades and explore some of the challenges of bringing new supply online on time and on budget. And based on that work, we think it's more likely than not that the lithium price rises from here, adding a helpful second driver to the Albemarle investment case.

SP: Okay, thank you. Changing tack a little and talking about ESG, any example of engagement or research you'd like to mention?

LB: We have had a variety of ESG research and engagement this quarter, but perhaps just one example to highlight would be a recent meeting with the Head of Sustainability at Watsco. As a reminder, Watsco is a leading distributor of air conditioning equipment in the US. And one of the tailwinds to its growth is customers upgrading to more energy efficient equipment, either as a result of regulatory shifts or to benefit from lower energy costs.

So, you might expect Watsco to be all over the emissions disclosure piece, and yet we found them to be somewhat of a laggard in that department, and it's something that we've been really encouraging them to improve on. So, it's very encouraging in this recent meeting to hear that work on their sustainability reporting is now well underway and that we can expect targets and disclosures in the not-too-distant future. It's also very pleasing that they've asked us to make introductions to other companies that we regard as further on in their sustainability journey, in the spirit of sharing best practice. I think that's a great example of how, despite us being a very small shareholder from Watsco's perspective, in terms of the credibility and the impact of our engagements, we can really punch above our weight.

SP: Thank you. Now, looking forward, as I've said, investors seem quite bullish, optimistic, still rushing to AI-related names. Do you fear missing out in that environment?

LB: No. I think we recognise that we won't always keep up with markets in periods where they're rising very sharply, particularly if that's being led by a small number of stocks that aren't necessarily a good fit for our investment philosophy and strategy. And there I'm thinking about Nvidia and Facebook. However, I think the key thing is that our focus hasn't changed. We remain committed to looking for well-run companies with strong balance sheets and strong return profiles, benefiting from multi-year growth opportunities ahead of them. And I think over the next several weeks,

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myself and other members of the team will be out on the road at conferences and company meetings, uncovering more of these opportunities and maintaining a healthy pipeline of new ideas.

SP: Thank you for this update. Three key messages I retain. The first one is that portfolio returns have been positive but lacked very strong global equity markets. The second message is there's been a bit of reshuffling in the pharmaceutical names in the portfolio. And the third is that there is no fear of missing out. We know that the quality compounders that are in the portfolio tend to lack very sharply rising equity markets, but there is no fear and rush to chase those names. And we remain focused on the next decade for [our] holdings.

Thank you Lucy for your time. And thank you, everyone, for joining us today.

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

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

	2020	2021	2022	2023	2024
Global Income Growth Composite	-8.0	50.4	7.7	-1.1	12.5
Responsible Global Equity Income Composite*	-7.2	49.7	8.8	-0.7	14.4
MSCI ACWI Index	-10.8	55.3	7.7	-7.0	23.8

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years	Since inception
Global Income Growth Composite	12.5	10.7	8.3	N/A
Responsible Global Equity Income Composite*	14.4	11.4	N/A	13.3
MSCI ACWI Index	23.8	11.5	9.2	9.6

*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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