Manager Insights: Lawrence Burns

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Lawrence Burns, Investment Manager

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

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Hello, I am Lawrence Burns, Deputy Manager of Scottish Mortgage.

I'm going to use the next few minutes to talk about a core aspect of our investment philosophy, outliers.

In investment, the reality is that most companies simply do not matter. Over the last 30 years, half of the net wealth created in global stock markets came from just 0.25 per cent of the stocks – that is just 160 companies.

These companies are what we call outliers. They exploit the asymmetric pay-off structure of equities which is uncapped upside yet mathematically bounded downside. This structure means that a £100 investment in a stock can theoretically return £10,000 but the losses from that investment can never exceed £100.

This is why outliers can be so powerful in equities. And whether the world is serene or chaotic, our objective remains the same: to find and invest in extraordinary companies capable of delivering outlier returns.

Finding Outliers

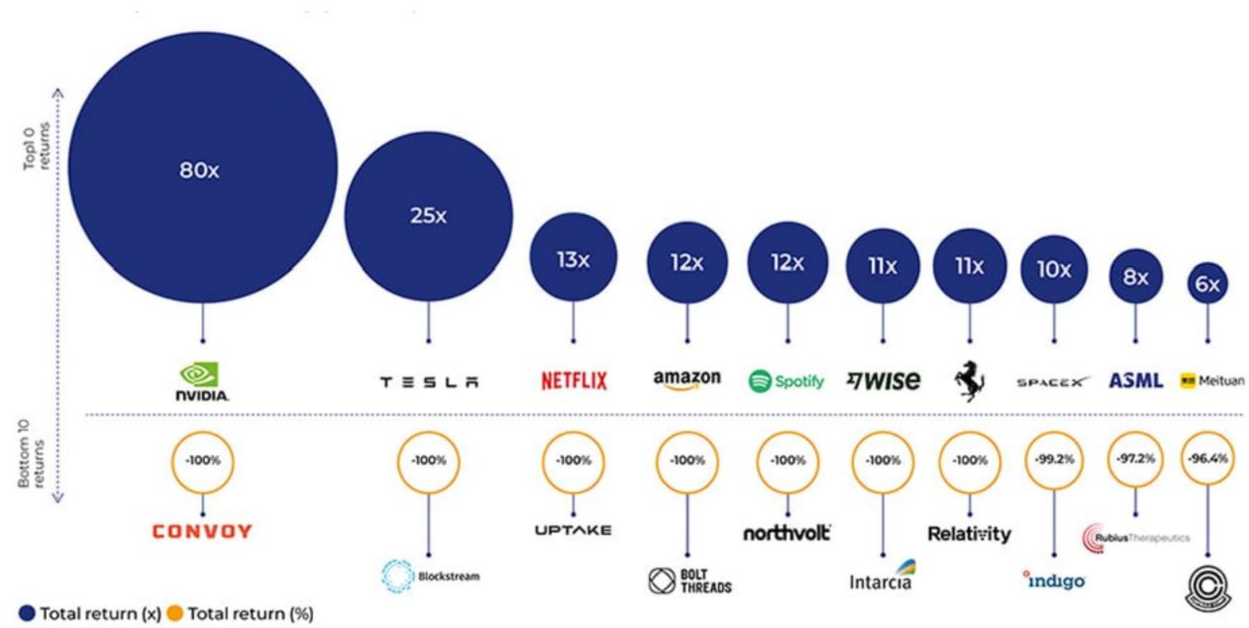
Finding outliers is a challenging endeavour. They are, by definition, very rare, whilst their characteristics are heterogeneous. Define the parameters of your search too narrowly, and you risk missing out on a new generation of outliers that might look very different from those of the past.

Outliers can be young, fast-growing companies, such as Chinese ecommerce giant PDD, which is still less than 10 years old. PDD falls just outside our top ten outliers, but has still delivered a 6x return for shareholders since its IPO in 2018.

Outliers can also be much older businesses with less explosive but steadier, more resilient growth. Ferrari celebrated its 85th birthday last year but was still able to return an 11-fold return for Scottish Mortgage over the last decade.

Asymmetric Returns

The Scope for Uncapped Upside and Bounded Downside



Top and Bottom Absolute Stock Contributors 10 years to 31 March 2025
Source: Revolution. Sterling. Total return or top and bothhom 10 contributing equity holdings 31 March 2015 to 31 March 2025.

We believe the portfolio today has a diverse range of potential outliers. With companies founded across the globe, from Stockholm to São Paulo to Singapore. The nature of the growth is also diverse, from space rockets to digital banking apps to the most coveted cars and handbags in the world.

We would be very wary of being too prescriptive as to the characteristics of outliers, but there are several commonalities we have observed over the years.

Outlier Characteristics

The first is that outliers are unconventional. It is not possible to achieve extraordinary outcomes through deploying ordinary methods. Therefore, the strategy, culture and leaders of outliers usually appear as unorthodox. In the case of SpaceX, to dramatically lower launch costs, it took a radically different approach.

It sought to make rockets reusable. To accelerate innovation, it rejected the traditional aerospace approach of extensive planning and validation before building a prototype. Instead, it adopted an iterative approach of rapidly building prototypes, testing them, analysing the results and implementing improvements in subsequent designs.

Now, in practice, this has meant early test flights, which have often ended in spectacular explosions. Traditional aerospace companies go to great lengths to avoid public failures, whilst SpaceX broadcasts them live to global audiences and frames them as valuable learning opportunities.

Backing unconventional companies can look prescient when they are successful, but when they fail, you usually end up looking very foolish. It's a willingness to look foolish that is really a necessary requirement for investing in outliers.

The second characteristic is that outliers are long-term focused. It takes many years, not quarters, to seize large market opportunities and for formidable competitive advantages to form. To succeed, outliers are focused on these long-term outcomes, not maximising value creation over the short or even medium-term.

For much of its history, Amazon's approach to profitability defied stock market conventions. The company chose not to make profits for many years and instead constantly reinvested back into the business. This long-term approach allowed the company to build out its delivery infrastructure, deepening its competitive moat, and to seed new business areas such as Amazon Web Services, as well as to deter others who did want to make a profit from competing against them.

Many of the companies we invest in are founder-run, just like Amazon, because such a leadership structure enables long-term decision making.

The third characteristic is that outliers address large opportunities. This allows a company to grow to multiples of its current size. Wise, the UK-based financial technology company, facilitated £68bn in cross-border transfers in just 6 months last year.

However, it still served less than 5 per cent of the consumer cross-border market and less than 1 per cent of the business cross-border market. The company's mission is thus to create the financial infrastructure capable of serving not just billions but trillions of dollars of transactions. It has ample space to grow and to continue its outlier journey.

Now, the most rewarding outliers have what we call multiple acts. Having achieved success in one large market, they leverage their advantages to be successful in another.

Amazon started as an online book seller but leveraged its ecommerce business to build its cloud services business. Today, Amazon Web Services contributes 70 per cent of Amazon's operating profit. NVIDIA started out producing graphics chips for PC gamers before investing heavily and presciently in artificial intelligence.

Mercadolibre started as a Latin American ecommerce platform. However, to reduce the friction of completing transactions when few people had credit or even debit cards, it developed a payments platform and started offering credit. It leveraged the relationship with its ecommerce customers and its data insights from their purchases to offer a broad range of financial services. Today, its fintech revenues exceed 40 per cent of the business. It may even have a third act emerging as an advertising platform, leveraging the data its ecommerce and fintech platforms provide to tailor adverts to users.

Alternatively, take Spotify. It's leveraging its leading position in music streaming to offer podcasts, audiobooks and is running a pilot program for education content right here in the UK.

This pattern of multiple acts is repeated again and again amongst the most rewarding outliers that we invest in. As business analysts, it requires us to take an imaginative and creative approach. The challenge is often to imagine just how valuable an outlier can truly become.

Now the fourth and final characteristic is that outliers are adaptable. They are not static companies but adapt to both opportunities and challenges. Companies must evolve to changing circumstances because to be static is to become obsolete.

Hermès started as a manufacturer of high-quality equestrian gear for the horse-drawn carriages of noblemen and royalty. It took a century before it produced its first luxury handbag.

When I first met the founder of Bytedance, TikTok's parent company, it was to talk about its flagship product, Toutiao, a personalised news aggregation app. A precursor to Douyin and TikTok.

The end of the pandemic made even clearer the importance of investing in adaptable organisations. The world changed, demand for digital products and services slowed, and the cost of capital rose as interest rates soared. A number of the leaders in our portfolio recognised this shift in the external environment and they pivoted their companies.

Mark Zuckerberg of Meta and Daniel Ek of Spotify both sought, as examples, to right-size their organisations to the new environment early on, focusing on efficiency and profitability. At the same time, both still invested in new growth areas, with Meta spending billions to develop AI tools such, whilst Spotify entered into the audiobook market. They have both navigated a difficult environment admirably and been handsomely rewarded for doing so.

The world is constantly changing. We cannot predict all the ways in which it will change over our five-to ten-year investment horizon. Right now, no one can even predict what global trade will look like several months from here.

However, if we are able to invest in companies with adaptive leaders and cultures, we can at least outsource some of this challenge to them. It is for this reason we endeavour to back great businesses that are run by people that are far smarter than ourselves.

Annual Past Performance To 31 March each year (net %)

	2021	2022	2023	2024	2025
Share Price	99.0	-9.5	-33.6	32.5	6.0
NAV	111.2	-13.2	-17.8	11.5	11.4
Benchmark*	39.6	12.8	-0.9	21.0	5.5

Source: Morningstar, total return, sterling. *FTSE All World Index (GBP).
Past performance is not a guide to future returns.

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