

Positive Change Q4 investment update

January 2024

Investment manager Kate Fox and investment specialist Rosie Rankin give an update on the Positive Change Strategy covering Q4 2023.

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Rosie Rankin (RR): Hello and welcome to our Positive Change update. I'm Rosie Rankin, an investment specialist on Positive Change, and I'm delighted to be joined by investment manager Kate Fox. Kate, I wondered if we could start off today by looking back over the past year. And I wondered if you could share your reflections on 2023.

Kate Fox (KF): Sure. Well, it feels as if a lot has happened in 2023, Rosie, certainly on the global stage. Whether it's been the tragic outbreak of another war, this time in the Middle East, while there's been increasing intensity to the war between Russia and Ukraine, as well as wars ongoing elsewhere in the world. We've seen rising evidence of the devastating impacts of climate change, whether it's been floods in Libya or forest fires in Greece, to name a couple of examples.

There have been the developments in AI, artificial intelligence, which is really gaining momentum at pace, creating new opportunities, as well as some important questions and challenges for society to consider. And we've seen the continued trend in interest rates rising. So, they've now risen at the fastest pace, I think, in four decades. So that is increasing the cost of financing, which is impacting businesses and individuals and has really impacted market sentiment over the last year.

Now, all of this sounds as if it's very much full of doom and gloom, but I think we should remember the progress that we've experienced in 2023 as well. So, scientists, entrepreneurs and decision makers continue to try and find solutions to global challenges that we face today.

If we bring it back at a local level, to the portfolio, I'd like to mention Moderna. So just a few years on from developing a vaccine to help us deal with a global pandemic, Moderna last year had some really encouraging results in its trial looking into the use of its personalised cancer vaccine, along with a drug made by Merck to treat late-stage patients of melanoma. So, the results showed that the use of the Moderna personalised cancer vaccine, in combination with the Merck drug, could

reduce the risk of recurrence or death by nearly 50 per cent and reduce the risk of it spreading or recurrence by just over 60 per cent, which really is remarkable. So, research will continue there, whilst continuing to look for treating other types of cancer. So, to think that the world is on the cusp of developing a vaccine for cancer, that's something to celebrate.

So, much has been happening in 2023. Much has changed in the world. But we remained resolutely committed to our philosophy and dual objectives with the Positive Change Strategy, because, if anything, 2023, either the catastrophes or the scientific breakthroughs, has really shone a brighter light on the need for change and the opportunities for investing in companies that are driving change.

RR: Thank you, Kate. You've described a world that is abounding in opportunity but also challenges: a very complex situation. So, I wondered if we could dive a bit more into the investment performance of Positive Change. It's been a volatile year with ups and downs, but I'm pleased to say that over the last quarter this strategy has outperformed. And I wondered if you could talk a little bit more about what's contributed and detracted to the performance over that short-term period of the last quarter.

KF: Of course, Rosie. And you know me well enough to know I'm less comfortable talking about quarterly performance, but I appreciate that it's really important to our clients to hear about that, and particularly at a time where the backdrop is so dynamic and complex. And as you say, it's pleasing that this is a quarter where there has been positive absolute and relative performance. We've outperformed by around about 3 per cent.

To mention some of the top contributors, I would include MercadoLibre, Shopify and Duolingo. So, these are companies that are in our social inclusion and education theme. And what's been really pleasing is to see the fantastic operational progress there, now being rewarded in share price performance.

So, if we consider MercadoLibre, for example, it managed to grow revenues by just over 40 per cent in US dollar terms in its most recent quarter, as it continued to take greater market share of the fast-growing ecommerce market in Latin America and increase its take rate while also growing its fintech business. I think what was particularly pleasing, in the most recent results, was the profitability of the business as well, despite it continuing to invest in logistics and further embedding its competitive advantage. Its operating profits came in at 18 per cent this quarter, compared to about 11 per cent this time last year. So that's been pleasing.

A very similar story at Shopify, which grew revenues by 25 per cent, as it's gaining traction in the enterprise market. So that's serving larger customers as it's expanding in other geographies. It's also increasing its take rate as well, which is pleasing. And again, profitability surprise to the upside there as well.

And Duolingo, the popular language learning app, continues to grow at pace. So, it's grown its members by just under 50 per cent – it's now got 83 million users. And what's exciting is that the

percentage of paying users is increasing, so it's managing to monetise its platform while also looking to expand its offerings.

So, it's now looking to offer a learning platform in music and in maths. And despite this handsome growth in membership and revenues at Duolingo, what really excites me is the runway for growth. So, they've got 83 million users today. There are 1.8 billion language learners today. And Duolingo isn't just addressing the current market. It could expand the market. So, for example, I didn't know that I was in the market to relearn French until I started engaging with Duolingo. So, I think that's exciting.

In terms of the negative contributors or the detractors to performance, I'd mentioned Remitly, So the company's operational performance has been encouraging. It's been strong, but I think that the market has perhaps taken fright, to the extent that we can't predict or understand what the market is doing, at the fact that they are looking to invest in advertising and marketing. We actually think quite differently. We think that that commitment to investing in advertising and marketing could help them really cement their leading position in providing online remittances. So, we're really encouraged by this investment in the company's future.

I'll also mention Moderna, because I understand that this is a company which is of much intrigue for our clients. More recently, they've reduced their revenue predictions for 2023 and they've experienced some one-off costs, whether that's inventory write downs or downsizing their manufacturing footprint as we move from pandemic to endemic status for Covid.

So, while the execution hasn't been perfect, I think we do need to have some perspective here, in that this company is transitioning from having developed and produced this vaccine that rescued the world from a global pandemic at scale, while continuing to invest in it and its pipeline. So, it's under transition. And I think, again, the market is perhaps a little bit nervous about the fact that the company is continuing to invest in its R&D pipeline, but we actually are really excited by that.

So, with Moderna, we see more than a Covid company. We think that the platform is much broader than that. This is a genuine technology platform which has got the potential to completely transform the rate of success in developing drugs. We're really encouraging the fact it's investing the cash that's been generated through the vaccine into developing its growing and maturing pipeline. So, I think they've got just under 15 candidates currently, and that spans beyond Covid to other respiratory vaccines, rare diseases and the cancer vaccine as well. And also, there's some flexibility. If they need financial flexibility, they've got different levers that they can pull. So, we remain excited about the opportunities for Moderna.

RR: Great. Sounds like there's lots going on with the companies in the portfolio, some really encouraging progress in terms of operational progress that you've described. So, against that background, could you talk a bit about some of the key transactions that have happened in the portfolio over the last quarter?

KF: Yes, of course. So, over the last couple of years, one of the reflections that we have made, one of the learning points, or really reminders for us, has been that you can have a company with a fantastic growth runway, run by a management team with a great vision and high ambition, but execution counts. So, we've learned from that. And applying these learnings, we've actually sold our holding, or our clients holding, in Orsted the Danish wind farm developer and operator, and that's been done to execution concerns.

So, the company has had to make some quite significant write downs to projects, and that's been a result of some things that were out with their control. So rising interest rates, higher cost of financing, supply chain challenge, and changes to tax credits in the US, but also because of some internal decisions that they made, in terms of the forward investment commitments that they made, which really undermined our confidence in management. So, we've sold the position there.

M3, which is Japan's largest doctors' portal and online advertising and marketing platform for pharmaceutical companies, is also a company that we've moved on from. So, I think the growth runway there is still terrific because I see that, for pharmaceutical companies, there's greater scope for them to shift their marketing and advertising spend online. But M3 specifically has been diversifying into new business areas, into new geographies, and often doing so through making a number of acquisitions and often bigger acquisitions. And with this comes greater complexity and greater execution risk. And this has been compounded, really, by not particularly great transparency from the company. So, we've decided to move on despite a derating.

So, the proceeds from these sales have been redeployed towards companies that we're excited about. About a dozen names. We've made some small additions, including Moderna and an exciting new holding that we've taken a small position in. And that is Joby Aviation. So, Joby Aviation is looking to be a leader in a fast-emerging industry, a new industry which is that of electric vertical take-off and landing aircraft.

So, these are essentially electric flying taxis, which have got the potential to completely transform metropolitan transportation, reducing emissions and congestion and could actually end up changing the footprint of cities. Joby Aviation has developed a prototype and is going through its certification process. And what was really exciting to see, in November, was footage of its first test flight in New York against some blue skies there. So that's an exciting new holding.

RR: That does sound exciting. I'd be really keen to finish off with a final question. Just talking about what the team is up to now. What is exciting the team? What's the outlook for 2024?

KF: So I would say that, in terms of what we're going to be doing, it is going to be much more of the same. It's about us trying to identify and own companies that are providing products and services, that are providing solutions to global challenges, that are going to help our world become healthier, more inclusive, more environmentally sustainable.

I actually think that we're at a really important juncture in time as a society and as investors, because much change needs to happen. And that change creates a great opportunity. I feel it's somewhat of a watershed moment in time. Being a bit more specific than that: what's in the

research pipeline? Well, we're continuing our work to identify opportunities in electric vehicles, whether that's looking beyond EV manufacturers, beyond Tesla, thinking about those, some in China, or thinking about the supply chain more broadly.

So an unlocking question for us is, is there a sustainable competitive advantage in battery manufacturing, for example? Really intrigued to see what AI will mean in the healthcare space and the continued developments in the use of genomics, in terms of our understanding of biology. Really curious to look at the companies that are helping the mining industry, which is a dirty and grubby industry, but is going to be critical to the energy transformation. I'm looking at companies that are going to help that industry become more efficient and more environmentally friendly.

And we continue to look at digital platforms and the opportunity that they present in terms of providing more inclusive economic growth. So, against what might have been a sort of backdrop of somewhat gloom and doom, we're resolutely optimistic and determined to find the changemakers of the next decade.

RR: Kate, thank you so much. Your optimism does shine through, and I think we should all be excited for 2024. And thank you to everyone who's taken the time to watch this film and also for your interest in Positive Change.

Positive Change

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

	2019	2020	2021	2022	2023
Positive Change Composite	30.1	86.0	9.7	-30.4	15.3
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	Since inception
Positive Change Composite*	15.3	16.3	N/A	18.1
MSCI ACWI Index	22.8	12.3	N/A	10.3

*Inception date: 31 January 2017.

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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