

Small caps, bubbles and tech giants

November 2025

Investment specialist Bill Chater describes how Global Discovery's search for the world's best small caps, while intermediary client manager Megan Rooney gives her take on AI bubble headlines.

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

Cherry Reynard (CR): Good morning. I'm Cherry Reynard, your host for Upfront, where we bring you the latest insights on Baillie Gifford's UK funds. Today, I'm speaking with investment specialist Bill Chater, who'll be answering your questions live. So do send them in by clicking on the dropdown menu on your screen.

Now, before the audience questions, we have investment specialist Jon Henry speaking on Amazon and its role as the digital backbone of our modern world. But first, client relationship manager Megan Rooney is here to answer some of the questions that have been filtering in to the team over the last few weeks. Welcome to Upfront.

So, welcome, Megan, to this, the last episode of the year. Now, we had lots of questions submitted ahead of this episode. So, thanks to everyone who has written in. Let's start with this one. There's been a lot of chat about potential bubbles. So, what do you think the chances are of a meltdown, and what might be a trigger for that?

Megan Rooney (MR): It's a very valid question. If we look at the AI hyperscalers, your Alphabet, your Apple, Microsoft and Amazon, for example, their market cap now rivals entire economies, and their level of concentration has only increased, which has heightened that concern.

Now, first and foremost at Baillie Gifford, we believe that AI is a paradigm shift. It has unlocked profound change, and it will continue to do so going forward. That being said, parts of the market are looking frothy. Both of those things can be true at the same time. Now, are we in a bubble? Is it going to pop? That's exceptionally hard for us to sit here this morning and say rightly or wrongly one way. Unfortunately, you only find out you're in a bubble in hindsight.

CR: Yes, absolutely. So where do you think we are then?

MR: You'll have heard us before, and I'm sure the audience will have as well, we reference work of Carlota Perez and her work on technological revolutions a lot at Baillie Gifford.

CR: Yes, absolutely. We should say that we talked about Carlota Perez with Gary Robinson in a previous episode. So, viewers should check that out if they want to know more.

MR: Indeed. So, we think today we are still in that exuberant installation phase. There's going to be volatility. There might even be cracks along the way. But what matters is that key infrastructure that's been built today, and who captures the long-term value of that going forward. So that's your likes of your data centres, your chips, your connections to the grid.

An infrastructure build-out like that transcends bubbles. It provides a foundation. And we know that if we look back at previous bubbles. For example, if we look at the 19th century railways, lots of those investments failed, but the tracks endured. They reshaped markets, and they provided an economic boost. The same with the dot-com era. It paved way for the age of the internet.

And it's also worth reminding ourselves that the outcomes of companies during the dot-com era diverged wildly. The classic example is Amazon and Cisco. Both were overvalued internet companies. Both saw their share prices crash. Cisco's never recovered. Amazon's just soared, and it's continually compounded dramatically in the decades that followed. So, we're less concerned about when that bubble pops and the companies that will capture that enduring value over the long term.

Now, some companies will fail. We're not saying that's not going to happen. And after all, that is a feature of an efficient marketplace. We would expect that to happen. Our job is to pick the winners of tomorrow. And that's why we believe that being selective is key, especially in a market like today. And that's why it's really important you have active management on your side.

CR: Yes, absolutely. You mentioned the dot-com bubble there. Superficially, there do seem to be some parallels. But I wonder if you could talk a bit about what you feel is different this time.

MR: There are a few things that are different. The first one would be the economic base is broader, and it's based on real money. So, we don't invest in all the hyperscalers at Baillie Gifford, but across our portfolios, we do have exposure to Amazon and Meta and also Microsoft. And importantly, these companies are funding that spend largely by operating cash flows.

We also hold NVIDIA widely across our portfolios. Some of the numbers, when you read those deals, they are eye-watering amounts, but it's based on real money. NVIDIA generated just shy of 36 billion in a single quarter alone this year from its data centre output. So, these companies are spending real money, not monopoly money, which is a big difference.

Second is that the constraints this time around are physical bottlenecks. It's access to chips. It's connecting to the grid. It's the cooling supplies. It's even very mundane things like getting permits. These things take time, and they naturally create a process that slows down that supply, and that

ensures that demand doesn't run ahead of itself. If we contrast that to the dot-com era, we saw the opposite happened. Supply outpaced demand. And that was a result of that easy venture financing that the telecoms companies had access to.

Third is context and scale. The numbers are massive. This year, by the end of 2025, it will be roughly \$400 billion spent in AI data centres. That only is equivalent to around 1% of US GDP. If we compare that to railroad spend, it peaked at 6%.

And the final thing worth highlighting is policy. Governments view AI infrastructure as strategically important. There's not a government in the world that isn't thinking about this. And again, that's another difference. There's policy that is supportive of this rollout, like the CHIPS Act in the US. We didn't have that in the dot-com era. And if private enthusiasm does cool, that should help cushion the demand, because there is strong demand from governments across the world.

CR: Yes, certainly look at the recent results from the hyperscalers over the past couple of weeks. We've seen that demand really isn't slowing at all.

MR: No, it's not. We're not short of demand. We are short of capacity. And that was summed up perfectly by Andy Jassy at Amazon in their latest earnings call. He noted that they're going to be continually aggressively investing in capacity, because that's where they see the demand. But most importantly, as soon as they're adding that capacity, they're able to monetise on it. So it's showing that these investments are generating money. And there's no shortage of demand from Amazon, but also across the full hardware stack, NVIDIA, TSMC, ASML, all companies which we invest in.

CR: Yes, absolutely. Now, what would you say to some of the critics that have said, we're not seeing any of the benefits of efficiency or profits from AI yet? Is that a fair argument?

MR: I think if we start here, a year ago, it might be a fair argument. But what we're hearing from our investors and the companies that we're meeting, the founders, we're hearing firsthand that they are seeing tangible benefits from AI that weren't present 12 months ago. Companies like Shopify, Roblox, Mercado Libre, they're not building this infrastructure, but they are benefiting from it. They're using AI to enhance operations, make them more efficient, tailor bespoke client experiences, for example, and also, most importantly, widen margins. And our health care names? Tempus AI are using AI to help oncologists diagnose in real time, and Recursion are using AI to help develop the new drugs.

And we're seeing that across the world as well, in our Chinese names too. So CATL is a battery manufacturer. They're using AI to make their batteries more efficient. And the big cloud platforms like Tencent are helping leverage that with their advertising. So we're not just seeing benefits from the AI hyperscalers. We're seeing it across geographies and across sectors within our portfolio, which is really important.

CR: Yes, absolutely. And then just before we move on, there's been a lot of fearmongering around AI, negative rhetoric, this kind of thing. Do you think it is possible that the trend could stall or even reverse?

MR: There's a lot of pushback from AI in the creative space, and I think that is valid. But is the trend going to reverse? No. If we think about your average day, it's incredibly hard to live without AI. Take my morning commute this morning. The first thing I've done is unlock my phone with facial recognition, ID, which is AI. And then I opened the Trainline app, I bought my ticket to work through the Trainline app, and the app can now tell me which carriages are going to be quieter.

As I sit in the train and put my headphones in, Spotify serves me my playlist of the day. As I'm on social media, going through Instagram, going through Reddit, again, I have bespoke content that's curated to me based on AI and its understanding of what stuff I'm more likely to interact with.

Even when I get off the train, I go to buy my morning coffee, I tap my phone and pay with my Revolut app. AI is checking that transaction in real time to make sure it's not fraudulent. And then even when I'm walking past Greggs and I toy with that sausage roll, that being there isn't an accident. Food companies like Greggs are increasingly using AI to ensure they've always got the right amount of sausage rolls ready for their customers.

So, we invest in all those companies at Baillie Gifford. And the point really from that example is that AI isn't a gadget anymore. It's not just ChatGPT. It is a utility layer that's embedded in all aspects of our life now. So yes, it's important for us to ask, are we in a bubble? What do we think about concentration levels? But clients should also be asking their fund managers, do you have a diversified exposure to AI across the full value chain? Because if you're buying the indexes, you likely don't. And the companies that are invested, is that based on robust fundamentals, or is it purely on AI hype and momentum?

CR: Okay, great. Thank you so much for joining us today, Megan. Now, for those of you watching live, if you have any questions, simply click on the Ask a Question tab. Now, as part of each programme, we feature an in-depth look at some of the transformational companies Baillie Gifford invests in. Today, we're learning about Amazon, a company that needs no introduction. But what really makes the company special? Let's find out.

Jon Henry (JH): In the past, the thrill of shopping from home meant flipping through hefty catalogues, placing an order by mail, and then waiting weeks for your purchase to arrive. Well, now almost anything that you want can be delivered to your door within hours. This remarkable shift is largely thanks to one pioneering company, Amazon. But Amazon's impact doesn't stop at shopping. It has also built the digital foundation of our modern world. Amazon Web Services, or AWS as you might know it, is the invisible backbone of the internet, quietly powering the apps and data that are integral to our everyday lives.

There are three key reasons why Amazon's special. Firstly, it is relentlessly innovative. Amazon's culture drives long-term value. AWS alone adds enough computing capacity daily to run a Fortune

500 company, for example. Second, its core services have become the infrastructure that we can depend on. How many times has Amazon come to the rescue and delivered something next day that you desperately needed? Well, 250 million Prime subscribers pay to access that service today. And thirdly, its diverse ecosystem, from retail and cloud to advertising and subscriptions. Amazon's revenue streams are broad and growing.

Scale is no growth limiter for Amazon. With £100 billion of AI spending pledged this year alone, it's set to build more data centres and custom chips to process exponentially more data. AWS will become an indispensable business partner for more companies who will come to rely on more of its web services. Think about the expanding global financial firm whose workers log into the secure cloud workspaces hosted by Amazon, access their real-time analytics, provided by AWS Redshift, deploy new code using AWS CodePipeline, all with peace of mind that AWS Shield and GuardDuty is continuously monitoring security.

For merchants, Amazon's reach and ad targeting will be the best way to grow, whether you're an artisan candlemaker or a global clothing brand. For customers, hyper-personalised experiences will become the norm. Imagine AI assistants like Rufus or Alexa planning your week, buying your outfits and delivering groceries at your convenience. Amazon's future can't be captured in a spreadsheet. Its culture of innovation and its day-one mindset mean that we're still early in its journey. The best is yet to come.

CR: That was investment specialist Jon Henry introducing Amazon. Baillie Gifford has invested in the company since 2005, a long relationship that clearly has more to give. Now, to move on, we're joined by Bill Chater for a fund update.

Welcome, Bill. Now, to introduce you to those watching, you're an investment specialist on the Global Discovery team and joined Baillie Gifford in 2018. Now, I wonder if we could start with a quick overview of Global Discovery and what it's about.

Bill Chater (BC): Yes, of course. Well, firstly, thank you very much for having me today. It's great to be here and being able to join your audience. The question which really resonates with Discovery investors is whether you believe all of today's largest companies will be the same in ten years' time. It's a question that has particular relevance at the moment, given a lot of what you've just spoken to Megan about, the concentration at the top end of the market, the valuations there, but also the sense that those businesses are so firmly entrenched.

But if all of those companies were to stay the same, it would buck almost every historical trend. The index, an index like the S&P, that sees renewal of about a third of its constituents over a ten-year period. And looking back, you see sectors like industrials or energy used to really dominate it and now languish. And these things are all reminders of the critical fact in investing, which is that landscapes can change, and things that used to be leaders can become laggards, and vice versa.

And that thesis is really key to Discovery and allows it to have enduring relevance. You see, the strategy looks for the next generation of great growth businesses, companies that could enter and

then dominate an index like the S&P. And more than that, we want to find them early, when they're small, when they're still going through some of their most exciting phases of growth, then hold them for the long term, really harnessing that asymmetrical potential in long-term equity returns.

CR: Absolutely. I wonder if we could turn to a question that's been submitted through the Events page. So, they point out that it's been a painful period of performance for the Trust over the past few years, but that has rebounded more recently. I wonder if you could talk me through that, what's prompted that shift.

BC: So, we're really excited by the returns we've been able to generate over the last 12 to 18 months. Both the Global Discovery OEIC and the Edinburgh Worldwide Investment Trust have delivered strong absolute returns of more than 20%, robustly ahead of a rising benchmark. But we acknowledge that the longer-term numbers remain disappointing, a consequence really of an extraordinary period from 2021 to 2024. And I'd like to thank those clients who stuck with us during that period. I know we tested your patience.

But we do feel a corner has been turned. We are excited, as I say, by recent returns. But we are laser focused on repairing that long term track record and rewarding those clients who stuck with us during those lean years. And what we're really invigorated by is the sustainability of the recent performance drivers. So here I'm talking about the fact that we've sharpened our edge, a better process with a heightened probability of good client outcomes, the fact that we feel we are either at or approaching a small-cap rotation, and then finally, the structural growth opportunities we're finding, where the need of economies and governments are intersecting.

CR: Yes. Were there any lessons learnt from that period of underperformance, anything you did differently?

BC: Absolutely. So we've worked incredibly hard over the last 12 months to evolve and improve our process. We have broadened the investment decision-making group. We've added a bespoke framework for portfolio construction. And we've tightened our investment guidelines to improve diversification. This was targeted, surgical intervention to strengthen the process and, as I say, heighten the probability of improved long-term returns.

And the results have been observable. So you can see now a tighter portfolio, moving from around 100 names to about 60, allowing us to focus on our best ideas. But within that tighter group, we've been able to improve the industrial diversification. Simultaneously, we've increased the level of competition for capital for the earlier-stage names that we have observed to be the most volatile, while increasing the allocation to cash-generative, profitable businesses.

And the satisfying thing is that all of this has been supported by a rich period for idea generation, with the team adding 15 or so new businesses over the last 12 months. And the outcome of that is a portfolio that's in rude health. So forward growth estimates are nearly triple that of the benchmark. And quite honestly, we'd be disappointed if it didn't beat those. Those are sell-side analysts. We expect more of our businesses. We think it can deliver more than that.

CR: Absolutely. You talk about small caps there, and small caps have been really unloved. It's been a torrid time, and actually in spite of some improvements in the broader economic environment that you'd think might help small caps, like lower interest rates. Do you still see headwinds, or what is the opportunity from here?

BC: I might be biased. I think that the best opportunity in markets today is hiding really in plain sight. You're right, it's been a torrid time to be a small-cap investor, that aggressive rate-hiking cycle. And I'd also throw in that the narrative around technology that favours returns to scale means that the market as a whole has been incredibly unloved. But that has created an incredible opportunity.

Look, small caps aren't just cheap at the moment, they are historically screamingly cheap. So you've got that relative valuation gap between large caps and small caps market being the widest it's been in 20 years. Then if you take just the five largest businesses from the S&P, their combined market cap is more than five times the Russell 2000's. Look, these aren't just indicators. These are like big flashing lights.

CR: Yes.

BC: So, for us, we're observing this, and we think that... Remember what I mentioned earlier about leaders and laggards reversing in markets, and needing to keep that in the back of your mind? We're aware of that, and also considering some of the things you've already mentioned, so greater clarity around the path for US interest rates, but also the market's awareness around this elevated level of concentration in the top end of markets.

So we believe there is the conditions for a rotation. And we have seen, in the latter part of this year, stronger periods for small-cap performance that really underlined that. Look, it's not something we can explicitly factor into our process. We're not talking about market timing, but we do think it could be a meaningful driver of returns nevertheless.

CR: Yes, absolutely. If we could turn to one of the themes in the portfolio, a remark on the scarcity and security theme, which doesn't seem to me a very Baillie Gifford type theme, but I wonder if you could talk about that.

BC: Yes, it's really interesting you say that. I wonder if after I explain a little bit more, if you can understand the appeal of it to the team. We sense that after a couple of decades of pretty benign globalisation, with that being the prevailing mega trend, we are moving towards a period perhaps better characterised by great power competition.

Look, this isn't just about tariffs. This is about national defence spending increasing at a rate not seen since the Cold War. It's about governments being willing to intervene in markets that they consider to have strategic importance. Think of the US government's investment in Intel as a great characterisation of that. It's about a move away from allowing the market to pursue lean efficiency

towards a greater primacy of security and managing scarcity in areas that have strategic importance.

Now, we sense that technology is in many ways both the catalyst and the beneficiary of this, that governments have awoken to the fact that mastery of the coming wave of technology, and here I'm referring to things such as AI, obviously, but also things such as quantum computing, space technology, electrification, these are the planes, these are the avenues which are going to determine long-term geopolitical advantage. And so whereas before, the governments may have been happy to let the market dominate here, they are now intervening in a greater way, which is important, because many of these technologies, they're very capital intensive, and that had perhaps been a blocker to their development.

You see, they require a large amount of capital to get them off the ground, but customers may have been unwilling to provide this if they sensed there were uncertainties about the company's ability to deliver on those orders. And governments are stepping into that impasse. So Megan mentioned supportive legislation. I would also include in there direct investment, and I would also include governments stepping in to be a backstop for demand.

Now, for investors such as ourselves, and I'll return to the premise of your question, this is an incredible moment. This is an unlocking event in numerous technologies of significance. So we're incredibly excited about it. We've had awareness of it really for the last few years, with it factoring into several of our investment cases, and it's resulted in having myriad and complementary exposure to this trend within the portfolio.

CR: Absolutely. Now, just quickly before we move to the Q&A, one question that was submitted through the Events page was another question about AI. I wonder, they've asked if you could highlight some of the AI holdings in the Global Discovery Fund that investors might not have heard of.

BC: Of course. So AI is actually one of the exposures that really factors into that idea of scarcity and security. We're aware that as investors who look lower down the market cap spectrum for our ideas, we can't access the hyperscalers that many investors choose to use to get AI exposure. Instead, we've been thinking a lot about AI infrastructure.

Behind AI is the data centre. It is absolutely necessary. And we have found fascinating businesses that are providing components that are going to be critical in this infrastructure. So I would highlight Astera Labs, which is a US chip manufacturer. It develops a component called a retimer. That improves the efficiency and the fidelity by which data can transfer within the data centre itself.

But I would also highlight a company called IREN. And one of the other ideas within this scarcity and security is the need to invest and develop infrastructure within the US. One of the biggest bottlenecks to AI data centre capacity there is going to be access to power. And IREN really sits right at the heart of that. It is a neo cloud provider which is really based on the premise that access

to power is going to be the bottleneck, and is so designing and locating its data centres where it knows it has readily available ability to access the grid.

I would say with these companies that the thing that's really exciting we've taken note of is that growth here isn't speculation. It's happening here. It's happening today. Both of those companies are growing at more than 150% per annum. And I would just say that the thing that excites us, and looping back to what I said earlier about the sustainability of the performance drivers, is that given that we're in the foothills of this technology, we think opportunities such as this can continue to drive returns for years to come.

CR: Yes, absolutely. Okay, thanks, Bill. Now to answer the questions that have been coming in over the programme. What do we have here? We have, any thoughts on gold and crypto, specifically the role and the price of gold?

BC: So, as I've explained the philosophy, you'll understand that we can't directly invest in commodities. Nevertheless, we watch markets closely, and we're aware of the price action in areas such as gold and Bitcoin. We consider these more about how could they impact specific company fundamentals and their prospects for long-term growth.

So, we have factored them into our thinking. In fact, just a few days ago, I was in a stock discussion about a mining technology provider that has a component that allows miners to identify and understand the richness of gold veins in rock using sonic waves, which would be quicker, more efficient, easier than the conventional method, which is actually to break that rock down and melt it down to understand it. So very much there, the thesis is based around a continuing elevated gold price increasing the amount of mining, and those miners needing to find better efficiency.

And then with Bitcoin, that company I mentioned earlier, IREN, well, that had its foundation as a Bitcoin miner. But with the change in the price there, but also the economics from AI compute, it's been able to repurpose and reposition those data centres, transitioning away from Bitcoin mining and focusing entirely on AI compute.

CR: Okay, great. Then another one. You mentioned 15 new ideas. I wonder if you could go into a bit more detail on some of those new holdings.

BC: Yes, absolutely. I think what I would emphasise is the breadth in the idea generation that's taken place over the year. So some of the names I've mentioned would be within that cohort. We have thought about that AI infrastructure, the development there and the need for solutions there. So Astera and IREN would be in that group, but we've also taken a position in a Taiwanese semiconductor manufacturer called ASPEED. And they develop the chips that really manage the physical conditions within data centres.

But we've also had an appreciation and awareness of the technology that's emerging from China, not necessarily trying to make a call on the economics of the country, but more looking for

outstanding businesses which are really leading the way. So we've taken a holding in a flying taxi manufacturer, which I suppose is what you might expect from Discovery.

CR: Yes.

BC: But I would just say that, again, this is a company which is delivering here and now. They're already providing unmanned short trips around the Great Wall of China. And also from that Chinese market, a provider of solutions for self-driving cars. And we're still enthused by the opportunities within biotech. One of our recent purchases has been in a company called Guardant Health, which is a precision oncology testing provider really leading the way in an innovative field called liquid biopsy.

CR: Okay, great. Right, we are out of time, but thanks so much for joining us today, Bill. And thank you all for joining us this year. Now, to find out more about the topics we've discussed on the programme, please go to the website at bailliegifford.com. The UK Intermediaries team are here to help, so do get in touch if you have any questions. Until next year, goodbye.

Baillie Gifford Global Discovery Fund

Annual discrete performance to 31 September each year

	2021	2022	2023	2024	2025
Class B-Acc (%)	5.7	-42.9	-17.0	-3.0	16.9
Index (%)*	33.5	-9.1	5.1	13.1	11.9
Target (%)**	35.5	-6.8	7.0	14.9	13.9
Sector Average (%)***	23.2	-8.9	7.8	16.2	12.1

Source: FE, Revolution, S&P. Total return net of charges, in sterling. Share class returns calculated using 10am prices, while the index is calculated close-to-close.

*S&P Global Small Cap Index

**S&P Global Small Cap Index (in sterling) plus at least 2% pa over rolling five-year periods.

***IA Global Sector

Past performance is not a guide to future returns.

The manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund in the Investment Association Global Sector.

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