Baillie Gifford™

Global Alpha
Q2 investment update

July 2024

Investment manager Spencer Adair and investment specialist Philip Rae give an update on the Global Alpha Strategy covering Q2 2024.

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

Philip Rae (PR): Hello and welcome everyone. Thank you very much for joining us for this short video update on your Global Alpha strategy. My name is Philip Rae. I'm an investment specialist on the Global Alpha team and I'm delighted to be joined today by Spencer Adair. Spencer is one of the three named investment managers on your Global Alpha portfolio, and we're going to be discussing everything from the market environment to recent performance, also covering on the portfolio positioning and touching on recent transactions. Then we'll leave it with Spencer's outlook for your Global Alpha portfolio, as we look ahead to the remainder of the year and beyond.

Spencer, thank you for joining me. We have quite a lot to get through today, Spencer. So, if you wouldn't mind, maybe we can, before we dive in, start with what Global Alpha is about? What's the essence of the strategy? And how are we seeking to allocate capital in this portfolio?

Spencer Adair (SA): Absolutely. Pleasure to be here. So Global Alpha is all about capital growth over the long term. That capital growth will be delivered by the fundamental progress of our companies. So, we're looking to identify companies that are growing above average rates for above average time periods, and that compounding will really drive returns for our clients.

In terms of allocating capital, we start with a blank sheet of paper. We are 100 per cent bottom-up. We look at the best or optimal balance between risk adjustment and reward, that’s what we're trying to do. And if I compare that to the index, the index only looks at the size of the company, the current size of the company, and therefore prices in known future growth. We're looking for underappreciated growth in our approach. So, the market is appreciated growth, we're underappreciated growth. So, we're very happy to be different from the benchmark.

We think the secret of outperformance, of alpha, is three things. So, A equals B plus C plus D is the simple formula. A is alpha. The B is bottleneck. So where can we find a bottleneck, a supply-side constraint that sets up profitable future growth today? The C is change or progress. Where are we finding progress, adaptation, something new that's coming along that creates a new profit pool? And then the D is duration. So that change and that bottleneck and on supply-side, do they exist for a long enough period of time to allow compounding to take effect? So that's what we're trying to do with Global Alpha.

PR: Thank you. So, in terms of duration, we've been in a long period where the US has dominated global equity markets. Technology has come back after a difficult 2022. And a lot of it's been centred around artificial intelligence, there's a lot of excitement around this theme today. Can you maybe just talk about that, particularly in relation to how it's driven index concentration and how you think about that market backdrop?

SA: So, I try not to think too much about the market, but my observation would be that the drivers of returns recently, that formula that I outlined, it's looked more like outperformance equals the Magnificent Seven initially, and then more recently outperformance equals the Magnificent One with NVIDIA and AI. So, the market has become really narrow. On some measures, this is the narrowest market leadership for four or five decades. So, for a very long period of time – we're having to go back to the Nifty-Fifty and that era. That doesn't help us. That's a headwind. We revel in, we enjoy the breadth of growth opportunities. We're looking for change and growth from a whole range of different industries. I think over 30 industries are represented in the portfolio today. And we love that. So, despite the fact that things have become very narrow, we've actually done okay. We've kept up. And I think that's a better result than I might've imagined, given how narrow things are.

What excites me is that whenever markets inevitably broaden out again, then we're very, very well positioned. So, we haven't lost too much ground on that concentration, and then we're excited and set to do better as things broaden out.

PR: I guess in terms of maintaining that broad approach, one of the things I know you and the team have done is looked at what was the scout network. They've been rebranded as trusted advisors. Maybe you could just explain to clients the rationale behind that and what it means for their portfolio.

SA: Look, we're always trying to change and improve the process. We're always sitting back, reflecting, tweaking. So, we never sit still with our process. The philosophy is unchanged, the process changes all the time. The trusted advisor network hasn't changed though since 2005. So, this is the first big change in 19 years and we've done that in order to deliberately widen the type of inputs we're getting into the process.

So, if I go back 19 years, a lot of the research, a lot of the intelligence that Baillie Gifford was gathering sat in all of our regional teams. And that's what our scouting network tapped into. And then over the last period, there's a series of other really exciting teams have come through, generated strong returns, generated lots of great ideas. And our links to those newer teams were more informal. And so, this is simply formalising what was already there. We've added four new advisors into the group.

One comes from our Income Growth team. So, this is very high-quality companies, high return on capital, paying dividends. They are primarily playing into the duration aspect of what we're trying to look for, long duration companies. And Novo Nordisk, which is one of the newer names in the portfolio from earlier this year, came from that trusted advisor, so we're seeing that impact.

We also have a new US scout to sit alongside our existing one, Mike Taylor, and he is deliberately looking for ideas from a broader growth perspective. He is very good at looking for the bottlenecks, the B part of the process, and looking for supply-side constraints. And then two new scouts, two new trusted advisors from teams which are much higher growth. So, they're really looking at that change function and the growth function. And so, we're bolstering all the different parts of our portfolio.

At the same time as doing that, we can't have our meetings becoming larger and larger, and less and less energy. So, we're actually halving the number of scouts, trusted advisors, per meeting, but having more frequent meetings. So that means that every meeting's smaller, more energy, more debate, more challenge, and that's great. That feels really good for the process, for getting things coming through.

PR: We're deliberately diversified in our approach. We've got a scouting network structure that's bringing new ideas into the portfolio, and we've got a really rich pipeline of growth ideas coming through. I'm wondering if you could just talk us through some of those areas of interest, and some of those growth opportunities more specifically.

SA: Yes. So, there's lots here and it is really diverse. And if I look at the new names we're putting into the portfolio, the growth drivers are fantastically diverse. We've got everything in there from Japanese internet and mobile, to the electrical poles that are used to support the grid. One of my favourites that we bought more recently is a company called Comfort Systems that is sitting on this core bottleneck of trained engineers, either electricians, electrical engineers or air conditioning engineers. And their business is booming as all the data centres get built and all the reshoring back to America is happening. So, their order book has gone from maybe $1.5bn a few years ago up to $6bn today. They're sold out now until 2026. You cannot get the skilled engineers in order to build these plants. And we're sitting on it. We're sitting with a company that controls, I think, 17,000 of these engineers. So, a critical resource, a critical bottleneck we've identified where growth is coming through.

So, we are really excited about the breadth of growth we see out there. We think the market leadership has been quite narrow, and we expect that to broaden just as the fundamentals come through.

So that's US infrastructure. We're also excited about the US technology companies globally that have built up scale continuing to prove their profitability. And that might be Spotify or Block or Coupang. And that's in Europe, US and South Korea. So, it's really a global phenomenon. And it's companies that have built up user scale, but haven't fully turned on the revenue and the profit potential. And that's coming through. By and large, it's surprising the market. So as this profit comes through, the share prices are doing very well. And then finally, one of our weaker areas has been healthcare. And yet we are more excited than ever. I look at the fundamental progress our companies are making. In the last couple of months, we've had big, important test points from both Alnylam and Moderna come through, which suggests that they are on the right track for progress. The share prices over a 12-month period haven't really responded. That's fine for us. We can be very, very patient. We're loving what we're seeing there.

So, that's all a bottom-up answer to your question. Now, when I try to put a top-down answer to that, the portfolio companies are growing at around 15 per cent earnings growth. That's much faster than we've grown historically. That's much faster than the index is growing. So, we've got top-down evidence and proof that the growth is broad and exciting. And as the market leadership broadens, we're very well positioned.

PR: That's the thing. When you look at it, the expected growth here is very strong. And that has historically been what has helped the strategy deliver outperformance over many years. So, if that growth continues to come through, you'd expect share prices to follow suit. So that's really helpful.

Thank you very much, Spencer. I appreciate your time. And thank you very much for all our clients who are watching this video today. I appreciate your ongoing support. And we look forward to discussing with you next quarter, when Global Alpha will be giving you another update on the strategy. Thank you very much for tuning in.

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Global Alpha

Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
Global Alpha Composite	14.0	45.3	-32.8	17.1	13.0
MSCI ACWI Index	2.6	39.9	-15.4	17.1	19.9

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
Global Alpha Composite	13.0	8.1	8.6
MSCI ACWI Index	19.9	11.3	9.0

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.

Past performance is not a guide to future returns.

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