As with any investment, capital is at risk. Past performance is not a guide to future returns.

Hello and welcome to this programme from Baillie Gifford. The latest in a series of webinars where we talk to the representatives of the business' different investment funds. Today, we're talking to Rosie Rankin, who is an investment specialist on the Baillie Gifford Positive Change Fund. So, thank you for joining us, Rosie.

Let's talk about the fund from its fundamentals and the title, the Positive Change Fund and it's stated aim, to contribute to a more sustainable and inclusive world. Different people will have different views on exactly what that means. So, let's start by asking you what does Baillie Gifford take it to mean?

Great place to start, Richard. So Positive Change has two equally important objectives. Attractive investment returns and that's really easy to define because it's 2% per annum ahead of the MSCI ACWI over rolling five years. You're right, what does contribute to a more sustainable and inclusive world actually mean? To us, we have four clear impact themes. So, we're looking for companies whose products and services are helping to meet challenges in areas of 1) social inclusion and education, 2) environment and resource needs, 3) healthcare and quality of life and 4) base of the pyramid.

Now, what do I mean by base of the pyramid? Well, that's looking for companies who are helping those at the very bottom of the global income ladder. So, the four billion people or so, who are on less than $3,000 a year. So, it's looking for companies whose products are helping meet challenges in those areas.

You had both sides of it there. The aim to beat your benchmark and the aim to do good. So, let's just talk a little about the basis that you elect companies to get into the fund. Is it a balance of subjective and objective criteria? How, if I was running a fund, would I persuade you that my fund should be in there?

So yes, if you were running a company, what exactly are we looking for? So, as I said, both objectives equally important. So, in terms of that investment perspective, we're looking for well run businesses who have a clear and strong competitive advantage. Who have good financial characteristics and are attractively valued. Who we have confidence can achieve a doubling of share price on a five-year view and for that doubling to be driven by the fundamentals of the business. So that revenue and earnings growth coming through. We also want that company to be contributing towards a more sustainable and inclusive world.

One question I'm often asked is, is there a tension between your two objectives? For us, we're looking for companies where there's not a tension, but actually, there's a synergy because what we want is for the products of the company that are driving that revenue growth, to be the products that are also contributing towards change. So, to give you a really simple example, we invest in Duolingo, the language learning app. As they attract more users to the app, they will attract more advertising revenue. They'll get more paid subscribers. That is going to drive their revenue and ultimately, earnings. That is also what's going to drive their impact as they expand the number of learners that they're benefitting.

So, we're looking for that clear synergy. Of course, to come back to your question, there is a mix of very objective criteria. You can measure things like number of learners, but you do have to overlay that with a subjective understanding of what does it actually really mean for someone in an emerging market, for example, to be able to learn a language for free? What does that open up for them in terms of educational or employment opportunities? So, it's a mix of a very strong objective basis with a subjective lens and understanding on top of that.

How do you tease out those subjective measures in looking at a company like Duolingo, for example?

So, when we're looking at any company, we look at three factors when we're thinking about their impact. So, we want to think about intent. We want to think about product impact and we want to think about business practices. So, for something like intent, this is really trying to get beyond a company's mission statement. Every company tends to have quite an inspiring mission statement, but actually, thinking about what's the real intent of this management team? Does it go just beyond profit maximisation? Do they really want to drive a positive change in the world? Are they trying to make a difference?

You have to look at evidence points in terms of how they are targeting their products and services. What industry initiatives they're participating in. How they're really trying to drive forward a positive contribution to the world. Then in terms of that product impact, I guess this is where it gets really interesting because what you can actually measure isn't necessarily the most exciting change that the company is driving. So, to give you a different example, we invest in a Brazilian bank called Nu Bank. We know that they have close to 100 million customers now. Around 10% of which it's their first ever bank account. So that's the measurable bit.

Then you think, what difference has it made to that 10% of the customers, having access to financial services for the first time. That's when we have to do more work to understand on a more qualitative basis, actually how has this improved or otherwise, people's lives. So, there's no shortcuts in this type of work. Which is why I think running an impact fund like this is very resource intensive.

So, you've got over those two hurdles for the companies you look at. Then you've got to think about how can this make the returns that your investors are looking for. Is that straight back to financial analysis?

Often those two pieces of work are done concurrently. So, the way that the Positive Change team is structured, there's ten in the team who all work fulltime on Positive Change. It's one of the largest investment teams at Baillie Gifford. Six are investment managers and analysts and four are impact analysts. So, when we're looking at a company, we will have an investment expert looking at the investment characteristics of the company and an impact expert looking at the impact characteristics.

It's only when we're satisfied that a company can meet both their objectives that we will invest. So, if we see a company that's doing something very beneficial for the world, but we don't think it will make attractive investment returns, we won't invest and vice versa. So, a company does have to meet both criteria and ideally, as I said, there'll be that synergy between what is going to drive long-term returns and what is going to drive the positive impact.

Obviously, no firms are ever all good or all bad and you've always got a balance. I'm just curious about how you balance out these factors. So, you might look at a company like TSMC, a very major holding in the fund. Produces cutting edge chip equipment and fabs and doing some very positive things for the world. Bringing the world together and helping it communicate better, but it uses an awful lot of water. It uses an awful lot of energy to make its products. So how do you balance those factors out when you're talking to a company?

That's actually a really good example. You're absolutely right in terms of, there is no perfect company. This is not a portfolio of perfect companies. If we were holding out for a portfolio of perfect companies, I don't know what would be in it. In terms of looking at companies, its being really clear about the positive change that they're driving. Also, really clear about any negative impacts of either their products or their business practices. As you said, TSMC is world-leading in terms of its [marker 10:00] manufacture of semiconductors, which are used in such an array of products driving positive change, but it is very energy consumptive and it does use a lot of water.

In that case, before we invest, we want to investigate actually, how is the company themselves thinking about these huge challenges. It's really encouraging that TSMC are very aware of their energy usage and water consumption. They've been very active in engaging with shareholders like us. They've set very clear targets. So, despite the fact that TSMC is growing its operations, by 2030 it wants to reduce its greenhouse gas emissions by 30%. It wants to have 40% of its energy coming from renewable sources. Similarly, by 2030, it wants to reduce its water consumption by about 30% and, also, use much more reclaimed water.

So, it's being really thoughtful about the challenges. Setting really clear targets that we can monitor and being open to engagement. I think that's what we want to see from companies. Is acknowledging where they're having any negative impact and being proactive about addressing those and open about it. In turn, we have to be open with our clients about any negative impacts of companies and we do that in our reporting.

You brought up a very interesting point there, because companies have targets and intentions and that's great. Once a company is in your portfolio and you can talk about TSMC or any other company that you want, how do you ensure it stays true to the qualities that made you invest in it in the first place?

Again, you're spot on because it's very easy for companies to set targets, but then how do we keep them honest to that? So, you can monitor a company's progress by the metrics that it publishes. Either through its quarterly results or its annual sustainability reporting. We're also very active in engaging with companies. So last year, for example, we met with every company in the Positive Change portfolio to have conversations because again, it's that mix of having the metrics that you want to measure and see progress against. Also, understanding perhaps, the challenges around that or what the company's intentions are thinking about that. So yes, it's very much about monitoring the numbers and speaking and engaging with the companies about what's happening behind the numbers, the story behind the numbers.

We've obviously had international accounting standards for years and, more or less, every company that you'll invest in will stick to those. Are there similar KPIs for social measures and environmental measures that enable you to compare one company and another?

So, it's not as straightforward as international accounting standards, sadly. Of course, they took many hundreds of years to develop. We are seeing a lot of development in metrics, which is pleasing. I would point particularly on the environmental side, we're seeing not quite standardisation, but definitely more progress in that area. On the social side, there's much less standardisation, but I think the role that we can play as investors, is encouraging companies to report.

Engaging with companies, not just encouraging them to report, but to talk to them about the frameworks that we would find useful and that other investors find useful. Often within the portfolio, we may be investing in a relatively early-stage company that's just come to the public markets and is grappling with the array of reporting demands being asked of it. So, they're thinking, how do I navigate this? What's the material ones for me? So, I think we're definitely seeing progress there and we're seeing companies wanting to report as well, which is good.

So, let's turn to the fund itself and its performance. It has been a tough three years for the fund. Why do you think the fund underperformed the benchmark and did it raise any questions? Did it make you think about raising the strategy, having lived through this difficult period?

You're absolutely right, it has been a tough three years for the fund. So, if you had invested three years ago, to the end of May this year, your investment would have fallen by 10%. That is in huge contrast if you had invested five years ago to the end of May, when your investment would have risen 95%. So, there's been a very different experience, depending on when you invested. Over the last three years, there are a few factors. I think one is the general market environment. We definitely saw in the latter part of 2021 into 2022 long duration growth stocks of the type that we very much favour being out of favour with the market.

We saw a real disconnect at that point, between the fundamental progress of some of the companies in their portfolio and their share price performance. Then of course, in more recent months, we've seen incredible market concentration and excitement around a few names dubbed the Magnificent Seven. Where we've seen a lot of the market performance concentrated in those names. Of that Magnificent Seven, we have one in the portfolio, Tesla. So that's one reason. I think in terms of other reasons for relative underperformance, of course some companies have not worked out.

Some of those companies we've taken the decision to move on from. I would point to companies there such as Orsted, the Danish renewable energy company or Berkeley Lights, a biotech company. So, some have not worked out. For other companies, they're absolutely working out, but we feel they're a bit unrecognised by the market just now. Moderna is a great example. It's actually come back in share price terms a bit more recently, but has definitely been in the doldrums over recent years as the market has focused on declining COVID revenues, despite the fact that it's making really good progress across different areas of clinical trials.

So that answers the first part of your question in terms of the why. I few reasons there. The second part of your question was what have we done about that? Probably, first of all in terms of what we haven't done is, we haven't changed our philosophy at all. We're very much focused on investment returns and having a positive impact over the long-term. Clients can be really confident that we've not changed that. In reflecting on lessons learnt, the last three years have really shone a light on the importance of execution. We like investing in ambitious management teams, but the ability to execute on that ambition is so important.

Arguably, when we look at companies where things have gone wrong, it's been that execution point that's where they've perhaps, faltered. So that's shone a light on that. So that's an area we'll definitely be focusing on in future. I think also, it's just about recognising that we absolutely want to have young, early-stage companies in the portfolio. When we look back, it's many of those that have driven investment returns. Particularly when they enter the portfolio, we want to make sure that we're going in at a relatively small position size. Really, to reflect that initial risk as well.

So, companies such as Joby Aviation, which is an early-stage electric aviation company or Rivian, the electric vehicle company, have gone into the portfolio recently, but at a 0.5% position size. Just half a percent, which allows us exposure to the potential of that name, but without taking undue risk.

So, we've had a quick review of the last three years. What makes you think the next three years will be better?

We very much hope the next three years will be better because fundamentally, at Baillie Gifford, our view is as long-term growth investors, that over the long-term your share price will follow the fundamentals of your business. What do I mean by that? It's that over that five-year view, share prices will be driven by the revenue growth and the earnings growth of the companies in which we invest. If you look at the positive change portfolio, it's a portfolio of companies with really strong fundamentals. So, the predicted revenue growth [marker 20:00] over the next three years is about twice that of the benchmark.

Similarly, predicted earnings growth over the next three years is about twice that of the benchmark. It's a portfolio that's really investing in its future growth as well. So, if you look at the innovation ratio and the amount that companies are spending on R&D as a proportion of revenue that's high. It's a portfolio with low levels of debt. So, you just look at this portfolio and think, this is a portfolio poised for growth. The million-dollar question is, when? I can't answer that.

Fair enough. No forward projections, please. What we can talk about, which is going to be big over the next three years, is already starting to be very big is artificial intelligence. You can talk about the opportunities that it provides. Does it also threaten some of the stocks you have in the

portfolio? Let's take Duolingo again. I can get my language lessons in all sorts of form, from ChatGPT. Is this a threat for some of the companies that you own?

I think when we're looking at AI, we've got to look at it with a really open mind in terms of all of us are just at the early stages of realising that potential of AI, what it means for our businesses and lives. Both in terms of the opportunity it presents, but also the risks. I think for Duolingo in the short-term it would definitely provide more of an opportunity than a risk. They are using AI within their language learning to great effect. Whether that's to simulate conversations. It's to tailor individual lessons based on a user's previous mistakes. So, they're using it to great effect. Looking out very long-term, what will the future of language learning be? Will AI provide simultaneous translation for us all so that language learning diminishes?

That's a much more longer-term threat. I think, when we're thinking about AI within the portfolio, it's more excitement than threat that we're really seeing. I referenced earlier, the Magnificent Seven and a lot of that performance and excitement we're seeing around those companies is due to artificial intelligence. I think it's completely wrong to view artificial intelligence as being a story of seven stocks. Actually, when you look across the portfolio, we see companies such as you mentioned, TSMC or ASML, which are critical to the infrastructure of artificial intelligence or you look at companies which are using artificial intelligence to solve challenges.

Whether that's something like Deere with precision agriculture or Moderna using artificial intelligence to help develop new therapies. You also need companies which are helping make AI sustainable. Datacentres use incredible amounts of water. So, we have companies in the portfolio such as Xylem, which is a water infrastructure company which helps datacentres use water more efficiently. So, I think it would be wrong to dismiss any threats from artificial intelligence because we're just at the start of understanding what it can do, but I think at the moment, our excitement outweighs that.

It is in the name of the fund about positive change and making the world a better place. There are some people out there, some eminent scientists who say that AI is a threat to us all and the very existence of the world. How do you take that onboard and how does that drive what you do and trying to make the world a better place?

I think you're right. At the core of what we do is we have to be optimistic because when you look at the world today and look at some of the really critical challenges that we face. Whether that's around climate and extreme weather. Whether it's around geopolitics and conflict or social inequalities, it could get overwhelming in terms of thinking about the challenges that we face. So, within positive change, what we endeavour to hold on to is that optimistic mindset that human ingenuity will allow us to solve and address some of these challenges and move forwards. Of course, you always have to be cognisant of the risks and the threats that we face in so many realms of our lives, but in order to move forward and progress, you have to have that hope and optimism that ingenuity will provide a solution.

You outlined a bit earlier, your four areas of interest. Social inclusion and education, environment and resources, healthcare and quality of life and base of the pyramid. Is the portfolio divided more or less equally into those areas or is there any one that you see offering more scope? Both from the impact vision of the fund and the investment return impact of the fund.

We don't take a top-down view. So, we don't sit back and say we want 20% in this theme and 40% in that theme. Exposure to the themes will happen in a very organic way, depending on where we've found ideas. At the moment, social inclusion and education is the largest theme within the portfolio. It's about 40%. So, as well as having education companies in there such as Duolingo and Coursera, we have a company such as Nu Bank, which I mentioned, the Brazilian bank. HDFC, an Indian bank. Companies such as ASML.

If you went back four or five years, it was healthcare and quality of life which was the largest theme. It was about 40% at that time, reflecting many of the healthcare opportunities we saw. So, it will ebb and flow over time, in terms of that allocation to different themes.

So, there's no top-down decision to allocation between those different themes.

No. The themes are really useful in terms of helping us with our research agenda. So, we are looking at areas such as energy transition or sustainable agriculture. The four themes are also very useful as a framework for reporting our impact. So, if you look at our annual impact report, it's divided into those four sections, but we don't use it for top-down allocation.

Going to come to a few questions from the audience now. A couple to do with ESG. "The fashion for ESG funds came a few ago and then has dropped off suddenly. Is it much harder to persuade investors, whether at the wholesale or the retail level that an impact fund as yours, should be worth considering?" Has that ESG story been and gone?

Your reader who sent in the question is absolutely right in terms of, in the decade I've been working in the area, it has gone from being very niche to being a completely hot topic to being there's more scepticism. It certainly hasn't changed the demand that we're seeing for Positive Change more broadly. I think the reason for that is because there is such synergy between actually what is going to be the big structural growth drivers looking out over the next two decades? So, strip it all back.

Strip all the terminology about sustainable, ESG, responsible and, actually, just think about what has driven growth over the last two centuries?

It's been the big transitions that we've seen. So, whether you're going back to industrialisation and the huge amounts of capital that made the world industrialised or electrification or the dawning of the railway age or oil and gas. Actually, looking forward, what is going to generate similar levels of prosperity and growth over the next few decades? We truly believe it's this transition that we have to make in terms of the energy transition. How we actually live our lives in ensuring that there's peace and stability and social inclusion. All these factors from our perspective, aren't nice to haves, they're [marker 30:00] intrinsic to the continuing prosperity and stability of the planet.

There's a lot of E and S out of the ESG in the way you pick stocks. So very little reliance on G, the governance of particular companies or indeed, the countries where they operate in. Is governance an important factor for you?

Yes, it is. Of course, a company is in the portfolio because of its product impact, but when we're looking at the business practices, which is one of the pillars of what we assess before we invest in a company, looking at the E, the S and the G. Ultimately, we're investing in a company for five to ten years. Perhaps longer. So, governance factors are really important in terms of thinking about how a company will ultimately thrive over the long-term. That it's got appropriate governance structures in place.

When we're doing that analysis around a company's governance structure, we do want to be very aware of where a company is domiciled. What stage it is at in terms of its maturity, to make sure that it has appropriate governance structures in place for that stage of its growth. So yes, your view is absolutely right. I hadn't actually mentioned it so far today, but it's something that's an intrinsic part of our analysis.

Couple more questions, more about the composition of the fund and how you go about making the portfolio. The first one is, "How long do you monitor a potential investment before buying into it?" Then, you've stated the aim is to hold these companies for a long time, but what is the average investment holding time for your portfolio?

So, in terms of that first question about how long do we monitor a company for before investing? That can really vary from a number of months. We can start to look at a company. Be very enthused, think now is absolutely the right time to invest and invest after a period of months or it may take us a few years to get comfortable. When I say 'get comfortable' it may be because we are waiting just for evidence that the company is making the progress that we would expect from an operational perspective or it may be waiting for an opportunity to invest from a valuation perspective.

One of the companies in the portfolio, Remitly for example, we looked at it at IPO. Really liked the company, but felt it was quite richly valued at IPO. So, we waited a few years to invest, until there was an attractive entry point. So, we will be patient, where we're either waiting for evidence of progress or waiting for an appropriate valuation. The second part of the question was just about how long do we hold a company for? So, we are a low turnover portfolio. So turnover is typically below 20% per annum, which is very consistent with our five-year holding period.

Around half of the companies in the portfolio-, so we typically have about 30, 35 companies in the portfolio. 16 of the companies we've owned since the very inception of positive change, which was January 2017. So, we've owned for over seven years. So yes, we are very long-term.

You mentioned something there about the IPO for Remitly and it being a rather rich valuation. Does it worry you that so many companies now come to IPO at such rich valuations? In a sense, a fund like yours might miss out on the real value-added of investing in a company.

No, I think we absolutely just approach it on a case-by-case basis. Some of the companies that we have participated in at IPO, and it's something that we like doing within an impact fund. Of course, you're supplying primary capital, have worked out extremely well. So, some of the top contributors to performance, whether that's Nu Bank or Moderna, we participated in at IPO. Then other companies have been much less successful, but that's part and parcel of our investment approach. The ones that have been successful have far outweighed the ones that haven't.

I'm going to wrap up there and say thank you. It's all we've got time for today. So again, thank you Rosie, for your time and your insights. We do have more sessions like this coming up. So please do keep an eye out for those, if you found today useful. Until the next time, thank you and goodbye.

Baillie Gifford Positive Change Fund Annual Past Performance
To 31 March each year (net %)

	2020	*2021*	*2022*	*2023*	*2024*
Baillie Gifford Positive Change Fund	*15.9*	*79.3*	*2.1*	*-9.3*	*7.0*
MSCI ACWI	*-6.2*	*39.6*	*12.9*	*-0.9*	*21.2*
MSCI ACWI plus at least 2% pa	*-4.3*	*42.4*	*15.2*	*1.1*	*23.6*
IA Global Sector	*-6.0*	*40.6*	*8.4*	*-2.7*	*16.7*

Source: FE, Revolution, MSCI. Positive Change Fund Class B-Acc. Total return in sterling.

Share class and Sector returns calculated using 10am prices, while the Index is calculated close-to-close.

The manager believes the MSCI ACWI plus at least 2% a year 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 is the Investment Association Global Sector.

Past performance is not a guide to future returns.

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- The Fund’s concentrated portfolio relative to similar funds may result in large movements in the share price in the short term.
- The Fund has exposure to foreign currencies and changes in the rates of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested.
- The Fund’s share price can be volatile due to movements in the prices of the underlying holdings and the basis on which the Fund is priced.
- The Fund invests in companies whose products or behaviour make a positive impact on society and/or the environment. This means the Fund will not invest in certain sectors and companies and the universe of investments available to the Fund will be more limited than

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