# BAILLIE GIFFORD EMERGING MARKETS: INTRODUCTION

Will Sutcliffe, Sophie Earnshaw and Mike Gush, investment managers in the Emerging Markets team with a combined total of 45 years' experience, give an introduction to the team's approach.

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*All investment strategies have the potential for profit and loss, capital at risk.*

*This communication was produced and approved in February 2020 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.*

**Will Sutcliffe (WS):** We've been running dedicated GEM (global emerging markets) mandates since 1994. Now obviously that's a period that's had plenty of highs and plenty of lows for the asset class. So we like to think it's a tried and tested approach. Our key goal is to build long-term relationships with like-minded clients. Now we're aware we can only do that if we generate significant alpha after fees and we're very proud of the track record we've built up over the last quarter century or so.

The team itself is relatively small. Now obviously there are lots of conversations going on with other Baillie Gifford investors who also look at emerging markets as part of their broader mandate. But when it comes to decision making for GEM clients, we like to keep things nimble.

It's also a very stable team. If you look at the five or six most senior investors, we've all been working together in emerging markets in excess of a decade so hopefully that provides reassurance that that track record actually means something.

**Sophie Earnshaw:** It's becoming commonplace for investment managers to tell you that they think about things over the long term but we'd argue that only a small proportion of firms have the remuneration structure and the firm structure to really incentivise long-term thinking about the businesses in which they invest.

Information overload is a challenge and short termism, particularly in emerging markets, is prevalent. We've found that over the short term, share prices bear no relation to company fundamentals. That's why we don't think our skill lies in short-term forecasting.

What really interests us is the strong correlation we've found between share prices and company fundamentals over the long term. If you can find a company that delivers earnings growth in the top quintile over a 5-year view, we've found that you can be rewarded with roughly a doubling in total return over that period.

**Returns Follow Earnings Over Long Term in Emerging Markets**

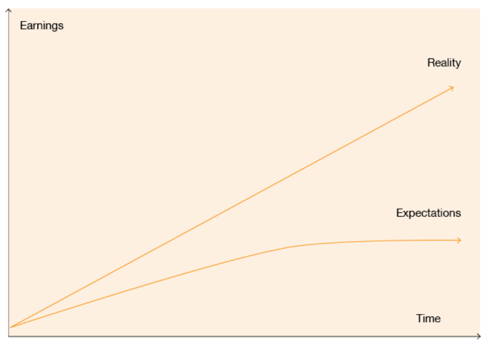

Source: Baillie Gifford & Co and Factset.
MSCI Emerging Market and FTSE Emerging Market Indices constituents as of the end of December of each year between 1997 and 2019 and with a market capitalisation larger than time-adjusted USD1bn. Earnings growth rates are based on previous fiscal year data, all in USD.

That's why our process is focused on finding those businesses, those companies that we believe can double in share price terms over 5 years and we'd expect the majority of that doubling to come from earnings growth rather than a rerating.

**Mike Gush:** To find these ideas for fundamental research, we're looking to exploit three key inefficiencies.

One of the inefficiencies we're looking to exploit is underappreciated growth duration.

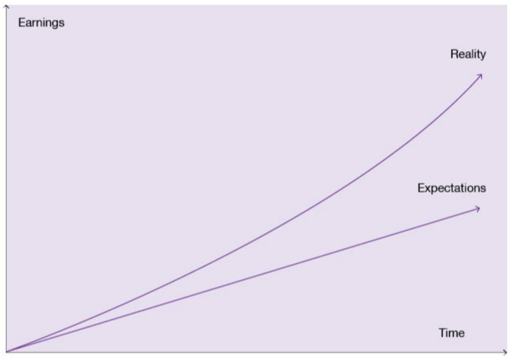
**Duration**




These are businesses with strong competitive positions, excellent management teams and importantly are investing through the cycle. Investing in R&D (research and development), investing in capital projects. These investments can take years to come off. It's not a case that they make their return in the next quarter or next coming quarters. And having the patience to let that deliver is really important. One of the great strengths of Baillie Gifford is the partnership structure, which allows us to take that long-term view and accept some short-term volatility on the way.

The second inefficiency we're looking to exploit is underappreciated growth pace.

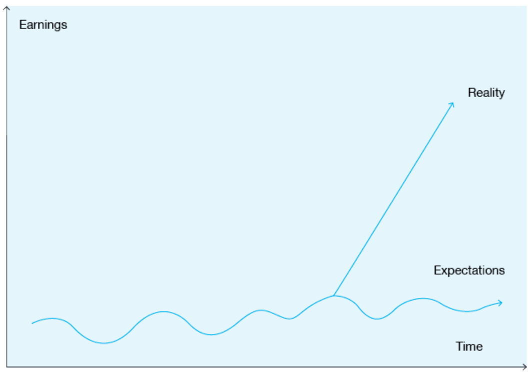
Pace




These are businesses that are growing much faster than the market expects, and importantly, sustaining that for many more years. A good example of this would be internet companies. These network businesses really do grow faster the more they scale and people have been very slow to adjust to that. We tap into multiple research sources and a wide number of independent research providers in order to help inform where we should be looking for these ideas.

The last inefficiency we're looking to exploit is underappreciated growth surprise.

Surprise

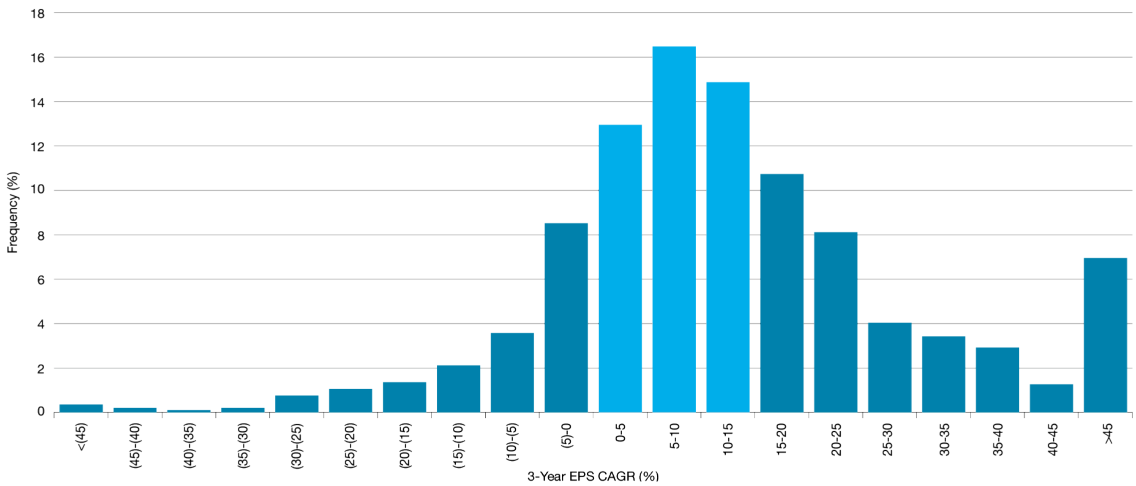



These are businesses where we have a very different view as to the future than the market expects. Typically, they operate in more cyclical industries and it's through a key parameter, an external factor often, where we have a very differentiated view, such as a key commodity price.

**WS:** Our growth hurdle is ambitious. Very few companies in emerging markets will meet it. Just as unfortunately very few countries in emerging markets are ever likely to truly emerge. So we're asking a lot from the companies that we invest in and we think that one thing we can exploit in that sense is the market's consistent inability to correctly price the likelihood of extreme returns.

So if you were to look at the sell-side forecasts for growth rates in emerging market companies right now, they seem to imply that we live in this nice neat world where every single company will grow somewhere between 5 per cent per annum and 15 per cent per annum.

**Emerging Market Stocks – Range of Sell Side Estimates for 3-Year Compound Annual EPS Growth Rate**




Source: Baillie Gifford & Co and Factset.
Based on Emerging Market stocks in MSCI EM Index or FTSE EM Index. Data as at 31 December 2019. US Dollars.

But the reality of course is that most don't. Most will grow far in excess of that level or far below. We live in a world of fat tails. And of course, the companies that interest us, are the ones on the right-hand side of that distribution.

So that failure of imagination, if you like, is something very powerful, that active investors can exploit.

**Annual Discrete Performance to 30 June Each Year (Net, %)**

| | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Baillie Gifford Emerging Market All Cap Composite | 11.8 | 7.8 | -0.7 | 51.0 | -35.9 |
| Baillie Gifford Emerging Market Leading Companies Composite | 10.2 | 7.2 | 3.7 | 50.1 | -34.4 |

**Annualised returns to 30 June 2022 (Net, %)**

| | 1 Year | 5 Years | 10 Years |
|---|---|---|---|
| Baillie Gifford Emerging Market All Cap Composite | -35.9 | 3.0 | 4.7 |
| Baillie Gifford Emerging Market Leading Companies Composite | -34.4 | 3.8 | 5.5 |

Source: Baillie Gifford & Co, USD.

Past performance is not a guide to future results. Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. All investment strategies have the potential for profit and loss.

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