INTERNATIONAL ALPHA Q1 INVESTMENT UPDATE

Investment Specialists Sachin Sharma and Andrew Brown give an update on the International Alpha Strategy covering Q1 2023.

Sachin Sharma (SS): Hello and welcome to this International Alpha video update for the first quarter in 2023. My name's Sachin Sharma and I'm an investment specialist for the International Alpha strategy and it's my pleasure to be joined today by Andy Brown, who is also an investment specialist for the International Alpha strategy with over 17 years' experience here at Baillie Gifford.

Now, as a reminder, the International Alpha strategy employs a bottom-up, long-term growth approach to investing. We believe in having a high active share and we seek to invest across four different types of growth companies. So, Andy, thanks for joining me today.

Andrew Brown (AB): Hi.

SS: It's been quite an eventful start to this year, similarly to 2022. There's been no shortage of short-term media headlines. We've seen the fallout of the global banking system and we've seen the demand environment change quite rapidly in the first quarter. What has this done to the International Alpha strategy over this period?

AB: Yes. It's been quite a change, hasn't it? When we reflect on the previous 18 months before this quarter, the fast interest rate rises that we saw, the fastest monetary tightening in 40 years, had a really big impact on growth stocks. We saw growth stocks sell off, particularly those businesses that have longer-duration cash flows, so businesses that generate most of their value further out into the future. These are the sorts of businesses that Baillie Gifford particularly likes because, as you pointed out, we take a long-term view. We like businesses that deliver that sustainable growth.

Now, that was a tough environment for us and we also saw a big disconnect between operational performance and share prices, particularly with the European names, I would suggest. The strategy has quite a significant exposure to European stocks and, within that, European industrials. Last year it was very frustrating that even though operational performance was typically quite sound, the share prices were not being rewarded.

Now, as we've moved into 2023, the strategy has outperformed. It's been a much more supportive environment for us. Not owning banks and energy companies has been very helpful. Last year, not owning them was a big driver for poor performance. But importantly, the stocks that are delivering strong operational performance in Europe are now beginning to be rewarded.

So, to give you some examples of that, different types of companies… So, Ryanair, the low-cost airline, has now seen its revenue well above where it was before the pandemic. Load factors are very high. It's been taking market share in its core markets. So, it's been doing very well, but the shares continued to be quite weak last year because there wasn't much travel. The world was far from normal. Now, obviously, things are normalizing and Ryanair is in a stronger position.

A very different type of business, Spotify, was very weak last year. This year the shares have been strong and here we've seen subscriber growth. Premium subscriber growth has been quite strong, but we've also seen some better numbers coming through on the advertising side of the business. So, two very different examples, but overall, when we look at the performance, it's Europe that's been the main driver.

SS: That's interesting. So, a bias towards quality growth and being long-term that hurt us last year, but it's actually beginning to be rewarded with the strong businesses that we have in the portfolio in those most immediate quarter. So, amidst the volatility that we've discussed, what changes have you made to the portfolio? Have there been more transactions, perhaps, than normal?

AB: Well, in keeping with our long-term investment approach, turnovers remain very low actually. All we've done within the portfolio is make one complete sale and use the proceeds of that to add to some of the existing holdings. That's very typical for us. It's very typical. If we're happy with the execution of the existing holdings, it's very typical for the portfolio to remain fairly unchanged from one quarter to the next.

Just to add some details around the stock we sold and the additions that we made, we sold a Swiss freight forwarder business called Kuehne and Nagel. This is a business we've owned for some time on behalf of our clients. It is performing well operationally, but freight rates had got very elevated during the pandemic and it seems quite likely to us that those rates will begin to come off. As a result, the earnings generated from Kuehne and Nagel are likely to fall. The valuation ascribed to Kuehne and Nagel is quite high relative to its long-run history after a period of very strong performance.

We also own another similar business within the strategy and that business has a particularly strong balance sheet, a war chest of cash, if you like, that it can use for accretive deals. Indeed, it's got a great record of adding value through deals. So we've decided to stick with that business and sell Kuehne and Nagel.

In terms of where the money has gone, well, we always review existing holdings as well as looking for new ideas and some of the holdings that we've reviewed… It's been very clear that there's been a big disconnect between operational performance and what we've seen in share price terms.

Now, I won't go through every name, but one to pick out perhaps is the Southeast Asian e-commerce platform Sea. Now, this is a business that we purchased in 2021 initially, but the shares have been extremely weak. What we've seen happen over the past six months or so is that the business has begun to make great progress in its core markets and it's begun to retrench from areas where it didn't have scale. We think that's exactly the right thing for management to be doing and that has come through in better profitability numbers. What's really encouraging is that it's been taking market share at the same time as putting up its prices. So, we think that's very encouraging. So that's one that we've added to during the quarter.

SS: And how about new ideas that you've been discussing? You mentioned that the portfolio seems to be in a robust position. What's the outlook from here and how do you marry that with the new pipeline of ideas?

AB: Yes. This is one of the most difficult things actually, is the competition for capital in the portfolio. So even though turnover has been very low and we haven't made many changes, we've got lots of ideas percolating under the surface. We've looked at lots of different types of growth companies actually.

Just to give you a flavour of what's on the substitute bench, if you like, we've got a Canadian athleisure retailer. We've got an Italian semiconductor testing business. We've got a provider of Chinese burial services. We've got a Danish manufacturer of hearing implants. So, very different types of companies and growth opportunities. Now, these businesses require some further work from us. We like to be very thorough in our research, but certainly all of them look quite interesting and merit some further work.

So, I think just overall, it's just a great time, we think, for our investment style. The last 18 months have been so challenging, but as we go into a period where, I guess, the economic backdrop is more fragile, having a portfolio with very strong balance sheets… And as a reminder, this portfolio is net cash in aggregate. Having a portfolio that's populated with businesses that have very durable competitive edges, very strong financial characteristics, and are run by very able management teams… We think that's a great place to be.

SS: Great. So, a portfolio with a heavy bias towards quality balance sheets, with companies that aren't reliant on things like interest rate rises to turn a profit and are ultimately going to be the masters of their own growth in the long term is exactly where the portfolio is.

AB: Exactly.

SS: Great. Well, thank you, Andy, for joining me today and thank you, everyone, for dialling in to this International Alpha video update.

Annual Past Performance to 31 March Each Year (Net %)

	2019	2020	2021	2022	2023
International Alpha Composite	-4.6	-7.2	61.4	-16.3	-5.6
MSCI ACWI ex US	-3.7	-15.1	50.0	-1.0	-4.6

Annualised returns to 31 March 2023 (Net %)

	1 Year	5 Years	10 Years
International Alpha Composite	-5.6	2.5	5.5
MSCI ACWI ex US	-4.6	3.0	4.7

Source: Baillie Gifford & Co and underlying index provider. USD. Net of fees 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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