Baillie Gifford™

International Concentrated Growth Q3 investment update

October 2023

Investment specialists Paul Taylor and Hamish Maxwell give an update on the International Concentrated Growth Strategy covering Q3 2023.

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

Paul Taylor (PT): Hello, and welcome to the International Concentrated Growth strategy update for the third quarter of 2023. My name is Paul Taylor. I'm joined by Hamish Maxwell today. We are both investment specialists working on the ICG strategy. The strategy is a concentrated, between 20 to 35 stock, portfolio of the most exceptional growth businesses in the international equity space.

What we're looking to identify is companies using new business models, and new technologies to disrupt incumbents and take rapid market share gains. This type of investing can be exceptionally valuable in terms of investment returns, and to make that work for us, we invest with high conviction, active share in the portfolio [is] around the 90 per cent range, and low turnover. We're looking to own these businesses over a 5-to-10-year time horizon, during which time their competitive edge can turn into positive investment returns.

With that being said, the environment that we're investing in this quarter has not been favourable for growth businesses, so Hamish can we hear what's been on our minds recently.

Hamish Maxwell (HM): Thanks, Paul and hi, everyone. I'll start by quoting management of Adyen, the Dutch digital payments company, who said that we've been recently reminded that growth is not linear. And of course, it isn't. Very often the best performing long-term stocks are the most volatile, short-term. And that's because there are different drivers for share price over different horizons.

Over the long term, share prices are driven by profits, and that's actually really intuitive because people invest in companies hoping to benefit from their future cash flows. So growing profits means growing share prices. But profit growth, as you said, takes years. So, this link is clearest over 5 to 10 years, whereas in the short term, share prices are much more unpredictable. After all, future profit growth hasn't happened yet, so the market has to forecast it, and the ability, and indeed the willingness, of the market to forecast profit growth is determined by things like the emotional content of the news, of our trading volumes, including algorithmic trading, and by unpredictable politics and economics.

So, it's a different sort of driver over the different horizons. The best long-term growth companies are hence very often the most volatile, short-term.

The extent of this can surprise people. For instance, among our biggest winners since [the] strategy's inception 20 years ago, we've got Hermès, the French luxury company, which has returned over 30 times with the biggest drawdown of nearly 50 per cent. Industrial company, Atlas Copco, has returned over 20 times, with the biggest drawdown of 60 per cent. And Tesla, over 15 times returned, with the biggest drawdown of nearly 70 per cent.

And if we'd acted on any of these periods of volatility and sold because of the volatility, we'd have missed out on lots and lots of upside.

PT: Yeah, that's really interesting. It's really good to be able to come and talk to people about this during these times. Because [we're] reminding people what we're focused on is long-term intrinsic value creation at these businesses, not trying to second guess market volatility.

HM: Exactly. Yes, so if we focus on fundamentals, there's actually a great deal to be really excited about. Remember the Great Depression of the 1930s gave birth of the helicopter, to supermarkets and the car radio. And [in] the tough economics of the 1970s we saw disruptive businesses like Intel growing nearly 20 times.

Now, every area is different, but this period of pressure on the markets is creating opportunities for companies, creating the sort of change that you introduced earlier.

PT: Yes. So I mean, in terms of what's in the portfolio today, what would you highlight as being the change of tomorrow?

HM: Yes, okay. So let's think about the recent challenges of inflation and costs of capital, which are well-known. Here's an opportunity for businesses to provide a counterweight of deflation, if you will. One really good example is in healthcare, where lots of technologies are coming together. For instance, our holding Genmab, the European immunotherapies business, and Moderna are driving down costs by using a platform model to approach diseases.

There are big cost reductions in our renewable energy holdings. SolarEdge and Tesla are at the heart of that and we're confident the market is going to be transformed by cheaper and cheaper energy.

And then there's the ongoing digitalisation of the economy. That's been a deflationary force for decades. Many in the audience will be familiar with Moore's Law, doubling computing power every couple of years, likewise, a deflationary effect. And our holdings, ASML and NVIDIA are driving and benefiting from that progress in computing power.

Even slower globalization can create an opportunity if you think about supply chain management, about transport networks and the electrification of the economy.

So while it seems that Jerome Powell can't say or do anything without the market desperately trying to figure out exactly what that means for the near term, and responding quite grumpily to that recently, we're much more interested in the fundamentals. And what we see is a great deal of progress that the market is going to have to catch up on.

PT: Yes, that's super interesting. Just thinking about more recently, we think in 5-to-10-year time horizons. This quarter has been challenging from a performance perspective. Is there anything you'd highlight that's been [part of] the drivers behind that?

HM: Yes, so a couple of broad themes, I suppose. Given that we're a high growth portfolio, the fact that there has been this anti-growth sentiment linked to rates and inflation, that has weighed particularly heavily on us. We think we're near the end of the rate rise cycle, and so fundamentals are going to get back in the driver's seat at some point in the near future.

There's also been some stock specifics among performance drivers. Negative contributors have included Adyen, which had a sharp selloff linked to margin suppression through hiring and growing competition in the US. But the counterpoint is that hiring for growth could actually be really smart, and the efficient US payments market isn't its key solutions arena.

Adyen is a pretty understated business, which is quite a famous Dutch characteristic. So when we met with management recently, we encouraged them to think about how they communicate the excellent progress they've been making.

ASML is the lithography company at the heart of progress in semiconductors, and that's a market that could grow three times in the next decade, but it's such a high-profile business now that it tends to be sensitive to gyrations in forecasting around the cycle. We saw some of that recently. Big opportunity ahead, though.

And then Delivery Hero, the food delivery platform, which is leading in dozens of markets. It invests very heavily in growth and that can often test the market's limited short-term patience.

Not all negative though, some positive contributors. MercadoLibre, Latin America's most valuable business, continues to make deep and broad progress in ecommerce and digital finance, which is great. NVIDIA has had massive demand for its GPUs, which is linked to the global surge in advanced computing and AI. Many will be familiar with this. And the Chinese ecommerce business, Alibaba, has been rewarded for its ongoing reorganisation as a holdings company.

Overall, the prevailing force on share prices has been negative recently, with the broad anti-growth sentiment and some stock specifics. But again, if you look at the fundamental progress going on in the portfolio, there's loads that's encouraging. And again, the market is going to have to catch up with this at some point.

PT: Yes, it's a huge, huge amount going on in the outside world at the moment. Could you touch on what the team's been doing in Baillie Gifford recently?

HM: Yes, so we can actually use short-term volatility to our advantage by looking for the biggest gaps between the market and between our assessment of operational progress and of earnings growth potential. And once we identify that sort of opportunity, as you said, we reflect it in meaningful position sizes and long holding periods. Hence our turnover is down at around 10 per cent.

We didn't actually put on any trades during Q3, but this isn't a sign of complacency. The portfolio construction group has been really, really busy with research, engagement and analysis. So, for instance, we once again met with the research institute IMEC, helping us to understand the frontiers in semiconductors, and that's really important to our holdings ASML and NVIDIA.

We had some helpful meetings with visionary business leaders at Modena, at Adyen which I mentioned, ecommerce platform Shopify and luxury holdings company Kering. So loads learned about those opportunities. We were the only manager invited to an influential Latin American tech forum for CEOs, many of whom wanted to meet us as long-term investors in the region's most valuable business, MercadoLibre.

And academics continue to offer us lots of insight to secular trends that underpin the growth we're looking for. We recently spoke with Adam Tooze, the historian, and Doyne Farmer, the complex systems scientist, which has helped us understand global complexity and industry advancements.

So, lots and lots of hard work going into our analysis. And within that we think there's loads to be optimistic about.

PT: Yes, so I mean, that really does lead to the question- what next?

HM: Yeah. So, mentioning the sport of cricket might elicit a groan or two from clients who, perhaps understandably, find the sport unfathomable. But the England team has recently undergone a bit of a transformation called 'Bazball', which effectively is about the team aiming to play without fear, blocking out external pressures and accepting the certainty of some failure in return for the potential of extreme upside.

We think that's a really useful analogy for investors, who need to remember that downside is capped, but upside is theoretically limitless. We understand that periods of underperformance are painful for clients, and we feel that keenly with our clients. But our main message is that we can turn periods of short-term volatility to our advantage by looking for the biggest gaps in what the market is valuing versus our assessment of operational progress and earnings potential.

And again, when we look at that progress in operations and fundamentals, we think there's loads to be excited about and the market is going to have to catch up with this once the sentiment shifts.

PT: Yeah, that's super interesting and it's always nice to be able to come and talk about how optimistic we are about the future, regardless of prevailing market sentiment over the quarter. So thank you very much.

That just leaves me to say thank you very much for your interest in the ICG Strategy. We hope you found comments informative and helpful, and we look forward to speaking to you again in the future.

Thank you.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

International Concentrated Growth

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

	2019	2020	2021	2022	2023
International Concentrated Growth Composite	-1.6	81.5	28.4	-48.9	14.6
MSCI ACWI ex US	-0.7	3.5	24.5	-24.8	21.0

Annualised returns to 30 September 2023 (net%)

	1 year	5 years	10 years
International Concentrated Growth Composite	14.6	6.1	10.2
MSCI ACWI ex US	21.0	3.1	3.8

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.

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Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

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Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

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