INTERNATIONAL ALL CAP Q1 UPDATE

Investment Specialist Katie Muir and Investment Manager Joe Faraday give an update on the International All Cap Strategy covering Q1 2023

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

This communication was produced and approved in April 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

Katie Muir (KM): Welcome to the Baillie Gifford International All Cap Strategy update for the first quarter of 2023. I'm Katie Muir, and I'm an Investment Specialist for the Strategy, and I'm joined by fellow strategist, Joe Faraday, who is also a member of the Portfolio Construction Group for the Strategy, since 2008. As a reminder, the Strategy aims to deliver strong, long-term performance, by identifying high quality international opportunities.

We believe share prices ultimately follow earnings growth, or reflect earnings growth over the long-term. We therefore focus on fundamentals to identify individual companies to invest in. We then hold these investments, typically for five to ten years, thereby, taking a differentiated view from the market. So, to start with, Joe, can you maybe share some reflections on what the market backdrop has been like, more recently?

Joe Faraday (JF): Sure. I think we'd agree, here, across the team and at Baillie Gifford, that 2023 has got off to a rather interesting, and actually, exciting start. And, I think, if we think about the market backdrop, we almost need to unpack that and cover three broader areas. There are the tailwinds, so what's been supportive, there are some headwinds that we need to call out and just help navigate through.

And then for us it's about focusing back on the actual fundamentals, as you commented on, each of the individual companies in the portfolio. So, starting with the tailwinds. Despite a lot of what we read in the headlines, we think there's a really broad, conducive, supportive environment for growth investing at these times.

And you can cut that a few different ways, but if you look through different sectors or countries, or some broader factors, actually, the backdrop now for growth investing or growth from companies is a lot more supportive than it was 6, 12, 18 months ago. So, if we look through a few of the different end sectors, consumer demand remains strong. Industrial demand remains very, very strong, you see that in order growth or pricing power in those companies.

Demand for tech across many areas remains strong. So, when we look at certain segments of the market, inherently, we find very attractive, we're upbeat on what we're seeing and feel that lies ahead for growth in certain company types there. You can also apply that through the lens of different countries. So, clearly, one to cite would be the reopening of China. That's boded well for what that means for that country, but also demand more broadly around the world.

Wider emerging markets, growth is in firm footings and there are strong fundamentals for those. And then elsewhere, as well, the UK has escaped the claws of recession, you're seeing reflation in Japan, and broadly, quite a supportive environment, in many ways, across vast parts of Europe as well. And on top of that, you could fold a few other factors. So Central Bank policy, fighting off and fending off inflation seems to have boded quite well so far, at least.

Labour markets are inherently very, very tight. So, if we try and combine all of those factors together, actually, we feel there's quite a vibrant backdrop, or exciting backdrop for many companies to be growing onto around the world. That said, it isn't easy. There are some headwinds, and a couple I would call out of particular note would be the fragility of the financial sector. And then, not a new one, is geopolitics.

But in terms of the financial sector, we're all very aware of what happened with Silicon Valley Bank, there's Credit Suisse, those money market rates. And that proves, in the first order impact, the fragility of the banks or the banking system, and that's an area we've been somewhat underweight, or always thrown caution to the nature of the quality of those business types. But we need to extend that on, I think about the second or third order.

What that means for the wider economy, for financing of companies, for the shrinks of cash flows or funding of certain company types. So, that's a headwind we just need to make sure we navigate through very, very carefully, through each and every holding. And the second one, as I mentioned, was geopolitics. It isn't new, but China-US relations remain very fraught, and there's a lot going on in Europe, there's the Ukraine conflict, and there's a lot of change in leads of central banks and political leaders.

And again, we just need to pause for thought. I think it's almost checking with business types about, is there this bifurcation or carving up of the opportunity set for them, and what that means for certain companies. So, being mindful of that. But let's pull that together and turn it towards more Baillie Gifford speak of what we want to focus in on, and it's the fundamentals and it's the company types.

And I think you can apply it at the individual company, the portfolio, and also, arguably, this macro level as well. What we're trying to look for right blend of is growth, quality, and resilience. And on that count, if we think about that broad backdrop for international equities, we think there are firm grounds to be optimistic at these times.

KM: Great. Thanks, Joe. So, those are some thoughts on the recent investment environment. If we maybe turn to the portfolio now. Can you maybe talk about how the Strategy is positioned, and what we're seeing across individual portfolio holdings?

JF: Sure. So, I think I'll pare it back a little bit, and I want to maybe continue on this spread of growth, quality, and resilience. So, we've explored that, in certain ways, across the market backdrop, and we apply that onto the portfolio, and what we see, we're really upbeat about a collection of holdings that we have, and the long-term outlook for growth and the performance of those.

So, in terms of growth, the forecast, or where we expect these companies to be in three, five, ten years' time, we are very upbeat on that. Sales growth, profit growth, earnings per share, free cash flow we see, we are very confident in double digit type growth on these companies. Mr Market, in contrast, for the broader index, appears to be pointing at low, or at best, mid-single digit type growth for company types across that wider index.

So, there is a lot of growth we are seeing and identifying, and we're very upbeat on that count. The second one is around quality. If we look at levels of profitability, certainly gross margins or levels of returns, return on equity, return on assets, sustainable growth rates, and we look at the portfolio through that lens, again, we're very, very upbeat.

And it's got to be that blend of growth and quality that is important to navigate through what could be a tougher period, operationally, for some. And then this third lens or pillar would be resilience. And if we look through the robust balance sheets, the low levels of indebtedness, strong free cash generation, how there's only a very small handful of loss makers in the portfolio, on that count, we're very, very upbeat.

So, if we think of growth, quality, and resilience at a portfolio level, we're optimistic about what we're seeing. Now, I want to indulge a little bit on stocks, and go on a bit of a whirlwind tour of the portfolio through that way, and think about growth and what we are seeing from the individual companies themselves. So, I'll use three of the four growth drivers that we identify across the portfolio. The first of those is the online revolution. It's about a quarter or so of the portfolio holdings.

Many of those holdings are growing very quickly. We're still seeing growth rates of 20 per cent to 50 per cent. To call out one, there's a company called Adyen, based in the Netherlands, but it operates world over, and it's a payment platform business, and that's seen top line growth of 30 per cent. That's really, really strong. But importantly, it's investing for the long-term.

Almost every tech company out there is laying off staff. They are hiring. There are 750 people being added to their labour force of 3,000. They're on the front foot. They're planning for the long term. That's great to see. So, it's growth, and also, growth that will continue coming through. So, that's one segment of the portfolio we're upbeat on.

Another grouping would be what we call technology and industry, so ongoing rise of automation, semi-conductors, etc. And an example there would be some of the factory automation businesses, so a couple of the Japanese companies or holdings that we have. One would be SMC that's a leader, globally, in pneumatic equipment. And then Keyence, that's a leader in vision sensors on process lines. They're seeing really strong growth, in excess of 20 per cent.

It's formidable to see, and going back to that broader growth backdrop, the labour market is very tight, but it's a perfect environment for ever more automation on process lines, etc. So, it's really good for those businesses or those holding types. And the last one I would call out would be some of the consumer orientated businesses, so call it the rise of the middle class. You can extend that out further, and it overlaps with some of the internet companies. It's about 40 per cent of the portfolio, if you include some of those.

And again, across wide levels of consumption, we're seeing a very strong growth backdrop. So, the luxury end, Louis Vuitton is now over €20bn of sales for that brand alone. It's growing more than 20 per cent, year-on-year, across the LMH Maison of brands. You're seeing strong growth at Richemont, at Burberry, Gucci is over ten billion of sales now, as well, at Kering.

So, the luxury goods companies have been very, very strong, in terms of growth. There's the middle of the pack consumption, Shimano, and on down to the discount of the lower end discount, food retailers, pharmacy chains, baby products, again, seeing strong growth. So, I appreciate there's a lot in there to unpack.

We're a flat portfolio, there are lots of different holding types in the All Cap Strategy, it's about growth, quality, resilience, and seeing lots of growth across the wide range of holding types that makes us upbeat at these types.

KM: And I think it's great to see the growth coming through from a variety of different business types and across regions and industries, as you mentioned, in the portfolio. And also, it's been encouraging where that fundamental progress has been rewarded by the market, certainly, more recently. Maybe turning to research activity now, what has the team been up to, more recently? And has this led to any changes in the portfolio?

JF: For sure. The backdrop of what we had last year into the new ideas coming through into the portfolio long continues. It's a great time to be latching on to new names. It's fascinating. And our job is to constantly try and upgrade the portfolio. And I'll come on to the new name that's got in in a second. I just want to emphasise that we benefit from the broad engine room of research that happens at Baillie Gifford.

Over the last few months, there's over 1,000 company meetings that have been done. It's the insights from all of those that we narrow down and harness, and that leads to what we'll ultimately do and choose for the client portfolio. Also, in terms of process, it's tried and tested. It's what we've done for over 30 years. And we have a saying that ten, becomes two, becomes one. There are around ten possible ideas we explore at our portfolio meeting each month.

We narrow that down to two. We use our five question framework. It goes through a really robust, rigid analysis by one of us on the portfolio team. We select one, typically, that's the regular flywheel or way names get into the portfolio. So, that continues, tried and tested. So, that's exciting. But what does that lead to? And I'm actually going to pick one of the more durable growth names that we've brought through into the portfolio.

We've talked a lot about high levels of growth. But our job is to look for a wide range of growth types. And a durable business that we brought through into the portfolio is a company by the name of Cosmos. I doubt many people have ever heard of this company before. It's based out of Japan, and it's a discount food retailer. It's got around 1,200 stores. Now, what's my point here?

But our job is to identify what we think are much larger, significant growth companies for the years to come. Cosmos is rolling out stores, over 100 a year, so you almost get to 10 per cent growth rate just from store rollout alone. There's a reflationary environment emerging in Japan. We think margins can go from 4 per cent to 6 per cent. So, this is easily a double digit grower. We're really comfortable on that count.

In terms of management, or the strength and quality of the business, this is quite unique and special. There's the Uno family behind it, so a father and sons combination, and there's professional management as well, so we think that bodes well for how well this business will be run, and it's about the interest of all stakeholders and shareholders combined.

And then in terms of valuation, yes, this is a premium, but it's a modest premium for growth, or the longevity of growth, that we see on offer here. So, that's a different growth type that's come through into the portfolio. And I'll just mention two other side points to this. We've owned lots of these business types through the years. We own a wide range of growth types. There's 10 per cent durable compound is up to more fast growers.

This is certainly one at the more durable end. But we've owned similar company types and franchise models, pharmacy chains, discount food retailers. So, we're able to draw on those vantage points and insights to apply here, in our analysis. And if that isn't enough, the second factor is this has benefitted from really robust insights at Baillie Gifford Research. It's been owned in one of the smaller cap strategies for over 13 years.

So, we really know this company well. So, it's solid foundations, taking a long-term view, and having conviction about the growth and the quality of the company for many, many years to come. So, I think that would be my example I'm calling out, and I hope at each quarter, there's a wide variety, as there always is, of different prototypes that come through, ultimately, into the portfolio.

KM: Great. Thanks, Joe. So, to summarise, we've had an encouraging start to 2023. Despite the headlines, there is steady growth happening in many countries around the world. At the portfolio level, we've remained optimistic about the outlook, based on the operational progress being made at many of our individual holdings, and also, the structural growth tailwinds that they are exposed to.

The portfolio continues to grow well, well in excess of the market, and exhibits high quality characteristics, such as higher returns on equity and assets. And it's also resilient, with solid balance sheets and strong free cash flow generation. Our approach remains one of patient investment in a diversified portfolio of solid franchise businesses, run by sensible management teams.

We see many opportunities in our research pipeline, and look forward to delivering strong investment returns over the long term. So, I hope viewers have found our comments useful. That just leaves me to say thank you for your interest in the International All Cap Strategy, and we look forward to speaking to you again soon.

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

	2019	2020	2021	2022	2023
International All Cap Composite	-5.2	-5.7	66.6	-16.4	-7.9
MSCI ACWI ex US Index	-3.7	-15.1	50.0	-1.0	-4.6

Annualised returns to 31 March 2023 (Net %)

	1 Year	5 Years	10 Years
International All Cap Composite	-7.9	2.8	5.2
MSCI ACWI ex US Index	-4.6	3.0	4.7

Source: Baillie Gifford & Co and MSCI. USD.

Past performance is not a guide to future returns.

Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Risk Factors

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Important Information
Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial Intermediaries
This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe
Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018. Baillie Gifford Investment Management (Europe) Limited is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. Baillie Gifford Investment Management (Europe) Limited is also authorised in accordance with Regulation 7 of the AIFM Regulations, to provide management of portfolios of investments, including Individual Portfolio Management ('IPM') and Non-Core Services. Baillie Gifford Investment Management (Europe) Limited has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. Through passporting it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Similarly, it has established Baillie Gifford Investment Management (Europe) Limited (Amsterdam Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in The Netherlands. Baillie Gifford Investment Management (Europe) Limited also has a representative office in Zurich, Switzerland pursuant to Art. 58 of the Federal Act on Financial Institutions ("FinIA"). The representative office is authorised by the Swiss Financial Market Supervisory Authority (FINMA). The representative office does not constitute a branch and therefore does not have authority to commit Baillie Gifford Investment Management (Europe) Limited. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan
Mitsubishi UFJ Baillie Gifford Asset Management Limited (‘MUBGAM’) is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia
Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a “wholesale client” within the meaning of section 761G of the Corporations Act 2001 (Cth) (“Corporations Act”). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a “retail client” within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person’s objectives, financial situation or needs.

South Africa
Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America
Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited (‘BGE’) relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel
Baillie Gifford Overseas is not licensed under Israel’s Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.