Baillie Gifford™

China Growth Trust
March 2024

Sophie Earnshaw and Linda Lin, co-managers of the China Growth Trust, discuss events in China, provide a portfolio update and look at the areas of potential growth.

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

Sophie Earnshaw (SE): Welcome to this discussion on China. We're going to talk about recent events, the portfolio, and introduce you to Linda Lin. Linda is a partner at Baillie Gifford who has recently returned to Edinburgh after a number of years in our Shanghai office, and she'll be joining me as co-manager of the China Growth Trust.

I'm Sophie Earnshaw, one of the managers of the China Growth Trust and the China Fund. This year is the 30th anniversary of Baillie Gifford's first investments in China on our clients' behalf. I've been managing the China Fund for a decade now and have worked closely with Linda over the years to evolve our approach to China.

An important part of that was the opening of our research office in Shanghai in 2019, which Linda has run for the last four years. Linda, perhaps I can begin by asking you a bit about your experience in Shanghai and the role that the research office plays.

Linda Lin (LL:): Thanks, Sophie. It's great to be settling back into Edinburgh, and I'm excited to join you on the Trust. Before I deep-dive into Shanghai, it's perhaps a good thing to highlight being in Edinburgh is not a new thing for me. I joined Baillie Gifford in 2014 and spent much of my time working with our Long Term Global Growth Strategy here in Edinburgh before I moved there to set up our office. This has clearly been an exciting time to develop our approach in China, but I see the evolution of one dedicated China Team as the next step, and that's what brought me back.

There are a number of benefits to our Shanghai office. But perhaps to say first, since we've opened it, we've continued to add resources there, with two new investment graduates joining us in the last two years, as well as a dedicated ESG analyst. I'm back now, but we still have a team of seven, with Rio Tu who has been with Baillie Gifford for a decade and is in charge of the local team.

Taking a step back, one of the most difficult things to invest in with China, is a very short-term focus of most market participants. Our key advantage is to bring a long-term and patient process to investing, which allowed us to ignore the short-term fluctuation and focus on the long-term, innovative and secular trends which we hope will generate returns for our clients.

As a result, we didn’t really open the Shanghai office in the financial centre of Shanghai. It helped us get closer to some growth companies in China in the future. It also started building the relationship with them at an earlier stage, digging deeper into the China A-share market, which is poorly covered and researched, especially in English. And, also, we get the opportunity to talk to private companies with huge opportunities in the future.

SE: And one of those companies is ByteDance. I think one of your biggest strengths is your ability to forge really strong relationships with founders and leading companies within China. Do you think can say a little bit about that in relation to ByteDance? As you know, it’s the largest holding within the China Growth Trust.

LL: Sure. We started researching ByteDance in 2017 and have been learning from the founder, Zhang Yiming, and his team since then. I still remember in 2017, it launched the most popular mobile news app, called Toutiao, in China. It’s got around 100 million daily active users, but after almost seven years’ time, it has become one of the largest global social networks, owning the super apps like TikTok and Douyin, and it has achieved 2 billion daily active users. And this has been an exciting journey with this company. And I know our China Investment Trust became a shareholder of this company in 2020.

SE: What will happen to those relationships now that you’re back in Edinburgh?

LL: I think our relationship with Chinese companies goes far beyond my own connections. In the China Fund, for example, we started owning ENN Energy and Tencent since 2008. And now we have a team in Shanghai. And, on top of that, in Baillie Gifford, we have more than 80 investors who have China in their EM [emerging markets], international and the global remit, which helps us for the idea generation, as well as bringing global perspectives to our debates on Chinese companies.

And, also, being on the ground really helps us to deepen our third-party relationships. For example, our relationship with Shanghai Jiao Tong University, UK-China Low Carbon School, and, also, Huisheng Consulting. But this actually really builds on the relationship, that has gone before, for example, the due diligence provider, Fathom, and the policy advisor, Trivium, which helps us to identify some of the opportunities as well as mitigate downside risk for us.

Speaking of the risk, we have been very cautious in the last couple of years. China has a difficult situation, with the index down significantly, and our performance has been behind. I understand this has been a painful period of time with many in the Trust. So, what’s your thoughts about this, Sophie?

SE: Yes, it’s been a really difficult, painful time for investors in the Trust and, also, for, I think, everyone that’s been invested in China over the past couple of years. There’s really three main drivers, I think, behind the very weak absolute performance. Firstly, the domestic economy, secondly, regulation and then, thirdly, geopolitics.

At this point, it's probably worth just reiterating that we are bottom-up stock-pickers. We own a portfolio of around 60 stocks out of a potential universe of 6,000. But over the past couple of years, it has really been the big picture that's driven returns.

On all three of those points, I think where the outlook is looking a little bit rosier, a little bit better, so, in terms of the domestic economy, it's really property that's been very weak, but we're now seeing the Government really starting to address this seriously. When it comes to regulation, I think we have now turned a corner, and we appear to be in a more normalised regulatory environment. And then, thirdly, on geopolitics, I think this will remain a headwind, but it does look like things have stabilised, at least from a low base.

Even more importantly, though, the companies that we're finding still have big growth opportunities ahead of them. And some of those growth opportunities are independent of the broader macroenvironment outlook. One example here, a company that I know you're very, very familiar with, PDD. This is an ecommerce company. It's actually grown its revenues by 94 per cent in the most recent quarter, and it's opened its app, Temu, in over 55 different countries.

LL: Yes. And I have met a private company called Xiaohongshu, which is a leading social media company in China. It's taken them less than ten years to reach a 300 million scale of monthly active users. And in the last two years, they grew their revenue and profitability significantly.

SE: Wow, yes. And the companies that we have in our portfolio, they are really exposed to what's going to drive China over the next decade, so consumption, automation, digitalisation, a whole host of issues. And they're not really exposed to a lot of the things that make the headlines, so property, financials, utilities.

LL: I think many people are spending too much focus on the macroeconomic environment, but at the end of the day, there is still a lot of wealth being created in the second-largest economy and the second-largest capital market in the world. There are still a number of companies that will benefit from this big trend that will continue regardless of the economic backdrop. And we should focus on those opportunities.

SE: And that's true even over the past year, where the companies that we own in the portfolio have continued to deliver very well operationally. But we've seen share prices really diverge from fundamentals, and that has been painful, as a lot of the companies that we own have derated. But at the end of the day, from where we stand now, we have a portfolio of companies exposed to very big opportunities that are now actually very, very cheap.

I'll give two examples. CATL. So, this the world's largest EV battery manufacturer. This is a company that's grown its revenue and profits over ten times over the last four years. But it's now only trading on a price earnings multiple of around 15 times, meaning that the price we're being asked to pay for this company's growth is very, very low. And the same goes for Meituan, a company that in the most recent quarter grew its revenue at 20 per cent and yet, similar to CATL, is only trading on less than 15 times forward price earnings.

Valuations are looking very attractive, but it's not just about valuations. It's about finding those companies with those big growth opportunities. And that's really what our day-to-day job is focussed on. But I think here maybe it'd be useful or helpful if you could just reiterate the approach that we have to investing in China. I know it's an approach that you've been instrumental in developing.

LL: Sure. I think it will be super-helpful for us to emphasise the three key points from that approach. I think, firstly, we have a very different time horizon, which allowed us to stay patient and explore the market inefficiency in a market dominated by the short-termism. And, secondly, we're looking for different perspectives, which means that we are searching for the opportunities which are really benefitting with a long-term and secular trends. I think, lastly, we have a very different focus on the upside. It means we can invest into some of the growth companies others may miss.

I think there are some interesting numbers that helps us. For example, China has already been the largest industrial robotics market globally. But when we're talking about the robot density, China only comes third to some countries like South Korea. And in the next ten to 20 years, there's huge upside in these areas.

And, secondly, perhaps for someone who likes to have a drink, Chinese people drink baijiu more than the rest of the world drink whisky, vodka, gin, rum and tequila. And this type of opportunities that for the investor globally, you can only find in the Chinese A-share market.

As a result, we're more focussing on the discovery process rather than simple coverage. And we will look at those areas China is turning the taps on.

SE: Yes, as you say, China does still have some long-term challenges, ESG, geopolitics, potentially, a slowing macro. But I also think, as you're implying, it's really important to remember some of the real-world forces that are still happening, that haven't changed over the past couple of years that could be really impactful. Things like renewable costs continuing to fall, factory automation continuing to increase, or Generation Z becoming an increasingly important consumption driver. I could go on and on.

It sounds like we're in agreement, I think, and maybe this is a good point to conclude on, if you look forward rather than backwards, we think we can still see a China that's very much likely to grow as a result of innovation, consumption, automation, digitalisation. And for us as curious stock-pickers in both Edinburgh and Shanghai, actually, it's quite a lot to be excited about.

LL: Yes, totally agree.

SE: Yes. Thank you, Linda. Thank you today for joining us for this discussion on China.

LL: Thanks, Sophie.

Annual Past Performance to 31 December Each Year (%)

	2019	2020	2021	2022	2023
Baillie Gifford China Growth Trust	20.3	56.1	-28.6	-25.6	-26.3
MSCI China All Shares Index*	15.1	12.6	-12.0	-13.8	-16.4

Source: Morningstar and MSCI. Share price, total return, sterling.
*Changed from MSCI AC Asia ex Pacific index to MSCI China All Shares Index on 16/09/20. Data chain-linked from this date to form a single comparative index.

Please note, Baillie Gifford was appointed by the board to manage what was the Witan Pacific Investment Trust as of September 2020

Past performance is not a guide to future returns.

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For a Key Information Document for the Baillie Gifford China Growth Trust, please visit our website at www.bailliegifford.com

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- The Trust invests in overseas securities. Changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.
- Baillie Gifford China Growth Trust invests in China, where potential issues with market volatility, political and economic instability including the risk of market shutdown, trading, liquidity, settlement, corporate governance, regulation, legislation and taxation could arise, resulting in a negative impact on the value of your investment. Investments in China are often through contractual structures that are complex and could be open to challenge.
- Unlisted investments such as private companies can increase risk. These assets may be more difficult to sell, so changes in their prices may be greater.
- The Trust can borrow money to make further investments (sometimes known as "gearing" or "leverage"). The risk is that when this money is repaid by the Trust, the value of the investments may not be enough to cover the borrowing and interest costs, and the Trust will make a loss. If the Trust's

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- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.
- The Trust can make use of derivatives which may impact on its performance.
- Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.
- The Trust's exposure to a single market and currency may increase risk. Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.
- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.
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