Baillie Gifford™

International Alpha Q4 investment update

January 2025

Investment manager Steve Vaughan and investment specialist Andrew Brown give an update on the International Alpha Strategy covering Q4 2024.

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Andrew Brown (AB): Hello. Welcome to the International Alpha fourth quarter portfolio update. My name is Andy Brown. I'm an investment specialist for the International Alpha Strategy, and I'm joined today by Steve Vaughan, a member of the investment team and a member of the Portfolio Construction Group for International Alpha. Steve, hi.

Steve Vaughan (SV): Hi, Andy.

AB: Thanks for joining today.

Steve, during the final quarter of the year, international equities fell in value, but they did deliver a positive return during the year. How did the portfolio perform against that backdrop?

SV: Yeah, so a very similar picture for us, both in absolute and relative terms. We ended the year broadly in line with the index. Things were actually looking a little bit better for us until mid-December, when the Feds came out a bit more cautious on the path of rate cuts for next year, but I think you can put that in the category of noise. Performance is still not where we want or expect it to be but there's plenty of positives that we can take, and we've certainly done more than steady the ship since 2022 and ahead since then, so that's really pleasing.

AB: Yeah, that's good to hear. And sentiment is one thing, but operational performance is what we're paying most of our attention to. How would you describe operational performance for the Strategy over the year?

SV: Yeah, I think that's been really, really very strong. We could talk about stock specifics all day, but we're seeing that translate into aggregate levels. So the delivered growth for the portfolio is back to sort of historic multiples above the index. That's whether you look at sales growth or

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earnings growth, whether you look at it over one year or five years. So that's probably the most tangible evidence I can point to in terms of the progress that the portfolio is making.

I think there's actually been plenty of companies within it that have exceeded even our positive expectations over the year. That's been particularly the case with some of our rapid growth names to the point where we've actually been reducing several of them over the past couple of months. I'd call out Spotify as a particularly strong performer, a period of operational efficiency alongside some price rises for customers in many markets. I've seen that go from a negative operating margin to just under 12 per cent in the latest quarter, so incredible progress over a year.

Shopify is also continuing to do really, really well. You know, mid-20s revenue growth at an impressive 20 per cent free cash flow margin. So, some of those rapid growers that were difficult for us in 2021/2022 have definitely proven themselves.

I think it highlights a broader point that, you know, we never just buy top-line growth. Every company is in the portfolio because we believe that it's got a durable long-term business model and that it will generate profitability over that longer term. So that's been really, really pleasing to see.

AB: Yeah, that's really encouraging to see that rapid growth names have been demonstrating they can become profitable but not sacrifice that top-line growth.

Steve, one thing that we've talked to clients about a bit over the past year or so is a stated intention to broaden the range of ideas being considered for the portfolio. How would you describe the progress that we've made there?

SV: Yeah, I think that's been, again, really, really pleasing in 2024. I guess as a reminder, we did very little, really, to react to the difficult period that we had in 2022, because, ultimately, we firmly believed in our philosophy and process and our approach. But inevitably, we made changes around the edges.

And that broadening of the research funnel that you mentioned is one of those really tangible changes that we did make. Given our long-term approach and low turnover, that does take time to translate into portfolio outcomes. But we've seen that come through in the past year.

So we bought nine businesses, which is very much in line with our long-term turnover, so no change there. But I think it's fair to say that the range of those businesses, whether you look at it in terms of business model, in terms of growth opportunity, in terms of geographic location, I think they are now probably a bit more different than they would have been a couple of years ago.

So to give just two examples to illustrate that, We bought Kaspi, which is Kazakhstan's leading payments platform. It's a rapid growth business, you know, low 30 per cent revenue growth as it expands into a wider range of financial services. But we also bought Stella Jones, which is a Canadian supplier of utility poles. So these unglamorous wooden poles that are absolutely critical for upgrading and expanding the electricity distribution grid throughout North America. So that business is much slower-growing but we've got what we think has a multi-decade growth opportunity ahead of it.

AB: Well, that's great to hear. So, you know, some interesting new stocks making their way into the portfolio, hopefully increasing the resilience of the portfolio and the diversification at the same time.

So, Steve, thinking about the research agenda now, can you provide us with a window or a bit of an insight into what you're thinking about or what the team's working on?

SV: Sure, so I guess we could maybe talk about that at a couple of different levels. As a team, maybe more strategically, we had one of our regular off-sites just before Christmas. These are always our opportunity to sort of step back from the day-to-day, think about our investment philosophy, our approach, what we're doing well, where we can improve.

To give some insights there, I mean, a lot of the discussions focused around improving further our risk management, portfolio construction, particularly around ensuring adequate diversification into the portfolio and what else we can do to further improve the rigour and challenge that we bring to individual investment cases.

Again, maybe more sort of day-to-day, the team continues to work on a really wide range of portfolio ideas. But we've also been experimenting with some different ways of working. Again, as everyone probably knows, the research is very individual-led, but we've been trying to supplement that with a bit more team-based and collaborative work.

So an example of that, we recently as a team looked at a range of copper miners in our international universe to supplement some work that had been done by individuals on specific stocks. And the aim from the team was to bring more situational awareness and context to those individual ideas. It's actually something that we did quite successfully before we bought Roche in a different context earlier in the summer. And again, we're finding it useful, again, just all about bringing different perspectives and awareness. So that's at the team level.

For me personally, for everyone on the team, it's always a balance between finding new ideas and updating our analysis and understanding of existing holdings. I've probably spent a little bit more time recently on the latter, not least because I met quite a few of our holdings at an investment conference at the end of November. So I've been reflecting on that.

And I've also been doing some work on Demant, which is a hearing aid supplier. They had a bit of a change of strategy in the large US market that I wanted to understand better. So I just finished a bit of work before Christmas on the changes there. So having done a bit more, maybe, on existing holdings,

Looking forwards, I'll be trying to do a bit more idea generation in the first couple of months of the year. I'm always amazed and excited about the depth and breadth of our international universe.

There's some really great companies that are out there that we think are completely overlooked by the market. I mentioned Stella Jones that we found earlier. TFI, we bought just before Christmas, is a Canadian logistics provider. I'd also put that in the camp of exciting but overlooked businesses. And it's always really exciting to try and find the next one of those. So that's what I'll be doing over the next couple of months, hopefully.

AB: Well, there's lots to unpack there, and I'm sure during the year we'll have conversations with clients to bring some of these things to life.

Steve, I know talking about the outlook is quite difficult for stock pickers, but just looking forward over the next year and I guess beyond, what is it that makes you optimistic about the portfolio?

SV: I mean I think the main one that we've touched on already is really the fundamentals of the portfolio. We've talked about the delivered growth. I think the forward-looking growth for the portfolio looks really good as well. I think consensus estimates are about 40 per cent ahead of that for the index. So the future there is bright.

The quality is still there. Whether you look at it across balance sheet, returns, free cash flow, margins, that quality is there and actually improving, I think, helped by some of those rapid growth names that we talked about earlier. And that's really important and exciting because ultimately, as long as we're disciplined on valuation, those fundamentals will translate into superior outcomes for clients over the longer term.

AB: Well, that sounds like a great platform to start the year. Steve, thank you very much for your time. And thank you, everyone, for listening.

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International Alpha

Annual past performance to 31 December each year (net%)

	2020	2021	2022	2023	2024
International Alpha Composite	26.7	-0.5	-28.9	19.0	5.3
MSCI ACWI ex US Index	11.1	8.3	-15.6	16.2	6.1

Annualised returns to 31 December 2024 (net%)

	1 year	5 years	10 years
International Alpha Composite	5.3	2.4	5.6
MSCI ACWI ex US Index	6.1	4.6	5.3

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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