BAILLIE GIFFORD UK GROWTH TRUST MANAGER INSIGHTS

In this short film, investment manager Iain McCombie discusses changes to the portfolio, the impact of inflation on growth stocks, and why there are grounds to be optimistic during periods of volatility.

All investment strategies have the potential for profit and loss, capital is at risk.

This communication was produced and approved in September 2022 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.

A Key Information Document is available at bailliegifford.com

Iain McCombie: Hello, I'm Iain McCombie – one of the co-managers of the Baillie Gifford UK Growth Trust.

There's an old Chinese saying that says it's a curse to live in interesting times. Well, times certainly are interesting.

Markets continue to experience many of the same economic headwinds we have become all too familiar with.

Sadly, the ongoing crisis in Ukraine shows little sign of abating. Energy and food costs continue to rise, pushing UK inflation to its highest rate in 40 years. And this has triggered further monetary policy tightening.

UK politics also seems very unsettled. In short, it sounds like the saying about interesting times being a curse is right.

Well, I, along with my co-manager Milena Mileva, take a different view. Interesting times also means opportunities for investors who are truly long term in their outlook.

What does this mean for growth investors in the UK?

First, the bad news. What we can see at the moment in the UK stock market, and others, is a brutal change in sentiment.

You've possibly heard the phrase that the stock market is a discounting mechanism. And what that means in plain English is that share prices today try to reflect both current and future news.

With future news, rightly, you place a discount on it because it hasn't happened yet, and the longer in the future it occurs, the higher it gets discounted.

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What's happened at the moment is that as interest rates and inflation have risen, many people's discount rate has risen. To put it simply, good news in the future is discounted more, so it becomes less valuable. So the share prices of fast-growing companies have been marked down – that's what happened.

But here's the good news – what I've said sounds awfully logical, it's what many investors are taught from textbooks, it's what you may have read in the papers, and it is broadly correct in normal times but… but it's nonsensical in interesting times. It tells you nothing about how to make money.

These conditions should be seen as an opportunity for a long-term investor. That's what my 28 years' experience of investing at Baillie Gifford tells me.

Market sell-offs are often indiscriminate and what we are seeing is that, regardless of the fundamental operational progress that many of the companies in the portfolio are making, the stocks have been marked down.

So what does this mean for the Trust's portfolio?

It's imperative that we carefully navigate through the 'noise' in good times and bad. Which is why we remain resolutely focused on carefully analysing the fundamental characteristics of the holdings in the Trust.

That allows us to form our own opinion on the long-term growth opportunity that we see from here. And by sticking to this long-established investment philosophy, we firmly believe that we will be able to add value over the long term.

What this means is that despite all the tumult in the markets, we've largely stuck with the stocks in the portfolio. Operationally, they continue to do well.

Take the international car distributor, Inchcape. Recently, it announced better than expected trading this year, driven by robust consumer demand in many of its markets, and this led to a significant upgrade in profit guidance for the full year ahead. But the stock market shrugged off this clearly good news from the company.

So this discounting mechanism I talked about earlier, isn't working. Growth is being under-priced.

Now some of you are probably thinking 'well he would say that wouldn't he' – but it's not just me saying it. We can see private equity taking advantage. Earlier this year we sold out of Ultra Electronics, which agreed to a bid.

More recently the home emergency repair business HomeServe has agreed to a bid from private equity, while data and events business Euromoney has had a bid approach, again, from private equity.

In some ways this is mixed news. We'd rather not sell out of companies whose fundamentals we continue to like but at least it gives us reassurance that our thesis is right.

Now finally, times like these are an opportunity to add to positions in companies we own, such as credit data provider Experian and the investment platform AJ Bell.

We've also tracked with care special businesses we'd like to own – ones that have sold off in these choppy markets but, importantly, the fundamentals of them remain strong. An example of this recently was the purchase of Softcat – a business that's a long-term play on corporate IT spend.

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So, to sum up, yes these are interesting times. Challenging times. But by sticking to our process, we think there are good grounds to be optimistic and we can use this volatility to our advantage.

Annual Past Performance to 30 June Each Year (Net %)

	2018	2019	2020	2021	2022
Baillie Gifford UK Growth Trust	16.5	-0.2	-2.5	31.7	-35.1
FTSE All Share Index	9.0	0.6	-13.0	21.5	1.6

Source: Morningstar, share price, total return in sterling. Returns reflect the annual charges but exclude any initial charge paid. Past performance is not a guide to future returns.

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