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## **International Alpha Q3 review:**

**Martina Hodges (MH):** Good morning and happy Friday. Welcome to our quarter three 2025 webinar series. And today we will be focusing on our International Alpha strategy. My name is Martina Hodges, and I will be your host for the next 20 minutes or so. I am part of Baillie Gifford's financial intermediaries team, and I am delighted to be joined today by Beatrice Faleri. Beatrice is a dedicated investment specialist on our International Alpha team.

Please note that the information discussed today is with regard to the strategy and may differ slightly to the investment vehicle that you are invested in. But before we begin the discussion, just briefly outline the agenda. So, we're going to focus on the recent drivers of performance and their impact on your portfolio, as well as how the current market environment is shaping our investment decisions and overall outlook.

We really encourage participation. We're absolutely delighted that you can join us. So please, please do focus on that Q&A function if any questions spring to mind. And I will be sure to follow up afterwards if we don't get to them during the discussion. Also, please be on the lookout in your inboxes. The quarterly updates should be hitting your inboxes very soon.

OK, so Beatrice, I know that the focus this year has been a lot on tariffs. And whilst I don't think that it should be the main topic of discussion, we would be remiss if we didn't at least talk about it, because we are seeing some of the effects of that come through in some of the companies that we are invested in. So, could you maybe talk about the investment environment more recently and how that's impacted the portfolio? You could pull out some of the highlights and indeed some of the lowlights for the third quarter.

## **Beatrice Faleri (BF):**

Yes, thank you, Martina. It's great to be here again. So, you're right, tariffs have been the focus, but it's fair to say that it was really a challenging quarter for quality growth investors across the board. International equity markets were broadly positive. And that was helped by expectations of monetary policy easing in places, and then also ongoing enthusiasm around technology, especially AI. But then, beneath the surface, what we saw was one of the sharpest rotations into value in several years, particularly in Europe and Japan. So, capital flowed into lower-quality cyclicals, especially banks and short-duration financials, and many of the quality growth names derated.

In Japan, we had an environment of corporate reforms and tighter monetary policy that reinforced this dynamic. And a similar thing happened in Europe with the ECB pausing rate cuts. Meanwhile, some growth companies performed well, but the leadership was very narrow. And this was mainly driven by the AI theme. So, semiconductor names across emerging markets and some Chinese internet platforms rose almost indiscriminately.

As you will know, we don't buy broad baskets of companies or chase momentum, so we didn't capture the full extent of that rally. And that can feel really uncomfortable in the short term. But our discipline, which is owning only those businesses where we have long-term conviction in value creation, is what we believe really preserves long-term returns. So, as other areas of the

market rally doesn't anticipate it, quality companies really suffered. And that was partly because of valuation compression, but also, as you said, because of concerns around the impact of tariffs. And that was especially around export-oriented industries. So, what happened was that early in the year, many people assumed that the effects of tariffs would be limited. In fact, we didn't really see it show up in P&Ls. But this quarter, the strain of tariffs really was much more clear in softer orders, more cautious guidance from management, and also a few profit warnings.

This environment hurt several of our core holdings from IMCD, DSV, these are European industrials and trade companies, and then also Japanese exporters like MonotaRO and Shimano. We saw our overweight in software as well. Companies like Constellation, Topicus, and Lumen come under pressure because of concerns that AI might disrupt these business models. But in all these cases, we've seen quite limited evidence of these concerns expressed in fundamentals.

So, to summarise, growth as a style did better than quality in a narrow sense. Because the winners were concentrated around AI, but the real winner this quarter were value stocks. And as you will imagine, this is really not the most benign backdrop for a quality growth strategy like International Alpha, unfortunately.

**MH:** (05:27)

So, you touched on it just there, maybe just going into the overall performance. So, what have been the key drivers, both positive and negative, for the quarter?

**BF:** (05:41)

Yes, so the strategy finished flat, and we were well behind the benchmark in terms of performance, which is very disappointing. Among our top detractors were again these high-quality names that I've mentioned before. So, companies like Deutsche Börse surrendered some of the year-to-date gains after a mixed update and software activity. DSV, the logistics and trade company that had issues related to the Schenker integration, this big acquisition that they're doing, and our developed Asia holdings were weak too, especially the export-oriented companies.

Emerging markets was a brighter spot. So, parts of the portfolio that are tied to the digital economy did what we expected them to do, especially Tencent, for example, executed well across gaming and advertising. And Samsung Electronics was another standout performer that benefited from a tightening memory cycle for its memory chips and then also progress in high bandwidth memory. One additional headwind in digital and software was not owning Alibaba for us, and that's a company that really rallied strongly in the index. We also saw some of our faster-growing companies come under pressure as sentiment turned a bit more cautious on these rapid growth names. These are businesses like MercadoLibre, Adyen, Monday.com. They all continue to deliver very robust results, double-digit growth, healthy margins, continued reinvestment. But the market chose to focus on soft and near-term guidance rather than this long-term opportunity that we tend to prioritise. So, we believe that in these cases, the reaction really was disproportionate to the fundamentals.

Much of the benchmark's outperformance this year has not been driven by superior earnings, but by multiple expansion in a narrow group of stocks. So that's another element that makes us a bit more optimistic. The portfolio, in contrast, has continued to deliver faster underlying earnings growth and also experiencing evaluation compression. So, the two effects kind of cancel each other out. But we must remember that over time, it's earnings, not multiples, that drive shareholder returns. And that gives us confidence that the current gap between fundamental and share prices will eventually close.

We're so obviously disappointed by the result this quarter, but not particularly concerned in a fundamental way, because as I said, the evidence from company fundamentals remains very strong. And the vast majority of our holdings continue to meet or exceed expectations. Underperformance has been driven by market dynamics and not by deteriorating business performance. So, if you take the portfolio as a whole, the growth characteristic, profitability and resilience is stronger than ever. Over time, our holdings have delivered faster earnings growth, higher margins and better returns than the index. And the gap between our portfolio and the index is also widening. The valuation premium between the portfolio and the index, on the other hand, still exists, but is narrowing. And to us, that means that we have a stronger portfolio at more attractive prices. So that's exactly where long-term outperformance is built.

**MH:** (09:21)

I think it has been quite a volatile year and everything that you've just talked about is very evident that as part of our process and ignoring the noise, it really does pay off and it does then show us some opportunities as well. So, where have the team concentrated their effort this quarter? And, you know, related to some of those opportunities, is there anything to share on trading activity?

**BF:** (10:00)

So, yeah, periods of market dislocation, as I was saying, create some of the best opportunities for us. Where sentiment turns abruptly and investors crowd into these narrow themes, even great companies can be overlooked or punished unfairly. So, we think the opportunity set for us, for International Alpha, is extremely attractive. There's a huge breadth of ideas coming through the funnel and the research pipeline is expanding. So, we keep finding companies that are growing, that have attractive competitive advantage across a range of industries and geographies. Some of the themes that we've been exploring include things like automation, electrification, and financial inclusion. We can go into that later. But we've also been revisiting areas where we have historically had under-representation in the portfolio. For example, banks or staples, and even selective parts of energy and defence companies, looking for businesses that can combine quality and growth in less obvious places.

Obviously, most of what we review doesn't meet the very high bar for inclusion in the portfolio. But this process of reviewing all these different companies really sharpens our sense of genuine long-term opportunity seeking for us.

In terms of trading activity this quarter, we've held firm in several of these high-quality growth names that I was talking about, where we believe the opportunity is still very attractive. And we've also added selectively where share price weakness has allowed us to do so. At the same

time, we've also been proactive in upgrading the portfolio, reviewing companies that haven't been performing and reallocating capital to high-conviction ideas. We bought three new names, all in the financial space.

The first one is B3, the Brazilian Stocks and Derivatives Exchange. This is a capital-light, structural growing company that benefits from the deepening of Brazil's financial markets so, greater financial inclusion in Brazil. And the other two are banks, SEB in Sweden and United Overseas Bank or UOB in Singapore. Both are very high-quality franchises that combine discipline, capital allocation, with a very strong balance sheet and attractive opportunity for through-cycle growth.

In terms of sales, we sold to position FANUC, which is a Japanese automation business and Reliance Industries, which is a Indian conglomerate. In both these cases, these companies were facing competitive pressures that we believed were breaking the investment case. So, while it's been a difficult quarter from a performance standpoint, I would say it's been a very fertile one from an investment perspective. The volatility that we've seen has helped us actually strengthen the portfolio, and we continue to add what we see as resilience and growth with new ideas at good valuations.

**MH:** (13:18)

You mentioned this a couple of times, and it's something that we are all being bombarded with, and, that is AI. It's in all the headlines. We're being told we're going to be replaced by robots. How is the team thinking about it? How is the portfolio positioned to benefit? Or are we going back to the dot-com days? Is it a bubble?

**BF:** (13:41)

Yeah, well, that's the million-dollar question, isn't it, Martina? And you're right, AI continues to dominate the conversation in markets, and that's understandable. It's an incredibly transformative technology, and we're only starting to see the potential of it. But as investors, our task is to separate long-term structural opportunity and short-term excitement. We tend to think about AI in two layers. There is the infrastructure layer that enables it, and then the applications that will eventually harness it. And the infrastructure layer, which includes semiconductors, memory, physical technology that makes AI possible, has been where most of the enthusiasm has concentrated, at least in international markets, where you have players like TSMC, ASML, Samsung Electronics that we have exposure to that are absolute leaders in this area. They are global champions with technological leadership, scale advantage, balance sheet strength. And also, you know, I really want to spotlight Samsung as an example of a company that has required patience for the investment case to play out.

You know, a few quarters ago, it was really struggling because of some quality issues in its high bandwidth memory chips, but it has since recovered and its technological competitive advantage seems now clearer than ever. But there's the application layer, where we believe that a huge part of the opportunity lies that is still at an earlier stage. Many of the holdings in a portfolio, we believe, are beneficiaries of AI in this sense. Names like Spotify and Shopify. But they're at a much earlier stage of being recognised by the market as beneficiaries, we believe. And that's not unusual. In many technological revolutions before, from railways to shipping

containers, investors are known to first reward the infrastructure builders and then, only later recognise the value of the businesses that are built on top. But we are comfortable with that timeline. We're long-term investors, so that's what we do.

And then another important dimension in this AI debate is China. And that, as I mentioned, has seen this meaningful rebound in technology shares this quarter. That's because of optimism about regulatory reforms and policy support, but also a huge inflow of capital into technology and artificial intelligence. The broad rally in Chinese technology names has been very powerful, but as I said earlier, also indiscriminately, and we don't own every name that's worked. So, we don't own Alibaba, for example, but we're quite comfortable with our exposure to Chinese technology. Within the portfolio, Tencent and Tencent Music Entertainment are two of the names that we believe are really harnessing the entire theme, and they will continue to do so. You know, what's interesting about Tencent is that it's not only benefiting from this more stable regulatory environment, but it's also deploying AI to improve game production efficiency and also targeted advertising. And that's already starting to affect its financial structure, its margins and returns. We continue to view these two companies as capable of compounding value across multiple growth pillars for many years. So, we're really comfortable overall in our AI exposure there.

**MH:** (17:15)

We just had a question come in, and it was, what was the name of the Swedish bank? But that was SEB.

**BF:** (17:22)

Yes, that's correct, SEB.

**MH:** (17:27)

Okay, so thank you for the AI overview. I'm glad we're thinking about it as part of our overall portfolio because I don't think we can get away from it, that's for sure. Switching gears to outside of AI, what other investment opportunities would you say that are emerging? What are the key takeaways for our clients listening? What insights should they leverage as we look towards the end of 2025 and 2026 and beyond?

**BF:** (18:04)

Yeah, you're right. AI is really not the only game in town. And for us, opportunities emerge when everyone is looking in one direction and we have room to roam into different themes and attractive areas outside of this mainstream. So, you know, and there's attractive areas within these sub-areas as well. So, you know, I was talking about Chinese technology, and internet platforms have been doing really well, but there's an entire other aspect of Chinese technology that we find really attractive that might be a bit more unexplored. So, for example, one area is automation and robotics. We've had one analyst who was in China earlier this year on a research trip, and she visited a number of companies that are developing humanoid robots. And this looks like a field where China is scaling faster than everyone else.

What's striking here is not just the pace of innovation, but also the country's proven ability to drive down costs and industrialise new technologies quickly, from chip design to component integration to application to manufacturing. So that scaling advantage, which is backed by an increasingly self-sufficient domestic supply chain, that makes this wave of Chinese technological innovation structurally really important and also quite interesting for us.

Then another theme that we've been looking at that's, you know, you could see it as adjacent to AI is electrification. One of the least discussed, we believe, themes in what is enabling this boom in datacentre and AI as well. But it's not just datacentres, it's also electric vehicle, it's also power infrastructures. And so all of the components of the electrification supply chains are experiencing an increase in demand. And at the base of all of this is copper. Copper is seeing its demand increase sharply as the key material for electrification, but at the same time, the supply of copper is constrained and declining. In a twist of not quite International Alpha type of companies, we've been revisiting the mining universe to identify well-managed producers that are positioned to benefit from this supply-demand imbalance.

And again, here we're looking for companies with capital discipline, diversified assets, and strong governance. Those are really important, especially for miners. But in general, we see copper exposure as these picks and shovels way to participate to both growing electrification globally and then the build out of AI infrastructure. And then on a completely different tack, we're exploring plenty of what I would call unloved areas of the market. So, with economic uncertainty, especially around the consumer economy increasing, a lot of these consumer stocks have derated significantly. So, recently we had a beverage sprint, which is a day in which we discussed a bunch of spirits and beverage companies, and that highlighted several groups that combine resilient brands, steady cash generation, long-term premiumisation potential, even in what people would believe to be mature markets in the West and elsewhere.

In sectors where sentiment is fragile, there are now many quality franchises that we believe are a very attractive valuation. They are pricing in very, very little growth, and those could be attractive through cycle opportunities for us. So, while AI dominates the headlines, for us, the opportunity set is very broad and exciting. And, you know, for me, the takeaway that I would get from all this for clients is this is exactly the sort of market environment where it pays to be patient and selective.

So when quality of favour and valuations reset, patience and long-termism become competitive advantages.

**MH:** (22:34)

Linked to your positivity and finishing up on a Friday on a positive note, we've been encouraging clients to consider diversifying their portfolios globally and indeed reiterating clients' decisions to invest internationally. And if people aren't listening to us, the valuations are speaking for themselves. In fact, Beatrice, you focus on this in the paper that you wrote earlier this year. So, can you please reiterate why we are so excited about international equities?

**BF:** (23:12)

So, it really comes down to three things. International markets are cheaper, broader and more diversified than pretty much any other market. International markets are cheaper. That means that valuations are at a multi-year low relative to the US, and that gives investors access to high quality companies at very attractive prices. When I say broader, I mean that the opportunity set spans thousands of businesses and industries that don't really exist in US markets. I mean, the example of chips, logic chips and memory chips is one of the many ones. There's also luxury, different economic and industrial cycles that the U.S. market simply doesn't cover. And then finally, more diversified means there's exposure to different economic cycles, but also currencies and sources of innovation, which is especially valuable, I would say, as the U.S.

**BF:** (24:12)

market becomes more and more concentrated around one theme and this group of mega caps name. So, you know, in my very biased opinion, I think International markets are just a perfect hunting ground for long term active investors like us. It's fertile, is underexplored and is rich with mispriced opportunities.

**MH:** (24:36)

Thank you. Thank you for your insightful update and discussion on our International Alpha strategy. And thank you everybody for your participation today. We really appreciate it. As well as your dog, Beatrice, that was- Yes, sorry about that. As always, this is part of our webinar series. We do have additional sessions next week, which we would love for you to join us. If you do have feedback, please get in touch with your relationship manager. This is your update. Please make your suggestions and anything that you want us to cover next quarter.

**MH:** (25:11)

We hope to see you then, if not before. I wish you all a wonderful day and a weekend, a good weekend, whenever it comes. Thank you again. Thank you.

**BF:** (25:21)

Bye, Martina. Bye.

**MH:** (25:22)

Bye.

## International Alpha

### Annual past performance to September each year (%)

	2021	2022	2023	2024	2025
International Alpha Composite (gross)	16.1	-37.9	19.4	31.8	9.3
International Alpha Composite (net)	15.4	-38.3	18.7	31.0	8.6
MSCI ACWI ex US Index	24.4	-24.8	21.0	26.0	17.1

### Annualised returns to 30 September 2025 (%)

	1 year	5 years	10 years
International Alpha Composite (gross)	9.3	4.4	8.8
International Alpha Composite (net)	8.6	3.7	8.2
MSCI ACWI ex US Index	17.1	10.8	8.8

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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