

Portfolio Update

Claire Shaw, Portfolio Director

Q2 2024

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Claire Shaw (CS): Hello and welcome to this quarterly update from Scottish Mortgage. My name is Claire Shaw. I am the Portfolio Director for the Trust. The next ten minutes, we're going to talk you through our latest thinking on the portfolio, pulling out the key topics that are front of mind right now.

We are just past the halfway point of 2024, and right now, investors are navigating a complex macro backdrop, with really two key uncertainties being front and centre in people's minds. Firstly, the relentless speculation and column inches dedicated to if and when we will see interest rate cuts and to what extent, and secondly, the heightened geopolitical risk.

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There's a record number of people going to the polls this year. Half the world's population vote in 2024, the US election undoubtedly being one of the most critical. And so this relationship between policy decisions, economic pressures and market dynamics has more recently resulted in some heightened volatility.

But what really matters most are those structural and secular trends that are driving our economy, mega forces such as artificial intelligence, the energy transition, the digitalisation of commerce and finance, the advances in healthcare. All these transformational forces are unleashing massive investment in the economy, and we think that those investment opportunities transcend the macro backdrop.

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What we know is that these structural forces are powerful long-term trends. They won't necessarily move in straight lines. Slowdowns can and do happen. And, in a similar vein, the size, speed and impact of capital investment in the race to build out AI or the low carbon transition is also uncertain. But ultimately, we think these themes could transform economies and markets on a scale rarely seen in history.

And, that's what gives us grounds for optimism and why we're so excited about the portfolio of companies we have in Scottish Mortgage today, companies who are on the right side of these structural trends, the ones at the forefront of innovation and driving progress.

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So, we're not going to add to the noise around stock market concentration. The narrative is well-known. Momentum, crowding and concentration are now at multi-decade extremes. But Scottish Mortgage is a concentrated portfolio. You would expect that. We're long-term growth investors, and we're hunting for outliers. So the natural conclusion is a concentrated portfolio. And you can see that our top ten positions make up just over 50 per cent of the portfolio.

So, I think the point we want to make is that we are as concentrated, if not more concentrated, from the major indices, but we're concentrated in a different way. If you look at our top ten, yes, we have some of those US tech giants, NVIDIA, Amazon, Tesla, but also, we have exposures elsewhere in the world.

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If you go to China, we have Pinduoduo and Meituan, in emerging markets, MercadoLibre. In Europe, we have ASML and Ferrari, companies that have formidable competitive positions and continue to deliver and execute quarter after quarter, year after year.

Adding to our diversified top ten are some private companies. We have SpaceX, which is our largest private holding today. The progress that SpaceX continues to make is staggering, whether that's on the successful launch of Starship, the explosive growth in Starlink subscribers, as well as having a near monopoly now of the launch market.

So, I think you can see that our exposures are very different to the market. This isn't just about US big tech. Scottish Mortgage is about active concentration, where stock picking really matters.

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When you take a step back and consider what is the purpose of Scottish Mortgage, it's to identify, own and support the world's most exceptional growth companies, whether public or private. This is our North Star.

And when you look at the returns from the Scottish Mortgage portfolio over the past decade, they reveal a clear pattern. Yes, of course, we've made some mistakes that have resulted in losses in individual holdings, but, however, we've also made some very successful investments. And thankfully, the maximum we've been able to lose is 100 per cent, but the returns from winners has been many multiples of the initial investment. And it is this asymmetry which has been crucial for us.

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Why this matters is that in an environment that we're seeing today and the market conditions that we're witnessing, time in the market beats timing the market. And so if you look at our top five when we first held, NVIDIA we've owned since 2016, Tesla since 2013, ASML since 1996, Amazon, 2005, Ferrari, 2016.

Coming back to the narrative that it's a small number of companies that are driving stock market returns, this isn't us just jumping on the bandwagon. We have owned these companies for years, decades in some instances. But what makes us different is we identified the opportunity early, i.e. it was Amazon that was powering a revolution in retail from high streets to online, or Tesla helping the world transition from the internal combustion engine to electric cars.

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And, why this time in the market matters is you get to capture the benefits of compounding. By not tinkering around with position sizing and trying to time the market, you can see the quantum of returns that we've made for our shareholders.

But to deliver these large multiple returns at scale, companies either need to be tapping into or driving a significant structural change in the economy. And coming back to our introductory point, many of our companies are doing just this.

We spent a lot of last year conveying to our shareholders that the Scottish Mortgage portfolio has exposure to artificial intelligence right along the value chain, from the picks-and-shovels hardware businesses, through the infrastructure layer, down to the applications of AI in industry. And, this slide shows you this value chain in action and what players we have exposure to in each layer.

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And we think it should no longer be a surprise to investors that the rise of AI has been a primary contributor to market performance. It's clear that innovation is driving profits. And while the first leg of AI rally has mostly involved the chip designers, NVIDIA really, an increasing number of AI winners are emerging.

So I think the question that's on a lot of people's minds is what happens next? As the AI rally broadens to involve more companies, you want to look at the next layers. Who are those potential beneficiaries?

When we think about phase one, as I say, it's been chips or, should we say, NVIDIA. No other company has come close to reflecting AI enthusiasm the way NVIDIA has. The stock has returned more than 500 per cent since the beginning of 2023.

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But coming into that phase two layer, companies beyond NVIDIA that stand to benefit from the build-out of AI-related infrastructure include other players in the semiconductor industry, the hyperscalers, cloud providers, data centre REITs, to name a few.

And, for Scottish Mortgage, we have a range of companies in this phase. Take one of our new buys, TSMC, which is basically a diversified royalty on both compute and AI as one of the world's leading manufacturers of AI chips. We also have Meta, via Amazon, AWS, Snowflake, Databricks, Cloudflare, to name a few here.

Coming into phase three and phase four, where you have the AI-enabled revenue and AI productivity gains, these are companies that will be able to incorporate generative AI advances into their product offerings, whether that's software or IT service companies or companies that you can use AI to boost productivity, especially in sectors that have high labour costs, those in commercial or professional services firms.

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So, I think when you pull all this together, we still believe we're early in experiencing the impact of AI. And while that initial impact has been relatively concentrated to a few players, we believe this will gradually expand out within the layers. And our exposure to AI expands all three of those layers.

And, finally, a word on our private companies. As of the end of the second quarter, Scottish Mortgage had 25 per cent of the Trust in private companies. During the quarter, we had one IPO, Tempus AI, a company Scottish Mortgage has held privately since 2018.

And this question of IPOs has been a hot topic of conversation from our shareholders, with many posing the questions, when do we think the IPO window will open again? And whilst we wouldn't want to comment with any great conviction about this, we think that we are through the IPO winter. We are seeing those green shoots of recovery come through. And when market conditions do fully turn, we do believe the recovery will be meaningful, given the number of pent-up potential IPOs in the market.

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We think it is a mixture of both macro-related factors, interest rate cuts and clarity around the outcome of critical elections, as well as company-specific factors, the overall health and robustness of companies' profitability and cash generation, that will see us transition from an IPO drought, which has characterised much of the last two years, to the IPO window being fully open again.

So, thank you for listening to our quarterly update. To receive this video and other regular updates straight to your inbox, you can join our mailing list. So to do this, please follow the sign-up link on our website. Thank you very much.

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Scottish Mortgage Annual Past Performance To 30 June each year (net %)

2020	2021	2022	2023	2024
55.4	62.8	-46.1	-6.3	33.4

Source: Morningstar, share price, total return, sterling.
Past performance is not a guide to future returns.

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