MONKS INVESTMENT TRUST MANAGER INSIGHTS

In this manager update, Clients Department director, John Carnegie, and Spencer Adair, manager of the Monks Investment Trust, come together to discuss what the trust offers, review performance and answer those topical questions on shareholders' minds.

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John Carnegie (JC): Hello and welcome to a short conversation about the Monks Investment Trust to coincide with this year's annual general meeting. My name is John Carnegie, and I'm joined by Spencer Adair, who's recently been named as the manager of the Monks Investment Trust.

Spencer joined Baillie Gifford in 2000. He's worked on the Global Alpha Strategy, which manages the Monk's Investment Trust, since 2005 and he's been a deputy manager of the Monk's Investment Trust since 2015. Welcome, Spencer.

Spencer Adair (SA): Thank you, John.

JC: Spencer, the fact that you're a new manager may apply a different philosophy or process for the way that the trust is being managed. But can you tell us about how Monks Investment Trust is organized?

SA: Well, the short answer is we're not changing the philosophy. It's evergreen. So the core aims and philosophy of the trust – unchanged. The process, as in how we implement that philosophy, is always in a state of perpetual evolution and improvement.

So any changes there are tweaks and business as usual. Monks is and remains a trust that's laser focused on long-term capital appreciation. We scour all four corners of the world looking for businesses whose growth prospects are underappreciated. Monks is global and Monks is underappreciated growth.

The portfolio contains 120 stocks at any one time. [The number of holdings in equities typically ranges from 70 to 200. At the financial year end, the portfolio contained 127 equity holdings]. That's out of an opportunity set of several thousand. So we say (I say) no all the time to ideas. We only invest in businesses with clearly superior growth prospects.

And if you want to kind of put numbers on that, we say we're only going to invest where we see a greater than 30 per cent probability of doubling our shareholders funds in the next five years. So there's no guarantee, but that's what we're aiming for.

Monk's only backs the most ambitious companies. It's representative of some of the best ideas coming out of Baillie Gifford. Now we back those businesses with your capital and then let the management teams

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have the time and the space to execute on their ambitions. These growth plans often take five years to come to fruition, so patience is required and there will be ups and downs along the way. So Monks is long term, supportive and patient.

And then finally, from a philosophical perspective, we do believe in the value of diversification. The long term growth drivers behind the 120 different companies in the portfolio are well spread. We don't let any one stock dominate returns. We have a range of growth businesses, each at different stages of their life cycle (our growth cycle), and they're operating in very different geographies and industries. So Monks is well diversified.

JC: So it's good to hear there's no change to the philosophy or the process and the team is focused on constantly evolving in order to find those stocks that are going to at least double over the next five years and more.

SA: Absolutely. Sums it up perfectly, John.

JC: So, Spencer, the last 18 months have presented a very different environment for investing. I'm based in our Edinburgh office today. You're working from home. Can you talk about how the portfolio team has managed the trust in that more difficult environment?

SA: Yes. In a way, apart from the boredom of sitting in this room for the last 18 months and missing my colleagues, seeing [them] face to face, a lot of what we do has been uninterrupted.

So we're not managing Monks in order to trade pieces of paper every day. We're thinking about how the world evolves over the next five to 10 years, so that's quite a slow process. Lots of reading, lots of talking to interesting people. And sitting at this desk, using this camera on Zoom, the big benefit is that we've got fantastic access to company management teams, to regulators, to academics, to journalists. And we've been able to continue business very much as usual.

I think if we were a trust where you had to change your view every five minutes and you have to have a very up to date view on exactly where value lay for every single company and you were trading pieces of paper, it would be more difficult. But because of the great tech that we have and the philosophy that the team has introduced, it's been business as usual.

I can't wait to get back into the office and sit beside you, John. And I certainly hope this is the last AGM that we do virtually, and that next year we can take questions directly from the floor in some institution. I look forward to that.

JC: Well, I absolutely agree. And we are, at Baillie Gifford, slowly moving more colleagues back into the office, and hopefully that will accelerate over the next few months.

So, Spencer, as we've just referenced, we've lived through turbulent times over the last 15, 18 months. But the performance of the Monks Investment Trust has been strong through the financial year to the end of April 2021. And indeed, it's been solid for the last three months over the summer period to the end of July.

So maybe you could talk us through some of the highlights over that 15-month period from the beginning of May 2020 through to the end of July 2021?

SA: Sure John, can I be annoying and start with two caveats before I answer your question directly?

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The first is that 15 months ago, or the beginning of the last financial year for Monks, the market was pretty much at peak fear over Covid. So we have a very weak, or low, or flattering starting point. So please, shareholders don't think that the returns generated over the last 12 or 15 months are in any way indicative or representative of what you can expect every year for the long term. This is unusual.

The second caveat is that everything we do is focused on the long term. And I know this is an Annual General Meeting, and therefore I have to talk about the last period. But what really matters is how we're building your wealth over the next five years, or the next 10 years. We happened to have a great year, well 15 months. At some future AGM it won't be great, but what really matters is the long-term compounding of your wealth.

So I hope that that's clear. I can only make that second caveat in a good year. So apologies if I sound a little bit miserable for making it.

So let me start with some figures. The net asset value of Monks grew 55 per cent in its accounting year since the beginning of May 2020.

Now, if we extend that period up until the very latest point we have figures – over 15 months – Monks grew at NAV by 58 per cent. Now, both of those results I'm extremely happy with. Both are comfortably ahead of the average listed company growth of the world index.

Over those two time periods, the world index I think grew at 34 per cent and 38 per cent, respectively. So very short-term time horizons but crudely, we are 20 percentage points better than the market for over a 12 or 15-month period. Much better than I hoped for, certainly much better than I feared 15 months ago. But I derive much more pleasure, and I think there's much more signal in the long-term numbers.

Now since the beginning of May 15, so six years ago – and that's when the current team took over the managing of Monks within Baillie Gifford – the trust’s net asset value has grown by 184 per cent and the share price by 230 per cent. And those are both in contrast to an index up 108 per cent.

So if we translate those numbers into a real world example, if you had bought £10,000 worth of Monks shares at the beginning of 2015 and you had reinvested all the dividends, today they'd be worth £33,000. If you had put that money into a tracker fund, it would be worth £20,800.

So as you see over the last five or six years, we are really beginning to generate significant wealth for our clients, our shareholders, over the long term. Anyway, back to the noisy short term. I know that's what your question was.

I would like to highlight a few numbers, before we get to the performance ones, that I think are really relevant but don't get a huge amount of coverage in either the press or from journalists or from IFAs.

But I think they're important because it highlights what we're trying to achieve with the trust. Now the first thing I'm really proud of is our lack of dealing. Despite the world changing a lot and lots of turmoil, lots of headlines, lots of sensationalist pressures going on, the portfolio turnover at Monks was 16 per cent last year.

Now that implies we continued to take a five-year plus time horizon when assessing each stock. We were not buffeted into panicking. We didn't have any reactionary trading. So it was continued, careful, slow thought about the next five years and the turnover figures imply that that continued.

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Now the exact turnover figure will bob about every year, depending on individual ideas. I would expect it to remain at approximately 20 per cent on average, over the long term.

The second figure which I think gets a little bit lost is that the trust, its costs, and the trust issued just under 13 million shares in the 12 months in the year. And we issued those shares when we were trading at a premium to NAV.

Now this meant that more of your capital, shareholders capital, was captured by a lower tier of fees, and we put that fee scale in place in 2018. So we've been slightly preparing for this, although we didn't realize at the time that it would come quite so quickly.

Now that means that for you, our shareholders, our charges have dropped from 48 basis points last year to 43 basis points this year. And as the trust continues to grow over the long term, we would expect that fee proportion to continue to drop. We think we're already one of the lowest-cost global trusts in the UK and we've got a mechanism in place to drive those fees even lower.

Third number that doesn't get a lot of attention is that we didn't chase the markets higher. As the rebound happened in the shares, we allowed the gearing of the trust to fall. And today it's 0.8 per cent. This is unusual. We expect gearing to be modest but approximately 10 times higher than it is today. So we have a lot of dry powder to deploy. We are waiting for an opportunity in markets to become greedy. So at some point, a lot of fear will arise and we'll be ready to go.

So John, I've given you a lot of numbers there, and I haven't really directly got to your question about what worked and what hasn't worked in the last 12 months. Do you still want me to continue?

JC: Well, Spencer, let me throw at you three company names that have performed very well over the last 15 months. Two of them in fact are very well known, household names now. Tesla, the electric vehicle company, Moderna, which has been at the forefront of the vaccination effort during the pandemic, and the third one less well known, is Sea, which is a South East Asian ecommerce, gaming, and online payments company.

SA: So John, I think we should come clean here. You happen to have picked the three top performing stocks in the last 15 months. So I'm going to answer your question but what I'd love you to do is also pick a few things that haven't worked out as well, because that's too one-sided.

OK, let's put these in context and then I'll talk about the companies. Last 15 months, 58 per cent growth in net asset value and 1.5 per cent of that came from Tesla, the electric car company, as you say. What we've seen in the last 15 months is further confirmation that over the next decade, internal combustion engines, be they the petrol or particularly diesel, will be increasingly uncommon and will eventually be phased out in terms of new purchases and that the world is going electric. That may be hybrid initially and then fully electric but Tesla's view, and I happen to believe that, is that we will end up with full electric vehicles.

So we've had a number of countries around the world implementing change that supports that big move. We've also had the company building factories at lower cost and ahead of schedule, which is not always the case at Tesla. In three continents, in the US, China and Europe, we've had progress, although a little slower than I hoped, in terms of autonomous driving and being able to simply, safely get in your car and let it take you from A to B.

We're not sure exactly when all of that technology will be ready, but the long-term potential is that driving becomes materially safer when we let the computers do it, as opposed to let the humans do it. Of course, there will be high profile news stories every time an accident happens initially but, over the long run, we

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would expect autonomous driving to improve congestion, safety and a whole range of other things that are coming.

So Tesla's really made great strides in both the acceptance of its products, the execution in key markets, building up its factories, and then also developing the technology to get ready for autonomous driving.

If Tesla's 1.5 per cent of performance, Sea is also 1.5 per cent. This is a company that is growing very rapidly in South East Asia. It has the backing of Tencent, the Chinese social media giant. It's growing in gaming, so mobile phone gaming, simple gaming. It's growing in ecommerce. Very low levels of penetration but catching up extremely rapidly with the rest of the world.

And during the pandemic, I think we've all ordered more things online. But with Sea in South East Asia in particular, we think that that's a real structural move from a very low point to they're really gaining critical mass.

And then thirdly, developing digital financial products and payments. Still quite a long way to go there. But as the many hundreds, if not billions of people in their target geographies open up and we've had the mass adoption of smartphones, this is an early company providing those services to a whole range of new consumers. And we are both excited by the demographic growth drivers, the economic drivers and the technological drivers at Sea. So it's really opening up very, very rapidly and positively.

Your third one, John, was Moderna, was it?

JC: Yes.

SA: So as we probably all know, Moderna is one of the three companies that develops and got vaccines approved in the UK but also they're approved in many parts of Europe and in the US and increasingly in other geographies around the world.

Pretty remarkable for a business that's only, I think, 11 years old. They're up against AstraZeneca and Pfizer, who are much more established and well known. So Moderna has really come from nowhere to really accelerate.

It contributed about 1.2 per cent to performance. So a little less than Sea and Tesla. For us, there's of course the speed at which they developed the vaccine was a real validation of that technology. They told us they could do this, but until you see it, you’re always a little bit sceptical.

The exciting thing that we're trying to think through today is, what does this mean? And we've had a giant test case that you've had an acceleration of acceptance of the MRNA technology that Moderna have. The next point is, what do they do with the windfall? How do they invest the money they're making from the vaccine? And then also, what does that mean for health care broadly?

It's hard to underestimate how excited we are when thinking about that second question about where this can go to. We think this can be very material. We're still doing our due diligence and work, of course, as always. But it does strike us as one of the most exciting options that we have that's come across recently.

If I look at the top five performers in general, the other two would be 1 per cent from Trupanion, which is a pet insurance company, so provides cover against a big vet bill and 0.9 per cent from Farfetch, which is a luxury goods marketplace online.

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Just think about those top five: Tesla, Sea, Moderna Trupanion, and Farfetch. They are listed in the US, they operate in South East Asia, listed in Europe. So you've got an amazing diversity of end drivers here.

Everything from how much do you love your dog, to what your car is going to look like in the future, to how we're going to get and develop vaccines and other medicines, to how you might buy your loved one a luxury treat for his or her birthday.

It's an incredible representation of the diversity behind some of our growth drivers. And I did say at the beginning that Monks really does value diversification, here's the living proof of it. Also no one stock there's dominating.

So, you know, the most successful stock is one and a half per cent out of 58. Your eggs are well spread across a whole range of different companies. It's not just about one or two names really working in this.

JC: So, Spencer, you quite rightly said we should put a little bit of focus on some of the companies that have been performing less strongly. And here, unlike the top performers, there's a common theme. The top four biggest detractors for the portfolio are all Chinese.

So you've got Alibaba, you've got Naspers, which owns a big stake in Tencent, and you've got two of the Ping An companies, Ping An Insurance and Ping An Health Care and Technology. All of these are generating the vast proportion of the revenues from China.

SA: Yeah thanks, John. And the reason why I was quite keen to stretch out to 15 months rather than 12 was to capture the last few months where you've had this this weakness in China, because I think it's important and I think it's developing and I think it's worth highlighting to shareholders.

So, yes, Alibaba has cost you over the last 15 months 0.7 per cent. Ping An insurance, 0.6. Naspers, 0.5 and Ping An Health, 0.4. So, you know, between those four, I think it's about two percentage points detraction.

That's primarily come in the last few months and it's been a share price reaction to some of the tougher regulations that have been arising in a whole variety of different industries within China. Everything from education to social media and gaming. So a range of changes have been made.

It's probably too early to be definite about what's happening. So although I'm keen to highlight it I think it's worth bearing in mind that our thoughts are still being formed and still developing.

Back at the beginning of the year we wrote our Monks Research Agenda and one of the topics was companies, particularly technology companies, have to operate with the grain of society. And we actually called out China specifically as an area that's particularly important.

Now clearly, we didn't know exactly what was going to happen, but this isn't a total surprise to us because we actually expect a lot of the tech giants from Facebook and Amazon and others across the world to also have to be able to better answer the question, are you investing? Are you helping, investing along with the grain of society? This isn't a surprise.

We've also seen this before specifically within China. So we've had a series, we've been investing in China for many years, and we've had a series of these things that come along.

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So we are looking very closely at how the companies are reacting. Who's just getting on and doing it, making changes and who's being a little bit stroppy and digging their heels in. And that's a bad sign for us culturally. We do need alignment between the State and the company, if you're operating in China.

In terms of what the State are trying to do, an awful lot of sensationalist coverage saying that this is, you know, unacceptable and interference, et cetera. I would view what's happening in China as being quite healthy in the long term.

Clearly painful in the short term, but helpful in the long term, because they are trying to make – they're trying to rebalance – the power between you and me in the street, the person in the street, and these very, very large organisations and companies.

And they're trying to say, you know, you cannot make education so expensive that people can't afford it. You cannot be pinching the best teachers from schools. You cannot be trying to sell or get kids addicted to games if they're under 16. You can't allow them to gamble.

All of those rules that they're introducing make for a much more healthy and sustainable growth profile over many, many years. So although it's painful, my first reaction is this isn't daft, these regulations make sense, they make the companies more sustainable. And therefore, we should welcome what's happening and really try to think about these things on net present value term. We are losing a little bit this year, but we're going to gain a lot more in the subsequent years.

If I could pick you up on one thing though, John, and this may be controversial, I don't think China is our largest mistake. It's contributed 2 per cent underperformance in a very, very strong year. By far, my personal biggest mistake was not buying Moderna early enough.

We actually discussed it for inclusion in Monks at a share price of 25, and we didn't buy it until the share price was 70. And that period of doing more work, more due diligence, more digging, trying to verify their claims – that was the bit that we moved too slowly on.

What I should have done is bought a very small holding at 25, whenever we had the original thesis and excitement. And then we should have spent the time over the next few months, you know, double checking everything.

But my biggest mistake by far in terms of performance was not owning Moderna early enough when it became fairly obvious this tiny, young upstart of a biotech company had made a serious scientific breakthrough. I was too sceptical and we should have been faster.

JC: Well, thank you, Spencer. You've covered a lot of ground there. I might finish just by summarising those three points that you made earlier, which I think are very important ones to remember.

First is that we're very long-term investors for the Monks Investment Trust. So that low portfolio turnover, 16 per cent, the number you mentioned suggests we own stocks for at least five years. The longer we own those stocks, the greater chance we give them to generate the potential that we see in those stocks.

The second point was that Monks has low costs and therefore shareholders keep more of the returns that we're making and we're committed to trying to reduce those costs in the future.

And then the third point, which is important, is that the gearing has come down, but that gives us some dry powder. If we see opportunities in the stock market, we can regear the portfolio and then hope to take advantage of markets in the future.

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So I'd like to thank Spencer very much for his time. Baillie Gifford is very committed to the Monks Investment Trust, and we very much hope to see many of you at next year's Annual General Meeting.

If you need more information on Monks, please go to the website monksinvestmenttrust.co.uk. Thank you, Spencer.

SA: Thanks, John. Thanks a lot.

Important Information

Annual Discrete Performance to 30 June Each Year (%)

	2017	2018	2019	2020	2021
Monks Share Price	59.9	22.1	9.5	15.3	30.2
Monks NAV	35.6	17.7	9.7	17.0	37.2
FTSE World	22.9	9.4	10.4	5.8	25.5

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

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Monks 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.

Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Trust may issue new shares when the price is at a premium which will reduce the share price. Shares bought at a premium can therefore quickly lose value.

The trust invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.

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 investments fall in value, any invested borrowings will increase the amount of this loss.

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