UPFRONT: EPISODE TWO

Financial journalist Cherry Reynard, intermediary client manager David Rolland, investment specialist Claire Shaw and investment manager Gary Robinson discuss the current investment landscape, EV battery maker Northvolt, waves of innovation, and companies our US funds are excited about.

Capital is at risk. Past performance is not a guide to future returns.

This recording and stock story were produced and approved in June 2023 and have not been updated subsequently. They represent views held at the time and may not reflect current thinking.

Cherry Reynard (CR): Good morning. I'm Cherry Reynard, your host for Upfront, where we bring you the latest insights on Baillie Gifford's UK funds. Today I'll be speaking with investment manager and partner, Gary Robinson. At the end of our chat there'll be an opportunity to ask Gary your questions, so please do send them in by clicking the 'Ask a Question' tab on the right-hand side of your screen.

We also have director, investment specialist Claire Shaw, who'll be introducing the green battery manufacturer, Northvolt. They've successfully tested a lithium-ion cell capable of powering a lorry for 1.5 million kilometres. But first, I'm going to ask client manager David Rolland some of your burning questions. Welcome to Upfront.

[Intro sequence]

Welcome, David. Now you joined the UK Intermediaries team last year as a client manager, and having built up 12 years' experience working in the financial sector. And today you're here as the representative for your team, to talk about some of the topics that have been dropping into your inbox over the past few weeks.

David Rolland (DR): Morning, Cherry. As Megan mentioned on the previous episode, our clients are keen to hear from us a bit more. So, the purpose of the show is really just to answer some of the queries that have been coming into our investment teams.

CR: Okay, great. To kick off, I wonder if you could talk about how you feel the markets have been progressing so far this year?

DR: Whereas markets are broadly positive this year, I think some of the concerns that led to the sharp sell-off in 2022 are still lingering. Albeit, I think encouragingly, some of the more catastrophic potential scenarios appear to have been averted. Inflation appears to be falling globally. Central banks, with a few exceptions, have suggested that rates have peaked or at least are closer to peaking, but I think there's still recessionary concerns, and tensions between China and the US, which could cause some further short-term pain.

CR: How have the Baillie Gifford funds been performing in this environment?

DR: The majority of the funds this year, encouragingly, have picked up in 2023. If we take the American Fund as the obvious example, and you'll hear a bit more from Gary Robinson later on, about that in a bit more detail. But if you look at our UK strategies and most of our global funds, I think it's fair to say that the strong operational progress that we've been talking about for some time is now starting to come through and be reflected in share price terms.

Now, we can see this has not happened across the piece. If you take our Japanese strategies, they have not enjoyed participating in that uptick that we've seen in the Japanese market this year. That's really been led by some very large-cap companies, and also from the autos and financial sectors, of which we have very little exposure. In short, in Japan we have a bias further down the cap spectrum and these companies are yet to enjoy that upturn, despite some really exciting economic prospects, but we remain confident that they will.

CR: Okay, great. Now you mentioned the geopolitical tensions there, and obviously the US and China are still at loggerheads. That has prompted some concern that China may be uninvestable. What's your view on that?

DR: I think that's a fair question, given the backdrop of the last couple of years. But we think there's three macro drivers for that. You had zero-Covid, you had the regulatory clampdown and you've got the geopolitical issues that we talked about. We think two of those have now been resolved. The Chinese government have completely rolled back and dismantled zero-Covid, they've ended the regulatory clampdown and, most importantly, they've put forward actually quite a pro-growth or markedly pro-growth agenda, reiterating their support for wealth creation and the private sector. You've got to remember that 80 per cent of the jobs in China are actually in the private sector.

So, in terms of it being uninvestable, no, we think there's lots of compelling opportunities in China, it's just the environment is not one-dimensional. It just makes sense to have a heavy tilt in favour of those companies that are aligned with the Chinese government's policies.

So, as examples, we take Inovance. That's a company that's supporting China's manufacturing ambitions to be better at manufacturing in the fields of automation and robotics. Or you take SG Micro, so that's supporting a strategically important industry for China, in this case the production of semiconductors.

CR: Elsewhere there's been a lot of chat about the dreaded R-word, so recession, and certainly the environment still looks pretty challenging. What are Baillie Gifford's thoughts on that?

DR: I think that's fair again, recession is a word that's taking up a lot of column inches just now. The market thinks you need GDP growth, you need economic growth, to grow. Our view is that you don't, it's just one of many ways. Now don't get us wrong, expansionary growth led by GDP growth and general globalisation obviously helps, but it's not needed across the board in our view.

Just to take that a little bit further, there's a study that shows on the expansionary growth side, as wealth or GDP grows, people spend a disproportionate amount on luxury goods. So from 1997 to 2019, the luxury goods market grew twice that of global GDP. That makes it expansionary. It's just a function of more people with more income. And, of course, we've got exposures to companies that rely on that type of growth in our portfolios. We take examples as Kering or Hermès, two businesses that we've backed and invested in for well more than a decade.

But what if demand doesn't grow, but a company provides a new, better, cheaper way of supplying that existing demand? We would call that disruptive growth. As an example, take Chewy. They're an online pet shop, effectively, selling food, accessories, general pet stuff. Now if you have a pet, it's likely that pet's appetite is pretty stable. In my experience, the exception to the rule would be Labrador dogs. But if you have an online provider that can get that food to your door in a more convenient, cheaper way, that's going to be a lot better and less hassle for you [than] taking the time and going to the shop.

Or Dexcom. That's a company [that's] very close to my heart. My family have a long and intimate history with type 1 diabetes. Before Dexcom, the most efficient way of testing blood glucose levels was finger-prick testing. Which is, by the way, exactly how it sounds. You prick your finger, try to squeeze some blood out of it and then try to get that blood onto this tiny little test strip. And sometimes you'd be out and about, so you'd be out on a windy, rainy day. You get the picture. Dexcom transformed how diabetics get those live glucose readings by creating the technology for them to do so. There's 40 million diabetics in the United States, so we think there's a huge runway for growth.

CR: That's interesting. So if a company is disrupting existing demand patterns, it can grow even amid a crisis?

DR: Yes, that's certainly our contention. But there's other ways to grow too. Another example would be something we define as replacement growth. That's when a new type of demand surfaces and that forces innovators to create new supply and chase that new demand. An example might be our attitudes towards climate change. There's a noisy and visible demand for clean energy that simply didn't exist 20 years ago.

Or, our attitudes towards healthy lifestyles or just general sustainability. But if you take electric vehicles as that example, in 2012 there [were] 130,000 electric vehicles sold globally. You fast-forward to 2021 and it was almost that number every week, so totalling 6.5, 6.6 million vehicles sold in 2021. So you see that relatively predictable structural trend of growth. That only took EV's market share to 9 per cent, so there's a huge runway for growth from there.

In terms of our exposures, I think most obviously you have NIO in China and Tesla in the US. But also on the private company side, Northvolt, which is a company that design and manufacture batteries specifically for EVs. And that handily, Cherry, is our stock story for the day.

CR: Great, thank you so much for that update, David, and for joining us today.

DR: Thank you.

CR: Now, for those of you watching live, if you have any questions, our Q&A function is on the right-hand side of your screen, which you can access by clicking the 'Ask a Question' tab.

Now as part of each programme, we'll be featuring an in-depth look at some of the transformational companies Baillie Gifford invests in. Today we're learning about Northvolt, whose mission is to build the world's greenest battery with the smallest possible carbon footprint.

[Stock story transition]

Claire Shaw (CS): To drive the energy transition, we are going to need batteries – and lots of them. However, batteries are made from finite materials, and by 2030, 250,000 tons of battery packs could be reaching end-of-life in Europe every year. In order for batteries to be a viable, greener alternative to fossil fuels, battery materials need a recycling solution.

Northvolt is a company embarking on one of the most ambitious renewable energy projects of today – to create the world's greenest batteries. It is at the forefront of developing and producing sustainable lithium-ion batteries for electric vehicles, or EVs, that could efficiently recover battery-grade metals.

One factor that sets Northvolt apart from other battery manufacturers is its commitment to sustainability. Its batteries are manufactured using primarily renewable energy, with a mission to deliver batteries with an 80 per cent lower carbon footprint compared to those made using coal energy. It has also implemented a circular business model, which involves recycling and reusing batteries at the end of their lifespan. By doing this, Northvolt is reducing waste and creating a closed-loop system for its products.

Northvolt has formed exciting collaborations with some of Europe's leading automotive companies, including BMW, Volkswagen and Scania, to produce batteries for their EVs. We believe this commitment to working with industry leaders to drive innovation in the EV market gives Northvolt a strong chance of becoming Europe's regional champion.

By producing sustainable batteries in Europe, Northvolt is helping to reduce the continent's dependence on battery imports from Asia. This not only supports Europe's goal to become more self-sufficient in key industries, but also helps to reduce carbon emissions associated with transportation and production.

Job creation resulting from Northvolt's rapid growth could also help stimulate local economies and provide opportunities for individuals in the renewable energy sector. The company currently employs over 1,600 workers in its factory in Northern Sweden and aims to grow to 3,000 by 2025.

Northvolt's innovative approach to battery production may make it critical to meeting the growing demand for energy storage solutions.

CR: It's really interesting to see how the performance capability of green batteries for vehicles is improving. Northvolt has recently started a new programme, dedicated to developing aviation battery systems, so there's a potential to revolutionise air travel as well. All very exciting.

Now, to move on, we're joined by Gary Robinson for a fund update.

[Fund update transition]

So, welcome, Gary. Now you're a partner in the firm and a named manager on the American Fund and the US Growth Trust. Can you give us a brief reminder of the US strategies' approach?

Gary Robinson (GR): Yes. Well, the approach taken by both funds is to identify the exceptional growth companies in America and then hold on to them for the long term. And we do that in a relatively concentrated way. So, the American Fund invests in between 30-50 public stocks and then the US Growth Trust invests in a similar number of public stocks, but also can invest up to 50 per cent of its assets into private companies, too.

CR: Okay, great. David spoke a bit earlier about market progression this year, and the US market, in particular, has been pretty strong. Do you think this could be a positive sign that the outlook for the US is about to improve?

GR: Well, we have seen a very strong bounce in growth stocks year-to-date. I think that's quite interesting because it's come at a time when earnings estimates have still been under pressure and there's still a lot of talk and fear about a recession. So I think what that tells you is that there's already quite a lot of bad news in the price of stocks right now. But what matters most to us as long-term investors isn't what's going on with the stock prices in the short term, but rather what's happening with the fundamentals. And on that front, it's pretty encouraging, too.

A couple of things I would point to. One is that the companies in the portfolio are responding and adapting very well to the current environment and, two, they're continuing to execute really well against the big growth opportunities that they have ahead of them.

CR: And so what are you seeing companies in the portfolio doing to adapt to the current environment?

GR: I think one of the main things that we're seeing right now is a shift in emphasis from growth at all costs to a more balanced mix of growth and cost control. This is manifesting in the portfolio in a couple of different ways. One thing is just that the current environment's actually been quite good for some companies in the portfolio, because what we've seen in capital withdrawal from some industries, and that's created a more benign competitive landscape.

So, one example I would pull out on that is DoorDash, the local restaurant delivery company. During the height of the pandemic there was a lot of irrational competition in that sector. It was a time of abundant and cheap money, and there were lots of competitors around that probably didn't have a right to exist. And so, as that backdrop has changed, as the capital markets environment has become more difficult, we've seen that capital withdrawal, which has enabled DoorDash to really cement its position as a leader in that market.

Another example that I would pull out is there are a number of companies in the portfolio that are adapting to the current environment by becoming leaner and more focused. Shopify is a good example there. Shopify is a company that provides software to merchants, to enable them to run their businesses online. And, like most e-commerce businesses, Shopify over-invested during the pandemic and has spent the last 12-18 months trying to correct that and get fitter and more efficient.

One of the things that we saw with Shopify recently is that they've gotten out of their logistics, their delivery business, in order to really focus down on AI, which they think is absolutely critical for the future. And this is something that some people have criticised the company for, they see it as flip-flopping, but I see it as a company that's willing to change its mind and is willing to show conviction when the facts change.

CR: Obviously AI has been a huge topic of conversation. AI chip maker Nvidia has been one of the strongest performers in the portfolio, indeed in the whole market for the year to date. Can you explain a bit more about the company and how it's progressing?

GR: Yes. First of all, I think AI is going to have a profound impact on the economy, it's going to have a profound impact on the world. I actually think that it could end up having a bigger impact than the internet had. And Nvidia, we think, is going to be one of the prime beneficiaries and actually one of the key drivers of that change. You know, the way we've been thinking about AI is to really think about the AI stack, the value chain. What you've got is, at the bottom of the stack you've got the hardware providers like Nvidia, like the semiconductor capital equipment companies, and I think those stand to do pretty well.

Then above that layer you've got the data centres, the cloud companies that the large language models are running on, so the AWSs of the world, or the Azures of the world. Then above that, you've got the large language models themselves, so that would be OpenAI's GPT models or Google's Bard models. And those, I think, it's still early days and it remains to be seen whether the companies that are building those models will be able to forge a competitive advantage, or whether that layer of the stack is going to become commoditised.

Then right at the top you've got the application layer that sits above these large language models, and that's the most fluid and uncertain of them all right now. But where we're most confident in value accruing is in that bottom layer. And that's where Nvidia sits, it's in essence almost a provider of picks and shovels to the AI goldrush.

Now what Nvidia does is it's a chip maker, but it makes a special type of chip called the graphics processing unit, or GPU. And what's special about these chips is that they're able to do a massive number of calculations in parallel, and that's exactly what you need in order to train and run these large language models. And Nvidia is by far the leader in that market, so is really well-positioned to benefit.

One final point I just wanted to make on AI is that there seems to almost be a perception that this has come out of nowhere. It hasn't. We've been building up to this point for a very, very long time. AI stands on the shoulders of giants. And the technologies that have been needed to deliver these generative AI models have been developed over decades, going all the way back to the transistor, which sort of kicked off the current technological revolution. But what I think is so exciting about AI is it's got the potential to actually drive these technologies much broader across the economy and have a much bigger impact.

CR: And more philosophically, you've talked about these five waves of innovation. Can you talk about that in a bit more detail?

GR: Yes, so, I think it's interesting to study previous waves of innovation because it can give you a sense for where you sit in the current wave of innovation. There's actually an academic called Carlota Perez, who we've engaged with quite a lot, who's done a lot of work in this area. She studied patterns of innovation stretching back 250 years to the Industrial Revolution. And what she found was there's actually been five major waves of innovation over that 250-year period.

You had the Industrial Revolution, which was the first one. Then you had the age of steam and railways. Then you had the age of steel and electricity. Then you had the age of cars and mass manufacturing. And now we're in the IT revolution, which kicked off with the discovery of the transistor.

And what she found by studying these different waves was that they were all really quite similar, they all followed a similar pattern. They were all 50 years or even longer, so a really long duration, and they were split into two distinct phases.

The first phase, what she called the installation phase, was where the technologies of that particular revolution were deployed quite narrowly in the economy. What you had was a lot of capital chasing a small number of opportunities. So you had a lot of turbulence on the back of that, a lot of income inequality and social unrest. Then, when you shifted to the second phase, the technology started to spread more broadly across the economy, which led to a golden era for employment, and that was the deployment phase.

CR: Okay so now we're somewhere in between [one and two]?

GR: I think that's right. I think we're transitioning from that narrow installation phase to the much broader deployment phase.

CR: And how does that influence the way you're positioning your portfolio at the moment?

GR: We still have some installation era-type companies in the portfolio that we've held for a long time. Netflix would be one example and Amazon would be another example. Those companies, we're still excited about them, there's massive growth ahead of those businesses. But I think what's happened on the back of this broadening out of the current technological paradigm is that it's opened up a much broader range of opportunities for us to invest in as growth investors. And that's resulted in a portfolio which has exposure to more different kinds of structural growth.

For example, we own Tesla in the portfolio, which is helping to drive the auto industry from internal combustion engines to EVs. We own IT companies like Snowflake and Cloudflare in the portfolio, which are helping to drive this shift from on-premise into the cloud. We own innovative and disruptive companies in, for example, the healthcare sector, the specialty chemicals sector, the financial services sector.

CR: Okay, great, and just one final question before we move on to the Q&A. You mentioned private companies as a tool to benefit from emerging growth opportunities. What does that private companies exposure look like in the portfolio today?

GR: At the end of, I think May, we had 34 per cent of the fund invested into private companies and that was spread across 24 private company holdings. As I mentioned at the beginning, we can invest up to 50 per cent of the fund (US Growth Trust) in private companies, so we've still got quite a lot of headroom to either support our existing holdings as they need to raise more capital, or to invest in new private company opportunities, as and when they arise.

That 34 per cent is actually quite concentrated. Around about half of the 34 per cent that we have in private companies is in the top five private company holdings, so relatively concentrated. These are not two people in a garage in Paulo Alto-type companies, they're big, innovative, relatively mature, potentially generationally important companies that comprise that top five.

One name that I would pick out is a company called Stripe, which provides software to enable companies to integrate payment into their apps and websites. Before Stripe came along it was a nightmare to do that, it was really hard to accept payments globally, because the financial system is so complex. Every country has different banks, different credit cards, different credit card rails, different mobile wallets, different regulators, different regulations. And for a small business, trying to navigate that global landscape, it was pretty much impossible. And so what Stripe has done is it's built a software platform which sits above that financial system, integrates with it on behalf of its customers and abstracts away that complexity, so all a customer of Stripe needs to do is integrate into the platform with a few lines of code, and then they can accept and make payments anywhere in the world.

CR: Okay, great, And so, finally, it's time for our Q&A section.

[Your questions transition]

CR: We've had a few questions in from our audience. The first one is about private companies and how they're valued. Could you just give us your thoughts on that?

GR: Yes, so we have a robust private company valuation process. We have a private companies valuation team inside Ballie Gifford that's independent of the fund managers, that's staffed by qualified accountants. They collaborate with an external valuation provider called S&P Global, to revalue the private companies in the portfolio.

And that happens regularly, there aren't any stale valuations in this portfolio. We review each company in the portfolio at least once a quarter, but we also update valuations in response to trigger events. So, if there's been a major operational development, then we will revisit the valuation. Or if there's been a big move in the public market peer group, then we'll revisit the valuation.

Just to give you [a] more tangible sense, for that last year, every private company in the portfolio was revalued at least four times, and many companies in the portfolio were revalued even more [often] than that.

CR: Okay, and somebody just wanted confirmation that it's just the US Growth Trust that can hold private companies.

GR: Yes, just the US Growth Trust, the American Fund doesn't hold any private companies.

CR: Another question we've had in is about SpaceX, and why it might be more than just a moon shot. Obviously it is a moon shot, in a way, but…

GR: It's a Mars shot, and a moon shot.

CR: Talk about the investment case for that, if you could.

GR: SpaceX, it's completely disrupted the launch market. SpaceX last year accounted for something like two-thirds of all of the mass put into orbit, so it's taken massive share within the space launch market. And that's just remarkable to me because this is an industry where previously it was only really nation states that did that sort of thing. But SpaceX has come in as a private company and it's become dominant.

It's done that by really disrupting the industry with the new technology, it's made rockets reusable. The way that I would describe the impact that this has had to the space industry is if you think about the commercial aviation industry, if you were taking a flight from London to New York and then they scrapped the plane after you'd taken that flight once, imagine how expensive the tickets would be. That was the space industry before SpaceX came along. Now with SpaceX, rockets can be reused and that has dramatically lowered the cost. One of their Falcon rockets was just reused for the fifteenth time, and by bringing down the cost that's enabling SpaceX to go into new market opportunities that it wouldn't have been able to pursue otherwise.

The biggest one is a service it's building called Starlink, which is a constellation of low earth orbit satellites delivering high bandwidth, low latency broadband anywhere in the world. Now, we're a bit spoiled in the West because most of us have access to fast broadband, but there are a lot of people around the world who have either slow or no internet, and Starlink has got the potential to really help them out and change the lives of millions of people around the world.

CR: Okay, and then, another question on macroeconomic factors and the extent to which interest rates influence your decisions at company-level.

GR: I'd say from a longer-term perspective, we don't think the macro is the main thing which will influence outcome. We're investing in structural growth companies, and we're investing over the long term, so five years plus. And over that sort of time horizon, the thing that will matter most for outcomes for these companies is whether they're able to execute on those structural growth opportunities.

So, for an Amazon the most important question is, will a lot more commerce be done online and will Amazon be able to capture its fair share of that? Rather than, will interest rates be 2, 3, 4 or 5 per cent. It matters at the margin and it can impact the timing, but I don't think it impacts the ultimate outcome. The way we do think about the macro is in terms of resilience, this question of what if. What if things are harder for longer? And what we're looking for is to try…

The companies that we own, we own them all because we think they're going to be strong businesses in the long term, but we need to be cognisant that they have to face current conditions, as they exist today. And so, we look to analyse the resilience of businesses by looking at their profit and loss statements, analysing their balance sheets, and thinking about their cultures and their competitive advantages and how that feeds into the durability and adaptability of these businesses.

CR: All right, thank you so much for your time today, Gary. And thank you all for joining us. To find out more about the topics we've discussed on the programme, please do go to the website, **bailliegifford.com**. The team are here to help, so do get in touch if you have any questions.

We'll be back in August to hear more from the Intermediaries team and the Sustainable Growth team. So until next time, goodbye.

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Annual past performance to 31 March each year (%)

	2019	2020	2021	2022	2023
Baillie Gifford American Fund	26.6	10.8	105.1	-20.1	-29.1
Baillie Gifford US Growth Trust	23.1	11.4	117.0	-19.9	-42.3
S&P 500 Index	17.9	-2.2	40.5	21.2	-1.7
S&P 500 Index + 1.5%	19.6	-1.0	42.2	22.6	-0.2
Investment Association North America Sector	15.7	-4.0	42.4	16.1	-4.0

Source: FE, Revolution, Morningstar, S&P. Share price, net of fees, total return in sterling. American Fund is based on Class B Acc shares.

The American Fund aims to outperform (after deduction of costs) the S&P 500 Index, as stated in sterling, by at least 1.5% per annum over rolling five-year periods. The manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund is the Investment Association North America Sector. There is no guarantee that this objective will be achieved over any time period and actual investment returns may differ from this objective, particularly over shorter time periods.

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- The Fund's concentrated portfolio relative to similar funds may result in large movements in the share price in the short term.

- The Fund has exposure to a foreign currency and changes in the rate of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested.

- The Fund's share price can be volatile due to movements in the prices of the underlying holdings and the basis on which the Fund is priced.

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- The Trust 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.

- The Trust has a significant investment in private companies. The Trust's risk could be increased as these assets may be more difficult to buy or sell, so changes in their prices may be greater.

- 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.

- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.

- Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.

- The Trust's exposure to a single market and currency may increase risk.

A Key Information Document for the Trust is available at **bailliegifford.com**.

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