Baillie Gifford™

European Equities
Q1 investment update

April 2025

Investment manager Christopher Howarth and investment specialist Thomas Hodges give an update on the Europe ex UK and Pan Europe strategies covering Q1 2025.

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

Tom Hodges (TH): Welcome to this quarterly update video covering the European Equity Strategy. My name is Tom Hodges. I'm an Investment Specialist on the team. And today I'm joined once again by Christopher Howarth, an investment manager on the European team. And we're not exactly short of things to talk about this quarter, from tariffs, increasing defence spending, declining growth expectations for the US, Germany's abandonment of the Schwarze Null and embracement of what seems like a fiscal bazooka. It's certainly been eventful. And European equities have performed really strongly against this backdrop. And in particular, it's been the banks and defence companies which have led the charge to sectors or industries which are typically associated with the value style. So this continues growth's significant underperformance of value in Europe over the past few years, in stark contrast to other markets like the US. Now, in terms of our own performance, it might not be surprising that we don't have exposure to these two areas, banks and defence, and we have underperformed quite significantly as these two sectors have rallied exceptionally strongly in the past few months. So, I think, Christopher, it makes sense to start with this.

Christopher Howarth (CH): Yes, and this has been a challenging period in which to be a growth manager. It feels as if the tectonic plates of the global economy are shifting and sectors which haven't traditionally been considered to be growth categories, and that of course includes defence, are now not only outperforming, but look as if they could actually become growth sectors over the next decade. Now, this of course can be quite painful in the short term, but it does actually create a whole raft of new opportunities in the future. It might be that actually the defence rally that we've seen so far, which has, of course, so far been led primarily by expansions and multiples and the promise of future growth, it might be that that rally has been overblown. But actually, what's more interesting is the second and third order consequences. So, the supply chains, for example, raw materials - we've seen some movement in these sectors so far, but nothing of the sort that is commensurate with the scale of the spending that would potentially be taking place. So, it's safe to say that these are areas that we've been looking more at.

Banks, of course, are in another category. It's probably better to regard these as cyclicals rather than long-term growth opportunities and that's typically why we have stayed away from them in the past, partly also because they don't tend to be that good actual businesses. But of course, with rates remaining high and the possibility of lower capital requirements in the future, banks have outperformed significantly and this has hurt our relative performance to date.

TH: But if we take away from what we don't own in the portfolio, defence and banks, and to what we do own, when you actually look at the portfolio, we've had some promising signs as we've moved through results season.

CH: Yes. And in previous videos, we've also talked about the cyclical turnaround in some of the industries that we have exposure to in the portfolio. And we have been seeing encouraging signs from companies like Sartorius Stedim, which makes bioreactors, and IMCD, which is a chemicals distributor. Both companies have reported that their order books are starting to fill up. And we've also seen positive signs from Kingspan, which supplies to the construction industry.

And then on a separate note, we've also seen a very strong performance from Dino Polska, a Polish supermarket, which has really benefited as food deflation has come down and the competitive environment in Poland has become more favourable. So, that's been an encouraging cyclical story alongside the wider market turmoil.

TH: But in terms of the cyclical upswing across the portfolio, do tariffs pose any kind of risk to that?

CH: So tariffs have certainly been a key area of discussion over the past quarter and really since Trump's election. Now, while there's a lot of sound and fury around this area at the moment, a lot of the companies in the portfolio at the moment don't have a huge amount of tariff exposure. In the cases where they sell to the US, this is frequently done through localised production. So, that's Lonza, Novo Nordisk, Atlas Copco, for example. And then in other cases, they don't sell to America at all, for example, Dino Polska. So, in general, we don't see tariffs as being a major threat to businesses in the portfolio. But of course, the uncertainty around tariffs does hurt valuations generally.

TH: And in terms of portfolio activity, there's only one purchase to report on this quarter.

CH: That's right. So, we've taken a position in Edenred. This is a business that we've owned before and it has actually sold off quite significantly in the meantime and we're quite pleased to take a position again at what we believe is a very attractive valuation. Edenred administers employee benefit schemes, so meal vouchers effectively across a range of markets. So while it might sound like an unglamorous business, it's actually a very good sort of business to own through unstable times.

TH: But before we end, I think it's fair to say that the economic environment has its challenges and is shifting. And clients will want to hear about how we see things evolving going forward.

CH: So I think, as always, there's a difference between the short-term volatility and long-term returns. And I think at the moment, we're seeing a lot of uncertainty in the markets as we digest statements about tariffs, the high defence spending and all sorts of large-scale fiscal changes. But over the long term, we know that it's not the actions of politicians that determine returns, but it's actually individual companies with strong competitive advantages, high pricing power and strong returns on invested capital. And when we look at our portfolio, we're pleased to see that we have many businesses with very strong competitive advantages and returns on invested capital are higher than the market average. So, we are optimistic about the portfolio's potential through this period of volatility.

TH: So thank you for that, Christopher. And just to sum up, the strategy underperformed over what was quite a turbulent quarter, with significant optimism benefiting what would traditionally be viewed as value sectors like banks and defence, where we have very little exposure. But when we look to the portfolio in its current state, we see significant grounds for optimism. The trends which are benefiting the likes of banks and defence at the moment could broaden out and affect the portfolio positively and continue what we see as a growth acceleration across multiple different sectors in the portfolio. So, when we look at the portfolio today, we see a case for a growth acceleration, we see strong, adaptable and high return on capital businesses, which are valued quite attractively. So, we think that the portfolio has real potential for both that return in terms of growth return, but also a return from valuation going forward. And so, in that sense, we remain incredibly optimistic. Thank you for your time.

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European Equities (including Europe ex UK Equities and Pan European Equities strategies)

Annual past performance to 31 March each year (net%)

	2021	2022	2023	2024	2025
Europe ex UK Equities Composite	80.1	-19.4	-11.6	7.2	-7.6
MSCI Europe ex UK Index	49.5	1.4	2.9	16.0	5.6
Pan European Equities Composite	79.0	-20.1	-12.6	5.9	-6.7
MSCI Europe Index	45.7	4.1	2.0	14.8	7.5

Annualised returns to 31 March 2025 (net%)

	1 year	5 years	10 years
Europe ex UK Equities Composite	-7.6	4.9	5.1
MSCI Europe ex UK Index*	5.6	13.8	6.8
Pan European Equities Composite	-6.7	4.3	2.7
MSCI Europe Index	7.5	13.8	6.3

*FTSE World Europe ex UK prior to 31 December 2016.
Source: Revolution, MSCI, FTSE. 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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