Baillie Gifford™

Baillie Gifford Managed Fund Q2 investment update

July 2024

Investment manager Iain McCombie and investment specialist Lucy Haddow give an update on the Managed Fund covering Q2 2024.

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

Lucy Haddow (LH): Hello and welcome to this quarterly update on the Baillie Gifford Managed Fund. My name is Lucy Haddow, I'm an investment specialist on the fund and I'm joined today by Iain McCombie, a partner in the firm and co-manager of the Fund since 2012.

It's not been the easiest time for investors in the Managed Fund over the past few years. So the plan over the next 10 minutes, or so, is for us to provide you with an update on quarterly performance, talk through portfolio positioning, but also then give you that sense as to why we have optimism that the Fund can deliver long-term value creation.

As a reminder, the fund is invested in three asset classes. We have 75% in equities, 20% in bonds, and that balancing 5% in cash. And we have the ability to hold more or less in those asset classes depending on where our enthusiasms lie. And I've no doubt we'll get into that over the course of our conversation.

So, Iain, perhaps we can start with performance, please. What's been going on over the last quarter? And what's really been driving the volatility of the Fund that we've seen?

Iain McCombie (IM): OK, well, I think the first thing is we've had absolute positive performance, but we've underperformed the average fund. So, what's going on there? Well, I think the first thing is there's a macro backdrop. People have been talking about interest rate expectations and politics and so on. But in terms of interest rate expectations, it's been pushed back in terms of when we think interest rates will come down. Now, we're bottom-up investors. We're not predictors of that. But I think from a backdrop, that's probably a little bit unhelpful for us as growth investors in the short term. But I don't think in the long term that makes any difference.

I think another factor, Lucy, is what's been going on in the US. It's really striking that, in the second quarter of the year, just three stocks accounted for 90% of the S&P500's growth. Now, we own one of them, Nvidia, which is now the most valuable company in the world. But that's a really narrow market in some respects.

And staying on the US, we've also seen tremendous volatility. In fact, my colleagues were just saying they think it's probably the most volatile, in terms of individual stock share price performance, for a very, very long period of time. So, there's a number of funny things that are going on there.

But what's really positive, and I think this is a really important thing, Lucy, is the fundamentals are actually in pretty good shape in the portfolio. And that's the sort of thing that we're looking at, that we can see that the earnings growth is starting to come through and the opportunities for growth investing are as good as ever. So, I think that's very positive for us.

LH: And that focus on the fundamentals, it requires patience. It requires a long-term focus. I feel sometimes, when I'm talking to clients, that that can sometimes be misconstrued as inaction. So, can you talk a little bit through what that long-term patient approach means in practice?

IM: In one sense, we're unapologetic about the fact we have low portfolio turnover. And that means it's not that we're being lazy, it's just the fact we believe in the companies that we own. And it all comes back to the thing I'm sure people have heard before, that share prices follow fundamentals. And it's not just a kind of mantra. If you look at the data in any country, it backs that up. The fastest growing companies in the long term perform the best.

So, what we're trying to do as investors is find for you, in the Fund, the most attractive growth opportunities we think we can find. And then when you do find them, you want to own them for as long as you can and not get spooked out of them when you get that share price volatility, as inevitably you will get. But that's really what patience is about, backing your judgment and making sure that the portfolio is as good as it can be.

LH: As you say, we hold companies for the long term, but nonetheless, there is turnover within the portfolio, new buys, complete sales, additions and reductions. Could you talk a little bit about what we've been doing on that front over the last couple of months?

IM: In terms inaction, as you said, what are we doing there? I mean, we're always reviewing companies. And if we think the fundamentals have changed, then we'll do something about it. So, for example, we sold out of Adidas. I'm sure everybody knows that company. You know, it's had a tough period. We've seen some early signs of recovery, but we're not really sure about the long-term growth story there. So we took that opportunity of a bounce in the share price to exit that position. And that's what we should be doing. If it doesn't make sense, let's move on.

But equally, we're finding new opportunities to invest our capital. And I think one of the things, Lucy, that I find always exciting is it's not just a technology where you can find growth. So, for example, in the UK, a very parochial example, we took a new holding in a company called Shaftesbury Capital. Now, it's a property company. It's actually a product of a merger of two companies.

And what's exciting about it is it brings together the two premier portfolios in the West End of London. So this company now owns pretty much all of Covent Garden, it owns all of Carnaby Street, it owns pretty much all of Chinatown and some other little villages in that area. These are fantastic assets and what the team, who are predominantly from one of the teams, have done is, they've done a great job in making Covent Garden, and I'm sure, Lucy, you've been there at times in the last year or two. It's really busy. It's really buzzing. Great shops. Really interesting food and beverage. And, importantly for shareholders, high rents and growing rents.

Now, what they're looking at to do with this merger is to take over some brilliant assets, particularly things like Carnaby Street, which I think have certainly lost their way, and jazz them up, get new tenants in, make it a buzz, make it a go-to place again, which it used to be. And that's the potential for it. And that's not in the share price at the moment. The best thing of all, Lucy, for that, is you're getting all that potential with a 30% discount to net asset value. Now that is really attractive as a growth investor.

LH: So, we've got fantastic new companies coming into the portfolio. Continual review to make sure those that aren't stacking up are making their way out. But it's a difficult market backdrop, as you said. So, what has to change for fund performance to pick up? And perhaps the second question within that is why should clients believe us when we say that it will get better?

IM: Look, it's difficult for any of us to say what's going to cause performance to improve. If we knew that, that's the magic question. I can't give you that answer. But what I can say is that you try and look at the things you can control, which is what you own in your portfolio, and to be happy with the shape of the portfolio. And the way you do that is individual stock picking. But then looking at the aggregate data, what does it tell you in terms of that portfolio? And we're really excited about it, in the sense of we think you've got attractive growth, you've got better financial strengths, lower debt levels than the market, and the premium that you would expect to pay for that – and you would expect to pay a premium in the short term – has come down back to levels we saw 2018.

So, we had a bit of a boom, we've had a bit of a bust, but actually we think that's really attractive. In terms of valuations, I mean by that. That's really positioning us well for the future. I don't know when that will change. Now, it could be interest rates. I don't know. But the thing I would say is we don't know when that will change now it could be interest rates. I don't know. But the thing I would say is, we don't have to wait for interest rates to come down to say everything's happy. If interest rates stay where they are, we think the growth fundamentals in the portfolio will come through very nicely.

I think that's hopefully reassuring for people that you know if we stay where we are, in terms of the macro environment, we're fine. We're better than fine in fact. If things get better in terms of economic growth and interest rates come down, I suspect we'll be even better. But we're not betting on that scenario at the moment at all.

LH: So, what are you most excited about within the fund, either at an asset class level or indeed at an individual holding level?

IM: Well, I've already talked about Shaftsbury Capital, and I don't want to bore the listeners about that. But what I think actually is really interesting is the fund managers. We get together for the different regions on a quarterly basis, and we talk, and this helps us in our bottom-up asset allocation process. And what I think, Lucy, is really striking is the tough times that you've referenced. You know, some people listening to this might think, oh, everyone's going to be feeling pretty low or feeling pretty defensive. Actually, it's not like that at all. It's actually that people are doing what you would expect.

Now, I've been involved in Baillie Gifford for 30 years, and I've been involved in the fund for quite a long period of time, 20 plus, 25 plus years. All I'm seeing at the moment are the things you would expect people to be doing when you get a period of underperformance. You use that opportunity to improve the quality of your portfolio. Because the paradox actually is, when you have underperformed, you find great stocks that are underperforming and are being derated, and this is the time to start buying them. And that's what you're seeing in the portfolio.

So, some of the portfolio activity, and I'm sure people will be looking at what we have been buying. You're buying these stocks at much more attractive ratings than you'd have done two or three years ago. And yet the fundamentals of those companies are improving. And that's really exciting for me, because that means that we're being paid to take risks to outperform. That's what our job is about. And what I can reassure people who are listening is to that is we're doing that. We're finding those opportunities, and we think we can turn that to your advantage.

LH: And translating that into the asset allocation of the funds, we're overweight equities, so 79%, and then 19% bonds, 2% cash?

Yes, that's correct. And that's proof in the pudding. A great example of that bottom-up asset allocation. We're backing that enthusiasm of our equity investors in the fund.

LH: Brilliant. Well, I think that's a really enthusiastic and positive note on which to finish this update.

I hope that's given you a real sense of the optimism that we have about the future of the Baillie Gifford Managed Fund. It's a resilient portfolio. The companies are growing faster than those in the benchmark. And the cherry on top is that it's attractively valued at this point in time.

So, thank you very much for tuning in and please don't hesitate to get in touch should you have any further questions. Thank you.

Baillie Gifford Managed Fund

Annual past performance to 30 June each year (net %)

	2020	2021	2022	2023	2024
Baillie Gifford Managed Fund B Acc	16.1	26.9	-28.3	9.7	9.4
IA Mixed Investment 40%-85%	-0.0	17.2	-6.4	3.0	11.9

Source: FE, Revolution, net of fees, total return in sterling. Class B Acc Shares.

Past performance is not a guide to future returns.

The manager believes an appropriate comparison for this Fund is the Investment Association Mixed Investment 40-85% Shares Sector median given the investment policy of the Fund and the approach taken by the manager when investing.

Important information and risk factors

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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.

Further details of the risks associated with investing in the Fund can be found in the Key Investor Information Document or the Prospectus, copies of which are available at **bailliegifford.com**.

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