Baillie Gifford™

Global Alpha
Q3 investment update

October 2024

Investment manager Helen Xiong and investment specialist Ben Drury give an update on the Global Alpha, Responsible Global Alpha, Global Alpha Paris Aligned and Responsible Global Alpha Paris Aligned strategies covering Q3 2024.

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

Ben Drury (BD): Hello, and welcome to the library at Baillie Gifford, and welcome to the Global Alpha third quarter of 2024 manager update. My name is Ben Drury. I'm an investment specialist in the Global Alpha team, and I'm joined today by Helen Xiong, one of the three portfolio managers.

As a reminder, Global Alpha is a diversified global growth strategy of around about 85 companies and very much looking to invest in opportunities from right across the growth spectrum. We capture this diversity of opportunity and represent this diversity with reference to our three growth profiles: being compounders, disruptors and capital allocators.

If we open here today with a question around performance, so markets were up by about 6 per cent or so in US dollars, the portfolio very much in line with that performance at the overall index level, and, as always, a lot going on in markets. We saw some very significant volatility, particularly in Asian markets in August. We've seen the first long-awaited rate cut from the Fed in the US, and just at the end of the quarter some big stimulus being announced by the Chinese government.

Do you think any of this matters? And if not, what do you think is important for long-term investment returns that we should be talking about today?

Helen Xiong (HX): Yes, I think there's a lot of excitement around the rate cuts. But ultimately, I think a lot of those macro variables, which may correlate with stock markets over the short term, don't really matter over the long term. What really matters over the long term is delivered earnings growth. And so, you might ask me, well, do those macro variables matter for the delivered earnings growth? And I'd say, while for more mature companies, it may matter. For some of the cyclical companies, it may matter. But for a lot of the companies that we invest in, what really matters is the structural growth underpinning that. The structural forces tend to be a lot more important than some of the macro and the cyclical forces that we've seen.

An example would be Li Auto, which is the EV (electric vehicle) maker in China. In China, what we've seen is a weak consumer environment. So, auto unit volume sales are down. But within that, EV sales are up because EV is taking shares from the ICE (internal combustion engine) cars. And then within the EVs, Li Auto is taking market share. So, they have been growing volumes double digit despite the overall market, which is down.

And that's a very consistent pattern that we see across the portfolio. Whether it is companies like DoorDash in the US, whether it is MercadoLibre in South America, Pinduoduo in China or Coupang in South Korea. And I think what ties all of those companies together is really two things. One is the structural growth that we talked about. And secondly is really the operational excellence of those companies. It's just extreme focus on driving more efficiency, more value for consumers, rather than focusing on the competition or the macro variables.

BD: You mentioned there quite a diverse range of companies operating in different markets, in different industries around the world. And it's been one of, if not *the*, dominant theme in markets recently, has been one of really a focus on one single theme, that being AI. And one result of that is that the larger companies within the index, which are perceived as being some of the largest beneficiaries of this trend, have become much larger. We've seen index concentration increasing as a result and that being something of a headwind for a more diversified approach like ours.

How do you think about the role and value of diversification within the Global Alpha portfolio and whether that's likely to become more important, versus the environment we've seen over the last 18 months or so?

HX: I think in the last little while, diversification has not mattered. And to your point, it's been more of a penalty to be a diversified portfolio. But I think we have to recognize that we are in a very special moment in time, and this is not always going to last. I think particularly in the US, where we've seen a small number of companies accounting for a vast majority of the growth and the returns in the market because of the excitement around AI, I think some of that excitement is definitely warranted. We do think that AI is going to be a very important technology that is going to have profound changes on many different industries. But certainly as we move from the capex build-out phase of the AI, into some of the product implementations and then the real-world applications of AI, that's going to broaden out and a lot of other companies will benefit from that as well.

And that's what we're seeing at the moment. If you look at the earnings contribution, the forward earnings from the whole market, the contribution from the Mag-7 companies is diminishing fairly rapidly and the market will broaden out in the future. So, it's been narrow. We've been using that opportunity to buy some of the other companies that we think are perhaps being overlooked.

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BD: Could you give us some [recent] examples that illustrate that diversity?

HX: Sure, yes. So, I think one of the examples would be Dutch Bros, which is a drive-through coffee chain in the US. I think it's the fourth or the fifth most popular coffee chain in the US. Their customers skew young. And really, it's a multi-decade rollout story. But I think what's special about that one is that despite being a tiny fraction of the size of Starbucks, the unit economics at the store level is already better than Starbucks.

Another example would be Builders FirstSource, which is a buildings products distributor in the US. The buildings product market is incredibly fragmented in the U.S. There is a very long runway to consolidate the market, as well as move up the market into more prefabricated products.

BD: In terms of additional value-add products?

HX: Additional value-add products, yes.

BD: I think certainly Dutch Bros came from an investment trip that Calum, one of the analysts in the strategy, did earlier in the year. You yourself recently have been in California and London. Jacob, one of the other analysts, has been in Hong Kong. Can you give us an insight into the sorts of questions you were looking to try and build your understanding of the answers towards during those trips? The sort of companies you met, and so on?

HX: So, I think the purpose of my trip really, in addition to meeting and catching up with some of the exciting companies we were owning, was really trying to answer the ROI question in AI capex, which is: all of this tremendous amount of money has been spent on building data centres for AI. Is it actually going to generate meaningful ROI over time? And I won't bore you with all the details, but the short answer is yes.

But I certainly think one of the highlights from my trip this time was riding on a Waymo, which is the driverless taxis that Alphabet has. It's exactly the same experience as an Uber, but I think it's much, much better than an Uber. And it's quite exciting because I think we've been talking about autonomous driving for quite a long time now and it's quite nice to see that it's actually on the road and open to the public.

And I think, to sort of link it back into that ROI question, a lot of the lenses that people have been using in thinking about the ROI have been very narrow. They've been looking at, well, is it delivering revenue growth now, is it leading to cost reductions now? But I think Waymo is a very good example of a product, a real-world application, which is certainly not generating meaningful revenue at the moment, but you can really see the potential here if you can remove the driver from all of those trips. And what would I pay for if I didn't have to drive to work every day? So, I think the opportunities for AI to broaden out in the economy and deliver some of the applications that we can't imagine today is very exciting.

BD: And this is really driving at the sustainability of that capex spend and what we think is going to underpin the kind of long-term growth of that area and the exposure – therefore underpinning the earnings growth of the companies that provide that exposure within our portfolio, within our clients' portfolio.

HX: It is, yes.

BD: Well, thank you very much, Helen. I think if I was able to summarise the points that we've covered: I think the earnings growth being very strong within the portfolio and the value of that earnings growth in terms of underpinning attractive long-term returns; I think the diversity of the different sorts of companies providing that earnings growth within the portfolio and therefore the sustainability of those levels of earnings growth over the coming five-year period; and the value of getting out and meeting companies and really asking the questions that matter and focusing on what is really likely to continue to underpin that earnings growth over long periods of time.

So, thank you for joining us and we look forward to talking to you again next quarter.

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Global Alpha (including Global Alpha, Responsible Global Alpha, Global Alpha Paris Aligned and Responsible Global Alpha Paris Aligned strategies)

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

	2020	2021	2022	2023	2024
Global Alpha Composite	31.1	25.6	-35.2	15.5	30.4
MSCI ACWI Index	11.0	28.0	-20.3	21.4	32.3

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	10 years
Global Alpha Composite	30.4	9.9	9.6
MSCI ACWI Index	32.3	12.7	9.9

Source: Revolution, MSCI. 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.

Past performance is not a guide to future returns.

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