Baillie Gifford™

Global Alpha
Q1 investment update

April 2024

Investment manager Spencer Adair and investment specialist Ben Drury give an update on the Global Alpha Strategy covering Q1 2024.

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Ben Drury (BD): Hello, and welcome to the Baillie Gifford Global Alpha update for the first quarter of 2024. My name is Ben Drury. I'm an investment specialist within the team, and I'm joined today by Spencer Adair, one of the three portfolio managers for the strategy.

Hello, Spencer.

Spencer Adair (SA): Hi, Ben.

BD: How are you doing?

SA: Good. Thank you.

BD: Just as a brief reminder, the Global Alpha strategy is a global equities strategy that looks to exploit opportunities from right across the growth spectrum. And we capture this diversity of opportunity within the portfolio by reference to our three growth profiles, being compounders, disruptors, and capital allocators.

Spencer, if we start with the first question, let's start with performance. Markets have been in an optimistic mood over the quarter, rising by, if you're looking at US dollar terms, almost 10 per cent or so over the quarter, continuing a run that started towards the end of October last year. Over the quarter, the portfolio's kept pace with this, and indeed over that slightly longer period since markets first entered the more optimistic frame of mind, the portfolio's comfortably ahead.

If you look at the two stocks, which were the best performing in absolute share price terms, probably no prizes for guessing the first, Nvidia, and the second, Comfort Systems, a heating, ventilation, and air conditioning company. Is there anything that you would use to link those two?

What sort of environment would you say we were in that enables both of those two seemingly very disparate businesses to do well?

SA: So, on first glance, they appear quite different businesses, high-tech chips, and essentially people that install air conditioning electrical systems. I think what links them in the short term is that they're both benefiting from an AI-related capex boom. So, with lots of investment going into datacentres and AI, chips are one of the big shortages, and Nvidia chips are what everyone's seeking after. But also, the ability to actually physically build these buildings, to have the electrical engineers on site, to do the air conditioning, and that's led to Comfort Systems, who've been investing heavily for a long time in this area, being really nicely positioned. And they've had record order books, very strong inflows, people prepaying in order to book for their facility. So, both of those have really benefited there.

I think what we're trying to do in this whole area is, we're looking for management teams that are investing ahead of a change, and both Nvidia with the development of the GPU chips, and Comfort with their development and recruitment over the years, and the prefab model that they've got. They've created their own luck, both of these. So, we look for where can returns really inflect upwards? Where's their scarcity? And where might that scarcity meet future demand shock? And that's really happened here. So, both these companies, although they've done very well over a quarter, it's really been 10, 20 years of careful investment, pre-planning, doing unpopular things in order to get to this point, and they're now reaping their rewards.

BD: And I think actually that's a good highlighting of the sort of breadth of opportunity that we're finding within that AI capex boom. It's not just Nvidia, there's a whole range of other companies. I think also those characteristics you just talked about, of investing ahead of scarcity, that inflection in demand, that ability to scale up manufacturing, would apply to Novo Nordisk, one of the new purchases in the portfolio for the quarter.

SA: Novo's a stock which, its core business is treating diabetes. And there's really terrific financial characteristics of that core business. Return on equity, 70 per cent. This is a real royal family type, aristocratic kind of growth case. They discovered, though, that, in order to try to treat diabetes, one class of their drugs, the GLP1s, had a side effect of lots of weight loss, 15-to-20 per cent in obese patients. And what's fascinating today is that there is a real scarcity in treating obesity. So, there are about 800 million obese people in the world, closer to 900 million. And 1 million of those have been treated with GLP1s. They can't make these drugs fast enough to actually roll them out and treat.

That's exciting for us as growth investors, because it means there could be a decade, even 20 years of growth to come. And very few companies can fulfill that growth, because you're going to require tens of billions of dollars of capex to build the plant. So, we had one of our colleagues out in Denmark recently visiting, seeing the capex, seeing the plants. There are three countries in the world that are not supply constrained, Denmark being one of them. And in Denmark, between 7 and 9 per cent of obese patients are getting treated with GLP1s. If you kind of map that onto the rest of the world, that may mean a hundredfold increase in volumes, which is crazy. So, in order to do that, you have to have the drugs, you have to have them patented, you have to have all the trials done, and you have to have the manufacturing facility. So, Novo is sitting on several really interesting scarcity points that they're benefiting from.

The other thing is the utility. So currently, these drugs are primarily used in popular culture for slimming. People think they're just for weight loss. Actually, they reduce the risk of death from all cardiovascular events by 20 per cent. So you've got 20 per cent less chance of a stroke or a heart attack. You reduce your liver damage, you reduce your kidney damage. They may even be protective against Alzheimer's. There's a lot more studies being produced. And I think the stickiness of patients will be much higher when it's not just, ‘’do you want to slim down and feel better?’ It's going to be, ‘do you want to live longer? Do you want to lower your risk of really nasty diseases?’ So, I think actually the scarcity point, these guys are really sitting on an even bigger one once this extra data comes through.

BD: Thanks for that.

If we change gears slightly, we mentioned markets have been in ebulliant form recently and indeed touching all-time highs. In that context, how are you thinking about valuation? Where are you seeing pockets of opportunity of attractively valued companies and then thinking about valuation across the portfolio as a whole?

SA: So, a lot of the market has been moving ahead. It's been driven primarily by a small number of tech companies for the last 18 months. A lot of the world looks quite inexpensive and cheap. So, generally speaking, anything maybe healthcare related is really quite lowly valued. 10-year relative lows in valuation. Anything emerging market related, pretty lowly valued. So, the exciting thing for me is that over the almost 20 years we've been investing this way, we've typically paid 15-to-20 per cent premium to the market. And that's because our companies are better quality, higher inside ownership, better return on capital, that lowered balance sheet risk. But also because they're faster growth.

And for most of that 20-year period, growth has been roughly a third faster than the benchmark. So if the benchmark was growing 10, our companies would go 13. Now, in the last 6 to 12 months, there's the gap between our portfolio’s forecast earnings and the markets really opened up. And we're now growing over twice the market rate. So, has the market gone up? Yes. Are we able to find high quality, out-of-favour growth without paying a big premium? Absolutely. And indeed, the waterfront of areas that I can pick from are much broader today. So, although we started off with AI and those areas, it's a much, much broader range or menu of growth that I'm picking from today. And that's really exciting. So, I'm not really too concerned about aggregate levels of valuations.

BD: That's probably a nice segue into the final question. Just let's finish with some of the areas that you are particularly enthusiastic about. I'd reference the Research Agenda, which we produced recently. We've touched on two of the four topics, which were included within that being AI and capital cycles and the concept of scarcity. The other two would be healthcare and infrastructure. Do you want to just articulate briefly the enthusiasm for those two areas?

SA: Healthcare demand continues to build. And it's a function of fundamental progress in drugs and technology, but also aging populations. My mum, who's almost 90, consumes about 10 times the healthcare that I consume as someone in my late 40s. So, as we age, people consume a lot more healthcare. And that's a driver, which is just underwritten. And they've been very good places to invest for a long period of time. The exciting thing is that last year, 2023, healthcare had its worst year for 20 years. It wiped out at least a decade's worth of outperformance. And so, we're sitting today with lots of fear, lots of headwinds, people concerned over drug prices, people concerned over the impact, indeed, of Novo Nordisk GLP-1s on some areas, people concerned about hangover from the pandemic still. We're seeing actually signs that lots of that are clearing.

So we are out on the road, we're meeting companies. It's one of our priorities for research. But we're seeing lots of new drugs be approved, good technology coming through, balance sheets being strengthened. And so it wouldn't surprise me if we find another couple of healthcare names across the portfolio. We'll buy them because we like them, not because they fit the Research Agenda, but we're doing a lot of work there.

On the industrialisation piece, a lot of the really critical core infrastructure in the west was put in after the Second World War until maybe 1970. And so, you had this golden period of investment. It's now really old. It's beginning to fail. We had the concrete in the schools in the UK. It's across the US equally. You've got bridges and roads being a pretty bad shape. So, we have to invest just to catch up to where we should be. And then on top of that, you add reshoring, you add challenges to the grid, you add in trying to adapt to climate change. We think actually we're at the start of what some of our companies have called a really golden period. We think there's 5, 10 years of really strong demand growth to come. Many of these industries have been unglamorous, have been focusing down, consolidating their strength. And a little bit like we saw in AI, at some point there'll be a big boom in the world of AI. So we've got to be a big inflection point for growth of these companies. And we don't think that's priced in at all.

BD: Thank you.

That's a good place to finish. Thank you for watching. And we look forward to speaking to you again next quarter. Thank you.

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Global Alpha

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

	2020	2021	2022	2023	2024
Global Alpha Composite	-6.4	73.0	-11.4	-10.5	20.2
MSCI ACWI Index	-10.8	55.3	7.7	-7.0	23.8

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years
Global Alpha Composite	20.2	9.1	8.9
MSCI ACWI Index	23.8	11.5	9.2

Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

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