EUROPEAN GROWTH TRUST: MANAGER INSIGHTS

Investment manager Stephen Paice explains the European Growth Trust's objectives, with an update on the portfolio as well as reflections on recent events and reasons for optimism.

As with any investment, capital is at risk. Past performance is not a guide to future returns.

This communication was produced and approved in January 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

A Key Information Document for the Baillie Gifford European Growth Trust plc is available at bailliegifford.com

Stephen Paice: We've been managing European equity portfolios since 1985, becoming significant – and I hope influential – shareholders in some of Europe's best and most dynamic growth companies.

We've only managed this investment trust for three years, and in performance terms, we had a very good start, however, over the last financial year to September 2022, we've experienced – as managers and fellow shareholders – the worst period of performance we can ever remember.

Therefore, it's worth giving a reminder of what we are trying to achieve, some reflections on recent events, and finally an update on the portfolio and why we're becoming increasingly optimistic.

Objectives

Our investment style has undoubtedly been out of favour, however, we're not going to change this. We are looking for 30-60 exceptional companies, some of which will be unlisted, run by entrepreneurs and families whom we trust.

These companies typically grow faster than average, have low levels of debt, and the potential to at least double over a five-year period. We are not making short-term bets on energy prices or inflation.

We are looking for companies that, over the coming decades, have the potential to be much larger, and more profitable, than the market thinks. This means we are more interested in secular shifts in consumer behaviour, disruptive technologies, and cash-rich capital allocators.

Not all these investments will work out, however, by taking this long-term approach, it gives us the best chance of identifying a relatively small number of outliers that can create a lot of value for both society and our shareholders.

Reflections on the past year

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What I just outlined will sound quite appealing to like-minded investors, however the harsh reality is that over the past financial year, the company's net asset value fell by 40 per cent and because the discount also widened, its share price fell by 48 per cent.

This is just one year in isolation, however, when investors see numbers like this, the question normally asked is whether something has broken or changed with the original investment case, and if not, whether this is a good opportunity to buy in at a much lower valuation.

And for the Trust, we firmly believe it's the latter.

There have been some companies in the portfolio where growth has normalised after benefitting from covid-related tailwinds. These include food delivery companies like Delivery Hero and Just Eat Takeaway, online fashion marketplace Zalando, and online classifieds business Schibsted.

For most of the portfolio, however, we think that operational progress has been pretty good, and if anything, prospects for increasing market share and profitability have improved. Competition which has been funded by cheap and easy to access capital has also retrenched and become much more rational.

The main issue though has been the valuation reset we've seen, particularly for growth or long-duration companies. Higher and more persistent inflation has led to higher interest rates, and this has led to a much faster and greater correction in company valuation multiples than we expected.

Now it's incredibly difficult to know for sure what will happen over the next year or two, and while it doesn't drive our investment decisions, we think that it's more likely that inflation and interest rates will stabilise or fall from here.

Either way, we strongly believe that, over long periods of time, it's growth in cash flow and sensible capital allocation that will create the most value. And this is what we continue to focus on.

Portfolio

As always, it's important that we take advantage of dislocations between price and genuine value, so we've added to many of our existing holdings where we don't think the investment case has actually changed, but where the share prices are materially lower, in some cases by more than 60 per cent or 70 per cent.

And at the same time, we've been opportunistic and added some new names to the portfolio. Some of these we have followed and admired for a long time but valuations, which put us off in the past, have also now fallen sharply.

These include companies like Crispr Therapeutics, which is using a gene-editing platform to help cure diseases like sickle cell anaemia; Evotec, which provides services to drug companies who want to outsource some of their research; and Nexans, a French cable manufacturer whose products help build a more efficient and greener electricity grid. We also invested in McMakler, a private online real estate agent, taking our overall private company exposure to around 11 per cent of total assets.

Outlook

We appreciate how difficult it is for investors and shareholders in the current environment. Asset prices have fallen, there's a cost-of-living crisis and the economy is slowing. This doesn't mean it's a bad time to invest though.

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When your perception of the world and of the companies making it a better place, differs greatly from consensus, the probabilities of generating positive returns can be much higher.

Europe as a region is unloved, growth is out of favour, discounts on holding companies and investment trusts have widened, and the price we are paying to access innovation, and exceptionally smart management teams who can deploy capital at high rates of return, is now much lower.

It's not going to be any less volatile, but for those with a long-term mindset, the future looks a lot brighter.

Annual Past Performance to 31 December Each Year (Net %)

	2018	2019	2020	2021	2022
Baillie Gifford European Growth Trust	-15.2	16.9	64.8	4.2	-41.4

Source: Morningstar, FTSE. Share price, total return in sterling.

Past performance is not a guide to future returns.

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The specific risks associated with the Trust include:

- *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's risk could be increased by its investment in private companies. These assets may be more difficult to sell, so changes in their prices may be greater.*
- *The Trust's risk is increased as it holds fewer investments than a typical investment trust and the effect of this, together with its long term approach to investment, could result in large movements in the share price.*
- *Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.*
- *The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.*

- *The aim of the Trust is to achieve capital growth. You should not expect a significant, or steady, annual income from the Trust.*

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