Baillie Gifford™

# Sustainable Growth Q2 investment update

July 2024

Investment manager Kathrine Davidson and investment specialist Alasdair McHugh give an update on the Sustainable Growth Strategy covering Q2 2024.

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

**Alasdair McHugh (AM)**: Hello and welcome along to this update on the Sustainable Growth Strategy. As a reminder, we're looking to invest in businesses that are sustainable in both senses of the word, capable of delivering enduring growth as well as enduring good over time.

Now, our agenda for today, we're going to talk a little bit about the trips that the team have been making abroad to see companies in their own domain, whether those are existing holdings or prospective new holdings. But first, we want to say a little bit about performance and positioning over the past three months and in the year to date. I think last time we told you about the AI-fuelled rally that began in October of 2023, we talked about how that positive sentiment was beginning to broaden out from just the AI-focused stocks to those other areas of the market. Now, that hasn't continued into the second quarter of the year. What we've seen really is very strong results from a number of the big tech names. And that's really reasserted their dominance over the index.

So Katherine, I want to talk first about a question that a client asked me just a couple of days ago, if I can pose it to you. And that was simply, do we have the right portfolio for this current environment?

**Kathrine Davidson (KD)**: Nice to start with a softball one, I mean, the answer is clearly no, as you can see from the performance year to date. And we're not satisfied with that any more than the clients will be. As you said, it's a really difficult environment for active management. We've got the top 10 names in the index are now over 20 per cent of the weight, which is just huge opportunity cost if you were to match that. And the last time the index was that concentrated was I think a decade ago. So we get really difficult environment, but you know, no excuses. We've not been well positioned for it. I think the more important question and the one that we're asking on the desk is do we have the right portfolio for the future? And that's where we're much more confident. So we are very excited about the companies we own. We have a broad, diversified portfolio of really resilient companies that are exposed to a wide range of growth drivers. And that does include AI. So we still have our positions in NVIDIA. We've got our largest name now is TSMC, but also the hyper scalers, Alphabet and Amazon. And where we're actually seeing more opportunities is kind of further down the value chain at the so-called application layer. So companies that are using AI to make their core businesses better, to innovate, to strengthen their competitive edge. So names like Recruit. Its doing some interesting stuff, Shopify, Spotify, and that's where we think there's less appreciation of the power of AI at the moment.

**AM**: Okay, so probably fair to say then we're not going to strive to mimic the benchmark weights in those big tech names. Do you want to talk a little bit about how we are thinking about portfolio positioning, the changes you've been making lately?

**KD**: Yeah, sure. So we've actually been trimming our position in NVIDIA because it's been such a strong performer and reallocating that capital to some areas that we think have been unfairly beaten down due to short term concerns. So the likes of UnitedHealth, which is very sensitive to the US political cycle, or Cognex, which is a very cyclical business, but now starting to show some green shoots. We've also added two new names this quarter, again, with exposure to big structural megatrends, but beyond AI. So firstly, Raya Drogasil, a Brazilian pharmacy chain. And secondly, Epiroc, which is a European mining equipment company, was actually spun out of one of our other holdings, Atlas Copco, a few years back. And they make drilling rigs and other big heavy equipment for use in mines. It's exposed to the energy transition in two ways, really. Firstly, that we're going to need a lot more stuff out of the ground to build batteries and fuel the energy transition. So there will need to be more mining, but mining is currently a very carbon intensive and very dangerous business. And Epiroc helps mitigate both of those by developing electrified equipment and also more automation to help keep people out of those dangerous environments. And then a couple of sells as well. We moved on from Samsung SDI and perhaps more interestingly from Tesla, which has obviously been a long-standing holding. And I mean, I still think it's been one of the most powerful stocks, not only in a portfolio context of delivering a huge amount of value for clients, but in terms of driving the transition, Tesla's done more than any other company to drag its industry kicking and screaming into the future. But we have to be considering the future prospects rather than their legacy. And looking at this point, we are less convinced there's good returns to be made from here for our clients. In particular, the competitive intensity from the Chinese manufacturers is really picking up. I think you guys saw that on the ground this quarter.

**AM**: Yeah, well, I guess that's maybe a good point to move on to research activity over the last little while. I joined Toby on a trip to China, and we certainly saw pretty intense competition from very good quality EV manufacturers out in China. I think probably our main takeaway, though, is that there are a number of companies across a range of industries that are seeking that second act abroad, trying to sell very good quality products into Western markets. And with the support of the state and their Little Giants initiative. I think that's going to be a powerful thing and something we need to watch for right across the portfolio. Just before we went out east, you had gone west. You gave yourself a bit of a packing nightmare by starting in Florida and finishing in Canada. Do you want to talk a little bit about that trip and really what your key takeaways were?

**KD**: Yeah, I think I started at 30 degrees in Florida and ended in Quebec City at minus 10. So that was a bit of a nightmare with hand luggage, but whatever. Yeah, it was a really productive trip. I saw 24 companies in Florida, most of which were completely new names to BG and to the strategy. So that was largely about prospecting for new ideas, interesting things in diagnostics, trucking, fintech. Came back with lots of stuff for the team to work on. And then I went on to sunny Pittsburgh and spent an entire day with one of our relatively recent purchases, MSA, who you'll recall from previous videos. They are the world leader in firefighting equipment and hard hats. And I think the management team said, oh, we've never had anyone come and spend a whole day with us before. So they really rolled out the red carpet. I got to meet all of the management team, spend a lot of time with the incoming CEO. But I also got to go out to a couple of the factories and meet people on the factory floor. And that was really interesting for getting a bit more colour on the company's culture and its sense of mission, which is something that a lot of companies will write about. But it was really tangible talking to people. So I met quite a few employees who'd been there for 30, 40, 50 years. I think a couple of guys in their 90s who were coming up to their 70th anniversary of working for MSA. And are really kept there by the strength of the mission and the fact that what they are doing is important and it saves lives. Some second generation people whose kids had come to work in the same facility. And in an environment where blue collar labour is quite tight in the US, MSA have never had trouble hiring and their retention is really high, which is a genuine financial benefit to the business. Conscious of time. And then I finished up in Canada, seeing a few of our longstanding clients and visiting a thrift store chain we're looking at where I was also able to buy some warm jumpers.

**AM**: Yes, very convenient! So I think that really shows the importance of getting out and seeing companies on their own turf and shows just how deep our research is. And that's very much the start of the research process as well, right, so those insights come back to Edinburgh we do more work on those companies and we might see some of them in the portfolio in the near future. So I think we're going to talk about those trips in the quarterly letter, which will be across our clients' desks in the next little while. So we'll maybe leave it there. And I'll thank you for your time for coming along today. I'll thank our clients as well for listening in, and also for your patience and for your loyalty in what has continued to be a pretty difficult time. You know, the market has been driven by that AI theme. We have a range of themes in the portfolio. We think that's the appropriate thing for the next decade for your portfolio. We're willing to be out of sync with the market for a time for that to play out. But we do appreciate that that requires patience, from us, but also from you. So thank you for that. And we'll look forward to speaking to you again next quarter.

## Sustainable Growth

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

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|
| Sustainable Growth Composite | 29.7 | 53.4 | -45.2 | 12.7 | 8.5 |
| MSCI ACWI Index | 2.6 | 39.9 | -15.4 | 17.1 | 19.9 |

### Annualised returns to 30 June 2024 (net%)

| | 1 year | 5 years | 10 years | Since inception |
|---|---|---|---|---|
| Sustainable Growth Composite* | 8.5 | 5.9 | N/A | 10.2 |
| MSCI ACWI Index | 19.9 | 11.3 | N/A | 11.1 |

*Inception date: 31 December 2015.
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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