Baillie Gifford

Global Income Growth Q3 investment update

October 2024

Investment Analyst Lucy Browne and investment specialist Seb Petit give an update on the Global Income Growth and Responsible Global Equity Income strategies covering Q3 2024.

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

Seb Petit (SP): Hello, and welcome to this quarterly investment update on the Baillie Gifford Global Income Growth Strategies. I'm Seb Petit, an investment specialist, and I'm delighted to be joined today by investment analyst Lucy Browne. As a reminder, our strategy aims to invest in quality long-term compounders, companies which we expect to deliver attractive rates of growth of earnings and dividends, and which are truly resilient through the cycle.

Welcome, Lucy. After a first half of the year which was quite strong for global equity markets, the third quarter was a bit flat, and so was the return of our portfolios.

What is your high-level take on the quarter?

Lucy Browne (LB): I think focusing on the flat headline returns is a bit deceptive here because it masks what has been quite [a] significant volatility within the quarter. In early August there was a period of market turmoil triggered by Japan having its worst daily losses in almost 40 years. And we've also seen some of the air come out of the tech sector in late August as results, while quite strong in that sector, haven't quite lived up to very high growth expectations. Later in the quarter a U-turn by the Bank of Japan and then a higher than expected interest rate cut by the U.S. Federal Reserve has helped global equity markets recover a bit by the end of the quarter.

SP: Okay, so you allude to the sort of tech jitters in August and for once in a quarter not owning NVIDIA was a positive contribution to relative performance.

But beyond NVIDIA, what explains the portfolio returns this quarter?

LB: So our top contributors have been U.S. distributor Fastenal, which has had very strong results, and there's also hopes that in a lower interest rate environment that will be helpful for driving further growth. And then our Swiss asset manager Partners Group announced a major distribution agreement, which the market viewed very favourably. Then in late September we've also seen a rally in Chinese equities, which has been very helpful for performance, particularly with Midea and Anta Sports boosting performance.

In terms of the detractors, unusually this quarter we've seen Novo Nordisk go from a contributor to a detractor. That's despite continued strong revenue growth. But we think some investors are now taking profits after a very strong period of performance. In terms of other detractors, Edenred, the employee benefits company, continues to be plagued by worries about the French regulatory scrutiny of that business model. It's one that we're monitoring, but we think that the market is overly concerned and we continue to hold.

SP: Thank you.

In terms of transactions, I noticed that you sold out of the UK savings platform Hargreaves Lansdown. Can you tell us more about that?

LB: So shares of Hargreaves have been weak for about 18 months now for a variety of reasons. But the company attracted a private equity bid earlier in the year. And in the middle of summer, the board recommended that shareholders accept that offer. Given that it was a single bidder situation and there was a non-negligible risk that the deal would fall apart, we decided to divest before the deal ultimately closed.

SP: Thank you. So, you reinvested that money into CME Group. Can you tell us the rationale there?

LB: Yes, so CME Group is the world's largest derivatives marketplace. Clients can hedge and speculate pretty much every product from interest rates to weather to soybeans. And we think there's lots to like about that business. Attractions include that it's a natural monopoly with pricing power and that it benefits from increased use of derivatives by companies over time. It's really [about] long-term growth and an attractive model. In terms of why now, why did we decide to invest this year, shares have recently de-rated as the market worries about the impact of lower interest rates and also about a new entrant to the market. Having done some more due diligence on CME Group, we think that the market's concerns are overblown and that the recent de-rating was an opportunity to invest in a great business at a fair price.

SP: Thank you. So, [a] derivatives trading place, this is not our first stock exchange stock. What is so attractive about these businesses?

LB: That's right. We have now a small collection of these financial infrastructure names in the portfolio. All tend to be natural monopolies, so difficult for new entrants to dislodge. Often very cash-generative, resilient through cycles, and all benefiting from long-term enduring growth tailwinds. However, I would say it's not the case that this is just us making the same bet four times. There are common growth drivers, but each one has nuances to it. So, for example, Hong Kong [Stock] Exchange allows us to participate in increased financial transactions and trading between China and the rest of the world, whereas our Brazilian stock exchange B3 is more about increasing access to equity financing and investing in a market that's traditionally been dominated by local banks. In the case of CME Group and Deutsche Böerse, in addition to sort of drivers around increased financialization and use of derivatives, there's also the helpful tailwind of regulators in these markets really pushing for increased transparency and moving more volumes onto regulated and reputable exchanges.

SP: Thank you. Moving on to the team's activity, I noticed there was quite a lot of research trips in the last quarter. Can you tell us more about those?

LB: Yeah, so we've had a mix of people out at conferences, visiting clients at their sites and locations. And really, this is a mixture of visiting existing portfolio names and building conviction in those and our hunting for new ideas. Both James and Ross have spent several weeks in the US over the summer. And between them, [they] have seen a combined 40 to 50 companies. Just to give you a sense of how much time and effort is going into that exercise. And ultimately, I guess, our average holding period is about eight years. So we really think it's worth spending that time to get to know companies better and get access to their management teams.

SP: Thank you. So can you give us an example of a company you spend time on?

LB: Yeah, so one new idea that we've been working on this summer is Tractor Supply, which is one of the largest rural retail chains in the US.

Over the past four months, we've had several meetings and encounters with the company. Back in June, I had a dinner with the management team in New York. While Ross was out in the States, he did some proper on-the-ground due diligence visiting some of their stores. And the company has also given us access to the CEO in one-to-one meetings, including a recent conversation, which was all around his motivations and management style and trying to get a better understanding, ultimately, of what makes him tick. This is a business where we feel we've learned a lot more about it, our understanding's better, and it's a business that we really admire. However, for the time being, we still consider this [is] one where the valuation is quite challenging, doesn't leave a lot of room for error, and it's one where there's no action right now, we're just waiting for a better opportunity to invest for our clients.

SP: Thank you.

So now we're entering the fourth quarter. Equity markets are quite optimistic after the rate cuts [and] after the Chinese stimulus. What is your outlook for the rest of the year?

LB: So, we try not to take a strong view on macro matters. It's really difficult to forecast. And ultimately, I'd rather focus on what we feel we can do best, which is concentrating on the fundamentals and working more on building conviction in existing names and finding new ideas. However, what I would say is the past quarter and all the volatility that that has entailed has really, I think, shown the benefit of having a well-diversified, well-balanced portfolio.

SP: Thank you, Lucy, for this update. Three key messages for me. The first one is that headline returns, which were broadly flat, masked quite a lot of volatility. The second key message is that although turnover was quite low, there's a lot of research being done by the team. And the third message is that the spike in volatility in August shows again the importance of maintaining a well-diversified portfolio. Thank you, Lucy, for your time and thank you everyone for joining.

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Global Income Growth (including Global Income Growth and Responsible Global Equity Income strategies)

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

	2020	2021	2022	2023	2024
Global Income Growth Composite	14.2	23.6	-18.2	19.6	23.9
Responsible Global Equity Income Composite	14.6	24.0	-17.8	20.7	24.3
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	Since inception
Global Income Growth Composite	23.9	11.3	9.1	-
Responsible Global Equity Income Composite	24.3	11.9	-	13.5*
MSCI ACWI Index	32.3	12.7	9.9	14.0

*Inception date: 31 December 2018.
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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