BAILLIE GIFFORD | Long Term Global Growth

Reflections

Second Quarter 2021

For thousands of years, humankind has sought the elixir of youth.

In the fifth century, Herodotus conceived of a mythical spring that rolled back the years for anyone who bathed in its waters. More recently, sheep placenta facials, cryogenic chambers, snail secretion therapies and sensory deprivation tanks have all been cited as credible means of resisting ageing.

The quest has remained futile of course, but there may be lessons to learn from a handful of unusual organisms that show no signs of deterioration as they advance in years. The most interesting anti-ageing strategy probably comes from the humble sea urchin, able to maintain the length of its telomeres – the stretches of DNA found at both ends of each chromosome. In most organisms, telomeres tend to shorten with age. When they get too short, cell division stops completely, and the resulting cell depletion cripples the body's ability to renew muscle and immune system components. In this respect, sea urchins have established a way of arresting their ageing clocks. Their telomeres don't shorten, their cells never cease dividing and the elixir of youth pays out in spades.

Investment portfolios are, in their own way, living organisms and in LTGG we think we have something to learn from sea urchins. We have, over the past seventeen years, worked hard to keep the portfolio youthful and forward looking.

Early flushes of LTGG

To lend some context, it's worth reflecting on just how much the Long Term Global Growth portfolio has evolved over the years in order to maintain the length of its telomeres. During the early flushes of LTGG in 2004, we held a potpourri of western consumer growth champions: Wrigley, Walgreen and Canon. There was also a cohort of venerable European companies driving industrial led growth in China: Atlas Copco's air compressors and Sandvik's abrasion equipment underpinned the build out. A number of holdings were driven by newly minted Asian consumers: Porsche, Hermès etc. Then there was a Brazilian and Russian twist – and one that grew in the mid noughties, so that by the time we barrelled into the heavy chop of 2008, our holdings in the traditional resource companies such as Petrobras, CVRD, Gazprom and Lukoil were collectively around a fifth of the portfolio. As recently as a decade ago, a good chunk of Long Term Global Growth remained in these industrial propellants of globalisation – and although many of them seem anachronistic now, our clients enjoyed handsome pay-offs.

By that stage though, the Long Term Global Growth portfolio was morphing towards a new cohort of dominant players – those driving and benefiting from the rise of the mobile internet. Beyond Amazon, Alphabet and Apple, we held a new generation of companies largely located on the west coast of US and the east coast of China. The investment cases for Alphabet, Baidu, Tencent, Facebook and Alibaba were each unique. But they were built on the unifying premise that the mobile internet allied to a dollop of globalisation, would offer unprecedented reach and returns. The mobile internet platforms were indeed powerful drivers of return for our clients over the decade between 2010 and 2020 – and increasingly large holding sizes to boot. Two such holdings were approximate eight baggers, and others were trimmed off the ten percent limit on occasions. In fact, as recently as three years ago, this small handful of monoliths still represented around 40 per cent of LTGG.

During the first seventeen years of LTGG, many of the stocks mentioned above have reinforced our belief in the importance of outliers. Beyond the twelve five baggers, we've had a ten bagger, a fifteen bagger, a twenty-five bagger, a forty bagger, a seventy-five bagger and a ninety-five bagger. But the onus is on us to make sure that the portfolio retains its ability to deliver these extreme returns. Over the last three years, we've moved on from twelve holdings that no longer have the outlier potential that we seek, and we've bought seventeen new holdings that do.

On this basis, we have strong grounds for confidence that the Long Term Global Growth portfolio remains in the early flushes of youth. But it's worth elaborating further, touching on a handful of telomere extending aspects of our current thinking.

Embracing the unfamiliar

One of the most important cognitive elements, is our recognition that consumer patterns and attitudes are evolving increasingly rapidly and with ever greater amplitude. While the human needs for self-actualisation, esteem and belonging are innate and immutable, they are being expressed in new ways. Tastes are being shaped by social groups who are culturally similar but geographically distant. The lines between the physical and digital-self continue to blur.

This update is solely for the use of professional investors and should not be relied upon by any other person. It is not intended for use by retail clients. Past performance is not a guide to future returns.

To those in the throes of middle age, this can be discombobulating. I profess to unease when my daughter recently earned five pounds stacking logs – only to 'blow' this pocket money on a pair of virtual Gucci sneakers for her online Roblox character. But we need to be imaginative about the possible size of the market for virtual luxury in the long term and it's encouraging to observe that Kering is already on the front foot. It is also amply clear that the experienced Long Term Global Growth investors who predate Generations Y & Z, need the help of colleagues in understanding the mood and aspirations of a new cohort of conscious consumers. In this sense, the multigenerational and multicultural dynamic within the LTGG team (and indeed across the broader Baillie Gifford investment floor), has never seemed more important.

It was the younger members of the team who pushed us to be more imaginative on the true size of the opportunity for Beyond Meat. This holding's investment case is predicated firmly on the removal of the cow as a rather inefficient middle-man between the sun and the stomach. Some within the team see no reason why the opportunity for Beyond Meat shouldn't ultimately be larger than the $500bn market for traditional protein forms.

Meanwhile, it was our Shanghai-based colleagues who patiently educated us on the potential for our clients' new holding in Bilibili – the fastest growing mainstream entertainment portal for Chinese teenagers and young adults. Bilibili's range of video, gaming and anime comic content is formidable (and hugely under monetised) but the registration process for any budding Bilibili curator or commentator involves a test with one hundred multiple choice questions on topics including copyrights, commentary etiquette, platform neologism and – à la Mastermind – niche questions based on topics of the entrant's choosing. To western observers, this is bemusing because every successful social platform in the west is focused on reducing registration friction. But for Bilibili, the initiation ritual of the entrance exam cements the bond that users have with the platform, aligning them with the existing community to drive a stickier userbase and fewer trolls – a dynamic that is so easy for a cognitively narrow stock market to overlook.

Going with the grain of society

As many countries enjoy a relaxation of Covid restrictions, Mr Market is focused on short-term beneficiaries of 'the pleasure after the plague'. There are interesting parallels with the Roaring Twenties here, but to our minds, they extend beyond post-pandemic hedonism. Much of the new wealth created in the 1920s was patchily distributed and accompanied by a pervasive sense that the older generation had let down younger people. In 1920, John F. Carter, an irate 23-year-old wrote "the older generation had certainly pretty well ruined this world before passing it on to us. We have been forced to live in an atmosphere of 'tomorrow we die,' and so, naturally, we drank and were merry."

These words could just have easily come from a disenfranchised youngster today. The pandemic has exposed and accentuated pre-existing inequalities, leading those on the wrong side of the bargain to seek redress. In an LTGG context, we need to remain alert to these shifts – and to appreciate where they may act as tailwinds for the portfolio, because to our mind, a number of our clients' holdings are acting as democratising forces. Shopify is a good case in point. The platform's growth – comfortably in excess of 100 per cent per annum – is largely a function of its ability to level the playing field by lowering the costs of starting and scaling a business, reducing the barriers to entrepreneurship by means of affordable tools and online infrastructure. Shopify handles security, inventory management, shipping, electronic payment processing and a slew of other services that many small business owners may not be able to deal with themselves. Meanwhile, Shopify Capital offers short-term business funding in the form of merchant cash advances, routing around prohibitively expensive legacy banks and understanding trends in merchants' growth potential with ever increasing accuracy as the platform scales.

In a similar vein, some of the greatest Growth opportunities are materialising from the companies that are shifting humankind towards more sustainable ways of consuming by driving efficiencies and eliminating surplus. Pinduoduo's 'farm to table' platform is one example – cutting out huge waste in farm produce and short circuiting layers of infrastructure by matching Chinese food supply and demand through a group buying model. In a similar vein, Meituan is well on the way to developing China's primary 'Software as a Service' ecosystem for food distribution which we believe has a strong chance of replacing wasteful wet markets as the primary channel for transacting in produce. In the field of energy meanwhile, Tesla has begun a pioneering shift away from using cobalt within its batteries. Its lithium iron phosphate (LFP) technology (already used in flagship energy storage products) could underpin not just the automotive ambitions but also the ramp up of Tesla's grid-scale energy storage offering which will be key to accelerating the demise of dirty peaker plants.

Improving the research framework

In our quest for continuous improvement, we've also been reflecting on the Ten Question Stock Research framework. It has served LTGG very well for seventeen years and we see no reason for radical change. But as the world evolves, so should we. We've been pushing ourselves to think further about question five in particular. This question has morphed a bit over the years:

In 2004, Q5 read: "Why do your customers like you and why will they continue to like you?"

2015, we added: "Do you contribute to society?"

But, in a bid to continually improve, we have refined the societal element further to ask:

2021: "What societal considerations are most likely to prove material to the long-term growth of the company?"

It's a hard question because honing in on the materiality of any impact can't be achieved with bland generalisations, heuristic shortcuts or easy metrics. But the entrepreneurs that we back should be well suited to leading in areas such as supply chain transparency and labour rights. They should also be ahead of the game when it comes to environmental considerations and we are currently in the process of developing clearer expectations of portfolio holdings in terms of their emission disclosure levels and their Net Zero ambitions.

Winds of change: a strengthening regulatory breeze

We've never claimed any expertise in macroeconomic forecasting or political analysis. That remains the case. But we do need to remain alert to tectonic shifts in geopolitics and state capitalism. For most of the past century, geopolitical power has been intimately connected to fossil fuels. But the table stakes are shifting and as we look ahead, we recognise that the inputs of the next decade may well be different. The world's leading economic powers are more concerned with a secure supply of chips than oil. This dynamic has the potential to throw up some interesting new ideas and the Shanghai-based members of the Long Term Global Growth team have been travelling to meet the companies that might benefit. It also seems likely to reinforce the long-term opportunity for Veldhoven-based ASML which remains one of the most understated and least asked about holdings in the portfolio. But ASML's lithography machines remain key to underpinning the next generation of silicon chips. The lack of any real competitor suggests that further spats over chip technology might catalyse a belated appreciation of the extreme value and importance of ASML's technology

The pendulum is swinging back towards more state involvement in other areas too. With Alphabet, Amazon and Facebook facing growing regulatory oversight, the road ahead may be less long and profitable than was once the case and that's why this trio of holdings with a collective market cap of over $4trn now represents under 10 per cent of the portfolio – less than half the level three years ago. In the case of Alphabet we've moved on completely – concerned by the company's aloof lack of acceptance that some form of oversight might be appropriate. In recent months, the paring back of these positions has provided us with the funds to invest in some telomere-extending younger companies. Coupang, the Korean commerce platform, may ultimately be showing Amazon the way in terms of motivating and enfranchising its workers. The Trade Desk is emerging as a potential thorn in Google's side in the domain of online advertising as it looks to provide a more healthily transparent forum for the sale of online advertising inventory – an almost inestimably large opportunity.

We're keeping an eye on the evolving regulatory landscape in China as well. While the likes of Tencent, Alibaba, Meituan and Pinduoduo (whose user base has now overtaken Alibaba's) embody the Chinese dream for many local citizens, the central government is wary of these tall poppies garnering excessive influence. We've seen these platforms' wings being clipped of late, but this is not new and our updated scenario analysis suggests ample scope for outlier style returns, even if returns are capped by regulation to some degree.

Maintaining a strong subs bench

The next portfolio telomere stretcher relates to the subs bench. With aggregate earnings growth seven times faster than the index, the operational performance of our clients' portfolio incumbents remains extremely robust. But every holding needs to work hard to continue justifying its place so it's important that competition for capital remains intense. To that end, we remain pleased by the abundant flow of new ideas. Crises tend to encourage people and businesses to try new ways of doing things. The number of start-ups boomed in the Roaring Twenties and today, new business formation is once again surging as entrepreneurs seek to fill gaps in the market. Our ever extending lines of sight into the private markets remain extremely valuable as we seek to identify the next generation of potential outliers. One case in point is eHang, a manufacturer of electric passenger-grade autonomous aerial vehicles. Although the company is not quite investible for us yet, we need to familiarise ourselves with the investment case (and test out its aircraft) in preparation.

John and Linda, two members of the LTGG Team, cleared for take off in advance of a recent flight in an eHang electric urban transport pod.

We're also finding manifold opportunities in companies that are already listed. We've been discussing HeyTea which could overtake Starbucks in China – and Yatsen who take a unique approach to managing online influencers in the context as they look to build a new China-focused cosmetic brand. We've also been spending time with the management team of Full Truck Alliance (FTA), whose online platform matches truckers and shippers in China's desperately inefficient overland freight market. Elsewhere in the world, we've been exploring the blue sky for 10x Genomics whose single cell sequencing platform is unlocking more granular diagnostics and monitoring – a possible winner in the genomics application layer to complement Illumina's genomics infrastructure platform.

But despite this abundance of new ideas, we remain selective. Against a backdrop of global Covid-stimulus, there's a great deal of capital sloshing around. Parts of the market look rather frenzied so prudent and disciplined stock picking is crucial and we've refrained from investing in a number of quite well-developed new ideas (Airbnb, Docusign, Roblox and Snowflake for example) based on our inability to conceive of an outlier scenario from current valuations.

Relishing volatility

It's worth touching on a final telomere stretching element of LTGG that remains central to unlocking future upside: our ability to not merely tolerate, but to actively enjoy volatility. To put this in the context of the current portfolio holdings over the years, we've seen seventy separate instances of share price falls in excess of 30 per cent. Within this dataset, it should come as no surprise that the big winners have proved the most volatile[1]. Normality is a paved road, but few flowers grow on it.

In recent years, we've had fewer opportunities to enjoy the advantages that volatility affords the truly long-term investor following an uncharacteristically smooth period of returns. But it remains the case that short-term volatility is part and parcel of our approach. So, against a market backdrop that seems flighty once again, we remain alert to opportunities to top up positions on any short-term weakness.

Conclusion

Taken together, we strongly believe that these six ingredients form a powerful elixir – a portfolio of longevity and promising long-term upside. The proof of the pudding is that both revenue and earnings growth has never been faster for LTGG. The icing on that cake is that many of your holdings have massive latent pricing power and great potential returns to scale.

But we know it takes energy to maintain distinctiveness. To quote Jeff Bezos in his last Amazon letter to shareholders, "The world wants you to be typical – in a thousand ways. It pulls at you. Don't let it happen".

In the context of LTGG, we can assure you that we won't.

[1]The ten strongest performers that are currently held in the portfolio have collectively seen 35 individual falls of over 30 per cent.

Important information and risk factors

Annual past performance to 30 June each year

	2017	2018	2019	2020	2021
LTGG Composite Net (%)	34.9	37.6	0.1	56.4	61.7

Source: Baillie Gifford & Co. US Dollars.

Past performance is not a guide to future results. Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. All investment strategies have the potential for profit and loss.

Risk factors

The views expressed in this article are those of the authors and should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect personal opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

Any stock examples and images used in this article are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual examples will represent only a small part of the overall portfolio and are inserted purely to help illustrate our investment style.

This article contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated. The images used in this article are for illustrative purposes only.

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/ Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018 and is authorised by the Central Bank of Ireland.
Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018 and is authorised by the Central Bank of Ireland.
Through its MiFID passport, it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Similarly, it has established Baillie Gifford Investment Management (Europe) Limited (Amsterdam Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in The Netherlands. Baillie Gifford Investment Management (Europe) Limited also has a representative office in Zurich, Switzerland pursuant to Art. 58 of the Federal Act on Financial Institutions ("FinIA"). It does not constitute a branch and therefore does not have authority to commit Baillie Gifford Investment Management (Europe) Limited. It is the intention to ask for the authorisation by the Swiss Financial Market Supervisory Authority (FINMA) to maintain this representative office of a foreign asset manager of collective assets in Switzerland pursuant to the applicable transitional provisions of FinIA. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co.

Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 and a Type 2 licence from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at Suites 2713-2715, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. Telephone +852 3756 5700.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Important information and risk factors

Australia

This material is provided on the basis that you are a wholesale client as defined within s761G of the Corporations Act 2001 (Cth). Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth). It is exempt from the requirement to hold an Australian Financial Services License under the Corporations Act 2001 (Cth) in respect of these financial services provided to Australian wholesale clients. Baillie Gifford Overseas Limited is authorised and regulated by the Financial Conduct Authority under UK laws which differ from those applicable in Australia.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited (`BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755–1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This document is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Oman

Baillie Gifford Overseas Limited ('BGO') neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently, BGO is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. No authorization, licence or approval has been received from the Capital Market Authority of Oman or any other regulatory authority in Oman, to provide such advice or service within Oman. BGO does not solicit business in Oman and does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. The recipient of this document represents that it is a financial institution or a sophisticated investor (as described in Article 139 of the Executive Regulations of the Capital Market Law) and that its officers/employees have such experience in business and financial matters that they are capable of evaluating the merits and risks of investments.

Qatar

The materials contained herein are not intended to constitute an offer or provision of investment management, investment and advisory services or other financial services under the laws of Qatar. The services have not been and will not be authorised by the Qatar Financial Markets Authority, the Qatar Financial Centre Regulatory Authority or the Qatar Central Bank in accordance with their regulations or any other regulations in Qatar.

BAILLIE GIFFORD

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Copyright © Baillie Gifford & Co 2015.

CM15978 LTGG Q2 Commentary IC 0721
Ref: 53583 INS AR 0852