BAILLIE GIFFORD | Long Term Global Growth

Reflections

December 2022

Operational Growth Hurdles

2022 will likely be remembered as the year when inflation finally returned to many economies. Equity markets which have been battered for months by rising interest rates, regulatory overhaul in China, growing social unrest, war in Ukraine and broader geopolitical sabre-rattling, now endure fears of an impending global recession.

Given this stew of nasty macroeconomic headwinds, you may be wondering if the Long Term Global Growth (LTGG) Team should lower its expectations for the operational growth of the companies we invest in. If the rapacious fundamental progress of LTGG holdings during the past decade is now nothing more than a peculiarity for the history books, should we accustom ourselves to investing in single-digit growth companies given the new era of presumably lower growth?

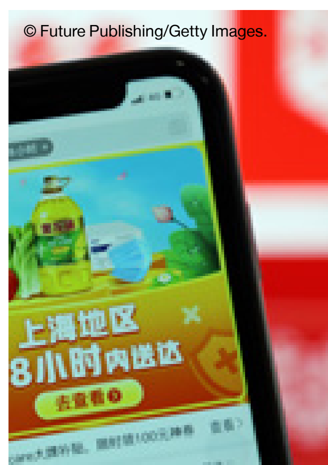
The argument makes intuitive sense. Business environments are indeed more challenging and so it follows that there are several cases of operational deceleration in the LTGG portfolio. Alibaba, whose revenues were growing at around 40% year-on-year in September 2019, posted just 3% growth in September 2022. Meta's year-on-year revenue growth plummeted from a healthy 35% last year to -4% in September 2022. Meanwhile, Illumina's revenue growth decreased from 40% in September 2021 to 1% by September 2022.

However, there is much more to this than first meets the eye.

1. *A large swathe of the LTGG portfolio is not in fact decelerating.* Hermès, whose compound annual revenue growth rate was a little over 11% during the decade to 2019, posted 29% in the first half of 2022. Tesla's revenue growth increased from nearly 40% in September 2020 to 56% in 2022. Recent results from Spotify, CATL, Adyen and Kering tell a similar story of post-pandemic acceleration. In fact, at the time of writing, 13 names in the portfolio (nearly 40% of the portfolio by weight) have either witnessed an acceleration in their revenue growth over the past two years to September 2022 or have (so far at least) staved off any notable deceleration.

2. *Comparators matter.* Several companies' operations were hit hard by temporary closures during the pandemic lockdowns of 2020. From such deep lows, it is unsurprising that holdings such as HDFC and Intuitive Surgical have since enjoyed a strong rebound in sales growth as the world has reopened and demand returned. Conversely, companies that generated record levels of growth during the pandemic, such as Moderna, Roblox and Shopify, have yet to fully lap their extraordinarily high Covid-era comparators. Some pandemic-related noise is still in the numbers.

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.



© Future Publishing/Getty Images.

©ImaginechinaLimited/AlamyStockPhoto.

3. *Growth slowdown ≠ slow growth.* By way of example, and despite slower growth than in recent years, Dexcom is still growing its year-on-year revenues by 18%, The Trade Desk by over 30%, and Pinduoduo by 50%. All things held equal, there are numerous other examples of companies still on track to at least double revenues over the next five years. For many LTGG companies, growth might be slower but is far from being slow.

4. *Slowing or negative real economic growth is not a reliable barometer for the growth of LTGG holdings.* Since the inception of the LTGG strategy in 2004, average rolling five-year revenue growth across the portfolio has more than doubled to circa 30%, whereas global GDP growth remains in low single digits. That said, companies whose growth comes from an expanding market may be relatively more exposed to changes in GDP growth. That's another demerit of today's maturing and slower growth holdings, such as Meta, Tencent and Alibaba. However, many LTGG holdings do not require a benign economic backdrop to succeed. For example, expansion of market share matters more than overall market expansion to the 'disruptors-of-the-disruptors' such as Pinduoduo and Shopify; in an environment where many businesses are in cost-saving mode, companies such as Adyen and The Trade Desk enable their customers to do more with less; and where geopolitics and/or onshoring spur more demand for local production, companies such as ASML and BioNTech stand to benefit.

5. *The portfolio is not static; it evolves as we forever seek out future growth.* Since 2020, we have recycled nearly half of the portfolio by weight into 17 new purchases. We redistributed nearly 16% of the portfolio from Tesla alone in 2020 and 2021. We have also trimmed Tencent twice this year as our conviction in its potential for compelling growth has weakened. Investment decisions such as these help to explain why long-standing holdings such as Tencent, Alibaba and Illumina no longer hold top spots in the portfolio – they have instead been overtaken by exciting newer arrivals such as Moderna, Pinduoduo and Adyen. We have also added to attractive growth names this year such as Spotify, Shopify, NIO, Atlassian and others.

Meanwhile, our new ideas pipeline remains as diverse and abundant as ever. In recent months we have for instance been researching opportunities in electric aircraft, Latin American e-commerce and fintech, solar energy, quick-service restaurants, data security, and cancer screening.

6. *Many deep multi-decade transformations simply outweigh periods of economic gloom.* LTGG holdings are pioneering or disproportionately benefitting from secular shifts. For instance, with each doubling of battery production, cost decreases by nearly 20%. CATL, which is presently growing revenues by over 200% year-on-year, is at the forefront of this phenomenon. Turning to genomics, Illumina has announced it can sequence a human genome for $200. That's a 50-fold cost reduction compared to just a decade ago, conferring advantages to companies such as Moderna and BioNTech. Further examples of transformations can be found **here.**

We do not therefore believe there is any scarcity of high-growth companies in the portfolio, nor do we believe that our growth hurdle needs to be lowered. At the time of writing, the average rolling five-year revenue growth in the portfolio is circa 30% p.a., earnings growth is circa 20% p.a., and free cash flow growth is over 30% p.a. Despite such robust operational performance, valuation multiples have deflated across the board. Indeed, holding all things equal, the LTGG price-to-earnings ratio in five years' time would be expected to drop to single digits. Is that a realistic price multiple for a collection of the world's leading growth companies? Even assuming very low exit multiples in our probability-adjusted scenarios for LTGG holdings, our analysis of their fundamentals still leads us to have confidence in their ability to generate multi-bagger returns over the coming five to ten years. We believe this is a rare and exciting opportunity to invest in the next generation of great growth companies.

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

	2018	2019	2020	2021	2022
LTGG Composite	-1.6	34.1	102.0	2.4	-46.4
MSCI ACWI	-8.9	27.3	16.8	19.0	-18.0

Annualised returns to 31 December 2022 (Net %)

	1 Year	5 Years	10 Years	Since Inception
LTGG Composite	-46.4	3.5	7.9	11.7
MSCI ACWI	-18.0	4.5	5.8	8.7

*Inception date 29 February 2004.

Source: Baillie Gifford & Co and MSCI. 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.

Important information and risk factors

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

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

Potential for Profit and Loss
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.

This communication 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 communication 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.

Financial Intermediaries
This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe
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. Baillie Gifford Investment Management (Europe) Limited is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. Baillie Gifford Investment Management (Europe) Limited is also authorised in accordance with Regulation 7 of the AIFM Regulations, to provide management of portfolios of investments, including Individual Portfolio Management ('IPM') and Non-Core Services. Baillie Gifford Investment Management (Europe) Limited has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. Through passporting 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'). The representative office is authorised by the Swiss Financial Market Supervisory Authority (FINMA). The representative office does not constitute a branch and therefore does not have authority to commit Baillie Gifford Investment Management (Europe) Limited. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

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 license 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

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a 'wholesale client' within the meaning of section 761G of the Corporations Act 2001 (Cth) ('Corporations Act'). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a 'retail client' within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

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 material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Legal Notice

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

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

Copyright © Baillie Gifford & Co 2022.

CO1442250 LTGG Monthly - Dec 22 0123
Ref: 29861 10017839