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LONG-TERM TALENT

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South Africa-born Gemma Barkhuizen and Robert Wilson, who comes from Northern Ireland, joined the Long Term Global Growth (LTGG) team as part of Baillie Gifford's graduate training programme. They are, respectively, postgraduates in history and philosophy, and were poised for careers in academia before our recruiters helped them change their minds and switch to investment. Here they share their experiences, talk about what's important to them, and give their view of LTGG's way of looking at the world.

GEMMA

How did you come to join the LTGG team?

I joined Baillie Gifford on the Investment Research Graduate Scheme just over two years ago. After studying at Rhodes University in South Africa, I completed a master's in modern history at Durham University. I had this romantic idea of a life dedicated to research and stimulating debate within a collegiate atmosphere and was set to do a PhD. But I found I was becoming increasingly frustrated with knowing more and more about less and less. Just as I was rethinking what I wanted to do with my life, Baillie Gifford's recruitment process was targeting university departments that wouldn't ordinarily produce asset managers. I responded out of curiosity and was pleasantly surprised to discover that the job was really about figuring out how the world works.

After spending a year on the European Equities team, I joined LTGG in September 2018. The idea behind the rotation of trainees is that you sample different investment styles and figure out what you like. LTGG has the kind of approach to investment that you either really like or you really don't. Happily, I found quite early that my fit with LTGG was just great and I was able to stay on.

ROBERT

You studied philosophy at Cambridge and Yale. Is there a link between philosophy and investment?

There is a similar process involved. What I liked about philosophy was finding a topic, reading a lot about it, writing about it, arguing about it and developing it. It's the same structure as I have now, so there's no big change.

Some topics within philosophy are immediately relevant to what we do here, like assessing what is the appropriate amount of empirical evidence needed before something becomes knowledge, how we can think about what is likely to happen, and what is the nature of explanation. I had thought a lot about these topics.

Interestingly, these issues do come up in my work. We do use a philosophical vocabulary. I'm so convinced about the relevance of philosophy that I've started a series of philosophy seminars, bringing philosophers into the office from Cambridge and Edinburgh universities. So far, we've had 20 or 30 people attending them to discuss the bedrock of how philosophers think of a subject, in the hope of embedding that language and analytical approach into what we do.

GEMMA

Can you give me an example of a stock you've brought to the portfolio and explain why you favoured it?

There's Peloton, a digital fitness company. It markets gym equipment, but also sells subscriptions for membership of an online library of digital fitness classes. It's like a Netflix for fitness, but of course the economics are much better: creating a few exercise classes compared to having to make an entire expensive TV series. What excites me about Peloton, and why I think it demonstrates the dynamics of the kind of growth outlier we are looking for, is that it's trying to disrupt an enormous and growing gym market, not just in the US, where it started, but now in the UK, Canada and Germany as well.

Fitness is a market that has remained stubbornly fragmented and immune to digital distribution. It has come up against the banal fact that people tend to go to the gym or the spin studio that happens to be nearest their office or home, a constraint that limits the addressable opportunity of any single fitness company. With Peloton, that's no longer true. If I'm using Peloton Digital, for example, I'm doing a fitness class with an instructor based in New York who is one of the best in the world. I would never have been able to get a class from that instructor, and he or she would never have been able to address a community of more than a million people, if it had been limited to a particular studio.

It's rational for Peloton to pay for the very best instructors because the company can spread those costs over a global subscriber base in a way that no other fitness company has been able to do. That's my hypothesis, to which I would add its first-mover advantage, the brand it has carefully built up and the motivation of the management team. All of these make me think it might be exceptional, not just another humdrum fitness company.

ROBERT

Tell us about your interest in gaming. How did it come about?

I had a PlayStation when I was six, and I've played games ever since. I can see a lot of change in the way I've played and in the role that games play in people's lives more generally.

Gaming interests me because it has compelling economics but also major challenges. It's a hard sector to analyse because it's so hit-or-miss. What puts off investors is that you can publish one great hit title and you can take 80–90 per cent margin and then the next game doesn't even earn back the cost of development.

Game companies are getting better at monetisation, but there are risks associated with that, for example, with the 'loot box' model. This is considered exploitative and is illegal in some parts of Europe, but it's the most common way in which games are monetised in Japan. In this model, games are free to play, but there's a gambling component within them. There's still a lot of experimentation with ways to make money out of gaming in different parts of the world.

Tencent is one of the most valuable companies in the world and a very large portion of its cash flow comes from intelligently monetised game content. You can already see how these are much more attractive businesses than they have been historically. The investment community hasn't really caught up with that yet, probably because it is still largely made up of older men who don't play video games. They're not necessarily picking up change.

GEMMA

There's been lots of negative press coverage about unlisted companies taking too much time to reach profitability. Does that matter?

The market tends to treat all currently unprofitable companies the same, without any regard to the strength or weakness of their underlying business models or to to the credibility of their path to profitability. These things matter profoundly. Frankly, it's just laziness. There are big differences between these companies.

Let's go back to Peloton, which listed on public markets towards the end of last year. This is a company that isn't yet profitable, but its accounting loss is a result of it spending more than a third of its revenues on sales and marketing, ploughing these revenues into customer acquisition. That's a worthwhile investment, because the return that it earns on each individual acquired is very high and it has a lot of scope to improve that because of the loyalty of its customers. Peloton has very low attrition rates, lower even than Spotify or Netflix, which are companies we love. It's even more remarkable considering the difficulty of remaining loyal to any fitness regime. Investors should not think of this spend as a loss, but rather as a worthwhile investment.

The market tends to punish companies for not being sufficiently short term, and not being able to hit a quarterly earnings target because they've been investing in a long-term opportunity. We like that. We think that's what they should be doing, but it's harder to do when you're a publicly listed company. It's important to think of the structure of the industry that the company is in and the defensibility of the earnings it's trying to create. The fact that a company isn't profitable today doesn't tell you anything about that. You need to dig deeper.

How does LTGG work with Baillie Gifford's Unlisted Equities team?

A bit of history might be helpful here. Peter Singlehurst, who heads the Unlisted team, started to look at more private companies while he was a member of the LTGG team. At that time, a growing number of companies were deciding to stay private for longer because they were able to access capital that was previously only available on public markets. The dedicated Unlisted Equities team was spun out of this effort. At the same time, Baillie Gifford's Scottish Mortgage Investment Trust was becoming more interested in unlisted companies and its managers, James Anderson and Tom Slater, are LTGG team members. So it is natural that researching private businesses is embedded in our way of thinking. The Unlisted Equities desk is right next to ours. Its team often comes to our stock discussions. We'll float ideas by them if we come across interesting private companies and they will flag up things about a company when they know it's going to be listing soon.

ROBERT

You recently returned from China. What were your impressions?

When you go to China and engage with companies, it becomes clear that the emerging-market-versus-developed-market distinction is not real. There are many ways in which Chinese companies and the Chinese economy are more sophisticated than those of Europe or the US. This is not a more developed economy in aggregate, but in areas such as mobile payment, social media and digital entertainment, China is moving quicker than the West.

The Chinese retail sector is probably more sophisticated. There's more use of data, and vending machines seem to sell almost everything. The categorisation into 'developed' and 'undeveloped' is a weird distinction. It's as if we in the West have achieved a steady state and they're going to converge towards us. The whole language around this just seems increasingly meaningless.

I don't think western investors have an easy time understanding how competitive the Chinese environment actually is. The culture of super-apps means the platforms compete on new products all the time, while smaller, disruptive firms at the margin battle it out in a way that makes Silicon Valley look pretty polite. The companies that survive have come through that environment and it shapes their cultures distinctively.

We sold the search engine Baidu because we were increasingly unconvinced by its ability to stay adaptable. Platforms like Toutiao and Douyin (TikTok outside of China) were springing up in terrain that was a little too close for comfort and hiring Baidu staff who were frustrated by its lack of experimentation. ByteDance, which owns Toutiao and Douyin, has since become an important competitor, and although still an unlisted business, we've been following it closely.

All of these businesses have distinct cultures. It's misleading to call Alibaba 'the Chinese Amazon', or to see ByteDance in terms of a Western counterpart.

How does LTGG work with Baillie Gifford's newly opened Shanghai research office?

There's a certain amount of physical exchange in that the people from the Shanghai and Edinburgh offices go back and forth. John MacDougall, our Shanghai-based partner and member of the LTGG team, comes back to Edinburgh frequently. Then there's also the fact that we share virtual meetings: Mark Urquhart, for example, has just published a note, and John is marked as 'in' the meeting, even though it was held in South Korea. In terms of our investment process, I would emphasise that little has changed, although our discussion slots are scheduled at nine in the morning which is four in the afternoon in China. We hold most of our discussions by Zoom teleconference – another stock we have discussed recently. The Shanghai-based investors are pretty much there with us in everything but a physical sense.

GEMMA

LTGG has just celebrated its 15th anniversary. What will it look like in 15 years' time?

If you look back at the initial LTGG portfolio 15 years ago, although the team was trying to do something different, rock-solid standard benchmark stocks were still well represented. Since then, the portfolio has incrementally changed and what we've ended up with bears very little resemblance to what we started off with, even though in theory it followed the same investment philosophy.

The pursuit of transformational growth and what we think might be the very best growth companies in the world has become increasingly extreme over time. If I had joined LTGG 15 years ago, I would have had a very different experience than now. I hope that if I am still working on LTGG in 15 years there will have been continuous pushing of the boundaries, moving further and further away from following industry practice and convention.

I don't know where that will take us, but one of the things that I think might prove to be very important for the strategy is the Shanghai office. This region is going to matter structurally. We need to get to know these Chinese companies and these consumers.

That might be one of the things that we'll look back on 15 years from now and think, 'Can you imagine that we used not to have a China office? How were we able to weed out all of the misperceptions of companies in that region?'

ROBERT

What do you find most enjoyable and rewarding about your job?

I like the stimulation. I struggle to imagine any other private sector work that is as interesting as what we do in terms of learning a lot about a lot of different things in the most expedient way. If, like me, you have an academic disposition, that's really rewarding, especially when the firm supports your research financially. You can go and do what you think is useful because we believe that this is of great value to us and our clients.

Autonomy is important as well, and that's an especially nice feature of LTGG. You get a lot of space to pursue anything you think is a good idea, though of course you can't just do what you want without any hope of it ever being useful. But, even if 80 per cent of it is not useful and 20 per cent is that 20 per cent makes the approach more valuable than it would be if it were more prescriptive.

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