Baillie Gifford US Growth Trust

Investing in the rapidly approaching future

Investment trusts
North America

15 September 2023

The managers of Baillie Gifford US Growth Trust (USA), Gary Robinson and Kirsty Gibson, aim to invest in exceptional US businesses with the potential to grow substantially faster than the market and deliver exceptional returns over the long term. Businesses capable of such growth tend to operate at the cutting edge of technology-led change, and USA has exposure to companies focused on artificial intelligence, space travel and drone delivery. The fluctuating fortunes of growth stocks over the past couple of years, combined with some de-rating of USA's unlisted holdings, mean that USA's performance has undershot market returns during the first five years since inception. Cumulative returns over the five years ended August 2023 totalled 49.1% in NAV terms, lagging the market return of 73.8%. However, the managers believe the 'phenomenal' fundamental performance of many portfolio holdings, combined with their very good growth prospects, augur well for the company's ability to realise its return target over the longer term.

NAV relative to benchmark over five years

Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

Analyst's view

- Investors may be drawn by USA's focus on high-quality, high-growth futuristic investments and by its long-term return ambitions.
- USA's private company holdings (comprising 30% of the portfolio) may appeal to those seeking exposure to the world's most innovative, dynamic businesses and the ideas of their visionary founders.
- Baillie Gifford's reputation as a long-term, patient investor in the US and in private companies gives USA's managers the ability to access exciting unlisted opportunities, arguably a significant competitive advantage.
- Viewed from a risk management perspective, an investment in USA can, arguably, be seen as offering investors insurance against a world that is changing far more quickly that traditional risk models acknowledge.
- USA's historically wide discount may offer investors the opportunity to gain exposure at a potentially attractive level.

Price		**156.8p**
Market cap		**£478.5m**
Total assets		**£621.1m**
NAV*		198.5p
Discount to NAV		21.0%
*Including income. At 12 September 2023		
Yield		0.0%
Shares in issue		305.2m
Code/ISIN		USA/GB00BDFGHW41
Primary exchange		LSE
AIC sector		North America
52-week high/low	181.4p	132.8p
NAV* high/low	218.1p	169.4p
*Including income		
Net cash (at 31 August 2023)		0.5%

Fund objective

Baillie Gifford US Growth Trust (USA) aims to produce long-term capital growth by investing predominantly in equities of companies that are incorporated, domiciled or conducting a significant portion of their business in the United States. The trust invests in both publicly listed and privately owned companies. Its benchmark is the S&P 500 TR Index (in sterling).

Bull points

- Offers exposure to companies at the cutting edge of technology, and those responding to social trends in innovative ways.
- Provides investors with otherwise hard to access unlisted companies.
- Competitive ongoing charges.

Bear points

- USA is relatively new, having been established in March 2018, and so needs more time to prove its investment thesis and realise its ambitious return target.
- Unlisted companies are currently under pressure and bring additional risk, although USA's private holdings are all late-stage investments, with a median valuation of more than US$2.0bn (as at end May 2023).
- Short-term performance may be subject to further volatility.

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Baillie Gifford US Growth Trust is a research client of Edison Investment Research Limited

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USA: Targeting companies with exceptional returns

USA's managers, Gary Robinson and Kirsty Gibson, aim to invest in exceptional US businesses that they believe have the potential to grow substantially faster than the market, with the objective of delivering above market returns. Specifically, they target stocks with the potential to grow returns by 2.5x or more over rolling five-year periods. The managers believe such businesses tend to operate at the cutting edge of technology-led change. To maximise their access to the best ideas and opportunities, regardless of ownership structure, the managers invest in what they view as high-quality publicly listed and private companies, which currently comprise 68% and 32% of portfolio holdings, respectively. Their intention is to retain their investments for long periods, to allow the businesses time to realise their full growth potential.

USA offers exposure to many exciting, disruptive trends

For Robinson and Gibson, the future feels closer than it has ever been before. Concepts that were once the stuff of science fiction – artificial intelligence, space travel and drone delivery – are now being developed and commercialised by companies that USA owns. And the pace of change wrought by these innovations is increasing, disrupting the status quo in many areas of life, and, according to the managers, offering the prospect of redressing longstanding inequalities in access to healthcare, education and financial services, as well as myriad new investment opportunities.

Much of this change will be powered by artificial intelligence (AI), and USA offers shareholders exposure to this mega-trend by its investment in companies such as NVIDIA, the world's leading provider of semiconductors for AI applications. This stock has been the focus of much attention and excitement over the past year, since the launch of ChatGPT, an AI-powered app that simulates human conversation, captured the world's imagination, but USA's managers spotted the company's potential and acquired exposure soon after the company's inception. NVIDIA has an 80–90% share of the market for the most advanced AI-specific semiconductors, where efficiency and speed are imperative, and Robinson and Gibson see further very significant upside for the stock, even as other tech majors scramble to compete in this important market.

However, AI is just one aspect of the structural change currently sweeping the globe. In the managers' view, every sector of the market is ripe for creative destruction. As one example, they cite the potential for further dramatic growth in e-commerce. Despite its popularity, and the boost received by the pandemic, only c 20% of retail activity globally is online. USA has exposure to this trend via its holdings of listed online retailers Amazon and Wayfair, Shopify, an e-commerce platform that helps retailers market their products online, and Stripe, an unlisted online payments provider with a faster and more efficient operating system than competitors. The automotive sector is also on the cusp of a major transformation. Within a couple of decades, all new cars are likely to be electric, and some will be autonomous. USA's position in Tesla, the world's leading electric vehicle (EV) manufacturer, as well as its position in NVIDIA, whose components are integral to EVs, give shareholders exposure to this inexorable trend.

With access to unlisted companies usually beyond the reach of retail investors

Unlisted companies are a key driving force behind such structural changes, as they tend to be the most innovative, dynamic businesses, often focused on products that may appear to cater to niche markets, but which in fact have enormous potential for exceptional growth over time, as structural change creates demand for new products and services. Baillie Gifford has a growing presence in private market investing, and its reputation as a large, patient investor, willing to give companies the time they need to realise their full potential, means that it is not unusual for the owners of unlisted businesses to seek out USA and other Baillie Gifford funds as investment partners. USA's managers believe this gives them a greater ability than competitors to access exciting opportunities, unavailable in public markets or to retail investors. Viewed from a risk management perspective, an investment in USA can, arguably, also be seen as offering investors insurance against a world that is changing far more quickly that traditional risk models acknowledge.

At end August 2023, USA had positions in 24 unlisted companies, including two in the company's top 10 holdings (Space X, Elon Musk's satellite and rocket company and Stripe, see Exhibit 4). This underlines the managers' point that USA's private holdings are not small-scale businesses with uncertain futures. On the contrary, USA's private holdings are all late-stage investments, seven or eight years into their development, with what the managers claim to be proven business offerings. The estimated median valuation of the trust's private company holdings stood at more than US$2.0bn at end May 2023. All are expected to launch on public markets in due course, once their development is sufficiently advanced and market conditions are conducive.

De-rating of private companies has hurt returns in recent years

USA was launched in March 2018. The rapid technological advances seen during the pandemic boosted many of the company's holdings, and returns were very strong over the following three years, and well in excess of US stock markets. However, performance has disappointed more recently, such that over the five-year period to end August 2023, cumulative returns totalled 49.1% in NAV terms and 15.1% on a share price basis, lagging the market return of 73.8%. This underperformance is in part attributable to a significant loss and marked underperformance sustained in the financial year ended July 2022, when growth stocks, especially those in the United States, were severely de-rated (see Edison's last report for details), although the performance over the year ended 31 August 2023 continued to lag the market. USA declined by 4.6% in NAV terms and by 7.6% on a share price basis over this period, compared to a benchmark return of +6.5%. While its holdings in listed companies generally did well over the 12 months, as a selection of large tech stocks returned to favour, the aggressive interest rate increases of the past 18 months have pushed up the discount rates used to value many smaller, long-duration growth companies. This has eroded the valuations of USA's unlisted company holdings, especially those that are not yet profitable, and those with high financing costs (see the Performance section for details).

But operating performance of underlying holdings has been 'phenomenal'

Having asked investors to judge them on their long-term performance, USA's managers are understandably disappointed by these figures, which sparked a re-evaluation of their investment strategy and all portfolio holdings. However, this process only served to strengthen their conviction in the long-term appeal of USA's investment strategy. This confidence is based on the fact that the company's underlying investments in both listed and unlisted companies are performing well at an operational level. In fact, in their view, the fundamental progress of many of USA's portfolio holdings has been 'phenomenal'. For example, Shopify, one of USA's top holdings, has seen its revenues triple to $3bn over the past five years. In addition, Shopify is investing in AI applications, launching new services, and reducing its cost base, and with almost $4bn in cash it has ample scope to continue investing in areas where it has a competitive edge. Amazon, another large, listed holding, has also seen extraordinary growth. Revenues generated by its cloud offering Amazon Web Services (AWS) grew from $26bn in 2018 to $88bn at end Q223. Yet the structural opportunity for cloud-based companies remains compelling: 90% of global spending in IT is still focused on in-house, rather than cloud-based facilities, leaving massive scope for the expansion of demand for AWS's services.

Among USA's unlisted positions, Space X, USA's second largest position, is showing rapid, profitable growth, having tripled the number of launches over past five years. It dominates the launch market, commanding two-thirds of the market. Its reusable rockets give it a notable cost advantage over competitors. Space X's Starlink initiative, a satellite communications system that provides fast broadband to rural areas, now has a million users and USA's managers expect the company to become profitable in 2023. Zipline, another unlisted holding, is also going from strength to strength. This medical drone delivery company was USA's first private investment in 2018. At that time, Zipline was operating mainly in Rwanda, delivering vital medical supplies to remote areas. It now services 3,400 hospitals and health facilities globally, with contracts that will increase its client base to more than 10,000 by end 2023. Zipline is now the largest autonomous drone company in the world, and it is just getting started. The company is expanded its delivery services into e-commerce, and animal and agricultural products, and its US home delivery system launched in mid-2023.

Managers optimistic about capacity for exceptional returns

The success stories and future prospects of these and many other USA portfolio holdings leave the company's managers, and its board, excited about their potential, and optimistic that despite the recent glitch in performance, USA is well-set to deliver the exceptional returns it is targeting over the long term.

Perhaps the greatest risk to this outlook is the temptation to try to 'fix' near-term performance, by shifting to a more defensive, conventional investment strategy. However, Robinson and Gibson's conviction in their investment process means they are determined not to panic or abandon their principles as long-term growth investors. Instead, they are asking investors to be patient until market conditions stabilise, and investors refocus on what they view as the very positive fundamentals of USA's portfolio holdings.

As a further illustration of their confidence in their investment thesis, when asked to nominate other risks to USA's outlook, the managers say they perceive a risk in not being sufficiently optimistic, and curtailing investments prematurely, for example when a business has grown, say, tenfold, when it has potential for much greater expansion.

Discount offers value

For investors who share Robinson and Gibson's confidence in USA's futuristic investment approach, and its objective to generate extraordinary returns over the long term, now may be an especially good time to acquire or top up exposure to the company. The discount at which USA's shares trade relative to its NAV has been close to par for much of its five-year history. However, the discount has widened markedly over the past year or so, to around 20% at present, well above historical levels, as performance has dropped away and market sentiment towards the company's growth investing style has soured. USA's board has previously made efforts to support the share price via share buybacks. However, in May 2022 the board decided that, having bought back £3.6m of shares with only a limited impact on the discount, it would instead use the capital to invest in new growth opportunities.

Nonetheless there is, arguably, significant scope for USA's discount to narrow back towards its longer-term average, if and when relative performance improves, and/or investor sentiment towards tech-driven, high growth strategies improves. In the meantime, the current, historically wide discount provides a window of opportunity to acquire USA shares at an attractive level.

Performance: Disappointing due to de-rated private holdings

Exhibit 1: Five-year discrete performance data

12 months ending	Total share price return (%)	Total NAV return (%)	S&P 500 TR GBP (%)	CBOE UK All Companies (%)
31/08/19	7.9	6.8	9.8	0.3
31/08/20	67.0	72.5	10.9	(13.5)
31/08/21	41.6	39.8	27.6	27.1
31/08/22	(51.2)	(39.3)	5.0	1.8
31/08/23	(7.6)	(6.1)	6.5	5.5

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

As mentioned above, USA's listed holdings have performed well over the past year, while the company's unlisted holdings, which comprised 32% of the portfolio at end August, were a drag on absolute and relative returns. Baillie Gifford does not release a breakdown of performance between the listed and unlisted components of the portfolio; however, insight into the performance of USA's listed holdings can be gleaned from a comparison with Baillie Gifford's American Investment Fund, which has an approximate 90% crossover with USA's listed holdings, shares the same benchmark and is co-managed by Robinson and Gibson. This fund returned 5.8% in the year to end August 2023, compared to the benchmark return of 6.5%.

The main contributors to USA's returns over the financial year to end May 2023 include Shopify, NVIDIA, Netflix (an on-demand streaming service) and Duolingo (a language learning app). The impressive growth in Shopify's revenues discussed above was reflected in an 84% increase in the stock's share price, while NVIDIA's share price more than tripled over the year in response to the recent increased focus on AI. Netflix's share price more than doubled over the past year as its subscriber base continues to grow thanks to the global shift to on-demand streaming services. USA's managers expect the company to remain the prime beneficiary of this trend, due to the quality of its content offering. The market also welcomed Netflix's efforts to rationalise spending, which would be expected to increase its profit margins. Duolingo's share price rose a more modest 33% over the period, but the high quality of its free content is generating demand for subscribers, and its use of AI offers the possibility that this form of learning could replace human tutors in as little as five years. This suggests further substantial upside in demand for Duolingo's offering, and its stock.

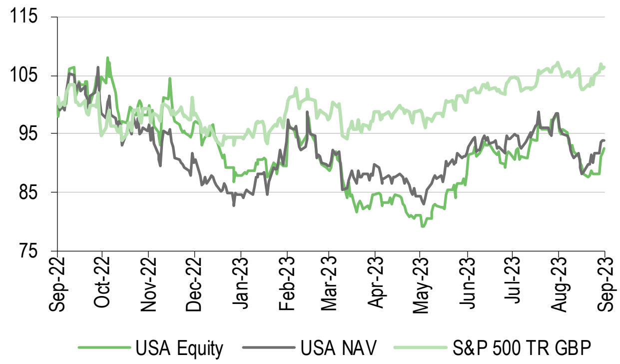
However, these and other positive influences on USA's recent performance were more than offset by the de-rating of the company's unlisted holdings, for reasons discussed above. The company's unlisted holdings are valued on a rolling three-month basis by a specialist team within Baillie Gifford, in accordance with International Private Equity and Venture Capital Valuation guidelines. These valuations are assessed by independent external auditors. USA's board also conducts detailed bi-annual reviews and can challenge valuations if deemed appropriate. The main unlisted detractors from USA's returns over the financial year included Stripe, Faire Wholesale, an online wholesale marketplace, and Brex, which offers online real-time accounting services to businesses. However, the managers' ongoing conviction in the long-term prospects of these companies means that all remain in the portfolio.

This is not the case for First Republic, a Californian regional bank. It was one of USA's few listed holdings to detract meaningfully from performance over the financial year. The managers had held this stock since inception, as they liked its focus on customer service, good management team and what they viewed as conservative lending culture. They saw great potential for First Republic to expand to the East Coast, to service not just entrepreneurs, but also doctors and other high net worth individuals. However, the collapse of Silicon Valley Bank sparked a weekend run on First

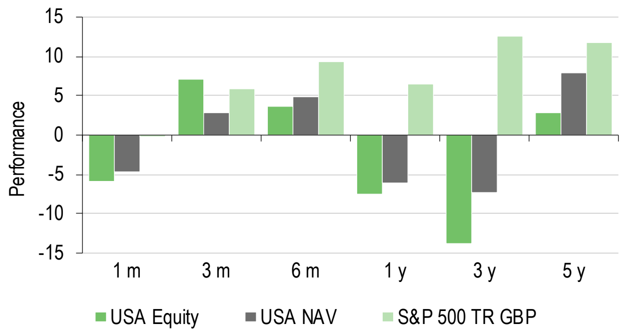
Republic's deposits, which USA's managers felt impaired the bank's short-term viability. With great reluctance, they sold their position when markets opened the following Monday.

Exhibit 2: Investment trust performance to 31 August 2023

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three- and five-year performance figures annualised.

AIC North America peer group comparison

Baillie Gifford US Growth Trust is a member of the Association of Investment Companies (AIC) North America sector, which has seven constituent members, with varying mandates (Exhibit 3). Three of these funds focus on providing income, as well as capital growth, two (Canadian General Investments and Middlefield Canadian Income) are focused primarily on the Canadian market, and one has a dedicated sustainability mandate. The JPMorgan American Investment Trust and Pershing Square Holdings share USA's goal to achieve capital growth from North American investments, but none of the other funds in this sector shares USA's intense focus on exceptional growth companies.

However, there are several closed-ended funds in other AIC sectors whose investment strategies share USA's objective of realising long-term capital growth from investment in global listed or unlisted technology companies. So, to provide a fuller picture of USA's true peer group, Exhibit 3 also includes a selection of these funds.

Exhibit 3: Comparison with AIC North America peer group and selected technology companies

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Performance fee	Net gearing	Dividend yield
Baillie Gifford US Growth	458.3	(17.3)	(17.1)	45.2	-	(19.0)	0.7	No	105	0.0
BlackRock Sustainable American Income	146.2	(7.7)	34.4	32.6	160.4	(6.2)	1.0	No	101	4.4
Canadian General Investments	426.3	(1.8)	41.1	66.4	194.0	(36.1)	1.4	No	112	2.7
JPMorgan American	1,418.7	(1.8)	48.5	70.1	292.2	(0.7)	0.4	No	103	0.9
Middlefield Canadian Income	107.3	(16.9)	46.2	24.2	81.8	(14.1)	1.3	No	121	5.2
North American Income Trust	383.7	(6.9)	34.0	21.8	156.4	(11.2)	0.9	No	107	4.1
Pershing Square Holdings	5,540.6	11.5	67.1	213.4	-	(36.3)	1.6	Yes	103	1.4
AIC average	**490.1**	**(8.7)**	**31.2**	**43.4**	**177.0**	**(14.5)**	**0.9**		**108**	**2.9**
USA rank in AIC peer group	**3**	**7**	**7**	**4**	**N/A**	**3**	**2**		**4**	**7**
HgCapital Trust	1,734.8	7.0	82.9	145.3	398.7	(19.1)	1.7	Yes	77	1.8
Scottish Mortgage	9,112.4	(16.0)	(10.7)	51.0	347.4	(19.2)	0.3	No	114	0.6
Allianz Technology Trust	996.6	0.2	23.1	92.6	520.0	(10.5)	0.7	Yes	98	0.0
Polar Capital Technology	2,641.8	0.2	18.0	82.2	464.2	(13.0)	0.8	Yes	97	0.0
Average – Technology peer group	**3,621.4**	**(2.1)**	**28.3**	**92.8**	**432.6**	**(15.5)**	**0.9**		**96.7**	**0.6**

Source: Morningstar, Edison Investment Research. Note: Performance as at 31 July 2023 based on ex-par NAV. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

USA is the third largest fund in its North America peer group, but the smallest among its technology peers. Its NAV total return ranks lowest among its AIC sector peers over one and three years, and fourth over five years. The trust's underperformance in the past two years, discussed above, has dragged down its performance over longer periods. Its returns lag those of its broader peer group over all periods shown in Exhibit 3. Its share price discount to cum-income NAV is the third widest among its AIC sector peers, although the share prices of its broader technology peer group are all trading at discounts broadly comparable to USA's. USA's ongoing charge is competitive, being the second lowest of all its peers, and in common with most, it does not have a performance fee. USA's gearing level, at 5%, is lower than the average of its North America peers, but higher than the average of its technology peers. It is the only trust among its AIC peers not to pay a regular dividend, although several funds in its broader peer group adopt a dividend policy similar to USA's.

Current portfolio positioning

As at end August 2023, USA's portfolio comprised 74 stocks, including 24 unlisted companies, which together comprised 32% of the portfolio. Portfolio turnover remains low, at c 7%, consistent with the company's five-year plus investment horizon, and the managers' conviction in their portfolio holdings.

However, the managers continue to add attractive names to the portfolio when opportunities arise. Listed company acquisitions included Roblox, a gaming platform for younger players, Sweetgreen, a salad restaurant, Doximity, a Californian online network of medical professionals, and Samsara, a software infrastructure company helping trucking companies optimise their assets and operations. The managers also re-opened a position in Meta Platforms (formerly Facebook). They closed this position in 2021 due to concerns about the company's ability to navigate an increasingly complex set of regulatory and social obligations, and to continue to attract the best engineering talent. However, Meta has since improved its engagement with regulators and users, and concerns about recruitment have proved unfounded. Robinson and Gibson are attracted by its capacity to utilise AI to enhance its product offerings in both the social media and virtual reality segments of its business. The managers purchased one unlisted business, Oddity Tech, a fast-growing online cosmetics and well-being company, which subsequently floated in July this year.

The managers also added to an existing position in listed company DoorDash, an online local delivery service, currently mostly focused on takeaway food. The company has impressed USA's managers with its efficient operations, which are important in a low-margin business such as deliveries, particularly when the cost of financing is increasing, as it is at present. They expect DoorDash's operational savvy to allow it to outpace its less efficient competitors over time. Robinson and Gibson also admire the scale of DoorDash's ambitions – the company aims to provide local delivery services not just for takeaways, but also for groceries, pharmaceuticals and many other online purchases. Its global customer base is growing, and USA's managers expect it to continue to increase in line with the broader growth in e-commerce.

In addition to their reluctant sale of First Republic Bank, discussed above, the managers closed positions in several other listed names due to poor operational and share price performance, including fitness company Peloton, software infrastructure company Appian, Butterfly Network, a manufacturer of portable ultrasound machines, Carvana, an online used car dealership and Teladoc, a telemedicine provider. They also recently sold Illumina, a company specialising in gene sequencing, as they believe the company has been slow to react to emerging competition.

USA's holding in Tesla was trimmed as a further source of funding. The stock has had a bumpy ride over the past year but has been supported recently by the anticipated launch of Tesla's new cyber truck, as well as by its commanding position in EV manufacturing, and resultant generally strong margins, which are giving it scope to undercut competitors.

Exhibit 4: Top 10 holdings (at 31 August 2023)

Company	Company descriptions	Portfolio weight %		Change (pp)
		31 August 2023	31 August 2022*	
Space Exploration Technologies	Satellites & Rockets	6.3	5.7	0.6
The Trade Desk	Advertising buying platform	5.7	4.6	1.1
Shopify	Ecommerce platform	5.3	2.6	2.7
NVIDIA	Semiconductors	4.8	1.6	5.2
Amazon.com	Ecommerce platform	4.6	3.7	0.9
Tesla Inc	Electric vehicles & energy storage	4.3	5.2	(0.9)
Stripe	Payments systems	4.1	4.4	(0.3)
Netflix	Streaming service	2.9	1.6	1.3
Moderna	Pharmaceuticals	2.8	3.7	(0.9)
CoStar	Real estate services	2.5	2.3	0.2
Top 10 (% of holdings)		**43.3**	**35.4**	

Source: Baillie Gifford US Growth Trust, Edison Investment Research, Bloomberg, Morningstar.

Exhibit 5: Portfolio sector exposure at 31 August 2023 (% unless stated)

	Portfolio end-August 2023	Portfolio end-August 2022	Change (pp)	Index weight	Active weight vs index (pp)
Information technology	32.5	33.2	(0.6)	28.2	4.3
Consumer discretionary	21.0	19.8	1.3	10.6	10.4
Communication services	12.7	4.5	8.2	8.8	3.9
Industrials	12.5	15.1	(2.6)	8.4	4.1
Healthcare	10.7	17.5	(6.8)	13.2	(2.5)
Financials	3.5	5.9	(2.4)	12.5	(9.0)
Real estate	2.8	0.3	2.5	2.4	0.4
Materials	2.3	2.9	(0.6)	2.5	(0.2)
Consumer staples	1.3	0.4	0.9	6.6	(5.3)
Energy	0.0	0.0	0.0	4.4	(4.4)
Utilities	0.0	0.0	0.0	2.4	(2.4)
Cash	0.7	0.5	0.2	0.0	0.7
	100.0	**100.0**		**100.0**	

Source: Baillie Gifford US Growth Trust, Edison Investment Research. Note: Figures may not add up to 100 due to rounding.

Dividends: Not a feature of USA

USA's priority is to generate capital growth over the long term, so it does not seek to provide shareholders with a dividend. The company's net revenue per share was negative in the financial year ended 30 May 2023, as it has been since inception, as portfolio companies tend to reinvest cash flows to boost future growth, rather than pay dividends to shareholders. USA's board therefore recommends that no final dividend be paid for FY23. However, should the level of underlying income increase in future years, the board will seek to distribute the minimum permissible to maintain the company's investment trust status, by way of a final dividend.

For details of USA's fund profile, investment process, valuation methodology, fee structure and board, see Edison's last update note.

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