



Baillie Gifford China

China & Greater China

Introduction

This is an All China strategy investing in both offshore and domestically listed China 'A' shares. It is an unconstrained approach looking to invest in exceptional growth businesses which have the potential to double over 5 year time horizons.



Why RSMR Rate this Fund

- China remains one of the world's fastest growing economies and the 'A' share market is biased to domestic consumption
- Baillie Gifford is a leader in growth investing and has successfully invested in China for many years
- Research resource significantly strengthened through opening of Shanghai office
- Chinese stock market has historically rewarded fastest growing companies favouring growth over value investors
- China is at the forefront of digitalisation and adoption of ecommerce globally
- Inefficient stock market favours research intensive fundamental approach

Fund Process

Baillie Gifford is a long-term active growth investor and the China Equity Fund is no different. Stock picking focuses on a company's potential, not just currently, but over a meaningful time period, typically five years and beyond. The fund looks to deliver results through the power of compounding.

Baillie Gifford have opened their first investment office outside of Edinburgh in Shanghai and two of the idea generators for this portfolio are based there. These are John MacDougall who has moved over as Partner in charge of that office, together with Rio Tu, who has also moved across from the Edinburgh office. There are then three portfolio decision makers based in Edinburgh, Mike Gush, Roderick Snell and Sophie Earnshaw.

Whilst the Strategy was launched in February 2006 it has evolved along with the market there now to include investing in domestic China equities the 'A' share market and to aid research into this market the office was opened in Shanghai. There is a China Equities Portfolio Research Group composed of five individuals based between Edinburgh and Shanghai with the aim of connecting local insights with global perspectives. Whilst there can be short term noise in the various Chinese stock markets, over time share prices follow fundamentals and therefore companies which can sustainably grow their business in terms of earnings and cash flow will be the best rewarded. As well as the investment professionals at the firm there are also insights from specialists typically with a non-financial background providing further due diligence on political and macro-economic conditions and feedback on products and services from on the ground in China. Within Baillie Gifford, as well as the EM team and Shanghai office 17 of the other 21 teams have conducted their own research on China stocks. Relationships have been built with company founders, industry specialists and independent research providers. All team members whether they are analysts or involved with portfolio construction, spend the majority of their time researching companies.

At the core of the process is fundamental research on companies which looks to identify mispriced stocks by focusing on the long term outlook for these businesses and industries. All proprietary research is shared on a common portal, the Research Library. Opportunities for a business come from either industry background or competitive advantage, whilst execution depends on company management and financial constraints assessed by looking at the balance sheet. Thirdly, there is valuation ie whether the positive news is in the price. ESG considerations form an integral part of the process, with good corporate governance having the potential to enhance shareholder value over the long term. Portfolio construction does not rely on quantitative models and the team are happy to be different from the Index and competition. All investment ideas are discussed by the team at the weekly stock meeting. The weighting of a new idea will depend on the level of conviction in the investment case, together with the potential upside in the stock and assessment of the impact on performance if the decision is wrong. The fund holds 40-80 names with a maximum position of +5% relative to the MSCI China All Share Index at the time of purchase. There is a minimum of six industries within the fund. Stocks are sold if a company no longer meets the growth hurdle, the investment case has deteriorated, or a rise in valuation means there are better ideas elsewhere.

The fund is looking to invest in innovative growth companies within China which are very often technology enabled disruptive businesses



Important Notice

This factsheet is aimed at Investment Professionals only and should not be relied upon by Private Investors. Our comments and opinion are intended as general information only and do not constitute advice or recommendation. Information is sourced direct from fund managers and from a number of websites. This information is therefore as current as is available at the time of production.



gaining market share. Within the portfolio between 70-80% of the fund is exposed to domestic China and therefore the growing middle class.

Evaluation

The fund will perform well when the Chinese economy is growing and liquidity conditions are supportive of domestic equities. Returns for this unconstrained approach will be driven by bottom up stock picking which will determine the success of the fund. The fund will perform poorly if Chinese shares are out of favour.

Application

The fund is a satellite option for investors as it invests in one country rather than the broader Asian region. It invests in one of the most dynamic parts of the world and focusses on innovative fast growing businesses and therefore offers the potential for significant long-term upside for investors who can accept at times periods of volatility

Our Opinion

Baillie Gifford have proven themselves as one of the best long-term active growth investors in the world and the China Equity Fund follows the bottom-up stock picking strategy utilised across the firm. This fund invests in both domestically listed and off shore Chinese equities with the former in particular an inefficient market due to at times speculative trading by private clients. The dislocations versus fair value this produces results in an inefficient market which a long term fundamental investor such as Baillie Gifford has been able to successfully exploit. Within China top-down factors can have a greater importance and interestingly the team utilise a number of external research providers who undertake macro-economic and political analysis together with conducting due diligence on company management. As a long-term investor in companies ESG factors are an important part of the process. This is an unconstrained portfolio, so can significantly differ from the Index at both stock and sector level in the team's quest to find sustainably fast growing companies in China which empirical evidence suggests will deliver the best returns.

The Baillie Gifford China fund has a long record, having been launched in 2006, but the strategy has evolved with the setting up of an office in Shanghai and utilisation of the Stock Connect scheme to access the domestic China 'A' share market in a much more meaningful way. This has allowed the fund to increase its focus on long-term structural growth trends such as the continued emergence of the middle class in China, especially outside of Tier 1 cities. The investment process is unsurprisingly growth orientated and there is a focus on stocks with the potential to double over five years.

The fund already has a proven record and this is likely to be only enhanced by the greater research resource looking at China both from the Shanghai office and the numerous separate teams based in Edinburgh, in addition to the dedicated emerging markets team. The portfolio has been re-shaped with the addition of a number of individual 'A' shares in the fund post the opening of the Shanghai office. The fund is ahead of its benchmark index over 1, 3, and 5 years and is worthy of an RSMR rating. It is a useful satellite addition to investor portfolios. The China 'A' share market has tremendous depth in terms of stock choice and also some degree of uncorrelated returns versus other developed and emerging markets due to the largely domestic retail investor base and so the inclusion of a fund such as this in investor portfolios does aid diversification which is a plus in itself in today's world of interconnected stock markets.



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