Baillie Gifford™

International Growth

January 2024

Lessons in Morale

As 2022 turned into 2023, I was reading *Defeat Into Victory*, an account of the loss and then recapture of Burma during the Second World War by Field Marshall William Slim. I'm not usually a fan of military history, but after the dreadful investment performance we delivered in 2022, it will be clear why I turned to the book as an example of the attitudes needed to recover after taking a beating.

Slim describes the three sources of 'morale' that he believes necessary for a group to succeed as: Spiritual, Intellectual, and Material. The language is archaic, reflecting the times, his character, and the nature of the task. But he means something like the following

- Spiritual: a sense of purpose. The task is important and worthwhile, and individuals have a sense of agency so feel able to contribute to its achievement.
- Intellectual: a belief that the object can be attained, and that the process being followed gives a good chance of success.
- Material: good working conditions and the best tools for the job.

We work in finance, so the material conditions are good, in fact, disproportionately so at a societal level. The other two are more relevant.

I believe one of the enduring strengths of Baillie Gifford to be the sense of purpose we have about our task, or what Slim termed 'spiritual' motivation. While we operate *in* the financial industry, we are deeply aware of its flaws and are in a sense not *of* the financial industry. The people we recruit as trainee investors tend not to come from a finance background and often stumble across our firm through our sponsorship of a book festival or literary prize. When I was involved in our recruitment efforts, I was delighted by how often I heard, "You're the only finance company I'm applying to".

So what?

Tough times are inevitable in investment. We recently heard a talk from a former colleague who described the three periods of extremely poor performance he – and his clients – had endured over his 50-year career. What carried him through those periods was a belief in both the value of what he was doing and in the way he was going about it. Again, the spiritual and the intellectual, in Slim's terms.

The former colleague – who interviewed me when I applied to work at Baillie Gifford 25 years ago – spoke about how he wouldn't entrust money to any investor who hadn't suffered a bear market. That echoes a remark from a current colleague: "I've learned more in the last two years than the previous eight". Periods of sharp underperformance are profound learning experiences provided you have the organisational structure, client base, and mental attitude that allows you to use them to the full. In the last two years Baillie Gifford, and the International Growth team, have been tested as rarely before, and I believe we are holding up well. I want us to look back in a few years' time and feel proud of how we responded to the challenge of this period, knowing that our response resulted in good returns to clients over the following years. I feel confident that we are on track to be able to do that.

Where next?

As I write this in late December 2023, stock markets have rallied on the hope of interest rate cuts next year. As we've said before, we claim no insight into the near-term direction of interest rates, but I would be wary of assuming a rapid fall to much lower levels, however much that may help our investment style in the short term. We have found the work of Bill White, former chief economist of the Bank for International Settlements, useful in thinking through the likely long-term path of monetary policy. He was a helpful guide in 2008-10 and is firmly in the 'higher for longer' camp for various structural reasons.

Another note of caution is that arbitrarily stopping the clock at the end of December to check the score can give a misleading impression. In December 2008, things felt awful following a 40% fall in the MSCI World amid the wreckage of Lehman, AIG and the rest. A year later, after a 74% rally, the financial world was a sunnier place. But before reaching the end of 2009, you had to first live through the wrenching falls in the first ten weeks of the year, when markets lost about a quarter of their value in short order. That wasn't much fun at all, but it was a great learning experience from which we emerged stronger, and which provided the base for strong investment returns over the following years.

I offer those comments not as a Scrooge-like counter to the festive spirit, but as a reminder that near-term movements in asset prices or interest rates are largely unpredictable but can have a disproportionate impact on long-term outcomes if you allow them to damage your behaviour. While we certainly hope that recent positive momentum continues, hope isn't a strategy, and it's quite possible that the year-end rally goes into sharp reverse.

The companies in the portfolio

We wrote last year about the possibility of a 'triple whammy': a valuation hit from rising discount rates; an earnings hit from weaker economic conditions; and a growth hit from diminished long-term prospects. The first had already occurred, and as long-term growth investors we really focus on the second and particularly the third of these.

In a portfolio of around 50 companies run by managers who embrace uncertainty there will always be some holdings that are struggling operationally. But our overwhelming sense is that the companies we hold on your behalf are in good shape. There have been some earnings hits – Adyen, for example – but the long-term growth prospects for most of the holdings, Adyen included, remain extremely attractive.

The discrepancy between near-term share price moves and business fundamentals can be shown with an example. We took a holding in AutoStore, a mid-cap Norwegian provider of box storage solutions for warehouses, in the last quarter of 2022 at a price of around 19 Krone. That is just under half the price the shares traded at following the IPO some two years earlier, in which we chose not to participate. The share price rose slightly over the first few months of our ownership, before halving between August and October 2023 for no apparent reason. Since then, it has risen by ~70% in a matter of weeks and is now back to around 20 Krone. In the meantime, there has been continued progress in its business – which is a beneficiary of trends towards warehouse automation and e-commerce – such that revenues in 2023 will grow by around 10%, with the prospect of acceleration thereafter. From the perspective of business fundamentals, not much has changed since we first invested, but you wouldn't know that from the whipsawing share price!

AutoStore is a useful example but a small holding, around a half of one percent. We run concentrated portfolios, with the twelve largest positions usually representing around 50% of the portfolio. More important than this example is that most of these large holdings – the likes of ASML, MercadoLibre, Spotify, Ferrari, Atlas Copco, TSMC or PDD – continue to perform well, to be run by people we trust, and to have large growth opportunities ahead of them in a range of different industries.

On Credulity and Stupendious Works

If one of the reasons for our high 'intellectual morale' is that we think the businesses we invest in are well placed, a second is that we believe our process for uncovering new growth companies is robust, and the final one is that we expect technological progress to provide fertile ground in which to search.

Generative AI, GLP-1 anti-obesity drugs, and the continued rollout of renewable energy technology are three developments that are different in nature but hugely consequential. We need to be alive to their investment possibilities. Sins of omission trouble us more than sins of commission, so we are reflecting on our failure to own Novo Nordisk but are not inclined to pursue that company further, given the still-fluid competitive situation in the GLP-1 field. The path to a trillion dollars of market cap – which is needed for it to be an attractive investment – feels a narrow one, and we are more inclined to look at smaller companies in the field.

As 2023 rolls into 2024, I've been reading *Pandæmonium, 1660-1886: The Coming of the Machine as Seen by Contemporary Observers*, an anthology of perspectives on the Industrial Revolution in the UK written as it was unfolding. Amid all the dark satanic mills there are rays of light, such as the Marquis of Worcester writing in 1660 about a machine to pump water: "And I may boldly call it *The most stupendious Work in the whole world*". That may prove to be an accurate description of Generative AI. But until we have a better sense of its real-world impact, perhaps we should settle for the Marquis's more modest description of another invention, "And therefore I call this *A Semi-omnipotent Engine*". I'm not sure that something can be 'semi-omnipotent', but for all its flaws, that description captures the potential power of Generative AI rather well.

The former colleague we mentioned earlier thought that one of the attributes that had served him well was his ability to remain 'credulous'. That's not something to which many people in their eighth decade would cheerfully admit. But as Growth investors, we do need a childlike ability to wonder at the open possibilities of the new unencumbered by the weight of history or the fear of being wrong. By taking that attitude we will certainly end up holding shares in some companies that don't work out, but it is the only way to give ourselves the chance of investing in the small number of companies that really matter. We believe we have some of that small number and will continue searching for more.

We remain highly motivated by the task before us, and – thanks to the quality of our clients and the organisation in which we work – confident about our ability to deliver good long-term returns. We are, as ever, deeply grateful for your support.

Tom Coutts

RISK FACTORS AND IMPORTANT INFORMATION

The Baillie Gifford International Growth Fund
(Share Class K) as of December 31, 2023

Gross Expense Ratio	0.60%
Net Expense Ratio	0.60%

Source: Baillie Gifford & Co

The Baillie Gifford International Growth Fund
Annualised total return as of December 31, 2023(% p.a.)

	1 Year	3 Years	5 Years	10 Years
K Class	14.36	-12.10	8.74	5.31
Benchmark	16.21	2.05	7.85	4.37

Source: Bank of New York Mellon, MSCI. Net of fees, US dollars.
Benchmark: MSCI EAFE Index benchmark data used until November 22, 2019. MSCI ACWI ex US Index data used thereafter.

The performance data quoted represents past performance and is no guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end performance please visit our website at www.bailliegifford.com/en/usa/non-professional-investor/funds/baillie-gifford-international-growth-fund

Returns are based on the K share class from 28 April 2017. Prior to that date returns are calculated based on the oldest share class of the Fund adjusted to reflect the K share class fees where these fees are higher.

The Baillie Gifford fund's performance shown assumes the reinvestment of dividend and capital gain distributions and is net of management fees and expenses. Returns for periods less than one year are not annualised. From time to time, certain fees and/or expenses have been voluntarily or contractually waived or reimbursed, which has resulted in higher returns. Without these waivers or reimbursements, the returns would have been lower. Voluntary waivers or reimbursements may be applied or discontinued at any time without notice. Only the Board of Trustees may modify or terminate contractual fee waivers or expense reimbursements. Fees and expenses apply to a continued investment in the funds. All fees are described in each fund's current prospectus.

Expense Ratios: All mutual funds have expense ratios which represent what shareholders pay for operating expenses and management fees. Expense ratios are expressed as an annualized percentage of a fund's average net assets paid out in expenses. Expense ratio information is as of the fund's current prospectus, as revised and supplemented from time to time.

The MSCI All Country World ex US Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance in the global developed and emerging markets, excluding the United States. This unmanaged index does not reflect fees and expenses and is not available for direct investment.

The Baillie Gifford International Growth Fund
Top Ten Holdings as at December 31, 2023

Holdings		Fund %
1.	MercadoLibre	7.01
2.	ASML	6.50
3.	Ferrari	4.90
4.	Spotify	4.47
5.	Adyen	4.13
6.	Atlas Copco	3.96
7.	TSMC	3.62
8.	L'Oréal	3.55
9.	argenx	3.42
10.	Genmab	3.12

It should not be assumed that recommendations/transactions made in the future will be profitable or will equal performance of the securities mentioned. A full list of holdings is available on request. The composition of the fund's holdings is subject to change. Percentages are based on securities at market value.

This content contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned.

As with all mutual funds, the value of an investment in the fund could decline, so you could lose money.

The most significant risks of an investment in the Baillie Gifford International Growth Fund are Investment Style Risk, Growth Stock Risk, Long-Term Investment Strategy Risk, and Non-U.S. Investment Risk. The Fund is managed on a bottom up basis and stock selection is likely to be the main driver of investment returns. Returns are unlikely to track the movements of the benchmark. The prices of growth stocks can be based largely on expectations of future earnings and can decline significantly in reaction to negative news. The Fund is managed on a long-term outlook, meaning that the Fund managers look for investments that they think will make returns over a number of years, rather than over shorter time periods. Non-U.S. securities are subject to additional risks, including less liquidity, increased volatility, less transparency, withholding or other taxes and increased vulnerability to adverse changes in local and global economic conditions. There can be less regulation and possible fluctuation in value due to adverse political conditions. Other Fund risks include: Asia Risk, China Risk, Conflicts of Interest Risk, Currency Risk, Emerging Markets Risks, Equity Securities Risk, Environmental, Social and Governance Risk, Focused Investment Risk, Geographic Focus Risk, Government and Regulatory Risk, Information Technology Risk, Initial Public Offering Risk, Large-Capitalization Securities Risk, Liquidity Risk, Market Disruption and Geopolitical Risk, Market Risk, Service Provider Risk, Settlement Risk, Small-and Medium-Capitalization Securities Risk and Valuation Risk.

For more information about these and other risks of an investment in the fund, see “Principal Investment Risks” and “Additional Investment Strategies” in the prospectus. The Baillie Gifford International Growth Fund seeks capital appreciation. There can be no assurance, however, that the fund will achieve its investment objective.

The fund is distributed by Baillie Gifford Funds Services LLC. Baillie Gifford Funds Services LLC is registered as a broker-dealer with the SEC, a member of FINRA and is an affiliate of Baillie Gifford Overseas Limited.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.