

Baillie Gifford™

# China Equities

Philosophy and Process



For professional  
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# Overview

**Baillie Gifford was founded in Edinburgh during the late Qing Dynasty (1908). For over a century, we have focused on investing in a truly active, long-term and patient way on behalf of our clients.**

Over the last 40 years, China has undergone an unparalleled period of economic growth and created some of the most exciting companies in the world. China's domestic stock-exchanges, known as the A-share market, were (re)established in 1990. The first overseas listing of a Chinese company in New York was in 1992 and Hong Kong in 1993.

At Baillie Gifford, we have brought an active and long-term approach to investing in Chinese companies since 1994. We have had a dedicated China Strategy since 2006. And with the greater accessibility of China's domestic markets offering an exciting opportunity in this large but under-represented and under-researched universe, we launched a dedicated A-share strategy in 2019.

We believe our advantage is derived from bringing together global and local insights with an investment philosophy that seeks above average returns by participating in disruptive and secular trends. These play out over years, not quarters. This is why the size of China's markets and the speed of its growth and innovation make it an exciting market for fundamental, alpha-searching stock pickers. Our long-term approach is reinforced by an alignment of incentives that matches this time frame and focuses us on the growth upside and differentiated insights that are rarely captured in today's share prices.



# Why invest in China

**China is now the world's second largest economy and is home to the world's second largest stock market. One in six big winners<sup>†</sup> comes from China. Yet it is less than 3% of global fund allocations. This doesn't feel right to us and we expect its importance to increase for investors.**

China offers the opportunity of persistent growth outperformance, a large and expanding consumer market, continued technological upgrades and rapid digitisation, further opening to foreign investors and domestic reforms, and a large policy toolkit to offset shocks to the economy.

More importantly for us as stock pickers, China has already produced some of the biggest and most innovative companies in the world, and is home to a growing number of exciting opportunities.

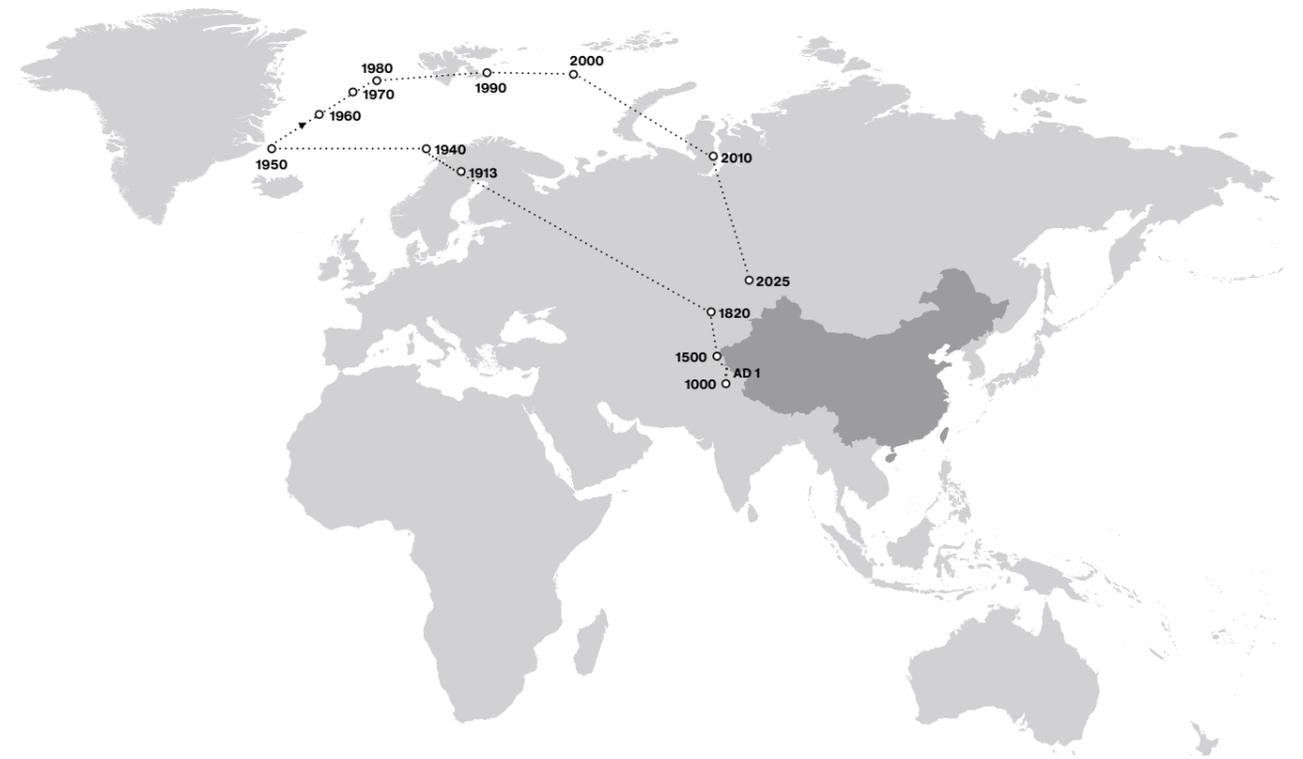
The size and scale of the opportunity, and the need for dedicated onshore and offshore resources with a global context and understanding, is asking questions as to the best way to gain exposure to the asset class.

China's stock markets provide inefficiencies borne from the short time horizons of market participants. This leads to high turnover and momentum, an asymmetry of information resulting from a lack of institutional coverage, and a wide dispersion of returns. It has indices which are heavy in old economy sectors, often dominated by the state, where governance structures and decision making are more ambiguous, and where ESG and disclosure standards are weaker.

An active approach to investing is critical. In little more than a decade, China has gone from being a low cost manufacturer to now increasingly leading in sectors that combine to form the infrastructure of the future. Failing to look beyond broad generalisations of geopolitical and governance concerns will prevent an appreciation of how dynamic, innovative and capable many Chinese entrepreneurs are.

We strongly believe that a number of Chinese companies are benefiting from some of the best structural growth opportunities in the world. This portfolio is all about trying to capture these.

## Shifting economic centre of the world?



Source: McKinsey Global Institute. Calculated by weighting national GDP by each nation's geographic centre of gravity; a line drawn from the centre of the earth through the economic centre of gravity locates it on the earth's surface.

**12%**

of global market cap\*

**19%**

of global GDP by purchasing power

**26%**

of listed stocks\*

**23%**

of big winners<sup>†</sup>

Source: FactSet, Worldscope. \*In MSCI investable indices. <sup>†</sup>Stocks delivering 15% p.a. or better on average for the 5 years to end 2022. US dollars. Based on a global universe filtered by 5 year cumulative return. Data includes secondary listings.

# Our China Equities strategy

## Strategy summary

Our China Strategy is a portfolio of 40-80 of the most exciting growth companies, regardless of their market cap, where they're listed or their size in an index. Our investment universe comprises over 6,500 companies listed primarily in China, Hong Kong or the US. Our aim is to outperform the MSCI China All Shares Index after fees over the long-term. We look for businesses that enjoy sustainable competitive advantages and have the potential to grow their earnings significantly ahead of the market average over the long term. We specifically seek companies who have the ability to at least double returns over a five-year period. Our China Strategy has a track record since 2006 with a consistent philosophy based on long-term investment horizons, a focus on growth, and a truly active approach to stock selection and portfolio construction.

## What makes this strategy unique?

### The domestic market – very short term

- Impatient, retail driven
- High turnover equated with hard work and seen as a positive
- 'Renting', not owning

### Baillie Gifford – very long term

- Patient, focusing on company fundamentals, and on the five year or longer trajectory of the business
- Incentivised on rolling five year performance; willing and able to look through short term volatility
- Supportive and trusted relationships with large Chinese companies we have held for years

<b>Tencent</b> since 2008	<b>Alibaba</b> since 2012	<b>Meituan</b> <b>Dianping</b> since 2015
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## Our philosophy and competitive edges

Our goal is to use our global perspectives and local knowledge to identify the next generation of exciting growth companies and build a portfolio of 40–80 of the best ideas. We seek to identify mispricing relative to fundamentals and accept that it can take time for this to be reflected properly in company valuations.

We believe that long-term returns are derived from investing in disruptive and secular trends which play out over years not months or quarters. We are looking for businesses that enjoy sustainable competitive advantages and have the potential to grow their earnings significantly ahead of the market average over the long term. As growth investors, we are focused on the identifying the innovative companies with competitive advantages that position them to benefit from, and contribute to, China's economic, societal and cultural development over the long-term.

We believe fundamental research focused on the five-year prospects for companies makes for a differentiated approach to managing Chinese equities, in an asset class where impatience and short-termism abound. We think our approach delivers an active edge in three key areas: Time Horizons, Perspectives and Insights.

### Time horizon

Companies grow over time. The true value of a business is rarely determined by what will happen in the next few quarters, but by what will happen in the many years ahead. It is over years that deep changes in industries and behaviours occur, and that competitive advantage and management excellence are recognised. Being able to think and act independently of the structures and short-term incentives of traditional finance is an important advantage.

A long-term focus also embeds the consideration of ESG factors at its heart. We believe this is vital in a country like China, given the role of the state, lower levels of disclosure, and the need for engagement with companies. It allows us to mitigate the risks of getting Chinese companies wrong, but importantly, it helps us discover where the best opportunities lie.

Fighting the instinct to involve ourselves in conventional market short termism requires important behavioural and cultural traits. Our partnership structure allow us to think differently and independently, and that provides our opportunity.

### Perspective

We believe that balancing on-the-ground insights with a global perspective gives us an important edge. An open and collaborative culture allows us to understand Chinese companies not just in their own market, but in a global context too.

Having investment managers and analysts on-the-ground in Shanghai enables us to deepen our long-standing relationships with existing holdings, identify the next generation of exceptional companies at an earlier stage, better understand societal and cultural developments, and forge partnerships with academics and industry specialists in the region.

When added to the global perspectives derived across Baillie Gifford, we can gain far deeper insights into companies and sectors of interest. The benefit from our global perspectives is multi-fold: Baillie Gifford's long history of researching growth companies globally, well-established trust with global companies as long-term, patient investors, as well as our strong academic connections, not only deepens our understanding of the industry trends and the competitive environment that Chinese companies operate in, but also provides checks and balances when assessing Chinese companies in a global context, including an assessment of the geopolitical environment and ESG standards.

### Relationships and insight

Given our investment time horizons, we prioritise meeting with academics, industry specialists and owners of businesses who think about their strategy, not financial analysts who think about the next quarter's earnings.

With three decades of experience investing in China, we have built relationships as a patient and supportive shareholder and developed strong access to some of the largest and most influential companies. Relationships take time to build but they have been critical in helping us understand China's ongoing development and the future direction of Chinese businesses.

These relationships, often built on trust and reputation over many years, provide access to a range of interesting companies, ensure management teams are aware of our approach and philosophy, and in doing so, help position us and our thinking in a different light to much of the market. This has provided an advantage in our understanding of companies early in their growth stages, and insight into the future challenges and opportunities for companies we hold.



# Our China team



**Linda Lin\***

10 (14) years' experience



**Sophie Earnshaw**

14 (14) years' experience



**John MacDougall\***

24 (24) years' experience



**Rio Tu**

10 (10) years' experience



**Louise Lin**

10 (10) years' experience



**Tony Wang**

4 (8) years' experience



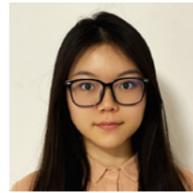
**Freddy Zhu**

4 (6) years' experience



**Clark Ren**

2 (3) years' experience



**Doris Gu**

Joined in 2023



**Lin Qin†**

2 (4) years' experience

**A dedicated China Team with experienced decision makers, bringing together onshore and offshore investors that balance local insights with global perspectives. All our investors are first and foremost analysts. We also benefit from Baillie Gifford's broader investment teams who research Chinese companies in the context of global and international strategies.**

The China Team is comprised of nine investors and one ESG analyst. Linda Lin and Sophie Earnshaw manage the strategy, supported by the broader team in Edinburgh and Shanghai. In addition, Baillie Gifford has circa 180 investment managers and analysts based in its Edinburgh office, many of whom have China in their global, international or Emerging Markets remit.

As at end December 2023, Baillie Gifford had US\$25 billion invested in Chinese equities on behalf of our clients. The breadth of our research spans the listed and unlisted universe in China, providing insight into major long-term trends, disruptive opportunities and areas of proactive and positive governance. This approach has fostered relationships with company founders, industry specialists and academics who think in timescales aligned with our clients' interest, instead of the short-term focus of the modern financial world. When coupled with the wider perspective of a global approach that links to worldwide experiences and insight, our China Strategy seeks to identify and own only those exceptional companies with the industry background, competitive advantages and quality of management to be positive outliers over the long term.

## Shanghai research platform

Baillie Gifford's Shanghai office provides an on-the-ground presence which helps overcome the challenges provided by language and location when it comes to engagement and insight, while retaining the lens of Baillie Gifford's long-term investment philosophy within a notoriously short-term market. It allows us to deepen our long-standing relationships with existing holdings, identify the next generation of exceptional companies at an earlier stage, better understand societal and cultural developments, and forge partnerships with academics and industry specialists in the region. Our investment team also includes a dedicated ESG analyst. Research conducted in Shanghai is used by investment managers in the construction of the portfolio, and feeds different perspectives into our broader investment strategies.

\*Partner  
 † ESG Analyst  
 Years at Baillie Gifford (years experience).  
 As at 31 January 2024.  
 The China Equities Strategy decision makers are Linda Lin and Sophie Earnshaw.

# From idea to investment

**Our investment process can be broken down into three parts: idea generation, research and portfolio construction. We are also aware that a fourth part, 'ownership', is typically the longest part of our process. The ongoing research, engagement and understanding gained through this period is a critical part of our investment approach.**

## Idea generation

There is no silver bullet to adequately describe exactly where ideas will come from. Our approach is multi-fold, and attempts to cast the net wide, often beyond traditional financial sources. Our objective is discovery not coverage. We are willing to look in different places to better understand the risks and opportunities of investing in China, and focus our research on a small number of companies with sustainable growth potential. Our philosophy, time frame of analysis and long investment time horizons require a different approach. In particular, we find that relationships with industry thought leaders, academics and unlisted companies provide a valuable flow of ideas, and often a genuinely differentiated perspective. We also benefit from working alongside other investment managers and analysts within Baillie Gifford who also research Chinese companies. All bring a truly long-term, active, growth mind-set. By feeding into broader strategies, our Shanghai investors are an important part of discussions about global opportunities and local innovation, which often lead to new ideas for research.



### Investment research

Fundamental research sits at the heart of our process and is the source of added value for our clients. We are interested in detailed, differentiated, proprietary research focused on the long-term outlook for companies and industries. Every new idea to the portfolio must be passed through our research framework to ensure long term fundamentals are thoroughly analysed. This also provides a consistent and replicable process. The research process comprises two parts. First is a 10-question stock research framework which contemplates the scale of the opportunity and focuses predominantly on the upside investment case. Second is a due diligence checklist which is more focused on downside risk management including ESG factors.

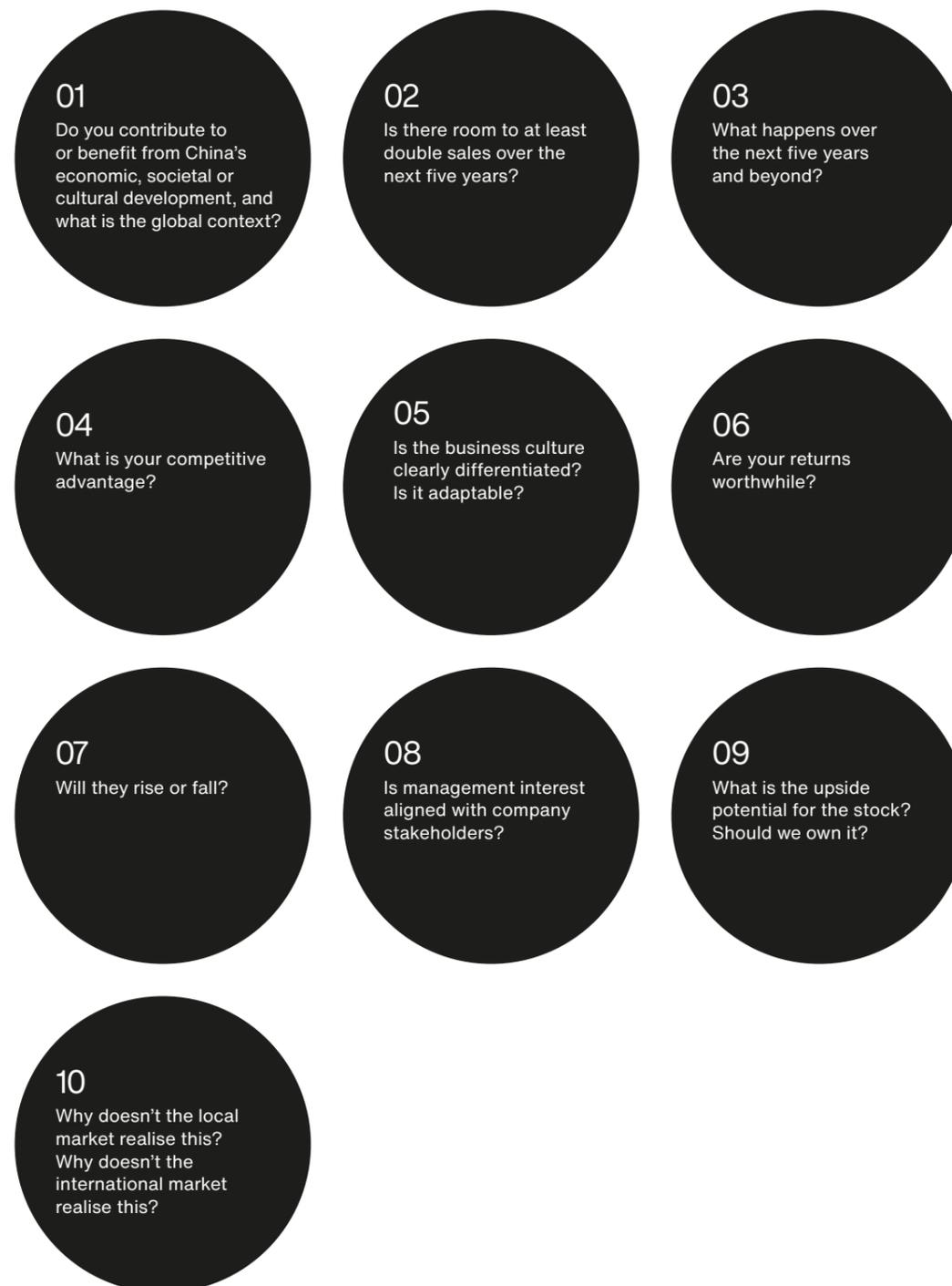
The 10-question framework encourages us to consider the scale of the opportunity for the company over the next five-to-ten years along with the cultural and financial factors which will allow the company to capitalise on this opportunity. When conducting research, we will draw heavily on the Shanghai research platform which provides closer access to visionary management teams, independent academics and industry leaders in China. We aim to marry this local insight with the broader understanding and global context provided by Baillie Gifford's wider connections and the stock research of Baillie Gifford's global and regional investment teams.

We use the answers to the questions to help us construct a range of outcomes, which look at the long-term scenarios for the value of a company and the likelihood of success.

Our long investment horizon means that the sustainability of a business is central to our analytical work. When owning a company for five plus years rather than parking the money on its share price for a few months, we ask different questions. While our objective remains resolutely in maximising long-term investment returns, helping the portfolio's companies push toward industry best practices in all aspects of their corporate behaviour should be entirely consistent with this aim.

We focus on environmental, social and governance (ESG) factors that are of investment relevance in the long term. These are built into our 10-question research framework. In addition, we have a proprietary due diligence checklist which looks further into ESG, management ownership, financials and previous history. This may be supplemented by third party forensic analysis through our long-term relationships with these independent due-diligence experts as and when required.

### The 10-question framework





# Portfolio construction

Ultimately, the decision to buy or sell a stock is taken by the portfolio construction group which comprises Sophie Earnshaw and Linda Lin.

We are agnostic to where we find the best growth companies in China. By focusing on a portfolio of 40-80 companies, we can narrow our efforts towards only those companies that have the potential to double over five years. The weight of any new holding will be aligned with the enthusiasm for the stock among the group, and reflective of both its potential upside, the probability we associate with this, and the competition for capital among other holdings within the portfolio. Individual stocks are selected on their own merits based on the value they bring to the existing portfolio.

Given our long investment horizon, 'ownership' is actually the longest part of our process, including ongoing research, engagement and portfolio management. The understanding gained through this period is a critical part of our investment approach.

The China Team meets weekly for formal stock discussions, alongside sharing ongoing research and threads of exploration. The decision makers meet monthly on a formal basis to discuss the overall composition of the portfolio. There are also quarterly ESG and risk reviews. This is in addition to the many ad hoc discussions that occur between the team and our wider investment colleagues.

**Some of the factors considered when weighting new ideas are:**

- The level of conviction in the investment case.
- The potential share price appreciation and portfolio return if our analysis proves correct.
- Assessment of the probable impact on the performance of the portfolio if we are wrong.
- Overall shape of the portfolio and concentration of risk: what does this idea bring to the portfolio?

Our sell decisions are generated by frequent re-examination of our holdings. We particularly look for an adverse change in the fundamentals of a business, a loss of confidence in management or valuations where we think the market fully reflects our long-term view. We accept that we make mistakes and in these instances are quick to sell, and move on.

# Risk

**Our approach to risk is pragmatic. It seeks to ensure that portfolios are sufficiently diversified and managed in accordance with client guidelines, while at the same time accurately reflecting the team's investment convictions.**

We believe that the risk of an investment losing money is the most important risk to any portfolio, over and above risk as defined by tracking error or volatility. In addition to the aspects highlighted below, Baillie Gifford's dedicated Investment Risk, Analytics & Research Department uses a range of tools and measures to analyse risk within our portfolios. These include risk models provided by APT (Advanced Portfolio Technologies), Style Research and Factset. Our Investment Risk, Analytics & Research Department is highly experienced in using these models and has a detailed understanding of their methodologies, as well as their limitations.

The following are the main aspects of risk that we consider:

## Fundamental risk

Our first line of defence is rigorous stock analysis. New buy ideas are subject to thorough review by the China Team. The investment case for all holdings is constantly re-examined, with input from a plurality of Baillie Gifford research teams. We will tolerate uncertainty in an investment case, and embrace the possibility that any individual investment may have a wide range of outcomes.

## Portfolio risk

We seek to maintain an appropriate level of diversification at the overall portfolio level in order to mitigate analytical mistakes. The investment managers take the overall portfolio context into account when considering any buy or sell ideas that result from the weekly stock review. Our aim is to assess the real risks within the portfolio through forward-looking and open-minded debate, rather than relying solely on backward-looking risk models. Every quarter the portfolio risk guidelines are formally reviewed by the risk department and the product group. This comprises the senior investment managers, risk manager, investment specialists and representatives from our Shanghai office.

## Liquidity risk

We have guidelines that ensure the portfolio remains sufficiently liquid, to enable positions to be exited or client cash flows to be managed with minimal impact on the overall strategy. These rules have evolved from our long experience of investing in Emerging Markets.

## Trading risk

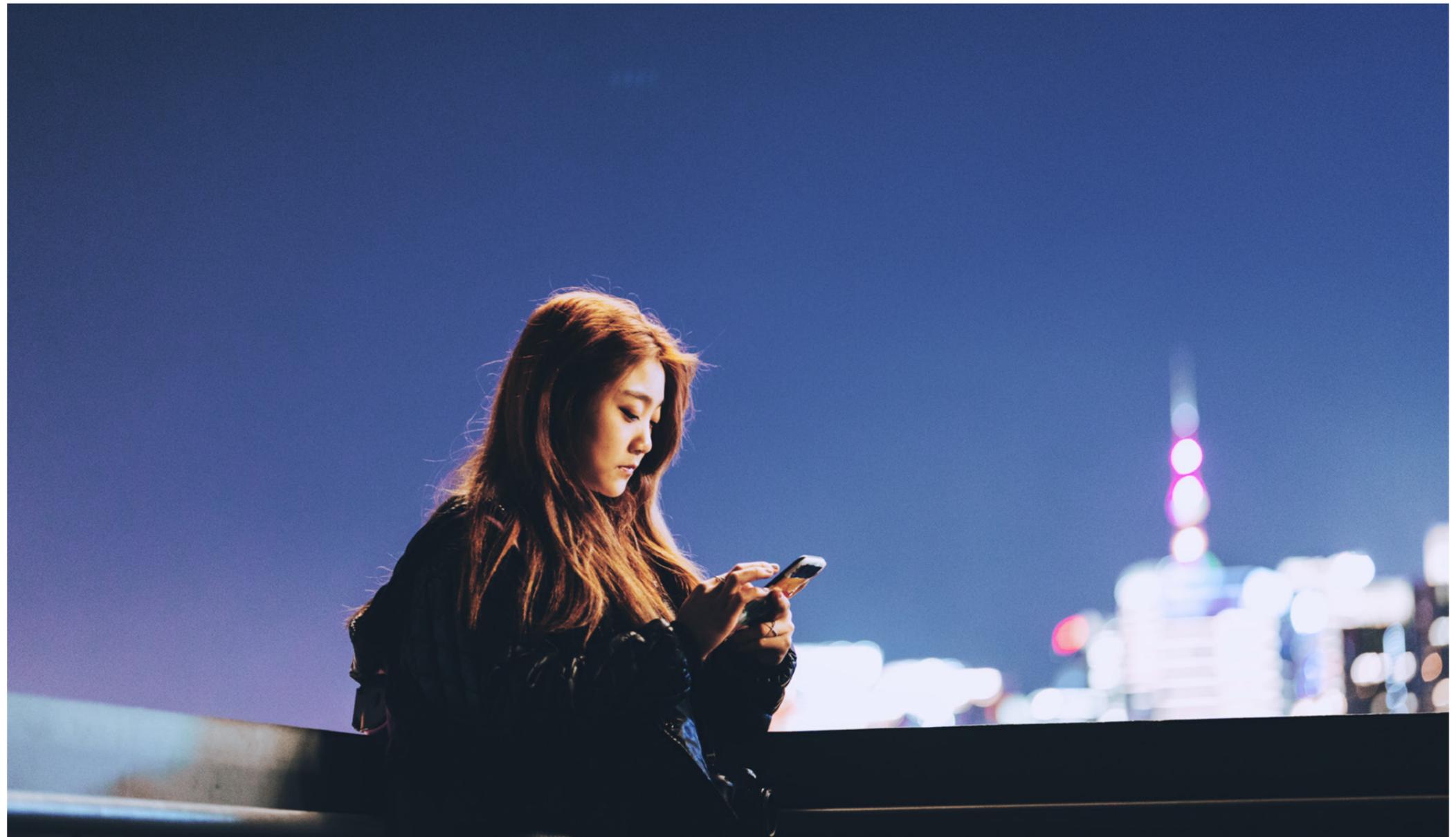
Baillie Gifford has a dedicated Trading Team. In addition to this separation of functions, our proprietary Restrictions System is designed to prevent inappropriate transactions before any trading takes place.

<b>Benchmark</b>	MSCI China All Shares
<b>Time horizon</b>	5+ years
<b>Number of holdings</b>	40-80
<b>Individual stock limit</b>	Index +10% (subject to vehicle rules)
<b>Number of industries</b>	Minimum of six industries (no more than 75% in top three)

# Conclusion

This shift from a poor developing country to a major economic power in just a few decades has been spectacular. It has forced other countries to ask how China's rise may impact their economic interests and global influence over the next century. China's inclusion in global bond and equity indices has also shone a light on the ongoing capital market reform process and the opening of its domestic markets to the world. We believe the speed and scale at which innovation and development have taken place cannot be overlooked. China has already produced some of the biggest and most innovative companies in the world.

This is why we at Baillie Gifford remain excited as long term investors. We believe a poorly researched market dominated by short-termism with large return dispersions is an exciting one for patient, curious stock pickers.



# People



**Linda Lin**  
Investment Manager

Linda is the head of the China Equities Team, and a decision maker on our All China and China A share strategies. She is also a member of the Long Term Global Growth (LTGG) Team. Linda joined Baillie Gifford in September 2014 and worked in Edinburgh until relocating to Shanghai in 2019 as Head of the Investment Team. She became a partner of the firm in May 2022 and is now based in Edinburgh. Prior to joining Baillie Gifford, Linda spent four years as a global equity analyst with Aubrey Capital and two years in real estate investment in China. She graduated BComm in Accounting and Finance from the University of Auckland, New Zealand in 2007 and MSc in Finance and Investment from the University of Edinburgh in 2011. Linda is a native Mandarin speaker.



**Sophie Earnshaw**  
Investment Manager

Sophie is an investment manager in the China Equities Team. She is a decision maker on our All China Strategy, which she has managed since 2014, and on our A Share Strategy since its inception in 2019. She also provides China insight to the Emerging Markets Leading Companies and International All Cap portfolio construction groups. She is a CFA Charterholder and graduated MA in English literature from the University of Edinburgh in 2008 and MPhil in eighteenth century and romantic literature from the University of Cambridge in 2009.



**John MacDougall**  
Investment Manager

John is an investment manager and decision maker in the Long Term Global Growth (LTGG) Team. He is also a member of the China A share portfolio construction group. John has been a partner in the firm since 2016. He joined Baillie Gifford in 2000 as an investment graduate. Prior to his current roles, he worked in the North American, Japan and Global Discovery teams. John graduated MA in Ancient & Modern History from the University of Oxford in 2000.



**Rio Tu**  
Investment Manager

Rio is an investment manager in the China Equities Team, and Head of Investments in our Shanghai office. He joined Baillie Gifford in September 2014 and moved to Shanghai in 2019. He previously worked in the Global Income Growth and Emerging Markets teams. Rio is a CFA Charterholder. He graduated MA (Hons) and MEng in Engineering from the University of Cambridge in 2008, after which he remained at the University, working as a research student in the Department of Engineering. Rio is a native Mandarin speaker.



**Louise Lin**  
Investment Manager

Louise is an investment manager in the China Equities Team, and Head of Research based in Shanghai. She joined Baillie Gifford in September 2014 and moved to Shanghai in 2021. She previously worked in the Japanese Equities and Global Discovery teams. Louise is a CFA Charterholder and graduated MMath in Mathematics from the University of Oxford in 2013. Louise is a native Mandarin speaker.



**Tony Wang**  
Investment Manager

Tony is an investment manager in the China Equities Team. He joined Baillie Gifford in 2020 and is based in our Shanghai office. Before joining Baillie Gifford, Tony spent four years as an investment analyst at CIC in Beijing. He graduated MA in Financial Mathematics from Columbia University and BSc in Applied Mathematics at Tsinghua University. Tony is a native Mandarin speaker.



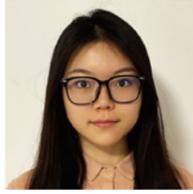
**Freddy Zhu**  
Investment Manager

Freddy is an investment manager in the China Equities Team. He joined Baillie Gifford in 2020 and is based in our Shanghai office. Before joining Baillie Gifford, Freddy spent two years as an investment analyst at CICC focusing primarily on the energy sector. He graduated MA in Energy and Environment from Johns Hopkins University, MA in International Relations from Tsinghua University, and BA in Economics and Finance from Tsinghua University. Freddy is a native Mandarin speaker.



**Clark Ren**  
Investment Analyst

Clark is an investment analyst in the China Equities Team. He joined Baillie Gifford in 2022 and is based in our Shanghai office. He graduated from Cornell University in 2021 with an MS in Applied Economics Management and completed a BSc in Finance and Business Analytics from Indiana University Bloomington. Clark is a native Mandarin speaker.



**Doris Gu**  
Investment Analyst

Doris is an investment analyst in the China Equities Team. She joined Baillie Gifford in 2023 and is based in our Shanghai office, where she was an intern in 2020 and 2022. She graduated from Renmin University of China in 2023 with a MA in Finance and completed a BA in Biology from Tsinghua University. Doris is a native Mandarin speaker.



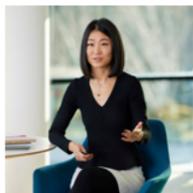
**Lin Qin**  
ESG Analyst

Lin is an ESG analyst in the China Equities Team. She joined Baillie Gifford in 2021 and is based in our Shanghai office. Before joining Baillie Gifford, Lin spent two years as a climate change consultant at the World Bank in Washington D.C. She graduated MA in Energy and Environment from Johns Hopkins University, MA in International Relations from Tsinghua University, and BA in English Language and Literature from Tsinghua University. Lin is a native Mandarin speaker.



**Ben Buckler**  
Investment Specialist

Ben is an investment specialist and he chairs the China Product Group. He joined Baillie Gifford on the Investment Management Graduate Scheme in 2001 and was an investment manager in our Emerging Markets Equity Team until 2008, when he relocated to China. Ben worked in Hong Kong for six years as an executive director in the Asian Equities business at UBS. He returned to Baillie Gifford in 2018. Ben graduated MA in Geography from Mansfield College, Oxford in 2001, holds an MBA from the University of Oxford and is a CFA Charterholder.



**Qian Zhang**  
Investment Specialist

Qian joined Baillie Gifford in 2021 as an investment specialist in the Emerging Markets Client Team. Previously, Qian worked as a senior client portfolio manager covering Emerging Markets strategies at Pictet Asset Management and JPMorgan Asset Management. She began her career at Merrill Lynch in 2008. Qian graduated MSc in Mathematical Risk Management from Georgia State University and BSc in Economics and Statistics from Peking University. Qian is a native Mandarin speaker and a CFA Charterholder.

# Why invest with Baillie Gifford?

## Our partnership structure

We believe that no investment firm, however rigorous its approach, can consistently achieve great things for clients if the right corporate conditions are not in place. Baillie Gifford is an independent investment manager, wholly owned by the partners who work within the firm. The partnership structure has prevailed for over 115 years and enables us to take long-term views. We see it as a key strength because successful investment management is not easy. It requires dedication, independent thought and a long-term perspective.

We are not a faceless corporation, we are a place where we do everything we can to let individuals thrive and ideas flourish. Our satisfaction comes from the pursuit of knowledge and its application to investments, knowing that if we do a good job, as well as achieving outperformance for clients, we will have contributed to society's progress too.

## Long-term investment horizon

We are long-term investors in everything that we do. This philosophy permeates the firm, driven by an understanding that companies don't grow overnight, nor do they grow in a straight line. Inevitably there will be periods of market doubt and volatility, especially for those businesses that are growing quickly. Remaining patient and supportive shareholders during such periods is crucial if our investment teams are to benefit fully from the asymmetric return potential offered by these companies. A long-term perspective is also valuable in recognising the power of compounding and the performance that can be generated from companies which compound their returns over decades.

## Benefitting from multiple perspectives

Imagining what the future may hold requires mental flexibility. We need to imagine the potential implications of dramatic change and embrace uncertainty. We need to be ready to let go of preconceptions, while continuously learning and adapting our thinking to consider what we have learned. Trying to be precise is the enemy of good investing. In times of profound change we believe our interdisciplinary approach gives us an advantage.

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### Hong Kong

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