# CELEBRATING 20 YEARS OF OUR INTERNATIONAL GROWTH STRATEGY

MB Malcolm Borthwick

NT Nick Thomas

JA Julia Angeles

MB Hello. I'm Malcolm Borthwick, managing editor at Baillie Gifford. "The immediate economic outlook is at worst grim, at best uncertain. Recession cannot be ruled out. Unpredictable factors such as the war, financial sector problems and the activities of hedge funds make the immediate outlook even more opaque than usual."

So, when do you think that was written? A few months ago, perhaps? It was, in fact, published 20 years ago in the International Growth Strategy's first quarterly report. Since that time, the strategy has grown and flourished.

Some things have changed over the last two decades. For example, back in 2003 the top 10 holdings included the energy titans BP and ENI. The strategy no longer holds any oil and gas companies. Instead, it's made up of transformational growth firms, including computer chip equipment maker ASML and the ecommerce champion Mercado Libre.

But other things have remained constant. Vanguard, for instance, remains the strategy's cornerstone client. L'Oréal, the cosmetics company, and Atlas Copco, a leader in pumps and power tools, remain core holdings. And our commitment to long-term growth investing is unwavering.

Another constant is Nick Thomas, who helps make International Growth's investment decisions, and he joins us here in our Edinburgh studio.

But before we start the conversation, please remember that as with all investments, your capital is at risk and your income is not guaranteed. Nick, great to have you with us.

NT Thanks Malcolm, it's a pleasure.

MB So let's start with why the strategy was formed back in 2003.

NT Yes. So back in 2003, it's fun to remember back that far, back to the start of my career as a young investment graduate at Baillie Gifford. I think we were responding to two factors, one of which was external and one was internal.

So the external one came from a client, you mentioned them already, Vanguard, who… They liked our investment approach and how we picked stocks. They liked our structure as an independent partnership with great stability. They thought our portfolio construction was feeble. And they said, we'd love to appoint you to a mandate. Can you make a more excitingly built portfolio with fewer stocks and less overlap?

That was pushing on an open door internally because James Anderson, who was the pioneer of this strategy, he'd been arguing in favour of building portfolios more like that, with more ambition, for a while. So I think that external impetus married up very nicely with what James wanted to do. And then off we went.

MB And what were you trying to achieve as a strategy? Because there was a bit of a change in approach in the early years, wasn't there?

NT Yes. There was a lot of evolution, I mean it's been great. I've spent quite a lot of the last week or two reading back through the papers over the last 20 years to remember what was happening. There was a lot of evolution at the beginning because it's a big difference, you know, to build portfolios in siloes, with individuals managing different pieces of them. It's a big change to come together and build it as one holistic whole. There's a lot of cross-comparisons that have to be made, there's a lot of investment styles that have to be aligned and you have to iterate at it. So I think it took us five or six years actually to hit a tempo that would be more recognisable to what clients now have.

MB And in the early years, the splits were more geographical and the style change more towards a bottom-up stock picking. Is that correct, Nick?

NT I think so. The bottom-up/top-down distinction that we hear a lot about in investment, I think we've done quite well to blur that. What we've tried to do is invest in areas that we think have great thematic growth, where there are big tailwinds blowing behind them and where we can find great stocks run by interesting entrepreneurs. So it's that confluence of top-down and bottom-up that I think we've really focused in on. So I would push back against that distinction slightly.

MB And tell me a little bit about your own role in the strategy, Nick. Because in the early days, you were an investor, weren't you?

NT Yes, I got involved when I was a young analyst and became a portfolio manager and helped James and the team to go through that process of iteration and process change, and how to make up a more concentrated portfolio that expressed its views in a more concentrated way, that went up the risk spectrum and aligned to what clients really needed.

We developed the sense that most of our clients were overdiversified and were looking for a more committed international portfolio, and we thought we should be able to deliver that to them. And then that was the work of the early years, was getting there. I then transitioned in about 2009 to work more on our client side, so to become a specialist on the portfolio that I'd previously been a portfolio manager of, stayed on the decision-making group to try and help from that angle, and that's the role I still have today.

MB And do you find it helpful, having been involved in the investing side of it, transitioning to the client service side of it?

NT Yes, I think it's undeniably the case. You have an advantage in trying to explain to your client base why you're doing certain things if you've been involved hands-on yourself. And I think it also makes you a better colleague to your investment team, because you understand the pressures and the time horizons, and where the stresses can come from, and you can hopefully be a better shield to allow them to invest really successfully.

MB And I'm particularly interested, as I mentioned in the introduction, in the two stocks that have remained in the portfolio over the last couple of decades, L'Oréal and Atlas Copco. What's the enduring appeal of these two companies?

NT Yes, it's great, isn't it, that we have some that have gone… And they go back beyond the start of our strategy. I think they've both been invested in by Baillie Gifford clients back into the 90s, and maybe even earlier.

Well, I think there's two things in the International Growth team that we really look for in companies. It's a transformational growth opportunity, or a very distinctive culture. And you can't really argue that making air compressors or makeup are necessarily transformational businesses, so you have to be very convinced about the distinctive cultures. And I think in both cases, you do have that.

In Atlas, you have a very decentralised, very entrepreneurial business that has been incredibly efficient and dominated its industry for a very long time, just lots of very small incremental gains that its customers benefit from, and very sticky customers.

And at L'Oréal, you've got the stability of basically a family ownership sitting behind it that allows it to invest in a long-term way and just gradually squeeze out its competition. So I think they both fall into the category of distinctive cultures that is a big feature of our portfolio.

MB And it's not always easy to be a long-term investor in terms of building conviction in companies, and also having hold discipline, like you're saying there with both L'Oréal and Atlas Copco. So, one of the questions that I put to one of your colleagues, an investor in the strategy, was which company did she find had been the most challenging to buy and hold over the years.

JA Hi, I'm Julia Angeles. I am one of the Investment Managers for International Growth. So one that comes into my mind is ASML. This is a company that produces machines that help us to drive Moore's Law, so more computing power at lower cost. And the technology they develop is very, very complex.

And at the time, most of the demand for the semiconductor industry came from the consumer electronics. So, when people looked at that industry, they thought, actually, how does this industry elevate growth, because we're already so penetrated on smartphones, iPads, etc?

But one of the areas that many people always saw is, actually, how the power of data and analytics has been gradually transiting to other areas beyond consumer electronics. So we start seeing, first, online ecommerce, online shopping, application in healthcare. Suddenly, data became important for many different industries. And at the time, it was a bit controversial because you need to make a bit of a leap of faith, and you almost need to be a science fiction lover to see actually where technology could get. So this is one of the areas.

And another one, what was also difficult at the time, is actually to get some conviction that the company can continue succeeding in driving the cost and bringing new technology to actually continue the Moore's Law. And that's where we made our own assessment and made the leap. And eventually, actually, we got it right.

MB And that was Julia Angeles. International Growth first purchased ASML in June 2013 and as at the end of October 2022 it was the strategy's largest holding. Thinking more broadly, Nick, how has the strategy evolved over the last couple of decades, both in terms of its client base and its portfolio?

NT Yes. So the client base has been remarkably stable. I think that's been one of the biggest advantages and helps that we've had as a team. So, essentially, our current client base, the majority have been with us for over 10 years and have been on this journey with us. And I think that gives us confidence and stability as we go through the ups and downs that we have.

In terms of evolution, I would put it in two categories. I think there's been quite a strong sense of rotation, if you like, of the economic themes and geographic themes in the portfolio. They've been through three or four cycles in a 20-year period, roughly demarcated.

And then there's been evolution in the investment style that we've pursued, where we started out, a heavy focus on compounding growth, very high-quality companies with lots of visibility and great balance sheets and very respectable businesses. That's evolved over time to a focus on more transformational growth, higher top line expansion, less developed business models – in some cases younger companies with bigger growth opportunities in front of them.

So, I think we've become more 'growthy' and our portfolio construction has become quite a lot more ambitious. So, we're prepared to have more money in the biggest holdings, that would not have happened 20 years ago, and to have greater concentrations of themes in the portfolio as well. So we've evolved in a couple of directions.

MB And what's the thinking behind that greater concentration?

NT I think it's partly just we try and listen very closely to what our clients want. And I think as we've gone along this journey, they've appreciated it, it's fitted in with what they need in their much bigger overall plans. So that's been helpful. I think that close connection to what clients want has always been very good.

And it also reflects what we see in the world around us. So, we've detected, probably, I think, going back 12 or 13 years, you start to see reference to this in the papers, 'winner takes all' economics really taking hold in some industries. And I think it's one thing that we've been quite good at, is just reacting to changes in the world as we see them.

So that pushed us towards the logic of, well, rather than having 80 stocks in the portfolio, maybe 50 would be a better number because there probably aren't 80 big winners out there. So that process of concentration was driven partly by just keeping our eyes open and seeing what was happening in the world of business.

MB And is there anything, looking back at the evolution of the strategy, where you see one or two key inflection points?

NT Yes, I think there are. There was a big shift in the late 2000s, so sort of 2007/8. The period up to then had been dominated by investing in the commodity super-cycle, if you like, and the underlying driver of that was the industrialisation and urbanisation process in China.

So, you mentioned at the beginning of our conversation, we had some oil companies in the portfolio that were benefiting from that. We had mineral mining companies that were benefiting from that. So these are stocks that, looking at the portfolio now, you would never expect to see them. But that was a big growth driver at that point.

That then shifted into much more… We've always been very interested in emerging markets and been heavily exposed to it. It shifted into much more domestic consumption in emerging market companies, so banks in Turkey, banks in India. And then perhaps the dominant theme in the portfolio, if you look on a 20-year view, what is happening in China, so the shift towards some of the Chinese consumer companies that played a very big role.

MB But I'm interested. A lot of the portfolio at the moment is in mainland Europe, maybe as much as 60 per cent.

NT It is. I'm struggling to provide an overarching narrative as to why that is. One thing that we've talked about over the years is the importance of cities and clusters. So, you could maybe say that in Europe there are some very interesting cities. We zeroed in on Berlin in the sort of 2009/10 period as being one where a lot of companies were being created, and that's been quite fertile for the portfolio.

A lot of them came through the Rocket stable. We have Zalando in the portfolio, as an example, that stayed in for a long time. You have the Danish, and in the Low Countries, clusters of biotech and biomedical expertise. They've become quite heavily exposed in the portfolio, and Julia has done a great job of deepening our knowledge there.

And we got very interested, perhaps a bit later than we should've done, in luxury goods companies. So to define that broadly, that goes from Northern Italy and Ferrari over to Paris and some of the brands that are run out of there. So that's quite an area where Europe has a lot of comparative advantage as well. So I tend to think of it in those clusters rather than how much we're exposed to Europe.

MB Yes, absolutely. And what have you learned over the last 20 years, as a strategy and as investors?

NT Well, one thing that stood out to me as I read through all of our many hundreds of minutes that went back that far is how frequently we were brave at the point where others were fearful. So quite a few, if you're looking for turning points, places with a lot of stress in the market.

So, the financial crisis, 2008/2009, the Eurozone crisis which, sort of around 2011/12 I guess, where what we were doing was saying, this is a short-term phenomenon, it doesn't derail the big hypotheses we have about what's happening in the world, and it's giving us buying opportunities in exceptional companies. And it was around those times that companies like ASML or Baidu or Tencent or PPR came into the portfolio for the first time. And then you now know, with hindsight, that they were the great investments for the next decade.

So that resonates a lot with me at the moment, because we're obviously in another period of financial stress. And I think it's great for us to be able to remember and look back on those periods and say, well, that's when we actually added the most value for the next decade, was by being brave and persisting with our approach rather than caving into the pessimism that always abounds at those times.

MB Yes, I think the point you raised about pessimism there and the need to be optimistic is really important. Going back to 2010, James Anderson published a paper, *Rational Optimism, Confessions of an Unreformed Optimist*. And his opening paragraph is: "It is always hard to be optimistic. It usually appears naïve and unprofessional, yet almost any investment worth making is controversial. A world without challenges is improbable and a stock without walls of worry is usually unappealing."

I think that's as true now as it was then. So, let's go back to a view from now from Julia, to get her view on the importance of optimism.

JA Optimism is a scarcity, especially in the current environment when we are bombarded by so many negative news, from wars to inflation. And yes, so it's very hard to remain optimistic. However, technological progress is driven by optimists and optimism.

And first, we need scientific founders, innovators that create new technologies, and they need to be optimistic about it when they go into such a difficult task. And then we need investors who are also optimistic on behalf of the founders, that actually, they can get over the line. So we need the convergence of two. And I believe that it's actually our role to remain optimists if we are to find those companies that will define the future.

MB That was Julia Angeles there, speaking about the future. So staying with the future, there have clearly been a number of influential investors over the past two decades, but what about the next generation? Who are they and what do they bring to the team, Nick?

NT Yes. So we have a team of six that runs the portfolio. The three youngest members of the team would be Lawrence, Brian and Julia, who've all joined within the last decade. We have the advantage of being able to plan for the long term and pick who we think would be a good complement.

And optimism has always been a defining feature of our team, so I think it naturally attracts people who think like that, and it fits with what we're trying to do. I think, if you're trying to buy growth companies with a ten-year investment horizon, it's rational to be optimistic. And I guess that was the premise of James's paper, because what you're trying to do is find these right tail outcomes, these companies that can grow for a very long time. You need that mindset to do it.

Brian, Lawrence and Julia bring that in their own different way. We think people should invest with their own personalities and focus on the things that they're very interested in. So, Lawrence has played a great role in helping us deepen our understanding of China and has pioneered a lot of our work into the technology platform areas. That's been tremendously valuable. He's only getting going, I think. He's got a tremendous amount to offer, and he's now the deputy chair of the group.

Julia is an expert in the healthcare sector, has done a great job at developing external relationships with academics, founders, a wider range of interesting thinkers outside the walls of the finance industry, which is carrying on a theme that James started us with. That's really very valuable.

Brian is a specialist and a deep enthusiast for smaller company investing. That brings a whole different mindset to how you analyse a company, how you think about its bottlenecks, how you think about its place in a competitive landscape. So he brings something very distinctive to the team. So, you want people to bring their whole personalities and their own enthusiasm, and those three do it brilliantly.

MB So are you deliberately looking, when you recruit, for different personalities and investors who will be bringing a different skill set to the existing team?

NT Yes, I think so. Yes, that's right. There's a two-stage process. Who does Baillie Gifford recruit? And then who, within our walls, comes to the International Growth stable? And yes, at both levels, you want motivated, thoughtful, curious people, and then those who you think will fit within your recipe of a team.

MB And what do you think your point of differentiation is as a strategy with International Growth?

NT Well, I think to the outside world, I think simply having a long-term time horizon and being patient investors remains a very powerful differentiator. I think we've spent a lot more time in the last decade trying to analyse our own competitive edge as investment managers. And I think this is where this tolerance of short-term volatility and this willingness to seek out extreme outcomes has come more to the fore and become a more important part of what we do.

Because I think, well, we realise, or we believe, that not many others can do that very effectively within a corporate setting which kind of dominates the investment management landscape. It's difficult. It leaves you wide open to embarrassing failures. We think that by carrying on pursuing that, we're maximising our advantages.

MB And how do you make sure that the investors and the team get over those embarrassing failures? Is it hard?

NT Yes, I think so. I think there's lots of ways. I come back to – the clients are crucial. We have deep, long-term relationships with very professional clients who understand these points, and I think without that, you could not do it. I think we have a very strong culture internally at Baillie Gifford of assessed success over long periods of time.

Assessed them at the team level, not the individual level, which is a very important way of removing stress from the process and just to be clear about what you're trying to do. Because if you set out your framework, that you're going to be aggressive, ambitious, long-term growth investors, that makes it easier to tolerate the ups and downs.

MB We've talked about the inception of International Growth, the evolution of the strategy, but what about the next 20 years? What does that hold?

NT My crystal ball moment. Several things, I'm sure. The tempo of big thematic changes in the portfolio seems to be about roughly every five years, from what I can detect. I don't know if there's an underlying law as to why that is the case. So there will be several more phases within that 20 years.

At the moment, we feel like we're going into a growth phase in two different sectors. So in healthcare, where you're seeing this huge collision of the semiconductor technology that ASML have powered coming into contact with the genetic revolution of the last 20 years and big data that genetics produces, it's all colliding to suddenly give us a huge amount more knowledge about diseases and some incredibly almost magical tools to start treating them.

So we're very excited about what that means. As growth investors, you like nothing better than a huge industry that's getting disrupted by a new way of doing things. That's what healthcare looks like.

The other one is really in the energy transition space, where again it's very clear to us, if you take a long-term view, you can be highly confident that the fossil fuel industry is being replaced by renewable power, and that that has gigantic implications for the whole of society and not just the companies in those sectors. So we're working hard to find opportunities that should be thrown up by that big change.

MB So, it's good to end the podcast on an optimistic note. Nick, thanks so much for joining us.

NT Pleasure. Thank you very much, Malcolm.

MB And I hope you've enjoyed the conversation as much as Nick and I have. So, if you'd like to listen to more podcasts or find out more about what's on our managers' minds and what's shaping your investments, then check out the Insights section of our website at bailliegifford.com/insights. So, it's goodbye from us, and thanks for investing your time in this podcast.

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