Baillie Gifford™

China A Shares

Philosophy and Process

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Contents

Baillie Gifford™

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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† 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.

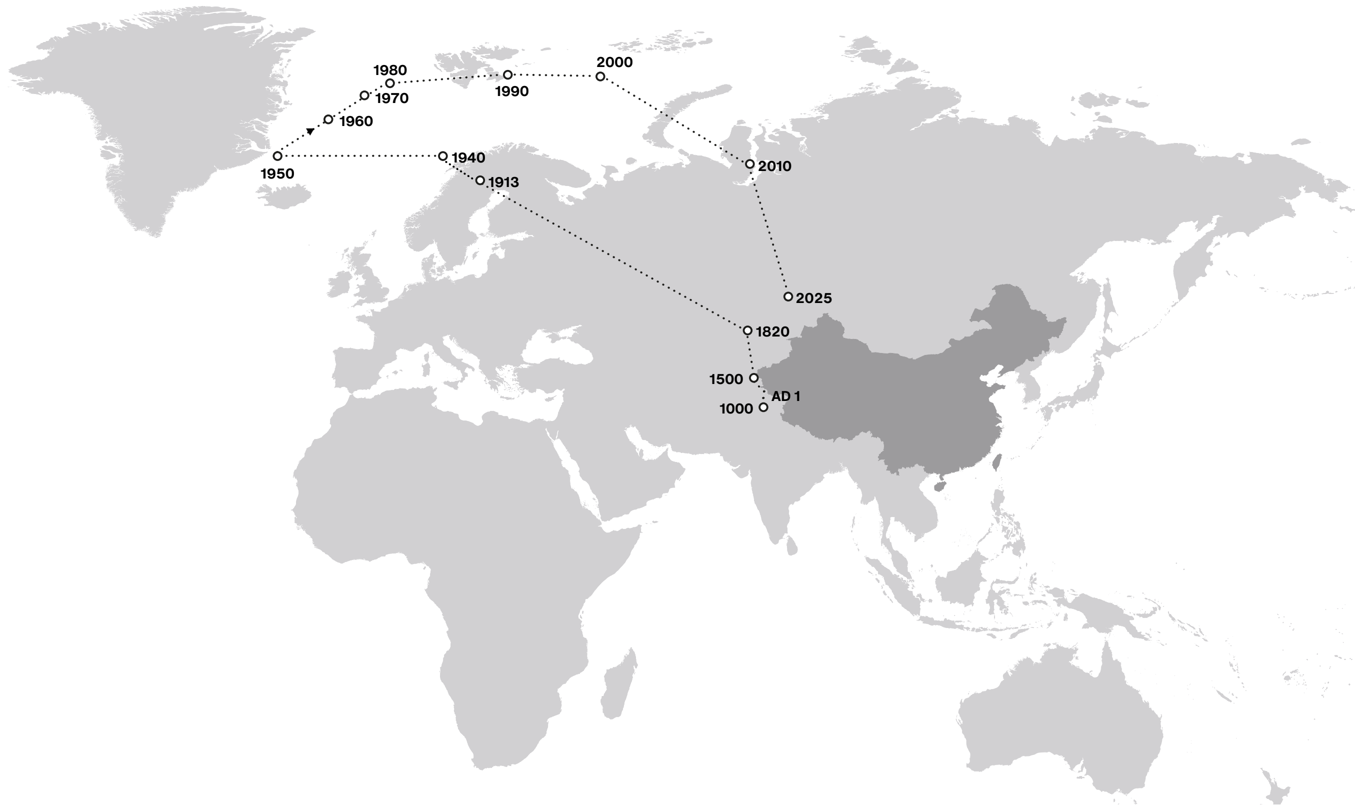
The size and scale of the opportunity, and the need for dedicated onshore and offshore resources with a global context and understanding, is asking questions as to the best way to gain exposure to the asset class.

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%	19%	26%	23%
of global market cap*	of global GDP by purchasing power	of listed stocks*	of big winners†

Source: FactSet, Worldscope.
*In MSCI investable indices.
†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 approach to China A Shares

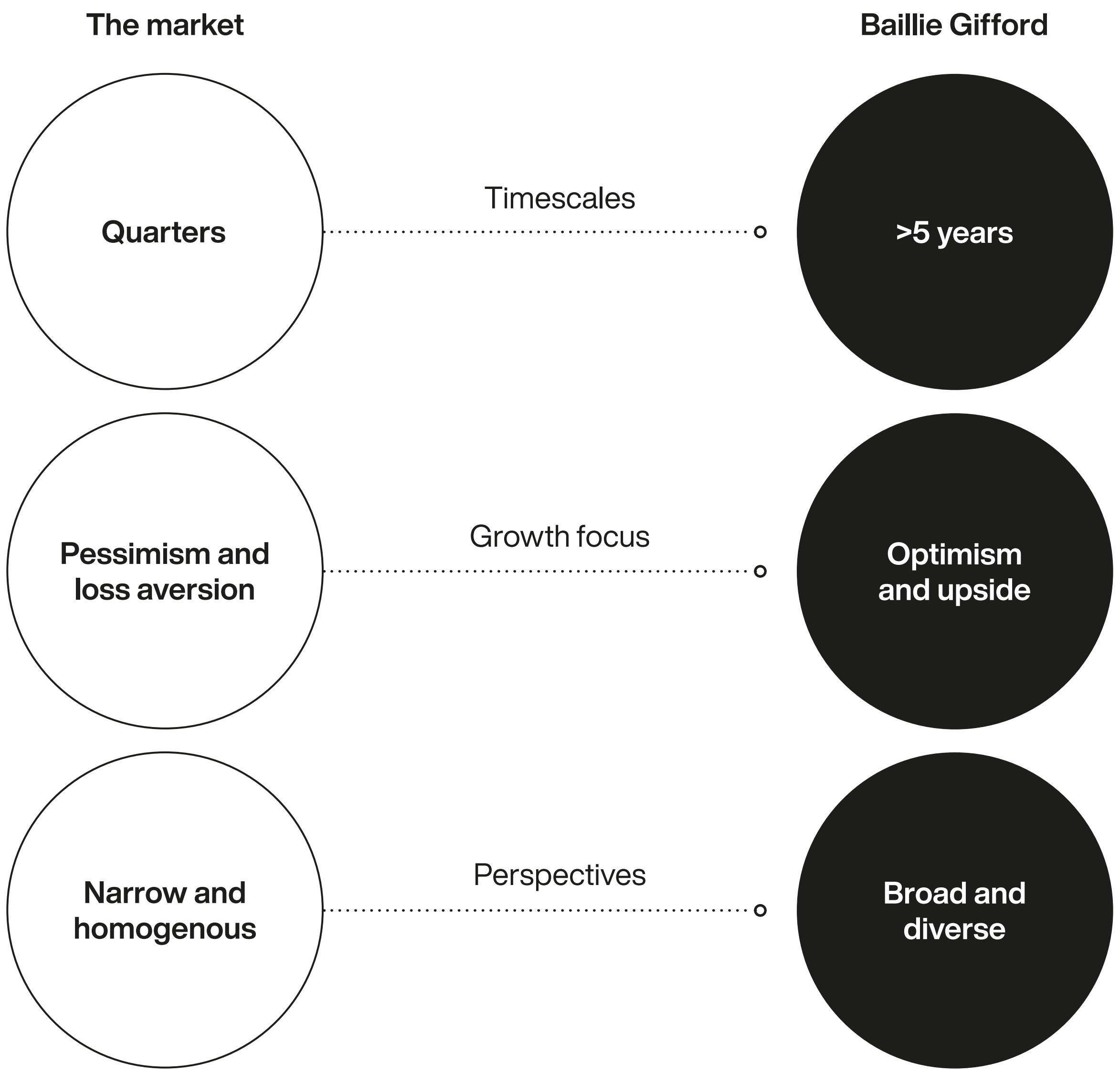
Strategy summary

The China A Shares Strategy is a purely stock-driven, unconstrained equity strategy focused on investing in exceptional growth companies listed on the domestic stock markets in China (known as 'A' shares). It has a concentrated portfolio of 25-40 companies listed on the Shanghai and Shenzhen stock exchanges.

The universe of China A Shares has over 5,000 companies. Over half of these are eligible to be bought via Hong Kong stock-connect. The MSCI China A Onshore Index is the broadest and most representative index.

The portfolio is benchmark agnostic. The companies which we invest in are expected to benefit from, and contribute to, China's economic, societal and cultural development, and be capable of growing to a multiple of their current size. We take a long-term approach with an expected investment horizon of five plus years. Our aim is to identify the exceptional growth businesses in China and hold them for long enough that the advantages of their business models and strength of their cultures become dominant drivers of their stock prices.

Our timeframe for analysis and ownership, as well as our upside focus, require a different approach and perspective. It is the stability and culture provided by our firm's partnership structure that allow us to pursue truly long-term, active, growth investing.



What makes this strategy unique?

This strategy is unique in three ways:

01

Timescales

In contrast to the short-termism of the average domestic market participant, it has exceptionally long holding periods.

02

Growth focus

Its core philosophy is centred on the asymmetry of stock returns and focuses on the upside of an investment case. We seek companies who have the potential for five times returns. This requires a long-term focus and an ability to be imaginative about the potential for China's best businesses.

03

Perspectives

It benefits from both global and local perspectives, as well as insights from academia, industry experts and visionary founders, with a long-term thinking framework beyond the traditional financial analysis.

Our China team

A dedicated China Team with experienced decision makers, bringing together onshore and offshore investors that balance local insights with global perspectives. All of our investment team 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 portfolio construction group and the investment specialists for the strategy sit outside of China. Baillie Gifford has circa 180 investment managers and analysts based in its Edinburgh office. 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 A-share 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.

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

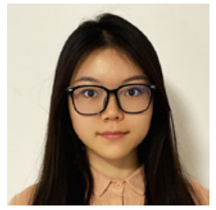
4 (8) years' experience

Freddy Zhu

4 (6) years' experience

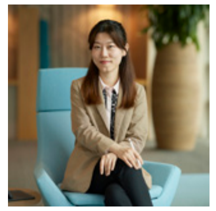
Clark Ren

2 (3) years' experience



Doris Gu

Joined in 2023



Lin Qin†

2 (4) years' experience

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

Identifying exceptional companies

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 investors within Baillie Gifford who also research Chinese companies. All bring a truly long-term, active, growth mindset. 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. It is predominantly focused on upside potential. 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 return, 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

01
Do you contribute to or benefit from China's economic, societal or cultural development, and what is the global context?

02
Is there room to at least double sales over the next five years?

03
What happens over the next five years and beyond?

04
What is your competitive advantage?

05
Is the business culture clearly differentiated? Is it adaptable?

06
Are your returns worthwhile?

07
Will they rise or fall?

08
Is management interest aligned with company stakeholders?

09
What is the upside potential for the stock? Should we own it?

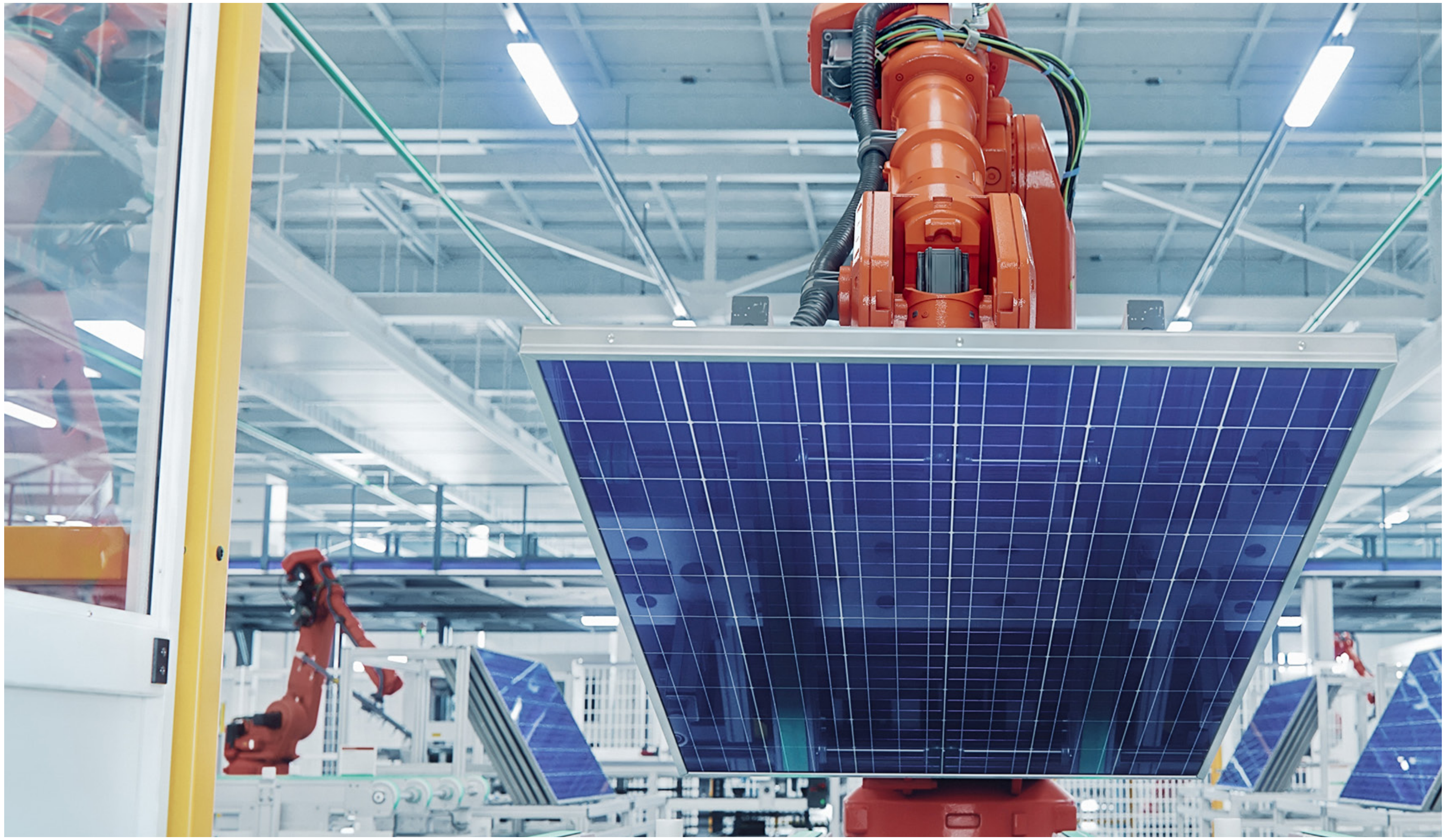
10
Why doesn't the local market realise this? Why doesn't the international market realise this?

Portfolio construction

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

We believe that exceptional growth companies are rare. We adopt a concentrated portfolio approach of 25–40 holdings. This enables us to focus our efforts on companies that we think are truly exceptional and to own them in such size that the impact of each will be meaningful to clients. 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 with no regard for their weights in an underlying index.

The China Team meets weekly for formal stock discussions, alongside sharing ongoing research and threads of exploration. The portfolio construction group meets quarterly to discuss the overall composition of the portfolio, aided by 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.



Once a company has been assessed through our 10-question fundamental research framework, the investment managers are responsible for making the ultimate decision on its inclusion (or otherwise) in the portfolio. There does not need to be consensus for a new idea to be bought for the portfolio. Strong emphasis is placed on backing individual enthusiasms rather than attempting to achieve consensus. The most rewarding investment ideas can be both controversial and highly uncertain to start with, and we believe requiring consensus on decision making would reduce our likelihood of buying such companies.

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.

Our buy and sell discipline is based on the fundamental characteristics of individual companies. Given our long holding period, ongoing research is actually the longest part of the investment process. Being able to identify new growth engines and prospects for a company is important, as well as understanding where growth is slowing and why. Ongoing engagement with the company leaders is important. We use our 10-question research framework to reassess the strength of the investment case on an ongoing basis. The inputs that these answers provide are then used to create a new set of long-term growth scenarios with their associated probability. This allows us to assess whether the investment's upside remains attractive.

Should the return no longer be sufficient to deserve a holding in the portfolio we will sell the holding. We do not have any triggers for automatic sales. The principal reason for a sale would be that the company answered the 10 questions less convincingly than before. Examples of situations that might lead to the sale of a stock include:

- An adverse change in the fundamentals of the business (e.g. deteriorating demand or evidence that a company's competitive edge was not as strong as we thought).
- A loss of confidence in management (e.g. where there are unexpected or poorly explained changes in management or where their actions are inconsistent with the long-term objectives).
- A situation whereby a company's shares have performed well to the extent that the scope for substantial upside has reduced, and there are better opportunities elsewhere.

We see risk differently

We believe that the main risk to clients who invest in the Chinese equity market is the failure in long-term wealth generation, not how close the portfolio is to an index. In our opinion, long-term success in equity investing requires risk taking and ambition, not excessive caution and downside risk aversion. We have a strong conviction that our A-share portfolios should be concentrated and focused on the long term, with portfolio positioning reflecting the upside potential we see in individual companies, rather than market capitalisation or any other benchmark-based metrics. It is the perceived uncertainty in an investment case that allows for the existence of substantial upside, and it is only through genuine and material differences to indices that we can hope to do a truly admirable job for our clients.

To this end, we believe many of the traditional risk tools are unhelpful. We do not intend to measure tracking error and we eschew the underlying assumption that the benchmark is a risk-free option for equity investors.

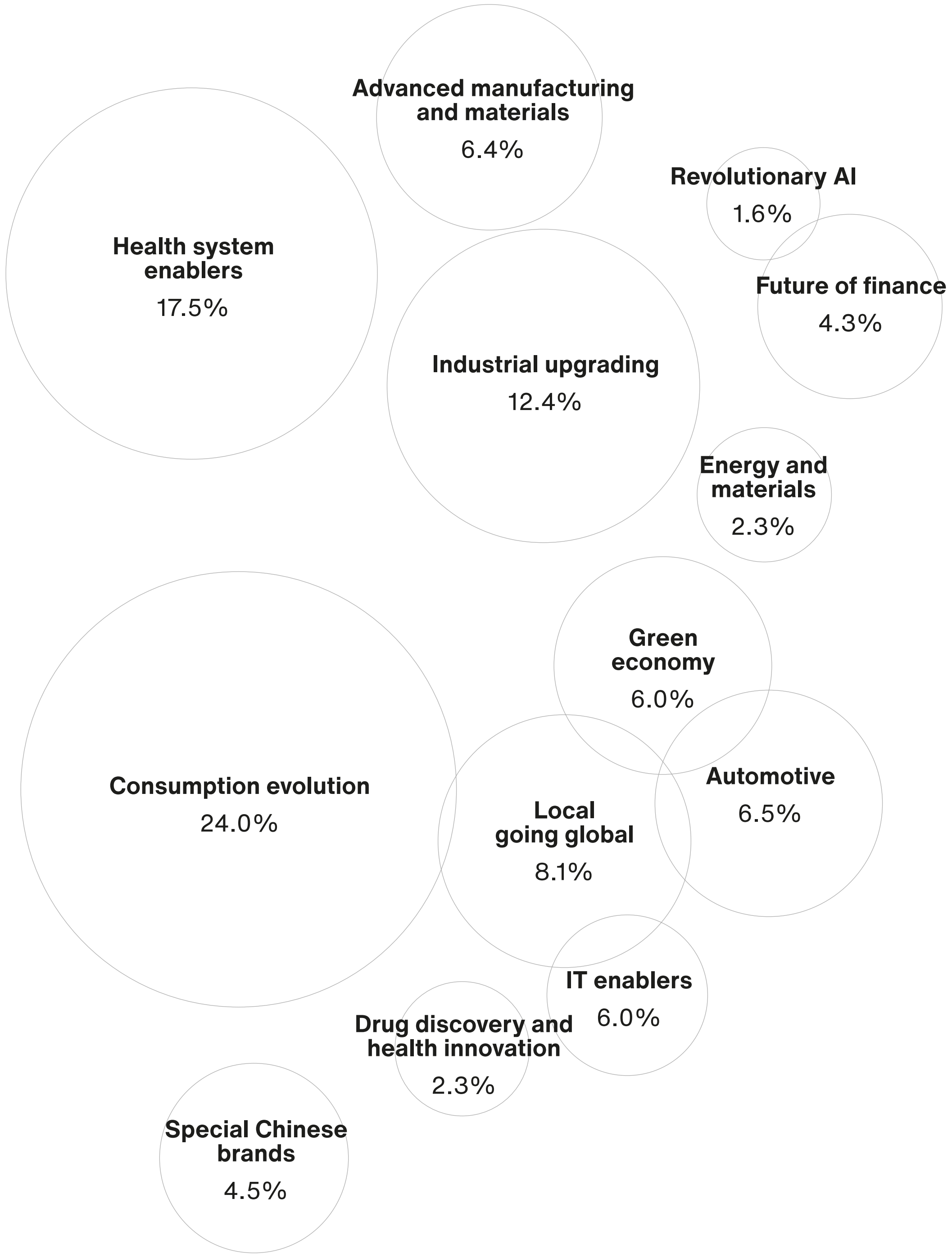
We also find MSCI-based sectors unhelpful as a risk management tool as they are often poor descriptors of a business and its risk profile. They are often broad and not reflective of an underlying commonality. This is particularly the case in China where the speed of development and addition of companies to indices are rapid and constantly changing. The large number of state-owned enterprises in the index and state involvement across a range of sectors also require an additional lens in terms of analysis of both opportunities and risks.

In addition to thinking carefully about the fundamental case for each individual investment in the portfolio, we manage the overall portfolio within a series of investment guidelines which are intended to ensure that there is a sufficient level of diversification in the portfolio. We believe that these controls are prudent in the context of the portfolio's overall objective of maximising returns over periods of five years and beyond.

Key characteristics

Benchmark	MSCI China A Onshore Index
Number of holdings	25–40
Maximum stock positions	Max 8% at time of purchase, 15% absolute for segregated mandates, 10% absolute for UCITs vehicle (5/10/40 rules apply)
Minimum number of sectors	5 (with a minimum of 5% in at least five)
Thematic risk analysis	25% in one category triggers annual thematic review
Liquidity	US$1bn market cap or above (at time of purchase)

We group stocks by the long-term growth drivers we have identified in our investment research, which is a subjective process. We believe that the real risk in the portfolio lies in the growth opportunities identified for individual companies not playing out, rather than how index providers choose to classify the companies in the indices. These thematic concentrations are expressed in the following Euler diagram.

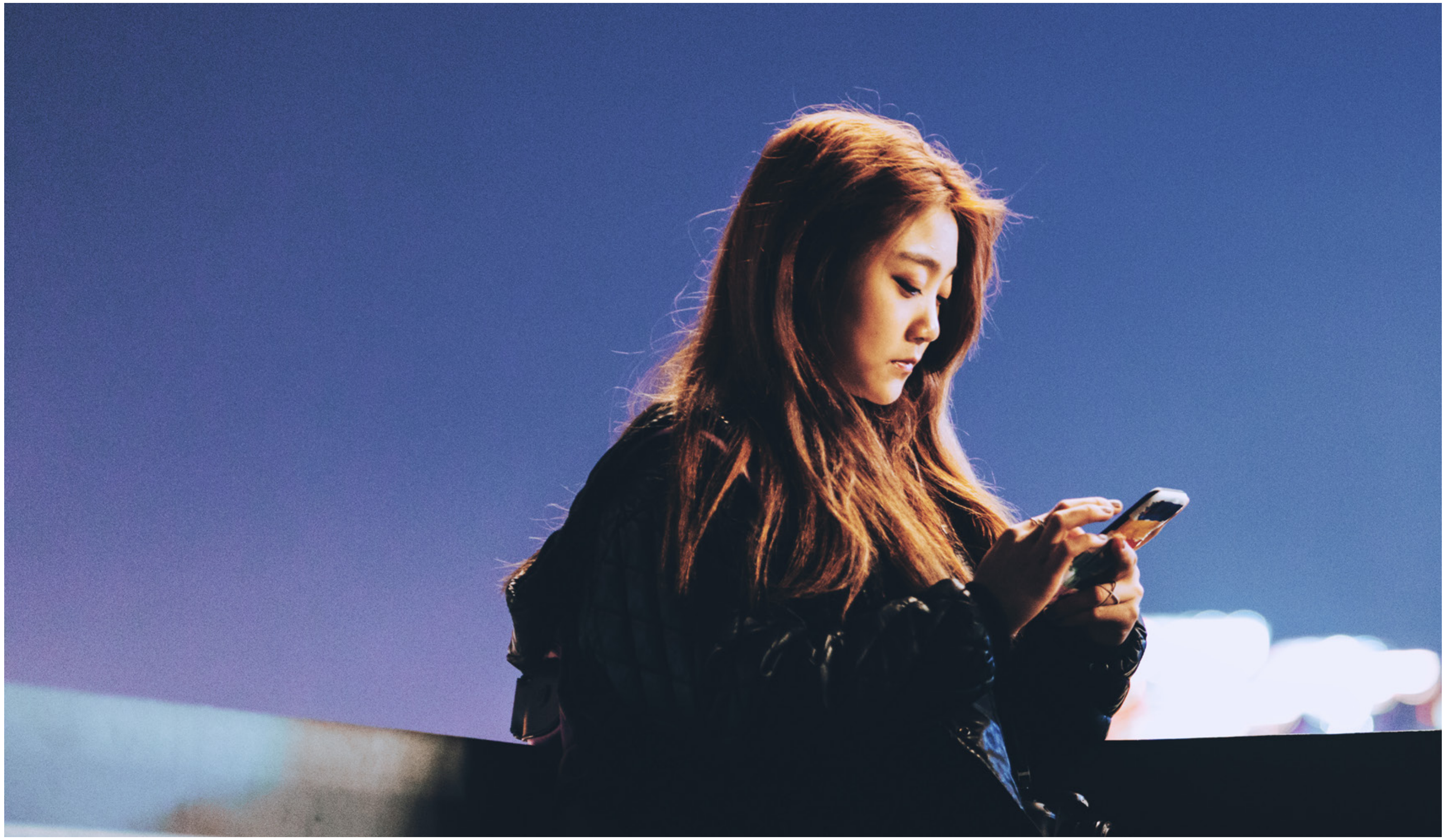


Based on representative portfolio as at 31 December 2023.

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 equity 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

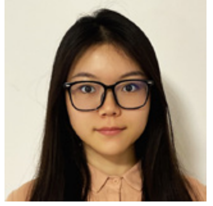
Tony is an investment manager in the China Equities Team. He joined Baillie Gifford in 2020 and is based in our Shanghai office. Before joining Baillie Gifford, Tony spent four years as an investment analyst at CIC in Beijing. He graduated MA in Financial Mathematics from Columbia University and BSC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

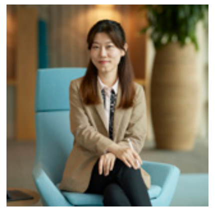
Clark Ren
Investment Analyst

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.

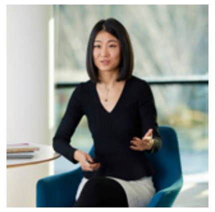


Lin Qin
ESG Analyst

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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