US Equity Growth

Philosophy and Process

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Baillie Gifford™

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Key beliefs

A small number of exceptional businesses will dominate stock market returns in the decades to come. These businesses will generate substantial and enduring growth, made possible by the strength of their business models and corporate cultures. Over time, this growth will become the dominant driver of their share prices and will deliver outstanding returns to patient shareholders.

We assess investment opportunities over periods of five years and beyond. This allows us to see value where others don't. We invest in the best of these opportunities for our clients and we hold them for long enough to capture the asymmetric upside inherent in their business models.

We search for a clear distinction between our view of a company's prospects and that implied by the prevailing share price. The upside for successful stocks is unbounded, so our research prioritises the implications of things going right. We place as much importance on understanding each company's purpose, ambition, and culture as we do on competitive positions. It's both a creative and an analytical process with uncertain outcomes and wide error ranges.

Our culture is central to our ability to invest this way. We are tolerant of uncertainty and we are empowered to maintain bold positions in concentrated portfolios. We believe that this gives us the best chance of delivering great investment performance to our clients.

Investment philosophy

The importance of upside

Stock returns are not normally distributed. The downside is limited to the value invested. But the upside is open-ended; outliers matter. This key feature of stock markets is why historical returns are remarkably concentrated – just 0.4% of US companies delivered half of all the net excess wealth created over 90 years to 2016. That's 90 companies from a possible 26,000. We look for future outliers because we know that owning them will drive portfolio returns.

Why growth

There is a clear relationship between share price performance and delivered earnings and revenue growth. Over rolling 5-year periods, our minimum investment time horizon, the best returning stocks also exhibit the highest rates of growth. Wall Street gives credit for what it can see, but it systematically struggles to capture companies' future growth prospects in share prices.

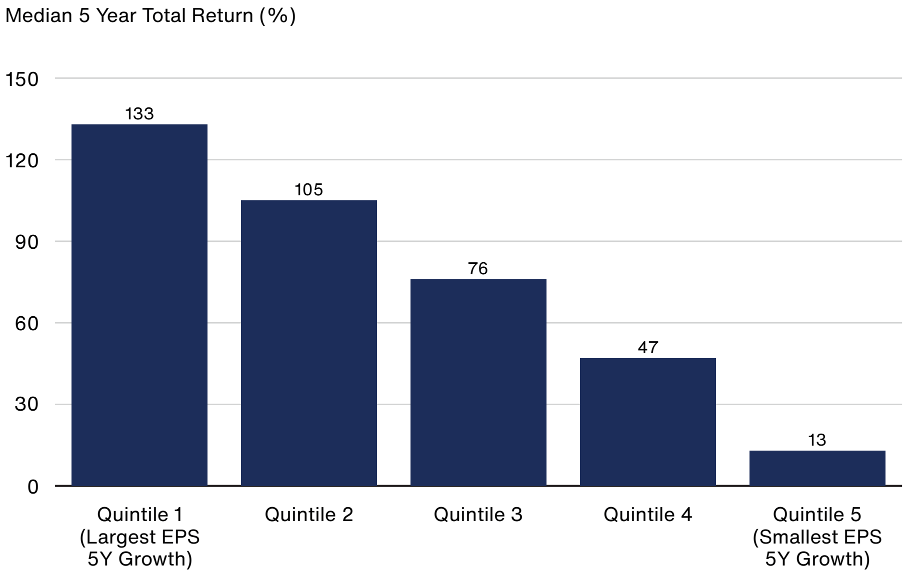
There are recurring features amongst businesses with the potential to grow at a faster rate and on a more sustainable basis than their peers. These businesses are disruptive, innovative and adaptable. They are unusually ambitious. In broad terms exceptional growth companies often share three characteristics:

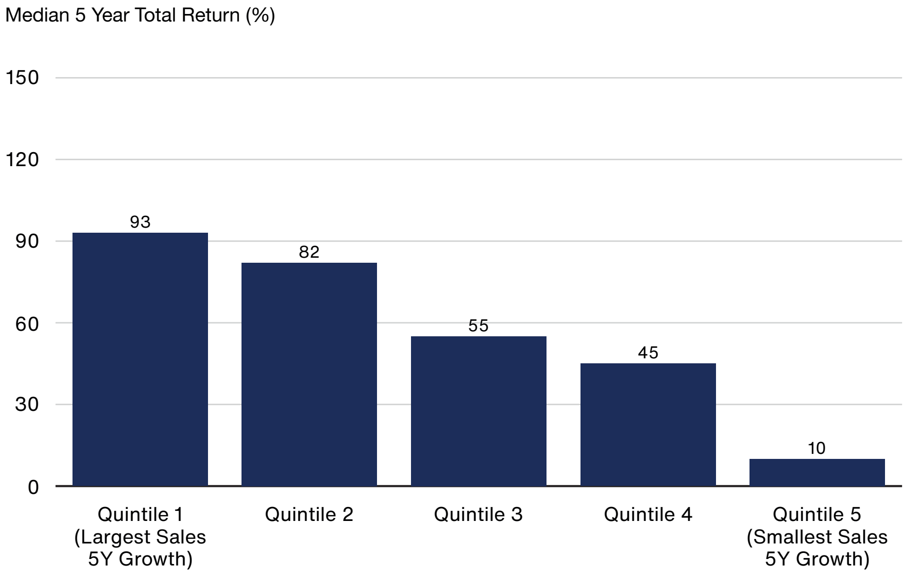
01
They address a large opportunity relative to their current size

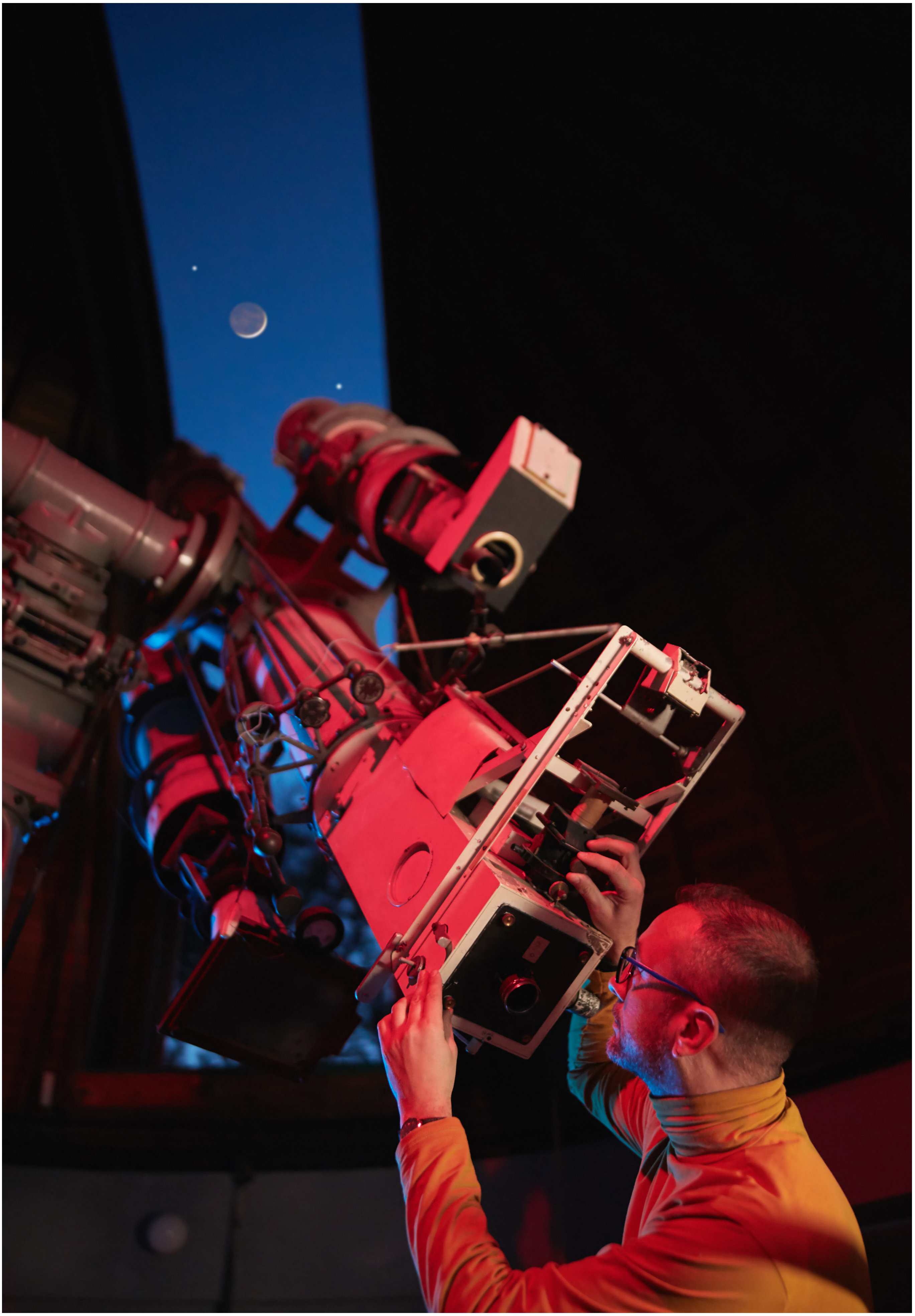
02
They possess at least one sustainable competitive advantage

03
Have a purposeful and effective culture

Rolling 5 year S&P 500 constituent returns split by quintile of earnings and revenue growth (1990–2021)







The power of culture

We believe that exceptional growth companies can be identified in advance through thoughtful and imaginative research. We are convinced that culture plays a critical role in separating out the exceptional business from the merely good ones around it. In spite of the evidence to support the contention that culture is an important driver of long-term investment returns, it appears to be routinely overlooked by most investors.

Companies with purposeful cultures, often run by founders, understand that to endure they have to be willing to invest in the future and to embrace change. The most effective cultures permeate every level of an organisation with ambition and determination and empower staff with a bias to action and a willingness to experiment. Our experience is that companies with these cultures tend to be more adaptable and durable than average. They also grow faster and are adept at unlocking new growth opportunities. They have the capacity to continually surprise on the upside.

We appreciate that an effective culture can take many forms. We don't seek to apply a set of best practices; instead we take the time to analyse the nuances of each business and its managers. Unconventional approaches can often contribute to a company's cultural edge and we are open-minded enough to support them when we believe that they enhance the long-term opportunity.

Sustainability matters

We define sustainability as the ability to balance value creation with value capture. Our search for transformational growth potential is also a search for companies which understand the long-term implications of their ambitions. Companies that deliver more value than they capture will thrive; those that don't will not survive.

We recognise the subjective nature of what is positive for society and we view this through a wide lens. No company is excluded from our investment universe unless clients specifically require that reassurance.

We create a Societal Contribution Hypothesis for every company we own. We consider what each company might deliver to society if it grows as we think it could; an approach we believe to be highly aligned with our investment style.

There is no perfect company. All companies will make mistakes on the road to fulfilling their potential and some will not succeed. We are cognisant of positive and negative implications of success, and we focus on the issues we believe to be most important for the long run sustainability of each company. These inform further work or engagement with a company, helping us to become better stewards of our clients' capital whilst supporting the ambitions of the companies we own on behalf of our clients.

We also consider the relative importance of our own actions as shareholders. In some cases, our support has the potential to meaningfully affect a company's chances of success.

Investment process

In any five-year period, around 20% of the best US stocks return at least 2.5x or more their starting share price. We seek out a clear understanding of how we might make a 2.5x return or better by owning any stock for our clients, and why we believe that this outcome is significantly more likely than the one in five base rate implied by markets. In some cases we consider higher but less likely return scenarios.

Research

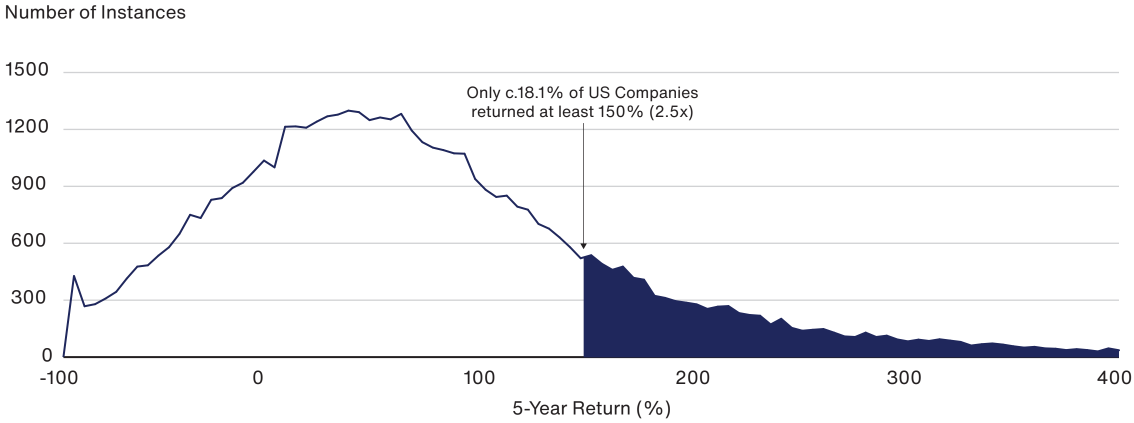
The purpose of our research is to identify stocks with the potential to generate substantial long-term returns for our clients.

Routine information carries little value. We seek out different sources of information. This ranges from the insights that founders can give us into their business to academics, industry experts and inquisitive researchers. We are outward looking and open minded in gathering this information.

Our analysts adapt their approach to suit each company. They are encouraged to foster new sources of insight. They are generalists and are unconstrained by arbitrary industry or sector boundaries. We believe that giving motivated and curious people independence improves our chances of generating valuable investment insight.

We benefit from the firm's culture of collaboration and our dozens of colleagues who also research US businesses. Insights and ideas are shared openly in both directions. There will often be disagreement, but we welcome this as a valuable tool for improving our investment ideas.

S&P 500 rolling 5 year stock returns from 1985–2021



Source: Factset, S&P.

Specialism
Dedicated US research team

Perspective
US in a global context

Genius
Access to visionaries

140 investors create global perspective
46 global investors covering US
233 US meetings in 2021
Depth of research

The search for eight great ideas annually

Early insight
- Private companies: many exceptional growth companies are private

Inquisitive research
- Journalists with different skill sets
- Alzheimer's disease
- Liquid biopsy

Connecting
- Academia
- Industry experts

Immersion
- Extended investment trips US West Coast technology
- Health care clusters

8 question framework

We frame our research using the following questions. Our consistent application of the framework ensures that the key investment issues are always covered and it enables us to compare competing investment opportunities.

01
What might the world look like if this company is successful?

02
What about the company's culture, increases the likelihood that it will achieve long term success?

03
What are the enduring sources of edge

04
What is exciting about the market opportunity?

05
What are the important forward-looking financial characteristics? Are the long run incremental returns attractive?

06
How might we make a 2.5x return over the next five years? How likely is this?

07
Is there potential for this stock to be a real outlier?

08
What should we do next?

Discussions

Separate team reading days provide a further opportunity to step back from the day-to-day and to discuss broader topics.

The full team meet regularly to discuss stock research. These meetings are explorations of investment cases and they end with a collation of “Unlocking Questions” which inform the next stage of research. We discuss new opportunities and existing holdings at these meetings.

Portfolio Meetings take place every seven weeks with the whole team. Everyone submits thoughts on the current portfolio and opportunities for further investigation in advance. We allocate workflow and the investment managers often make decisions on individual positions at this meeting.

Portfolio implementation meetings are held by the investment managers on an ad hoc basis and following on from Portfolio Meetings.

In addition, the team share information and topics of interest informally on a daily basis. Separate team reading days provide a further opportunity to step back from the day-to-day and to discuss broader topics.

Decisions

Controversial ideas can be the most rewarding and this is particularly powerful when the potential gains are so much larger than losses.

Our decision making is deliberately biased towards individual enthusiasm. Even if only one of the managers wants to buy a stock then we will take a holding if the stock fits our investment philosophy and any key questions have been answered. Controversial ideas can be the most rewarding and this is particularly powerful when the potential gains are so much larger than losses.

Our process is oriented around owning future outliers, including through periods of weakness. We consider selling stocks only when we can no longer see a likely enough path to sufficient upside from the current share price, or when an idea we have higher conviction in requires funding. We are wary of prematurely reducing holdings in successful stocks and we consider price moves in the context of evolving growth opportunities.

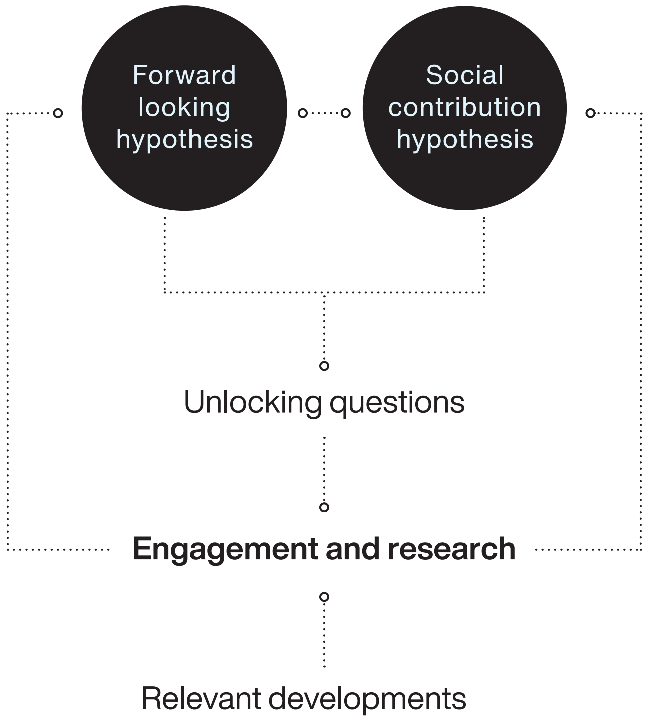
Developing our understanding

We aspire to be long-term owners of stocks; this gives us the best chance of realising the benefits of outlier returns for our clients. We can only invest this way by constantly deepening our understanding of each holding. Companies will evolve as they grow and our assessments of each opportunity must keep pace.

We maintain a Forward Looking Hypothesis for each company we invest in. The FLH sets out the key elements of each investment case and provides a baseline to refer to when conducting subsequent research or assessing the significance of incremental developments. Each FLH is supported by a Social Contribution Hypothesis, a Climate Unlock and a set of Unlocking Questions which help us to further our understanding of the key opportunities and challenges facing each company.

These tools give our research direction and inform our interactions with company management teams.

We engage regularly with the management and boards of the companies we invest in. It helps us to develop insights into their cultures and it advances our thinking on other businesses too. We raise concerns or encourage change when we believe there is an opportunity to improve long-term returns. In exchange, we provide management teams with a shareholder base which supports their long-term ambition.



Portfolio management and monitoring

We manage concentrated portfolios of the best opportunities we can find. Our holding sizes reflect the potential upside for an investment and the likelihood of it being realised.

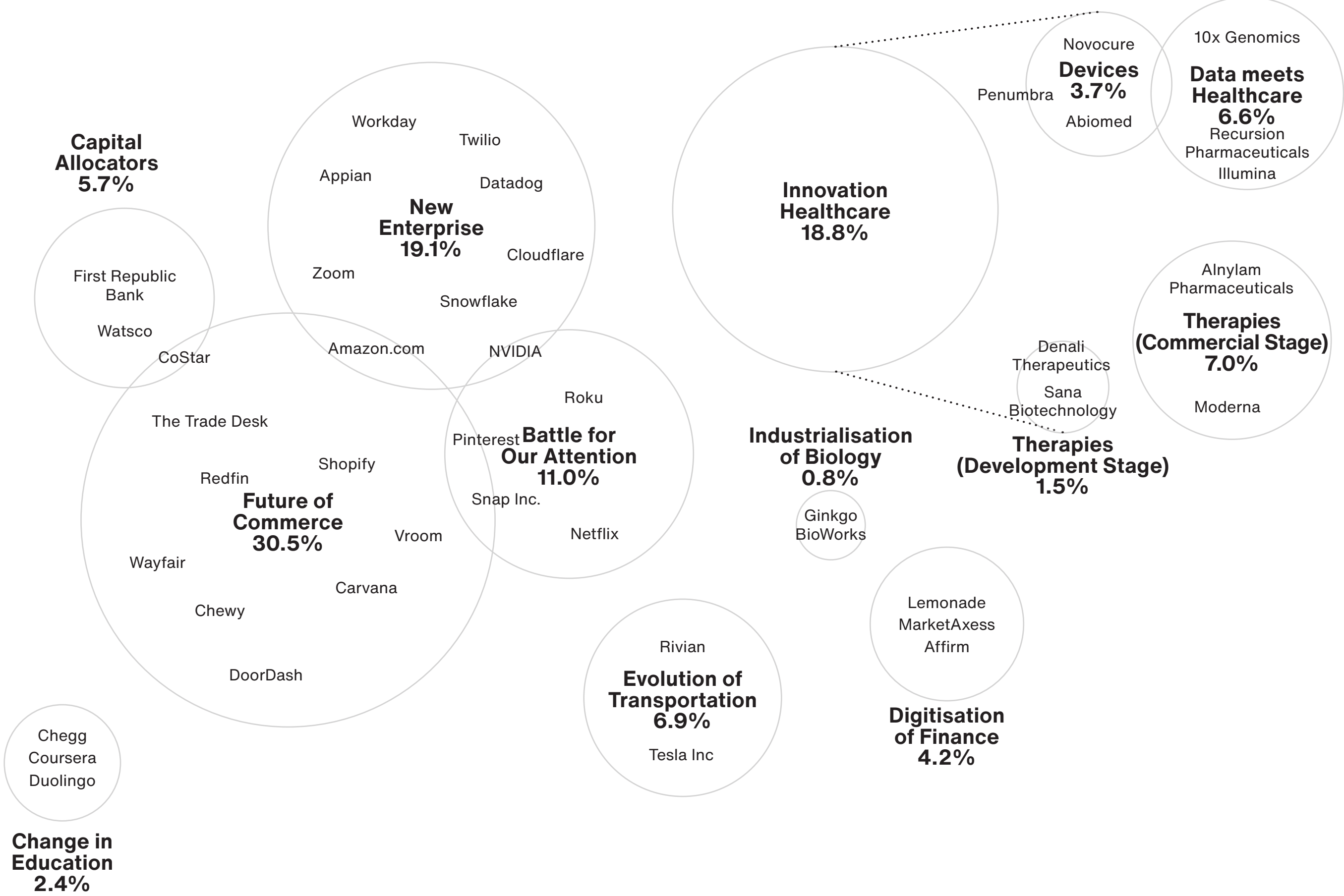
We expect returns from the strategy to be variable in the short-run. We don't measure the strategy's tracking error or other behaviour against a benchmark index. We do not view volatility as a good proxy for `risk'. Volatility fades with time. We view permanent loss of clients' capital as risk. And benchmarks are certainly not risk free.

We recognise that the companies we invest in may benefit from related structural growth drivers, and related risks. We maintain an overview of this by monitoring our key exposures, which is summarised in the diagram below. This does not drive our stock selection process but it gives us a useful understanding of thematic concentrations.

Performance objective*	+2% p.a. or greater over rolling 5 years
Performance index	S&P 500 or Russell 1000 Growth
Number of holdings	30–50
Sectors	Minimum of 5
Market cap	>$1.5bn at initial purchase
Individual holding	8% at purchase 15% absolute**
Stocks listed outside US	Up to 15%, reasonable link to US required

*After management fees. The performance target stated is in no way guaranteed, nor is it intended to be precise. We believe it to be a reasonable estimate of the amount by which we can outperform the relevant benchmark in the long term through the consistent application of our investment process, taking into account the opportunity set and the characteristics of the markets in which the strategy invests. Factors that may lead to Baillie Gifford failing to meet our investment performance objectives in future include a significant change in market characteristics such that our growth investment style is unrewarded for a period of time; or misjudgement of the prospects for long-term earnings growth for a significant number of individual stocks in which we invest.
**10% for UK OEIC and Irish UCITS.

Cultural outliers



Even within this concentrated group of holdings, a small number of companies stand out. We call them Cultural Outliers. They can be particularly challenging to hold because of their capacity to surprise investors and to reinvent themselves, but this also creates the potential for particularly large returns to shareholders. Their distinctiveness is rooted in their corporate culture. We cannot predict exactly how they will pivot in future, but identifying their cultural features helps us to prepare for the future and to be more effective holders of these businesses. We are open to managing a standalone portfolio of only these businesses for clients.

Cultural outliers: Affirm, CoStar, Ginkgo BioWorks, Shopify, Snap Inc., Tesla Inc, Twilio
Based on a representative US Equity Growth portfolio, new client portfolios may not mirror the representative portfolio exactly.
As at 31 December 2022. Figures may not sum due to rounding. Excludes cash.
This thematic risk analysis is reflective of the team's views. Stocks may appear in more than one circle if they are exposed to the same thematic risk.
Stock name size is representative of holding size.

People

Our US Equity Growth Strategy is managed by four investment managers. They work together in our US Equities research team, supported by a small team of analysts. The team benefits from, and contributes to, the wider research effort at Baillie Gifford. This approach provides an important source of leverage.

The four managers share an investment philosophy and process but they each bring their own perspectives and enthusiasms. This blend of personalities and backgrounds is a crucial part of how the strategy works.

Tom Slater

Tom is Head of the US Equities Team. He joined Baillie Gifford in 2000 and became a Partner of the firm in 2012. After serving as Deputy Manager for five years, Tom was appointed Joint Manager of Scottish Mortgage Investment Trust in 2015. During his time at Baillie Gifford, he has also worked in the Developed Asia, UK Equity and Long Term Global Growth teams. Tom's investment interest is focused on high growth companies both in listed equity markets and as an investor in private companies. He graduated BSc in Computer Science with Mathematics from the University of Edinburgh in 2000.

Gary Robinson

Gary is a Partner and Investment Manager in the US Equities Team. He graduated MBiochem in Biochemistry from the University of Oxford in 2003 and joined Baillie Gifford the same year. He spent time working on our Japanese, UK and European Equity Teams before moving to the US Equities Team in 2008. Gary is a generalist investor but retains a special interest in the healthcare sector dating back to his undergraduate degree.

Kirsty Gibson

Kirsty is an Investment Manager in the US Equities Team. Kirsty joined Baillie Gifford in 2012 and began her career on the US Equities Team, moving on to spend several years in small and large cap global equities departments, before returning to the US Equities Team. She graduated MA (Hons) in Economics in 2011and MSc in Carbon Management in 2012, both from the University of Edinburgh.

Dave Bujnowski

Dave is an Investment Manager in the US Equities Team. He joined Baillie Gifford in 2018 and became a partner in the firm in 2021. Dave's investment interest is focused on markets and businesses in which a highly dynamic societal change or business model shift affects potential future cash flow in a monumental and underappreciated manner. Prior to joining Baillie Gifford, he co-founded Coburn Ventures in 2005, a consulting and investment company that studies monumental change in business, markets and society to better understand the powerful forces that shape investment opportunities. In his 13 years at Coburn Ventures, Dave was a Partner, primary client-facing consultant, research analyst and portfolio manager of a long-short, market neutral hedge fund. He started his career in 1996, joining Warburg Dillon Read's equity research group as an associate semiconductor analyst before joining UBS's Global Tech Strategy Team. Dave graduated from Boston College in 1993, where he majored in Finance and Philosophy.

Douglas Jack

Douglas is an Investment Analyst on the US Equities team. He joined Baillie Gifford in 2020 and has spent time on Baillie Gifford's International Growth and UK equity teams. Douglas graduated MA in History from the University of Glasgow in 2018.

Brogan Harris

Brogan is an Investment Analyst in the US Equities team. He joined Baillie Gifford in 2021. Brogan completed a BSc and MSc in Biology, and a PhD in Bioinformatics at the University of Bristol.

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 57 partners who work within the firm. The partnership structure has prevailed for over 110 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.

Experience and collaboration

The partnership structure creates a collaborative culture and one in which people stick around. The US Equity Growth Strategy investors have an average of more than 19 years' experience and this includes several investors who have spent their entire careers at Baillie Gifford. However, the team doesn't operate in isolation, it draws on the investment ideas of over 100 investors at the Firm to bring together the best stocks for inclusion in US Equity Growth portfolios.

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 investors 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.

Ways to invest

Our US Equity Growth strategy is available to institutional investors via separate accounts and via three pooled vehicles, subject to eligibility requirements.

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