China A Shares

Philosophy and Process

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Introduction

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

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 most exciting 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.

Philosophy

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 Equities 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 China A Shares 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.

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.

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.

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.

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.

Process

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 seek to evaluate material environmental, social or governance considerations that may influence investment performance over our holding period. This is built into our 10-question research framework and supplemented by a proprietary due diligence checklist which aims to further identify material information across a range of areas that includes fundamental financial data, macro factors and ESG considerations. This may be supplemented by third party forensic analysis and independent due diligence as and when required.

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 investment managers Linda Lin and Sophie Earnshaw.

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 decision makers meet monthly 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.

Ownership

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 an important 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 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.

Risk management

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 China 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.

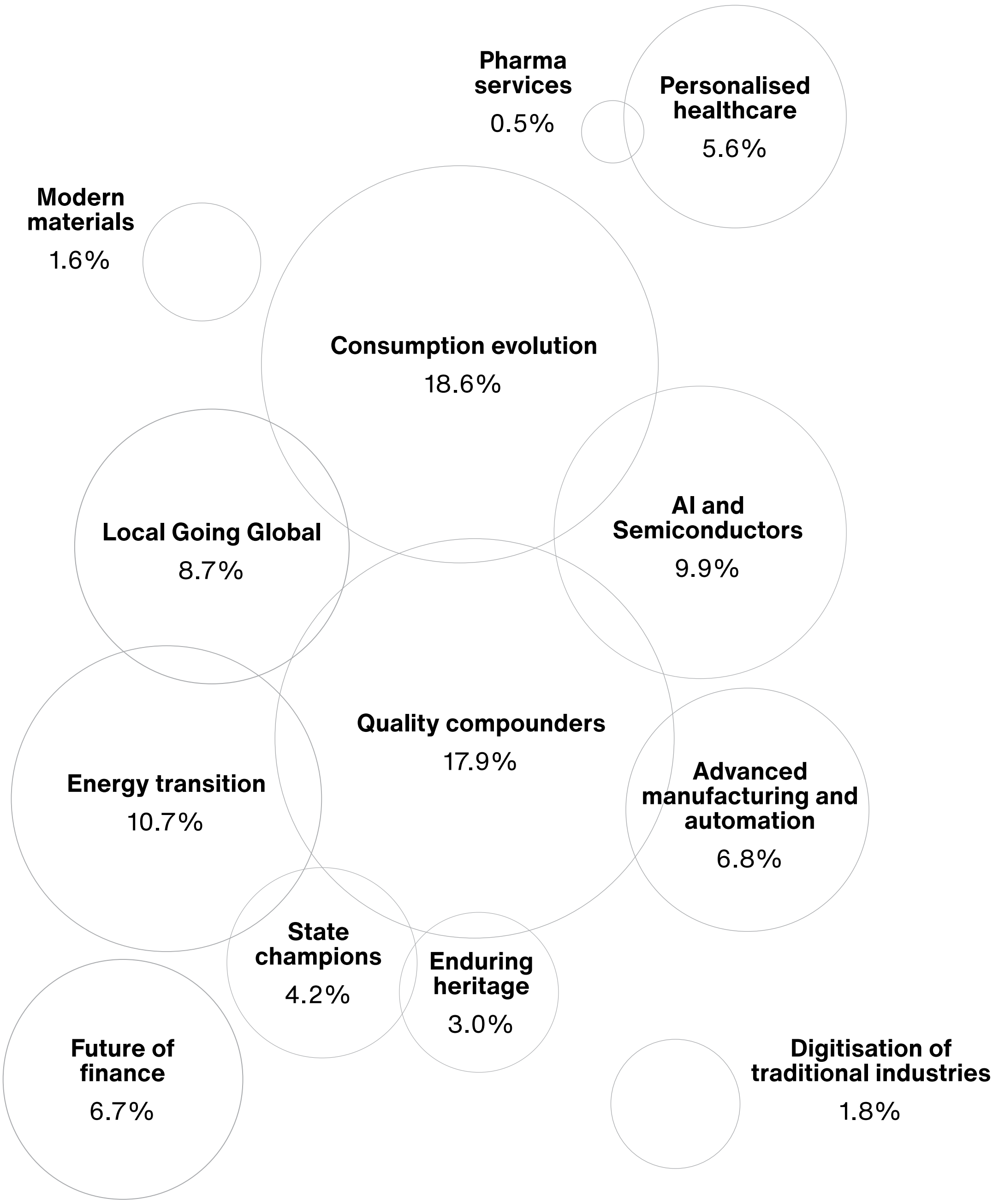
We also find MSCI-based sectors unhelpful as a risk management tool as they are often poor descriptors of a business and its risk profile. They are often broad and not reflective of an underlying commonality. This is particularly the case in China where the speed of development and addition of companies 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

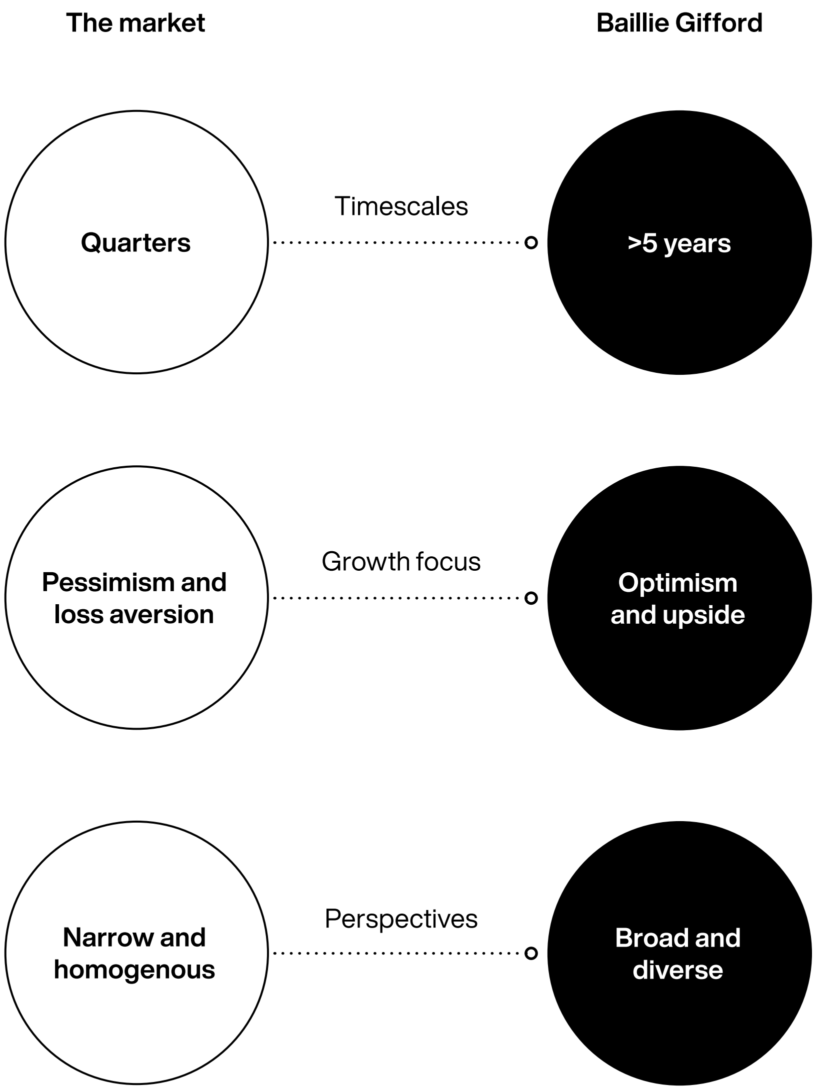
Benchmark	MSCI China A Onshore Index
Number of holdings	25–40
Maximum stock positions	Max 8% at time of purchase, 15% absolute for segregated mandates, 10% absolute for UCITs vehicle (5/10/40 rules apply)
Minimum number of sectors	5 (with a minimum of 5% in at least five)
Thematic risk analysis	25% in 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.



As at 30 September 2024. Based on a representative portfolio, excludes cash.
Figures may not sum due to rounding. Unclassified = 7.2%.

Competitive advantages



What makes this strategy unique?

We believe that this strategy is unique in three key 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. 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.

People

We have 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.

Baillie Gifford has the majority of its investment managers and analysts based in its Edinburgh office. 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 A Share Strategy seeks to identify and own only those 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 also feeds different perspectives into our broader investment strategies.

China Team

Linda Lin*

11 (15)

Sophie Earnshaw

15 (15)

Rio Tu

11 (11)

Louise Lin

11 (11)

Tony Wang

5 (9)

Freddy Zhu

5 (7)

Jiaxi Liu

9 (9)

Clark Ren

3 (4)

Doris Gu

2 (2)

Lin Qin†

3 (5)

*Partner
† ESG Analyst
Years at Baillie Gifford (years experience).
31 January 2025.
The China A Shares Strategy decision makers are Linda Lin and Sophie Earnshaw.

Linda Lin
Investment Manager

Linda is the head of the China Equities Team, and a decision maker on our China Equities and China A Share strategies. 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 China Equities Strategy, which she has managed since 2014, and on our China 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.

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 in our Shanghai office. She joined Baillie Gifford in September 2014 and moved to Shanghai in 2021. She previously worked in the Japanese and Global Discovery equity 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.

Jaixi Liu
Investment Analyst

Jiaxi is an investment analyst in the China Equities Team. She joined Baillie Gifford in 2016 and prior to joining the team, she worked in the Health Innovation and Global Income Growth teams. Jiaxi graduated BA/BMus from Northwestern University in 2009 before obtaining a Double Masters in Piano Performance and Musicology from The Peabody Institute of the John Hopkins University in 2011. She also gained a PhD in Music Cognition from the University of Cambridge in 2016.

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.

Clients Department

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 is an investment specialist within the Emerging Markets Client Team. She joined Baillie Gifford in 2021. 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.

Baillie Gifford

Clients

We are immensely proud of our supportive client base. Without them, our business could not exist.

Our primary goal is to build long-term relationships with aligned, like minded, clients. Our longest client relationship dates back to the early 1900s.

A core principle we have always upheld is prioritising our clients' interests above the firm's. In an industry that often puts financial gain over client outcomes, this focus is crucial. We aspire to be seen as more than merely the 'hired help', and aim to be recognised as a trusted, long-term partner, who can be relied on to give honest and objective advice at all times.

We are research-driven, patient and prepared to stand apart from the crowd. And because we're an independent partnership without outside shareholders, the long-term goals of our clients are genuinely our priority.

Partnership

Stability matters.

Since its inception in 1908, Baillie Gifford has proudly remained a private partnership. We have no intention of changing this. We have never had a merger or made an acquisition, nor do we seek to in the future. This is a rare level of stability in financial services.

All of our partners work within the firm which provides a unique level of alignment between them as owners, and our clients. This is a key differentiator in comparison to a lot of our peers.

Focus

We have a clear unity of purpose – excellent long-term investment returns and unparalleled client service. Our interests and long-term objectives are completely aligned with those of our clients.

We are not short-term speculators, rather we deploy client's capital to run truly active portfolios that give exposure to exciting and lasting growth companies. We would argue that it is visionary entrepreneurs and company leaders that generate long-term profits and share price increases, not stock markets or indices.

When active management is done well it can add material value over the long term. We need to be willing to take a differentiated view. This is not easy. It requires dedication, independent thought and a long-term perspective. Our whole firm is built around this, and we will always remain resolutely investment and client outcome driven in our outlook.

Important information

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