Baillie Gifford Emerging Markets Growth

Global Emerging Markets

Introduction

Baillie Gifford are long-term investors, and the EM fund approach is no exception. The investment philosophy is typical of Baillie Gifford equity funds – in essence it is bottom-up with a growth bias but also macro aware. Baillie Gifford funds typically have low turnover, and this is the case for this fund. There is a focus on growth stocks, but the fund invests in through cycle growth as well as secular growth names.

Click here to read the Baillie Gifford approach to ESG investing.

Why RSMR Rate this Fund

- This is a strong well-resourced and experienced team with depth of personnel.
- Top-down research resource especially in the field of geo-politics has been strengthened.
- The process is focused on long-term investing in companies which through cycle will grow faster than the market.
- The process is clear and has been consistently applied over many years and can include businesses in lowly rated sectors.
- Stock selection has been strong across a number of regions/geographies.
- Fund trades at only modest premium to market despite prospects of above average earnings growth.

Fund Process

The investment process has remained unchanged over many years with the belief that sustainable long-term growth is rewarded. ESG analysis has been integrated into the assessment of whether growth in a business is sustainable. The EM team focus on three underappreciated growth opportunities in their long-term outlook. The first of these is businesses with a long duration of growth such as TSMC where strong growth will continue for longer than the market consensus expects. The second is pace of growth where the speed of growth will outstrip market expectations. The final category is earnings surprises which includes businesses which might benefit for example from better than expected macroeconomic conditions, or an underappreciation of the asset quality of the business. The team look for companies which can grow profits in hard currency terms faster than the market over the long-term.

The team assess five key factors. The first of these is industry background as Baillie Gifford likes to invest in growth industries. They then look for companies with a competitive advantage and significant barriers to entry. The next stage of the process is an assessment of a company's ability to execute which involves assessing both financial strength and management. The latter must be shareholder friendly, an especially important factor in this region. The last item on the list is valuation. As a house, Baillie Gifford is more flexible on the valuation placed on companies than some other investors. They are less willing to sell a stock just because it looks expensive in the short term, and they try to work out what the company would be worth in 5 years' time.

Liquidity in emerging market stocks is assessed by screening trading volume, and the team undertake detailed fundamental research. The universe is further narrowed after screening through an assessment of industry background and competitive position. Analysts put together research reports together with detailed modelling of numbers which are then circulated amongst the team and discussed at the weekly meeting. The meeting discusses stock research projects and interesting ideas rather than reviewing maintenance research. On a monthly basis the emerging market policy committee looks at country and sector bets to ensure they are consistent with bottom-up ideas. Although company results are discussed at the daily meeting, the team rarely make snap decisions about a stock that has announced disappointing quarterly earnings, preferring to take a longer-term view. A dedicated risk team provide quarterly analysis of the fund, monitoring tracking error and active money. This is designed to inform the process rather than restrict fund managers.

Coverage of the universe is split on a geographic basis with at least two team members covering each region. The cross-fertilisation of ideas within the team has been a big contributor to performance over the years as the team look to use information from the discussion of intra-regional ideas to gain a research edge. They also undertake a significant amount of travel, making sure they meet the management teams of the companies they invest in.

As a growth investor it is vital that the team understand barriers to entry, particularly when buying higher PE companies, as any disappointment to the growth rate can lead to a downward move in the share price. The team therefore do a lot of work cross checking prospects for a business with competitors. Stocks are sold if there is a fundamental change in the investment case. The team do not operate hard price targets for buying or selling, but rather take a longer-term perspective. The longer-term growth opportunity over 5 years and what sort of profits this can generate are the key decisions on the investment case, together with an assessment of management's ability to execute the business plan effectively. The team do conduct reviews of underperforming names, but if nothing has changed, they are likely to add to the position.

Baillie Gifford have a dedicated ESG team which sits alongside the Investment Department providing research and working collaboratively with the investment managers contributing to investment decisions. One member of the ESG team is dedicated to supporting the Emerging Markets Equity Team.

Evaluation

The fund is based on long-term growth investing and they will do well in these environments. The portfolio is least likely to perform well in late cycle periods or when deep cyclical or value investing is leading markets. The fund invests in different types of growth businesses rather than just focussing on fast growing names.

Application

This fund can be used as a core holding and is suitable as a stand-alone holding or blended with more value orientated strategies.

Our Opinion

Baillie Gifford has the benefit of an experienced and well-resourced team of emerging market managers. The team is a long-term growth investor looking for stocks that can grow for a number of years above the market average where the duration of growth is underestimated by other investors. They can and do invest in companies which have a level of cyclicality over the short term and can be in less highly rated sectors than those favoured by investors with a pure focus on secular growth names. As emerging markets can be volatile, the team take into account macro factors when constructing the fund including geo-politics. The strength of the team and the process, and its growth with flexibility approach, together with the results generated over the longer term, make the fund worthy of a rating.