

UK EQUITIES – TIME FOR A CLOSER LOOK

December 2020



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UK EQUITIES – TIME FOR A CLOSER LOOK

Our economy may have taken a battering, but Kathleen MacMillan, UK equity investment specialist, finds plenty of compelling reasons to invest in British businesses.

The year 2020 has felt somewhat surreal for UK investors. Not only has our local economy been hit hard by the pandemic, but whole sectors of the stock market have come under pressure, including many high-profile firms. Meanwhile the headlines have been filled with the continued rise of US tech giants and Chinese platform companies.

SO WHY ARE WE SO OPTIMISTIC ABOUT INVESTING IN THE UK?

The good news is that if you invest in any of Baillie Gifford's UK Equity portfolios, you are not investing in the UK index. Instead, our genuinely active approach to stock picking allows us to invest, on your behalf, in a small collection of very carefully selected homegrown companies. As specialists in our home market, we have the exciting task of seeking out British businesses with solid competitive strengths, innovative ideas and fantastic growth opportunities. Indeed, the pandemic has actually accelerated the growth (and highlighted the resilience!) of many of these businesses.

As long-term investors, we seek out companies that are continually re-investing in their own long-term future, rather than paying out large dividends. This year's so-called Great Dividend Crisis, which has seen shareholder pay-outs slashed by up to 60 per cent, has been revealing. The Covid-19 demand shock is the retreating tide that, in Warren Buffett's famous phrase, shows who's been 'swimming naked'. Companies in the spotlight include those prioritising big dividend pay-outs in the present over investment in the future. Often, they have done so under board direction rather than out of any compelling business logic, sometimes even borrowing to support this activity.

These companies, many of them in the banking and energy sectors, were already facing the headwinds of structural technology shifts and changing consumer behaviour. Covid-19 has added urgency to their task of reinvention, calling time on the financial engineering sometimes used to compensate for lack of growth.

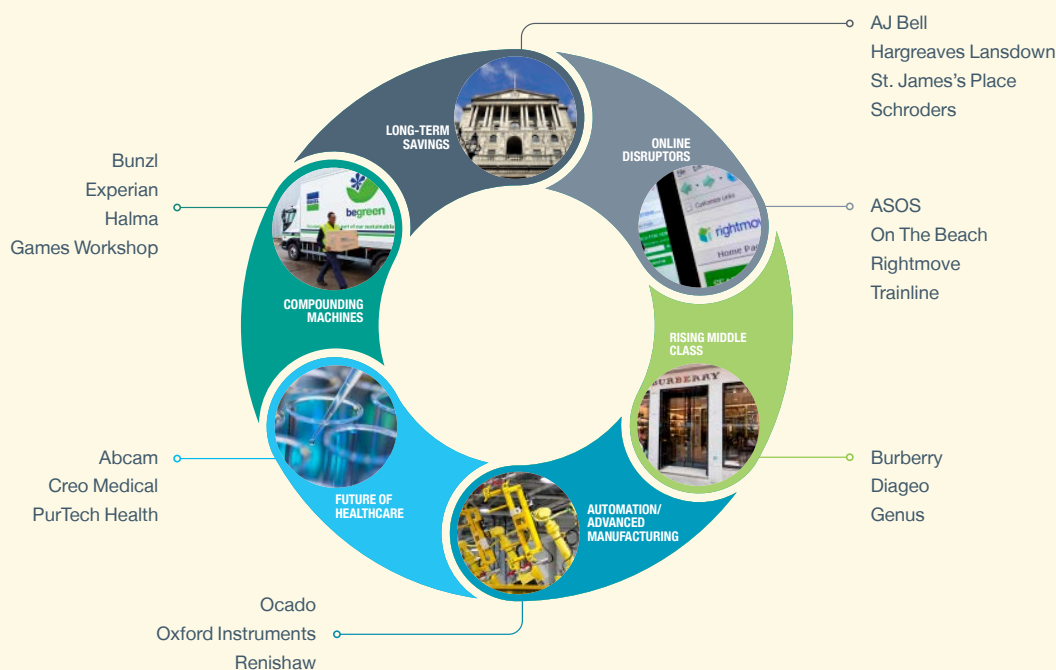
For us, the need for companies to invest in their future has never been more compelling. As long-term investors we make the most of our opportunity to engage with companies over many years, encouraging the long-term thinking and investment in the future that we ourselves prioritise.

Finally, many believe that UK equity investment returns depend on the success of the UK economy. However, with the majority of revenues being generated overseas, investing in UK companies is an excellent way to access global growth opportunities within a well-established and well-regulated market. The opportunity set is also truly diverse, and contains world leaders in fields such as healthcare, advanced manufacturing and long-term savings.

In terms of market cap, our opportunity set includes large and medium sized-companies with solid economies of scale, as well as a number of smaller firms in cutting-edge industries aspiring to be the giants of tomorrow. As specialists in the UK market, we have the ability to invest further down the market cap spectrum which gives clients the opportunity to invest in a number of exciting growth companies at an early stage.

HOW DO WE FIND THESE EXCITING OPPORTUNITIES?

As bottom-up stock pickers we start with companies, not industries or sectors. That said, a study of portfolio holdings reveals themes in our choice of companies. Some of these themes are based on global trends that we see as unstoppable over the long term. For example, the rise of the new middle class, the transformation of healthcare and the increasing ability of online platform companies to disrupt incumbents. However, growth comes in many guises and we also find great opportunities in companies that quietly get on with producing steady growth over the long term, our compounding machines.



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 These British businesses are worth celebrating in turbulent times as they highlight the benefits of thinking differently, for the long-term.

BEST OF BRITISH: PORTFOLIO COMPANIES TO WATCH

LONG-TERM SAVINGS

We believe that the UK retail savings market has attractive long-term growth characteristics, underpinned by the shift from defined benefit to defined contribution pension schemes. This move places the responsibility for looking after long-term savings on to individuals and many are turning to wealth managers such as **St. James's Place** to help them to navigate their financial planning. Investment platforms such as **Hargreaves Lansdown**, **AJ Bell** and have also benefited. Whilst Hargreaves and AJ Bell can be accessed directly by retail investors, IntegraFin has a slightly different model. Operating under the brand 'Transact', all IntegraFin's customers are directed there by their independent financial advisers. Set up in 1999, this business has a stable management team and its strong growth has been purely organic – a combination of attracting new adviser firms to its platform and increasing the assets from clients of existing advisers. We think a clear strength and differentiator in this competitive market is IntegraFin's strong focus on serving the adviser market through its own dedicated team of client service managers, and its internally developed IT system that it regularly updates. The financials of the business are simple and compelling as the bulk of revenues comes from charging a fee on the assets on the platform. We think there is strong operating momentum and, over the long term, there is scope to improve margins and returns as they add new assets on to the platform.

ONLINE DISRUPTORS

Across our UK portfolios we have invested in a number of online platform companies for many years. These businesses are typically characterised by a low cost base and as a result tend to have very high margins. They look to benefit from a shift in how consumers access their products. For example, Rightmove is the UK's largest online property portal. With around 80 per cent market share, we think its dominance should be self-reinforcing over time, with both buyers and sellers increasingly turning to the most popular site in order to transact. But we are not just focused on the established online disruptors. With Draper Esprit, we believe we have found a fantastic way to access early stage opportunities. Draper Esprit is a venture capital business that invests in early stage European technology companies such as the smart-banking app Revolut, the consumer review website, Trust Pilot and the telemedicine business, Push Doctor. In a relatively short time, the investment team at Draper has built up an interesting portfolio of fast-growing businesses that have the potential to be significantly larger.



RIISING MIDDLE CLASS

Genus is a world-leading animal genetics business which analyses DNA to find the strongest genetic profiles to breed ‘elite’ cows and pigs. By selecting animals with desirable characteristics, Genus is able to help farmers to produce pork, beef and milk more sustainably. As we continue to see a growing population with more disposable income, particularly across emerging markets, we believe that Genus will benefit from a rising demand for meat and dairy products. Furthermore, the industrialisation of Asian farming continues to be a strong tail-wind for Genus, helping to underpin demand for its products.

AUTOMATION/ADVANCED MANUFACTURING

Renishaw is an excellent example of a world-leading UK engineering company that specialises in ultra-high precision measurement technology and 3D printing. It recently announced a milestone development in a medical study looking to help patients with Parkinson’s disease. The trial was the first of its kind to be performed on humans and uses Renishaw’s 3D printing technology to create a device which allows drugs to be delivered directly into patients’ brains using one of Renishaw’s surgical robots. If the rest of the trial proves successful it would mean that patients could receive therapeutic treatment in an out-patient setting.





FUTURE OF HEALTHCARE

There has been rapid progress in healthcare innovation over the past decade, with an unprecedented level of convergence and collaboration between various fields of science and technology pushing the boundaries of what is possible. We are particularly excited about a number of British businesses that are playing key roles in revolutionising healthcare. Creo Medical is a medical device company whose surgical endoscopy equipment helps treat patients with diseases such as bowel cancer, without the need for invasive surgery. Still a small business, it recently reached an agreement with the Department of Health to accelerate the roll out of its equipment in UK hospitals. Although it's still early days, we believe that Creo could profoundly impact cancer treatment. Financial and operational risks remain, and progress has been hit by coronavirus, but we are optimistic that Creo, and our investment in the company, can meaningfully benefit society.

COMPOUNDING MACHINES

While they may not hit the headlines very often, there are a number of fantastic businesses able to sustain long periods of steady operational progress and to provide exceptional returns that compound over many years. Halma, is one example; possibly the biggest UK company you've never heard of. Halma is a global business operating in niche markets. It develops technologies which help to save lives and protect critical infrastructure, covering everything from detecting fires and gas leaks to monitoring air and water pollution. Barriers to entry are high and demand is driven by non-discretionary spending (eg fire safety). For over a decade, Halma has grown at a brisk pace, consistently increasing both revenues and profits on an annual basis and delivering excellent returns to long-term shareholders. Another example is Games Workshop, the Nottingham based miniature gaming company, well known for its fantasy game, Warhammer. Players collect, build and paint armies of intricate figurines, then used to play table-top battle games. It has a loyal and passionate customer base, and high-quality intellectual property which it's using to reach even further afield (eg video games, comics, TV). Importantly for us, its competitive strength and pricing power are reflected in its high gross margins (up to 70 per cent), sustained over long periods.

IMPORTANT INFORMATION AND RISK FACTORS

The views expressed in this article are those of Kathleen MacMillan and should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect personal opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication was produced and approved in December 2020 and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

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This article contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research.

All of the stocks referred to in this note are held in at least one of our UK portfolios.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated. The images used in this article are for illustrative purposes only.

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Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone *44 (0)131 275 2000 www.bailliegifford.com

Annual Past Performance (%) to 31 December Each Year

	2016	2017	2018	2019	2020
Baillie Gifford UK Equity Alpha B Acc	18.0	16.6	19.3	2.6	6.4
FTSE All-Share Index	16.8	11.9	5.9	2.7	-16.6
FTSE All-Share Index +2%	19.2	14.2	8.0	4.7	-14.9
Investment Association UK All Companies Sector	11.7	13.7	5.5	0.0	-12.8

	2016	2017	2018	2019	2020
Baillie Gifford UK Equity Core B Acc *	n/a	n/a	n/a	-0.1	-10.6
FTSE All-Share Index	n/a	n/a	n/a	2.7	-16.6
FTSE All-Share Index +1%	n/a	n/a	n/a	3.7	-15.8
Investment Association UK All Companies Sector	11.7	13.7	5.5	0.0	-12.8

*Please note as the fund's launch date was 17 January 2018, full historic performance is not available.

	2016	2017	2018	2019	2020
Baillie Gifford UK Equity Focus B Acc *	n/a	n/a	13.0	-5.1	9.9
FTSE All-Share Index	n/a	n/a	5.9	2.7	-16.6
FTSE All-Share Index +1.5%	n/a	n/a	7.5	4.2	-15.3
Investment Association UK All Companies Sector	11.7	13.7	5.5	0.0	-12.8

*Please note as the fund's launch date was 3 August 2017, full historic performance is not available.

Performance source: StatPro, FE, total return in sterling.

The Manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for these funds is the Investment Association UK All Companies Sector.

There is no guarantee that this objective will be achieved over time period and actual investment returns may differ from this objective, particularly over shorter time periods.

Returns reflect the annual charges but excludes any initial charge paid.

Source: London Stock Exchange Group plc and its group undertakings (collectively, the 'LSE Group'). © LSE Group 2020. FTSE Russell is a trading name of certain of the LSE Group companies. ['FTSE', 'Russell'] are a trade mark(s) of the relevant LSE Group companies and are used by any other LSE Group company under license. 'TMX®' is a trade mark of TSX, Inc. and used by the LSE Group under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

KATHLEEN MACMILLAN

Client Service Manager

Kathleen joined Baillie Gifford in 2018 and is a Client Service Manager in the Clients Department. Prior to joining Baillie Gifford, she worked as a fixed income Investment Specialist at Standard Life, having spent five years working in consulting and fixed income manager research. Kathleen started her career on the Aon Hewitt Investment Consulting Graduate Programme in London. She graduated BA (Hons) in Risk Management from Glasgow Caledonian University in 2010.



CURIOUS ABOUT THE WORLD

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**Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone *44 (0)131 275 2000 / www.bailliegifford.com**