DIGITALISING INDIA

LEAPING INTO POLE POSITION

Ewan Markson-Brown, Second Quarter 2017

BAILLIE GIFFORD

RISK FACTORS

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As with all mutual funds, the value of an investment in the fund could decline, so you could lose money. International investing involves special risks, which include changes in currency rates, foreign taxation and differences in auditing standards and securities regulations, political uncertainty and greater volatility. These risks are even greater when investing in emerging markets. Security prices in emerging markets can be significantly more volatile than in the more developed nations of the world, reflecting the greater uncertainties of investing in less established markets and economies.

Currency risk includes the risk that the foreign currencies in which a fund's investments are traded, in which a fund receives income, or in which a fund has taken a position, will decline in value relative to the U.S. dollar. Hedging against a decline in the value of currency does not eliminate fluctuations in the prices of portfolio securities or prevent losses if the prices of such securities decline. In addition, hedging a foreign currency can have a negative effect on performance if the U.S. dollar declines in value relative to that currency, or if the currency hedging is otherwise ineffective.

The most significant risks of an investment in The Emerging Markets Fund are Asia Risk, China Risk, Currency and Currency Hedging Risk, Emerging Markets Risk, Equities Securities Risk, Focused Investment Risk, Frontier Markets Risk, Growth Stock Risk, Information Technology Risk, IPO Risk, Large-Capitalization Securities Risk, Liquidity Risk, Long-term Investment Strategy Risk, Market Disruption and Geopolitical Risk, Market Risk, Non-U.S Investment Risk, Service Provider Risk, Settlement Risk, Small- and Medium-Capitalization Securities Risk. For more information about these and other risks of an investment in the fund, see "Principal Investment Risks" and "Additional Investment Strategies" in the prospectus.

The Emerging Markets Fund seeks capital appreciation. There can be no assurance, however, that the Fund will achieve its investment objective.

The Fund is distributed by Baillie Gifford Funds Services LLC. Baillie Gifford Funds Services LLC is registered as a broker-dealer with the SEC, a member of FINRA and is an affiliate of Baillie Gifford Overseas Limited.

Baillie Gifford has been managing dedicated Emerging Market portfolios since 1994 and launched the Baillie Gifford Emerging Markets Fund in 2003. This Fund follows the same philosophy and process as our other dedicated Emerging Market portfolios.

Top Ten Holdings as at December 2018

	Holdings	% of Fund
1	TSMC	5.37
2	Samsung Electronic	5.19
3	Alibaba	4.82
4	CNOOC	4.76
5	Tencent	4.42
6	Ping An Insurance	3.96
7	Naspers	3.93
8	Banco Bradesco	3.93
9	Reliance Industries	3.92
10	Norilsk Nickel	3.40

It should not be assumed that recommendations/ transactions made in the future will be profitable or will equal performance of the securities mentioned. A full list of holdings is available on request. The composition of the fund's holdings is subject to change. Percentages are based on securities at market value.

DIGITALISING INDIA – LEAPING INTO POLE POSITION

EWAN MARKSON-BROWN

"I invite you to make India a cashless society. Mobile phone and the whole banking system can pose many alternatives to currency notes. Technological paths are safe, secure and accelerated. I would like you to just help [make] this campaign successful."

NARENDRA MODI, PRIME MINISTER OF INDIA

EWAN MARKSON-BROWN

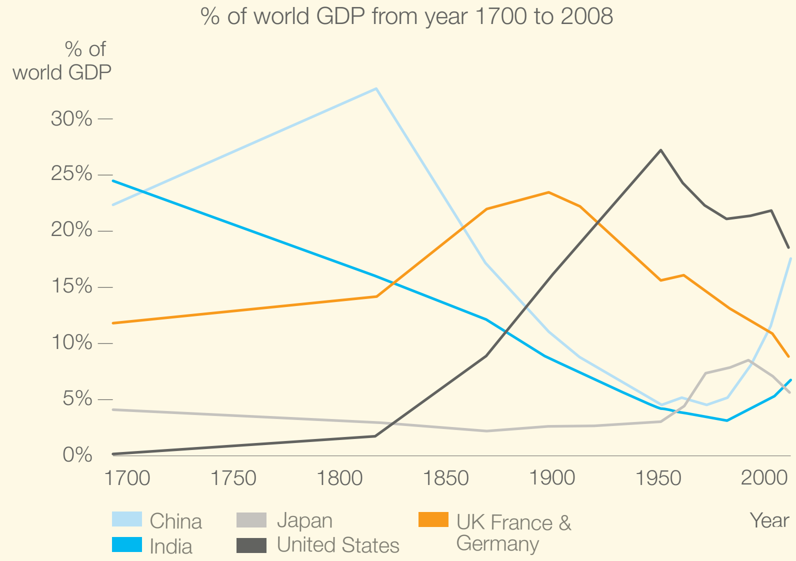
Investment Manager

Ewan graduated MA in Politics, Philosophy and Economics from Oxford University in 2000. He previously worked at Merrill Lynch and Newton as an Asia Pacific portfolio manager. Prior to joining Baillie Gifford in 2013, he was a Senior Vice President in Emerging Markets at PIMCO. Ewan is an Investment Manager in the Emerging Markets Equity Team.

Let us go back over 2000 years to 260BC when Ashoka, the Indian emperor of the Maurya dynasty unified a vast area which we now call India. Following a violent war, he forged a Buddhist empire based on peace and trade controlling around one third of world gross domestic product (GDP); until the birth of Christ when a long and mostly slow decline began.

With the adoption of socialism following independence in 1947, India's global GDP weight fell to its lowest in 1979 at just above 3%. Since then it has risen steadily. Today, we can see meaningful and significant steps taken by the government, the private sector and, most importantly, by the people of India to change their destiny.

With the average age of the population below 29, India will most likely be the world's youngest large nation until 2056. By 2030 it is possible that India's economy will have grown three-fold in nominal terms, from $3 trillion today to $10 trillion[1] – and be striving for the title of the world's largest economy by the middle of this century.



Source: The Maddison-Project, http://www.ggdc.net/maddison-project/home.htm, 2013 version.

There are certain moments in a country's history when it becomes clear that what came before cannot continue. For India, one such moment was 1991. The balance of payments crisis which ended socialism/stasis in the country ushered in a period of reforms and consequently much higher growth. The 2014 election of Narendra Modi as India's Prime Minister was another. Around 172 million voters, out of a total of 553 million, voted overwhelmingly for growth and Modi's BJP party – many of whom were under the age of 22. The impact of youth voters is likely to be even bigger by 2019; as politics change, so will the economy.

1. Based on analysis from Invest India, using a growth rate of 10% over 10 years.

A Sadhu pays the vendor through Paytm, a digital wallet company in Allahabad, India, Jitendra Prakash/REUTERS

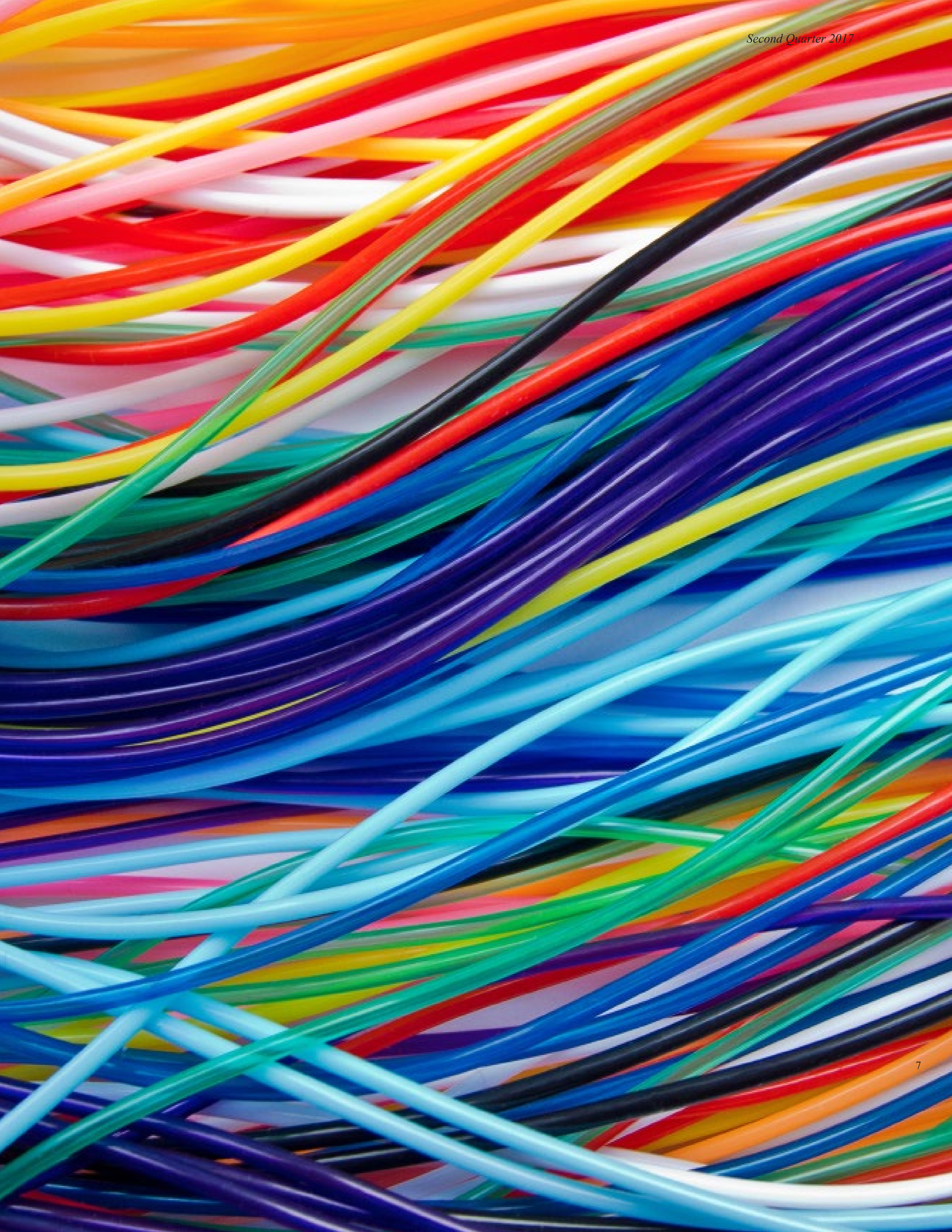
A NETWORKED POWER?

In November 2016, Modi unilaterally decided to demonetise over 85% of currency in circulation without warning, by withdrawing high value notes from circulation. Critics highlighted the short-term costs to growth and the inconvenience caused by this move. They also questioned the efficacy of the operation. Taking a step back, a bigger picture emerges. India over the past few years, via the Aadhaar program, has created the largest digitalised database of people in the world. One billion people have had their fingerprint and iris scanned and registered. In essence, India has created the groundwork for the largest digital and financial network within any country in the world. Demonetisation was just another step on the path towards making India a digital economy. This data network will drive profound changes in the economy.

India is leap-frogging developed nations into the digital age. At one small Indian private bank, an account can be opened and fully functional within ten minutes with only a mobile phone and a finger-print reader. The leading company in digital payments whose offline transactions have soared 12-fold since demonetisation, is helping India bypass credit and debit cards completely. In India, there are around 20 million unique credit card users and around 1.5 million point of sale machines at merchants. But imagine going for a run, no wallet or phone, you go into the local convenience store and buy some water with only your fingerprint – the Indian government is currently trialling this technology today. Frictionless and costless banking has arrived in India before anywhere else in the world.

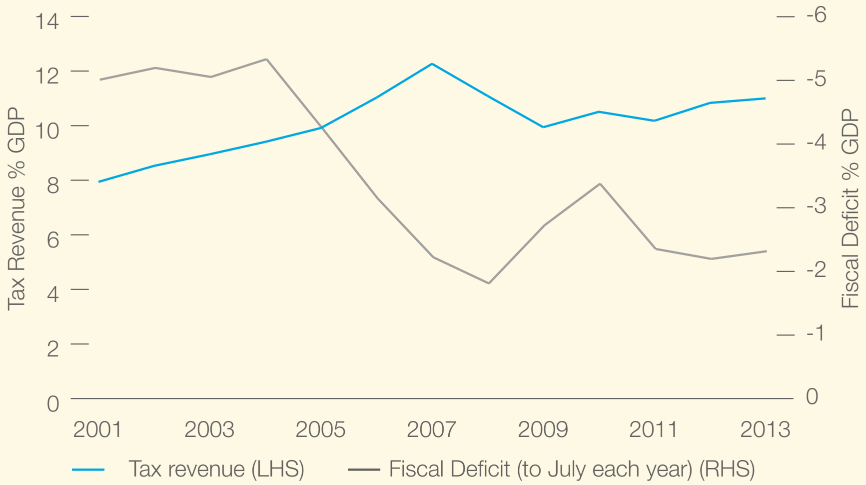
(As an added bonus, India now has the world’s largest dedicated 4G LTE network whose data usage has now surpassed both China and the USA, having been ranked 150th in terms of broadband penetration 12 months ago!).

The private banking sector, especially some of the smaller and more nimble banks who can embrace new technology, are very well placed to participate in the rapid growth of the financial inclusion of the Indian population.



Another aim of demonetisation was to help bring the unorganised, or black, economy into the formal economy by increasing the costs of tax avoidance. In India, most companies will have two books, one for the taxman and one for the owner. It is in this dual economy that the move towards digitalisation is really going to bring about change, as the costs of managing untaxed money and assets begins to spiral upward. The agreed implementation of a goods and service tax (GST) in July 2017 will bring about another profound move towards a more formal economy. In short, the final seller of a product or service has to pay the GST but can claim back the tax paid by all of its supply chain – effectively forcing the entire chain to be either in the formal or informal economy. This is likely to lead to a significant increase in India's total tax income which, latest (2013) data shows, languishes at around 11% of GDP. If this occurs, there will be a reduction, and possibly an elimination, of India's structural fiscal deficit and a renewed ability for greater government investment in infrastructure. It would also likely result in a fall in interest rates and a stronger currency.

India's Fiscal Deficit vs Tax Revenue. % of GDP



Source: Worldbank, Government of India

Many companies should gain from these trends. For example, we believe mortgage providers in the country will benefit significantly from increased housing starts. Land has been a good place to store illicit wealth; hence land prices are artificially high. Enforced digital land registration will bring land back into the formal economy, increase tax revenues and lower land prices. Government support for middle-income housing is likely to produce significant growth in the housing sector over the next few years.

DISRUPTION IS EVERYWHERE

DON'T UNDERESTIMATE THE POWER OF THESE NETWORKS.

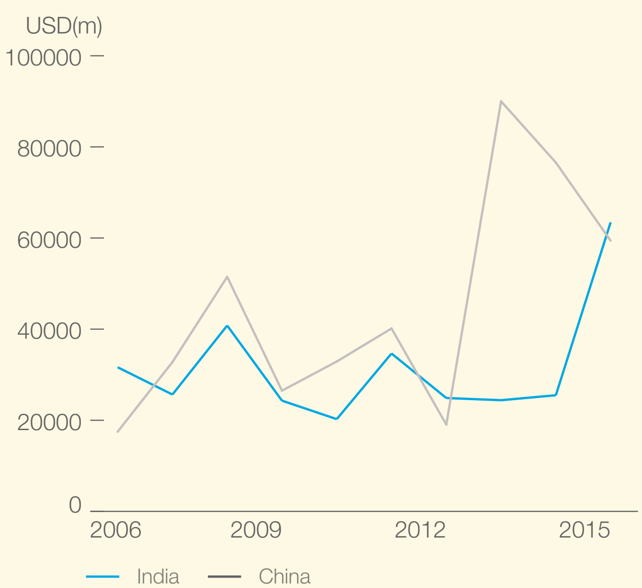
As an example, take a private company that was incorporated in 2006 as an associate business of a famous yoga guru. It initially launched toothpaste and a few personal care products based on Ayurveda, the natural Indian herbal heritage of foods and healing, with the goal of making people “proud of being Indian”. Using the Swami as the brand ambassador and offering quality and healthy products at a greater discount than traditional fast moving consumer goods (FMCG) companies, it has created its own distribution network, giving it a significant competitive advantage. Today the company claims it reaches over 1 million retail outlets. The power of the yogi’s network has enabled little to be spent on advertising, a key cost for FMCG products. This saving is reflected in the discounted pricing which, in turn, helps growth. The company claims that it is now the third largest FMCG in the country and by 2020 it aims to be larger than the long-standing number one player; as the company’s investor relations people are wont to say, “the best is best, the rest is rest!” Unfortunately, the company does not need capital but its story should be seen as a Siren's song, emphasising the power of networks and the risk that old business models face. The consumer staples space is one area where we believe increased competition is likely to reduce historic returns.

INDIA IS OPENING UP

INFORMATION FUELS COMPETITION AND GROWTH

In 2010, a not for profit organisation called ‘Invest India’ was established to help facilitate foreign direct investment (FDI) into the country, something which has historically been notoriously difficult. In 2015, India was, for the first time, the world’s largest recipient of FDI by capital investment. Today, Invest India has an FDI facilitation pipeline of $60 billion and has received over 58,000 enquiries, which the organisation believes will create a potential 1.7 million jobs over the next 24 months. The organisation spends 80% of its time on facilitation and 20% on promotion. It helps with market strategy and location searches. Most importantly, it liaises with local states and helps with government clearances, and will push for local policy changes when required.

Value of greenfield FDI projects by source/destination



Source: © UNCTAD, World Investment Reports 2013 and 2016.

The government has started to publish a ranking of Indian states based on ease of access for FDI and doing business. The rankings in themselves have made the Chief Ministers of the states enact reforms in the pursuit of improved rankings. The pace of improvement is such that it plans to update and disseminate the rankings in real-time. The act of measuring alone is fuelling internal competition and improving outcomes for foreign investors.

According to Invest India, the country is at a tipping point. Out of 29 states, nine have been growing strongly; nine have been growing around 5.5% – 7.6%; with a further nine likely to move into a growth phase in the next 24 months. The recent elections in Uttar Pradesh, the largest but one of the more deprived states, were won by Modi’s BJP with a higher voter share than in 2014, another example of the electorate voting for change and growth.

India remains one of the most exciting growth markets in the world today. We expect it to be the fastest growing large economy in the world, over almost all long-term timeframes. We continue to believe that economists, strategists and investors underestimate the profound changes that the government, and the people of India, are creating today via the growth of some of the largest data networks in the world. The positive effect of data networks, Digitalisation and increased transparency on an economy the size of India's will be felt for decades to come.

CURIOUS ABOUT THE WORLD

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