GLOBAL STEWARDSHIP ROUNDTABLE

Fourth Quarter 2018

BAILLIE GIFFORD

RISK FACTORS

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Annual Past Performance to 31 March Each Year

	2017	2018	2019	2020
Global Stewardship Composite Net (%)	39.4	17.1	9.5	-0.2

Source: Baillie Gifford & Co GBP.

Past performance is not a guide to future results. Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio.

Global Stewardship was launched on 31 December 2015; past performance is only available from this date.

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GLOBAL STEWARDSHIP ROUNDTABLE

The three year anniversary of the launch of our Global Stewardship strategy is an appropriate point at which to review how far we have come. It also provides an opportunity to reflect on performance over that period, and consider the evolution of the initial concept, which was built around the idea of using regional stock picking to create a global portfolio.

I joined the investment team for a Portfolio Construction Group meeting at which they discussed what they have learned since the strategy's inception and how they plan to develop in the future. We also addressed a few common client questions – if you're a team why don't you sit together? How does 'no veto stock picking' work? And what on earth does 'stewardship' mean, anyway? These and other questions were addressed during a typically robust discussion which focused on the process rather than any individual stock.

Anthony Tait, Head of Clients Department

What was the genesis of the Global Stewardship idea?

Iain McCombie (IM): My observation, drawing on my 20 plus years of experience at the firm, was that I felt there were two key strengths within Baillie Gifford: one was the stock-picking expertise of our regional teams, which I'm part of on the UK equity team, and the other was the very successful use of what we call a 'Portfolio Construction Group' (PCG) – a group of investors coming together to create a holistic portfolio of best ideas. Global Stewardship came from combining these two elements and taking the best of both – regional expertise with a global perspective.

We needed a team of course, and given I was Chief of Investment Staff at the time, I was in a great position to hand pick who I believed were the best possible individuals. Having worked with a lot of them over the years I also knew they'd make a cohesive group.

Gary Robinson (GR): I think one of the things that motivated us to set up Global Stewardship was that a lot of great companies that are held in our regional portfolios weren't making their way into global portfolios. These are stocks which tend to be off the radar screen of the largest global investors. Usually they are a bit smaller in size, but no less worthy in terms of investment merit. Global Stewardship has the opportunity to unearth these ideas, which we call 'local heroes', and build a portfolio that is genuinely differentiated from the average global portfolio.

Mike Gush (MG): One of the most exciting things about Global Stewardship is that we've collectively designed the investment process ourselves – this is how we want to manage money on a global basis. It was also our decision to integrate stewardship from day one, so we asked Andrew Cave, our Head of Governance and Sustainability, to join the PCG. We're all incentivised by the performance of the entire portfolio and we trust each other, as most of us have been at Baillie Gifford our whole careers. We have a philosophy, a process and a team that we really believe can hugely benefit our clients.

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What are your thoughts on stewardship within the Portfolio Construction Group?

Andrew Cave (AC): Global Stewardship adopts a structured way of thinking about material governance concerns and sustainability issues. It's built into the process so that it is something we are always thinking about as a team, and I think that is very powerful.

We prepare pre-buy research notes for all potential holdings, so we are thinking about governance and sustainability before anyone has a fully-formed view. This avoids the potential for cognitive dissonance as we have a cursory glance at the stewardship issues after a stock discussion. I am a member of the PCG so I actively participate in every single stock discussion, where I put forward my thoughts and concerns (if any) about the company being discussed. The final part is that we have an engagement priority list. This is a list of typically five to 15 companies where we have identified a material stewardship issue to engage on. This helps us focus on a small number of holdings and I do this in collaboration with the original stock sponsor.

I've probably attended 100 stock meetings now, and what we've found is that we don't have a section on the agenda to discuss stewardship, it just flows naturally into the discussion. That's because stewardship issues are investment issues if you're as long-term in your investment horizon as we are. For example, data privacy has been a key issue of late. We discussed it in relation to our holdings in Alphabet (Google's parent company) and Facebook, and both have been added to our engagement priority list.

Zaki Sabir and Andrew Cave.

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What are the benefits of operating as a Portfolio Construction Group for this type of global portfolio?

MG: The PCG provides a platform to put the stocks you're looking at in a global context, comparing them against other companies around the world and fitting them into a much bigger picture. There have been some good examples of stocks where we've changed position sizes based on the convictions of others around the table, coming from their experience. MarketAxess would be one – an electronic bond trading platform that Gary brought forward for discussion. Actually it was the conviction of others around the table that made us increase that weighting and I think that's very healthy. You wouldn't have that unless you were operating as a PCG.

IM: What we're trying to do is take the best stocks from our regional portfolios and put them into a global context – some of them frankly just don't make the cut. It's not that they're bad companies, it's just that there are better companies that we can own elsewhere. I've given up on a few ideas and I don't have a problem with that because what I care about is the overall performance of the portfolio. I want the best 80 stocks. I don't care where they're from.

The other really important point is trust. We're trusting people to come up with great ideas. I think that's very powerful as a group, working together.

Stephen Paice (SP): I think the trust element is also underpinned by the fact that we take collective responsibility for all stocks once they get into the portfolio. The fact is that our incentives are all aligned. We're incentivised by the performance of the whole portfolio. So, we don't want to focus on the regions – our emphasis is on the whole portfolio and what we can do for clients.

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Iain McCombie, Stephen Paice, Mike Gush and Anthony Tait.

Did you think about using a permanent global team structure at all?

GR: You immediately lose the link with the regional teams if you have a permanent global team, doing so would negate what I think is a key strength of the team. The defining feature of Global Stewardship is that by having regional experts putting the portfolio together, you get something that's quite different – a portfolio of global champions alongside local heroes.

Zaki Sabir (ZS): You could say that we get the fish fresh off the boat, we don't need to go to the market. It's that intimacy with regional teams that allows us to discover companies that have the greatest long-term investment potential early. We believe a permanent global team would find that hard to do.

Matt Brett (MB): It also works the other way too, in that our conversations in the PCG enrich the discussions at our regional desks. I think one of the dangers of being a regional expert is that your view, over time, can become narrow in the sense that you're looking for what is best in your region. You may have an idea, for example, that a company like Amazon is a formidable competitor for one of your holdings. However, it's only when you regularly participate in discussions concerning that company that you really appreciate how formidable it really is. You can then take that back to your region and it better shapes your view of the companies there.

How do you think about the regional weightings in the portfolio?

GR: From the bottom up. We want to pick the best 80 companies in the world, irrespective of where they reside, and then over and above that, we want to avoid having any undue concentrations or any undue correlations in the portfolio, so we do have sensible diversification guidelines.

MB: I think the concept of 'no veto' within the group is relevant here – this means that each representative has the power to put a holding in the portfolio, even if the rest of the group doesn't buy into the idea. This means that the portfolio, and so the regional weightings, are simply an output of all the individual investment decisions made by the regional representatives. We think this is important as it allows you to cut through certain behavioural biases, like when some regions look difficult to invest in. I think it's fair to say that in Japan, management teams tend to have characteristics which are challenging for global investors who are used to more promotional personalities.

ZS: The Japanese comparison is very interesting because other globally run funds tend to have a lower Japanese weighting. Matt has the power to get companies into the portfolio he is most enthused about. We have been outstanding Japanese stock pickers for decades so why can't we give these exciting Japanese companies the stage they deserve? That's what Global Stewardship allows us to do. And we can do it because we all know each other well having worked together for over a decade. We trust his judgement.

MG: I think Global Stewardship is the epitome of what Baillie Gifford does best – it's long term, active, growth-focused and is there to exploit inefficiencies in the market. A lot of global money is run by central teams that look at things thematically. There are lots of great growth companies that might not get into global portfolios because they're a bit too esoteric. I think the Japanese weighting is an exact reflection of that. When we look at the investment opportunity, they absolutely fit what we're trying to do, and it's great that nobody else sees it. We're anti-thematic, and that's a good thing!

GR: I would agree too. I think the regional expertise allows you to blast through the heuristics. Take a company such as Wayfair, which we have in the portfolio. Wayfair is an online furnishings retailer. It's fairly small compared to the large e-commerce platforms. The mental shortcut is that you don't invest in companies that compete with Amazon, so it's very easy to dismiss Wayfair. We know the business and its numerous attractions well and we have come to the view that Wayfair will likely prosper for years to come. I think if you just start with the top-down view, which is that Amazon is going to take everything in e-commerce, then it's very easy to dismiss a company like Wayfair.

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How do you think about stewardship and ESG more generally? Do you have different standards depending on what region the company is in?

AC: I think one of the benefits of the approach is that it's very much in line with the culture of the PCG – it's bottom-up fundamental research. We don't apply a top-down grid to our policy which would unfairly penalise stocks from emerging markets, relative to other governing standards. We look at everything individually and think about what the risks are in that company's market. We think we should judge each company relative to the consumer and regulators of that market. Therefore, it would be completely wrong to attach a London-centric or a New York-centric view of what is the right way to run a business. You must look at it in the context of its own market or region.

IM: More broadly, we want to focus on a small number of stocks where we think we have some influence and the issue is sufficiently severe that we can engage effectively. We want to help a good company get better, because by definition we're generally looking at good companies that are trying to take long-term views. It's very much about our common philosophy. But sometimes these companies have issues. Martin Marietta is a great example[1] – we think there's a real issue with its environmental disclosures which aren't good enough by global standards. There's a real business risk, because if the management don't rethink it and improve it, there's a danger that regulators could get involved and it could impact the business.

AC: The follow up to that is that Martin Marietta has recently been put on a list of 100 companies globally that a group of investors believe have the most responsibility when trying to address climate change. So, what we said would happen is happening. It's amazing for a regional aggregates business to get that kind of profile alongside oil and gas companies. So hopefully management have done their work this year and the company will move up the curve.

1. Martin Marietta was sold from the Global Stewardship portfolio in May 2019.

Performance has been great so far, but how will you deal with it if it turns the other way for a sustained period?

SP: It goes back to the culture of Baillie Gifford. We don’t have a blame culture, we trust each other. We’re long term. As long as we focus on the fundamentals and what we think generates value then we can avoid some of the volatility in the market.

GR: Again, it’s the role of the PCG, which is based on challenge, context and conviction. But with the challenge comes support. At the moment we probably skew towards challenge, which is probably fine when you’re performing as well as the portfolio is at the moment, but when you’re in the situation where the portfolio is underperforming, that’s when support becomes important. The PCG provides us and the other investors with the support we need to continue backing our conviction and investing for the long-term betterment of our clients’ portfolios.

How do the PCG deal with disagreements?

ZS: We have worked together for over a decade and that helps us to challenge companies put forward by one another, in the spirit of testing investment cases and ensuring the portfolio is the best it can be. Each investment is debated robustly, testing both the upside potential as well as the downside. This enables individuals to put businesses across geographies and sectors into context: how does the best investment idea in Japan compare to the tenth best in the US, for instance? Of course, differing views are aired during this process – we wouldn't be doing our job if they weren't – but ultimately we trust each other, both for putting stocks forward and for determining the level of conviction in individual stocks in the portfolio. Indeed, we have actively built in a mechanism whereby we back the individual to ensure controversial stock ideas make it into the portfolio at a weighting that has the potential to make a real difference. Disagreements are part of day-to-day life as an investor; having a common philosophy and a robust process are key to harnessing the value that they offer.

How do you balance your regional responsibilities with those for Global Stewardship?

MG: It really isn't an issue and, if anything, is a net positive. The whole process of Global Stewardship is designed to capture the very best that Baillie Gifford has to offer – expert regional stock picking and a tried and tested way of constructing portfolios. We believe putting investment ideas in a broader context, being challenged by experienced investors with different perspectives and, ultimately, having to weigh conviction across a global opportunity set leads to better decisions. Getting the stock research right is at the core of what we do, and commands the vast majority of our attention – and the knowledge of our regional experts is key. Being able to add a global perspective makes investment cases more robust, sees them challenged in ways that silo-based investors miss and allows us to properly judge the best stocks to own. This is exactly the excitement of running money on a global basis – getting one's best ideas in a global portfolio and judging them against other world-class businesses.

Mike Gush.

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CONCLUSION

Having joined the investment team for their Portfolio Construction Group meeting, I was struck most by the belief the investors have in one another and all that this strategy might achieve. I hope, having read this, something of their enthusiasm and passion for investing has come across.

At its simplest, Global Stewardship is a best-ideas portfolio: the investors want to pick the best 80 companies in the world based on bottom-up fundamental research. But the reality is so much more than that. Global Stewardship is the epitome of what Baillie Gifford does best as long-term, active growth investors. It combines regional expertise, a global perspective and the understanding that stewardship issues are investment issues. This means that the companies with the greatest long-term investment potential hit our investors' radars early. And having worked alongside one another for over a decade, the investors have established a level of trust and mutual support that belies the portfolio's three-year track record, enhancing the challenge and conviction they can collectively bring to bear on investment ideas. The result is a distinct portfolio of global champions and local heroes, one which we hope will prove its worth for many years to come.

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