
SHORT BRIEFINGS ON LONG TERM THINKING – EPISODE 10

NAVIGATING A STOCK MARKET CRASH

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MB Hello, and welcome to *Short Briefings on Long Term Thinking*. Thanks for joining us. I'm Malcolm Borthwick, managing editor of Intellectual Capital at Baillie Gifford.

These are turbulent times for investors. During the past few weeks, we've seen dramatic falls in global stock markets, even by historic standards.

Baillie Gifford was founded in 1908. It has survived the Great Depression, two world wars and numerous stock market crashes. So, what has more than a century of investing taught us about how to navigate a crisis like this? I'm joined by Scott Nisbet, who's a partner at Baillie Gifford.

But, before we start, some important information. Please remember that, as with all investments, your capital is at risk.

Scott, you joined Baillie Gifford in 1996, how does this crisis compare to others?

SN As you alluded to, Malcolm, we'd been through a lot of crises before I joined in 1996. But even since then, looking back, 1998 was the Asian and Russian debt crisis, in 2001 it was the tech bubble bursting. Though, in hindsight, some might say that's not the most accurate description. In 2008, it was the global financial crisis. Now we're in this crisis, and there have been others in between, like SARS. You start thinking, "wow, there have been a lot of crises". And yet, over the last 25 years, the value of equities has gone up.

I would say that each one is different in at least three different ways, but the first two ways, the first two levels of difference, people never talk about. And the third level of difference is the crisis itself, and people talk about that, but there are two levels before you even get there that tend to be ignored.

MB And what are those different levels?



SN The first level is a personal one. In 1998, I was a third-year investment analyst at Baillie Gifford. I had no idea what was going on. I knew that the stocks that I'd written about and recommended had gone down in price, but I didn't really get what was going on.

I think that's quite an important point, because nowadays I guess I'm one of the quite senior people at Baillie Gifford, but there are a lot of people in everybody's firms who haven't been there before. So, you need to bear in mind that personally people are at different stages in their career. They have different levels of experience, and therefore they will be experiencing the crisis differently each time. So, the first level is the personal level. The second one is the firm level. Baillie Gifford is not the same firm as it was in 1998 or 2008.

MB And how do you help people on a personal level who maybe haven't been through a crisis before?

SN Well, as I was alluding to with the firm, there are certain constants with Baillie Gifford. We remain an unlimited liability partnership, so we're very aligned with our clients' interests. We remain a place that tries to take a long-term view, and one that tries to really look after our younger staff.

But where the culture changes a bit, in a crisis - and I saw this in 2008 and I'm seeing it right now - is in the investment teams, for example, where we let people follow their passions. Our investment philosophy is if you can find a few absolute home runs that shoot the lights out, then that's what's going to make your portfolio return over the long run, and the best way for people to do that is by following things that they're very interested in.

So, we tend to have, by some standards, quite an unstructured approach. People just go and look at companies they're interested in, and this idea of coverage - how you are covering the market - is very outdated. But when it comes to a crisis, we have to change the culture a bit, because you need to give a bit more direction.

Not only do you need to show leadership, but you need to just give people jobs to do. One of the things we noticed in 2008, at Baillie Gifford, certainly with our clients and certainly with some of our competitors, is people actually stop doing their job. Everybody's going around saying that they're really stressed, "what do you think about the markets". What are you actually doing?

And so, at times like these, I think it's very helpful to give a bit more direction than we normally would. In 2008, there was something that we did which was a very useful exercise, and we're doing it again now, and that is looking at the balance sheets of the companies that we invest in.

Usually, we're spending a lot of time saying, "look how much this company could grow over the next ten years, it's worth five or ten times the amount it is today", which is great, and we'll come back to that. But it has to be around in the first place in order to grow. And therefore, right now, our analysts are spending some time looking at the balance sheets of the companies, as they did in 2008, to say, "right, let's just check that this is going to survive".



MB But this is very difficult, though from a behavioural analysis perspective, people are naturally trained to knee-jerk responses or maybe to trade on the negative as opposed to looking for the positives. How do you guard against that?

SN First of all, it's difficult even normally, but it's extremely difficult now. We say things like, "don't read too much news and go and find different sources, such as academia". And I think we've done a pretty good job of that. But if you look at behavioural studies like *The Power of Bad* and you look at work by people like Kahneman and Tversky, a ratio of about four to one comes out. You hear four times more negative news than you hear good news, or you have a four times stronger reaction to something going down than joy at something going up. So, to have a chance, you have to consciously combat that. You have to aim off for that.

In our stock discussions, I think one thing that separates us from many managers is that we spend most of the time looking at the upside. How well could this company do? Now, we do need to check it's going to survive first, but, then, how well could it do and how undervalued is it? Whereas, I think most people's tendency is to spend most of the time knocking the case down, saying "what about his or what about that?"

For example, we have a rule in the team that I work in that, for the first 20 minutes we discuss a stock, if you're going to speak, you have to say something that contributes to the bull case. If you say, "but what about", you get kicked out of the room.

Now, even after having this protocol for many years, you'd be surprised how often people still get kicked out of the room, because it's our natural tendency to be negative. So, I think you need to put conscious, almost formal, things in place to combat the natural instinct to be negative, an instinct that is compounded, for sure, at the moment.

MB Having perspective and staying calm is vital in these situations. How do you personally stay calm?

SN On a personal level, I think there are two things. One is that you need to get away from it all. So, playing a sport. For me it's tennis but it could be basketball, it could be playing the guitar. Something where you have to concentrate on the immediate thing in front of you right now, otherwise you're going to muck it up, and you're forced to put everything else out of your mind.

And the other way, for me, would be literature. As you probably know, people at Baillie Gifford come from all sorts of disciplines. We're quite unusual in that way. Typically, in a financial services firm, you'll have a lot of economics graduates or accountants and a lot of CFAs. We tend to have a lot more people from arts backgrounds.

Reading is great. When there's a bit of a crisis, I always think about the great novel or the wonderful book that I've read that is most akin to what we're living through and ask what I can take from it. For this crisis right now, there's a really obvious one that I've just put on my bedside table again last night, and I've started rereading.

MB And what's that?



SN It's *The Plague* by Albert Camus. He wrote that in 1947. Well, he actually wrote it during the Second World War, published it in 1947, and won the Nobel prize for it. It's the story of the bubonic plague coming and terrorising this small town in Algeria. The story is about the heroics that you see in human nature, and also some of the bad side: the cowardliness, the selfishness.

What Camus concludes at the end of *The Plague*, and I would really recommend people to read it, is that the crisis showed that there was more to admire in human beings than there was to despise.

He says at the end, future plagues will come and test future peoples, but the conclusion will remain the same, there is more to admire. So, as I'm quietly going around sending out crisis comms, and checking people are still doing their work at Baillie Gifford, in every interaction I'm slotting in Camus's very simple moral existential framework for how people behave in this crisis. And I'm happy to report that I think the good guys are well ahead at the moment.

I think human beings are very inventive and very innovative, particularly when in times of stress. That's when you see innovation come through, that's when habits change. I actually think that we're very well positioned to deal with this now compared to any point in our history.

MB That innovation also happens in companies, doesn't it?

SN Yes, the first level is are we keeping our business going, which is fine, and are we looking after our staff, and are our clients okay? Let's keep them calm and say, "yes, of course if you need money back, we can give you that."

And then, you go onto the portfolio and you look at some of the companies that we've bought recently. We don't want to sound triumphalist, we don't want this to be happening, but if this is going to happen, the fact is that we own a lot of shares in Zoom. The use of Zoom must be absolutely exploding worldwide right now.

We bought a lot of shares in Peloton. How many people are going to be using their exercise bike at home, who were going to go to David Lloyd or Virgin Active, or wherever and they're all shutting down? Look at Amazon. We already saw a huge move online in the last 10 or 15 years, but some of the companies we own, like Amazon or Netflix or Alibaba, they're going to get a further shunt in their direction.

There's a further secular move, because not only do people change the way they interact and behave now, but when things return to 'normal', in inverted commas, it's not the same normal as before.

I think in terms of our portfolios, you could make a very strong case that, once this horrendous period is over, we have portfolios that are very well positioned, in terms of the kind of companies they own, to benefit from even more growth in the future. You don't want to sound too arrogant about that right now, because there's a lot of economic cataclysm for a lot of ordinary people to get through first.

MB And from an investment perspective, there'll be successes as well as failures.



You deal very closely with a lot of clients, Scott, typically what types of questions are they asking you?

SN The first question they've been asking us is are you okay? With Baillie Gifford, our average duration of a client is about 15 years. That means they're not just a client. You know these people, you've met them many times, you've been through ups and down with them.

So actually, the first one is kind of an "are you all right?" question. The second one is are you able to continue doing the basics of your business, pricing funds every day, trading if need be, if a client needs their money back, that kind of thing. And we've been able to reassure them on that.

And then, the third question, which they're just getting round to now, because obviously there's a couple of weeks of adjustment and a lot of our clients are working from home and it's not normal for them either, is whether the portfolio is going to be okay. What's the most recent performance telling us?

Obviously, we usually avoid talking about very small periods of time. You can't really take any meaning from them. But because it's been so spectacular, clients are keen to try and derive some kind of conclusion about how Baillie Gifford is doing. And even in very short periods of time, when the market's been going down quite steeply, as you alluded to, our kind of companies are holding up pretty well. They're going down in value on the short-term basis, but not relative to the market. And most of them have very strong balance sheets, so most of them are going to survive.

Coming back to your point about successes and failures, one of the things that we try and be very tolerant of at all times is things going wrong. If you're going to be brave and buy companies that might go up many times, then you're also going to buy some companies that are going to disappear altogether. So the fact that some of our companies will disappear over the next six months isn't actually that different to normal. We're used to that, we expect that.

Arithmetically, it usually isn't that important for the return of the portfolio. What's important for the return of the portfolio is you have some of those home run winners. And as I said a couple of minutes ago, I think we have quite a number of them.

MB What about liquidity?

SN That's a very good point. That does come very much to the fore for clients at a time like this. One thing we found in 2008 is that although equities fell 45 percent or whatever the number was, equities continued to function. They worked, and we found that, in 2008, a number of our clients used us as a bit of a giant ATM machine, because they couldn't get their money back from anywhere else.

In that sense, we would question how people think of risk, because the ultimate risk is that you can't get your money back. People talk about equities as though it's a risky asset class. Well, if it's the asset class that remains liquid in times of crisis, then you need to rethink how you apply this word risk to equities.



A number of the questions we've had in the last couple of weeks have been if we needed some cash back, can you raise the money? And the answer is yes, of course we can. We wouldn't advise you to sell stocks at this level if you can avoid it, but, actually, the function of doing it is no problem. And we've been delivering cash back to our clients in the last couple of days, where they've needed it.

MB And just to clarify, this podcast will be going to both institutional and retail investors, that's more on the institutional side, isn't it?

SN Yes, absolutely. Obviously, if you're a retail investor, you're not trading in the volume that some of our clients are, so if liquidity isn't an issue for our institutional clients, it's certainly not going to be for retail investors.

But the point about staying calm, unless the retail investor needs the money - they have to pay for their house next week otherwise it doesn't go through - unless it's something like that, then I really don't think it's a good idea to be selling at this stage. Even if you wait two years, I know two years sounds like a long time now, you'll probably think, "wow, I'm so glad I didn't panic".

MB Scott, thanks very much for joining me, and I hope you'll join me again soon on the podcast.

SN You're welcome. Thanks.

MB You can find our podcast, *Short Briefings on Long Term Thinking*, at bailliegifford.com/podcasts, and you can subscribe at Apple Podcasts, Spotify and TuneIn. If you enjoyed the podcast, please spread the word. And if you'd like to find out more about Baillie Gifford, our culture and how we approach investing, check out bailliegifford.com/about-us. And many thanks to Lord of the Isles for the music. The track we've used is called *Horizon Effect*, which was released on Permanent Vacation. Until next time.

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