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# ACWI EX US ALPHA

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**Four investors from Baillie Gifford’s ACWI Ex US Alpha team describe the four strands that together comprise their strategy: quality compounders, rapid growers, through-the-cycle winners and capital allocators. Each focuses on a growth company that illustrates their thinking, and which shares ACWI’s long-term outlook.**

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**Susan Derbyshire:** We are resolutely growth investors but we recognise that there are different ways that companies can grow and increase their intrinsic value over time. We invest in quality compounders, in rapid growers, in through-the-cycle winners and also capital allocators. In this film, you’re going to hear from four members of the ACWI EX US Alpha Portfolio Construction Group. We’re going to spend a few minutes talking about how we think about growth and market inefficiencies.



First you're doing to hear from Jenny Davis, who is going to explain what we mean by, a 'quality compounder.'

**Jenny Davis:**

A quality compounder is a company that sells you stuff you need. Stuff you can't really avoid needing. So, things like clothing, food, healthcare, savings.

AIA sells life insurance. No one really gets to avoid needing life insurance because nobody gets to avoid dying.

AIA operates in Asia Pacific and in Asia Pacific, there is an enormous mortality protection gap and that gap is the difference between the amount of savings and protection that people have currently and the amount they would need in order to sustain their loved ones should the main bread winner die.

AIA is the largest life assurer in the region and yet it has penetrated only 2% of this total \$58 trillion opportunity. But to really understand why people would buy life insurance from AIA now, you need to understand the customer profile. China is driving over half of new business growth at the moment in AIA and if you think about the Chinese demographic at the moment, you have a very large generation that were born during the 1960s and '70s, during the cultural revolution. They will be typically nearing 50, they will be at the peak of their earnings potential. They are likely to have had only one child. They're likely to have seen an incredible rise in economic prosperity during their lifetime and all of these things combined mean that they are now turning their attention away from making wealth, towards protecting wealth, towards their legacy for the future generations.

They can't rely on the state to provide for them. They're less likely to be able to rely on family to provide for them and so they will come to the likes of AIA and private companies to provide that protection for the future. The average holding period in the market is under a year. For us, the average holding period is eight years. That means that we stick around long enough to see and benefit from the power of compounding.



**Andrew Stobart:** MercadoLibre is an example of a rapid growth company. It's Latin America's largest e-commerce business, operating across 18 countries in the region and this is a business which has been around for almost 20 years, so it's still growing quickly.

The company is also an example of a platform business. In this case, a digital platform business. Similar businesses in the US would include Amazon, Uber and Airbnb and these businesses can grow extremely rapidly and I was looking for similar businesses in Latin America. In 2010, on a trip to the region, I met several retailers and ecommerce businesses and almost all of them were universal in their praise for MercadoLibre. Both as a competitor but also as a successful and well-run business and in its Chief Executive, Marcos Galperin, who also owned 10% of the business. Someone who is still committed to the success and the long run of this company. In particular, the company was investing for the long run. It wasn't concerned about short-term profits. It wasn't concerned about short-term revenues and I think this was demonstrated, in particular, by the Chief Executive's statement to me that, "If we don't cannibalise ourselves, then others will come along and cannibalise us." There's constant need to reinvest so that others don't come along and disrupt you, and I still think today, that MercadoLibre is one of the more exciting investments in the portfolio.

**Angus Franklin:** Ryanair is a through-the-cycle winner, there is a short haul European airline in what is a very cyclical industry. The market doesn't really like cyclical companies. They put low ratings onto their shares because of the uncertainty of the earnings outlook. We can exploit that inefficiency by holding the best businesses throughout the cycle, safe in the knowledge that the business with a strong competitive advantage will emerge from the inevitable downturns far the stronger. It's key competitive advantage is its extreme focus on cost. That stems from many areas but principally a very young fleet, which means low maintenance cost, greater punctuality and greater fuel efficiency. It also has economies of scale through purchasing and negotiating. The average profit margin over the last 40 years with the industry as a whole is less than 1%. In contrast, Ryanair has managed to make margins close to 20% for a long period of time.



Another reason why we like Ryanair is we do feel we are aligned with the management of the company. The Chief Executive has been there since the beginning and owns 4% of the company's shares still. That means they are thinking long term like we are and they invest for the long term. Over the last 10 years, they spent €10 billion on expanding their fleet but they've matched that with also spending nearly €5 billion on share buy backs and dividends to its shareholders.

**Donald Farquharson:** Capital allocators are companies which we think will grow strongly over the long term, but where that growth will be punctuated by having to make large investments in the business or periodically because the company is making acquisitions. What we tend to find is that the market will appreciate growth but it likes that growth to be delivered in a predictable manner and the uncertainty that's engendered by acquisition or by making large capital investments means that the earnings progression may not necessarily always be that smooth and we think that that's a market inefficiency that we can capitalise on.

Nidec is an interesting business in its own right. It's the world's largest maker of high precision motors. One of the contentions we had when we looked at Nidec was that there was a big opportunity that was growing in other areas really for new ways of growth which didn't exist before. The first is the automotive market. The second is industrial robotics and factory automation. The third is interconnected devices, the internet of things and the fourth are drones. These, we think, are all areas which would be particularly good for Nidec's precision motors.

The automotive market, I think, is a great example where we're seeing migration from internal combustion engine to hybrid engine to full electric. Roughly five times as many motors go into an electric vehicle today than go into an ICE engine.



**Susan Derbyshire:** The market, as a whole, is not long term and that forms the basis of the inefficiency that we seek to exploit in making long-term growth investments for the benefit of our clients.

## BAILLIE GIFFORD INTERNATIONAL EQUITY FUND

### TOP 10 HOLDINGS AT 31 DECEMBER 2018

Holdings	Fund %
1 TSMC	3.44
2 MercadoLibre	2.64
3 SAP	2.62
4 AIA	2.51
5 Rio Tinto	2.39
6 Deutsche Boerse	2.32
7 Samsung Electronics	2.13
8 Nestlé	2.00
9 Fairfax Financial	1.90
10 HDFC	1.85

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.

