EUROPE EX UK MANAGER INSIGHTS

Stephen Paice, investment manager in the Europe ex UK team, gives an update on the activity and current positioning of the portfolio.

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Stephen Paice (SP): The current environment continues to be very uncertain, however equity markets by nature are volatile and, as investors, we have to live with this.

Over the last couple of months, we've certainly not had any reason to panic though, or be tempted to switch investment style or into stocks which are perceived to be either 'safe' or 'cheap' despite having limited growth prospects, or being lower quality, or even both.

What we do believe though is that governments will try and do everything possible to speed up the inevitable recovery and that entrepreneurial and financially strong companies exposed to long-term structural trends will tend to outperform. This is what has worked for us in the past and is what we will stick to.

Portfolio performance and positioning

Hindsight is a great thing but investing through a crisis is made much easier if you have a long-term investment horizon and the right kind of portfolio going into it. Performance continues to be very good and there are a couple of broader reasons for that.

The first is that we have very little debt at the portfolio level, partly because it doesn't suit our style of investing – we like companies that are asset light and can scale quickly – but also because the majority of companies we invest in have families or founders or other insiders with their own personal money at risk who themselves don't like taking on too much debt. These are the companies that are not only resilient but also capable of emerging from this crisis in a stronger position, whether taking share of weaker competitors or by acquiring them.

And the second reason is that, even before the crisis, the portfolio was tilted to structural growth from trends such as digitalisation and the shift in consumer behaviours from offline to online, which all seem to be accelerating in the current conditions, and limited exposure to some other sectors like banking and energy which haven't done so well. So not only does the portfolio have lower levels of debt, it is also growing revenues at much faster rate that the index. Positive contributors included Sartorius Stedim (which manufactures equipment for biosimilar and vaccine production), Bechtle (which is a German provider of IT services for small and medium enterprises), and Delivery Hero (which is one of our on-demand food delivery companies).

Outlook

Not having to worry about companies surviving also means we get to think more about how they might thrive, and we have exposure to two themes in particular that we think are important.

The Microsoft CEO recently said that they'd seen two years' worth of digital transformation in two months – from remote working to sales and customer service, to cloud infrastructure and security – and over the past couple of months we have been adding to companies that benefit from trends like this.

We've been adding to Prosus (which is a technology holding company), which has stakes in a lot of digital businesses, the largest of which is Tencent (a Chinese social media, fintech, cloud and gaming platform), which is now our largest holding and may well possibly be the largest company in Europe within the next five or ten years. Other companies in the portfolio that we are excited about are Adevinta (which is involved with online classifieds), Zalando (a leading online fashion wholesaler and marketplace) and Adyen (which is a Dutch technology company which is enabling businesses to take a variety of different electronic payments). These companies all operate in slightly different markets, however, they share some very similar characteristics such as having founders involved and, as they benefit for digital scale and network effects, they should get stronger as they get bigger.

The other less obvious theme that we are excited about is consolidation of niche, but very fragmented, industrial markets. Companies that should be able to benefit from this include IMCD (which is a Dutch speciality chemical distributor), NIBE (which is a Swedish manufacturer of energy-efficient heat pumps), and Kingspan (which manufacturers insulated panels for buildings). These companies dominate their respective industries, they also have long-standing managers or founders involved and should be in a very good position to acquire weaker competitors and deliver attractive rates of growth, despite being in slightly less glamorous industries.

We think that the current environment is going to provide something of a wakeup call for many of the companies and industries in Europe. We think that the market will continue to bifurcate into winners and losers – with the winners being able to benefit from this new digital world and the new tools available – and the losers – many of them in more traditional industries – unable to adapt. This is where we will continue to focus our efforts and fortunately we have a lot of attractive propositions in Europe. You just need to know where to look.

Annual Past Performance to 31 March Each Year (net %)

	2016	2017	2018	2019	2020
Europe ex UK Composite	5.6	29.8	9.9	-2.4	6.0
MSCI Europe ex UK *	-4.2	27.8	3.7	3.1	-7.5

Source: Baillie Gifford & Co. Sterling.
*FTSE World Europe ex UK Prior to 31/12/16
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Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio.

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