WHY THIS CRISIS FAVOURS GROWTH STOCKS

INTERVIEW WITH TOM SLATER

MB Malcolm Borthwick

TS Tom Slater

MB Hello and thanks for joining us. I'm Malcolm Borthwick, managing editor of Intellectual Capital at Baillie Gifford.

When something is cheap we often think we've found a bargain. The same goes for stock markets. When markets fall, many investors look for value stocks such as BP or Barclays, which they think are trading below their true value. But during the coronavirus downturn, growth stocks have tended to be more resilient. These are companies such as Amazon or Alibaba, which have more growth potential. To discuss why, I'm joined by Tom Slater, who's head of our US Equities team.

But before we start, here's some important information. Please remember that as with all investments, your capital is at risk, and this podcast is being recorded while we're in lockdown, so we're both at home and not in the studio.

Tom, why have growth companies tended to be more resilient during this crisis?

TS Well, I think there are several strands to that. The first is that the types of growth companies we're interested in, the ones that are bringing new approaches to existing industries, that are changing the way that we interact socially, that are changing the way we work, are absolutely essential tools in dealing with the current environment.

If you can't go out and meet people face-to-face, then you want to use consumer internet technology companies to socialise. If you can't go into the office to work, then, I think, the tools of remote working become really important to you. I think you also see an acceleration of some of the big trends that have been driving these changes.

To take one example, the online furniture retailer, Wayfair. We've seen furniture purchasing moving increasingly from physical stores to online. Now, in the current recessionary environment, furniture purchasing has collapsed for the market as a whole. But, because on-line was a relatively small share of that market, and because it's really the only place you can shop now, Wayfair has seen an acceleration in demand for its services. So, the broader economic conditions were not the main driver of that business. The main driver was the move from offline to online, and that has really been accelerated.

Another part of it is that the traditional, in inverted commas, 'cheap industries', where people have often turned to find bargains in these types of environments, have actually proved to be not at all resilient. The oil price has collapsed, so all the energy stocks have been under real pressure. People have learned some of the lessons from the financial crisis in 2008/2009, and so banks and the financial sector have not been a safe haven in these times.

So, it's a combination of the types of growth companies that we invest in helping to be part of the answer to the current crisis, and also the traditionally, in inverted commas, 'cheap' type companies really not delivering for investors at all at the moment.

MB And do you think that the structural changes which are being accelerated will stick?

TS I think that most of the extreme measures we're taking at the moment to deal with these exceptional conditions will not persist beyond the end of lockdown. But I think that there are lots of trends, which we were seeing anyway, whose prevalence will have been significantly increased. One example of that has been the explosion of demand for Zoom video calls.

Now, the video conferencing market is one that's been tiny for years, because the equipment was very difficult to use, and the experience was really poor. Zoom has transformed that experience, made it straightforward to use, and has been seeing rapidly growing acceptance in the enterprise market. With what's happening, we've seen an explosion in demand for services. But post-lockdown, as you start to see things moving to a more normal framework in the future, I think people who've become much more familiar with the service will start to say, "do I need to travel in person for this meeting or could I do it via Zoom?".

And so, you accelerate that trend which existed beforehand, but it doesn't become the new normal.

MB And how is this crisis similar or different from other crises you've seen

TS I think the premise of the question is quite an important one. It's not that being a crisis is something that is especially exceptional. Indeed, these sporadic crises in financial markets are what investors should expect. So, the question is, what are the similarities, what are the differences? I think one of the big differences, this time around, is that it's a much deeper and more sudden decline in economic activity.

We haven't, as a society, shut down the economy voluntarily before, but that's what's happening at the moment. I think what's going on currently is much more important than trying to predict what's going to happen, because it's inherently unpredictable. You've had a completely new phenomenon impacting a complex system. Anybody that can tell you definitively what is going to happen is lying. So instead of trying to actually predict the path from here, we focus much more on, "are we investing in companies that are flexible, that are resilient, that can be robust to the circumstances that are being thrown at them?"

And the other thing that I think is really important is that, in times of stress, the companies that are winning, that are dominant, that are powerful, tend to get more powerful, because their competitors are going to be struggling from a financial perspective. They're going to be focused on how to raise finance, how to cut costs. And what you often see is that the winners actually get stronger, or their advantages accelerate through these times of stress.

So, can you find companies that are robust and resilient no matter what the outcome, because we don't know what it's going to be? Can you find those companies that, relative to the other companies in their industry, are likely to become more powerful through these times of stress?

MB And do these situations help to clarify, maybe even further support the investment case of why you invest in these companies in the first place, and maybe force you to reassess companies that you also hold in the portfolio?

TS I think it's a really interesting prompt to test your conviction in an investment case. Have events been playing out as you hoped? Is the company doing what you wanted? Because when you go into a period where capital becomes much more scarce, you want to make absolutely sure that your capital is invested in your highest conviction ideas. But you also want to be investing in the companies that you think are able to contribute positively to society through these difficult environments. You want to be investing in the companies that are going to come out of this stronger.

So, take Amazon as an example. People are becoming increasingly reliant on their services to get access to basic goods and services. If you are unable to get out of the house, to go to the shops to buy basic necessities, their service can be a real lifeline. They've gone out and recruited 100,000 new employees in the US, they've pushed up wages for their employees during this period, and that's enabled them to service the increased demand that they're experiencing. They're prioritising away from their full selection of goods and focusing on essential items.

Those are exactly the things that as a society we're wanting them to do through this period, and they are exactly the sorts of things that a company with their balance sheet strength, their position in the market, ought to be able to deliver, to be part of the solution to what we're experiencing.

MB And this is something that you look at as part of your investment process, isn't it, Tom, in terms of how companies are benefiting society?

TS I think that when you're trying to analyse a company, having a clear sense of why it exists is really important. Companies that set out only to make money for shareholders are rarely effective at actually achieving that aim. Really, you're looking for companies that are creating value more broadly. Are they creating value for their customers? Do they help their customers get things done that they want to achieve? And how you define customers, I think, has to more broadly encompass what's good for society as a whole.

And so, thinking from the point of view of all stakeholders in the company, not just shareholders, is really important. Particularly when time horizons and financial markets are so short. If your shareholders on average own your shares for a very short period of time, you will be optimising for what they want the company to do. Instead you ought to be optimising for the long-run value creation for the stakeholders.

So, thinking about not just shareholders, but the broader set of interests of parties is really, really important.

MB And it does come back to the idea of obliquity.

TS Professor John Kay wrote a book, *Obliquity*. The idea was that if you have a company with an objective that isn't about making money but is about satisfying the needs of customers or clients, helping them to operate more effectively, then, as a result of having a clear objective, you get motivated employees with a clear purpose. You get a company that's going after a common goal and trying to be excellent at that task.

Often, the consequence of that approach is that the company can be very effective at making money. So, it doesn't achieve making money by trying to do that directly, but by this much more oblique path of being excellent at what it does. And so, I think that's an absolutely crucial quality that we're looking for in the companies that we invest in.

MB And you invest in a number of healthcare companies directly involved in finding a solution to the coronavirus. Tell me more about these.

TS What we've seen in recent years is a massive leap forward in our understanding of both genetic and molecular basis for disease. And we've invested in some of the companies that are both driving that change, companies like Illumina who make genomic testing machines, but also some of the therapeutic companies that are taking these tools and applying them.

One example of that is Moderna, a biotechnology company which is looking to build therapies using a chemical called RNA. And one therapy that you can look to build with this modality is vaccines. One of the quite remarkable things about this whole set of events that we've seen, is that, within a very short period of the Chinese government publishing the genetic make-up of the virus, around 40 days, Moderna had come up with a candidate vaccine.

It goes to show how quick it's become, that we can actually isolate and sequence a virus and how quickly we can take that information and translate it into a potential therapy. Now, I don't know if this will turn out to be the therapy that works. But certainly, in terms of the timelining, and having got that vaccine into safety testing in human patients less than two months from when we first understood the genomic code of the vaccine, to me is really quite remarkable.

MB You’ve talked about both Illumina and Zoom. What’s interesting about both of these companies is that there’s a sudden rapid uptake in their services and demand for their services, and high, intense, focus on these companies. How hard is that to respond, if you are one of these businesses?

TS It puts massive pressure on these organisations. I think what you’re really looking for, as an investor, is “are they companies that address a big opportunity?” For us, we’re really looking for companies that have a large and growing addressable opportunity. And the current examples illustrate that well. But then, you’re looking for something about the company that allows them to take advantage of that opportunity, or to endure the pressure.

Where we can come in is having a long-term supportive shareholder base. As a starting point, as you come under greater scrutiny, as you see greater demand for your services, as you’re having to work extremely hard to service that demand, you want to be able to rely on your shareholders, on your employees, to actually come together to try to deliver on that goal.

And there, it’s really important to try to understand the culture of the business. Why do the people come to work? What is it that motivates them? If you take the example of Zoom, the usage of their video conferencing service has gone from 10 million people to 200 million people over the course of the last few weeks. They amount of pressure that that puts on the services, the amount of scrutiny that’s brought on the business, is really challenging.

The way they’ve responded to that, I think, is exactly what you would want to see. There have been some criticisms. They have taken that criticism on board. They have responded to it, they’ve addressed it. They’ve explained why they’ve taken the approach they have in the past, they’ve been transparent about it, and then they’re working at a rapid pace to iterate and improve the product and address these concerns.

It’s exactly the type of response, as a culture, as a company, that you, as a shareholder, would want to see.

MB How has the environment of working at home affected how you approach things, in terms of how you analyse companies and everything else? Has it made much difference?

TS It’s made no difference. The way we work is to think about the long-term prospects of companies. And there’s really no particular place that it makes sense to do that from. What’s important is to get a diverse set of sources of information. To learn from experts, either at companies or academia, or in the fields that you’re interested in. To take your time making decisions, away from the noise and hysteria of markets. And none of those things are really affected by whether you’re working from an office environment or a home environment.

MB That’s a good place to end it, Tom. Thanks very much for joining me in the podcast, and I hope you’ll join us again soon.

TS Thank you.

MB 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.

This communication was produced and approved in April 2020 and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

Investment markets and conditions can change rapidly. The views expressed should not be taken as fact and no reliance should be placed upon these when making investment decisions. They should not be considered as advice or a recommendation to buy, sell or hold a particular investment.

Important Information
Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018 and is authorised by the Central Bank of Ireland. Through its MiFID passport, it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co.

Persons resident or domiciled outwith the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Stock Examples
Any stock examples used in this recording are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual examples will represent only a small part of the overall portfolio and are inserted purely to help illustrate our investment style.

This recording contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

Important Information Hong Kong

BAILLIE GIFFORD

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 licence from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at 30/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong. Telephone +852 3756 5700.

Important Information South Korea
Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Important Information Japan
Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Important Information Australia
This material is provided on the basis that you are a wholesale client as defined within s761G of the Corporations Act 2001 (Cth). Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth). It is exempt from the requirement to hold an Australian Financial Services License under the Corporations Act 2001 (Cth) in respect of these financial services provided to Australian wholesale clients. Baillie Gifford Overseas Limited is authorised and regulated by the Financial Conduct Authority under UK laws which differ from those applicable in Australia.

Important Information South Africa
Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

Important Information North America
Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in America as well as some marketing functions in Canada. Baillie Gifford Overseas Limited is registered as an Investment Adviser with the Securities & Exchange Commission in the United States of America.

BAILLIE GIFFORD