GLOBAL ALPHA
Q1 INVESTMENT UPDATE

Client Director Ben Drury and Portfolio Manager Malcolm MacColl give an update on the Global Alpha Strategy covering Q1 2023.

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This communication was produced and approved in April 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

Ben Drury (BD): Hello, everyone, and welcome. My name is Ben Drury. I'm the Client Director in the Global Alpha Strategy, and I'm joined today by Malcolm MacColl, one of the three Portfolio Managers for the Strategy. As a reminder, Global Alpha is a global growth portfolio of around about 90 holdings, representing opportunities from right across that growth spectrum. We capture these within the portfolio by reference to our three growth profiles, compounders, disruptors, and capital allocators.

The recording today will be about ten minutes, and we'll focus on the recent quarter, but very much trying to draw out some of those longer term themes and opportunities. Shall we start with a bit of a scene setter, Malcolm? How have you seen the environment over the last few months?

Malcolm MacColl (MM): So, Ben, for me, the last few months have actually felt quite similar, in terms of the market environment we're operating within, to perhaps the last couple of years, whereby I think that macro events seem to be very, very dominant as a feature. So, I think that the market is working through a period, whereby fear and uncertainty seem to be prevalent. That, I think, is perhaps the most extended period of this macro dominance that I've ever experienced.

So, I started in the industry in the late 90s, and we've had certain periods of this macro dominance, but never this extended time. For ourselves, I think what we need to reflect on is how does that create opportunity, as bottom up stock pickers? I think that we always feel that volatility, and again, macro dominance, does lead to good potential outcomes. And for ourselves, we need to make sure that we're not being distracted by what is perhaps noise on the periphery, in some instances.

We need to be cognisant of where macro events are important, but we need to bring things back to where real wealth creation comes from. And that, again, for me, is about underlying performance of businesses from an operational standpoint, the compounding of cash flows over long periods of time. And that's how we're focusing our effort and our work right now.

BD: I think volatility in markets has certainly been a theme over the quarter. We saw a very strong start to the year. More recently, there have been specific concerns about the banking market. We're recording this a couple of days before quarter end, but it looks like, in that context, the portfolio will actually be about flat, relative to the broad MSCI ACWI Index.

But if we talk specifically, maybe, about what's been going on in banking markets, a source of some of that volatility, particularly towards the end of the quarter, how has that fed through in the portfolio? And how has that impacted some of the work you've been doing, as a result?

MM: I think what's happening within the banking sector right now, the banking industry, I think, really, in many regards, is actually an extension of what we've seen more broadly within the macro environment, whereby the withdrawal of monetary stimulus and the rise in the rate environment, that is having a knock-on impact on these types of businesses.

We don't have a lot of money invested in banks. In fact, we have not had a lot of money invested in banks for an extended period. However, disappointingly, we did have a small holding, which we bought relatively recently, an incubator position within Signature Bank. Now, clients will have seen the messaging around this, and will have understood the reasons why we put that forward into the portfolio as a growth asset.

The reflection point for ourselves now needs to be whether or not there were mistakes within the analysis, and what points we want to draw out from that further. And from here, within the portfolio, again, little within banks, there's actually only one specific bank holding, that being HDFC within the Indian market. More broadly, we do have businesses operating in the insurance landscape. That's an important thing for us to be comfortable with the quality of their balance sheets.

So, that's the likes of AIA or Prudential, the life insurers. We've been spending a lot of time working on these companies, as you would expect, kicking the tyres, again, with regards to the balance sheets and what assets they have within there. We've actually spoken to the management teams of both of those companies over the past fortnight to gain reassurance. And we do believe that these are high quality assets, and that there should not be knock-on impacts into these areas.

BD: Thanks. You mentioned the importance of focusing on where we're seeing opportunities, and using the macro environment, or trying to look through that, to understand where opportunities are emerging and becoming more attractive. Do you want to talk maybe more specifically about where you're seeing some of those opportunities, and how they're starting to feed through into the portfolio?

MM: Yes. So, there are actually several different areas just now, Ben, which I find interesting, and I'm quite excited, because the potential for accelerating growth. And that, perhaps, slightly goes against the prevailing mood within markets, whereby people are quite worried about recessionary forces and such like, and tightening, and monetary environment, as we've already spoken about. But there are lots of things, which we're finding, which have seams of interest.

And two that I'd call out particularly would be the semiconductor market, and also, businesses, which are playing into the US infrastructure area. So, within semiconductors, we've had a number of different holdings, which are long term positions within the portfolio. But we think there are lots of different aspects of the broader digitisation of the economy, which are actually leading to a strengthening outlook for these businesses.

And also, people will have heard a lot about what's going on within the artificial intelligence area right now, ChatGPT and such like. We can see the volume potential coming through from the power of these tools really driving this industry in a new wave over the course of the next, say, five, seven, ten years. So, the companies, which are currently within the portfolio, will be the likes of TSMC, the Taiwanese business, the fabrication business.

Integris, which is a business predominantly involved in materials, which are sold into semiconductors. And the likes of, of Teradyne, which is in the testing business within semiconductors. I think we might add some other holdings into this area into the future. There's a lot of work going on, and Helen, one of the three decision makers in the fund, she's actually just been out in the US, visiting companies around this area.

With regards to infrastructure, which is a completely different seam of opportunity, what interests me there is the broader theme of reshoring, of rebuilding, really, of physical assets within America. This is something, which has really, arguably, been needed for a long, long period. Anybody that’s visited the United States will probably understand the extent to which their physical infrastructure is perhaps somewhat degraded right now.

And on a recent trip that I was on, actually, earlier this month, to see different companies in the States, I met with one of our larger holdings, an aggregates business called Martin Marietta. We've owned that company for several years now, and we know the management team well. I've never seen them more excited. And this was around what's going on with regards to the Federal level support for infrastructure expenditure, and also, at the state level.

And how that can flow through into demand for their products and services. So, other companies, which are currently involved in this broad theme within the portfolio, would be the likes of CRH, the Irish domicile building materials company. And there are several others, including the likes of Eaton, which is an electrical engineering componentry business. So, these are two big areas, which I think are exciting right now, and have got big, long growth runways.

BD: Any final messages for clients you want to leave us with?

MM: So, I think for myself, right now, the most exciting aspects of how the portfolio looks, first of all, is that the underlying growth metrics, so we mentioned the importance, at the start of this conversation, of focusing on fundamentals, versus perhaps what's going on with regards to the mood of the market. And the growth rates of the companies that we're currently investing in, Ben, are roughly two times the market average.

So, our companies really are delivering, from a fundamental perspective, when you look at them in aggregate. To give some context, as well, the balance sheet strength of these companies is excellent. So, the level of debt is very low. I think it's something like only a quarter of the average level of debt within the market. So, these companies, we believe, are actually very well set up.

We've already spoken there about different opportunities, from a growth perspective, in terms of the different growth categories, which may be accelerating. I see the real breadth of opportunity right now. That, again, is a very good thing, from our perspective. And then finally, we've obviously been through a difficult period of reset in growth asset valuations.

But from this starting point, I'm very excited about what these quality of businesses can actually produce for clients, and produce, in terms of outcomes, on, say, a five year plus horizon. That, I think, is a really a good place to be right now.

BD: Thank you very much. I think some of the themes that we've spoken about today, I think, are very consistent with those of you who heard us speak maybe three months ago. I think that's by design. I think that process of patient, diligent work on opportunities, and allowing those to come through to the portfolio over a period of time, is absolutely what you'd expect from our approach.

I think that theme of who has access to capital, at this point, and the increasing relative importance of that, and how that plays through in competitive advantage. And I think that theme of where growth is actually getting easier, and contrasting that to some of those companies that saw this burst of growth over the last few years, and saw that tail off.

There are other portions, where we see that structural growth rate accelerating, versus the last ten years. Thank you very much for your time, and we'll speak to you again.

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

	2019	2020	2021	2022	2023
Global Alpha Strategy	1.1	-6.4	73.0	-11.4	-10.5
MSCI ACWI Index	3.2	-10.8	55.3	7.7	-7.0

Annualised returns to 31 March 2023 (Net %)

	1 Year	5 Years	10 Years
Global Alpha Strategy	-10.5	5.4	9.1
MSCI ACWI Index	-7.0	7.5	8.6

Source: Baillie Gifford & Co and MSCI ACWI. USD.

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