



## **LWM Consultants Ltd**

### **Meeting the fund manager**

#### **Scottish Conference – Baillie Gifford**



We were recently invited to attend the Scottish Conference in Edinburgh; the conference provided us with access to managers from Baillie Gifford and Standard Life Investments. This update includes updates from three managers at Baillie Gifford.

The Scottish Mortgage Trust has been part of our portfolios since they were established in 2009, the trust was established in 2000 and the deputy manager, Tom Slater has been involved with the trust since 2009. The European Growth Fund was added to the portfolios in 2012, the fund is managed by Tom Coutts who is Head of European Equities.

The third update was from the global income team and although this is not a fund we use it was helpful to have an understanding of what they offer and alternatives in the market place.

#### **The Scottish Mortgage Trust**



The Scottish Mortgage Investment Trust was established in 1909, the lead manager James Anderson has been at the helm since 2000 and Tom came on board in 2009. James is preparing to take a six month sabbatical to write a book but has stated that he is using this time to recharge his batteries and has no plans to retire.

The style that both Tom and James adopt is similar and there is unlikely to be much change in the portfolio during this period. In the meeting Tom explained what they have been looking at and the opportunities going forward.

One point that Tom made which I think highlights the bias in the fund is that the market underestimates the power of technology and this is changing the why we engage with things.

He recently went to Silicon Valley where many of these companies are based – what he is seeing are attractive, profitable and growing businesses with visionary leaders combined with the start of globalisation of the end market.

Some of examples of technology based companies both in the US and globally he mentioned were Baidu and Amazon. Baidu is Chinas largest search engine, the business has grown rapidly despite the growth of Google.

Amazon is a marmite stock, it favours the long term greedy. It is a less mature business with low margins. It also re-invests all its cash in areas where it can create competitive advantage. Three areas of interest are the Kindle Fire, infrastructure in the US and also Prime Membership. Amazon Prime members spend ten times as much as other customers so repeat business is important. But one crucial element to the Amazon success story is that success hasn't brought in competition.

Away from technology China plays an enormous part in global growth. Tom sees opportunities in China; to him it offers serenity around the troubled western economies. Employment is starting to move from the coast to the centre, consumption is greater than GDP and the minimum wage is up by 170% in Shanghai. We are also starting to see transformation in their economy as money is invested in healthcare, technology and education. The story of China still has a lot to play.

In the western economy and in particular the UK banking system you are seeing the last of the old way of doing things going, the likes of Bob Diamond have gone and this is seen as a positive sign. The demise of speculative trading is good for balance sheets and Tom is upbeat for where this could lead going forward.



Going back to technology Tom expanded on some of his holdings. One company he talked about was Intuitive Surgical. This effectively has the potential to change the way surgery is done

using robotics. Although some of options are some way down the road we could see things like open heart surgery through robotics and more complex procedures with small incisions to remove lumps and growths - delivering a more efficient, quicker and safer means of carrying out surgery.

Looking at the retail sector and the globalisation of tastes and brands Inditex is a Spanish Company operating in 84 countries across the globe with China being its second largest market. It operates everything from Spain. It looks to understand what people are buying and deliver a different experience to its customers.

Technology giant Apple has grown to be one of largest companies in the world before its share price was pegged back. Some people feel there is a danger that it could become the next RIM or Nokia but Tom explained some facts which RIM or Nokia do not have. The assumption is that Apple will never innovate again. However, it is only five years since the iPhone was launched and 3 years since the iPad to assume they will never innovate again seems to be a large assumption.



Apple also has a large eco system with apps, iCloud and iTunes and for people to give up all of that seems unlikely. They also have a large amount of cash and therefore to assume the demise of Apple is perhaps a little too early.

Turning to the battle for market share of shopping online Ebay have said that they want to be able to have delivery times which do not put them at a disadvantage to Amazon so they are not looking to compete just not fall behind. This is at a time where in the US Amazon have just invested in 60 warehouses which are an hour away from the major cities driving down delivery times. Walmart has indicated they want to compete in the online space but have a dilemma where stores are incentivised to make profits and therefore if they open up lower online prices it could take away the element that incentivises the stores.



So in summary the fund does have a technology play but it also looks globally for opportunities around the world whether this is in healthcare, agriculture or distribution and we believe that Tom and James have placed the fund in an ideal position to take advantage of these opportunities.

### **Baillie Gifford European Fund**



We recently posted an update on the European Fund. The fund is managed by Tom Coutts who joined Baillie Gifford in 1999 and the European Team in 2007. Tom is head of European Equities at Baillie Gifford.

What is unusual about the fund is what he calls the multi sleeve approach. Although Tom is the lead manager it is as a group that decisions are made. So Tom manages 50% of the portfolio, Paul Faulkner manages 37% of the portfolio and Stephen Price 9%. There is cross between stocks that the managers choose and these will attract the highest weightings whereas the unique holdings attract the smallest weightings.

Tom doesn't look to override decisions by the team because the individuals will have a strong conviction in that particular stock. An example of a unique holding which has not been selected by Tom is Nokia. Nokia seems to be burning cash and often seem to miss the latest trends in mobile phone technology. However there are some things that are being missed, they have the largest market share in low end handsets in the developing world, in Finland they are the largest supplier of mobile phones and their cash flow has improved over the last six months. Effectively there is potentially more to the business than we can see.

The fund is a long term stock picker's fund. It is about high conviction and a focus on growth.

Tom sees opportunities in Europe, Europe is cheap over the last 18 years the average P / E ratio has been around 18 times now it is around 10 to 11 times. The problem is the flight to safety which doesn't make sense; German Bonds are paying 1.5% p.a. even buying a stock like Roche would deliver 1.6% p.a. and the top ten holdings in the portfolio deliver 3.3% p.a. Of course the risk is the volatility with equities but Tom believes you are compensated for this if you choose the right company.

The key for Tom and his team is to invest in the business and not the country. If you consider Europe there is too much debt and in some cases the wrong leadership as has been seen in Italy.

Whereas the position for companies is very different; if you consider Nestle this is a growing company with an entrepreneurial spirit and has been operating in markets like China and Malaysia for 100 plus years.

Tom is aware that many fund managers have a time frame of less than 12 months and many companies respond to this by focusing on the next quarter's earnings. What Tom's team are focused on is the long term and alignment of interests is important to this. 8 out of top ten holdings have some form of family interest. They want to be able to pass this onto their family.



A couple of companies they like are Atlas Copco and Colruyt. Atlas Copco is a global engineering company based in Sweden. It has seen a 42% growth in sales over five years and at the same time seen its share of the European market has fallen from 42% to 31% making it more of a global brand.

Colruyt is a Belgian Food Retailer which has shown that despite political instability in Belgium it has managed to grow seeing sales grow by 43% in five years.

Effectively whether it is a global or local company it is the ability to grow which is key to the team.

The fund looks to have long term holds and therefore turnover is low. It did suffer from underperformance in 1999 / 2000 and turnover increased significantly as positions were unwound. Tom believes this is a lesson for all of us, if there is a period of bad performance and high turnover we should be questioning the strategy.

### **Baillie Gifford Global Income Strategies**



Baillie Gifford offer two income global strategies the Global Income Fund and the Scottish American Investment Company (SAINT). They follow a similar strategy and holdings however SAINT has a debt holding as part of its strategy.

SAINT is slightly misleading in its name as it is a global fund; it was established in 1873 by Scottish investors to invest in the American railroads. That strategy has long since changed. Now at its core is global equity management with careful management of the debt.

We don't tend to use global income strategies in the portfolios however there were some interesting discussion points around the funds. The strategy is similar to other Baillie Gifford management strategies but with the exception around how cash is allocated i.e. not only invested in the business but also allocated to shareholders.

They are long term holders of stocks with a low turnover sub 20%. As this is a global fund it looks to maximise on global opportunities. One example is Brasil Insurance; they are insurance brokers and were set up three years ago. The business is expected to grow at 15 to 20% p.a. over the next 4 to 5 years.

The reason for the potential for this stock is that Brazil has one of the fastest growing middle classes and these individuals are being encouraged to purchase property. As they purchase

property they want to buy things for their property and they want to protect their goods. This has led to a boom in insurance in Brazil and Brasil Insurance is one of the most successful businesses to capitalise on that boom. In addition to the potential for growth the yield is currently 4.5%.

A new addition to the portfolio is Dolby Laboratories which develops chips and is cash generative. It has a product line which drives earnings growth which can both be re-invested in the business and be paid back to shareholders.

They recently sold out of Man Group; they had held this for a while on the basis that the AHL product would return to form. However, it became clear that the fees on this were a major part of the profit and it was unlikely they could charge these going forward.

Another interesting part of the portfolio is their Bond Portfolio, one these stocks is the Athena Debt Opportunities Fund which is around 3.8% of the portfolio. This operates in the structured finance market and was purchased in 2008 at \$100; it is now standing at \$135 and paying dividends.

The investment trust does have debt of around £80 million where the interest rate is around 6 ¾% so this has to be managed carefully. The market value of the debt is £105 million and the end date is 2022. Part of this money is managed via a property portfolio which is paying a yield of 8.2% which covers the interest payments.

What this fund / trust demonstrates is that as bond yields are squeezed well managed equity income fund could be considered as an alternative to providing income. The current yield on the portfolio is around 4%.

## **Conclusion**

We continue to remain firm supporters of both the Scottish Mortgage and European Fund. The Income Fund offers an alternative option for those seeking income and shows the opportunity set however as we don't use global income strategy other than the M&G Global Dividend Fund this is not one we would consider at this stage.

The source of information in this note has been provided by Baillie Gifford and is correct as at 28 February. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase this fund. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.