EDISON

Baillie Gifford US Growth Trust

Initiation of coverage

‘Blue sky’ thinkers seeking exceptional returns

Baillie Gifford US Growth Trust (USA) aims to deliver long-term capital growth by identifying exceptional US businesses that have the potential to grow substantially faster than the market. Specifically, managers Gary Robinson and Kirsty Gibson target returns of 2.5x on investments over five years. They believe that such stocks are most likely to be found at the cutting edge of technology-led change, in areas such as machine learning, robotics and genetic sequencing. The managers invest in publicly listed and private companies (with holdings comprising 83.5% and 16.5% of the portfolio, respectively), to maximise access to the best ideas, regardless of ownership structure. The rapid technological advances seen during the pandemic boosted many of USA’s existing holdings and gave the managers the opportunity to add new companies with strong growth potential. In the financial year ended 31 May 2021, the trust returned 62.8% in NAV terms, dramatically outperforming the benchmark return of 22.4%.

NAV performance relative to S&P 500 Index, three years to end-Sept 2021

Source: Refinitiv, Edison Investment Research

The analyst’s view

USA’s managers are concept investors who look for ‘blue sky’ investment opportunities with the prospect of exceptional returns over periods of five years or more. As such, the trust should appeal to investors seeking exposure to the US’s most exciting companies, operating at the cutting edge of technological change, and possessing the potential to grow rapidly. The trust’s strong performance since the onset of the pandemic provides impressive evidence of the managers’ ability to identify such companies, although returns were due in part to its large exposure to Tesla, now reduced. However, some investors may be cautious on the basis that USA’s five-year return target is very aggressive, while acquisitions are based on growth prospects, with little apparent reference to intrinsic valuations. Shareholders need to be prepared to give the managers time to consolidate their early success into a convincing long-term track record that meets their return target.

Share price has scope to return to premium

USA’s share price usually trades at a small premium to cum-income NAV. Although it is currently trading at a modest discount, there is scope for the share price to return to premium, if performance remains strong and/or if investors are attracted by the trust’s increasing exposure to unlisted shares, which are otherwise inaccessible to most investors.

NOT INTENDED FOR PERSONS IN THE EEA

Investment trusts
US equities

1 October 2021

Price	**318.0p**
Market cap	**£977.4m**
AUM	**£1031.7m**

NAV*		329.8p
Discount to NAV		3.6%
* Including income. As at 29 September 2021.		
Yield		0.0%
Ordinary shares in issue		307.4m
Code/ISIN		USA/GB00BDFGHW41
Primary exchange		LSE
AIC sector		North America
52-week high/low	399.0p	260.0p
NAV* high/low	355.3p	241.9p
*Including income		
Net gearing*		1.0%
*As at 31 August 2021.		

Fund objective

Baillie Gifford US Growth Trust (USA) aims to produce long-term capital growth by investing predominantly in equities of companies that are incorporated, domiciled or conducting a significant portion of their business in the United States of America. The trust invests in both publicly listed and privately owned companies. Its benchmark is the S&P 500 Index TR (GBP).

Bull points

- Offers exposure to companies at the cutting edge of technology and those responding to social trends in innovative ways.
- Provides access to both public and private companies to maximise access to the greatest number of attractive investment opportunities.
- An aggressive 2.5x return on investment target over five years and experienced, ambitious managers striving to make USA ‘a world class investment vehicle’.

Bear points

- The trust is relatively new, and the managers need time to prove that they can continue to deliver the kind of exceptional performance seen since the onset of the pandemic.
- There is a risk that USA’s high growth, long duration holdings may underperform as the pandemic boost fades and concerns about inflation and higher interest rates increase.
- Given the managers’ focus on long-term returns, performance may be subject to short-term volatility.

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Baillie Gifford US Growth Trust is a research client of Edison Investment Research Limited

Market outlook: The dawning of a new 'golden age'?

As global equity markets continue their remarkable recovery from the COVID-19 pandemic sell-off, most investors are focused on the ongoing disruptions created by the virus, the inflation outlook, the associated risk of higher interest rates and the implications of these events for stock prices over the next few quarters. Fears of persistent inflation and rising rates have generated some intermittent volatility in global equity prices in recent months. However, some market participants, such as the managers of Baillie Gifford US Growth Trust, have longer-term horizons that allow them to look through short-term volatility and focus instead on structural changes that will drive investment opportunities and returns over the next decade or more.

While such changes are constant, the pace and breadth of technological changes presently underway have been designed by some academics as a fifth industrial revolution. This so-called information, communication and technology (ICT) revolution is being fuelled by the exponential growth of semiconductor technology, combined with globalisation. The proponents of this theory include academic and international consultant Professor Carlota Perez, who argues that this revolution, like its predecessors, has the capacity to deliver 'quantum leaps' in productivity and enrich the lives of people around the world, in both industrial and developing countries, in a 'golden age' of increased employment, wealth and more equal access to goods and services.

Perez also predicts the growth generated by the ICT revolution will be 'smart' and 'green', as technology 'turns goods into services'. People will own fewer things but have greater access to the amenities provided by conventional ownership, thus reducing the material content of GDP. We already have some evidence of this phenomenon, for example, in the way that streaming services have replaced DVDs, CDs and gaming consoles. However, the sharing economy, in which consumers rent cars and other durable goods rather than owning them, is still in its infancy.

Perez maintains that the global pandemic has accelerated progress towards this golden age and changed the world radically in the process. The past 18 months have given people a vision of how technology can provide new lifestyle choices, such as remote working and schooling, yet also draw people together in support of common causes such as climate change mitigation. At the same time, some of yesterday's bold and unlikely proposals, such as universal basic incomes, became acceptable to governments, at least in the short term, and essential for many workers financially stranded by the pandemic.

But for Perez, the exceptional growth experienced by many companies since the onset of the pandemic is just a taste of what is to come. As in previous industrial revolutions, she believes success in politics, business and investing will go to those, like USA's managers, who strive to understand the seismic changes underway and turn them to their advantage. And in Perez's view, in such endeavours, 'it will be safer to be bold than timid'.

The fund managers: Gary Robinson and Kirsty Gibson

The managers' view: Tech-led change creates opportunities

USA's managers, Gary Robinson and Kirsty Gibson, share Professor Perez's views about the potential for the ICT revolution to generate innovation and wealth and they believe the exceptional US growth companies they seek are most likely to be found at the cutting edge of technology-led change. For this reason, they focus their research on companies at the cutting edge of innovation. At the moment, the managers are most interested in companies operating in the fields of machine learning, robotics, genetic sequencing and renewable energy and those using technology to meet social needs.

Robinson and Gibson believe that innovation in these and other fields is speeding up and spreading out, thanks in part to the extraordinary events of the past year and half. They say they are 'humbled at the pace and spread of change since the onset of the pandemic', which bought an avalanche of deep and lasting change, with many downstream effects that could never have been predicted. This rapid change is bringing 'tremendously exciting opportunities' across many sectors.

They cite several portfolio holdings to illustrate the ways these opportunities are unfolding. The managers purchased Zoom, a video communications company, in late 2019, just before the outbreak of the coronavirus, on the view that it was a useful tool for white-collar workers seeking to reduce travel to face-to-face meetings. The pandemic has since revealed the far broader potential of Zoom and similar products to connect people not just for commercial purposes, but also for home working, schooling and exercise, entertainment and consultations with medical practitioners. The managers argue that Zoom has become part of what they call the 'new infrastructure', which they see as having even greater future potential for integration into daily life, in the same way that we rely on electricity.

Exhibit 1: Top 10 holdings (at 31 August 2021)

Company	Sector	Portfolio weight %		Change (pp)
		31 August 2021	31 August 2020	
Shopify	Ecommerce platform	6.9	7.6	(0.7)
Moderna	Pharmaceuticals	5.9	0.9	N/A
Amazon.com	Ecommerce platform	4.3	7.7	(3.4)
Tesla Inc	Electric vehicles & energy storage	3.7	13.7	(10.0)
The Trade Desk	Advertising buying platform	3.7	3.4	0.3
Wayfair	Online furniture retailer	3.5	5.7	(2.2)
Twilio	Cloud communications platform	3.0	1.2	1.6
Stripe	Payments systems	2.8	2.4	0.4
Roku	Streaming service	2.7	1.7	N/A
Affirm	Payments systems	2.7	0.5	N/A
Top 10 (% of holdings)		**39.3**	**51.2**	

Source: Baillie Gifford US Growth Trust, Edison Investment Research.

Other holdings whose commercially developed concepts have infrastructure-like characteristics include top 10 holdings Shopify, Stripe, Affirm and Twilio. Shopify, an ecommerce platform, is integrated with social media channels and provides retailers of all sizes with web and mobile 'storefronts', as well as 'backend' services enabling them to manage inventories, orders and customer interactions. Stripe and Affirm are payments platforms provides retailers and many other businesses with the infrastructure to manage their finances online, while Twilio, a cloud communications platform, helps developers build automated customer communications, such as emails and voice and text messaging, into company apps. These businesses all assist small and medium-sized offline retail businesses to transition online and allowed many of them to adapt and survive during lockdowns. Many charge a monthly subscription fee that make access affordable.

The COVID-19 pandemic has fostered a permanent shift in the way people access media content. TV and movie streaming services such as Netflix and Roku have seen significant increases in subscribers, and advertisers have had to adapt to follow their customers online. The Trade Desk is an advertising buying platform that facilitates this process, enabling advertisers to target the relevant audiences. Advertisers buy exposure in real-time auctions based on data provided by the platform. This so-called programmatic advertising is still in its infancy, but it is growing rapidly, supported by its ability to demonstrate its efficacy and returns on investment.

The exercise industry is also being disrupted and revolutionised by technology and is another sphere in which the pandemic has accelerated demand, as people sought alternative forms of exercise when gyms closed and team sports were banned during lockdowns. For example, Peloton offers interactive fitness classes and programs that have the potential to reduce demand for gym memberships and personal trainers.

The urgent need for a coronavirus vaccine spawned some truly exciting developments in healthcare and USA's managers view Moderna, the trust's second largest holding, as the 'poster child' of this sector. Moderna is a world leader in the field of mRNA therapeutics, a new class of medicines that use the body's own functions to treat diseases. The company may be known for the rapid development of its COVID-19 vaccine, but the long-term growth potential of mRNA therapies stretches far beyond this one product. The vaccine delivered $10bn of unexpected cashflow for Moderna, which it is ploughing into research and development, with the goal of developing cancer therapies and vaccination programs for other diseases such as HIV and malaria.

In the education sector, Coursera, an online educational content platform, is breaking down the exclusivity of traditional universities by offering online degrees and training courses from world-class institutions. Its courses have a vocational focus and employers such as Google and Facebook are recognising Coursera's qualifications as legitimate alternatives to traditional degrees. In fact, Coursera offers employers the opportunity to tailor course content, so graduates have specific skills that match employers' requirements. By greatly improving students' access to higher education, at a lower cost, businesses such as Coursera have the potential to deliver significant social and productivity benefits.

While COVID-19 may have accelerated the development of many of these businesses, as previous industrial revolutions have shown, change can take many years, decades even, to percolate through economies and society more broadly. This is the reason USA's managers adopt a long-term focus. They believe that patience is one of the most underrated components of successful investing and they are prepared to give companies time to benefit fully from the forces driving demand for their products and services, even if, at times, this means weathering short-term volatility and periods of underperformance.

With so many exciting investment opportunities available, the managers stress they have the chance to keep 'raising the bar' when assessing companies for inclusion in the trust's portfolio, and in their view, the trust now only owns companies with the potential to be truly exceptional. If Robinson and Gibson are correct, they are well on the way to realising their ambition to make USA 'a world-class savings vehicle'.

Current portfolio positioning

The rapid acceleration of change during the height of the pandemic and the myriad investment opportunities this generated, meant that portfolio turnover was slightly higher than usual in the financial year ended 31 May 2021, at around 30% pa. However, turnover has returned to more normal levels of around 23% pa in recent months.

The major portfolio changes implemented over the past year are reflected in changes to the composition of USA's top 10 holdings – Roku, Moderna, Twilio, Stripe and Affirm are now all ranked in this list (Exhibit 1). Existing positions in Roku and Moderna have seen strong share price performance over the past year, while the managers added to their position in Twilio. This company has expanded its communications offering to integrate consumer data, thereby increasing its competitive advantage. The trust's managers believe Twilio's addressable market is huge, perhaps US$1tn, and it is only in the early stages of exploiting its growing market dominance.

Amazon and Tesla remain top 10 holdings, but Tesla has yielded its top ranking to Shopify. Tesla's share price rose over 600% during 2020, lifting its portfolio weighting to almost 15%, which the managers deemed to be excessive. Accordingly, they reduced the position significantly in January 2021, to reduce portfolio exposure to this name and to reflect their view that the share price has less upside potential after such a significant and rapid rise. However, Robinson and Gibson remain positive about Tesla's long-term prospects. The company is starting to solve the problem of

manufacturing vehicles at scale and its energy generation and storage sectors hold promise, although they are still at a relatively early stage of development. Former top 10 holdings Alphabet and Mastercard have been sold outright, as the managers view the upside case for both companies as increasingly challenged. They lack confidence in Alphabet's most ambitious projects such as Waymo, its autonomous driving unit, while Mastercard's traditional credit card model is being challenged by competition from new payment methods. The managers believe USA's other digital payments holdings such as Stripe and Affirm, offer more interesting technologies and greater growth potential.

Exhibit 2: Portfolio sector exposure at 31 August 2021 (% unless stated)

Sector	Portfolio		Change (pp)	Benchmark	Active weight vs benchmark (pp)
	end-Aug 2021	end-Aug 2020		end-Aug 2021	
Information technology	33.3	25.6	7.7	27.9	5.4
Consumer discretionary	23.1	37.2	(14.1)	11.9	11.2
Healthcare	19.0	10.7	8.3	13.4	5.6
Communication services	7.7	8.6	(0.9)	11.5	(3.8)
Industrials	7.0	7.1	(0.1)	8.2	(1.2)
Financials	4.9	6.9	(2.0)	11.2	(6.3)
Materials	1.3	0.7	0.6	2.6	(1.3)
Real estate	0.9	1.4	(0.5)	2.6	(1.7)
Consumer staples	0.3	0.3	0.0	5.8	(5.5)
Energy	0.0	0.0	0.0	2.4	(2.4)
Utilities	0.0	0.0	0.0	2.5	(2.5)
Cash	2.5	1.5	1.0	0.0	2.5
	100.0	**100.0**		**100.0**	

Source: Baillie Gifford US Growth Trust, Edison Investment Research

Other recent sales have included the disposal of the trust's position in Facebook due to concerns about the company's resistance to regulatory controls and its treatment of staff. The managers have also sold Slack Technologies, the business technology software platform, following its expensive acquisition by Salesforce.com, along with New Relic, Activision and Interactive Brokers, whose investment cases have not played out as expected.

These sales have provided capital for the acquisition of companies across many sectors that are applying digital technology. USA has new positions in innovative healthcare companies such as Recursion Pharmaceuticals, a biotech company focused on industrialising drug discovery and 10x Genomics, another life sciences company focused on single cell sequencing for use in medical research and testing. The managers believe both these companies are potentially at the forefront of a new era of lower-cost healthcare. They have also acquired an early-stage investment in Sana Biotechnology, which specialises in gene editing, a process with wide applicability in the treatment of diseases, including cancer.

Robinson and Gibson have also opened an exposure to the insurance company Lemonade, an online insurer with an innovative model that includes taking a fixed fee from premiums and channelling residual funds not paid out in claims to social causes nominated by policyholders. The managers have also purchased positions in e-commerce platforms Carvana and Vroom, which operate in the second-hand vehicle market, and two internet content companies: Pinterest is a visual discovery site, with great potential as a source of inspiration for activities such as cooking, handicrafts and DIY; and Snap (formerly SnapChat), which is a leader in augmented reality advertising. The managers believe advertisers are looking for platforms beyond Facebook and Alphabet and both Pinterest and Snap could be major beneficiaries of this shift. Coursera, the education content platform discussed above, is also a recent acquisition.

In their search for exceptional companies, the trust's managers are indifferent between publicly and privately owned businesses. In the financial year ended 31 May 2021, private, unlisted investments represented 16.5% of total assets, invested in 20 companies, up from 12.2% and 17 companies in FY20. The managers purchased small positions in seven new companies during the year:

- Brex, a financial management platform for businesses;

- Capsule, an online pharmacy;
- Epic Games, a video games company with several interesting lines of business;
- Honor Technology, which aims to improve the efficiency of the US home care sector;
- Lyra Healthcare, a provider of mental healthcare benefits to employers;
- Nuro, a delivery business, which is the first to receive US government approval to commercially deploy autonomous vehicles; and
- PsiQuantum, which is seeking to commercialise quantum computing.

Four existing private holdings listed during the financial year:

- Affirm, a payments and consumer finance company;
- Snowflake, a cloud-based data platform;
- Airbnb, a short-term letting business focused on the holiday market; and
- Butterfly Network, a portable ultrasound provider.

The managers have made several changes to the portfolio's privately owned holdings since the financial year end. They have added to existing holdings in Lyra Healthcare, Away, a high-end luggage company and Thumbtack, a site matching handymen, cleaners, furniture removalists and other service providers with local customers. The portfolio has also acquired a new position in Faire Wholesale, a wholesaler that supplies homewares, food and fashion to retail outlets. USA's managers stress that they remain on the lookout for 'high potential opportunities' not widely accessible through public markets.

The portfolio changes implemented over the past year, combined with valuation changes, have resulted in some notable changes to the composition of the portfolio at a sectoral level (as illustrated in Exhibit 2). There are no specific limits on sectoral allocations. The combined exposure to the trust's three largest sectoral positions – in IT, consumer discretionary and healthcare – remains almost unchanged, totalling 75% at end-August 2021, up only slightly from 74% a year earlier. However, within these top three sectors, there have been sizable increases in the weightings of IT and healthcare, while exposure to consumer discretionary stocks has been reduced markedly. Nonetheless, consumer discretionary remains USA's largest sectoral overweight (11.2pp overweight), followed by healthcare (+5.6pp) and IT (+5.4pp). The portfolio is underweight all other sectors, most notably financials (-6.3pp) and consumer staples (-5.5pp).

Performance: Boosted by pandemic's many winners

Exhibit 3: Five-year discrete performance data

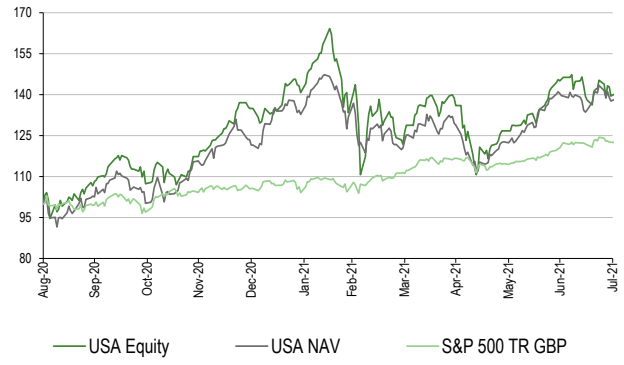
12 months ending	Share price (%)	NAV (%)	S&P 500 (GBP) (%)	CBOE UK All Cos (%)
31/08/17	--	--	18.1	14.3
31/08/18	--	--	18.6	4.3
31/08/19	7.9	6.8	9.8	0.3
31/08/20	67.0	72.5	10.9	(13.5)
31/08/21	41.6	39.8	27.6	27.1

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

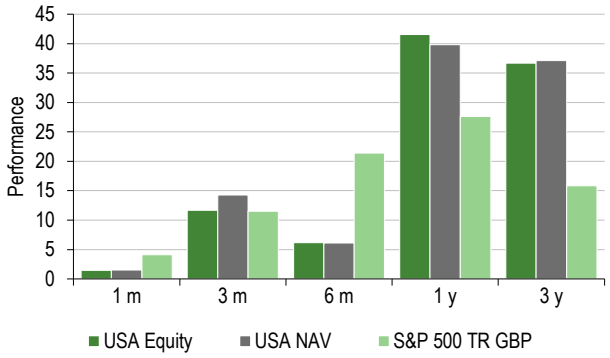
USA was launched in March 2018. After trading close to its benchmark, the S&P 500 Index (GBP), for a period, many of the trust's holdings received a substantial boost from the rapid technological advances triggered by the onset of the pandemic in early 2020 (see chart on page 1) and this dramatically improved the trust's performance in absolute and relative terms. In FY21 (to 31 May 2021), the trust returned 63.0% on a share price basis and 62.8% in NAV terms, compared to a total return on the S&P 500 Index (GBP) benchmark of 22.4%. This impressive performance has underpinned average longer-term returns. In the three years to August 2021, the trust has made an average annual return of 36.7% in share price terms and 37.1% on an NAV basis, significantly outperforming its benchmark, which returned 15.8% (Exhibit 3). It has also outperformed its peers and the UK market decisively over the past one and three years (Exhibits 5 and 6).

Exhibit 4: Investment trust performance to 31 August 2021

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

A range of holdings contributed to the trust's strong performance during FY21, including several of USA's top 10 holdings. However, Tesla's stellar performance, combined with its heavy portfolio weighting, ensured it had by far the largest positive influence (contributing 13.7pp to relative returns). The managers have since take some profits on the position, as discussed above. Roku, the streaming service and another top 10 holding was the second largest contributor (adding 1.9pp to relative returns), followed by Wayfair, an online furniture retailer that benefited from lockdowns, as consumers sought to upgrade their homes. Wayfair aims to consolidate suppliers on one site and solve longstanding issues by providing customers with help with online purchases and ensuring fast, reliable deliveries. Other top holdings Shopify, The Trade Desk, Moderna, Stripe and Affirm also contributed notably to returns, along with non-top 10 holding Peloton.

The positive impact these stocks had on USA's relative performance in FY21 was only partially offset by the more modest adverse impact of not holding Apple (which detracted 0.7pp from relative returns) or Alphabet (which detracted 0.6pp). The bond trading platform MarketAxess Holdings, Teladoc, a virtual healthcare business, and Vroom, the online used-vehicle retailer also detracted slightly. But in keeping with their long-term approach, the managers continue to hold all these companies, to give them time to realise their potential.

Regarding the performance of the trust's recently listed holdings, given the managers' long-term investment timeframe, they believe that, in general, it is far too soon to make a meaningful assessment of the performance of these companies. However, overall, Robinson and Gibson are encouraged by the continued progress made by these companies since their respective public listings. For example, Affirm and Snowflake have enjoyed positive starts. Affirm now has partnerships with the three largest US e-commerce players (Walmart, Shopify and, most recently Amazon) and Snowflake has maintained what the managers believe to be its very positive operating momentum, growing both its revenue and customer bases.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years
Price relative to S&P 500 TR GBP	(2.6)	0.2	(15.2)	14.0	99.7
NAV relative to S&P 500 TR GBP	(2.6)	2.7	(15.3)	12.2	102.2
Price relative to CBOE UK All Cos	(1.0)	8.7	(7.3)	14.5	145.0
NAV relative to CBOE UK All Cos	(0.9)	11.2	(7.4)	12.7	147.4

Source: Refinitiv, Edison Investment Research. Note: Data to end-August 2021. Geometric calculation.

Peer group comparison

Baillie Gifford US Growth Trust is a member of the Association of Investment Companies (AIC) North America sector, which has six constituents with varied mandates (Exhibit 6). Three of these

funds focus on providing income, as well as capital growth, and two (Canadian General Investments and Middlefield Canadian Income) are focused primarily on the Canadian market. The JPMorgan American Investment Trust shares USA's goal to achieve capital growth from North American investments, and these two trusts have some holdings in common. However, none of the other funds in this sector shares USA's intense focus on exceptional growth companies.

However, there are several closed-ended funds in other AIC sectors whose investment strategies share USA's focus on realising long-term capital growth from investment in global listed or unlisted technology companies. So, to provide a fuller picture of USA's true peer group, Exhibit 6 also includes a selection of these funds.

USA is the second largest fund in its North America peer group, but the smallest amongst its technology peers. Its NAV total return ranks fourth among its AIC sector peers over one year and first over three. The trust has also outpaced the performance of most of its broader peer group over both these periods. Its share price discount to cum-income NAV is the second narrowest among its AIC sector peers. Its ongoing charge is the second lowest of all its peers and in common with most, it does not have a performance fee. USA's gearing level is lower than the average of its North America peers, but slightly higher than its technology peers. It is one of several funds in its broader peer group not to pay a regular dividend.

Exhibit 6: Selected peer groups at 30 September 2021*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf fee	Net gearing	Dividend yield
Baillie Gifford US Growth	977.4	33.0	154.4	-	-	(3.6)	0.7	No	101	0.0
BlackRock Sustainable American Income	153.2	30.5	28.2	69.0	-	(3.8)	1.1	No	101	4.2
Canadian General Investments	477.0	42.8	65.8	142.6	275.8	(32.5)	1.5	No	112	2.2
JPMorgan American	1,333.9	33.5	53.3	123.2	418.2	(3.3)	0.3	No	106	1.0
Middlefield Canadian Income	117.1	43.6	24.5	41.9	123.0	(14.6)	1.3	No	115	4.6
North American Income Trust	401.4	30.5	18.1	55.0	234.8	(5.4)	0.9	No	104	3.6
Simple average (6 funds)	**576.7**	**35.6**	**57.4**	**86.3**	**263.0**	**(10.5)**	**1.0**		**106**	**2.6**
USA rank in peer group	**2**	**4**	**1**	**N/A**	**N/A**	**2**	**2**		**6**	**6**
HgCapital Trust	1,741.7	33.2	91.7	169.9	320.6	5.2	1.6	Yes	99	1.3
Scottish Mortgage	20,160.5	40.0	167.9	342.3	1,018.6	3.4	0.3	No	107	0.2
Allianz Technology Trust	1,260.9	28.8	110.2	297.3	897.1	(8.1)	0.8	Yes	96	0.0
Polar Capital Technology	3,284.3	21.8	94.8	226.3	716.7	(9.1)	0.8	Yes	97	0.0
Average – Technology peer group	**6,611.9**	**30.9**	**116.1**	**258.9**	**738.3**	**(2.1)**	**0.9**		**99.5**	**0.4**

Source: Morningstar, Edison Investment Research. Note: *Performance as at 29 September 2021 based on ex-par NAV. **Ordinary shares only. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Dividends: Growth focus means minimum pay-outs

As the trust's objective is capital growth over the long term, it does not seek to provide shareholders with a dividend. The net revenue return per share for FY21 was a negative 1.78p per share (compared to negative 1.05p in the previous year). As the revenue account is running at a deficit, the board is recommending no final dividend is paid for FY21. If the level of underlying income increases in future, the board will seek to distribute, by way of a final dividend, the minimum permissible to maintain USA's investment trust status.

Discount: Regular share issuance limits premium

Since inception, USA's share price has, on average, traded at a small premium to its cum-income NAV, although as was the case with most UK investment trusts, its share price briefly slipped into a significant discount at the onset of the pandemic. The trust is presently trading at a 3.6% discount but there is potential for the share price to experience renewed upward pressure relative to the NAV over time if performance remains strong and/or if investors are attracted by the trust's increasing exposure to unlisted shares, which are otherwise inaccessible to most investors.

However, USA's board actively manages the premium, aiming to keep the share price close to par. During the year ended 31 May 2021, 47.1m shares were issued at an average premium to NAV of around 6.4%, raising net proceeds of £132.9m. The board has the authority to issue a further 693.2m shares and since the end of the financial year, it has issued 0.5m shares (Exhibit 8). It can also buy back shares when the discount is substantial in absolute terms and relative to its peers, although to date, none have been undertaken.

Exhibit 7: Premium/discount over three years (%)

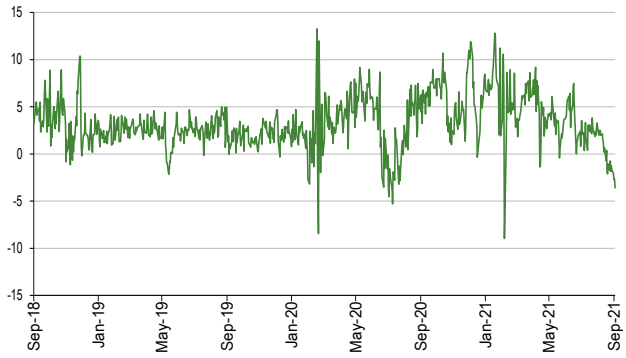
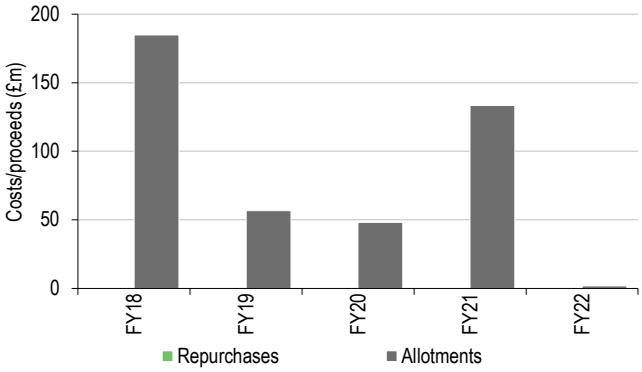


Exhibit 8: Buybacks and issuance



Source: Baillie Gifford US Growth Trust, Refinitiv, Edison Investment Research

Fund profile: Pursuing stellar long-run performance

USA was launched in March 2018 and is listed on the London Stock Exchange. The trust's alternative investment fund manager (AIFM) is Ballie Gifford & Co Ltd, which has delegated portfolio management services to Baillie Gifford & Co. It has been managed by Gary Robinson since inception. Kirsty Gibson joined him as co-manager in March 2021.

The trust aims to produce long-term capital growth by investing predominantly in companies that are listed or conduct a significant portion of their business in the US. The team aims to deliver outstanding investment performance by identifying the US's exceptional growth businesses and owning them for long enough that the advantages of their business models and cultural strengths become the dominant drivers of their valuations. The trust targets investment returns of 2.5x over the next five years. It is benchmark agnostic but uses the S&P 500 Index as a reference. USA is a constituent of the AIC's North America sector.

In addition to their manager roles with this trust, both Robinson and Gibson are named managers of the Baillie Gifford American Fund, which is an open-ended investment vehicle. Robinson has managed the American Fund since 2008 and Gibson has been a co-manager of that fund since 2012. The American Fund was launched in July 1997. It is similar to USA in most respects and has a longer performance track record, so it is a useful comparator when considering the longer-term performance prospects of USA. The American Fund invests at least 90% of assets in US companies and like USA, it focuses on companies set to benefit from long-term structure change. The holdings of the two funds are closely aligned. However, the American Fund's investment objective is less aggressive than USA's. It aims to outperform (after costs) the S&P 500 by 1.5% per annum over rolling five-year periods. In the five years to the end of its last financial year, which ended on 30 April 2021, the American Fund has significantly exceeded it investment target – the annualised return on the American Fund's B Accumulator shares over this period was 38.9%, compared to an annualised benchmark return of 18.8% and an annualised target return of 20.3%.

With the approval of the board, USA's managers may use derivatives for the purposes of efficient portfolio management, to reduce, transfer or eliminate investment risk in the portfolio. However, the

board does not expect the managers to enter into derivative or hedging transactions to mitigate against currency or interest rate risk.

Investment process: Giving best ideas time to excel

Baillie Gifford has been investing in innovative American companies for over 100 years and across the company, it presently has over £100bn invested in US equities. USA's investment manager, Gary Robinson, has 18 years' experience as an investment manager, all of which have been spent at Baillie Gifford. He has managed USA since its inception in March 2018. Kirsty Gibson, who has nine years' experience at Baillie Gifford, was appointed co-manager of the trust, along with Robinson, with effect from 1 March 2021. Both Robinson and Gibson are investment managers in Baillie Gifford's US Equities team and named managers of the Baillie Gifford American Fund (discussed above). Gibson replaced Helen Xiong, who joined Baillie Gifford's Global Alpha team last year.

Within a broad investment universe of about 1,700 sufficiently liquid listed stocks, the managers believe about 350 companies offer the potential to meet their investment criteria. In addition, their search for exceptional growth companies extends into the realm of private companies and the managers have increased their focus on unlisted companies recently. In FY21, private companies comprised 16.5% of the portfolio, up from 10.8% in FY19. This shift has been motivated by the view that US companies are choosing to remain private for longer and, as such, the public equity markets no longer offer the full spectrum of growth investment opportunities. The managers will consider private companies with pre-money valuations of US$500m or more and they usually invest in the late stages of a company's venture capital funding process. The trust has scope to invest up to 50% of its NAV in unlisted companies and the managers are largely indifferent as to whether a company is publicly or privately owned. They will conduct due diligence and allocate capital wherever they see the highest returns.

Robinson and Gibson are active, bottom-up investors who do not look at the index or target a specific tracking error. They seek to identify a small number of new investment ideas each year. Robinson and Gibson are part of Baillie Gifford's seven-strong US equities research team and their work benefits directly from their colleagues' insights and challenges. They also draw on ideas and perspectives from across Baillie Gifford's global investment teams, including its specialist healthcare/biomedical team, and they seek to foster links with external sources of ideas and information, including academics and visionary thinkers, inquisitive journalists and industry experts. In normal times, the managers also conduct in-depth research trips to technology innovation hubs and healthcare clusters. However, they do not use broker research, as the time frame of such reports tends to be too short to be useful, given that USA targets returns over a five-year time horizon.

The trust's research process casts a wide net over many disparate sources of information, so the team has constructed a framework for analysis and valuation that distils this information into a consistent format that facilitates comparison across potential investments. Capital is allocated according to its potential to generate the managers' target 2.5x investment return. Each potential and existing investment is assessed via the same eight questions intended to determine:

- what the world might look like if the company is successful;
- what aspects of the company's culture increase the likelihood that it will achieve long-term success;
- the company's enduring sources of 'edge', such as deep competitive advantages or 'moats';
- what is exciting about the market opportunity;
- the company's important forward-looking financial characteristics and whether the long-run incremental returns are attractive;

- how the company might meet the trust's target of 2.5x investment returns over next five years and the probability of this outcome;
- the potential for the company to be a real outlier; and
- what to do next – buy, hold, sell, watch or conduct further research.

The managers use this same research framework to assess private companies, but they apply a higher valuation hurdle. Instead of seeking an investment return of 2.5x, the target return for private companies is 5x. This higher target is intended to compensate for the lack of liquidity in private company holdings and also reflects the earlier-stage nature of such investments. Private company valuations are updated every three months by Baillie Gifford in accordance with International Private Equity and Venture Capital Valuation (IPEV) guidelines. In addition, USA's board conducts detailed bi-annual reviews and can challenge Baillie Gifford's valuations.

Meetings with the management, staff, customers and suppliers of target companies are very important to USA's investment process. These interactions also allow the team to understand the company's culture and its remuneration and incentive structures – factors that are particularly relevant given the trust's long-term investment time frame.

This fundamental analysis is discussed at weekly research meetings. The managers do not seek consensus between all team members. Rather, they focus on the potential upside of an investment and back the conviction of individual analysts. Robinson and Gibson manage the trust as a team, backing each other's convictions, so if one wants to own a stock, it will be held in the portfolio.

This process leads to a relatively concentrated portfolio, as the managers believe it is important not to dilute its exposure exceptional businesses. The portfolio typically holds 30–50 listed holdings, with a maximum of 90, including privately owned companies. Initial investments usually represent 1–2% of portfolio value, as the managers want any holding to be significant, although some investments in new biotech companies may be smaller. The maximum direct investment in any one company is limited to 10% of the trust's total assets at the time of the investment, although the holding is permitted to grow beyond this level due to subsequent performance. There is no maximum holding size, to give each portfolio holding the space and time to realise its full potential. The managers refer to this as their 'hold discipline'. For example, the trust's position in Tesla reached almost 15% before it was reduced in January 2021.

In general, the managers will assess each holding when its share performance hits their 2.5x target return on investment threshold. Depending on the outcome of this process, the stock may be held or sold. The managers will also dispose of positions if some fundamental change threatens the investment hypothesis, or if performance is muted and no longer looks likely to meet the 2.5x hurdle rate. Positions may also be trimmed or closed if the managers have better ideas or greater conviction elsewhere.

However, the managers will not sell a position simply because of short-term share price volatility. They will remain focused on the stock's long-term prospects and do not shy away from larger, less predictable risks, if they believe the potential pay-off is worthwhile. They point to the asymmetry of equity market returns to justify this approach – an investor can only ever lose 100% of capital due to a poor investment decision, but over time, can make many multiples of an initial investment from a successful investment. This asymmetry rewards optimistic investors with far greater gains from being right, than losses if they are wrong. It also means the costliest investment mistake can be excessive risk aversion.

Inevitably, risk-taking and the pursuit of long-term outperformance will be accompanied by some volatility and performance may be lumpy over the short term. But this is not something the managers discuss or analyse. They maintain that creating narratives around short-term performance distracts from the trust's long-term investment objective and therefore does not serve

its shareholders well. The managers ask to be judged instead on their performance over longer time frames.

USA's approach to ESG

The trust's board believes it is in shareholders' interests to consider environmental, social and governance (ESG) factors when selecting and retaining investments and has asked the managers to take these issues into account, provided the investment objectives are not compromised. The trust's managers' share the board's view on the importance of ESG factors, viewing them as integral to their success as long-term investors. At a fundamental level, investee companies can only be financially sustainable in the long run if their approach to business aligns with changing societal values and meets the expectations not only of the company and management, but also its customers, shareholders, suppliers and employees. The managers' recent disposal of the position in Facebook due the lack of management responsiveness to various concerns voiced by users, regulators and employees, is one illustration of the managers' application of this principle.

However, the managers' ESG criteria go beyond a company's financial sustainability. They are seeking 'game changers' – companies with the potential to change society for the better, directly, through the products they sell and indirectly, via the industries that supply them. To assess a company's potential to be a game changer, the managers create a societal contribution hypothesis as part of each investment proposition. This is a highly subjective, unquantified assessment of the benefit the company might deliver to society if it grows according to its forecast potential.

USA's managers believe in active ownership and they use the leverage provided by their steady and often sizable stakes to encourage companies to improve where necessary and realise their full potential, as both businesses and positive contributors to society. They expect their investee companies to operate in accordance with the principles set out in the United Nation's Global Compact on human rights, the environment, corruption and the treatment of workers. The managers will engage with a company's management if these standards are breached, with the aim of improving the firm's behaviour. If these efforts fail, the stock will be sold.

The trust's managers, Ballie Gifford & Co Ltd as AIFM and Baillie Gifford as portfolio manager, are signatories to the United Nations Principles of Responsible Investment and the Carbon Disclosure Project and members of the International Corporate Governance Network. Baillie Gifford became a supporter of the Taskforce on Climate-related Financial Disclosures (TCFD) in May 2020 and published its first firm wide TCFD-aligned report in March 2021.

Gearing

The trust has scope to use gearing up to 30% of NAV of the listed securities held by the trust, although typically, the board expects that borrowings will be 10–20% of NAV of the listed securities. The use of gearing has been modest to date and at end-August 2021 stood at 1.0%.

In October 2020, USA secured access to a new US$25m three-year, fixed rate facility with ING Bank that expires in October 2023. This facility is in addition to the existing US$25m five-year revolving credit facility with ING Bank, which expires in August 2023. At 31 May 2021, US$25.0m had been drawn down under the fixed rate facility and US$12.5m under the revolving credit facility. This compares with US$18m of credit being used at the same time last year.

Fees and charges

USA's managers endeavour to operate efficiently and economically and keep management fees and ongoing costs low, as they appreciate that even modest amounts can add up to substantial sums when compounded over long periods of time and the managers do not wish to dilute the compounding of investment returns with the compounding of costs. The annual management fee has recently been lowered. With effect from 1 September 2021, it is 0.70% on the first £100m of net assets, 0.55% on the next £900m and 0.50% on net assets in excess of £1.0bn. This compared to a previous fee of 0.70% on the first £100m of net assets and 0.55% on remaining assets. There is no performance fee, as the board believes that calculating the management fee on this basis is unlikely to exert any positive influence on performance. The trust's ongoing charge declined to 0.68% in the financial year to end May 2021, from 0.75% in the previous period.

Capital structure, life of the company and ownership

USA was launched by Baillie Gifford in March 2018. The trust is structured as an investment trust, with one class of ordinary shares. There are currently 307.4m shares in issue. The company has been established with an unlimited life. However, the board assesses the viability of the trust over a rolling five-year period and in the latest annual report, published on 10 August 2021, the directors state that they do not reasonably envisage any events that would prevent the trust from continuing to operate over the next five years.

The trust two largest shareholders are Quilter, which owned 10.6% of shares in issue as at 31 May 2021 and Brewin Dolphin, which owned 8.8% of shares at the same date.

The board

Exhibit 9: USA's board of directors

Board member	Date of appointment	Expected Remuneration end-May 2022	Shareholdings end-May 2021
Tony Burnet (chairman)	5 March 2018	£40,000	126,040
Graham Paterson (audit committee chair)	5 March 2018	£34,000	80,000
Sue Inglis	5 March 2018	£30,500	50,000
Chris van der Kuyl	1 June 2021	£29,000	Nil
Rachel Palmer	1 June 2021	£29,000	Nil

Source: Baillie Gifford US Growth Trust

General disclaimer and copyright

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