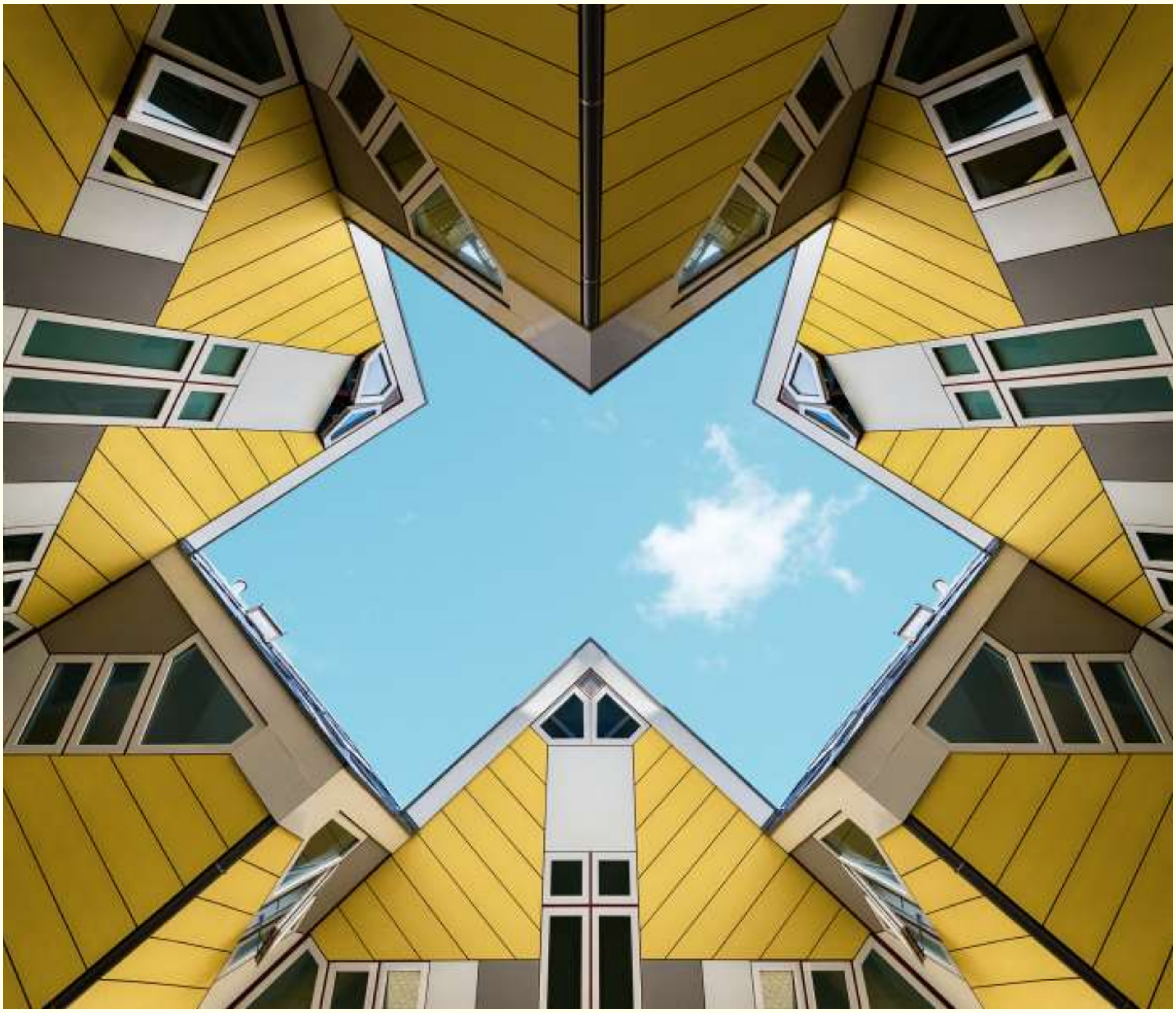
BAILLIE GIFFORD & CO

BCSSS BG Long-Term Global Growth Equity

Report for the quarter ended
31 March 2020



From great challenges can come great changes

There are times when we are cruelly and abruptly reminded that the economy, and indeed humanity, are wholly owned subsidiaries of nature. In the last quarter alone, we have seen the appalling devastation of forest fires from tinder dry conditions in some parts of the world, at the same time as devastating floods in other regions. There is no longer any credible scientific evidence to counter the argument that these impacts are at least in part being driven by anthropogenic greenhouse gas emissions.

The global coronavirus (Covid-19) pandemic is the latest reminder of the power of nature. Despite all of our scientific progress since the Enlightenment, we haven't escaped the fundamental laws of biology. It has already been widely noted that the pandemic is in many ways a more universal wake up call to capitalism than climate change, because its reach has been rapid and universal, whereas the wealthiest in society are much better-placed to adapt to climate change.

The scale of the human impact from the pandemic and the accompanying loss of livelihoods is currently impossible to quantify. We simply don't know how long it will take to return to some semblance of social or economic normality. In the meantime, it may be more helpful to reflect on the long term, and to focus on the potential for 2020 to become something of a turning point towards a more sustainable form of development.

Ever since the Dutch invented contemporary shareholder capitalism through the creation of the joint stock corporation at the beginning of the 17th century, the market economy has endured through almost every kind of catastrophe imaginable, from wars and disease to financial crashes and natural disasters. Horrific as the coronavirus pandemic is, this time will almost certainly be no different.

However, while it is entirely possible that the lessons are quickly forgotten and there is a rapid reversion to the pursuit of profits and growth at all costs, there are also a number of reasons to expect that this time we may see a much more thoughtful recovery that helps to put the world economy on a different trajectory.

One of the key reasons for this optimism is that, unlike the immediate run-up to other recession-triggering events, there was already an increasingly widely held view that the capitalist train was about to come off the tracks. Few (Bill Gates excepted) predicted that it would be a global pandemic that ended one of the greatest periods of expansion in history, but there were lots of other symptoms in the system.

First and foremost, we had pushed the environment to breaking point and, despite growing consternation and rhetoric, we hadn't yet summoned the collective political willpower to decisively address the growing risks. Global greenhouse gas emissions hit a record high in 2019, having more than doubled in the last 40 years. In 1980, the world consumed under 60 million barrels of oil per day. This has grown steadily ever since and, almost unnoticed, passed the milestone of 100 million barrels of oil per day for the first time in early 2020. Cities around the world were battling against increasing levels of local air pollution.

Despite incrementally improving fleet efficiency, the International Civil Aviation Organisation predicted last year that greenhouse gas emissions from aviation would triple by 2050. Clearly that was before the appearance of the pandemic. Global air passenger travel has grown by an average of well over 5% per annum in the last 20 years and, until this year, IATA – the airlines' trade association – was predicting that scheduled passenger numbers and air freight would almost double again by 2037. Bear in mind that all of this growth was projected with no imminent technological breakthroughs expected by the aviation industry to decarbonise mass air transportation.

In parallel to this, the growth of plastic pollution in oceans and global biodiversity loss has been equally stark and well documented. The intergovernmental process to address the issue of carbon emissions and climate change was due to be discussed at the end of 2020 in Glasgow, UK, at the COP26 talks. The global pandemic has already led to the postponement of this summit until 2021, and it has changed the political backdrop to this event considerably. However, if countries are to begin to turn the collective corner on emissions in the long term, a significant breakthrough will be required next year. The exact same level of national mobilisation and international collaboration to address an existential common threat is required, or there may be even greater consequences.

The other great strain on the system which has become increasingly difficult for companies to ignore is social. CEO-to-average-worker pay ratios have risen from around 30:1 in 1978 to closer to 300:1 today. The tension between the growth of the 'gig economy' workforce and zero-hour contracts on one hand, and spiralling executive compensation on the other, has led to a widespread political backlash and contributed to the growth of support for stakeholder capitalism. Aggressive tax minimisation by many global corporations over the past 30 years in particular has also jolted OECD (Organisation for Economic Co-operation and Development) countries into action, with a wide range of recently introduced policy measures being enacted to address so-called 'profit shifting' – where internal transfer-pricing mechanisms divert the bulk of profits to the lowest tax jurisdictions, increasing the need for post-financial crisis spending cuts by governments in key areas, such as public health and international development for example.

As we have seen with the struggle to suppress the spread of the coronavirus around the world, all of the above issues are of course inter-linked: a doubling of international air passenger traffic in recent decades, concerted efforts to minimise corporation tax contributions and financial crisis instigated cuts in central government spending. In a number of parts of the world, and not just in in developing countries, we have also seen the challenge of suppressing the virus when subsistence workers lack the job security to take proper time out from work to self-isolate.

This all leads to the inescapable conclusion that many aspects of capitalism were already well out of kilter long before the coronavirus, in a way that wasn't even good for the narrow economic self-interest of shareholders. With hindsight, some companies may now have latterly reached the conclusion that they have been paying sub-optimal levels of tax for years, neglecting to contribute to the necessary public goods upon which their business model depends. Effective governments and high-quality public services underpin sustainable economic growth, and national and international institutions actually matter. Businesses should support and invest in collaborative industry research and wider initiatives to address systemic issues. We can't reasonably expect the benefits of globalisation without an accompanying level of international cooperation to address systemic risks. It is now, of course, painfully clear that when international air travel, the undisputed carrier of pandemics, doubles in a matter of decades we should be investing more into public health research and disease prevention.

The inhumanity and devastation of the Second World War was the trigger for decades of work to define and protect human rights and civil liberties. When public health priorities are combined with the equally urgent need to address runaway environmental challenges and widespread and growing anger about a range of different inequalities, the need for action is amplified, the one glimmer of hope is that we can use the collective shock of the pandemic as an opportunity to realign the global economy onto a much more sustainable trajectory. It may be the very best chance we get.

Helpfully, the response to coronavirus has also accelerated a number of long-term structural shifts, such as the switch from business travel to video-conferencing, from commuting to home working, and from high street to online shopping, all of which are more resource-efficient alternatives. We may even find that we don't actually need to move ever greater numbers of people and volumes of physical goods around the world to enjoy higher levels of wellbeing. The good news is that many of your existing holdings are already very well aligned or indeed central to this wider sustainability transition, from next generation healthcare and biotech firms to leaders in video-conferencing, batteries and electric vehicle technology. We are even more resolute in our belief that the firms which are aligned with internationally recognised sustainable development goals will be the winners in the long run, not least because of redoubled public and investor interest in ESG and responsible business practices.

Coronavirus stewardship update

On a more immediate note, we have been contacting our holdings to express our support during the current crisis and to back any actions that they are taking to support the pandemic response and to act responsibly with respect to their workforce and other stakeholders, regardless of the impact on short-term margins. This long-term view is at the core of the Baillie Gifford Stewardship Principles (click link), and it is at times like this that such documents have to become much more than words on a website. We are giving careful thought to how we vote our holdings and approach company engagement during the upcoming proxy voting season to minimise the impact on, or disruption to, busy management teams, and we are urging companies to show restraint and awareness in their approach to compensation. Our dedicated in-house approach to proxy voting and bespoke governance software is even more important at times like this, allowing us to continue to assess each company's AGM ballot on an individual basis rather than relying on a rigid policy or third party advice. We are also reminded at times such as this of the importance of good governance and strong boards, with effective and engaged independent directors who have the bandwidth to commit much more of their time to crisis management and strategic planning.

While some businesses have attempted to ignore government guidance or immediately laid off as many employees as possible, the pandemic has brought out the best in many others and highlighted the innovative potential of corporations and small firms alike. From the consumer goods company Dyson manufacturing ventilators to LVMH quickly switching its production line to make industrial-grade hand sanitiser, to local shops around the world offering free local delivery to elderly residents, there is much to inspire; and their stakeholders will remember. Collaboration among research institutes and the pharmaceutical companies on potential vaccines also looks set to be instrumental in the fightback against the virus. As responsible long-term owners, we will focus our stewardship efforts on ensuring that our businesses are taking the necessary actions to address the range of pressing and interconnected governance and sustainability issues in the important months ahead.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	1	Companies	None	Companies	None
Resolutions	1	Resolutions	None	Resolutions	None

We have written to all LTGG holdings encouraging them to take a holistic view of their societal responsibilities, not to worry about short-term profits in the coronavirus pandemic and to offer our support as long-term shareholders.

Because it is turning out to be global in nature and potentially affects everybody regardless of economic standing, the coronavirus pandemic has been something of a universal wake up call to capitalism.

There are however reasons to expect a much more thoughtful recovery than we have seen from previous economic crises, with renewed commitment to addressing other systemic risks such as climate change.

Firm-Wide Company Engagement

Engagement Type	Company
Corporate Governance	Illumina, Inc., Kering SA, L'Oreal S.A., Meituan Dianping, Netflix, Inc., TAL Education Group, Tesla, Inc.
Environmental/Social	Amazon.com, Inc., Facebook, Inc., Pinduoduo, Trip.com Group Limited

Notes on company engagements highlighted in blue can be found in this report. Notes on other company engagements are available on request.

Company	Engagement Report
Amazon.com, Inc.	Meeting founder/CEO Jeff Bezos and members of senior management allowed us to delve into the opportunities and challenges created by Amazon's scale. Bezos noted that size can bring resilience - Amazon can come late to a new opportunity (such as advertising) but still compete thanks to existing infrastructure. Scale can also open new opportunities. Matt Wood, Vice President of AWS, stated that AWS's cloud servicing business could be eclipsed in size by its rapidly-growing machine learning business, as customers seek to use the data they have collected on AWS. However, scale can also slow decision-making. Bezos has therefore sought to instil a culture where reversible decisions are encouraged, enabling ideas to be launched quickly but adjusted or terminated as needed. It is clear that he remains the enabler of experimentation - Alexa, healthcare and Amazon's entry into India reflect an appetite for big bets that grow commensurately with Amazon's scale. On sustainability, we asked Dave Clark, VP Worldwide Operations, how one-day shipping affects Amazon's environmental impact. He explained that faster delivery does not equate to a larger carbon footprint, particularly as one-day delivery items are stored locally, cutting out air transport. The conversation spanned packaging, fulfilment, transportation and automation. Our impression was that sustainability is woven into Clark's thinking about optimising Amazon's operations.
Facebook, Inc.	CFO David Wehner believes Facebook's culture has changed from "move fast and break things" to "moving slower and balancing responsibilities". He feels founder/CEO Mark Zuckerberg has done well to push this change from the top. Our discussion with Monika Bickert, Head of Global Policy Management, was illuminating in understanding this cultural transition. Her task is to balance values and safety for the billions of Facebook users around the world. She noted that Facebook's content policies are all set in open and transparent forums (she invited us to attend in future), guided by the UN's Universal Declaration of Human Rights. Enforcement of these policies is Facebook's greatest challenge. Human content moderation is crucial - for example, the company's 300-strong election security team worked with external partners to remove misinformation on 100 elections worldwide in 2019. Facebook's artificial intelligence algorithms are also constantly improving. They not only stop image-based violations, but now also detect 80% of the 3 to 4 million items of hate speech removed every quarter. Bickert believes Facebook's position is strengthened by working with regulators and governments. She thinks regulation will ultimately help incumbents such as Facebook, whose content moderation algorithms appear to be forming a deep moat. We would like to think more about Facebook's company culture as it balances the challenges of innovation and responsibility over the next decade and beyond.
Illumina, Inc.	A discussion with CEO Francis deSouza provided an opportunity to review progress, challenges and Illumina's potential across the business, including oncology, non-invasive prenatal testing, population genomics, and partnerships in China. While there have been setbacks recently, deSouza believes the competitive environment has changed in Illumina's favour as the technology gap widens. The flipside is that Illumina's growing dominance is attracting greater regulatory scrutiny as evidenced by the cancellation of the PacBio merger. However, the company's global societal importance has been further proven in the context of the Covid-19 (coronavirus) pandemic, with deSouza himself traveling to Wuhan in December to oversee the sequencing of the virus - a vital step for the possible development of vaccines and treatments. Our impression from this meeting is that Illumina matters significantly more to the world for the next decade than its faltering growth in the last 24 months would indicate.
Kering SA	Central to Kering's culture is the ability and willingness to take risks. An expansive conversation with Gucci CEO Marco Bizzarri provided examples of this culture in practice. These include: Bizzarri's decision to promote the relatively unknown Alessandro Michele to creative director in 2015; Bizzarri's push for decentralised leadership whereby content creation teams in each major market operate autonomously; and Bizzarri's preference to have many direct reports, thereby cutting bureaucracy and sparking greater creative freedom. This appetite for experimentation shows no signs of abating. Bizzarri and Michele have agreed to work another 5 years together and both support a desire to extend the brand in new directions, such as a proposed subscription service comprising exclusive pieces and experiences at a range of price points. We feel their bond may be an underappreciated aspect of Gucci's continued growth.

Company	Engagement Report
L'Oreal S.A.	An investor and a member of the governance and sustainability team had a pre-AGM call with members of L'Oréal's IR and legal teams. In addition to new remuneration proposals and employee share option schemes, L'Oréal is excited about a new appointee to the board, Dr Ilham Kadri, CEO of advanced materials and speciality chemicals business, Solvay. Solvay has committed to using its unique business position to assist with the COVID-19 crisis in various ways, including donating disinfectants to local authorities in China and Italy. We see Dr Kadri's appointment as positive and look forward to her contributions to the future growth and success of the business.
Meituan Dianping	Founder/CEO Xing Wang is more energised than ever by Meituan's mission to 'help people eat better and live better'. On governance, he has delegated much of the operational oversight of the business, seeing his role as forging the next generation of leaders. This gives him more time to think about the next 10 years. In addition to discussing his longer-term aspirations for food delivery (100 million orders per day by 2025) and travel (becoming dominant in China for hotel booking revenues), we asked about regulatory and societal considerations. Xing observed that Meituan is well-positioned in that it continues to create thousands of jobs. The coming years will see rising wages for delivery riders - Xing views this positively. We asked about the environmental impacts of food delivery packaging, he agreed it will be a significant issue for Chinese consumers in the longer term. Meituan is already looking at using decomposable materials.
Netflix, Inc.	Investment managers and a member of the governance and sustainability team spoke with non-executive director and chair of the compensation committee, Tim Haley. As outlined in previous quarterly notes, Netflix has shunned requests from shareholders to conform to corporate governance best practice. Our research and engagement give us confidence that the company's governance is pragmatic and supportive of the long-term strategy. Haley explained that Netflix is focused on execution, and all governance and compensation decisions are taken with the best interests of shareholders and the company in mind. However, he admitted that it has become clear to the board that many investors disagree with the current governance posture. Haley believes this is due to poor communication and the board is working to improve its engagement with shareholders. We also discussed Netflix's culture, which Haley described as lean, informal, results-driven and largely unchanged since he joined the board in 1998. We believe Netflix has a differentiated business model and has demonstrated a strong long-term focus which warrants our trust and support. We will continue to monitor its governance practices and encourage timely evolution which is appropriate for the age, stage and operating environment of the business.
Pinduoduo	Our meeting with David Liu, Vice-President of Strategy, helped deepen our understanding of Pinduoduo's adaptability in the face of significant competition. In Liu's words, Pinduoduo "has grown up in the shadow of a giant" (referring to Alibaba). He believes that while Alibaba starts with people wanting a product, Pinduoduo is more social and allows for serendipitous product discovery given the power of social recommendations. Through gamification, just-in-time manufacturing and expansion into agricultural produce, Pinduoduo sees many avenues for further growth. We think this adaptability and dynamism may be partly thanks to its differentiated culture. It is striking that the company's 6,000 employees (3,500 of whom joined just last year) have an average age of 26. Despite significant workforce growth, the company remains nimble, with a flat corporate structure - i.e. very few steps to the founder CEO Colin Huang - resulting in an entrepreneurial culture that makes Pinduoduo Shanghai's place to work.
TAL Education Group	CFO Rong Luo pointed to numerous regulatory and societal tailwinds that appear to be supporting TAL's growth and innovation. After a couple of years of regulatory turbulence in the private education sector, the new policy on education favours scale operators. TAL - one of only two companies (with New Oriental) to have exceeded 1 million offline customers - is well-positioned to benefit. Moreover, TAL is investing in contiguous areas such as smart education in public schools, which local governments are increasingly rallying behind, and over the longer term could extend into areas beyond the education sector, such as training chefs and drivers.

Company	Engagement Report
Tesla, Inc.	Our call with founder/CEO Elon Musk and CFO Zach Kirkhorn followed Tesla's announcement in February 2020 of a $2.3 billion equity raise (about 1.5% of the company). Kirkhorn commented that the decision was opportunistic to guard against future unknowns, while Musk added that, given the dramatic share price appreciation, it made sense to raise money to help the company fill what is perceived as a significant gap in the automotive and energy markets. In a wide-ranging conversation covering Tesla's advances in manufacturing efficiencies, battery technology and solar energy, Musk stressed that the widening array of opportunities facing the company offers a "small but growing" chance of becoming the world's most valuable company. He also emphasised his openness to receiving continued feedback from us, preferably given bluntly and to him directly. A separate meeting with Jerome Guillen, President (Automotive), at the Fremont factory was valuable in understanding the strength of the management team surrounding Musk and how they work together. It is clear to us that Guillen, who successfully battled Tesla's Model 3 'production hell', now plays a critical role in developing Tesla's international factories. Our impression is that Tesla has moved from a culture of an idiosyncratic founder to a firm that has management and resources to be self-reinforcing and sustainably different.
Trip.com Group Limited	Our meeting with co-founder and chairman James Liang and CFO Cindy Wang led us to re-examine our confidence in the investment thesis for this holding. Our greatest concern pertains to the corporate culture. Despite an enormous growth opportunity, Trip.com seems to be operating as a conventional company. There appears to be a deference to James Liang among his executives. When we asked what culture means to Liang, his underwhelming reply was that Trip.com can match salaries with Expedia. On the subject of competition, Liang believes there is now a stable oligopoly in China between Trip.com, Meituan and Alibaba. We worry that this may signal a closed-mindedness to a real, ongoing competitive threat in its domestic market (particularly as Meituan's view is diametrically opposed to Liang's - namely that it seeks to rise up the hotel value chain and destroy Trip.com in China). Moreover, there were blank faces around the table when we asked how Trip.com is thinking about the environmental issues surrounding air travel over the next decade. Perhaps this is just the stage of the travel market in China and perhaps we are wrongly imposing a western carbon prism on the company, but the fact that the question didn't even register was surprising to us.

Votes Cast in Favour

Companies	Voting Rationale
Spotify Technology SA	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

We did not vote against any resolutions during the period.

Votes Abstained

We did not abstain on any resolutions during the period.

Votes Withheld

We did not withhold on any resolutions during the period.

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