SHINING A LIGHT ON……
BAILLIE GIFFORD AMERICAN FUND

At a glance

The US market is notoriously difficult for active managers to outperform; the argument is that it is highly efficient and therefore investors would be better to hold a fund that tracks the index rather than paying for active management.

We test all our funds against the index and although over short periods funds may underperform our aim is to identify managers who consistently add value. The Baillie Gifford American Fund had a good track record when we added it to the portfolio two years ago however its style of investing (quality growth stocks) has meant that it is starting to lag.

In this review we wanted to try and identify whether investors should be patient or whether this is a trend which might not reverse.

Who are the team behind the fund?

The lead manager is Mick Brewis. He is supported by Ian Tabberer, Gary Robinson and Michael Taylor. Mick has run the fund since its launch in 1997 and has a good long-term track record. However as indicated the shorter term performance has been poor. Ian has 11 years' experience with six years at Baillie Gifford; Gary has 11 years' experience with Baillie Gifford only and Michael 5 years again with Baillie Gifford.

A concern we would have is the retirement of Mick at the end of April however Baillie Gifford are careful to nurture teams so the departure of one member shouldn't have a material negative impact on the process and performance.

What is the story behind the investment?

Since March 2009, the US market has more than doubled.

The US economy is still on the road to recovery. Consumer sentiment has improved and nationally housing prices are recovering.

Opportunities remain in cyclical parts of the economy (i.e. those that tend to contract faster in recession and grow faster in recovery) and demand for autos, housing and rebuilding inventories will help boost the economy and support company profits.

Interest rates are likely to remain low and although tapering has started this will be a gradual process.

There are differing views as to whether investors can gain much more from holding US stocks, some argue that certain sectors are now expensive others argue there are still plenty of opportunities. In this environment we believe a good active fund manager picking out the attractive special situations can outperform the general market.

Fund highlights?

Mick Brewis is the lead manager and is due to retire at the end of April. Under his tenure the fund has delivered excellent long term performance however in recent years has struggled to outperform the S&P 500 index. If the fund cannot significantly outperform the index then why not hold the index?

Mick admitted that recent performance had been disappointing however he believes that the style that he adopts will pay dividends. In 2012 the fund was weighted too heavily in tech stocks which dragged down the performance, in 2013 it avoided companies with what he describes as unproven business models. He believes this part of the market is now frothy.

He discussed the likes of Facebook and Twitter. Twitter has never made a profit and may never make a profit. Facebook's recent acquisition of WhatsApp to remove a threat is a worry. All of these are purchased not on P/E ratios but on what future profits might be (i.e. hope, and the current prices are very very hopeful).

This style of management avoids these types of companies although he does have some tech including Trip Advisor, Google and EBay.

He believes the US is in a good place economically and there are plenty of unrealised opportunities. There is a bias towards domestic stocks. In financials he likes domestic players such as First Republic Bank. Other stocks he favours are Harley Davidson, Berkshire Hathaway and Watsco.

We discussed pharmaceuticals – he favours Johnson and Johnson, Bristol Myers and Pfizer. He feels these companies are better run than they were. Johnson and Johnson as an example state that they want to adopt the best R&D and they will outsource via joint ventures if this is the better way to achieve the desired outcome.

Many of the stocks held in the portfolio have not re-rated however Mick believes this is changing and the patient investor will be rewarded.

For such investors his approach to focus on domestic growth stories may appeal. However, there are two concerns, firstly there has been a long period of underperformance and we don't know if this will correct and secondly Mick will be retiring at the end of April and although he has worked with the same team for some time we don't know what the changes will mean for the ongoing performance.

Fund performance

The table below shows performance over the last five years and going into 2014:

	2009	2010	2011	2012	2013	2014
Baillie Gifford American Fund	18.37%	23.94%	1.18%	4.44%	25.21%	1.54%
iShares MSCI North America	15.39%	16.55%	-0.55%	5.15%	27.12%	-0.05%

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. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

Clearly Mick is very passionate about the fund and recognises the underperformance. We feel the fund could be positioned to do well however it is unproven and the years of underperformance are fact. There are other managers who have been able to profit and it is likely we remove the fund from our portfolios but continue to monitor it.