

SHINING A LIGHT ON..... BAILLIE GIFFORD GLOBAL DISCOVERY FUND

At a glance

For new investors choosing the right sector or country can be daunting. Often they are drawn to the best performers, and those being advertised. This strategy can work but the reverse is also true with investors being disappointed because they haven't fully understood the strategy.

We recently met one of the managers behind the Baillie Gifford Global Discovery Fund; the fund draws on the regional teams from the UK, Japan, Europe, US and Emerging markets to produce a best of breed global fund.

Its focus is on small cap companies but looking for those that will get bigger in the future. It means the fund is weighted towards such areas as information technology (36%) and healthcare (18.8%).

For investors looking to invest globally in the large cap businesses of the future then this fund could appeal. However, the nature of the businesses they invest in means that this fund will be volatile and has to be seen as a long term investment.

Over five years it has returned nearly 200%; our question for the manager is whether this can be repeated and this review provides an insight into this.

Who are the team behind the fund?

The team is made up of five investment managers bringing together their specialist small cap experience. Douglas Brodie is the Head of the Global Discovery Team, and he is supported by John MacDougall, Kate Fox, Brian Lum and Zaki Sabir.

Fund highlights?

We often see small cap managers who focus on the opportunities within the sector and in particular the growth aspects, and hold pure small cap stocks selling out when companies go up the scale. We also have managers who claim to be small cap but continue to hold companies which have moved into mid and large cap space.

In the discussion we had with the manager we felt this fund had a clear point of difference. The argument is that many small cap businesses will remain so. What they are looking for are those 'immature' businesses which have the potential to move up the scale.

This means they will hold onto stocks for a long period of time (between 5 and 10 years) and will hold large cap stocks. The fund has around 50% in micro and small cap, 45% in mid cap companies and 5% in large cap. This is reflective of the journey these businesses take.

We were interested in the number of holdings as this seems high. Initially they invest around 0.5% in each company, as they become more confident in them this increases to 1% and then above 2% they are convinced of the story.

The question arises as to what they are looking for. John explained that the role models are businesses like ASOS.

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There are three aspects which we covered.

John is looking for innovation and not 'me-too' businesses. 'Me-too' businesses often replicate an existing model and remain small cap because there is nothing to propel them into the mid and large cap space.

Secondly the management plays an important part. The team is seeking those with an entrepreneurial mind-set; good indications of this are whether they are prepared to push the boundaries or just sit back, and if they sell shares and take the money or reinvest it back into the business to grow it.

And thirdly is whether the business model is disruptive and difficult to replicate. An example of the last ten years is the growth of online retail and how that has changed individual shopping habits. This is an example of a disruptive business model but in itself would not be a strong reason to invest. Something like ASOS is an example where it is both disruptive and difficult to replicate, and this is why it is a role model for John.

This disciplined approach aims to identify the cream of the crop however by their nature these businesses can fail to deliver because it is such a fast moving area and therefore the manager reduces the risk by having a larger number of holdings. New additions to the portfolio will be at around 0.5% per company and as confidence grows this will increase above 2%.

Currently the fund invests in companies which offer a blend of products including antibody therapies, electric vehicles, high performance plastics, platforms for e-commerce, high end mobile graphics and animal breeding techniques. This will change over time.

In summary the fund manager looks to invest in the companies which can propel themselves from small to large cap over a 5 to 10 year time frame. The fund will have a bias to small cap but it will also hold mid and large cap stocks making it a multi cap fund. As a lot of the businesses which call into this category are technology and health care it can bring greater volatility into the fund which means investors need to decide whether the potential reward outweighs this risk.

Fund performance

Performance for the past five years and since launch vs DB X-Trackers FTSE All World Ex UK is shown below:

	2009	2010	2011	2012	2013	2014
Baillie Gifford Global Discovery Fund	48.00%	26.67%	-13.24%	18.91%	55.76%	1.57%
DB X-Trackers FTSE All World Ex UK	22.37%	16.83%	-8.33%	9.75%	20.98%	0.65%

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

In the global sector this fund has a different strategy. It is not trying to be a pure small cap fund but seeking those small cap businesses which can grow into larger businesses. It does have a large number of holdings but this is reflective of the style of management, and the need to protect against some of the potential volatility this type of investment will have. It is more suited to investors looking for a 5 to 10 year view and is not for short term investing.

The source of information in this note has been provided by Baillie Gifford and is correct as at April 2014. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. 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 rise.