Vanguard

Manager Select Series

As at quarter end 30 June 2020

Quarterly commentary

Vanguard Active Global Growth Fund

Fund overview

The Vanguard Active Global Growth Fund seeks to provide long-term capital growth by investing primarily in equity securities from around the globe that are considered to have above-average growth potential. The fund invests in 70-120 growth stocks in well-managed businesses which enjoy sustainable competitive advantages and grow their earnings faster than the market over the long term. Based on the characteristics of each company, Baillie Gifford categorises stocks into one of four growth profiles: stalwart, rapid, cyclical and latent; to recognise different growth rates. This allows the portfolio to capture growth opportunities that other investors may overlook. The portfolio is well-diversified, has low turnover and differs greatly from the index.

Investment expertise – The fund allows investors to tap into the investment expertise of Baillie Gifford's experienced research team with an average tenure of over two decades, using research from over 100 investment professionals.

Investors not speculators – The fund seeks to have a low turnover portfolio of stocks, using time and volatility to its advantage.

Fund details

APIR code:	VAN0722AU
Inception date:	3 September 2019
Portfolio manager:	Baillie Gifford Overseas Limited
Investment style:	Growth
Benchmark:	MSCI All Country World Index (with net dividends reinvested) in Australian Dollars
Currency:	Australian Dollars
Distribution:	Quarterly
Share classes:	Wholesale
Active share[1] (expected):	c. 90%
Management fee:	Base Fee 0.60% Performance Fee +/- 0.0825%
Strategy:	The Vanguard Active Global Growth Fund's strategy closely aligns with Baillie Gifford's Global Alpha strategy, which has been operating since May 2005.

1 Active share measures how much an equity portfolio's holdings differ from the benchmark index constituents.

Performance

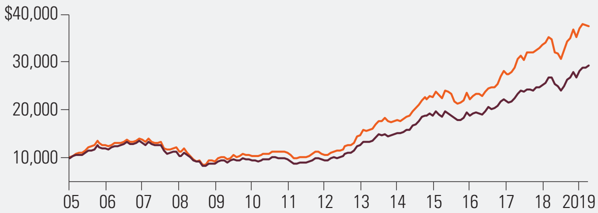
	3m %	6m %	1yr %	3yr % p.a.	5yr % p.a.	since inception %
Fund	13.48	5.38	n/a	n/a	n/a	15.58
Benchmark	5.98	-4.28	4.08	10.03	8.82	2.95
Outperformance	7.50	9.66	n/a	n/a	n/a	12.63

Inception date: 3rd September 2019.

Returns are in AUD and assume reinvestment of all income distributions. Past performance is not an indication of future performance. Returns for periods longer than 12 months are annualised. Fund returns are calculated after allowing for management and transaction costs. The fund is actively managed and does not intend to track or replicate the performance of the benchmark.
Benchmark is the MSCI All Country World Index.

Simulated past growth

May 2005 through September 2019



Based on the Baillie Gifford Global Alpha Composite in Australian Dollars. Benchmark: MSCI ACWI. The returns presented above are net of fees and reflect the reinvestment of dividends and interest. The results are for illustration purposes only and include an estimate of the fees that may have been charged by the Vanguard Active Global Growth Fund as described in the PDS. Simulation is from May 2005 to September 2019. The simulation end date roughly aligns to the inception date of the fund. Please refer to the disclaimer for further details.
Source: Baillie Gifford & Vanguard.

Portfolio overview | Data as at 30 June 2020

Portfolio characteristics

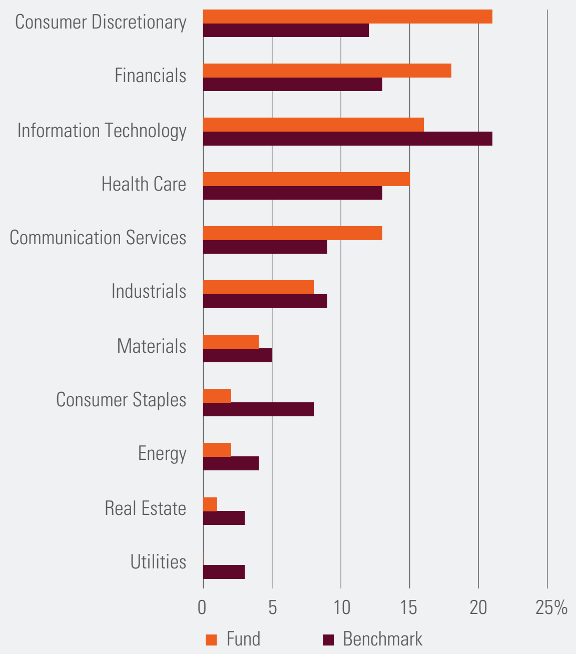
Fundamentals	Fund	Benchmark
Number of holdings	99	2,988
Median market cap	$69.7 B	$95.56 B
Equity yield (dividend)	0.91%	2.38%
Price/Earnings ratio	26.1x	19.4x
Price/Book ratio	3.8x	2.31x
Return on equity ratio	14.9%	15.7%
Earnings growth rate	15.9%	12.4%
Turnover rate (as at 30 June 2020)	n/a	n/a

Top 10 stock holdings

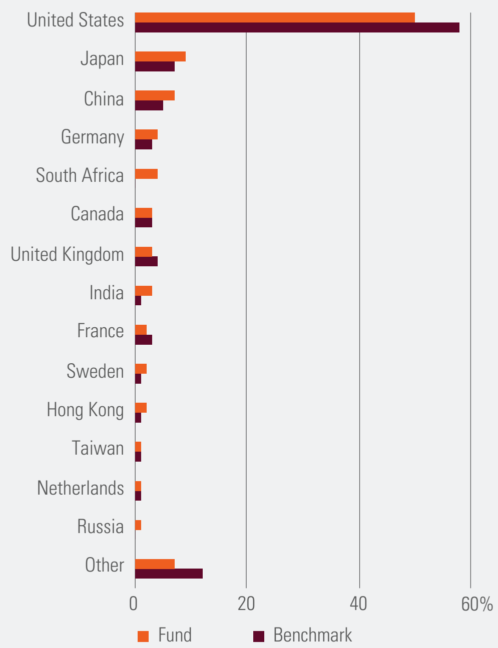
	Company	%
1	Amazon.com Inc.	4.2%
2	Naspers Ltd.	3.6%
3	Moody's Corp.	2.9%
4	Alphabet Inc.	2.8%
5	Microsoft Corp.	2.5%
6	Mastercard Inc.	2.3%
7	Shopify Inc.	2.3%
8	Alibaba Group Holding Ltd.	2.2%
9	Prudential plc	2.1%
10	Anthem Inc.	2.0%

Top 10 holdings represent approximately 27% of the total fund

Sector allocation



Market allocation



Notes: Sector categories are based on the Global Industry Classification Standard system ("GICS"), except for the "Other" category (if applicable), which includes securities that have not been provided a GICS classification as of the effective reporting period. Benchmark is the MSCI Emerging Market Index.

Overview

Over the past quarter, stock markets have more closely resembled the Roaring Twenties. The recovery, particularly in US markets, from the March lows has been extraordinary.

One of the notable features of this market fall and recovery is that market leadership has not changed. Those technology-enabled businesses operating in areas such as ecommerce, gaming, entertainment, food delivery and online education, which were already delivering extremely attractive rates of growth prior to the pandemic, have sailed through the crisis, enjoying 'demand binges' from locked down consumers. In many cases, competitive positions are likely to have been enhanced as less nimble competitors struggled and trends which Baillie Gifford may have expected to play out over the next five to 10 years, have been condensed into a couple of months.

Baillie Gifford has talked at length in the past about the stock-picking potential which arises from accelerating rates of creative destruction. The idea that incumbents within established industries are likely to be uprooted and replaced. What has been seen over the course of recent months, however, may be evidence of something closer to 'creative accumulation', where the innovation and disruption within an industry comes not from new entrants, but from the existing market leaders. Music streaming service Spotify, Canadian ecommerce enabler Shopify, US housing website Zillow, South East Asian gaming and ecommerce business SEA, Tesla and Amazon would all be examples of where this combination of market leadership coupled with a desire to continue to reshape their respective industries, backed up with significant investment. Huge (and expanding) addressable markets, restlessly ambitious management teams, a special culture, and increasing returns to scale appear to Baillie Gifford as the necessary ingredients in maintaining this process of creative accumulation and, as a result, sustaining exceptional rates of growth over long periods of time. It is with this framework in mind that they assess the recent share price performance of a range of holdings, including those mentioned above.

Fund highlights

Performance

The fund was up 13.48% through the quarter outperforming the benchmark by 7.50% which gained 5.98%.

Recent activity

Baillie Gifford has spent considerable time reflecting on the world which is emerging from the pandemic; how this may impact the businesses in your portfolio and where opportunities may be starting to appear. They have made a small number of changes to the portfolio over the quarter. These transactions have broadly fallen into three, overlapping, areas.

The first group would be those that are benefiting from accelerated adoption trends, or the demand binges mentioned earlier. In this category, a small addition was made to Illumina, the gene sequencing business. While the barriers of technological complexity, inertia in healthcare systems and the need for education have slowed adoption of their technology thus far, the race to understand the virus which causes Covid-19 and to develop effective treatments has highlighted the importance of putting data-driven understanding at the heart of healthcare.

There has also been a small addition to the holding in Naspers, the South African investment group. Naspers is seeing evidence of accelerating demand across a range of the industries and markets in which it invests, including food delivery, electronic payments and digital education solutions.

The second group is where Baillie Gifford are seeing a marked improvement in the competitive environment. This is perhaps most clearly illustrated in the case of new purchase Lyft, the ride- hailing business. Its main rival Uber, Post IPO and under a new CEO, now appears to be focused on demonstrating that the business model can deliver profitability. This change in behaviour holds the promise of a much more rational environment and one in which Lyft, with its more focused and inclusive approach, may thrive. Lyft brings exposure to an industry which is likely to continue to see enormous change on several fronts over the coming years.

The final group is where Baillie Gifford see little evidence of change. The investment case for many Growth Stalwart holdings is based around a deeply entrenched competitive position and a structural growth opportunity which extends well beyond the time horizons of most investors. This provides a degree of resilience in terms of the operational performance of these businesses and an ability to reliably compound growth in their earnings over many years. Several new holdings have been taken in companies which Baillie Gifford believe possess these qualities. This includes S&P Global, Estee Lauder and Adidas with small additions to AJ Gallagher and Broadridge.

Fund outlook

Baillie Gifford's investment approach starts from a position of optimism. They believe the world is full of opportunity and the biggest investment mistake is to obsess over what might go wrong with any individual investment and blind themselves to the transformative potential of great growth businesses as a result. It is understandable if many of us are feeling the effects of too much time in cyberspace recently, but the world will return to normal, even if it's a new normal that is different from the old. Baillie Gifford is focused on the task to make sure the portfolio is well positioned for the future as it distributes itself more widely.

Stock spotlight

Adidas

German producer of sports shoes and equipment

→ Stalwart Growth

There are two significant trends which are likely to support Adidas' growth over the next decade. First, growing health and fitness trends globally increases the pool of 'exercisers' and broadens the sports apparel market. Second, the continued shift towards digital sales channels which are higher margin.

China is likely to be an important market. An exercise boom is underway (note the Governments 'Healthy China' initiative) and gyms and associated memberships have grown significantly, doubling since 2008. The market is vast and spend on sportswear is low relative to the US (the average per capita spend on sportswear is $25 per annum compared to $300 in the US). Adidas' shift to ecommerce (online direct to consumer sales) over the coming years may have a meaningful impact on its profitability. Around 13% of Adidas' current sales are made online directly and the company expects to grow this proportion to around 25% over the coming years. This should enable operating margins to expand significantly. This is a long duration, high quality growth company and has been added to the portfolio as a Growth Stalwart holding.

S&P Global Inc

Credit rating agency

→ Stalwart Growth

S&P Global provides financial market data and intelligence to clients across a range of areas including the rating of debt securities, analytics tools, pricing data on a range of commodity markets and the provision of various benchmark indices. Each of these markets trend towards a natural oligopoly and offer the potential for extremely high incremental returns. These areas are also complementary in terms of S&Ps ability to apply data and insights gained in one part of the business across other areas.

The result is an exceptionally high quality earnings stream. There are also a number of potentially exciting new areas for growth including the rating of Chinese securities and ESG, where S&P's ability to provide both data and indices is a compelling opportunity in an emerging area desperate for standards.

CEO Doug Peterson has been in place since 2003 and has led the company's transition to a culture which is much leaner, more customer focused and ambitious than was the case a decade ago.

Baillie Gifford believes the combination of the exceptionally long-duration growth opportunity, extremely well entrenched competitive position and prodigious free cash generation makes this a very attractive Stalwart Growth holding and has taken a new position within the portfolio.

Lyft Inc

Ridesharing services

→ Cyclical Growth

Lyft is the second-largest US ride-sharing company and has grown quickly to command nearly 40% of the US ride-sharing market thanks to its driver and rider-centric culture.

The ride-sharing industry is still in its infancy accounting for only a low, single-digit percent of core urban miles driven in the US. As Lyft builds out a multimodal transportation network and broadens its services to include bikes, scooters and public transport, it helps increase choice and convenience for riders. Baillie Gifford expects this to underpin many years of rapid growth helping to deliver a structural shift from inflexible and expensive car ownership towards the flexibility of transportation-as-a-service.

The industry is changing rapidly and the impact of autonomous driving capability remains uncertain. However, with a strong position in a rapidly growing market, an attractive founder-led culture and greater industry-wide pricing discipline, Lyft is considered to be well-placed to benefit from the long-term shift in transportation from an ownership to a service model.