


## IMAP Independent Thought Podcast

## IMAP Podcast Episode 51: Why Short-Attention Markets Favour Long-Term Investors

Our host **Emily Barlow of (Evidentia Group)** is joined by **Catherine Flockhart, partner and investment specialist at Bailey Gifford** to discuss:

- How passive funds are overtaking active, and how the swing from institutional to retail trading, have made markets more volatile and short-term
- Why more short-termism creates greater opportunity for patient, long-term investors
- Building portfolios around breadth and resilience without compromising on growth
- Quality growth's difficult stretch, and which businesses AI could genuinely impair
- Where the most exciting ideas are right now, in AI and well beyond it
- Impact investing's natural growth tilt, and the headwinds these strategies have faced
- Why long-term investing means thinking in five to ten years, not one to three

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**Emily Barlow (host) - Evidentia: 00:18**

Welcome back to the IMAP Independent Thought Series podcast. I'm Emily Barlow, and today we're going to attempt to cover two areas that are very topical for investors.

Firstly, why equity markets have become more volatile and more short-term and how they price information, and whether that's actually good news for patient long-term investors. And then secondly, we're going to look at where that leaves responsible and impact investing after a period of performance headwinds.

To help us unpack both, I'm joined by Catherine Flockhart, partner and investment specialist at Bailey Gifford, who brings a perspective on each.

On the first, Catherine has recently written a paper on the changing dynamics of equity markets, arguing that increasingly volatile short-term-driven markets are creating more opportunity for patient long-term investors.

And on the second, she's a specialist on the firm's positive change strategy. So well placed to cover both topics. Catherine, thank you so much for joining us. Thank you very much for having me. It's lovely to be talking to you today.

If we now jump into that first topic, can you talk me and the listeners through what's actually changed in market structure and investment behaviour to bring about that more short-term volatile dynamics?

**Catherine Flockhart - Bailey Gifford: 01:32**

Sure, a few things have really been stacking up over a period of time that I think we're now starting to reach a tipping point where markets are just behaving in a much more extreme way than they did, say, a decade ago.

So, the owners or rather the traders in markets have really changed. In 2023, passive funds, so funds that just follow other investors or track indices, overtook active assets for the first time. So, most of the market is now driven by flows that follow other people's decisions.

Now, those passive funds were, of course, set up to follow the institutional investors that typically commanded the market. But what about today? Who are they following now? Well, now you have far more hedge funds. And for example, in the US market, there has been a 20 percentage point swing from institutional to retail investors between 2010 and 2025.

So, you have these guys with a 24-hour investment horizon trading from their bedrooms or their mums and dads' basements, and their actions are affecting share prices and then being amplified by rules-based approaches that follow based on technical factors, not long-term judgment. And then, of course, passive.

This change in ownership of the stock market and the way in which it's traded has really been sort of stacking up over time. And I would pick that 2023 inflection point where passives overtook active as a significant one, meaning that we're just seeing much more volatile short-term swings on relatively little news than we did in the past.

And if you think about this just for a second, you know, the point of capital markets is to channel capital to enterprises that can grow the economy and grow over the long run. The fact that over 50% of them are now commanded by passive funds is a bit bonkers when you actually step back and think about it.

**Emily Barlow (host) - Evidentia: 03:34**

So, can you explain? I mean, that's all fascinating, but can you explain why that more short-termism activity in markets is actually beneficial for someone with a longer-term time horizon?

**Catherine Flockhart - Bailey Gifford: 03:46**

Yes, I think this is actually the crucial point that we need to not forget, which is that weighing machine, as Benjamin Graham would have called it, is not broken over the long run. Empirical data still shows us that over five-year periods and beyond, the share prices of companies do still follow their fundamentals. So, the companies that can grow their earnings the most are those that are most likely to deliver the best share price returns over the long run. Okay. So that relationship still holds true, which is good news if you're a patient investor.

So if, like Bailey Gifford or other fundamental houses, you actually analyse the growth prospects of the businesses you own and think about whether they'll be bigger in five years' time or more profitable, you have a massive advantage, a bigger advantage even today than you did, because the majority of the rest of the market is punting around based on noise and yesterday's share price moves.

The market inefficiency we're exploiting, which is excessive short-termism and an inability to distinguish what matters over the long run from the daily news flow, has become greater. And so, yes, that can lead to an uncomfortable dislocation in the short term, but we think it can lead to even greater long-term upside because that share prices following fundamentals relationship does hold true if you're patient.

**Emily Barlow (host) - Evidentia: 05:18**

So, we've spoken about volatility and that short-term impact for advisors that are building portfolios for clients, albeit long-term investors, possibly thinking about it in a more short-term fashion.

One of the things you're saying is perhaps look through some of that short-term noise. Is there anything else from a practical standpoint that those advisors should be thinking about when building portfolios for their clients?

**Catherine Flockhart - Bailey Gifford: 05:43**

Yes, I think for us, we are first of all, we're bottom-up stock pickers. We're not asset allocators. And I certainly wouldn't claim to give anybody sort of portfolio broad portfolio building advice. That's obviously for individual advisors and individuals with their own aims in mind.

For us, what we're thinking about doing with our equity portfolios is really increasingly focusing on resilience. Markets have changed over the past few years. We had a period during and pre-COVID, a very long-run period of very low interest rates where the cost of capital was effectively zero. And yes, there were some straws in the wind, but geopolitics was relatively stable. And of course, today we have a much higher cost of capital for businesses and a very different, more fragmented global trade block, trade backdrop, and of course, significant geopolitical tensions.

I'd also argue, by the way, that we're living through two structural mega trends, AI and of course, climate change, which are both still happening apace.

And so those things together, you know, tell us that we need to ensure that we focus on resilience more so than ever. So, you know, profitable, adaptable companies with high quality management teams that can navigate a more challenging backdrop. And also, that we're seeking those opportunities from a broad range of places. So, for me, I think that the sort of watchwords there would be about breadth and resilience.

But let's be clear with not, you know, not compromising growth, because that fundamental growth that drives the share prices I spoke about, you know, that must be there. But I think breadth and resilience help us given the dynamics that we're investing through today.

**Emily Barlow (host) - Evidentia: 07:34**

So, is it fair to surmise that you're focused more on like a that quality growth angle, which possibly has, well, not possibly has been under pressure more recently with that strong AI thematic really driving market returns?

I'm just interested in just where we are in markets right now, if you see that changing, or is it just that it's been through a difficult stretch, and/or is there anything actually that undermines that thesis that's happening in markets at the moment?

**Catherine Flockhart - Bailey Gifford: 08:02**

Yes, sure as you know, we are growth investors. We're looking for companies that can grow earnings at above average rates over the long run. Sometimes those will be your traditional quality growth companies. Those tend to be more established companies with slightly more predictable cash flows and higher returns profiles. Sometimes those can be your more Bada Boom names, your more exciting early stage names.

So, we do invest in a range of different growth companies, but yes, certainly we invest in quality growth. And look, there has been quality growth companies last year, who had their most difficult year in 30 years. There was a significant derating in quality growth. The market said we don't want to pay as much for this anymore. And really for us, this is about just again looking at fundamentals.

- Are companies still delivering strong earnings growth?
- Are they delivering growth in line with expectations?
- Are they still delivering strong returns? I
- if they are, then you know, we're very happy to stay the course and stick with it because it, you know, history shows us that these companies deliver better long-term share price returns.

I would say though, let's not be complacent about that. I mentioned two mega trends, one of which is AI. And, you know, that absolutely will impair some of the traditional, “if you like”, and inverted commerce quality growth businesses or darlings of the last 20 years. Some of the software businesses that don't have strong competitive modes that can be effectively replaced by Claude or similar. You know, you must take a fundamental look company by company and think about is this business still relevant and does it have a defendable edge over the long run? But if it does, and it's really just been about a short-term share price de-rating, then you stick with it.

**Emily Barlow (host) - Evidentia: 09:54**

I guess that's a good segue into what is it that you're finding the most exciting at the moment in terms of opportunities**?**

**Catherine Flockhart - Bailey Gifford: 10:01**

Yes. So, I mentioned earlier that we're really looking for breath and resilience. Look, as growth investors, it would be remiss not to mention that, of course, we're excited about the long-term, you know, mega trend that AI brings to the global economy.

We are tremendously excited as growth investors and investors who love innovation about the potential of these companies to deliver change. But we're typically being very circumspect and careful about where we invest there. So, a number of the most successful share price returners this year have been some of the semiconductors or the chip memory names. Now, some of these names have historically been less high quality. And what you've seen is share prices surge during short-term periods of high demand. But you know, because there isn't a huge edge in making these chips, that can then simply attract new players into the market or flooding of more chips. And so, you know, prices collapse.

And so, it can be a very cyclical market. We do have some investments in some of those names, but typically we've tried to really focus on the high-quality, sustainable long-term players in this area, like ASML, which has a monopoly over basically the equipment that makes the semiconductor chips, and some of the quite niche, dare I say, quite dull, boring technical players that have a really strong defendable technical edge that we think can continue to deliver superior returns over the long run and through the cycle.

So, we're excited there, but we're being quite careful, quite choosy, and also very focused on resilience and funding. But beyond that, look, there's just a whole cornucopia. And I mentioned at the outset that, you know, short-term market dynamics create opportunity for us. And indeed, this year has actually given us some pretty rich pickings.

So, for example the positive change fund, which you mentioned at the outset, Weva, which is a software business that helps drug manufacturing, you know, more efficient drug manufacturing, better drug development. It's been always pretty expensive. We've admired it for a long time. And we used the big software sell-off, which was totally indiscriminate in Q1, to get involved and buy some shares there. And we've also bought shares in a few other healthcare names, which have been a bit out of favour this year.

And then also, you know, something totally idiosyncratic, we've added to our position in CASPI, which is a Kazakhstani super app, which is really helping to broaden the economy in Kazakhstan and bring a whole range of benefits to that country.

We just bought Cavco, who make affordable prefab housing in in the US, allowing many, many individuals to own a home who otherwise couldn't even dream of doing so. So, a genuinely really exciting and eclectic mix of names.

And I think the one thing I would say whether you're interested in impact investment or sustainable investment or just investment full stop, AI is really exciting and it's going to change all of our lives in ways we can't even imagine. But there are so many equally brilliant and exciting investment opportunities and companies growing in totally different parts of the economy, and we're searching just as hard for those today as we ever were.

**Emily Barlow (host) - Evidentia: 13:25**

Well, I think that then takes us really nicely on to the next theme that we were going to discuss in today's podcast, which is that *responsible and impact investing*, which you've just touched on in your last question. And also, another topic that we've spoken a lot about is growth investing.

So, I mean, a lot of RI funds typically have that growth tilt to them just based on the types of company that they invest in. So, my question is twofold. Is it possible to invest more style neutrally when it comes to impact investing, or does it not matter? Or perhaps, you know, is it something advisors just need to accept and work around?

**Catherine Flockhart - Bailey Gifford: 14:04**

So, on the style piece, look I'm very biased because we're growth investors and we are impact investors. That said, if you do look at the sort of universe of funds that would be typically defined as our peer group, there is an overwhelming growth tilt, okay!

So, some objective information there to back up really what our belief is, which is that with impact investing specifically, so impact investing is a very focused way of investing. It's investing to deliver good financial returns, but also a social or environmental impact. It's holding those two objectives as equally important and it's aiming to manage and measure both.

So, it's not just a kind of common garden, ESG or sustainable investments, it’s a very focused style of investment. And so to do that and to do that well, I really think you've got to be looking for the innovative, exciting companies that are going to disrupt industries and do things in different ways, like billion to one, which we think is going to revolutionize pre-natal testing that we invest in, or Remittly that we own, that's a Western Union disruptor that's helping immigrants across the world, transfer money far more easily and cheaply.

These types of businesses tend to be growth businesses. And when you're looking for something really special, which is something that can deliver fantastic returns and do something good for people or the planet, I tend to think it's those innovative growth businesses, is where you find that opportunity set most richly.

It's not to say value and impact investment cannot be done. I just think it's a more natural home as well within the in the growth realm. And I do think that it's important that investors in these strategies understand that there is a degree of style tilt there.

Because I think that's something that we saw play out over the past few years is an expectation perhaps that people might invest in this way and think, oh, I'm going to be beat the stock market every single year.

Of course, we should be delivering strong returns over the long run, but accepting that if one is investing in impact, there's likely going to be some sort of style tilt there over the short term. And accepting and understanding that, I think, is important.

**Emily Barlow (host) - Evidentia: 16:29**

So, you've actually touched on something else I wanted to ask you about, which is performance, and I mean there's been more than just performance in terms of headwinds, and we've talked about some of the broader thematics impacting markets. So, let's not touch on that again.

But I'm just interested if there's anything else in particular that has been problematic for these types of strategies in the sort of short-term recent history.

**Catherine Flockhart - Bailey Gifford: 16:53**

Yes, so look, aside from the broader market dynamics that we've spoken about, honestly, I think sustainable and impact funds have seen a confluence of headwinds that I couldn't possibly have imagined all in one go.

We've seen the changing market dynamics, and we've seen clearly very hostile stance towards energy transition in in the US, and significant geopolitical tension bringing about war and things like significant share price upside in areas like defence, which are pretty problematic for an impact fund.

We've seen, high cost of capital, geopolitical tension, war, hostile policy in the US, and lacking or lagging policy elsewhere in the world. I don't think we could have seen a more perfect storm. And almost every time I say that something else seems to work its way out of the woodwork. So, I should really stop saying it, and yes, the headwinds have been there.

But actually, you know, I think what we've lived through is an important maturing of the opportunity set, of the available funds within it, and I think also hopefully with the expectation of the end investors. So, I think the companies, those that benefited from zero cost of capital and sort of rode the regulatory wave, and burning through cash in a non-self-funded manner. Those are either exited from portfolios or have had to really shape up. And I think that was a necessary period of maturity. I think the opportunity set for us as investors has matured. I think we as investors have learned a lot and really are more focused now on resilience, as I spoke about earlier.

I think that was important to change, as the investment landscape has changed with us. And I think that that savers have understood how portfolios have behaved, and those who are still invested today, are not those who sort of rushed in wanting to have the cake and eat it, but those that actually understand what they're invested in the long run, and do understand that these products can deliver very good returns over the long run.

So, with all of those lessons learned and all of that sort of maturing of the opportunity set, if you look at our own positive change fund, we're marginally behind the index this year, but only marginally. And in a year where we've seen phenomenal index concentration around these semi-conductor names that are not traditionally really impact names and all of those headwinds that I've mentioned, I actually feel that shows what a good job we've done of reorienting portfolios and thinking about the environment.

And when those headwinds start to abate, which they will because we're investing behind structural change, and when the share prices start to follow the fundamentals, which they will because they always do, you know, I feel incredibly confident that the past few years have been a rich learning ground that set us up better to deliver returns for savers in the long run, because really that is what we're here for and that's what we must do.

**Emily Barlow (host) - Evidentia: 20:02**

Great. Thank you so much, Catherine. And we're running up on time already.

So just to finish us off, I'd love your thoughts on if there was to be one thing you'd leave our listeners with today, both on impact investing and perhaps more broadly on growth investing in the current environment, what would it be?

**Catherine Flockhart - Bailey Gifford: 20:21**

You know what I'm going to say before I say it probably. But think five years at least, ten if you possibly can. Any kind of investment, but particularly impact investment, cannot be done well if you have a one, or dare I say it, even three-year time horizon.

Long term means long term. And if you're investing in equities for your savings or your pensions, you should have decades. So, you should be able to be patient enough to reap the rewards. So, I would just really encourage patience and long-termism.

**Emily Barlow (host) - Evidentia: 20:59**

Catherine, thank you so much. It's been a pleasure chatting with you. And thank you to our listeners for joining us today. I mean, I certainly think it's a good reminder of the importance (we've touched on it a few times), of thinking for the long term, trying to ride through that short-term volatility, albeit a challenging thing to do.

If you enjoyed today's episode, please do share it with your colleagues and your network. And we look forward to having you join us next time.

**Catherine Flockhart - Bailey Gifford: 21:26**

Thanks, Emily.

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