Baillie Gifford Emerging Markets Q2 investor letter

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" You can't always get what you want. " - The Rolling Stones

I recently went to Amsterdam to participate in an emerging markets roundtable. On arrival at Schiphol, I was ushered towards gleaming new European Union Entry/Exit System (EES) terminals. I was duly fingerprinted and photographed, had my passport scanned and was told to proceed to the digital automated kiosks. Of course, these didn't work. I was then sent to the back of the analogue queue. There were four immigration officers processing approximately 300 people. One hour and 10 minutes later, I wearily made it to the front. This used to be my experience at US airports, but some years ago I took the time to sign up to Global Entry. On my last visit, I simply looked into a camera and passed through US immigration in less than 10 seconds. This is quicker than I can get back into the UK. Indeed, my UK passport is so brilliantly designed that about a third of the time the digital kiosk can't read it... so straight to the back of the analogue queue. Do not pass 'Go'. Certainly, do not 'collect £200', which is incidentally about what my faulty passport cost. What I'm meandering towards here is the concept of 'bottlenecks'. After a brief hiatus in March, when energy stocks leapt to the fore, the biggest driver of emerging market indices and our clients' portfolio performance over the past 18 months has been semiconductor stocks, notably TSMC, Samsung Electronics, SK Hynix and more recently MediaTek. We have held TSMC and Samsung Electronics continuously in our emerging markets strategies since the 2000s. We initiated these hodlings on the belief that the world was going to need more silicon chips and these companies would control the bottlenecks. Initially, this was for smartphones, then the cloud, followed b Internet of Things and autonomous driving. AI is just the latest and perhaps biggest iteration of the idea that 'the world is going to need more silicon chips'. We initiated our holding in SK Hynix before OpenAI announced ChatGPT to an unsuspecting world. In the first instance, what this means for our clients is that we have been ahead of this surge in semiconductor stocks. Accordingly, we have been in the privileged position of being able to maintain overweight positions, where local vehicle restrictions allow, while recycling profits into areas that we believe will be less correlated or uncorrelated with AI capital expenditure, aiming to maintain adequate portfolio diversification. However, this success is raising a concentration concern. TSMC, Samsung Electronics and SK Hynix now represent approximately 30 percent of the MSCI Emerging Markets Index and approximately 40 percent of the portfolio. Baillie Gifford has been running emerging markets strategies since 1994 and Asia ex Japan since 1989, so we have seen index concentration before: ASEAN banks in the mid-1990s; technology, media and telecoms (TMT) stocks in the late 1990s; commodity stocks in the 2000s; Chinese banks in the 2010s and Chinese platforms in the early 2020s. And yes, the more grizzled among you will quickly point out that these episodes all ended in a bust. So, whatever the euphoria, our experience tells us that these semiconductor companies are ultimately cyclical and there will come a time to sell or at least reduce exposure. However, we don't feel that time is now. While we accept that in the medium term there will be AI-related 'air pockets' (drawdowns), these will be due to deployment challenges rather than a lack of end demand. This view is supported by the fact that while these companies have seen their share prices soar, so have their profits and cash flows, which matter even more. As a result, valuations remain rational. By some estimates, in 2026, Samsung Electronics will be the most profitable company in the world. As mentioned above, we have been taking profits on these stocks on the way up. Where have we been redeploying the proceeds? China looks to be one of the most interesting possibilities. Recall that, in 2021, China peaked at 43 percent of the MSCI Emerging Markets Index. It currently sits below 20 percent, bronze medallist to Taiwan and Korea. How has this happened? In 2018, the US launched tariffs targeting industrial, technology, machinery, electronics and intermediate goods, reflecting US concerns about China's technology-transfer and intellectual property practices. This spurred the Chinese government to rapidly redirect lending and credit away from the property sector and into the industrial and technology sectors to reduce China's dependence on western supply chains. The results of this pivot have begun to emerge, with China now arguably the global leader in solar, wind, batteries, nuclear, high-speed rail, steel, shipbuilding and rare earths processing. Nowhere is this more dramatically highlighted than in electric and hybrid vehicle exports. In 2020, China exported fewer than one million vehicles. In 2025, it exported more than seven million, overtaking Germany and Japan. Much is made of the severe competition in the Chinese domestic market across a range of sectors, but any company that can survive and prosper in such an intense environment tends to emerge onto the global stage as world-class. Think of battery manufacturer CATL, now with approximately 60 percent domestic and 40 percent global market share. Another corollary of the pivot to self-sufficiency is that Chinese large language models (LLMs) now represent the only viable alternative to the US offerings. What the Chinese may or may not lack in performance terms, they typically deliver in tokens at 10-20 percent of the cost of their US counterparts. While the US certainly has the advantage in advanced semiconductors, China has the advantage in terms of plentiful power supply; typically, electricity costs about half of what it does in the US. Moreover, while the US behemoths focus on frontier models and the quest for artificial general intelligence, China's focus is on open source, rapid adoption and real-world applications. So, although AI rollout is a government priority, it is still unclear where the financial benefits and investment returns will accrue. For now, the team is comfortable holding companies such as Tencent, currently deemed an LLM laggard by the market, but whose global gaming franchise and 1.1 billion domestic users, as well as the data they provide, represent an almost unique opportunity for AI optimisation and application.

Performance Emerging markets rose over the quarter and our clients' portfolio outperformed. As mentioned above, the key positive drivers were the semiconductor holdings, where extremely strong demand has been driven by rising AI capital expenditure. Samsung Electronics delivered strong first-quarter 2026 results, with revenue of KRW133.9tn, up 69 percent year-over-year and operating profit of KRW57.2tn, up 56 percent year-over-year, driven mainly by strength in its semiconductor business. This performance reflects surging dynamic random-access memory (DRAM) and NAND flash memory (NAND) prices, strong demand for server memory and enterprise solid-state drives (SSDs) and constrained supply as more wafer capacity is allocated to high-bandwidth memory (HBM). Samsung's progress in HBM4 and HBM4E, combined with its ability to offer memory, foundry and advanced packaging together, is strengthening its position with hyperscalers and custom AI chip customers. Multi-year supply agreements with cloud providers, often involving prepayments, should improve earnings visibility and reduce cyclicality, while continued AI infrastructure investment is expected to support elevated memory demand and margins at least over the medium term. SK Hynix also delivered strong first-quarter 2026 results, with revenue of KRW52.6tn, up 198 percent year-over-year and operating profit of KRW37.6tn, up 405 percent year-over-year, driven by memory undersupply, strong shipment growth and sharp increases in DRAM and NAND prices. Profitability is expected to remain exceptionally high, supported by leading DRAM margins, a strong NAND recovery from layer technology migration and rising demand for enterprise SSDs linked to AI datacentre investment. The company remains a leader in HBM, with an estimated 50-60 percent market share, HBM4 production ramping in the second half of 2026 and early HBM4E samples already shipped to major customers. SK Hynix is also expanding capacity through major investments in Yongin, Cheongju and Indiana, while bringing key infrastructure planning forward to meet AI-driven demand. As with Samsung, ongoing supply constraints, limited cleanroom availability and longer-term agreements with cloud customers should support pricing power, cash flow visibility and elevated profitability for some time. MediaTek reported first-quarter 2026 revenue of NT$149.2bn, up 2.7 percent year-over-year and operating profit of NT$22.9bn, down 23.8 percent year-over-year. The mobile business remains under pressure from weaker mainstream smartphone demand, although forthcoming 2nm flagship system-on-chip (SoC) launches should support a recovery in the second half. However, the main strategic catalyst is MediaTek's expanding custom cloud AI application-specific integrated circuit (ASIC) business, led by a tensor processing unit (TPU) programme for Alphabet, with 2026 ASIC revenue guidance raised to US$2bn and a significantly larger 2027 market opportunity now anticipated. Investments in advanced packaging, 2nm silicon, automotive AI cockpit platforms, advanced driver-assistance systems (ADAS) partnerships and edge AI SoCs position MediaTek for longer-term growth beyond smartphones, particularly as AI workloads expand across datacentres, vehicles and connected devices. The Brazilian market has experienced significant weakness in the past three months, primarily driven by a 'hawkish' shift in domestic monetary policy, deteriorating fiscal credibility and the rotation of foreign capital towards global AI and technology themes. Accordingly, three of the main stock-level detractors over the quarter have substantial Brazilian exposure. These have all delivered strong growth and we are maintaining your positions. B3 , owner of the Brazilian stock market, reported strong first-quarter 2026 results, with total revenues rising 20.5 percent year-over-year to R$3.2bn and net income increasing 33.5 percent to

R$1.5bn, supported by stronger market activity and recurring revenue growth. Despite this solid performance, the share price has weakened due to Brazil's high interest-rate environment, which continues to weigh on equity allocations, trading volumes and investor appetite for local equities. Sentiment has also been pressured by softer sequential volumes, including a 15 percent month-on-month fall in May average daily equity traded value, foreign outflows and some uncertainty around the chief executive transition. Waiting for Brazilian interest-rate cuts has required more patience than expected, but B3 should be a prime beneficiary when easing eventually takes place. Petrobras ' market underperformance in second quarter 2026 reflected a sharp disconnect between strong operational execution and weaker cash conversion, as pricing lags, delayed government reimbursements and regulatory uncertainty outweighed record production. In first quarter 2026, net revenues rose 12 percent year-over-year to US$23.5bn and net income rose 4 percent, supported by record total production of 3.23 million boepd, 18 percent growth in pre-salt output and refinery utilisation of 95 percent. However, expectations were missed because upstream realised prices lagged Brent by roughly US$10 per barrel, with export contracts taking 30-45 days to capture higher crude prices, pushing some revenue recognition into second quarter 2026. Free cash flow and dividends were further constrained by working capital pressure, including in-transit inventories and a major build-up of government fuel subsidy receivables as administrative bottlenecks delayed payments. This meant the ordinary dividend missed expectations, disappointing investors despite strong downstream margins. Overall, Petrobras delivered impressive production and refining results, but the market focused on weaker cash returns, subsidy-related working capital drag and exploration delays. MercadoLibre delivered strong first-quarter 2026 revenue growth, with net revenues rising 49 percent year-over-year to US$8.8bn, but profitability weakened as net income dropped 15.6 percent to US$417m. The share price weakness reflects investor concern that the company is prioritising market share, logistics scale and fintech growth over near-term margins, particularly through free-shipping expansion in Brazil, higher fulfilment subsidies, lower-margin first-party sales and rising credit provisions as the credit card portfolio more than doubled. While the downturn in margins is now becoming somewhat protracted, we continue to believe that this medium-term investment sets it up for a long runway of growth in the future. Our conviction was reinforced by our recent work in Brazil, where we met MercadoLibre's country lead for Brazil as well as competitors and adjacent companies. We came away with greater confidence that the company is investing from a position of strength rather than responding to a weakening franchise.

Outlook We are not perma-bulls on the asset class, but we continue to find exciting opportunities around emerging markets across a range of countries, sectors and industries. In the past, the challenge has been funding these, but the proceeds of the AI capital expenditure cycle are proving a rich pool of capital to reinvest. Covid, the invasion of Ukraine, tariffs and recent events in the Middle East have made security and resilience, in their broadest forms, a much higher priority for many countries. In the first instance, this means higher defence spending, but it also means data and cybersecurity. Going further, there are security aspects to energy, agriculture, trade and logistics. This doesn't mean globalisation is dead, but it does mean that supply chains will be diversified and 'just-in-time' will probably be replaced by 'just-in-case'. Emerging markets can provide the raw materials, products and expertise necessary to help achieve this security. Despite this, a large swathe of investors continues to see emerging markets through a backward-looking lens as no more than a crude beta play on the global economic cycle. Our take is very different from this. We see the asset class as increasingly home to world-class companies that are driving product and service innovation worldwide. From the bottom up, the asset class is still undervalued and from the top down it is still lightly held. At this point, we think the biggest risk for emerging markets investors is not owning enough. Emerging Markets Annual past performance to 30 June each year (%)

2022 2023 2024 2025 2026

Emerging Markets All Cap Composite (gross) -35.4 9.4 15.3 12.7 53.7

Emerging Markets All Cap Composite (net) -35.9 8.6 14.4 11.8 52.5

Emerging Markets Leading Companies Composite (gross) -33.8 9.8 12.2 12.3 55.2

Emerging Markets Leading Companies Composite (net) -34.4 8.9 11.3 11.4 53.9

MSCI Emerging Markets index -25.0 2.2 13.0 16.0 44.2

Annualised returns to 30 June 2026 (%)

1 year 5 years 10 years

Emerging Markets All Cap Composite (gross) 53.7 7.1 13.6

Emerging Markets All Cap Composite (net) 52.5 6.3 12.7

Emerging Markets Leading Companies Composite (gross) 55.2 7.3 13.9

Emerging Markets Leading Companies Composite (net) 53.9 6.4 13.0

MSCI Emerging Market index 44.2 7.7 10.5

Source: Revolution, MSCI. US dollars. Net returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised. Past performance is not a guide to future returns. Legal notice: MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Risk Factors This communication was produced and approved in July 2026 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking. The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions. This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned. All information is sourced from Baillie Gifford & Co and is current unless otherwise stated. The images used in this communication are for illustrative purposes only. Important Information Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs. Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK. Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances. Financial Intermediaries This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

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