

Japan Income Growth Quarterly Update

30 June 2024



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**Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 bailliegifford.com**

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Past performance is not a guide to future returns. Changes in investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. Material market or economic conditions will have an impact on investment results. The returns presented in this document are gross of fees unless otherwise stated and reflect the reinvestment of dividends and interest. Historical performance results for investment indexes and/or categories, generally do not reflect the deduction of transaction costs and/or custodial charges or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that recommendations/ transactions made in the future will be profitable or will equal performance of the securities mentioned.

Potential for Profit and Loss

All investment strategies have the potential for profit and loss.

Stock Examples

Any stock examples, or images, used in this paper are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual examples will represent only a small part of the overall portfolio and are inserted purely to help illustrate our investment style. A full list of portfolio holdings is available on request.

The commentary relates to the above mentioned strategy and not all stocks mentioned may be held in the portfolio.

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Product Overview

Japanese Income growth is a regional equity strategy which aims to invest in attractive growth investments whilst generating an above market yield. We believe the Japanese equity market offers active managers a broad selection of high quality companies capable of delivering attractive and sustainable earnings growth for shareholders. At the same time, improving attitudes towards corporate governance and strong corporate balance sheets should support dividend growth.

Risk Analysis

Key Statistics

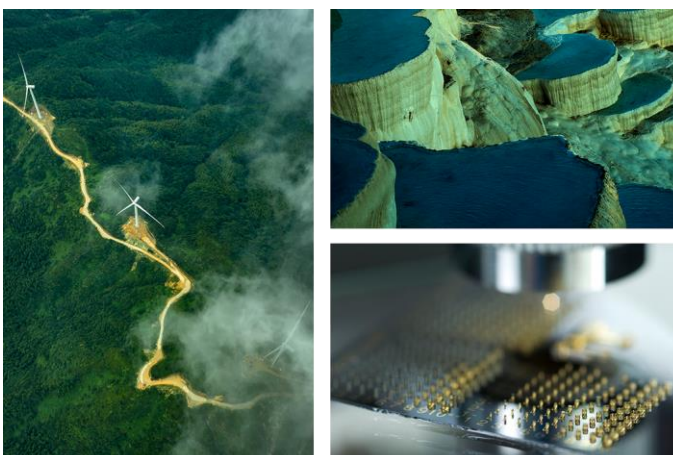
Number of Holdings	56
Typical Number of Holdings	45-65
Active Share	85%*
Annual Turnover	8%

*Relative to TOPIX. Source: Baillie Gifford & Co, Japan Exchange Group.

We appear to be reaching an inflexion point in the market, resulting in outperformance for the portfolio

Operational enhancements are resulting in stronger returns in many overweight internet names, while signs of recovery are emerging in the China-related consumer and capital goods companies

Japan's remarkable renaissance creates a conducive environment for several structural growth themes



Baillie Gifford Key Facts

Assets under management and advice	US\$283.7bn
Number of clients	649
Number of employees	1738
Number of investment professionals	372

A review of recent performance

After a period marked by cyclical expansion, it seems we're at a turning point, with evidence suggesting a diversification of returns beyond traditional sectors like banking, automotive, and resources. This has already resulted in the portfolio outperforming in the most recent quarter. We expect this trend to accelerate, which bodes well for the portfolio which has leant more heavily towards structural growth companies— characterised by enduring secular sources of upside— that have hitherto been ignored by the wider market.

Signs of success within the portfolio are becoming plentiful, particularly in the internet space, where strong operational improvements are starting to manifest in greater share price performance. Rakuten and Softbank - two significant overweight positions- offer obvious examples. Rakuten's entry into the world's most profitable telecoms market (which averages mid-teen operating margins) is beginning to bear fruit. With 7 million (and growing) paying subscribers, or 3% of the market Rakuten is quickly becoming a formidable fourth player, losses have halved and the upside opportunity (of cross-selling other online and fintech services to a growing mobile user base) is becoming increasingly apparent; shares are starting to react having delivered twice that of the broader market so far this year. Rakuten is not the only one getting noticed, with Softbank's shares delivering c.4x the index over the same period. Despite this jump, the share price still lags underlying asset growth; a group market cap of \$92bn is a fraction of its \$147bn stake in ARM alone. Although artificial intelligence ('AI') has become the buzzword of the business world, Masayoshi-Son's visionary ambition, immense capital might, and a unique network of partners (from within the vision fund) make the group a clear and credible forerunner within the field. This has also become central to the company's broader ambition, something which became apparent at the company's Annual General Meeting (AGM) whereby we witnessed Masayoshi extoll the long-term opportunity within artificial super intelligence or 'ASI'.

Another encouraging sign of improvement can be found in the China-related investments, in both consumer and capital goods, which have – up until now - been a source of poor portfolio returns. Recent travel to the country has helped placate our

worries as Donald outlines in his article [China through a Japanese lens](#) the slowdown experienced clearly remains a symptom of temporary factors and not a sign of deteriorating fundamentals. KAO, Japan's version of P&G is one such example. President Yoshihiro Hasabe emphatically explained to us how he intends to double returns by slashing the number of beauty care products in half and focusing only on the high margin range. The company is also flexing its pricing power: in the past 12 months alone prices have risen an average of 13%! This marks a sustainable recalibration for a company that commands dominant market shares within several different product categories. Hasabe-san is not alone. Shiseido president Fujiwara-san was equally energetic in his enthusiasm for how he intends to return the firm to its heyday level of profitability. Reassuringly, they continue to gain market share in the prestige skincare category within China, notably from brands Cle de Peau, NARS, and Drunk Elephant (the latter which was only released in China in April). If spending starts to pick up (of which there is growing evidence: Chinese tourism to Japan is now only 28% below its pre-Covid peak) and price hikes of 3-8% are maintained, the company will be on track to achieve its 9% Operating Profit Margin (OPM) target by next year, and 15% thereafter. These measures will help firm up company financials, placing both businesses in a more propitious position for the longer-term opportunity that exists within Asian premiumisation.

In terms of capital goods, specifically automation and robotic stocks, a downturn in machine orders and inventory overhang have hit sentiment toward the sector. This too is showing signs of change. Fanuc, with its signature yellow robots, has managed to hold on to its leading 24% market share within China (despite aggressive state-subsidising of local competitors). Having spent significant sums investing in capacity and people, operating leverage will likely play a major part in margin expansion once industry spending picks up again. The need for automation hasn't gone away, and we're pleased that Fanuc has continued to invest in anticipation of long-lasting growth.

Contrast these structural growth stories with a market geared towards cyclical expansion. Is the pivot point upon us? Monetary policies may be in reverse, the YEN's descent appears to be slowing, and economic expectations have recalibrated. Without these stimulants, cyclical constituents like

Toyota (which saw 12% margins, its highest since 1986 and well above its 7% average) may find it hard to maintain the same level of momentum. Indeed, Toyota's sharp downward adjustment to guidance could be the latest canary for this cyclical story.

Actions taken

During the quarter, we further reduced our exposure to the auto sector with the complete sale of USS, the largest second-hand car auctioneer with sites across the country. Although the company's business model remains attractive it is becoming increasingly difficult to see strong prospects for further growth from here. USS has already succeeded in dominating the Japanese car auction market, but prospects for long-term domestic volumes are poor. As such we decided to recycle these funds into two companies that present more promising opportunities. These include Eisai and Nippon Paint.

The first is a pioneer in addressing a growing societal problem of age-related diseases. Although we have witnessed a dramatic rise in life expectancy (from 32 in 1900 to 71 today), thanks to declines in mortality rates across all age groups, quality has not kept pace with quantity, as the growth in years free from disease or disability has not risen proportionally. This is becoming a palpable problem for many of us, as we become less removed from someone who suffers from mild cognitive impairment or Alzheimer's, a disease with no known treatment, until now. Eisai's 'Leqembi' is the first FDA-approved treatment that addresses a core cause of the problem, amyloid beta plaque build-up. Slower take-up than ambitiously expected due to a struggling healthcare system, and the black box surrounding the disease has provided us with an attractive entry point to add this opportunity to the portfolio.

Nippon Paint offers a less obvious, but equally attractive upside. Paint is an industry that lends itself to incumbency, thanks to the strength and importance of brand power and local scale. There are also several structural tailwinds at play. China, in which Nippon Point is the leading provider to the DIY market through its subsidiary Nipsea, China has only one-third of decorative paint usage versus developed markets and more wall space than the US, India and Japan combined, presenting a structurally growing opportunity set! The country's

property slowdown has created a unique buying opportunity for what is a high-quality growth company with several avenues for upside sketched out ahead.

What to expect next

Japan now stands on the brink of a remarkable investment renaissance having shed many of the negative connotations attached to its past. The country is no longer simply a place to trade, but a place more conducive to investing. Engagement is rising, returns are improving, and valuations remain attractive.

What does this mean for the portfolio?

The shift in corporate and consumer mindsets, favourable policy developments, and a growing interest from foreign investors have triggered greater market dynamism and fluidity than we've ever witnessed before. But where will the opportunity likely land long-term? Not, we think, in the old-world economy of resources, banking and transportation. Rather we believe it lies in the innovative and sustainable sectors of tomorrow: in digitalisation, automation (where a demographically triggered uptake is taking place), and healthcare (specifically the diagnostics and treatment of ailments related to a globally ageing population). These are just some of the exciting opportunities captured within a portfolio that, combined, is expected to deliver over twice the earnings growth of the market going forward.

To explore these opportunities and more, we would direct you towards the following piece of intellectual capital produced during the quarter:

[Japan: the next opportunity](#)

Performance Objective

1.5%+ gross of fees p.a over 5 years vs index.

The performance objective is aspirational and is not guaranteed. We don't use it to compile the portfolio and returns will vary. A single performance objective may not be appropriate across all vehicles and jurisdictions. We may not meet our investment objectives if, for example, our growth investment style is out of favour, or we misjudge the long-term earnings growth of our holdings.

Periodic Performance

GBP	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-3.1	-4.4	1.3
1 Year	7.4	13.5	-6.1
3 Year	-0.3	5.5	-5.8
5 Year	2.7	6.6	-3.9
Since Inception	6.1	7.0	-0.9
USD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-3.0	-4.3	1.3
1 Year	6.8	12.8	-6.1
3 Year	-3.2	2.4	-5.6
5 Year	2.6	6.5	-3.9
Since Inception	5.4	6.4	-0.9
EUR	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-2.3	-3.6	1.3
1 Year	8.7	14.9	-6.2
3 Year	0.1	5.9	-5.8
5 Year	3.9	7.8	-3.9
Since Inception	6.0	6.9	-0.9
CAD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-1.9	-3.3	1.3
1 Year	10.4	16.7	-6.3
3 Year	0.0	5.9	-5.8
5 Year	3.5	7.5	-3.9
Since Inception	6.1	7.0	-0.9
AUD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-5.3	-6.5	1.3
1 Year	6.4	12.5	-6.1
3 Year	0.6	6.5	-5.9
5 Year	3.6	7.5	-3.9
Since Inception	7.2	8.1	-0.9

Annualised periods ended 30 June 2024. 3 Month & 1 Year figures are not annualised.

Inception date: 31 July 2016

Figures may not sum due to rounding.

Benchmark is TOPIX.

Source: Revolution, Japan Exchange Group.

The Japan Income Growth composite is more concentrated than the TOPIX.

Discrete Performance

GBP	30/06/19- 30/06/20	30/06/20- 30/06/21	30/06/21- 30/06/22	30/06/22- 30/06/23	30/06/23- 30/06/24
Composite Net (%)	1.2	14.3	-11.6	4.3	7.4
Benchmark (%)	6.1	10.7	-8.4	12.9	13.5
USD	30/06/19- 30/06/20	30/06/20- 30/06/21	30/06/21- 30/06/22	30/06/22- 30/06/23	30/06/23- 30/06/24
Composite Net (%)	-1.8	27.8	-22.3	9.2	6.8
Benchmark (%)	3.0	23.8	-19.5	18.1	12.8
EUR	30/06/19- 30/06/20	30/06/20- 30/06/21	30/06/21- 30/06/22	30/06/22- 30/06/23	30/06/23- 30/06/24
Composite Net (%)	-0.4	21.0	-11.8	4.6	8.7
Benchmark (%)	4.4	17.2	-8.6	13.2	14.9
CAD	30/06/19- 30/06/20	30/06/20- 30/06/21	30/06/21- 30/06/22	30/06/22- 30/06/23	30/06/23- 30/06/24
Composite Net (%)	2.4	16.2	-19.0	12.0	10.4
Benchmark (%)	7.3	12.5	-16.1	21.2	16.7
AUD	30/06/19- 30/06/20	30/06/20- 30/06/21	30/06/21- 30/06/22	30/06/22- 30/06/23	30/06/23- 30/06/24
Composite Net (%)	0.1	17.2	-15.2	12.8	6.4
Benchmark (%)	4.9	13.5	-12.1	22.0	12.5

Benchmark is TOPIX.

Source: Revolution, Japan Exchange Group.

The Japan Income Growth composite is more concentrated than the TOPIX.

Stock Level Attribution

Top and Bottom Ten Contributors to Relative Performance

Quarter to 30 June 2024

Stock Name	Contribution (%)
MS&AD Insurance	0.9
Toyota Motor	0.8
Tokio Marine Holdings Inc	0.6
SoftBank Group	0.4
Sumitomo Mitsui Trust	0.3
Tokyo Electron	0.3
NTT	0.2
MIXI	0.2
Kao	0.2
Wacom	0.2
GMO Internet	-0.5
Hitachi	-0.5
Recruit Holdings	-0.3
Infomart	-0.3
Calbee	-0.3
Sumitomo Mitsui Financial Group	-0.3
PARK24	-0.3
Pola Orbis	-0.2
Mitsubishi UFJ Financial Group	-0.2
M3	-0.2

One Year to 30 June 2024

Stock Name	Contribution (%)
MS&AD Insurance	1.9
DMG Mori	1.2
Tokio Marine Holdings Inc	1.0
SBI Holdings	0.8
SoftBank Group	0.6
Sumitomo Mitsui Trust	0.6
Sony	0.4
Daikin Industries	0.4
NTT	0.4
Benefit One	0.4
Pola Orbis	-1.8
Shiseido	-1.1
GMO Internet	-1.1
FANUC	-1.0
Hitachi	-0.9
PARK24	-0.8
Pigeon	-0.7
Milbon	-0.7
Mitsubishi UFJ Financial Group	-0.7
Toyota Motor	-0.6

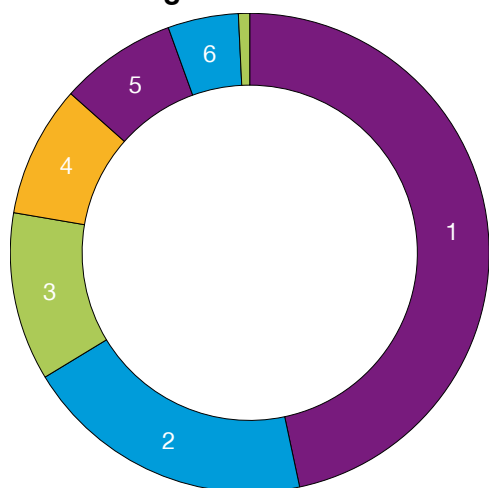
Source: Revolution, Japan Exchange Group. Japan Income Growth composite relative to TOPIX.

The holdings identified do not represent all of the securities purchased, sold or held during the measurement period. Past performance does not guarantee future returns. A full list showing all holdings' contributions to the portfolio's performance and a description on how the attribution is calculated is available on request. Some stocks may not have been held for the whole period. All attribution figures are calculated gross of fees, relative to the index from stock level up, based on closing prices. As attribution is shown relative to the benchmark, not all stocks shown are held in the portfolio.

Top Ten Holdings

Stock Name	Description of Business	% of Portfolio
SoftBank Group	Telecom operator and technology investor	4.7
SBI Holdings	Online financial services	4.5
Tokio Marine Holdings Inc	Offers property and life insurance	4.4
MS&AD Insurance	Japanese insurer	4.4
Sumitomo Mitsui Trust	Japanese trust bank and investment manager	4.3
DMG Mori	Machine tool manufacturer	3.8
GMO Internet	Internet conglomerate	3.4
Nintendo	Gaming consoles & software	2.7
Bridgestone	Tyre manufacturer	2.7
FANUC	Robotics manufacturer	2.6
Total		37.6

Sector Weights



	%
1 Manufacturing	47.4
2 Finance & Insurance	20.0
3 Transport And Communications	11.5
4 Services	9.0
5 Commerce	8.0
6 Real Estate	4.8
7 Cash	-0.8

Figures may not sum due to rounding.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	33	Companies	1	Companies	2
Resolutions	387	Resolutions	1	Resolutions	2

Company Engagement

Engagement Type	Company
Environmental	Bridgestone Corporation, Nintendo Co., Ltd.
Social	Nihon M&A Center Holdings Inc.
Governance	Fanuc Corporation, Kyocera Corporation, MISUMI Group Inc., MS&AD Insurance Group Holdings, Inc., Murata Manufacturing Co., Ltd., Nidec Corporation, Nihon M&A Center Holdings Inc., Nintendo Co., Ltd., SBI Holdings, Inc., Sysmex Corporation
Strategy	Nintendo Co., Ltd.

Company	Engagement Report
Nihon M&A Center Holdings Inc.	<p>Objective: We met with the management team of consultancy Nihon M&A, including President Suguru Miyake, Naoki Takeuchi and members of the IR team. The firm's human capital management and succession planning strategies were two focus areas. This follows recent challenges, underscoring a commitment to bolstering the company's resilience and long-term growth.</p> <p>Discussion: Since 2022, the company has seen a high turnover rate in its consultants. Given the importance of these personnel to the sourcing and dealmaking process, we wanted to increase our understanding of how Nihon M&A was approaching this issue. Miyake san acknowledged past recruitment challenges, attributing them to diverted management focus. In response to these turnover numbers, Nihon M&A is revitalising its hiring approach, reintroducing senior management involvement in final interviews and leveraging referral hiring. The firm aims to onboard a larger cohort of consultants to backfill any potential gaps. It will also focus on hiring recent graduates to support a long-term human capital pipeline. These changes are positive, considering the competitive landscape, with Nihon M&A increasingly vying for talent against large international consulting firms. They demonstrate that Nihon M&A is taking the issue of staff turnover seriously.</p> <p>Efforts are also being made to enhance company culture and retention through qualitative programmes. Miyake San and Takeuchi San have been engaging in informal meetings and dinners with senior consultants to revitalise the company's culture and understand consultants' long-term goals to improve their understanding of the needs and challenges of this cohort.</p> <p>Regarding succession planning, President Miyake, who initiated the process upon turning 70, mentioned that our previous discussions prompted deeper consideration of his successor. He suggested that knowing we would ask about succession had prompted him to inform Takeuchi san of his consideration as a possible future manager of the overall business.</p> <p>Outcome: Our meeting with Nihon M&A offered valuable insights into the company's approach to overcoming human capital challenges and establishing a robust succession plan. It was also positive to hear that previous engagements on succession had been fruitful in materialising change. The strategies discussed provide a positive outlook and provide us with areas to monitor in the future.</p>
Nintendo Co., Ltd.	<p>Objective: We met with gaming company Nintendo's Investor Relations Team to assess Nintendo's climate action, board composition and share incentives approach.</p> <p>Discussion: We started by discussing Nintendo's lack of emissions reduction targets and poor Transition Pathway Initiative (TPI) scoring. This score led to Nintendo's inclusion on investment restriction lists, which harmed the company's access to capital. While no commitment was made to a timeline to set more stringent targets, the company was receptive to our feedback about the potential implications.</p> <p>On governance, IR shared that Nintendo has taken steps to improve the composition of its board to include more independence and diversity of thought. A newly appointed board member appears to have relevant skills in merchandising; however, progress could still be made on the proportion of outside directors to provide effective challenges.</p> <p>Share incentives were also discussed. Stock awards as a percentage of overall pay are low, representing only 3 per cent of total pay. The discussion revealed a cautious approach to stock awards in part due to volatility through gaming console cycles. We fed back the principles underlying our support for share-based incentives, particularly the alignment with shareholders. They said they would take our feedback on board.</p> <p>Outcome: While there are signs of progress on shareholder engagement and board construction, gaps remain in climate action and share incentive alignment. We will continue to monitor Nintendo's progress on these topics.</p>

Voting

Votes Cast in Favour

Companies	Voting Rationale
Calbee Inc, Denso, FANUC, Itochu Corp, Japan Exchange Group, Kakaku.com, Kyocera, Kyoto Financial Group Inc, LY Corp, M3, MS&AD Insurance, Misumi, Mitsui, Mixi Inc, Murata, Nidec, Nihon M&A, Nintendo, Olympus, SBI Holdings, SMC, Sato Holdings, Sawai Group Holdings Co Ltd, Seria Co Ltd, SoftBank Group, Softbank Corp KK, Sugi Holdings, Sumitomo Metal Mining Co Ltd, Sumitomo Mitsui Trust, Sysmex Corp, Tokio Marine Holdings Inc, USS Co, Wacom Co Ltd	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Murata	AGM 27/06/24	2	We opposed the request to make changes to the company's articles of association. One amendment seeks to remove the requirement for shareholder approval of the dividend. We regularly encourage companies to provide a shareholder vote on the dividend as we believe this is a fundamental shareholder right.

Votes Abstained

Companies	Voting Rationale
Calbee Inc, Misumi	We abstained on the low dividend payment as we believe the company's capital strategy is not in the interests of shareholders.

Votes Withheld

We did not withhold on any resolutions during the period.

New Purchases

Stock Name	Transaction Rationale
Eisai	We have decided to take a holding in Eisai, an established Japanese pharmaceuticals company, based on our excitement around its novel Alzheimer's disease treatment. Alzheimer's is a leading cause of death globally (for example, in the UK it accounts for 11.5% deaths annually) but it has proved difficult to develop effective treatment. However, Eisai's drug Leqembi acts to clear amyloid beta plaques in the brain and has been shown to slow progression significantly. It has already been approved by the US FDA. Medicare actuarial estimates have aligned 3.5bn USD to treatment by 2025. As diagnostics improve and healthcare infrastructure ramps up to deliver this treatment we believe Eisai stands to benefit significantly.
Nippon Paint	We have taken a new holding in Nippon Paint, the Japanese paint products manufacturer. The business has robust financial characteristics, local scale, powerful brands and strong pricing power. It is exposed to many growth markets through its subsidiary Nipsea, including China and several other emerging Asian markets. Led by a management team with a strong track record of success, the company has already become the leading paint business in China and here there are opportunities for further market consolidation. Over the long term we have confidence in the growth outlook for Nippon Paint. In the near term, China's property market slowdown and challenging macroeconomic environment have created the opportunity to buy a high-quality growth business at an attractive valuation.

Complete Sales

Stock Name	Transaction Rationale
USS	USS is the largest second-hand car auctioneer with sites across Japan. The company's business model remains attractive but it is increasingly difficult to see strong prospects for further growth from here. USS has already succeeded in dominating the Japanese car auction market, but prospects for long-term domestic volumes are poor. We have therefore decided to reinvest in more attractive opportunities elsewhere.

Holdings Information	Please note the fund portfolio information contained within this report is confidential, proprietary information and should be maintained as such and not disseminated. The content is intended for information purposes only and should not be disclosed to other third parties or used for the purposes of market timing or seeking to gain an unfair advantage
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