

Baillie Gifford™

# Sustainable Income

Philosophy and Process



For professional  
use only.

**Potential for profit and loss**

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk.

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.

<b>Contents</b>	Introduction	02
	Competitive advantages	03
	Range of asset classes	04
	Process	06
	Risk management	10
	Team	11
	Baillie Gifford	13

# Introduction

Our Sustainable Income Strategy is designed to deliver the highest level of income that is resilient and sustainable over the long term. We care about the actual monetary amount of income we deliver, now and for years to come. We do that by focusing on long-term income, not short-term yield. And we seek to protect against the power of inflation over time.

Experience tells us that thoughtful security selection underpins income resilience. When looking for income, we look to the future – which investments are prepared for the challenges of tomorrow, in the market and in our society? This is in our DNA. We are long-term fundamental investors.

A diverse range of asset classes affords us flexibility to adapt to changing economic conditions. By picking the best investments from around the world, across nine different asset classes, we are ideally placed to deliver a lifetime of resilient income.

## **Sustainable Income seeks to deliver:**

- An attractive and resilient monthly income stream
- Preservation of income and capital in real terms over the long run

## **Benefits**

### **Reliable income**

First and foremost, Sustainable Income aims to provide an income which is resilient to shocks. We have a fantastically broad set of income-generating opportunities around the world and across nine asset classes and can deliver an income distribution which is attractive relative to prevailing market yields. Over time we expect the income stream to grow to maintain its real value. Over shorter periods we focus on minimising its volatility, allowing the monthly distribution to be incorporated into individual income requirements.

### **Sustainability**

A careful balance is required between current income and its long-term sustainability. We avoid setting a specific target or chasing a high current yield at the expense of future income. Instead, we aim to deliver the highest level of income we believe is sustainable, while preserving the value of both income and capital in real terms over the long-term. Tomorrow's capital is the engine of tomorrow's income, so the strategy invests in assets which can provide growth as well as income.

An understanding of ESG risks and opportunities is crucial for the long-term sustainability of income and is fully embedded into our investment process.

### **Reduced sequencing risk**

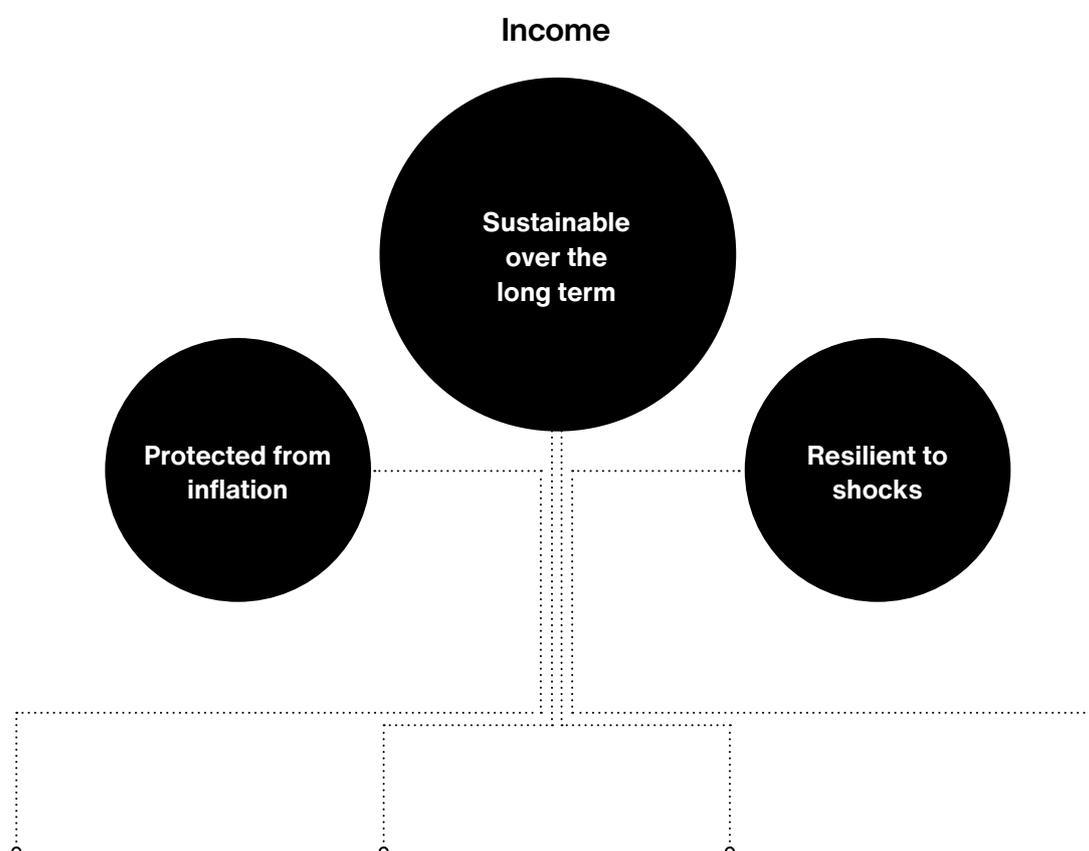
Long-term investment returns are adversely affected when drawdowns (the sale of assets to convert capital to income) are made during periods of poor returns. This is called 'sequencing risk' and the impact of this risk increases with greater volatility of returns. Sustainable Income aims to address this in two ways: first, by providing a high level of natural income to reduce the need to draw on capital; and, second, by investing in a diverse range of assets with distinct characteristics, thereby reducing capital volatility.

### **A core solution**

Thanks to its well-defined purpose and broad investment universe, Sustainable Income offers a one-stop-shop income solution, with clarity on the level of income and growth we expect to deliver over time. Individual needs may require a different overall balance and combining Sustainable Income with other investments can provide flexibility in approach if required.

# Competitive advantages

Our credentials in long-term security selection, multi-asset investment experience, and a singular focus on income mean Baillie Gifford is ideally placed to deliver a lifetime of resilient income.



01

## Focus on income

Designed to find resilient sources of income from a global opportunity set

02

## Asset allocation skill

Strong track record in managing multi-asset strategies, maximising benefits of a broad range of asset classes

03

## Stock picking expertise

Active management is essential to pick the best income payers of tomorrow

04

## Patient investors

Target long-term income, not short-term yield

Considering ESG factors is natural for long-term investors

# Range of asset classes

The Sustainable Income Strategy invests across a broad range of asset classes. We believe the best way to achieve our objective is through active management, utilising a broad opportunity set, with a clear focus on long-term income and capital preservation.

The range of asset classes we typically invest in is shown below:

<b>Equities</b> Income and real growth	<b>Real assets</b> Income enhancement and real capital preservation	<b>Fixed income</b> High income and nominal capital preservation
	<b>Property</b>	<b>High yield</b>
		<b>Investment grade</b>
<b>Global equities</b>	<b>Infrastructure</b>	<b>Emerging market</b> Hard currency
		<b>Emerging market</b> Local currency
	<b>Commodities</b>	<b>Government bonds</b>

**Equities** provide an essential component in any approach which aims to grow income and capital in line with inflation, because they are the primary route for benefiting from economic growth and corporate success. As part of a strategy that has an income focus it is clear that the level and dependability of dividends is important, and so too is the prospect of above inflation dividend growth from the portfolio as a whole. In addition, there may be special situations where the emphasis is on diversification relative to the overall portfolio. It is the real growth from equities which allows the strategy to also invest in other assets that have higher nominal yields but less potential for growth.

**Property** and **Infrastructure** are ideal components for a strategy that aims to provide an attractive income stream which maintains its value in real terms, because they benefit from both a high current income, and contractual or economic protection against inflation. In managing these assets as part of the strategy, it is important that the focus is on income rather than total returns. Where these assets are held through equity vehicles, short-term performance will be influenced by other factors but over the long term it is the performance of the underlying assets which will underpin both income and overall returns.

Under the broad heading of **Fixed income**, there are diverse opportunities for owning assets which provide a high current income, such as high yield or emerging market bonds. We have studied the history of income production across asset classes and noted how different fixed income assets offer excellent diversification benefits which should underpin the resilience of Sustainable Income's distribution. Along with the ability to allocate actively between the wide range of fixed income assets, there are opportunities to further enhance income whilst protecting capital through careful stock selection, sound macro economic judgement and hedging strategies.

This broad range of asset classes provides clear benefits for the strategy. The diverse sources of risk and return improve income resilience, and help lower the overall volatility of returns. Importantly, the broad opportunity set provides wide scope for active asset allocation, ensuring the strategy can take advantage of changes in market conditions.

# Process

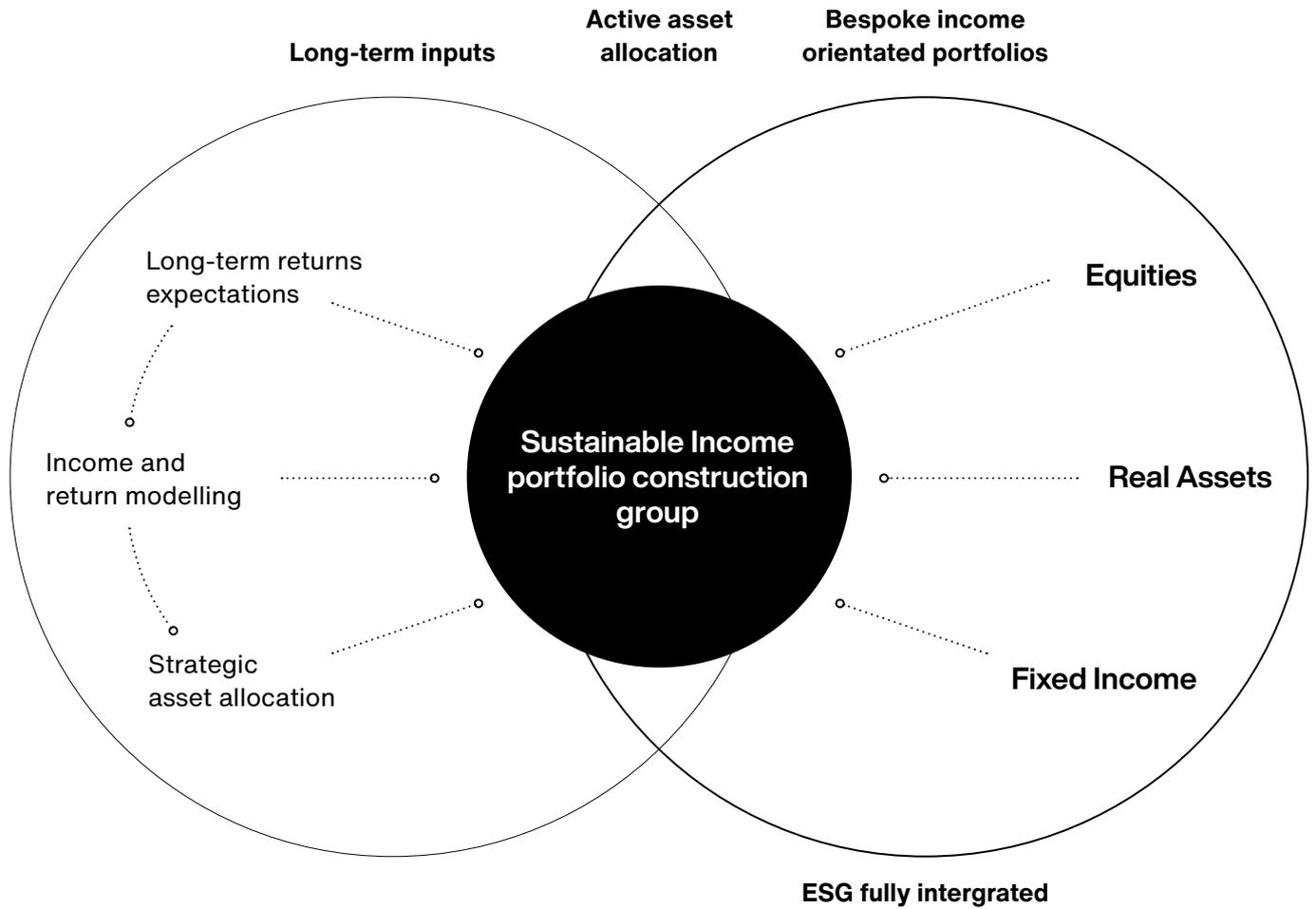
The Sustainable Income Portfolio Construction Group (PCG) sits at the centre of the investment process: it makes asset allocation decisions to deliver on the long-term investment objectives of the strategy.

We analyse long-term income and capital characteristics to design the strategic asset allocation, the anchor for the PCG's asset allocation decisions. In its regular deliberations, the PCG combines macro-economic insight with full visibility of the bespoke portfolios for each asset class, giving it a well-rounded understanding of the income and capital performance potential of each building block.

## Long-term inputs

A number of important inputs to the investment process help inform our short-term decisions by providing long-term context:

- Each year we produce a set of long-term returns expectations, which includes estimates of the prospective returns across the various asset classes we research and invest in. This analysis is built on a number of years of internal research into fundamentals and historic returns, as well as external specialist and academic input.
- We decompose these long-term returns into income and growth components, and use these to carry out income and return modelling for the Sustainable Income portfolio.
- Together these analyses lead us to ascertain the strategic asset allocation that should allow us to meet our objectives over the long term. This is not a strategic benchmark – nor is it static – rather it is a range of asset allocations that are consistent with the long-term objectives of the strategy, and help anchor shorter-term portfolio decisions.



## **Bespoke income oriented portfolios**

Bespoke portfolios in each asset class are constructed specifically to meet the objectives of Sustainable Income, with stock selection delegated to named investment managers or teams. We believe a focus on income is essential in all aspects of portfolio construction, and we benefit from the depth of resource and expertise across Baillie Gifford in selecting individual securities from a global opportunity set. Getting the stock selection right and favouring resilient companies and countries that will not cut dividends or default on coupons is particularly important in limiting the income drawdown in extreme market conditions.

When investing for the long-term, an understanding of ESG risks and opportunities is crucial to every investment case. As such, in all of our bespoke portfolios every new investment idea or current holding is considered from an ESG perspective. We may dismiss new investments and sell out of current positions if we have a fundamental concern.

## **Active asset allocation, portfolio construction and risk management**

The Sustainable Income PCG has full responsibility for all asset allocation decisions in the portfolio, for delegation where appropriate (to specialist teams as described above, for example), and for determining hedging policy.

The PCG formally meets every two months to determine asset allocation, but there is continual review of the portfolio and the team can make decisions at any time. The PCG reviews each asset class on a rolling basis, bringing in specialists from relevant teams where necessary. The close interaction of all our investors at Baillie Gifford enables many further informal discussions to allow the PCG to gain a high degree of insight into the many different factors that influence the investment decisions they make.

In making its decisions, the PCG is at all times wholly aware of the specific securities held in the underlying portfolios in each asset class, assisted by the direct role of the PCG members in managing underlying assets in each area. This ensures that any decisions and relative judgements are based on the characteristics of these underlying portfolios, rather than the broader asset class. In allocating assets we focus on current and future income, and on capital preservation.

While the long-term inputs described above help provide perspective, asset allocation decisions are dynamic – we retain broad latitude to ensure this is the primary tool to manage risks. Risk factors are considered on a holistic basis across the whole portfolio.

We also use simple derivatives to hedge certain risks where it is most efficient or appropriate to do so. For example, our policy is to hedge the majority of foreign currency exposure to sterling using currency forwards. We may also use interest rate derivatives to help protect the fixed income proportion of the portfolio against yield increases, or credit default swaps to offset some element of credit risk borne by corporate bonds.

We will not use derivatives strategies designed to enhance income, such as writing call-options.

## Spotlight on security selection

### Equities

Our specialist Global Income Growth Team invests in companies which can pay dependable dividends across the cycle, and which also have the prospect of real growth in profits, which will in turn lead to growth in dividends and capital over the long term. We also look for special opportunities which bring diversification to the portfolio. Sustainable Income also benefits from the breadth and depth of specialist knowledge in uncovering attractive opportunities for the portfolio.

### Real assets

We typically invest in listed closed-end vehicles, selected by sector research specialists. Naturally these real assets tend to generate attractive levels of income, but we further tailor our selection specifically for the Sustainable Income portfolio and its objectives. While these listed securities can have equity-like characteristics over short periods, in the long-run they possess more bond-like properties with stable cash-flows, and typically with some element of inflation linkage.

### Fixed income

Our Credit and Global Bonds teams focus on selecting individual bonds in focused portfolios, based on in-depth fundamental research. Within high yield, for example, we focus on resilience and diversity – we look for bonds with idiosyncratic risks we believe are well-rewarded through the cycle. Within emerging markets, our fundamental research looks to identify those countries with sustainably high bond yields and those undergoing positive structural changes.

## ESG

It is our firm belief that embedding ESG considerations into our investment process is helpful in achieving our aim of providing good long-term investment performance to our clients. Baillie Gifford has a long history of responsible investing. We have been a signatory of the United Nations Principles for Responsible Investment since 2007, and have always been highly rated.

As long-term investors, we believe our investment approach is naturally well-aligned with ESG considerations, because we aim to consider all factors that are material and relevant to the return potential and risk profile of each investment. We also prioritise effective dialogue with companies on governance and strategic issues, particularly where this has the potential to enhance returns, reduce risk or improve disclosure and reporting.

We have a dedicated ESG function. The Sustainable Income Team, and the other specialist teams which support our Sustainable Income Strategy, work in a collaborative manner with the ESG function who contribute and provide guidance on relevant issues.

As well as working with each investment team to provide support in this area, our ESG function also monitors and conducts related research on the individual companies held in Baillie Gifford portfolios, including those in which our Sustainable Income Strategy invests.

# Risk management

Risk management is an essential element of the Sustainable Income Strategy. As income is the primary objective of the strategy, one of the most important ways of ensuring resilience of income is to avoid over-dependence on any one source. Therefore, we pay particular attention to the short-run volatility of income and this takes precedence over short-term volatility of capital.

## Maximum one year decline in income

Our focus on limiting the volatility of income is primarily expressed in terms of protecting against a material fall. We manage the strategy with the aim of limiting any forecast decline in income to 10% on an annual basis. We regularly measure forecast income levels, and where the projected values show a decline greater than 10% the PCG will take action to adjust the portfolio in order to increase income. However, if we believe this action would likely result in a permanent loss of capital, reducing our ability to make future income distributions, we would allow income to fall further than 10%.

## Diversification guidelines

We manage the strategy with guidelines that limit the proportion of income that can come from any one asset class or security, and ensure the portfolio will always be well-diversified:

- Minimum of five asset classes with at least 5% invested in each of them
- Maximum of 5% forecast income from any one security in a given year
- Maximum 50% forecast income from any one asset class in a given year

## Scenario analysis

Scenario analysis forms a major pillar of our risk assessment process for the strategy. We formally undertake a scenario analysis exercise for the portfolio every six months. This consists of assessing the likely performance of the asset classes in which we invest over the next three years across a range of

core and specific scenarios, as well as the likely short-term performance of the same asset classes in a range of extreme scenarios.

## Risk models

We have a separate independent Investment Risk, Analytics and Research Department, who use risk models to provide a quantitative perspective on the portfolio. This helps inform our understanding of the portfolio and the range of risks it is exposed to. The team monitors realised and expected risk levels within the portfolio on both a daily basis using the APT model, and on a monthly basis using the Moody's Analytics model.

## Peer review

Peer review sees the investors and its investment decisions being constructively challenged by senior colleagues from elsewhere in Baillie Gifford. We think this is a valuable part of our process and helps the team avoid behavioural risks such as over confidence, as well as providing useful input to the generation of investment ideas. The main forum for this peer review are regular meetings with the Multi Asset Review Group and Multi Asset and Fixed Income Risk Committee the Investment Risk, Analytics and Research Department..

## Liquidity

Liquidity is an area of key importance to ensure daily dealing – this is carefully considered and the Sustainable Income PCG abides by the following rules:

- The portfolio must be sufficiently liquid to meet immediate notice redemptions equivalent to 10% of assets, with a mid-bid spread no greater than 2% (in normal market conditions)
- The portfolio typically invests directly in listed securities, but where external open-ended funds are held, no more than 5% of the portfolio is to be invested in monthly dealt funds; no more than 10% may be invested in weekly and monthly dealt funds combined.

# Team

The Sustainable Income Strategy is managed by a highly experienced group of four investors drawn from each of our specialist Equity, Fixed Income and Multi Asset teams. We call this the Portfolio Construction Group (PCG). The members are: James Dow, Head of our Global Income Growth Team; Steven Hay, Head of Income Research; Lesley Dunn, Head of Credit; and Nicoleta Dumitru, an Investment Manager in our Multi Asset Team. The role of chairperson rotates amongst the group in order to keep the debate fresh and avoid behavioural bias.

The PCG works closely with the other investors across our Multi Asset, Global Equity and Fixed Income teams, drawing on their expertise in asset class research, portfolio construction and risk management.

## Sustainable Income portfolio construction group



**James Dow**  
Head of  
Global Income



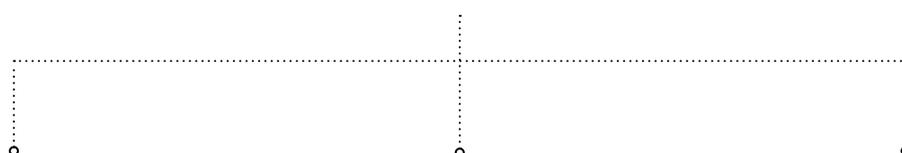
**Nicoleta Dumitru**  
Multi Asset  
Investment Manager



**Lesley Dunn**  
Head of  
Credit Team



**Steven Hay**  
Head of  
Income Research



### Equities

Dedicated Global Income Growth Team and wider Baillie Gifford global and regional equities platform

### Real assets

Multi Asset Team

### Fixed income

Three dedicated teams covering credit, global bonds and Income research




---

**James Dow**

James is head of Global Income Growth and co-manager of the Scottish American Investment Company, as well as a member of the Portfolio Construction Group for the Sustainable Income Strategy. He joined Baillie Gifford in 2004 and became a partner in the firm in 2023. Prior to this he was an investment manager in our US Equities Team. Before joining the firm, he spent three years at The Scotsman, where he was economics editor. James is a CFA Charterholder. He graduated MA (Hons) in Economics and Philosophy from the University of St Andrews in 2000 and MSc in Development Studies from the London School of Economics in 2001.




---

**Nicoleta Dumitru**

Nicoleta is an investment manager in the Multi Asset Team and part of the Sustainable Income and Multi Asset Income Portfolio Construction Group. She joined Baillie Gifford in 2013 after graduating BSc (Hons) in Management and Marketing from the University of Manchester that same year.




---

**Lesley Dunn**

Lesley is head of Credit and co-manager of the Strategic Bond Fund. She is a member of the Multi Asset and Income Leadership Group and the Sustainable Income Portfolio Construction Group. She joined Baillie Gifford in 2016 and became a partner of the firm 2023. Prior to this, Lesley spent 15 years at Scottish Widows Investment Partnership. She graduated BSc (Hons) in Maths, Statistics & Economics from Strathclyde University in 2000 and is a CFA Charterholder.




---

**Steven Hay**

Steven joined Baillie Gifford in 2004 and is Head of the Income Research Team. Prior to joining Baillie Gifford, Steven was a Fixed Income Investment Manager with Scottish Widows. His experience includes seven years undertaking analysis and research for the Bank of England's Monetary Policy Committee, and involvement in managing the UK's foreign exchange reserves. Steven graduated BAcc (Hons) in Economics and Accountancy from the University of Glasgow in 1992 and MSc in Economics from the University of Warwick in 1993.

# Baillie Gifford

## Clients

We are immensely proud of our supportive client base. Without them, our business could not exist.

Our primary goal is to build long-term relationships with aligned, like minded, clients. Our longest client relationship dates back to the early 1900s.

A core principle we have always upheld is prioritising our clients' interests above the firm's. In an industry that often puts financial gain over client outcomes, this focus is crucial. We aspire to be seen as more than merely the 'hired help', and aim to be recognised as a trusted, long-term partner, who can be relied on to give honest and objective advice at all times.

We are research-driven, patient and prepared to stand apart from the crowd. And because we're an independent partnership without outside shareholders, the long-term goals of our clients are genuinely our priority.

## Partnership

Stability matters.

Since its inception in 1908, Baillie Gifford has proudly remained a private partnership. We have no intention of changing this. We have never had a merger or made an acquisition, nor do we seek to in the future. This is a rare level of stability in financial services.

All of our partners work within the firm which provides a unique level of alignment between them as owners, and our clients. This is a key differentiator in comparison to a lot of our peers.

## Focus

We have a clear unity of purpose – excellent long-term investment returns and unparalleled client service. Our interests and long-term objectives are completely aligned with those of our clients.

We are not short-term speculators, rather we deploy client's capital to run truly active portfolios that give exposure to exciting and lasting growth companies. We would argue that it is visionary entrepreneurs and company leaders that generate long-term profits and share price increases, not stock markets or indices.

When active management is done well it can add material value over the long term. We need to be willing to take a differentiated view. This is not easy. It requires dedication, independent thought and a long-term perspective. Our whole firm is built around this, and we will always remain resolutely investment and client outcome driven in our outlook.

## 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.

### Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

### Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 license from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at Suites 2713-2715, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. Telephone +852 3756 5700.

### South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

### Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

### Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a "wholesale client" within the meaning of section 761G of the Corporations Act 2001 (Cth) ("Corporations Act"). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a "retail client" within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

### South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

### North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

### Israel

Baillie Gifford Overseas Limited is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

### Singapore

Baillie Gifford Asia (Singapore) Private Limited is wholly owned by Baillie Gifford Overseas Limited and is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence to conduct fund management activities for institutional investors and accredited investors in Singapore. Baillie Gifford Overseas Limited, as a foreign related corporation of Baillie Gifford Asia (Singapore) Private Limited, has entered into a cross-border business arrangement with Baillie Gifford Asia (Singapore) Private Limited, and shall be relying upon the exemption under regulation 4 of the Securities and Futures (Exemption for Cross-Border Arrangements) (Foreign Related Corporations) Regulations 2021 which enables both Baillie Gifford Overseas Limited and Baillie Gifford Asia (Singapore) Private Limited to market the full range of segregated mandate services to institutional investors and accredited investors in Singapore. The information contained in this communication is meant purely for informational purposes and should not be relied upon as financial advice.

[bailliegifford.com/sustainableincome](https://bailliegifford.com/sustainableincome)

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

Copyright © Baillie Gifford & Co 2023.