

**Baillie Gifford™**

# High Yield Bond Fund

Philosophy and Process



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# Overview

Baillie Gifford's High Yield Bond Fund is a high-conviction high yield bond strategy that invests in European and North American markets.

Our goal is to provide clients with an attractive income and the potential for capital growth by lending to a diverse range of high yield bond issuers.

Our differentiated approach focuses on long-term security selection, centred on a core conviction-based portfolio, with dynamic allocation and risk management.

## Research-driven

We believe the greatest inefficiencies are found at the individual bond level. Through in-depth, forward-looking research we seek to form a differentiated view relative to the market, identifying attractively valued bonds issued by resilient high yield bond issuers.

## High conviction

Our focus on resilience gives us the confidence to invest with patience and conviction as we seek to add value through bond selection. We blend this with our top-down view of the economic environment. Our collaborative approach is designed to identify macroeconomic trends and transitory forces. We then construct a diverse portfolio of 90-120 high yield bond issuers.

## Patient and flexible

While we typically lend to companies for many years, we are sensitive to evolving market conditions, actively managing exposure by credit rating, sector and the balance between core and opportunities holdings to make the best of the prevailing investment environment.

## Fund facts

<b>Inception date</b>	30 November 2001
<b>Investment managers</b>	Arthur Milson and Faisal Islam
<b>Comparator index</b>	IA £ High Yield Bond Sector
<b>Vehicle</b>	UK OEIC

# Why invest in the High Yield Bond Fund?

## Straightforward

### Our patient and flexible approach

Our strategy is aligned with the key sources of return in high yield markets. Income is the most consistent and largest contributor to high yield total returns over the long term. In the short term, market dislocations, including market overreactions, persistently create valuation opportunities that can be exploited by a flexible approach.

We focus our efforts on capturing attractive income in a well-diversified, low-turnover core portfolio and enhancing total returns using a structured approach to adding bonds with higher total return potential when opportunities arise. This provides a platform to consistently add value through bond selection over the course of the credit cycle.

## Consistent

### Investing in resilient bonds since 2001

The philosophy of the High Yield Bond Fund has remained unchanged since its inception in 2001. Our approach is built on a foundation of specialist credit research and a clear focus on adding value by investing with patience and conviction in attractively valued bonds issued by companies that can stand the test of time.

This sounds simple, but the truth is that high yield bond investing is hard. Experience, resource and skill are required to effectively navigate this specialist area of the bond market. Active management is essential, not only to provide an attractive income and the potential for capital growth but to manage the risks inherent in the asset class.

## Repeatable

### A straightforward and robust investment process

Our experienced management team is responsible for bond selection and portfolio construction, drawing on the knowledge and perspectives of our entire investment department. Company research takes place within our specialist credit team. Detailed research notes are produced on all potentially attractive investments and are subject to rigorous debate.

# Philosophy

In the long run, investment outcomes for high yield bond investors are determined by company fundamentals. Over shorter time periods, fickle investor sentiment means that valuations can diverge from reasonable assessments of fundamental value. We believe that active investors with clear and positive selection criteria, strong risk control, and a multi-year investment horizon, can capitalise on these opportunities to generate attractive returns from the high yield market over the cycle.

## **Fundamentals win out over the long term**

Over the long term, a company's fundamental strengths or weaknesses will be reflected in the performance of its bonds. Over the life of a high yield bond, investors will be repaid in most instances, suffer a default on occasion, or sell their holdings at a price reflecting one of those two expected outcomes. Repayment or default will depend on the fundamental performance of each company and is only weakly linked to investor sentiment.

Our in-depth analysis focuses on building a comprehensive understanding of a company's long-term prospects and its underlying fundamental characteristics. We seek to place bonds issued by resilient companies at the core of our high yield portfolios. These provide the bedrock of income generation.

## **Fickle investor sentiment creates opportunity**

Price movements of high yield bonds are more volatile than changes in company fundamentals alone merit. Investors with shorter time horizons or a focus on top-down rather than bottom-up evaluations may trade for reasons and at prices having little connection with a given company's fundamentals. These moments of disconnection create opportunities for active investors.

## **Positive selection, patience and risk control combine to capture reward**

Having the confidence to invest against the crowd requires a clear set of objective criteria against which to evaluate potential investments and a time horizon long enough to allow fundamentals to assert themselves over fluctuating market sentiment. Our credit research expertise, patience and structured approach to portfolio construction provide a strong platform to consistently capitalise on opportunities in the high yield market.

# Process

At the heart of our approach lies in-depth, in-house credit research. We seek to identify potential investments where the bond price has significantly deviated from its analysed fundamental risk.

A detailed understanding of the factors driving the fortunes of the companies in which we invest is, therefore, crucial to our success. We embrace alternative sources of insight, take the time to produce novel research and are not afraid to take a contrarian view.

## Idea generation

Investment managers meet regularly to discuss the market environment, key movers and portfolio construction requirements. The outputs of these discussions, alongside input from other decision-makers on the Credit Team, drive the research agenda.

We use a range of valuation, fundamental and performance screens to ensure credit research is targeted at investments with high potential. These screens are designed to filter the investment universe into attractively valued bonds with resilient fundamental characteristics. They also provide a platform to swiftly identify opportunities created by short-term market dislocations. Those ideas that pass initial screening, are shortlisted for further analysis.

## Credit research

Our credit research framework is designed to develop a clear forward-looking investment recommendation by building a comprehensive picture of a company's fundamentals. We want to lend to resilient companies, those that have strong prospects, appropriate capital structures and are proactively managing material sustainability issues.

- By assessing an issuer's prospects, we seek to explore qualitative fundamental factors such as the sustainability of competitive position, changes in market share and disruption over time, as well as growth drivers and risk factors that may play out beyond the next few quarters.
- Within capital structure, we elevate the importance of cash generation and earnings quality over time as critical drivers of under-appreciated resilience, relative to standard credit metrics such as leverage or interest coverage.
- In terms of sustainability, we believe companies which are effectively managing the impact of their business operations are better placed to adapt to change.

Our focus on resilience provides the common language for our team, which uses a wide range of inputs to inform the overall view – from company meetings and reports to competitor and industry analysis and the work of independent research providers and academic experts.

**Valuation**

Valuation assessment explores the expected return outcomes for the bonds under discussion. In addition to more standard relative value analysis, we seek to explicitly identify bull and bear cases for a proposed investment as well as associated catalysts that would trigger such outcomes. We also consider the expected volatility of a proposed investment. This informs position sizing and how we categorise the return drivers associated with the bonds for the purposes of portfolio construction.

**Debate**

Every new investment we make follows a robust team-wide debate of an analyst's report at our weekly new issue and credit research meetings. The emphasis is on utilising the team's experience to identify areas for more work and explore counterarguments to the investment case. Following debate and completion of any necessary follow-up work, managers express their individual views and discuss the merits of the investment in the context of the overall portfolio. Managers have an equal say in investment decisions. Due to the capped upside of bond returns, if one manager has a strong aversion to the investment case, this will usually result in the bond not being included in the portfolio.

**Coverage**

Every member of the Credit Team is first and foremost an analyst and spends the majority of their time conducting credit research. Research coverage is organised by sector on a global basis.

**Monitoring**

If a material change in resilience assessment or valuation opportunity is identified, analysts are responsible for flagging this on a timely basis to investment managers. This ensures deteriorating credits are quickly identified, discussed and acted upon. Outperforming bonds tracking in line with or exceeding our initial investment thesis are flagged as candidates for sale.



# Portfolio construction

Our approach is characterised by two guiding principles:

1. Over time, income is the most consistent and largest contributor to high yield total returns.
2. Market inefficiencies, including investor overreactions create pricing volatility which can be exploited.

To ensure the portfolio is optimally aligned with these sources of return, we use a core and opportunities framework to provide a structured approach to portfolio construction. We aim to consistently deliver outperformance throughout the credit cycle by capturing attractive income in a well-diversified core portfolio and enhancing returns through the opportunistic purchase of bonds with higher total return potential.

## Core

Through credit analysis, we identify bonds issued by companies that display lower earnings and cash flow volatility compared to equivalent peers. We take high-conviction positions in these bonds to form the core of the portfolio and the bedrock of income generation.

These holdings will typically be long term and low turnover in nature. We anticipate core positions to display lower bond price draw-down during periods of volatility compared to their peers. The composition of the core will include lower-rated bonds issued by robust companies. For example, a bond may have a lower rating reflecting the relatively higher leverage of its issuer. To take a position, our credit research would need to identify under-appreciated resilience that supports the capital structure.

Our in-depth, forward-looking research is designed to provide the confidence to maintain a yield profile in the core that typically exceeds the benchmark for the majority of the credit cycle.

## Opportunities

The higher-turnover, opportunities allocation within the portfolio provides the potential for high total returns through greater income generation and capital upside. It includes thematic and event-driven positions, valuation opportunities resulting from short-term market dislocations and off-benchmark instruments such as Additional Tier 1 bonds and Floating Rate Notes.

Our credit research reports clearly articulate the valuation opportunity and the catalysts for outperformance. This helps ensure a strong sell discipline, either when the upside has played out or if the investment thesis is not progressing as we expect. It also helps minimise downside risk should market conditions change or company fundamentals deteriorate.

This segment of the portfolio is subject to a high degree of monitoring reflecting the sensitivity of the portfolio to shifts in market sentiment and the greater risk/reward potential of these bonds.

## Adapting to market conditions

Allocation decisions are made by the management team based on their assessment of the investment outlook. The team actively manage positioning to control downside factor risk or benefit from favourable market drivers by adjusting the portfolio's ratings profile, sector allocations and the balance between core and opportunities holdings.

The management team's investment outlook is based on an assessment of the macroeconomic outlook, trends in company fundamentals, bond valuations and market technical factors. Their views are informed by structured interactions with our Global Bond Team at quarterly credit macro meetings and weekly portfolio management meetings attended by all of our corporate credit decision makers. This is supplemented, on an ongoing basis, by external strategy and sector outlooks and our monitoring of company reporting and guidance which act as a barometer for the broader market.

# Risk management

Our risk management process is designed to ensure we know the risks we are taking, that we are only taking risks that we choose to, and that we have informed challenge and oversight of our decision making.

There are three pillars to our management of investment risk:

- Knowing our companies well
- External review and challenge
- Clear investment guidelines

## Knowing our companies well

Knowing the risks associated with each investment and how these risks interact with those of other investments within the Fund is our first line of defence. Our initial research is thorough, our debate is rigorous, and we continually review and monitor the investment cases for each company we invest in by monitoring the investment case and valuations on a continuous basis.

## External review and challenge

Peer review sees the team and its investment decisions being constructively challenged by senior colleagues at Baillie Gifford. We think this is a valuable part of our process and helps the team avoid behavioural risks. The main forums for this peer review are quarterly Portfolio Review Meetings and quarterly Portfolio Risk Meetings.

Our independent Investment Risk, Research and Analytics Department uses a range of tools and measures to monitor portfolio style exposures, diversification, tracking error and thematic risks. The Department's formal quarterly independent check provides challenge to the investment managers and is used in internal reporting to the firm's Investment Risk Committees. We can also stress test the strategy using scenario analysis tools such as Bloomberg PORT.

## Clear investment guidelines

We manage the Fund within a range of clear investment guidelines aimed at ensuring sufficient diversification while providing protection against unwanted risks. For example, our guideline on low-quality credits – those rated CCC and below – limits the extent of aggregate credit risk to which clients are exposed, and thereby minimises the scope for overconfidence to produce significant losses.

## Portfolio guidelines

<b>Number of bond issuers (guideline range)</b>	90-120
<b>Maximum investment in an individual company</b>	+3% relative to the reference index, capped at 5% absolute
<b>Exposure to low grade issuers</b>	Maximum +10% relative to reference index in CCC and lower-rated bonds
<b>Exposure to investment grade issuers</b>	Maximum 20%
<b>Guideline tracking error range</b>	0-5%

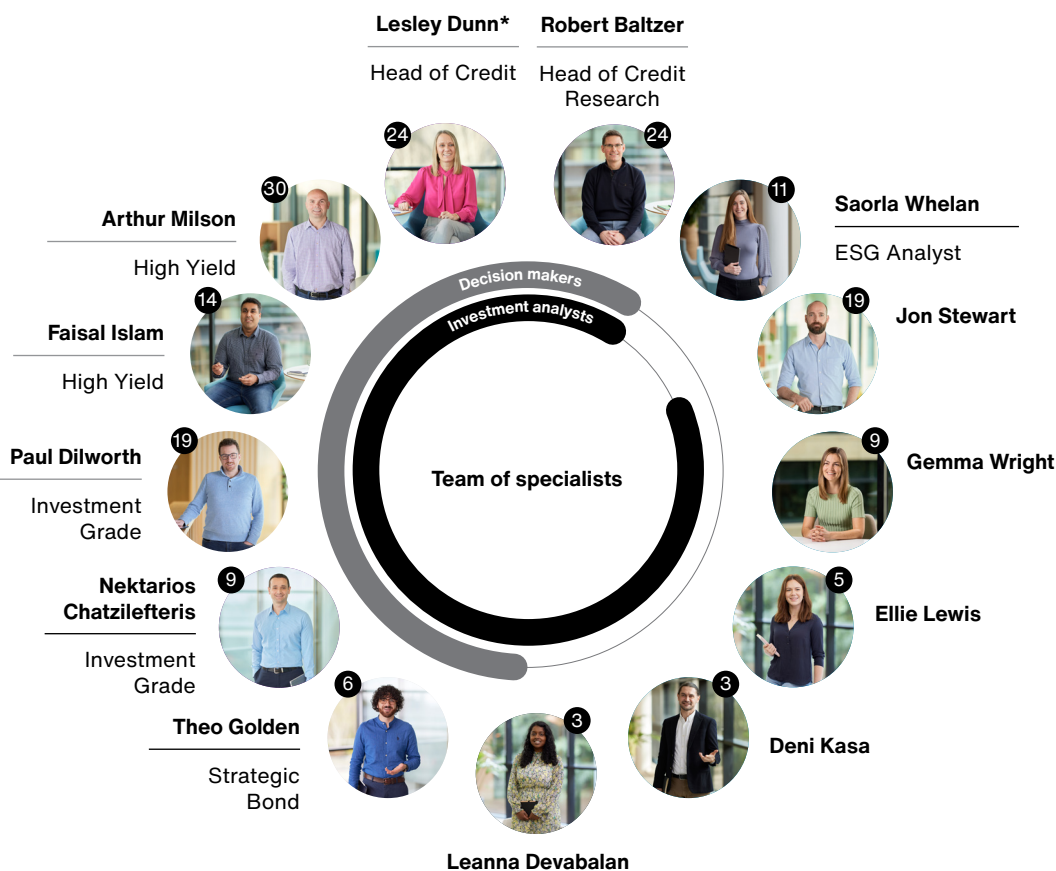
The ICE BofA Global High Yield 50% European-50% North American Constrained Index is used as a reference point for risk monitoring.

# People

Collaboration and focus are key characteristics of our Credit Team. The Team has a diverse range of experience and sector expertise. Each member shares a common enthusiasm for seeking out attractively valued bonds issued by resilient companies. Their close interaction provides a holistic view of the opportunities available across credit markets.

The High Yield Bond Fund has two decision-makers: Arthur Milson and Faisal Islam. In terms of credit research, they are supported by ten analysts and an ESG analyst. In addition, they collaborate closely with specialists in our Global Bond, Dealing and Investment Risk, Analytics and Research teams to gain insights into the investment outlook and portfolio risk.

## Credit Team



### Close collaboration

Global Bond Team providing macroeconomic insights

Dedicated fixed income dealing desk

Independent Investment Risk, Analytics and Research Department

\*Partner.  
Years of experience as at 31 January 2025.

## High Yield decision makers



**Arthur Milson**  
Investment  
Manager

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Arthur is an investment manager in the Credit Team, co-managing our high yield bond strategies. He joined Baillie Gifford in 2022. Prior to joining the firm, Arthur worked for abrdn/Standard Life Investments for 16 years as a European high yield investor. He started his career at KPMG in 1995 and worked in various roles including leveraged finance. Arthur graduated BSc in Biological Sciences from the University of Edinburgh in 1992, has a postgraduate diploma in commerce from the University of Wollongong and is a Chartered Accountant.



**Faisal Islam**  
Investment  
Manager

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Faisal is an investment manager in the Credit Team, co-managing our high yield bond strategies. Before joining Baillie Gifford in 2018, he worked for four years at PwC where he qualified as a chartered accountant in corporate finance, before moving to abrdn in 2016 as a high yield credit analyst. Faisal graduated BSc in Economics from the London School of Economics and Political Science in 2011 and is a CFA Charterholder.

# 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

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