FUND PROFILE

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BAILLIE GIFFORD

MANAGED FUND

April 2024

RSMR RATED FUND

OUR RESEARCH. YOUR SUCCESS

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BAILLIE GIFFORD MANAGED FUND

OUR FUND PROFILES provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

The **Baillie Gifford Managed Fund** has been an RSMR rated fund since August 2014. It is designed as a one stop shop for the best ideas of Baillie Gifford.It combines the stock picking expertise of the regional equity teams with the best ideas in government and corporate bonds along with a tactical allocation to cash.The fund has a high weighting to equities, typically 75%, as Baillie Gifford believe this asset class will be the key driver of returns over the long term.The fund has been through its value assessment review and has passed on all seven of the valuation criteria.

The fund is a practical core holding with a focus on the managers' skill set, using the range of investment research available within the wider Baillie Gifford group. Its approach is different to many peers, and it is backed by a strong investment philosophy that has been proven by the success of the growth orientated equity portfolios managed by Baillie Gifford. The team does not rely on big asset allocation bets but looks to deliver balanced exposure as Baillie Gifford are very aware that investors in this fund do not just want equity exposure.

Graham O'Neill, Senior Investment Consultant, RSMR

Graham began his career in the investment industry over thirty years ago. After graduating from the University of Kent with a Degree in Economic Analysis, History and Policy, he joined London & Manchester, later joining Phillips Drew, then GRE as a UK based fund manager. He then moved to Abbey Life Ireland, where he held the position of CIO running their Managed and large Equity funds. Graham joined RSMR in 2010.

IA MIXED INVESTMENT 40-85% SHARES SECTOR

At the time of writing the IA Mixed Investment 40-85% Shares sector contains 220 funds from 80 different fund providers, thereby providing investors and advisers with a significant number of investment choices.

The IA sector definition allows for a wide variety of investment strategies. There are a small number of stated constraints, which are:

- A maximum of 85% invested in equities, which includes convertibles
- A minimum of 40% in equities, which includes convertibles
- No minimum fixed income or cash requirement
- Minimum 50% invested in established market currencies (US dollar, euro, sterling), of which 25% must be in sterling
- The sterling requirement includes asset hedged back to sterling

This means that investment strategies could range from a 40% equity/60% cash allocation through to an 85% equity/15% other (e.g. commodities)/0% cash allocation, and all connotations in between.

There are a variety of methods which fund managers can use to implement their investment strategies, whether this be through an unfettered multi manager/fund of funds, fettered funds (only invest in internal funds) or a directly invested approach. The use of passive and/or active investment strategies, both in terms of the overall asset allocation and the underlying investments, provides further investment strategy options, plus there are the more standard income and/or capital growth strategies.

All of these points mean that it is important to fully understand a particular fund's aims and objectives, overall investment strategy, investment process, asset class exposure and their parameters etc. before selecting an appropriate fund.

A managed fund of this type invests in a range of assets to achieve a balanced risk and return. In order to manage these assets and understand how they will work together it is important to have an awareness of the global economic picture.

The economic picture is continually changing, and with the Fed now comfortable in loosening some of its financial conditions imposed in 2022/23 the prospect of rate cuts in 2024 have improved, which should present a more favourable backdrop for investors given markets are now pricing in a soft landing for the US. Despite the prospects of lower rates, markets are also expecting healthy profits growth, with consensus estimates for the S&P500 earnings at around +11-12% for 2024.The decline in core inflation should allow the Fed to avoid making policy more restrictive, as it does not want to tighten in real terms which is a generally positive scenario for equities.Elsewhere the language from the ECB has been more cautious around rate cuts and markets have taken the view the Fed may well act before the ECB, although lower rates in Europe look likely before year end.

On the broad geopolitical front, the US election in November 2024 will become a focus of market attention as the year progresses and the highly unusual circumstances surrounding both the Democrat incumbent (age and health) and Republican contender (legal battles) make the consequences impossible to predict with certainty.

Both Ukraine and the Middle East are caught in conflicts with no certainty as to how things will end. In Ukraine, Zelenskyy's domestic popularity has dropped and there have been reports through diplomatic back-channels that Putin is willing to consider a ceasefire. Once again, the US election is likely to be material to the outcomes and solutions to both conflicts.

On balance, markets are likely to continue for now on a relatively optimistic note with investors pricing in a soft landing for the US and the global economy, but for sustained progress throughout the year there will need to be a continued fall in core inflation numbers without a material deterioration in the profits outlook. For longer-term investors the outlook remains reasonably positive as the worst fears for both inflation and interest rates do not look likely to occur.

BAILLIE GIFFORD

Baillie Gifford & Co is an investment management firm regulated by the UK's Financial Conduct Authority (FCA). The company had funds under management and advice of over £225bn as at 31st December 2023, and is headquartered in Edinburgh. It was established in 1908 and is one of the UK's largest independent active investment management firms, employing over 1,830 people across the globe. Baillie Gifford is wholly owned by its 57 partners – all of whom work for the firm full time.

In equities, the investment philosophy focuses on growth over the long term with a view that sustained increases in company profits lead to higher share prices over time. There is a preference for small teams which are more dynamic in nature and have clear accountability. There is also a collaborative culture across the firm where investment ideas are discussed and debated across the investment teams.

BAILLIE GIFFORD MANAGED FUND

Manager	Iain McCombie & Steven Hay
Structure	OEIC
IA Sector	IA Mixed Investment 40-85% Shares Sector
Launched	1st April 1987
Fund Size	£5,709.0m as at 09.04.2024

Fund Management Team

Iain McCombie and Steven Hay have overall responsibility for the management of this fund as its named managers, however stock and bond picking is the responsibility of Baillie Gifford's regional equity teams as well as the Credit and Rates & Currencies teams. It is their enthusiasm and the availability of ideas in their respective opportunity sets that influences the allocations to each asset and sub-asset class. Iain McCombie is more involved within the equity element of the fund and Steven Hay is more involved with the fixed income element whilst also providing macroeconomic input. In terms of the underlying teams, there was a recent change to the manager of the government bond portion. The previous manager, Philip Annen, left Baillie Gifford at the end of September 2023. He has been replaced by Sally Greig, head of Baillie Gifford's Global Bond Team. Sally is responsible for the day-to-day management of the government bond portion alongside her team. Steven Hay remains the lead manager with oversight of fixed income as a whole.

Iain McCombie: Co-Fund Manager

Iain is the co-lead manager on the flagship Managed Fund, a fund he has been involved with for 24 of the fund's 37-year history. Iain is also the lead manager of the UK Core strategy and became a Partner of the firm in 2005. Since joining Baillie Gifford in 1994, he has also spent time in the US Equities Team. Iain graduated with an MA in Accountancy from the University of Aberdeen and subsequently qualified as a Chartered Accountant.

Steven Hay: Co-Fund Manager

Steven is the co-lead Manager on the flagship Managed Fund. He has been involved in running the fixed income portion of the fund since 2012. Steven joined Baillie Gifford in 2004 and is Head of Income Research. 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 with a BAcc (Hons) in Economics and Accountancy from the University of Glasgow in 1992 and an MSc in Economics from the University of Warwick in 1993.

Team Compensation

The partners are the sole owners of the firm and share directly in its profits. In this respect, the compensation and incentive package of senior executives is directly related to both performance and retention of existing clients. Partners' equity ownership is determined by the Joint Managing Partners. Baillie Gifford actively looks to move its most qualified people along the partnership track.

A firm-wide bonus is paid annually. Additionally, all staff receive a bonus through the Long-Term Profit Award scheme, sharing in the firm's long-term performance.

The remuneration for non-partner Investment Managers (Portfolio Managers and Researchers) at Baillie Gifford has three key elements (i) base salary, (ii) an Annual Performance Award and (iii) a Long-Term Profit Award. In addition, portfolio managers are eligible for the standard retirement benefits and health and welfare benefits available to all Baillie Gifford employees.

The Annual Performance Award (APA) for non-partner Investment Managers is determined as follows:

80% of the APA arrangement is determined by the investment performance of the investment team, the Portfolio Construction Groups (PCGs) (or a combination of both) that the individual has been part of over the specified investment time horizon, reflecting Baillie Gifford's emphasis on long-term investing.

Fund Objectives & Targets

The fund's objective is to achieve capital growth over five-year rolling periods – it is not managed against peer group asset allocations. The fund is designed to be a 'one stop shop' for growth orientated investors and reflects the Baillie Gifford belief that equities will deliver the best returns over the long term.

Baillie Gifford look to add value as stock pickers, across both equities and fixed interest, to achieve capital growth over rolling five-year periods. The fund only invests in liquid markets which means that Baillie Gifford can manage the fund with a relatively low investment fee. There is also a firm-wide belief in delivering a good value proposition to clients. Keeping costs low is a key part of this and is seen as the right thing to do. Baillie Gifford believe equities will deliver the best returns over the long term, but they recognise that the volatility from a pure equity portfolio can be too high for some investors and so fixed interest, including government and corporate bonds, emerging market debt, and cash, are used to provide diversification as well as return in the case of fixed interest holdings.

Investment Philosophy

The investment process is to offer a relatively simple product investing in equities, bonds and cash, and since launch has focused on long-term, active, growth investing, thereby providing one-stop access to Baillie Gifford's best regional equity and bond investment ideas.The only change to the process is that in November 2023 it added the commitment to support the goal of net zero greenhouse gas emissions by 2050 or sooner, along with an interim target of 75% of the holdings being net zero aligned by 2030, and the adoption of the UN global compact exclusions.

The Baillie Gifford Managed Fund is designed as a 'one stop shop' for Baillie Gifford's capabilities in regional equities and global bonds, along with a tactical allocation to cash. The fund has a high weighting to equities, typically 75%, as Baillie Gifford believe this asset class will be the key driver of returns over the long term, but there is also a meaningful strategic allocation to the diversifying assets of bonds and cash. The fund is a combination of six autonomously run portfolios with each individual component independently responsible for its own stock and bond selection.These are then brought together along with an allocation to cash with the aim of giving strength through diversity.

Investment Process

In equities, Baillie Gifford are bottom-up growth orientated, long-term investors and equity funds are relatively concentrated and managed with low turnover. There is a reliance on proprietary fundamental research, selecting individually attractive companies rather than taking top-down industry bets. The fixed interest portion of the Managed Fund serves two purposes – the first is to add value and the second to dampen the volatility of the equity exposure. The main sources of added value are likely to be stock selection in corporate bonds, duration, and yield curve positions in government bonds, together with active currency management and asset allocation. The philosophy of long-term growth investing is applied across all Baillie Gifford funds.

For every equity stock under consideration Baillie Gifford analyse three aspects: the opportunity available to the company, its ability to execute on that opportunity, and how the probability of future success is currently valued by the market. In fixed income, government bond positions are driven by an assessment of economic fundamentals and the market environment in a broad range of developed and emerging economies. In corporate bonds the team follows a stock picking approach backed by diligent fundamental analysis.

Each component part of the fund is the responsibility of an individual manager who constructs a portfolio of best ideas from their respective teams. A separate group, the Policy Setting Group, is tasked with whole portfolio oversight and asset allocation. Changes are based on investor enthusiasm for their respective component part rather than top-down considerations, but they do allow the fund to be tilted to favoured regions and asset classes. The fund has been managed in this way since its inception in 1987.

Baillie Gifford believe that in a complex world, the best way to generate long-term returns for clients is to focus on identifying and investing in companies which have the potential to grow at a faster rate and on a more sustainable basis than their peers. Rigorous qualitative research is conducted to establish whether prospective investments have a competitive financial and strategic advantage to deliver on that potential. Investment ideas are discussed and debated across investment teams, the vast majority of which are based at one location in Edinburgh.

Baillie Gifford believe that an investment in equities should be considered over a multi-year period, so the analysis of companies focuses on the long-term opportunities of the business with average holding periods measured in years, not months. This is very much in contrast to many market participants who look no further than the next few quarters. The regional equity and fixed income portfolios express conviction, with the managers seeking to be among the best performers over the long term, rather than avoiding being among the worst performers over short time periods. Equities have an asymmetric return profile so, as long as the top contributors to the fund deliver returns in excess of the largest detractors, there is an acceptance that some investment ideas won't work. Baillie Gifford have capitalised on the fact that the maximum loss in an equity is 100%, but the maximum gain is uncapped.

Within equities there are three broad considerations for each potential investment.

- The opportunity available for that company to grow its earnings and cash flow over the long term. Is there a sizeable long-term opportunity?
- Its ability to execute on that opportunity.
- How the probability of future success is currently valued by the market.

The opportunity will depend on the industry background and competitive advantage of the firm. The industry in which a company operates is analysed, together with how and why that company possesses clear and sustainable competitive advantages. They also consider the likely growth rate of the industry, the structure of pricing, the barriers to entry, the uniqueness or otherwise of the product offering, any enduring cost or technological advantages and the loyalty of customers.

Next, the ability of the company to execute on the opportunity considers financial strength and management. Financial characteristics are studied with a preference for high free cashflow, a well-structured balance sheet and secure access to sources of funding. The ownership structure is reviewed to ensure that minority shareholders will be rewarded if things go well. The abilities and motivations of management teams are considered with a strong emphasis on capital allocation as well as the culture of a business. These factors help assess whether a company is likely to capitalise on its opportunities for profit. Founders, owners and senior management are met both in Baillie Gifford's offices and on location.All investors are first and foremost analysts with the majority of time spent on the generation and research of investment ideas to identify companies with the prospect of superior long-term profit growth. Managers and analysts often undertake extended research trips and also use independent researchers on occasion, where this is deemed to add value.

When a potentially interesting company is identified, valuation is considered. This looks at the likely medium to long-term trends in earnings and cash flows, thinking about valuation in terms of what a company might look like in 5 to 10 years' time. Baillie Gifford look for companies where this long-term view is not reflected in the market's current valuation. This can lead to paying seemingly high near-term multiples when Baillie Gifford is confident the longer-term growth rate will remain high.

There have been a few small changes to the process in recent years, such as the direct investment in fixed income and emerging market equities (previously the fund gained this exposure through pooled funds). The fund has a strategic allocation to equities of 75% with an even balance between the UK, US, Europe, and developed Asia / emerging markets used as a starting point for asset allocation. The other 25% of the neutral position is split between fixed interest (20%) and cash (5%).Whilst asset allocation doesn't move dramatically (guidelines of +/-10% are in place), individual managers are asked whether they are finding net buying or selling ideas. The fund does not take a top-down view, for example that the US market is better than Europe, and so allocations are driven by stock specifics rather than making big macro calls. In summary, this is a bottom-up led fund in terms of allocation, with money channelled towards managers who have more buy ideas.

ESG

Baillie Gifford believe there is strong alignment between good ESG practices and achieving the best investment returns over the long run. They focus on in-house ESG research as they believe that this is where they can add value – by bringing a nuanced understanding of the performance of the companies held from an ESG perspective, and importantly, how they are looking to develop over time and the measures they have in place to achieve this. This is supplemented by an increased level of access to companies that comes with long-term holdings and a reputation as thoughtful, long-term investors that can support a level of engagement that is not possible for external ESG research providers.

Consideration of ESG starts in the research process. In equities, Baillie Gifford recognise that an investment in equities is an investment in a real-world business with unique features and they therefore examine and engage with businesses individually rather than apply screens to the investment process. They believe that a company cannot be financially sustainable in the long term if its approach to business is fundamentally out of line with society's changing expectations. They consider the values and long-term motivations of management as well as corporate culture.

Baillie Gifford seek to apply very similar principles to bond investing. Alongside a company's long-term prospects and capital structure, ESG factors are a key component in assessing a bond issuer's fundamental financial resilience. As well as providing warning signs of upcoming issues, ESG factors may also signal that a company is becoming a more attractive investment. For sovereign bonds, they lend to countries where they expect government spending will improve social and economic outcomes for the whole country. This improvement will in turn help the country service and repay its debt. As such, material ESG risks may deter them from lending to some countries.

The extent to which ESG factors are incorporated into the investment case is based on the materiality of any issue to the long-term sustainability of each company's business.

Once they have invested in a company on behalf of clients, the focus turns to ongoing review, engagement and voting (which is performed in-house). Baillie Gifford believe that they invest in some of the best companies in the world and that as they engage with them, these businesses can only become better. With respect to voting, they will always evaluate proposals on a case-by-case basis, based on what they believe to be in the best long-term interests of clients. Where possible, they vote all of their clients' shares globally and vote against proposals where they feel that these are not in clients' interests. When they do not vote in line with management's recommendation, they endeavour to discuss their concerns and communicate their decision with the company prior to submitting their vote.

The fund is committed to support the goal of net zero greenhouse gas emissions by 2050 or sooner.

Exclusions

The Managed Fund is subject to Baillie Gifford controversial weapons policy. This prohibits investment in controversial weapons such as landmines, cluster munitions, nuclear weapons where such weapons are in breach of the Treaty on the Non Proliferation of Nuclear Weapons, chemical weapons, white phosphorus and depleted uranium ('controversial weapons'). Baillie Gifford is not permitted to invest in companies that produce controversial weapons or in companies providing products or services that are integral to, and tailor-made for, the dissemination or use of controversial weapons.

The fund also adopts Baillie Gifford's policy on the United Nations Global Compact's 10 principles. This involves using of third-party data providers' views as flags for assessing where any breaches may occur. The ultimate decision on whether Baillie Gifford agrees with the third-party rests with the investment teams. If the team agrees a breach has occurred, the holding can be engaged with first, and ultimately sold if progress is not seen within a reasonable timeframe.

Beyond this, the fund is able to invest in any company or industry where the investment team believes it can generate sustainable, long-term growth.

PORTFOLIO CONSTRUCTION/STRATEGY

The Managed Fund is constructed on a bottom-up basis. Positions are not taken to manage exposure against an index, all holdings in the fund are included on merit. Each component part of the fund is the responsibility of an individual manager who works within a regional team. The Policy Setting Group, which comprises senior portfolio managers along with members of the Clients Department, is tasked with whole-portfolio oversight and sets targets for the allocation between equities, bonds and cash. The Managed Fund has scope to move from its strategic benchmark of 75% in equities, 25% in bonds and cash by +/- 10%.

Sales in the fund occur from the mirror image of buy decisions, so if there is a deterioration in the opportunity set for the business, or a belief the company can no longer execute to its potential, a stock will be sold. Therefore, holdings are rarely sold for just one reason, with each investment case being multi-faceted. The fund does not engage in short-term trading driven by moves in share prices. The team rarely makes complete sales on valuation grounds alone, rather, a rise in the valuation might cause them to reduce the size of a holding.

Baillie Gifford do not believe risk and volatility are the same thing. They argue there are limitations to managing volatility in the short term and as active managers they are happy to take risk, if the risk is intended and potentially well rewarded. The first line of defence is rigorous stock analysis. There are some more formal risk controls such as at the asset class level, the strategic allocation can be +/-10%, with the same measure applying at a regional level.For each sector (equities only) there is a maximum of benchmark +10% (no minimum), and for each stock benchmark +3% (excluding funds). The role of the independent Risk Team is to challenge and to help identify unwanted concentrations of risk. Asset allocation proposals are discussed by the Policy Setting Group but are always bottom-up driven rather than the group believing that a certain asset class or geography looks attractive. The team members responsible for equity selection take differing approaches, in that the US team look for a higher 2.5x return over five years for example, whilst the European team are looking for stocks with the potential to double over this period. This results in a mix of growth flavours within the fund. The team monitors positioning versus desired targets on an ongoing basis and may rebalance if a region drifts meaningfully from its target allocation. The fund does not make big asset allocation calls and doesn't automatically rebalance to strategic weightings at the start of the quarter.

The bond part of the portfolio is loosely compared to the aggregate bond index which is 50% developed market sovereign bonds and 50% corporate bonds but with a bias to investment grade. As an internal rule of thumb, the managers seek to ensure the beta of the bonds will not be above 0.25 versus equities. The fixed interest component is looking to provide diversification (not acting as a perfect hedge) versus an actively managed growth equities return stream, although the objective of a positive capital return over five years means, in general, negative yielding bonds have been avoided.

At the time of writing, the fund has 79% in equities, 2% in cash and around 19% in bonds – this is an overweight to equities but some of this had occurred prior to the formal target being increased. The rationale for these weightings is that the asset allocation process is driven by bottom-up ideas and manager enthusiasm and there is now a huge amount of positivity from all of the five regional equity managers which has driven the overall allocation to an equity overweight through four of the regions. The current target for the US element of the portfolio is neutral. This region tends to be higher beta, focused on outlier companies with a higher return target of 2.5x over five years, and the portfolio construction team are careful to manage the impact of risk on the fund. Therefore, while the manager, Kirsty Gibson, is very enthusiastic, the Policy setting Group decided on a neutral weight.

The fund's exposure to China (including Hong Kong) is typically around 3.5% (as at 1st April 2024) or a third of the emerging market portion in which it sits and despite the negative narrative about the country, Baillie Gifford believe there are plenty of interesting investment ideas.There are also risks, not least regulation which can impact businesses, as was seen recently when Tencent was hit by new gaming regulations, but this is primarily a bottom-up driven fund so stock specific issues would be considered on an individual basis.The fund also has exposure to China through stocks listed in developed Asia such as Japanese companies Shiseido in skincare and Nippon Paint. Overall the fund holds around 200 equities and 130 bonds, so there is very little individual stock risk, although the fund is biased towards growth stocks, which is an area of expertise for Baillie Gifford.

Baillie Gifford admit there is a strong style bias in the fund, and this can be detrimental under certain conditions, as was seen in 2022 when very few stocks delivered a positive return, but the team have tried to learn lessons from this difficult year.Although the fund's individual building blocks are managed by different teams the stocks often have similar characteristics, but this can vary regionally, for example, the UK is less of a pure growth market compared to the North American sleeve of the fund. In the UK there is less opportunity for investors to look for outliers and disrupters, in contrast to the US where many of these names go on to be global champions.

In late 2020 and 2021 the North American sleeve of the fund moved away from some well-established names in the technology and ecommerce space, and into some more embryonic disrupters which were effectively longer duration equities, yet to be profitable, which exposed the fund to long duration interest rate risk.Similarly in Europe, the fund had moved away from some well-established B2B names and into longer duration non-profitable technology which again exposed the fund to long duration interest rate risk.There is now greater awareness of the duration of cash flows in the fund and the risk in reducing exposure to steadier profitable cash generative growth names. The European team have tried to review the mistakes of those years by sitting down with the risk team and looking at what can be learnt. The emerging market team are looking at behavioural biases and how they operate, hoping to improve buy and especially sell decisions.

Portfolio Changes

Overall portfolio turnover remains low but volatility in markets can present opportunities.In China, the fund purchased Kweichow Moutai, the premium liquor brand in China, whilst Alibaba was sold in favour of PDD, a new purchase for the fund.Both Alibaba and Li Ning, another name sold, have seen increased levels of competition in their respective markets. The holding in Greggs was added to on investor enthusiasm whilst Meta, which had been sold in 2020, was first repurchased and then added to as the company became more focused on the use of AI. Capital allocation within the business has also improved with a re-focusing after its difficulties with regulators.

Notable sales included UK listed Abcam after a takeover offer and board room splits, whilst Norwegian classified company Adevinta was also subject to an offer and left the fund.In developed Asia, Australian listed Washington H Soul Pattinson was sold on ESG grounds – the company does not fit in with the net zero commitment as it is expanding its thermal coal business.The position in Tesla was reduced to fund new ideas, although Baillie Gifford remain positive on the stock which has far better margins in electric vehicles than Western competitors such as Ford, which actually takes a hit on each EV sale.The position in Tesla was trimmed after a strong performance run, whilst enthusiasm for Adidas waned after a boycott in China and the company finding growth harder to come by.

The fund has exposure to a number of luxury names including Richemont (which owns Cartier) and LVMH, but the former has seen some governance concerns over succession. European online retail business Zalando has struggled post Covid, and competition has increased in the clothing market. DSV was added to as the freight forwarding business, focused on trucks and cargo ships, continues to perform strongly, and international pharmaceutical company Sartorius was added having suffered due to being seen as a pandemic stock.

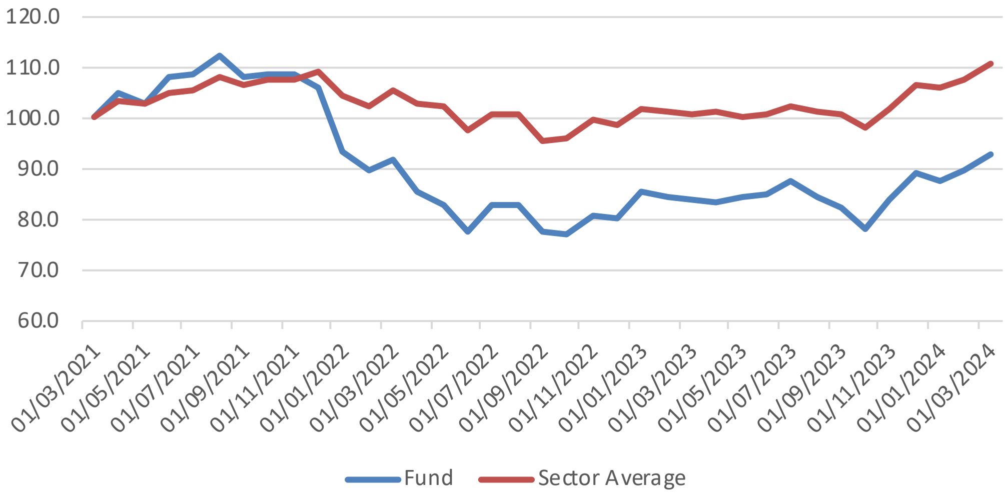
Stocks in China include Meituan, which has detracted as its current focus on high quality super-fast delivery, aimed at the biggest cities, is suffering from higher levels of competition and the squeeze on Chinese consumer spending. PDD, with its discount offering, is gaining market share in a tougher economic environment and is focused on lower Tier cities.The holding in Tencent remains and Baillie Gifford believe the attitude of the gaming regulator has softened towards it – this is the largest holding in a Chinese name, but it is still only a 0.6% holding.

Bond Markets

Baillie Gifford currently prefer equities to bonds and cash, hence the overweight position in equities versus the neutral 75% weight, although as a house they are now more positive on bond markets with the recent rise in yields. Baillie Gifford believe the wider macro environment is broadly positive, with recession risk only at normal long-term average levels of 10-15%. In bonds, there is a preference for some local currency issues as countries in Latin America such as Brazil, Chile and Peru raised rates early providing opportunities for earlier rate cuts. There is also a preference for emerging market over developed market duration.They believe there are some individual opportunities at the stock level in bond markets, such as Pension Insurance Corporation which is BBB and yielding 7%.

PERFORMANCE

Fund vs IA Sector



Data provided by Baillie Gifford, sourced from FE Analytics

The fund has been included in the IA Mixed Investment 40-85% Shares sector since 30th June 2009 and prior to that it was in the Balanced Managed sector. Baillie Gifford have adopted the IA Mixed Investment 40-85% Shares sector average as an appropriate comparator benchmark.

The fund performed strongly in 2023, but the three-year numbers remain behind benchmark/target due to the difficulties in 2022, although five year numbers have now once again improved to be ahead of the comparator benchmark.The fund had delivered very strong returns in 2019 and 2020 but lagged gains in 2021 as there was a rotation in the second half of the year towards value. 2022 was very difficult for the fund as concerns over rising inflation following the Russian invasion of Ukraine hit growth equities hard.In 2023, US technology names exposed to AI performed strongly and the top contributors included NVIDIA, Shopify, Tesla, and Amazon.The team continue to be positive on these stocks, despite the strong gains of last year, as they argue the businesses are leaner and fitter than in the past. The problems the sector encountered in 2022 resulted in companies becoming more focused on delivering profitability and positive cash flow.

Detractors in 2023 were quite mixed, for example First Republic Bank suffered in the US regional bank crisis of March of 2023, and Moderna was viewed as a Covid vaccine company but actually has 47 drugs in development with a number in late stage clinical trials and Baillie Gifford continue to believe there are huge opportunities for its MRNA technology platform. Meituan suffered from weakness in the Chinese economy, especially at the consumer end, and higher levels of competition. First Quantum Minerals (a holding) ran into real issues in a dispute with the Panamanian government over the future of its Cobre mine, which is unlikely to be resolved ahead of elections in April.

Over five years, a number of European food delivery businesses have been notable detractors, namely: Hello Fresh, Delivery Hero, and Just Eat Takeaway.Just Eat was sold in the middle of last year as the management made a number of poor decisions, including the acquisition of Grub Hub in the States.Delivery Hero has had stronger results and benefitted from the sale of its stake in Deliveroo.Results from Hello Fresh have been mixed and the team are becoming less positive on it and may review the holding. Baillie Gifford admit food delivery is a tough market as too much capacity went into the sector in the era of free money, however in the States Door Dash has been a strong contributor for the fund.

During 2023 Shopify benefitted from its increased focus on developing better AI tools to help its business, including back office automation and consumer facing assistants which was a move welcomed by the market.A number of the individual stocks held can be quite volatile on corporate announcements, and earlier in 2023 Adyen suffered a significant drop in its share price after announcing a slowdown in growth in its US business, although the company had stated it was investing for its longer- term future. A recent announcement of new higher revenue growth targets saw the shares immediately bounce 20%.Whilst this is clearly a volatile stock, all the individual position sizes of equities within the fund are small in absolute terms which allows the inclusion of potential outlier businesses as no one stock dominates fund returns.

Baillie Gifford believe the prospects for the fund are positive, backed up by strong fundamentals with three-year forward earnings growth at 9% p.a., well ahead of the benchmark at 3%p.a. and sales growth is forecast at 5% p.a. versus 1% p.a. for the benchmark.Despite this, the holdings in the fund only have half the debt of the benchmark and there is a relatively low valuation premium today for growth, with a forward price to earnings multiple only around 30% higher than the market, having often traded above the 40% level.

The valuation premium in the fund is back to 2018 levels, but back then earnings growth was forecast to be only 10% higher than the market rather than 3x the market level today.

SUMMARY & EVALUATION

The fund's objective is to deliver capital growth over rolling five-year periods. It sits within the IA Mixed Investment 40%-85% Shares sector, although the managers do not tie themselves rigidly to comparing and managing the fund against the peer group. The fund has a low fee structure, provides access to a large team of investment professionals, and is designed to be a 'one stop shop' for investors reflecting the Baillie Gifford belief that equities will deliver the best returns over the long term.

The fund had an extremely difficult time during 2022, as its higher equity weighting versus the sector detracted, compounded by the emphasis on growth (long duration) rather than value stocks. The longer-term record versus the sector remains strong, and the large number of holdings means individual stock specific risk is low, although factor risk (growth bias) is not low. The fund is managed with a strong style bias, which can impact performance over shorter time periods but was positive last year even though some markets, such as Japan, still favoured value names.

Since the Global Financial Crisis, bond exposure has always concentrated on positive yielding debt and so has often favoured credit including emerging market debt. As a long-term holding the fund is an excellent choice, but investors need to be aware that the equity exposure is high versus the IA sector and the fund is stylistically concentrated, favouring long duration equities. For investors with a long time horizon who can tolerate periods of volatility the competitive pricing, the exposure to the best ideas of the regional equity teams and the excellent long term stock picking record of Baillie Gifford make this a strong choice in the sector.

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NOTES

Our Research. Your Success.

Number 20
Ryefield Business Park
Belton Road
Silsden
West Yorkshire
BD20 0EE

Tel: 01535 656 555
Email: enquiries@rsmgroup.co.uk
www.rsmr.co.uk

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