

## Baillie Gifford Japanese Income Growth Fund

31 March 2024

### About Baillie Gifford

<b>Philosophy</b>	Long-term investment horizon A growth bias Bottom-up portfolio construction High active share
<b>Partnership</b>	100% owned by 57 partners with average 21 years' service Ownership aligns our interests with those of our clients Enables us to take a thoughtful, long-term view in all that we do Stability, quality and consistency

### Investment Proposition

The Fund applies the same well-tested growth investing philosophy and process that we use across all of our Japanese investments. For the Japanese Income Growth Fund, we combine this approach with a focus on companies that are improving returns on capital and balance sheet efficiency, to generate a portfolio of growth companies with a yield orientation. In this way we hope to generate strong long-term total returns as well as provide those investors that require it with a higher than market yield along the way. The Fund balances current income generation with growing that income over time, and invests across the market cap spectrum.

### Fund Facts

Fund Launch Date	04 July 2016
Fund Size	£516.9m
IA Sector	Japan
Active Share	86%*
Current Annual Turnover	7%
Current number of stocks	55
Stocks (guideline range)	45-65

\*Relative to TOPIX (in sterling). Source: Baillie Gifford & Co, Japan Exchange Group.

### Fund Manager

Name	Years' Experience
Matt Brett*	21
Karen See	12

\*Partner

## Fund Objective

To outperform (after deduction of costs) the TOPIX, as stated in sterling, by at least 1% per annum over rolling five-year periods through a combination of income and capital growth whilst maintaining a portfolio yield higher than the TOPIX.

The manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund is the Investment Association Japan Sector.

There is no guarantee that this objective will be achieved over any time period and actual investment returns may differ from this objective, particularly over shorter time periods.

## Periodic Performance

	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)
Class B-Inc (%)	7.6	8.9	0.1	4.3
Index (%)*	11.1	21.7	6.8	8.1
Target (%)**	11.3	22.9	7.8	9.2
Sector Average (%)***	9.4	18.2	4.4	7.7

Source: FE, Revolution, Japan Exchange Group. Total return net of charges, in sterling.

Share class returns calculated using 10am prices, while the Index is calculated close-to-close.

Baillie Gifford operates a single swinging price for the Fund and, therefore, may apply a dilution adjustment to the price to protect long-term investors from the costs associated with buying and selling underlying investments that result from other investors joining or leaving the Fund. This adjustment will affect relative performance, either positively or negatively.

\*TOPIX (in sterling).

\*\*TOPIX (in sterling) plus at least 1% per annum over rolling five-year periods (through a combination of income and capital growth).

\*\*\*IA Japan Sector.

## Discrete Performance

	31/03/19- 31/03/20	31/03/20- 31/03/21	31/03/21- 31/03/22	31/03/22- 31/03/23	31/03/23- 31/03/24
Class B-Inc (%)	-9.0	35.4	-6.1	-1.9	8.9
Index (%)*	-2.5	24.8	-2.7	2.8	21.7
Target (%)**	-1.5	26.0	-1.7	3.8	22.9
Sector Average (%)***	-3.4	31.8	-4.4	0.7	18.2

Source: FE, Revolution, Japan Exchange Group. Total return net of charges, in sterling.

Share class returns calculated using 10am prices, while the Index is calculated close-to-close.

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### Market environment

This quarter marks a momentous change for Japan, for it has now escaped from the shackles of the past: Its market has smashed through the “iron coffin lid” of 1989 to post new highs, and its central bank has claimed victory over the country’s multi-decade fight with deflation.

After 35 years of operating within the shadows of the market’s peak performance of 1989, pushing through that glass ceiling will likely send a strong message to foreign and domestic investors that Japan no longer needs to be defined by - or be a product of - its past. This may also help stimulate the same animal spirits that saw Japan emerge as an economic powerhouse during the Meiji Restoration and again in the post-war period when the country grew to account for over 40% of the global developed market index. If stock markets are a leading indicator of an economy, these new highs augur well for what could come next.

This news was soon superseded by another inflexion point when Japan became the world’s last country to end its negative interest rate policy. The final trigger appeared to be unionised wage negotiations, which have resulted in the highest pay packet increase in 33 years of over 5%. A potentially trendsetting level in the world’s only country where wage growth had effectively stopped for 30 years! This was considered a prerequisite to achieving the Bank of Japan’s 2% target of domestic demand-led inflation.

This well-telegraphed move further weakened the YEN (which extended its 7% year-to-date loss against the dollar) and a relative outperformance in cyclical sectors (such as Banks, Oil & Coal, Transportation and Mining) during the quarter.

### Performance

Softbank, DMG Mori and MS&AD Insurance were some of the strongest contributors to performance during the quarter. **Softbank’s** shares have rallied after strong earnings bolstered by gains within the vision funds (from listed and unlisted investments), strong performance from ARM (which has benefited from an increase in AI-enabled smartphone demand) and a windfall from Telecom asset T-Mobile. NAV has since risen dramatically for Softbank, as ARM’s share price doubled in February, leaving Softbank – which retains a 90% stake in the company – trading at a larger discount than before. **DMG Mori**, the world’s largest machine tool maker was also up after releasing strong earnings - making it one of the very few factory automation-related names that continues to grow despite the challenging environment. The main drivers were orders outside of China, especially Europe and the US, where the company has also been successful in raising average sale prices. Finally, insurance giant **MS&AD Insurance** saw its share price jump in reaction to its plans to unwind its substantial equity cross-shareholdings, which amount to roughly 109% NAV.

Detractors to performance include **Infomart**, a leading B2B platform provider for Japan’s labour-intensive hospitality industry, which has fallen despite the absence of negative news. Although the company

suffered during covid, the rebound in the industry has helped highlight the appeal of their labour-saving platform, the company is now signing up over 400 companies per day to its business-to-business platform. **Shiseido**, **Pola Orbis** and **Unicharm** - premium Japanese brands - remain sources of weakness for the fund as Chinese consumption and travel spend remain subdued.

### Notable transactions

During the quarter we initiated two new positions within the fund, in Nakanishi and M3, both of which operate within the healthcare space.

**Nakanishi** is a family/founder-run dental equipment manufacturer that commands high market share in the European and Japanese markets, with growing potential in America. Within dental equipment the company is particularly strong in rotary cutting tools (with rapidly spinning motors which turn faster than the engine of a jumbo jet!) and consumable drill bits, which sit within the premium end of the dental equipment market and generate a company-wide GPM of 65% and OPM of 32%. In the long term, we expect demand for its products to be driven by demographic trends in developed markets and rising standards of living/hygiene regulations in emerging markets. In particular, Nakanishi looks well placed to exploit growth in the Chinese and North American markets where it has recently made acquisitions.

**M3’s** primary service is the delivery of drug information to doctors: pharmaceutical companies spend over Y1 trillion on marketing each year but very little of this is done online, presenting M3 with an enormous opportunity to grow. As this service reaches a larger number of physicians and provides information on more drugs and medical devices, it increases the value to both parties whilst also collecting valuable data, which has enabled entry into adjacent areas such as clinical trial services, specialist job-search and career information. This makes the potential for M3 even greater.

These were funded from marginal reductions in Denso and financials Tokio Marine, Sumitomo Mitsui Trust Holdings and MS&AD Insurance.

### Market Outlook

A reversal in current cyclical drivers could pose a significant problem to large parts of the market, which are priced for a continuation of (what appear to be) peak earnings. Contrast that with structural growth opportunities within automation, the internet, and Asian premiumisation, which now present two appealing characteristics: because they have been overlooked and ignored by the flood of foreign money coming into the country, their growth is no longer priced at a premium; and they are already evidencing strong operational progress which the market can no longer afford to ignore. This bodes particularly well for the performance of this portfolio.

## Stock Level Attribution

### Top and Bottom Ten Contributors to Relative Performance

#### Quarter to 31 March 2024

Stock Name	Contribution (%)
DMG Mori	0.9
MS&AD Insurance	0.8
SoftBank Group	0.5
Sony	0.5
SBI Holdings	0.3
Tokio Marine Holdings Inc	0.3
Japan Exchange Group	0.2
Denso	0.2
Daikin Industries	0.2
Oriental Land Co.	0.2
Toyota Motor	-1.1
Pola Orbis	-0.6
Tokyo Electron	-0.5
Infomart Corp	-0.5
Mitsubishi Corp	-0.5
Unicharm	-0.4
Fanuc	-0.4
Pigeon	-0.4
Shiseido	-0.3
Milbon	-0.3

#### One Year to 31 March 2024

Stock Name	Contribution (%)
MS&AD Insurance	1.2
DMG Mori	1.1
Sony	0.7
Tokio Marine Holdings Inc	0.7
Japan Exchange Group	0.5
Keyence	0.5
SoftBank Group	0.5
Daiichi Sankyo	0.4
SBI Holdings	0.4
Benefit One	0.4
Toyota Motor	-1.7
Shiseido	-1.5
Pola Orbis	-1.4
Fanuc	-1.4
Tokyo Electron	-0.9
Pigeon	-0.9
Unicharm	-0.9
Sumitomo Metal Mining	-0.8
GMO Internet	-0.8
MIXI	-0.7

Source: Revolution, Japan Exchange Group. Baillie Gifford Japanese Income Growth Fund relative to TOPIX (in sterling).

Some stocks may only have been held for part of the period.

All attribution figures are calculated gross of fees, relative to the Index from stock level up, based on closing prices.

As Attribution is shown relative to the benchmark, not all stocks shown are held in the portfolio. See the List of Holdings section of this report for the stocks held.

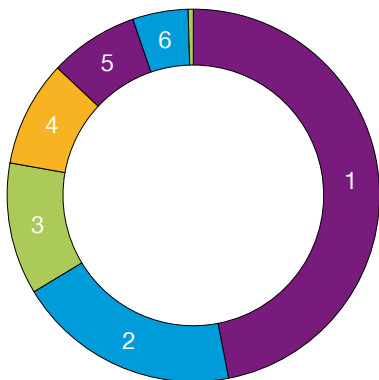
Transactions from 01 January 2024 to 31 March 2024.

### New Purchases

Stock Name	Transaction Rationale
M3	<p>M3 is a medical portal providing information to doctors and other healthcare individuals. Its primary service is the delivery of drug information to doctors: pharmaceutical companies spend over 1 trillion Yen on marketing each year but very little of this is done over the internet, presenting M3 - the world's foremost medical and drug information portal - with an enormous opportunity to grow. As this service reaches a larger number of physicians and provides information on more drugs and medical devices, it increases the value to both parties whilst also collecting valuable data, which has enabled entry into adjacent areas such as clinical trial services, specialist job-search and career information. This makes the potential for M3 even greater. The founder, Itaru Tanimura, continues to run the business and his stake in the company creates valuable alignment. We expect M3 to grow for many years both organically and through acquisition. We decided therefore to take a holding on recent share price weakness.</p>
Nakanishi	<p>Nakanishi is a founder family-run dental equipment manufacturer that commands a high market share in the European and Japanese markets. It is particularly strong in rotary cutting tools and, more broadly, in the premium end of the dental equipment market. Ageing demographic trends in developed economies drive the demand for its products, and there is significant demand growth in emerging economies as standards of living rise and hygiene regulations are tightened. Nakanishi looks particularly well placed to exploit growth in the Chinese and North American markets, where it has recently made acquisitions. Its share price has been weak lately owing to falling profit margins related to these acquisitions, but we believe they will improve the company's technological and distribution capabilities in the future. Therefore, we decided to take a new holding for the portfolio.</p>

There were no complete sales during the period.

## Sector Exposure



		%
1	Manufacturing	47.0
2	Finance & Insurance	19.4
3	Transport And Communications	11.5
4	Services	9.2
5	Commerce	7.7
6	Real Estate	4.8
7	Cash	0.4

As well as cash in the bank, the cash balance includes unsettled cash flows arising from both shareholder flows and outstanding trades. Therefore, a negative balance may arise from timing differences between shareholder flows and security trading, and does not necessarily represent a bank overdraft.

## Top Ten Holdings

Stock Name	Description of Business	% of Portfolio
SBI Holdings	Online financial services	4.5
DMG Mori	Machine tool manufacturer	4.4
SoftBank Group	Telecom operator and technology investor	4.2
MS&AD Insurance	Japanese insurer	4.0
Sumitomo Mitsui Trust	Japanese trust bank and investment manager	3.9
GMO Internet	Internet conglomerate	3.9
Tokio Marine Holdings Inc	Offers property and life insurance	3.6
Bridgestone	Tyre manufacturer	3.0
Calbee	Branded snack foods	2.8
Kubota	Agricultural machinery	2.8
<b>Total</b>		<b>37.0</b>

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	18	Companies	None	Companies	None
Resolutions	188	Resolutions	None	Resolutions	None

We published our Japan Strategy Stewardship Report available on our website

Financial Conduct Authority (FCA) has published its SDR regulation at the end of 2023 which will apply to UK-based investment funds and includes a new fund labelling framework and anti-greenwashing rule

The Environmental, Social and Governance (ESG) Voting analysts are currently analysing the first 'mini' AGM season for companies with December year ends. The 'main' voting season will be later this year in June

Company Engagement

Engagement Type	Company
Environmental	Bridgestone Corporation, Fanuc Corporation
Social	Fanuc Corporation
Governance	COLOPL, Inc., DMG Mori Co., Ltd., Fanuc Corporation, GMO internet group, Inc., Infomart Corporation, Kao Corporation, Kyocera Corporation, MonotaRO Co., Ltd., OSG Corporation, PARK24 Co., Ltd., Pola Orbis Holdings Inc., Systemex Corporation, Tokio Marine Holdings, Inc., Unicharm Corporation, Wacom Co., Ltd.
Strategy	Bridgestone Corporation, Fanuc Corporation, GMO internet group, Inc.

For further details on company engagement please contact us. You can also find further information on how we integrate environmental, social and governance (ESG) matters into our investment approach, [here](#).

Asset Name	Fund %	Asset Name	Fund %
SBI Holdings	4.5	Nidec Corporation	0.7
DMG Mori	4.4	Broadleaf	0.7
SoftBank Group	4.2	MISUMI	0.6
MS&AD Insurance	4.0	LY Corporation	0.6
Sumitomo Mitsui Trust	3.9	Sawai Pharmaceutical	0.6
GMO Internet	3.9	USS	0.3
Tokio Marine Holdings Inc	3.6	Cash	0.4
Bridgestone	3.0	<b>Total</b>	<b>100.0</b>
Calbee	2.8		
Kubota	2.8		
Nintendo	2.8		
FANUC	2.6		
Pola Orbis	2.3		
MIXI	2.1		
Seria	2.0		
DENSO	2.0		
Sumitomo Metal Mining	1.9		
Unicharm	1.8		
Kao	1.8		
PARK24	1.8		
Wacom	1.8		
Shiseido	1.8		
Murata Manufacturing	1.8		
Systemex	1.7		
Japan Exchange Group	1.7		
Rakuten	1.6		
Industrial & Infrastructure Fund	1.6		
Kyoto Financial Group, Inc.	1.6		
Itochu Corp.	1.6		
MonotaRO	1.6		
Olympus	1.5		
Sato Holdings	1.4		
Tokyo Tatemono	1.4		
OSG	1.3		
Kyocera	1.3		
SoftBank Corp	1.3		
Pigeon	1.2		
Infomart	1.2		
Sugi Holdings	1.2		
SMC	1.2		
Kakaku.com	1.1		
CyberAgent	1.1		
Nihon M&A	1.0		
Nippon Electric Glass	1.0		
Milbon	0.9		
COLOPL	0.8		
M3	0.7		
Mitsui	0.7		
Nakanishi	0.7		

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Share Class	Share Class Inception Date	ISIN	SEDOL	Annual Management Fee (%)	Ongoing Charge Figure (%)
Class B-Acc	04 July 2016	GB00BYZJQH88	BYZJQH8	0.60	0.62
Class B-Inc	04 July 2016	GB00BYZJQG71	BYZJQG7	0.60	0.62

The table displays the primary shares classes. Other share classes may be available for those investors who have a separate arrangement. Charges will reduce the value of your investment. Please refer to the Prospectus and Key Investor Information Document for further details. The Ongoing Charges Figure ('OCF') may be lower than previous declarations as a result of a revision to how the indirect fees associated with closed-ended investment companies need to be shown. This does not necessarily mean that fund expenses have gone down rather that we have reverted to how they have been calculated until 30 June 2022 to reflect the revised Investment Association's Guidance on Disclosure of Fund Charges and Costs (July 2020, updated January 2022, revised November 2023). A more detailed Costs and Charges disclosure is available upon request.

TOPIX

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#### **Additional Geographical Location Information**

**Israel:** This Report, as well as investment in the Fund described herein, is directed at and intended for Investors that fall within at least one category in each of: (1) the First Schedule of the Israeli Securities Law, 1968 (“Sophisticated Investors”); and (2) the First Schedule of the Investment Advice Law (“Qualified Clients”).

The Fund’s share price can be volatile due to movements in the prices of the underlying holdings and the basis on which the Fund is priced.

As with any investment, the clients’ capital is at risk. Past performance is not a guide to future returns.

Throughout the report all figures are rounded, so any totals may not sum. Not all stocks mentioned may be held by the portfolio.

All information as at 31 March 2024 and source is Baillie Gifford & Co unless otherwise stated.

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