Baillie Gifford™

Baillie Gifford Strategic Bond Fund

30 September 2024

Baillie Gifford Update

Philosophy	Long-term investment horizon A growth bias Bottom-up portfolio construction High active share
Partnership	100% owned by 58 partners with average 20 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

Performance is driven by bond selection. Ideas are sourced across both investment grade and high yield and are driven by our fundamental, bottom-up stock analysis. The portfolio is well diversified with exposure typically between 60-85 companies. The portfolio could be characterised as comprising the "best ideas" we can find across the high yield and investment grade markets.

Fund Facts

Fund Launch Date	26 February 1999
Fund Size	£402.7m
IA Sector	£ Strategic Bond
Current Number of Issuers	75
Typical Number of Issuers	60-85
Duration	4.8
Average Credit Rating	BBB
Tracking Error	0.9%
Tracking Error Range	1-4%
Redemption Yield	5.7
Running Yield	5.1

Fund Manager

Name	Years' Experience
Lesley Dunn*	23
Robert Baltzer	23

*Partner

Fund Objective

To produce monthly income. Opportunities for capital growth are also sought, subject to prevailing market conditions.

The manager believes that appropriate comparisons for this Fund are the Investment Association Sterling Strategic Bond sector average, given the investment policy of the Fund and the approach taken by the manager when investing and a composite index comprising 70%: ICE BofA Sterling Non-Gilt Index and 30%: ICE BofA European Currency High Yield Constrained Index (hedged to GBP) being representative of the strategic asset allocation of the Fund.

Periodic Performance

	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)
Class B-Inc (%)	3.0	13.0	-1.3	0.5
Index (%)*	2.8	11.1	-1.0	0.5
Sector Average (%)**	3.2	11.8	0.1	1.7

Source: FE, Revolution, ICE Data Indices. 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.
*70% ICE BofA Sterling Non Gilts Index / 30% ICE BofA European Currency High Yield Constrained Index (Hedged to GBP).
**IA £ Strategic Bond Sector.

Discrete Performance

	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Class B-Inc (%)	2.4	4.3	-21.1	7.7	13.0
Index (%)*	2.9	2.8	-20.0	9.1	11.1
Sector Average (%)**	3.6	4.6	-14.5	4.9	11.8

Source: FE, Revolution, ICE Data Indices. Total return net of charges, in sterling.
Share class and Sector returns calculated using 10am prices, while the Index is calculated close-to-close.
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Market environment

With inflation now close to target levels in the developed world, three of the world's major central banks – the US Federal Reserve (the Fed), Bank of England (BoE) and European Central Bank (ECB) – were among those cutting interest rates during the third quarter of 2024. In the US, the Fed's first interest rate cut of the cycle was by half a percentage point, with a softer labour market providing more conviction that policy rates are too high for current levels of inflation. Moving earlier, the BoE was much more tentative as services inflation remained high. In the Eurozone, the ECB also cut by a quarter percentage point in response to signs of slowing growth in the bloc's core economies.

Credit markets performed well over the quarter, responding positively to continued lower inflation and falling interest rates. While growth is slowing, importantly, developed market economies continue to grow. There are signs of deteriorating company fundamentals but weakness starts from a very robust starting point. Overall, these are strong market conditions for corporate credit and, in this context, high yield corporate bonds outperformed their investment grade counterparts.
Valuations, as measured by credit spreads (the additional yield provided by corporate bonds compared to government bonds), remain high relative to the past. 'All-in' yields continued to look attractive as interest rates remained near their highest levels in 15 years. This supported corporate bond returns as evidenced by the high demand for corporate bonds, most visibly in the buoyant new issues market – a further sign of a healthy market.

However, there was a short-lived "rout" in August which provided evidence of the fragility of market sentiment. The perception of a higher risk of recession combined with the unwinding of the yen carry trade (investors had been taking advantage of the significant yield differential between US and Japanese bonds but this began to narrow) led to a selloff in risk markets. While this settled quickly, reflecting the strong market backdrop, it served as a reminder that any economic scenario which does not reflect the market's base case is likely to be met with significant volatility.

Performance

The Fund's total return was positive in the third quarter. This was primarily driven by falling government bond yields (there is an inverse relationship between falling yields and bond prices) and coupon income. The Fund outperformed the comparator index but underperformed the peer group average return. Bond selection was the key performance driver relative to the comparator index with a range of bonds adding value including European Property company CPI and flexible workspace provider, IWG.

It is hard to attribute performance relative to the peer group average return due to the diversity of its constituent strategies. However, given that lower-quality segments of the market performed strongly, it is likely that the average peer held greater credit risk over the quarter.

Relative returns over the last 12 months have been strong with bond selection the key return driver. The Fund's allocation to recovering positions in the property sector and off-benchmark subordinated insurance bonds outperformed as the corporate bond market rallied. Over the last three years, Fund returns have been behind the comparator index. We underestimated the speed and scale of interest rate rises as inflation soared following the pandemic, and this detracted from index-relative performance due to the strategy's exposure to interest rate-sensitive sectors such as real estate.

Positioning

Corporate credit spreads (the risk premium bondholders receive for lending to corporates over governments) ended the quarter broadly where they started it. Despite a 'wobble' in August, the market continues to price in a supportive market backdrop for corporate bonds. Reflecting this, corporate bond spreads remain tight relative to history (there is an inverse relationship between credit spreads and corporate bond prices).

In this context, from an asset allocation perspective, our objective is to find an appropriate balance of risk in the portfolio, recognising the supportive backdrop but the potential, given tight credit spreads, for price volatility. We want the portfolio to be risk-facing overall but insulated from the parts of the market we think are most at risk of a sell-off. Asset allocation remains broadly neutral. High Yield exposure is c. 28% (just below the Fund's typical strategic allocation of 30%), with no exposure to the lowest quality CCC-rated bonds, which we deem too sensitive to high financing costs. We have used credit default swaps to reduce high yield exposure and, therefore, avoid selling out of our best ideas. At the end of the quarter, the Fund continues to outyield its comparator index, offering a gross redemption yield of c. 5.7%. This has been achieved through the Fund's overweight position in BBB-rated investment grade bonds (c. 17% relative to the comparator index). The portfolio continues to hold dry powder in the form of a c. 26% allocation to A-rated and above investment grade bonds, ready to deploy in the event of future volatility.

In terms of bond selection, increased activity in the new issuance market provided a broad range of opportunities to add attractively valued bonds issued by resilient companies. For example, we added bonds issued by TAG Immobilien, a German residential landlord with a smaller development arm in Poland. We believe the market is too focused on recent performance and is therefore underestimating the company's future resilience. Following a challenging period for the sector, this new issue from a conservatively managed business holds the potential to deliver an attractive income for the strategy over the long term. We also identified new opportunities in the secondary market with the potential for capital appreciation. Mobico, formerly National Express Group, is a diversified transportation business operating in Europe, the USA and the UK. Their recent downgrade to high yield has created a valuation opportunity in our view. We believe the market is underestimating the potential for disposals to deleverage the balance sheet and to fund bond buybacks.

Market outlook

The economic outlook is finely poised at this stage. There were various signs of a slowdown in the US economy during the third quarter, including weaker data on labour markets, manufacturing and consumer confidence. Very recently, some of those data points have been subject to positive revisions, and the latest US labour market data showed strong job growth and a decline in the unemployment rate.

Looking ahead, the upcoming US presidential election is considered too close to call, and this could bring market volatility in the very short term. Rising tensions in the Middle East could escalate further still, with spillover effects into the wider global economy, which have been limited thus far. For example, disruption in the oil market could cause inflation to rise from current benign levels.

This presents a challenge for central banks. While interest rates in many countries appear too high today given current growth and inflation rates, policymakers have indicated a wariness of cutting rates too quickly and risking a rebound in inflation. On the other hand, they will be cognisant of the potential for high interest rates to restrict economic growth.

We continue to believe a soft landing is the most likely outcome. In addition, company fundamentals remain broadly resilient although pockets of deterioration are emerging in some cyclical sectors as higher financing costs start to impact demand. There is no sign that the market's insatiable hunger for corporate bonds is likely to deteriorate in the short term. However, valuations remain high and, as recent events have shown, sentiment is fragile leaving the market vulnerable to bad news.

Distribution of Portfolio by Asset Class

	Fund Weight*(%)
Sterling	
Conventional Sovereign	1.6
Conventional Non Sovereign	59.5
Index Linked	0.0
Total Sterling	61.2
Cash & Derivatives	
Total Cash & Derivatives	6.7
Foreign Currency	
Conventional Sovereign	0.0
Conventional Non Sovereign	32.1
Index Linked	0.0
Total Foreign Currency	32.1

*Shows exposure to bonds in the currency before any hedging is applied

Distribution of Portfolio by Industry

	Fund Weight (%)
Financial Services	12.7
Banking	12.7
Real Estate	12.0
Insurance	12.0
Retail	6.8
Telecommunications	5.2
Commercial Mortgage Backed	4.0
Asset Backed	4.0
Agency	2.9
Services	2.7
Media	2.6
Health Care	2.3
Capital Goods	2.2
Basic Industry	2.2
Technology & Electronics	2.1
Others	6.6
Cash & Derivatives	6.7

Distribution of Portfolio by Credit Rating Band

	Fund Weight (%)
AAA	6.8
AA	2.7
A*	13.4
BBB*	42.4
BB*	17.5
B	10.5
CCC-D*	0.0
Cash & Derivatives	6.7

*Includes BG internally-rated bonds where there is no official rating.

Top Ten Issuers

	Fund Weight (%)
Barclays	3.3
Rothesay Life Plc	3.1
Annington Finance	3.1
Telereal Securitisation PLC	3.0
Investec Plc	2.9
DNB Bank ASA	2.6
Bharti Televentures	2.3
Banco Santander	2.2
CPI Property Group	2.1
Berkeley Group	2.0

Distribution of Portfolio by Region

	Fund Weight (%)
United Kingdom	43.9
Europe	22.0
North America	13.3
Emerging Markets	8.1
Developed Asia	4.0
Supranational	1.9
Cash & Derivatives	6.7

Company Engagement

Engagement Type	Company
Governance	B&M European Value Retail S.A., Burberry Group plc, The Weir Group PLC

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 %
Sterling Bonds	
Conventional Sovereign	
Long Gilt Future 10yr Dec 24	-0.01
UK Treasury 4.25% 07/12/2046	1.63
Total Conventional Sovereign	1.62
Conventional Non Sovereign	
Abrdn 5.25% 2026 Perp AT1	0.90
Admiral Group 8.5% 2034 T2	1.02
Annington Funding 2.308% 2032	1.80
Annington Funding 2.924% 2051	0.73
Annington Funding 3.935% 2047	0.59
B&M European Value Retail 8.125% 2030	1.45
Banco Santander 1.5% 2026	2.21
Barclays 1.7% 2025/26	1.17
Barclays 7.125% 2025 Perp AT1	2.19
Berkeley Group 2.5% 2031	1.99
Blackstone Private Credit 4.875% 2026	1.59
Burberry 1.125% 2025	1.08
CaixaBank 6.875% 2028/33 T2	1.52
Canada Pension Plan 1.25% 2027	1.47
CK Hutchison Telecom 2.625% 2034	1.55
Delamare 5.5457% 2029	1.00
DNB Bank 4% 2026/27	2.65
EDF 6% 2114	0.38
EDF 7.375% 2035 Perp	1.57
EIB 4.625% 2054	1.65
IBRD 5.75% 2032	0.28
Investec 10.5% 2030 Perp AT1	0.63
Investec 2.625% 2026/32 T2	2.25
J.P. Morgan 1.895% 2033	1.92
KFW 5% 2036	0.21
KFW 5.75% 2032	1.76
Kier Group 9% 2029	0.84
Legal & General 5.625% 2031 Perp RT1	1.42
Mitchells & Butlers 5.574% 2030 (A2)	0.16
Mitchells & Butlers 6.469% 2030 (C1)	0.48
Mitchells & Butlers FRN (AB) 2033	1.16
Mobico Group 2.375% 2028	0.51
Pension Insurance 5.625% 2030 T2	0.45
Pension Insurance Corp 8% 2033 T2	1.32
Pinewood 6% 2030	0.86
Pinewood Gp 3.625% 2027	0.43

Asset Name	Fund %
Rothesay Life 8% 2025	3.12
Schroders 6.346% 2029/34 T2	1.74
Telefonica 5.375% 2026	0.47
Telereal 6.1645% 2031 (B4)	0.99
Telereal FRN 2031 (C1)	2.03
TP ICAP Gp 2.625% 2028	0.16
TP ICAP Gp 7.875% 2030	0.75
University of Oxford 2.544% 2117	1.08
Weir Group 6.875% 2028	1.13
Welsh Water 2.375% 2034	0.42
WH Smith 1.625% 2026 Convertible	1.10
Yorkshire Water 6.375% 2034	1.79
Zurich Financial Services 5.125% 2032/52 T2	1.58
Total Conventional Non Sovereign	59.55
Total Sterling Bonds	61.17
Foreign Currency Bonds	
Conventional Sovereign	
Euro-Bobl Future Dec 24	0.00
Euro-Bund Future Dec 24	-0.01
Euro-Schatz Future Dec 24	0.00
US Ultra 10yr Note Future Dec 24	0.03
Total Conventional Sovereign	0.03
Conventional Non Sovereign	
Accor SA 7.25% 2029 Perp	0.50
Bath & Body Works 9.375% 2025 (144A)	0.87
BestSecret E+3.75% FRN 2029	1.08
Bharti Airtel 5.65% 2025 Perp	2.33
Brightline East 11% 2030 (144A)	0.97
Burford Capital 9.25% 2031 (144A)	1.04
CDIB ITRX Crossover GOS	-4.18
Cirsa Finance 10.375% 2027	0.83
Concentrix 6.65% 2026	0.84
CPI Property 1.5% 2031	2.17
Ctp N.V. 4.75% 2030	0.55
Goodman Group 4.25% 2030	0.23
Heimstaden Bostad 0.25% 2024	0.53
Helvetia 2.75% 2031/41 T2	1.93
IMA E+3.75% FRN 2029	1.12
Infopro Digital 8% 2028	1.29
International Personal Finance 10.75% 2029	0.52
International Workplace Group 6.5% 2030	1.64

Asset Name	Fund %
Intesa 3.75% 2025 Perp AT1	1.06
Jefferies Finance Group 5% 2028 (144A)	0.63
Kiko Milano 4.125% FRN 2031	0.31
La Doria E+4.5% 2029 FRN	0.21
Mineral Resources 9.25% 2028 (144A)	0.79
Motability 4% 2030	1.65
Motel One 7.75% 2031	0.52
Neopharmed 7.125% 2030	0.70
OCI 6.7% 2033 (144A)	0.58
Pershing Square 3.25% 2031 (RegS)	0.35
Pershing Square Holdings 3.25% 2030	1.43
Phoenix Life 5.625% 2025 Perp RT1	0.23
Realty Income 5.125% 2034	1.89
Sitios Latinoamerica 5.375% 2032	0.82
Sunrise Medical 6.5% 2031	1.09
TAG Immobilien 4.25% 2030	1.52
Temasek 0.5% 2031	0.73
Temasek 3.5% 2033	0.74
Teva 7.875% Pharma 2031	0.55
Townsquare Media 6.875% 2026 (144A)	1.29
Virgolino De Oliveira 11.75% 2022	0.01
Walgreen Co 8.125% 2029	0.75
Total Conventional Non Sovereign	32.13
Total Foreign Currency Bonds	32.16

Cash & Derivatives	
Forwards	
EUR Fwd Asset 21-Nov-2024 S	-22.94
GBP Fwd Asset 21-Nov-2024 P	36.78
USD Fwd Asset 21-Nov-2024 S	-13.20
Total Forwards	0.65

Swaps	
CDIB ITRX Crossover GOS	3.82
IRS GBP PAY FLT 26/07/29	-6.07
IRS GBP PAY FLT 26/07/42	-1.67
IRS GBP REC FIX 26/07/29	6.12
IRS GBP REC FIX 26/07/42	1.70
Total Swaps	3.90

Cash	
Collateral Account Memo	-0.22
EUR Futures Initial Margin Account	0.10

Asset Name	Fund %
GBP BNY Revenue Uncommitted Cash	-1.06
GBP CCP Initial Margin	0.47
GBP CCP Variation Margin	-0.08
GBP Futures Initial Margin Account	0.25
GBP Uncommitted Cash	2.52
USD Futures Initial Margin Account	0.14
Total Cash	2.13
Total Cash & Derivatives	6.67
Total	100.00

Share Class	Share Class Inception Date	ISIN	SEDOL	Annual Management Fee (%)	Ongoing Charge Figure (%)	Distribution Yield (%)	Underlying Yield (%)
Class B-Inc	26 February 1999	GB0005947741	0594774	0.50	0.54	5.30	4.70
Class B-Acc	21 June 2000	GB0005947857	0594785	0.50	0.54	5.30	4.70

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.

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