

Baillie Gifford™

# Monthly Income

Philosophy and Process



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# Introduction

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

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

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

## **Monthly Income seeks to deliver:**

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

## **Benefits**

### **Reliable income**

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

## **Sustainability**

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

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

## **Reduced sequencing risk**

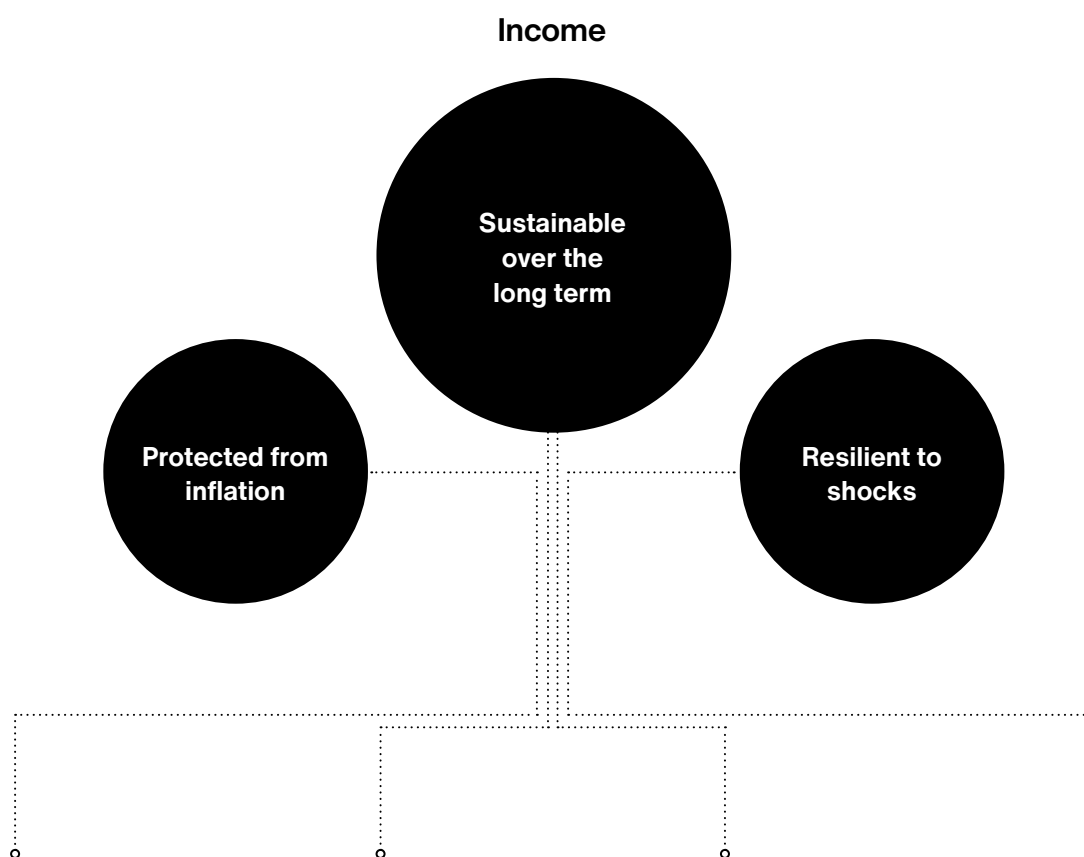
Long-term investment returns are adversely affected when drawdowns (the sale of assets to convert capital to income) are made during periods of poor returns. This is called 'sequencing risk' and the impact of this risk increases with greater volatility of returns. Monthly Income aims to address this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

## **A core solution**

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

# Competitive advantages

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



01

**Focus on income**

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

02

**Asset allocation skill**

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

03

**Stock picking expertise**

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

04

**Patient investors**

Target long-term income, not short-term yield

Considering ESG factors is natural for long-term investors

# Range of asset classes

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

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

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

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

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

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

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

# Process

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

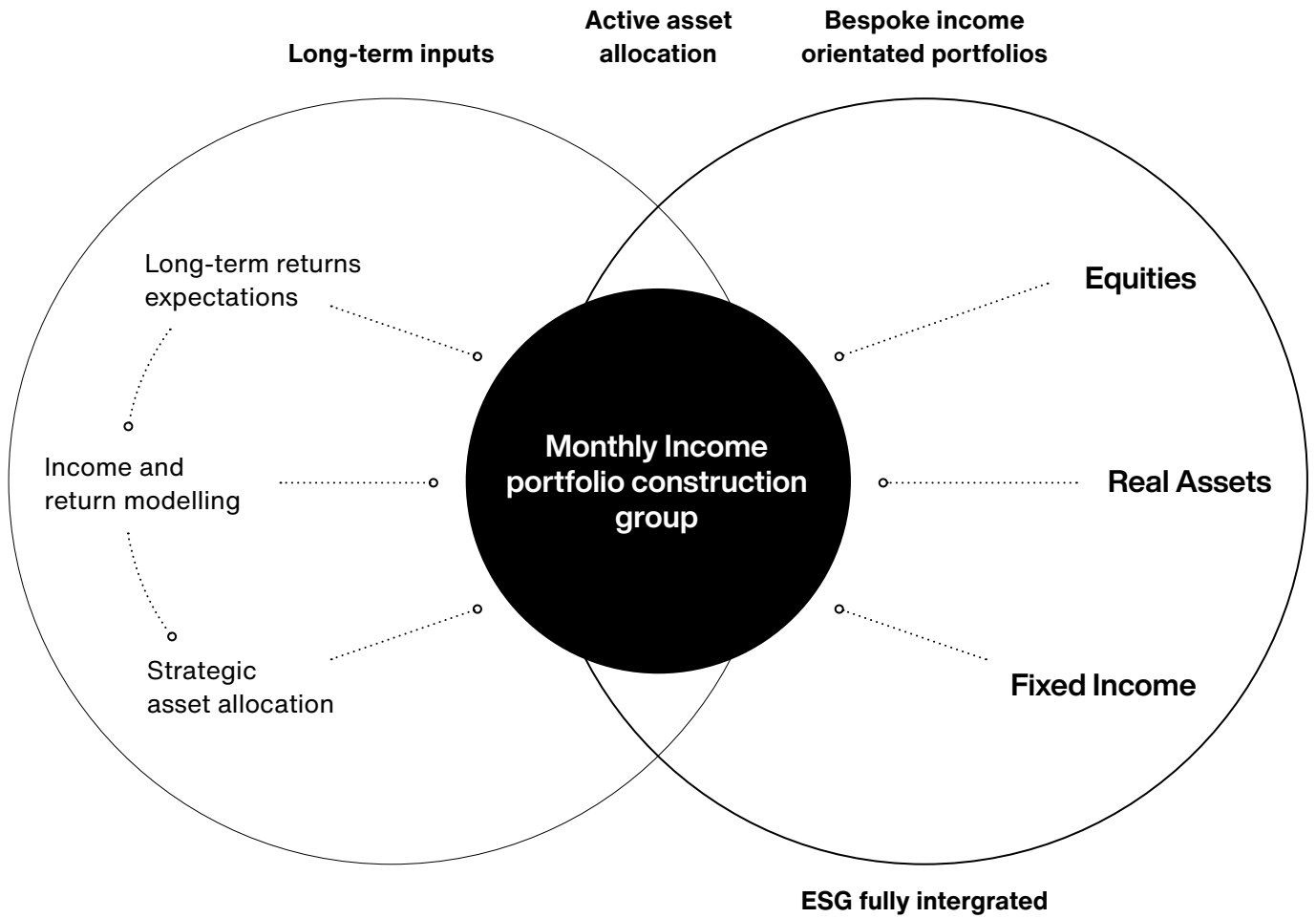
We analyse long-term income and capital characteristics to design the strategic asset allocation, the anchor for the PCG's asset allocation decisions. In its regular deliberations, the PCG combines macro-economic insight with full visibility of the bespoke portfolios for each asset class, giving it a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

## Long-term inputs

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

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





## **Bespoke income oriented portfolios**

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

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

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

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

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

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

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

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

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

## Spotlight on security selection

### Equities

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

### Real assets

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

### Fixed income

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

## ESG

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

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

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

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

# Risk management

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

## Maximum one year decline in income

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

## Diversification guidelines

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

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

## Scenario analysis

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

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

## Risk models

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

## Peer review

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

## Liquidity

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

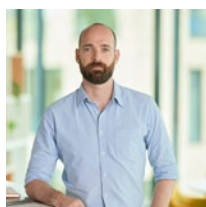
- The portfolio must be sufficiently liquid to meet immediate notice redemptions equivalent to 10% of assets, with a mid-bid spread no greater than 2% (in normal market conditions)
- The portfolio typically invests directly in listed securities, but where external open-ended funds are held, no more than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

# Team

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

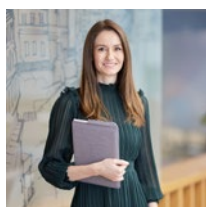
The PCG works closely with the other investors across our Multi Asset, Global Equity and Fixed Income teams, drawing on their expertise in asset class research, portfolio construction and risk management.

## Monthly Income portfolio construction group



**Jon Stewart**

Income Investment Manager



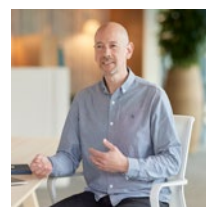
**Nicoleta Dumitru**

Multi Asset Investment Manager



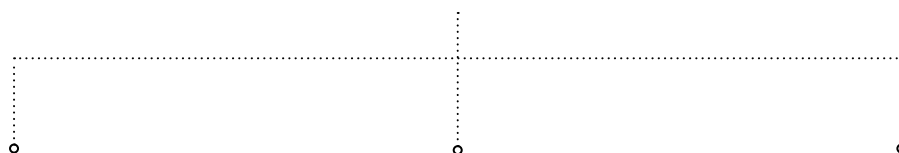
**Lesley Dunn**

Head of Credit Team



**Steven Hay**

Head of Income Research



### Equities

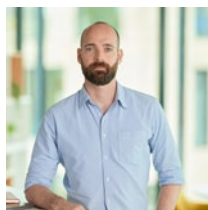
Dedicated Global Income Growth Team and wider Baillie Gifford global and regional equities platform

### Real assets

Multi Asset Team

### Fixed income

Three dedicated teams covering credit, global bonds and income research

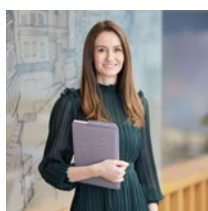



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**Jon Stewart**


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Jon is an investment manager within the Income Research Team specialising in listed property securities, as well as a member of the Portfolio Construction Group for the Monthly Income Strategy. He joined Baillie Gifford in 2020 from Standard Life Aberdeen where he was part of the Real Estate Equities Team managing a number of UK, European and global real estate equity mandates. Prior to that, Jon spent four years as a sell-side analyst specialising in real estate equities, having begun his career on the UK Equity Team at Ignis Asset Management. Jon is a CFA Charterholder and graduated with an MPhys (Hons) in Physics and Photonics from the University of St Andrews in 2006.




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**Nicoleta Dumitru**


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

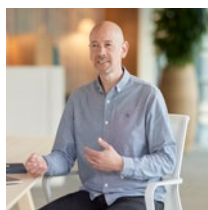



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**Lesley Dunn**


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




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**Steven Hay**


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

# Baillie Gifford

## Clients

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

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

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

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

## Partnership

Stability matters.

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

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

## Focus

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

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

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

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