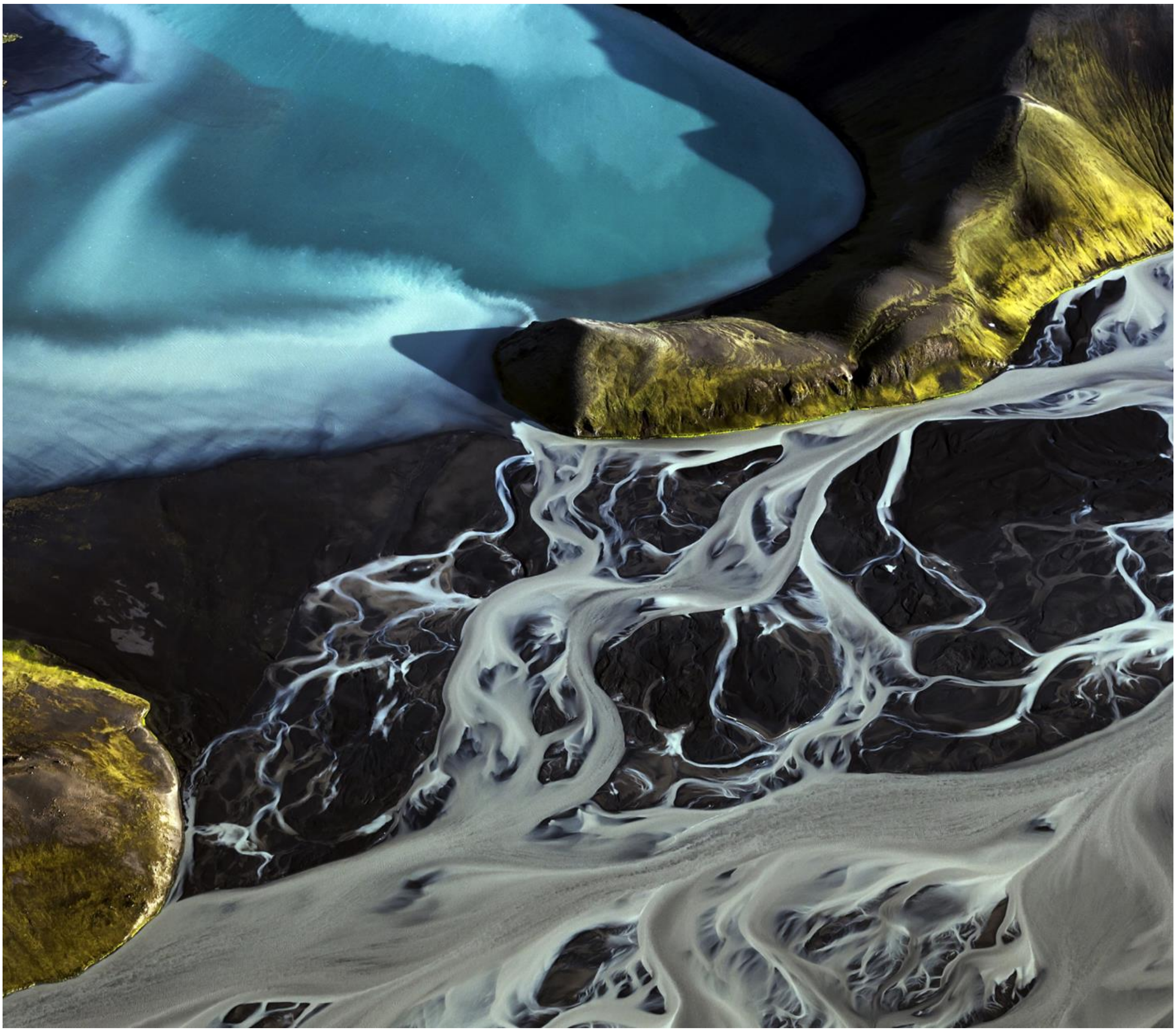
Baillie Gifford

Japan Growth Quarterly Update

30 June 2024



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Past performance is not a guide to future returns. Changes in investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. Material market or economic conditions will have an impact on investment results. The returns presented in this document are gross of fees unless otherwise stated and reflect the reinvestment of dividends and interest.
Historical performance results for investment indexes and/or categories, generally do not reflect the deduction of transaction costs and/or custodial charges or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing historical performance results.

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Potential for Profit and Loss

All investment strategies have the potential for profit and loss.

Stock Examples

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Product Overview

Japanese Growth is a concentrated, regional equity strategy that aims to produce above average long-term performance through investment in Japanese equities with a market cap of greater than Y150bn. We believe the Japanese equity market offers active managers a broad selection of high quality companies capable of delivering attractive and sustainable earnings growth for shareholders.

Risk Analysis

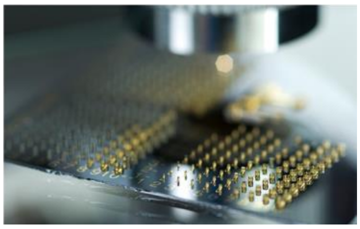
Key Statistics	
Number of Holdings	55
Typical Number of Holdings	35-55
Active Share	80%*
Annual Turnover	21%

*Relative to TOPIX. Source: Baillie Gifford & Co, Japan Exchange Group.

We appear to be reaching an inflexion point in the market, resulting in outperformance for the portfolio

Operational enhancements are resulting in stronger returns in many overweight internet names, while signs of recovery are emerging in the China-related consumer and capital goods companies

Japan's remarkable renaissance creates a conducive environment for several structural growth themes



Baillie Gifford Key Facts

Assets under management and advice	US$283.7bn
Number of clients	649
Number of employees	1738
Number of investment professionals	372

A review of recent performance

After a period marked by cyclical expansion, it seems we're at a turning point, with evidence suggesting a diversification of returns beyond traditional sectors like banking, automotive, and resources. This has already resulted in the portfolio outperforming in the most recent quarter. We expect this trend to accelerate, which bodes well for the portfolio which has leant more heavily towards structural growth companies — characterised by enduring secular sources of upside — that have hitherto been ignored by the wider market.

Signs of success within the portfolio are becoming plentiful, particularly in the internet space, where strong operational improvements are starting to manifest in greater share price performance. Rakuten and Softbank - two significant overweight positions- offer obvious examples. Rakuten's entry into the world's most profitable telecoms market (which averages mid-teen operating margins) is beginning to bear fruit. With 7 million (and growing) paying subscribers, or 3% of the market Rakuten is quickly becoming a formidable fourth player, losses have halved and the upside opportunity (of cross-selling other online and fintech services to a growing mobile user base) is becoming increasingly apparent; shares are starting to react having delivered twice that of the broader market so far this year. Rakuten is not the only one getting noticed, with Softbank's shares delivering c.4x the index over the same period. Despite this jump, the share price still lags underlying asset growth; a group market cap of $92bn is a fraction of its $147bn stake in ARM alone. Although artificial intelligence ('AI') has become the buzzword of the business world, Masayoshi-Son's visionary ambition, immense capital might, and a unique network of partners (from within the vision fund) make the group a clear and credible forerunner within the field. This has also become central to the company's broader ambition, something which became apparent at the company's Annual General Meeting (AGM) whereby we witnessed Masayoshi extoll the long-term opportunity within artificial super intelligence or 'ASI'.

Another encouraging sign of improvement can be found in the China-related investments, in both consumer and capital goods, which have – up until now - been a source of poor portfolio returns. Recent travel to the country has helped placate our worries as Donald outlines in his article *China through a Japanese lens* the slowdown experienced clearly remains a symptom of temporary factors and not a sign of deteriorating fundamentals. KAO, Japan's version of P&G is one such example. President Yoshihiro Hasabe emphatically explained to us how he intends to double returns by slashing the number of beauty care products in half and focusing only on the high margin range. The company is also flexing its pricing power: in the past 12 months alone prices have risen an average of 13%! This marks a sustainable recalibration for a company that commands dominant market shares within several different product categories. Hasabe-san is not alone. Shiseido president Fujiwara-san was equally energetic in his enthusiasm for how he intends to return the firm to its heyday level of profitability. Reassuringly, they continue to gain market share in the prestige skincare category within China, notably from brands Cle de Peu, NARS, and Drunk Elephant (the latter which was only released in China in April). If spending starts to pick up (of which there is growing evidence: Chinese tourism to Japan is now only 28% below its pre-Covid peak) and price hikes of 3-8% are maintained, the company will be on track to achieve its 9% Operating Profit Margin (OPM) target by next year, and 15% thereafter. These measures will help firm up company financials, placing both businesses in a more propitious position for the longer-term opportunity that exists within Asian premiumisation.

In terms of capital goods, specifically automation and robotic stocks, a downturn in machine orders and inventory overhang have hit sentiment toward the sector. This too is showing signs of change. Fanuc, with its signature yellow robots, has managed to hold on to its leading 24% market share within China (despite aggressive state-subsidising of local competitors). Having spent significant sums investing in capacity and people, operating leverage will likely play a major part in margin expansion once industry spending picks up again. The need for automation hasn't gone away, and we're pleased that Fanuc has continued to invest in anticipation of long-lasting growth.

Contrast these structural growth stories with a market geared towards cyclical expansion. Is the pivot point upon us? Monetary policies may be in reverse, the YEN's descent appears to be slowing, and economic expectations have recalibrated. Without these stimulants, cyclical constituents like

Toyota (which saw 12% margins, its highest since 1986 and well above its 7% average) may find it hard to maintain the same level of momentum. Indeed, Toyota's sharp downward adjustment to guidance could be the latest canary for this cyclical story.

Actions taken

During the quarter, we further severed our exposure to autos with the complete sale of Denso, the largest car parts maker in Japan. Although Denso has made headway in pivoting from internal combustion engine (ICE) to electric vehicle (EV) components, its heavy reliance on Toyota (which constitutes nearly half of its sales), exposes it to the inherent cyclical nature of the auto industry in the short term and to rising competition from new EV entrants, long term.

These funds have been recycled into two companies with greater run-rate in their earnings potential: Eisai and Kansai Paint. The first is a pioneer in addressing a growing societal problem of age-related diseases. Although we have witnessed a dramatic rise in life expectancy (from 32 in 1900 to 71 today), thanks to declines in mortality rates across all age groups, quality has not kept pace with quantity, as the growth in years free from disease or disability has not risen proportionally. This is becoming a palpable problem for many of us, as we become less removed from someone who suffers from mild cognitive impairment or Alzheimer's, a disease with no known treatment, until now. Eisai's 'Leqembi' is the first FDA-approved treatment that addresses a core cause of the problem, amyloid beta plaque build-up. Slower take-up than ambitiously expected due to a struggling healthcare system, and the black box surrounding the disease has provided us with an attractive entry point to add this opportunity to the portfolio.

Kansai Paint offers a less obvious, but equally attractive upside. Paint is an industry that lends itself to incumbency, thanks to the strength and importance of brand power and local scale, allowing companies such as Kansai Paint to establish profitable leadership in rapidly developing economies and so have attractive growth profiles. Two-thirds of Kansai's sales are outside Japan, with India (23%, where they are a market leader in decorative paint), Asia ex-Japan (14%) and Africa (8%) being interesting components of this. An area of particular focus is in industrial paints. This is the second largest market after decorative paint, enjoys some of the same technological demands as automotive paint (where they have a very strong pedigree) and has good scope to improve margins.

What to expect next

Japan now stands on the brink of a remarkable investment renaissance having shed many of the negative connotations attached to its past. The country is no longer simply a place to trade, but a place more conducive to investing. Engagement is rising, returns are improving, and valuations remain attractive.

What does this mean for the portfolio?

The shift in corporate and consumer mindsets, favourable policy developments, and a growing interest from foreign investors have triggered greater market dynamism and fluidity than we've ever witnessed before. But where will the opportunity likely land long-term? Not, we think, in the old-world economy of resources, banking and transportation. Rather we believe it lies in the innovative and sustainable sectors of tomorrow: in digitalisation, automation (where a demographically triggered uptake is taking place), and healthcare (specifically the diagnostics and treatment of ailments related to a globally ageing population). These are just some of the exciting opportunities captured within a portfolio that, combined, is expected to deliver over twice the earnings growth of the market going forward.

To explore these opportunities and more, we would direct you towards the following piece of intellectual capital produced during the quarter: *Japan: the next opportunity*

Performance Objective

2%+ p.a. over 5 years vs index.
The performance objective is aspirational and is not guaranteed. We don't use it to compile the portfolio and returns will vary. A single performance objective may not be appropriate across all vehicles and jurisdictions. We may not meet our investment objectives if, for example, our growth investment style is out of favour, or we misjudge the long-term earnings growth of our holdings.

Periodic Performance

GBP	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-3.0	-4.4	1.3
1 Year	6.0	13.5	-7.5
3 Year	-5.2	5.5	-10.7
5 Year	1.3	6.6	-5.4
10 Year	7.5	9.0	-1.5
Since Inception	8.0	8.3	-0.2

USD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-3.0	-4.3	1.3
1 Year	5.4	12.8	-7.4
3 Year	-8.0	2.4	-10.4
5 Year	1.1	6.5	-5.4
10 Year	4.3	5.8	-1.5
Since Inception	6.2	6.5	-0.2

EUR	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-2.2	-3.6	1.4
1 Year	7.3	14.9	-7.6
3 Year	-4.8	5.9	-10.7
5 Year	2.3	7.8	-5.4
10 Year	6.9	8.4	-1.5
Since Inception	8.4	8.6	-0.2

CAD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-1.9	-3.3	1.4
1 Year	9.0	16.7	-7.7
3 Year	-4.8	5.9	-10.7
5 Year	2.1	7.5	-5.4
10 Year	7.0	8.5	-1.5
Since Inception	8.2	8.4	-0.2

AUD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	-5.2	-6.5	1.3
1 Year	5.1	12.5	-7.4
3 Year	-4.3	6.5	-10.8
5 Year	2.1	7.5	-5.4
10 Year	8.0	9.5	-1.5
Since Inception	8.4	8.7	-0.2

Annualised periods ended 30 June 2024. 3 Month & 1 Year figures are not annualised.
Inception date: 31 December 2009
Figures may not sum due to rounding.
Benchmark is TOPIX.
Source: Revolution, Japan Exchange Group.
The Japan Growth composite is more concentrated than the TOPIX.

Discrete Performance

GBP	30/06/19-30/06/20	30/06/20-30/06/21	30/06/21-30/06/22	30/06/22-30/06/23	30/06/23-30/06/24
Composite Net (%)	8.1	15.5	-25.2	7.5	6.0
Benchmark (%)	6.1	10.7	-8.4	12.9	13.5

USD	30/06/19-30/06/20	30/06/20-30/06/21	30/06/21-30/06/22	30/06/22-30/06/23	30/06/23-30/06/24
Composite Net (%)	5.0	29.1	-34.2	12.5	5.4
Benchmark (%)	3.0	23.8	-19.5	18.1	12.8

EUR	30/06/19-30/06/20	30/06/20-30/06/21	30/06/21-30/06/22	30/06/22-30/06/23	30/06/23-30/06/24
Composite Net (%)	6.4	22.3	-25.4	7.8	7.3
Benchmark (%)	4.4	17.2	-8.6	13.2	14.9

CAD	30/06/19-30/06/20	30/06/20-30/06/21	30/06/21-30/06/22	30/06/22-30/06/23	30/06/23-30/06/24
Composite Net (%)	9.4	17.4	-31.5	15.4	9.0
Benchmark (%)	7.3	12.5	-16.1	21.2	16.7

AUD	30/06/19-30/06/20	30/06/20-30/06/21	30/06/21-30/06/22	30/06/22-30/06/23	30/06/23-30/06/24
Composite Net (%)	7.0	18.4	-28.2	16.2	5.1
Benchmark (%)	4.9	13.5	-12.1	22.0	12.5

Benchmark is TOPIX.
Source: Revolution, Japan Exchange Group.
The Japan Growth composite is more concentrated than the TOPIX.

Stock Level Attribution

Top and Bottom Ten Contributors to Relative Performance

Quarter to 30 June 2024

Stock Name	Contribution (%)
MS&AD Insurance	0.9
Toyota Motor	0.8
Recruit Holdings	0.7
SoftBank Group	0.6
Murata	0.4
Tokyo Electron	0.3
Sumitomo Mitsui Trust	0.3
Peptidream	0.3
Misumi	0.3
NTT	0.2
Hitachi	-0.5
freee K.K.	-0.4
Tokio Marine Holdings Inc	-0.3
Sumitomo Mitsui Financial Group	-0.3
GMO Internet	-0.3
Rohm	-0.2
SMC	-0.2
SHIFT	-0.2
Itochu Corp.	-0.2
Mitsubishi UFJ Financial Group	-0.2

One Year to 30 June 2024

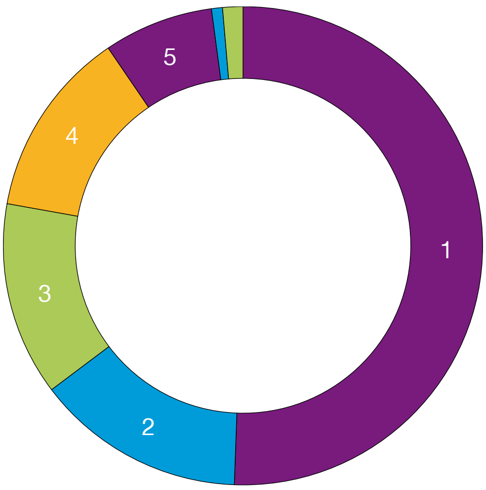
Stock Name	Contribution (%)
MS&AD Insurance	1.8
Disco	1.8
Recruit Holdings	1.1
SoftBank Group	1.0
SBI Holdings	0.7
DMG Mori	0.7
Rakuten	0.6
Sumitomo Mitsui Trust	0.5
Daikin Industries	0.4
NTT	0.4
Rohm	-1.3
Sysmex	-0.9
Hitachi	-0.9
Shiseido	-0.8
Mercari	-0.7
Mitsubishi UFJ Financial Group	-0.7
Toyota Motor	-0.6
GMO Internet	-0.6
Kose Corporation	-0.6
FANUC	-0.6

Source: Revolution, Japan Exchange Group. Japan Growth composite relative to TOPIX.
The holdings identified do not represent all of the securities purchased, sold or held during the measurement period. Past performance does not guarantee future returns. A full list showing all holdings' contributions to the portfolio's performance and a description on how the attribution is calculated is available on request. Some stocks may not have been held for the whole 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.

Top Ten Holdings

Stock Name	Description of Business	% of Portfolio
SoftBank Group	Telecom operator and technology investor	6.5
Recruit Holdings	Property, lifestyle and HR media	4.8
MS&AD Insurance	Japanese insurer	4.6
Sony	Consumer electronics, films and finance	4.5
Keyence	Manufacturer of sensors	4.2
SBI Holdings	Online financial services	3.9
Sumitomo Mitsui Trust	Japanese trust bank and investment manager	3.7
Murata Manufacturing	Manufactures and sells ceramic applied electronic components	3.4
Rakuten	Internet retail and financial services	2.7
Kubota	Agricultural machinery	2.4
Total		40.6

Sector Weights



		%
1	Manufacturing	50.6
2	Finance & Insurance	14.1
3	Transport And Communications	13.1
4	Services	12.7
5	Commerce	7.4
6	Real Estate	0.7
7	Cash	1.4

Figures may not sum due to rounding.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	33	Companies	2	Companies	4
Resolutions	403	Resolutions	2	Resolutions	4

Company Engagement

Engagement Type	Company
Environmental	Bridgestone Corporation, Nintendo Co., Ltd.
Social	Nihon M&A Center Holdings Inc.
Governance	Bengo4.com,Inc., Disco Corporation, Fanuc Corporation, MISUMI Group Inc., MS&AD Insurance Group Holdings, Inc., Murata Manufacturing Co., Ltd., Nidec Corporation, Nihon Kohden Corporation, Nihon M&A Center Holdings Inc., Nintendo Co., Ltd., Recruit Holdings Co., Ltd., SBI Holdings, Inc., Sysmex Corporation, Toyota Tsusho Corporation, YASKAWA Electric Corporation
Strategy	Nintendo Co., Ltd.

Company	Engagement Report
Nihon M&A Center Holdings Inc.	Objective: We met with the management team of consultancy Nihon M&A, including President Suguru Miyake, Naoki Takeuchi and members of the IR team. The firm's human capital management and succession planning strategies were two focus areas. This follows recent challenges, underscoring a commitment to bolstering the company's resilience and long-term growth. Discussion: Since 2022, the company has seen a high turnover rate in its consultants. Given the importance of these personnel to the sourcing and dealmaking process, we wanted to increase our understanding of how Nihon M&A was approaching this issue. Miyake san acknowledged past recruitment challenges, attributing them to diverted management focus. In response to these turnover numbers, Nihon M&A is revitalising its hiring approach, reintroducing senior management involvement in final interviews and leveraging referral hiring. The firm aims to onboard a larger cohort of consultants to backfill any potential gaps. It will also focus on hiring recent graduates to support a long-term human capital pipeline. These changes are positive, considering the competitive landscape, with Nihon M&A increasingly vying for talent against large international consulting firms. They demonstrate that Nihon M&A is taking the issue of staff turnover seriously. Efforts are also being made to enhance company culture and retention through qualitative programmes. Miyake San and Takeuchi San have been engaging in informal meetings and dinners with senior consultants to revitalise the company's culture and understand consultants' long-term goals to improve their understanding of the needs and challenges of this cohort. Regarding succession planning, President Miyake, who initiated the process upon turning 70, mentioned that our previous discussions prompted deeper consideration of his successor. He suggested that knowing we would ask about succession had prompted him to inform Takeuchi san of his consideration as a possible future manager of the overall business. Outcome: Our meeting with Nihon M&A offered valuable insights into the company's approach to overcoming human capital challenges and establishing a robust succession plan. It was also positive to hear that previous engagements on succession had been fruitful in materialising change. The strategies discussed provide a positive outlook and provide us with areas to monitor in the future.
Nintendo Co., Ltd.	Objective: We met with gaming company Nintendo's Investor Relations Team to assess Nintendo's climate action, board composition and share incentives approach. Discussion: We started by discussing Nintendo's lack of emissions reduction targets and poor Transition Pathway Initiative (TPI) scoring. This score led to Nintendo's inclusion on investment restriction lists, which harmed the company's access to capital. While no commitment was made to a timeline to set more stringent targets, the company was receptive to our feedback about the potential implications. On governance, IR shared that Nintendo has taken steps to improve the composition of its board to include more independence and diversity of thought. A newly appointed board member appears to have relevant skills in merchandising; however, progress could still be made on the proportion of outside directors to provide effective challenges. Share incentives were also discussed. Stock awards as a percentage of overall pay are low, representing only 3 per cent of total pay. The discussion revealed a cautious approach to stock awards in part due to volatility through gaming console cycles. We fed back the principles underlying our support for share-based incentives, particularly the alignment with shareholders. They said they would take our feedback on board. Outcome: While there are signs of progress on shareholder engagement and board construction, gaps remain in climate action and share incentive alignment. We will continue to monitor Nintendo's progress on these topics.

Votes Cast in Favour

Companies	Voting Rationale
Bengo4.Com Inc, Denso, Disco, FANUC, Japan Exchange Group, Kakaku.com, Keyence, LY Corp, M3, MS&AD Insurance, Misumi, Mitsubishi Corp, Mitsubishi Estate, Mixi Inc, Murata, Nidec, Nihon Kohden Corp, Nihon M&A, Nintendo, Olympus, Omron, Recruit Holdings, Rohm, SBI Holdings, SMC, SoftBank Group, Sony, Sumitomo Metal Mining Co Ltd, Sumitomo Mitsui Trust, Sysmex Corp, TOTO Ltd, Toyota Tsusho Corp, Yaskawa Electric	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Murata	AGM 27/06/24	2	We opposed the request to make changes to the company's articles of association. One amendment seeks to remove the requirement for shareholder approval of the dividend. We regularly encourage companies to provide a shareholder vote on the dividend as we believe this is a fundamental shareholder right.

Companies	Voting Rationale
Keyence	We opposed the low dividend payment as we believe the company's capital strategy is not in the interests of shareholders.

Votes Abstained

Company	Meeting Details	Resolution(s)	Voting Rationale
Mitsubishi Corp	AGM 21/06/24	2	We abstained on the request to make several changes to the company's articles of association. One amendment seeks to remove the requirement for shareholder approval of the dividend. We regularly encourage companies to provide a shareholder vote on the dividend as we believe this is a fundamental shareholder right. However, we decided to abstain recognising that we were supportive of the other amendments being proposed, and because we had not engaged with the company ahead of the vote on their rationale for making this change.
Yaskawa Electric	AGM 29/05/24	1.1	We abstained on the election of the chair of the board due to a lack of shareholder vote on the dividend.

Companies	Voting Rationale
Misumi, Toyota Tsusho Corp	We abstained on the low dividend payment as we believe the company's capital strategy is not in the interests of shareholders.

Votes Withheld

We did not withhold on any resolutions during the period.

New Purchases

Stock Name	Transaction Rationale
Eisai	We have decided to take a holding in Eisai, an established Japanese pharmaceuticals company, based on our excitement around its novel Alzheimer's disease treatment. Alzheimer's is a leading cause of death globally (for example, in the UK it accounts for 11.5% deaths annually) but it has proved difficult to develop effective treatment. However, Eisai's drug Leqembi acts to clear amyloid beta plaques in the brain and has been shown to slow progression significantly. It has already been approved by the US FDA. Medicare actuarial estimates have aligned 3.5bn USD to treatment by 2025. As diagnostics improve and healthcare infrastructure ramps up to deliver this treatment we believe Eisai stands to benefit significantly.
Kansai Paint	Kansai Paint manufactures and sells paint in Japan, India, Africa and the rest of Asia. The company was an early supplier to Japanese car makers in the 1960s, and it has used its scale in auto paint to build up operations in domestic and industrial paint. The Indian home paint opportunity is particularly attractive. The stock is undervalued relative to its growth potential and relative to peers, and so we have taken a holding for the portfolio.

Complete Sales

Stock Name	Transaction Rationale
Denso	Denso is the largest car parts maker in Japan, with close ties to the Toyota group. The shares have performed strongly in recent years as the margin has improved through a mixture of self-help and a weak yen. However, in the longer term, we have concerns about the Toyota group's positioning in battery electric vehicles amid rising competition from Tesla and various Chinese players. We therefore decided to sell to fund other higher conviction holdings.
Pigeon	Pigeon is a Japanese baby-care product manufacturer with high market shares in certain categories and geographies, most notably China. We have admired the business and regarded it as having a strong competitive position over the years but recent evidence suggests that this strong position is being eroded rather quickly by a clutch of domestic and foreign peers in China. Consequently, growth has slowed and we worry that the company might not recover to its former profitable levels. We have therefore sold our entire holding in the company.

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