

Baillie Gifford™

# Diversified Return Strategy

Philosophy and Process



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**Potential for profit and loss**

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# Introduction

The Diversified Return Strategy is an actively managed strategy that invests across a wide range of different asset classes, markets and investment instruments.

The aim is to achieve attractive long-term returns but at lower risk than equity markets.

## Approach

The investment approach is top-down, macroeconomic and research led. The portfolio reflects views on the long-term return and risk characteristics of different asset classes but also incorporates an assessment of shorter-term prospects, current valuations and near-term market and economic conditions.

An asset class is included in the portfolio based on its ability to enhance returns, or to reduce volatility. There is no fixed asset allocation benchmark. However, there are limits on the maximum exposure to individual asset classes in order to control risk.

## Experienced team

Baillie Gifford has managed multi asset portfolios for many years and the strategy is run by an experienced and well-resourced team of dedicated, multi asset investors.

The team sit within our Multi Asset and Fixed Income (MAFI) Group. They draw upon the whole resource and expertise of the firm, notably the long-established stock-picking capabilities and strong track record of our equity and credit teams, and the Investment Risk, Analytics and Research Department.

## Governance

Multi asset investing is not a new concept. Institutions and individuals have been following a multi asset approach for many years.

The Diversified Return Strategy offers actively managed exposure to different asset classes but through the convenience of a single portfolio. Traditionally, such an approach requires high levels of governance to select, manage and monitor a range of different asset classes.

## Suitability

Traditional approaches to multi asset investing can sometimes rely heavily on equities or one or two other asset classes. We aim to run portfolios that are diversified across a broad range of asset classes.

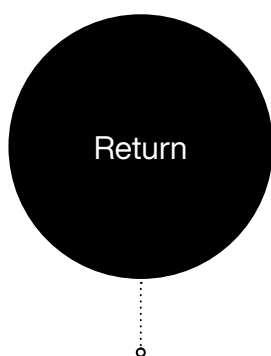
The Diversified Return Strategy is not a guaranteed return product and performance may well be negative in some years. Nonetheless, it may be suitable for investors seeking attractive long-term returns (five years plus) but at lower volatility than one would typically associate with an equity portfolio or traditional asset mixes.

We believe the strategy is suitable for:

- Defined benefit pension schemes seeking to have exposure to a broad range of growth investments without hiring individual managers for each underlying asset class
- The actively managed long-term growth option, and/or a component of a default fund in a defined contribution pension scheme
- Financial or charitable organisations or individuals with a long-term absolute return focus

## Dual objectives

To achieve (after deduction of costs)



An annualised return over rolling five-year periods that is 3.5% more cash\*

A positive return over rolling three-year periods



Annualised volatility of returns over rolling five-year periods that is below 10%

\*Cash rate applicable to base currency e.g. US Federal Funds Rate in USD base currency.  
There is no guarantee that a positive return will be achieved over rolling three-year periods, or any time period, and capital may be at risk.

# Philosophy

Our investment approach is to actively manage the portfolio with a flexible approach to asset allocation across a broad opportunity set.

The approach is underpinned by the following core beliefs:

## **Long-term growth**

An understanding of the prospective long-term risk and return characteristics of different asset classes is fundamental to making asset allocation decisions. Diversifying across asset classes can reduce risk without significantly reducing returns.

## **Active management**

Active management within asset classes can add value. Risk-adjusted returns can be improved by active management, changing the asset mix to reflect the best opportunities.

## **Focus on risk and return**

Focusing on absolute levels of risk and return is better than managing assets relative to a benchmark.

## **Thoughtful ESG integration**

ESG factors are investment factors, applicable across all asset classes.

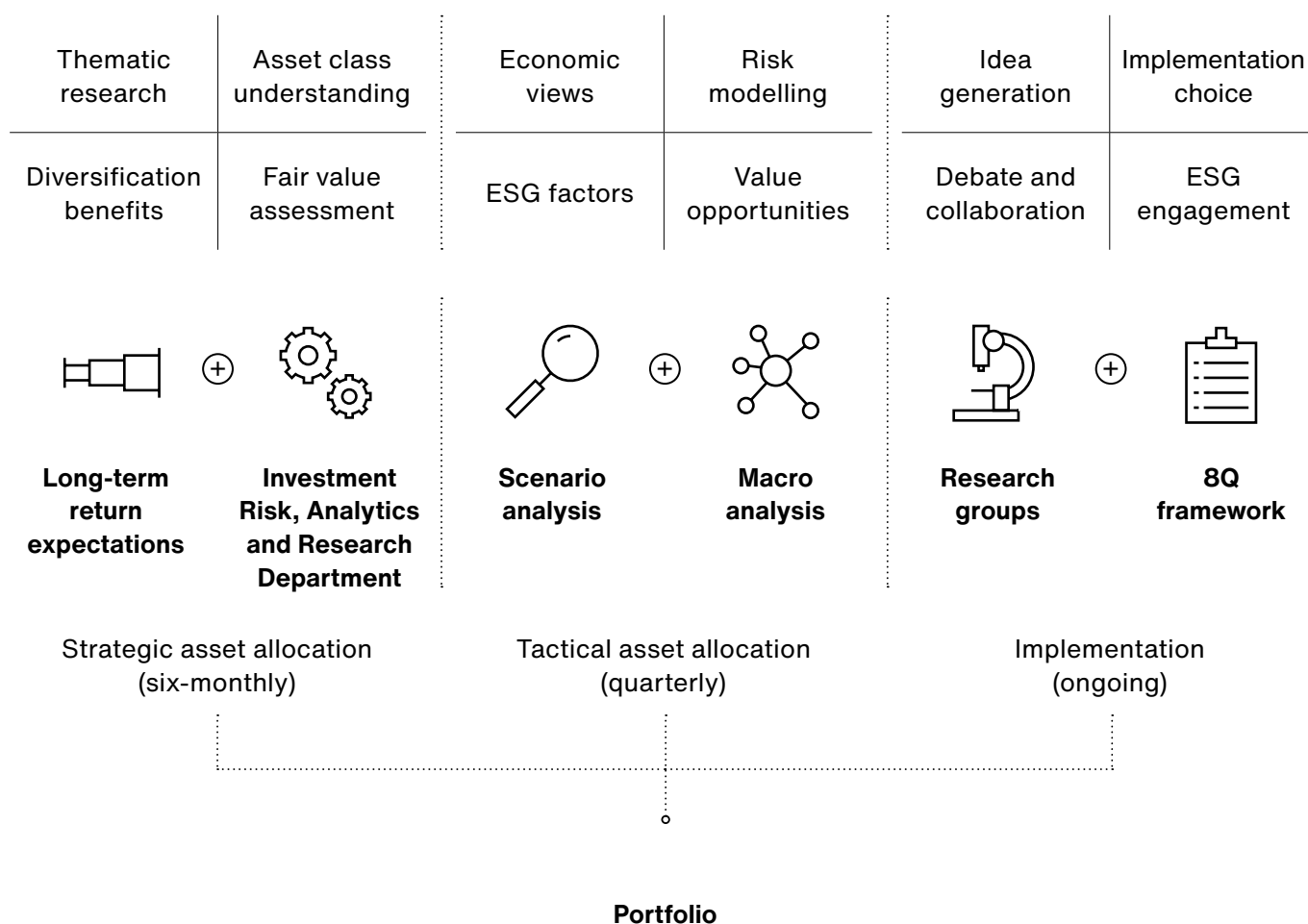
# Process

The key decision for the Diversified Return Strategy is asset allocation. The investment process is designed to identify the most interesting and attractive asset classes and then combine them into a portfolio capable of delivering attractive returns but with lower volatility than equity markets.

## 01 Long term: 5 years+

## 02 Near term: 1-5 years

## 03 Portfolio construction



There are a number of important aspects to our research work and portfolio construction.

Our long-term work assesses the return potential and attractiveness of the many asset classes available to us while understanding their risk profile and characteristics. We consider long-term thematic forces, what is fair value for asset classes, and determine when these assets can be expected to perform better or worse. This is formalised in our Long-Term Return Expectations, a set of return forecasts for the next ten years. We update these regularly, and they drive our Strategic Asset Allocation (SAA).

Our near-term work focuses on the economic environment and those scenarios in which we wish our portfolios to maximise opportunities while remaining robust. Our macro research groups assess conditions and determine the driving forces, assigning probabilities and asset class forecasts to the most likely scenarios. These scenarios are extended across the full opportunity set by the Multi Asset Team in its quarterly Scenario Analysis and considered by the investment managers in their six-weekly asset allocation discussions. The investment managers express their views on the near-term opportunities through their Tactical Asset Allocation, a set of positions that fit around the SAA.

Our bottom-up work involves researching stocks, bonds, funds and other securities within asset classes. Asset class groups of three or four analysts research and debate these rigorously. Research generally takes the form of an eight-question investment note, a standardised set of questions applied to all potential investments, regardless of the asset class. Asset class groups select securities and propose models for what is owned within their areas, advising the investment managers on their asset class's attractiveness.

Prior to investing and as part of ongoing portfolio management, we assess the sustainability features of our investments. We use a proprietary framework which references the Sustainability Accounting Standards Board's (SASB) Materiality Map and categorise holdings as either Enabler (the top score), Leader, Neutral, Adapting or Unsustainable. We then apply a series of milestones to the investment case so that we have a clear path to sustainability and an effective tool for monitoring. To ensure application, we set specific engagement priorities with any holding which does not meet our milestones potentially being divested from.

## ESG

At Baillie Gifford, we know our clients want us to achieve strong investment returns and we also know they care about the impact their capital can have on society and the environment. We take very seriously our role as stewards of our clients' capital and therefore want our actions to reflect our shared values and concerns, as well as the broader responsibilities that come with managing significant sums of money. We believe there is strong alignment between good ESG practices and achieving, over the long run, the best investment returns. Consideration of these issues are therefore embedded into our research and decision-making, and in our active engagement with our underlying investments.

The key areas in which ESG activities are incorporated alongside our investment activities are within our research and analysis, engagement with underlying holdings, active voting, and our reporting. The Multi Asset Team have dedicated ESG analysts. They have specific strategy knowledge and expertise on ESG issues.

Our investment approach is long term and based on the fundamental analysis of all the information relevant to each investment opportunity. ESG factors are part of this rigorous research alongside traditional financial factors, influencing our views and ultimately our investment decisions. Within our reporting we aim to be open and transparent on ESG issues as we are with other factors concerning our portfolios.



## How is ESG incorporated into the investment process?

### Debate and discussion

01

#### **Firmwide Shared Beliefs, principles and policies**

- Shared Beliefs, stewardship principles, ESG Principles and Guidelines
- Dedicated and embedded Multi Asset ESG analysts

02

#### **Top Down: ESG - risks and opportunities**

- Thematic macro research
- Climate scenario analysis

03

#### **Bottom Up: A case-by-case approach**

- Sustainability materiality assessment
- External relationships, industry memberships
- Identification and monitoring of ESG milestones
- Company engagement
- Q5 - Is this investment compatible with a sustainable economy?
- Restriction screening

04

#### **Portfolio Construction: An active approach**

- Inform position sizes
- In-house proxy voting
- Stewardship research and priority engagement
- Carbon budget management

05

#### **Reporting**

- Engagement and proxy voting
- Firmwide and strategy specific TCFD report
- Annual Stewardship report
- Fund-level carbon footprinting

# Range of asset classes

**The Diversified Return Strategy invests across a broad range of asset classes. This raises the likelihood of finding individually-attractive asset classes and also helps us achieve a balanced and diversified portfolio.**

The range of asset classes we invest in for the strategy is shown below. Those above the dashed line represent higher-expected return asset classes. Those below the dashed line represent asset classes that have more modest long-term returns but may, from time to time, have tactical appeal.

	Listed equities	Property	Private equity	
Emerging market government bonds	Commodities	High yield credit	Structured finance	Infrastructure
	Absolute return	Active rates and currency	Insurance linked	

## Diversified range of higher-expected return asset classes

## Lower expected returns safe-haven asset classes

Gold	Investment grade bonds	Developed market government bonds	Index linked bonds	Cash
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# Risk management

Risk management lies at the heart of the Diversified Return Strategy. As such, we attach as much consideration to risk issues as to the consideration of investment opportunities and their likely returns.

There are four main pillars to our management of investment risk:

- Diversification guidelines
- Scenario analysis
- Risk models
- Peer review

## Diversification guidelines

We adopt a number of guidelines to ensure that the portfolio remains flexible, absolute-return focused and genuinely diversified at all times. In particular:

- There are maximum asset allocation limits for each asset class as shown in the table. Furthermore, no more than half of the portfolio's maximum permitted risk will come from any one asset class
- There is no minimum allocation to any asset class. If we do not like an asset class, or expect it to deliver negative returns, then we will not own it

## Scenario analysis

Scenario analysis forms a major pillar of the risk framework. The investment team formally undertakes a scenario analysis exercise for the portfolio each quarter. This consists of assessing the likely performance of the asset classes in which the portfolio invests over the following 12–18 months across a range of core and specific scenarios. The core scenarios represent different states of global growth and the same for inflation. The specific scenarios look to capture events that may have substantial effects on the portfolio were they to occur. Examples might include economic or geopolitical shocks.

## Risk models

We 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 models we currently use are provided by APT and Moody's Analytics.

## Peer review

The team and its investment decisions are regularly subject to constructive challenge by senior colleagues from across 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 forums for this peer review are regular meetings with the Investment Risk, Analytics and Research Department and the Multi Asset and Fixed Income Investment Risk Committee.

	<b>Asset allocation max weight %</b>
Developed market government bonds	60
Investment grade bonds	60
Equities	40
Property	40
High yield credit	40
Structured finance	40
Infrastructure	40
Emerging market government bonds (Local currency)	30
Emerging market government bonds (Hard currency)	30
Commodities	30
Absolute return	30

# Team

We think diverse teams make better decisions. Our Multi Asset Team has a range of experience and interests. They all have in common an enthusiasm for seeking out exceptional investment opportunities. This is the same specialist team that manages our Multi Asset Growth and Sustainable Multi Asset Funds.

The team is led by James Squires, a partner of the firm. The team sits within our Multi Asset and Fixed Income (MAFI) Group, working closely with Baillie Gifford's Global Bond Team, and Real Assets Group.

They also draw upon the whole resource and expertise of the firm, notably the long-established stock-picking capabilities and strong track record of our equity and credit teams, and the Investment Risk, Analytics and Research Department. The MAFI Investment Risk Committee (MAFI IRC) provides support, advice and constructive challenge to the investment team.

Biographies of the team have been provided on the following pages.

## Multi Asset Team

**James Squires<sup>†</sup>**  
Head of  
Multi Asset

**Scott Lothian**  
Investment  
Manager

**Felix  
Amoako-Kwarteng**  
Investment  
Manager

**Nicoleta Dumitru**  
Investment  
Manager

**Laura Thomson**  
Senior ESG  
Analyst

**Siân Lombard**  
ESG Analyst

**Steve Bedwell**  
Quantitative  
Analyst

**Jonas Huruy Kidane**  
Analyst

## Global Bond Team

**Sally Greig**  
Head of  
Global Bonds

**James Carver**  
Investment  
Manager  
+5 analysts

## Supported by

**Regional and  
Global Credit**

**Regional and  
Global Equities**

**MAFI\* Investment  
Risk Committee**

**Investment Risk,  
Analytics and  
Research  
Department**

## Real Assets Group

**Jon Stewart**  
Investment  
Manager

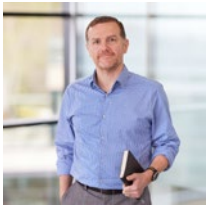
**Gemma Wright**  
Investment  
Manager

<sup>†</sup> Partner. \*Multi Asset and Fixed Income



**James Squires\***  
Head of Multi Asset

James is head of the Multi Asset Team and chairs our Multi Asset and Income Leadership Group. He became a partner in 2018. James joined Baillie Gifford in 2006, initially working in our North American Equity and Fixed Income teams. He has been a CFA Charterholder since 2010 and graduated BA in Mathematics and Philosophy from the University of Oxford in 2005.



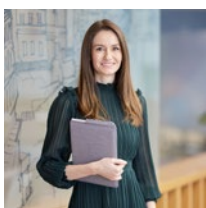
**Scott Lothian**  
Investment Manager

Scott is an investment manager in the Multi Asset Team. He joined Baillie Gifford in 2015. Prior to joining the firm, he worked as a Solutions Strategist for Schroders in London, led a multi-manager team for BEA Union in Hong Kong, and was a senior investment consultant at Towers Watson. Scott is a Fellow of the Institute and Faculty of Actuaries, and graduated BSc (Hons) in Actuarial Mathematics and Statistics from Heriot-Watt University in 1999.



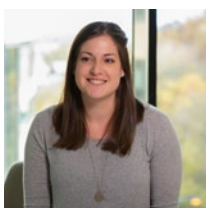
**Felix  
Amoako-Kwarteng**  
Investment Manager

Felix joined Baillie Gifford in 2011 and is an investment manager in the Multi Asset Team. He is a CFA Charterholder. Felix graduated BComm in Accounting from University of Cape Coast, Ghana, in 2008 and MSc in Investment Analysis from the University of Stirling in 2010.



**Nicoleta Dumitru**  
Investment Manager

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



**Laura Thomson**  
Senior ESG Analyst

Laura joined Baillie Gifford in May 2018 as an analyst in the central ESG resource and is now a fully embedded senior ESG analyst within the Multi Asset Team. Prior to joining Baillie Gifford she worked as an Environment and Sustainability Advisor for Laing O'Rourke, an international construction and engineering company. Laura also worked for over two years as an Analyst and Account Manager for CDP's Cities and Supply Chain Programmes. Laura graduated BA (Hons) in French Studies from the University of Sheffield in 2010 and with MSc from the University of Edinburgh in 2011.



**Siân Lombard**  
ESG Analyst

Siân joined Baillie Gifford in 2021 and works as an ESG analyst within the Multi Asset Team. Since joining the firm, Siân has contributed to the development and launch of the Sustainable Multi Asset Fund and continues to support its management. Alongside this, she coordinates ESG research, integration and engagement across the Multi Asset Funds. She is IMC qualified and has completed Baillie Gifford's Climate Change Risk in Finance Programme. Siân started her career at Deloitte, becoming a Senior Consultant in their Risk Advisory practice in London. She graduated from Durham University in 2017 with a BSc in Environmental Geoscience.



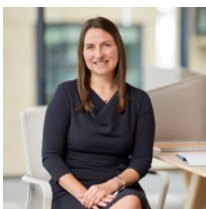
**Steve Bedwell**  
Quantitative  
Analyst

Steve is a quantitative analyst in the Multi Asset Team. He joined Baillie Gifford in 2003 and has worked in a variety of roles which have included trading bonds, derivatives and foreign exchange, and working on numerous projects aimed at improving the systems and processes used by the firm's investment teams. Steve started his career at Goldman Sachs after graduating BSc (Hons) in Economics from University College London in 1999.



**Jonas Huruy Kidane**  
Investment Analyst

Jonas joined the firm in 2022 and is an investment analyst in the Multi Asset Team. He previously worked as Asset Management Researcher at Citywire and holds an MPhil International Politics from the University of Cambridge.



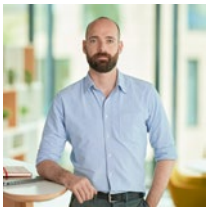
**Sally Greig**  
Head of  
Global Bonds

Sally is Head of Global Bonds and co-manager of the Sterling Aggregate Strategy. She joined Baillie Gifford in 2005, initially covering the US and UK government bond markets as an analyst before going on to manage emerging market bond portfolios for 16 years. Sally previously worked at the Bank of England as an economist in the Foreign Exchange Division providing regular analysis to the Monetary Policy Committee. She graduated MA in Economics and Statistics from the University of Edinburgh in 1998 and MSc in Finance and Econometrics from the University of York in 2003.



**James Carver**  
Investment Manager

James is an investment manager in the Global Bond Team, with a focus on macro research. He joined Baillie Gifford in 2018. He began his career with Deutsche Asset Management and spent 10 years working across emerging market debt, global macro and asset allocation before moving to Scottish Widows to run their Absolute Return Bond Fund. James gained an MSc (Hons) in Earth Sciences from the University of Oxford in 2001 and later completed an MBA at the University of Edinburgh.



**Jon Stewart**  
Investment Manager

Jon is an investment manager within the Income Research Team specialising in listed property securities. He joined Baillie Gifford in 2020 from abrdn 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.



**Gemma Wright**  
Investment Manager

Gemma is an investment manager in the Income Team. She joined Baillie Gifford in 2020. Prior to joining the firm, she worked as an equity analyst in Australia covering general equities and infrastructure. Gemma is a CFA Charter holder and holds a MSc Regulation from the London School of Economics and Public Policy from 2020.

# 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 are 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 clients' 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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**Baillie Gifford™**

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN  
Telephone +44 (0)131 275 2000

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