Strategic Bond Fund

Philosophy and Process

Baillie Gifford™

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Potential for profit and loss

All investment strategies have the potential for profit and loss.

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Overview

The Strategic Bond Fund seeks to deliver a monthly income stream and provide the opportunity for capital growth over a long-term investment horizon.

The Fund invests in a diverse portfolio of rewarding corporate bonds from across global credit markets.

Our distinct approach

We are long-term investors in a short-term market. In bond markets, long-term fundamentals are ultimately reflected in valuations. We take the time to see those opportunities through to fruition.

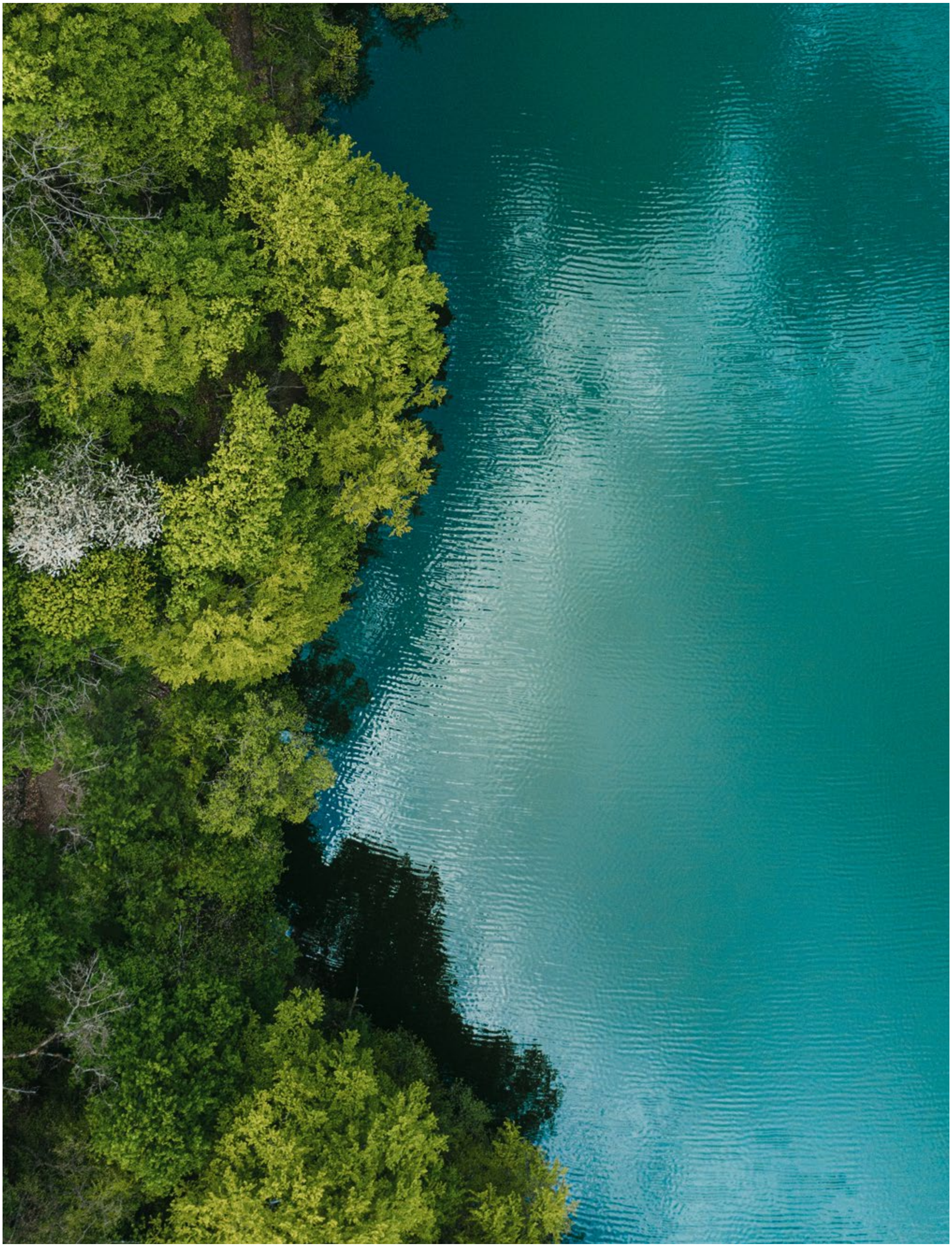
We lend to companies of the future, not the past. Typically, these companies are growing and making products or services that will continue to have relevance well into the future. Our preference is for resilient businesses with sustainable or improving balance sheets, strong competitive positioning, run by management teams which are cognisant of the need for good governance and progress in environmental sustainability.

Over the long term, it is the success of individual companies that delivers value to clients. Our approach to strategic bond investing is designed to ensure that these successes shine through. We believe market inefficiency is greatest at the individual company level. The global corporate bond market, with over 3,700 issuers, and 20,000 plus bonds, is a rich canvas of global opportunities, which offers a vast range of companies through which our strategic decisions may be expressed.

Fund facts

Inception date	26 February 1999
Comparator indexes	IA Sterling Strategic Bond Sector
	70% ICE BofA Sterling Non-Gilt Index (hedged to GBP) 30% ICE BofA European Currency High Yield Constrained Index (hedged to GBP)
Vehicle	UK OEIC

There's no time like the future



Strategic Bond Investing

The Strategic Bond Fund is designed to be a single solution to credit investing that can be held through economic, industry and market cycles. By exploiting market inefficiencies and making use of asset allocation flexibility, the Fund seeks to deliver returns in excess of the broad fixed income market.

Asset allocation through the cycle

A through-the-cycle solution requires considered global bond selection and asset allocation. The starting point for portfolio construction is a strategic allocation of 70% investment grade credit and 30% high yield credit. This position is not static, the management team have the flexibility to adjust asset allocation using three of the most important levers in our fixed income markets.

Credit risk

We adjust the portfolio's allocation to investment grade and high yield bonds based on our assessment of macro-economic and valuation conditions. Typically, in good times, the Fund owns more high yield bonds, and in bad times more investment grade bonds.

Government risk

We vary exposure to government bonds by adjusting the portfolio's spread duration. In the expectation of buoyant market conditions, we increase exposure to corporate bond risk, and in more troubled market conditions, increase exposure to government bond risk.

Geography and sector

We have the freedom to direct our prospecting efforts, on a global basis, to those geographies and sectors where the optimum risk/return resides. This enables us to select a diverse range of idiosyncratic bond ideas from across the world.

Philosophy

Fundamentals win out over the long-term

Over a long-term investment horizon, an issuer's fundamental resilience will be reflected in the performance of its bonds. Our in-depth analysis therefore focuses on building a comprehensive understanding of a company's long-term prospects and it's underlying fundamental characteristics, believing that these factors will ultimately prevail over short-term market fluctuations.

Focused, forward-looking research can identify the winners

The secret of great bond selection is thinking differently. It is about identifying companies that are embracing change and businesses that are producing the products and services of the future, not the past. Looking forward is not as simple as making predictions. It means understanding that the pace of societal, technological and environmental change can often be surprisingly fast. One may not know the exact timing of such step-changes, but given their likelihood, positioning for their ultimate arrival is sensible. Using some imagination now helps us to prepare for what may lie ahead, ensuring resilience by design.

The global corporate bond market is rich in opportunities

The global corporate bond market provides a large and diverse range of investment opportunities. These opportunities are in part created because some participants in our market use corporate bonds to achieve cash-flow matching objectives. This behaviour is not passive, but is highly directed and can, for a time, cause prices to deviate from their underlying fundamentals. Such behaviours and time horizons segment the market, most notably by geography and credit rating. This segmentation can lead to the valuation of individual bonds diverging from their fair value, providing a persistent source of investment opportunities for active, nimble bond selectors.

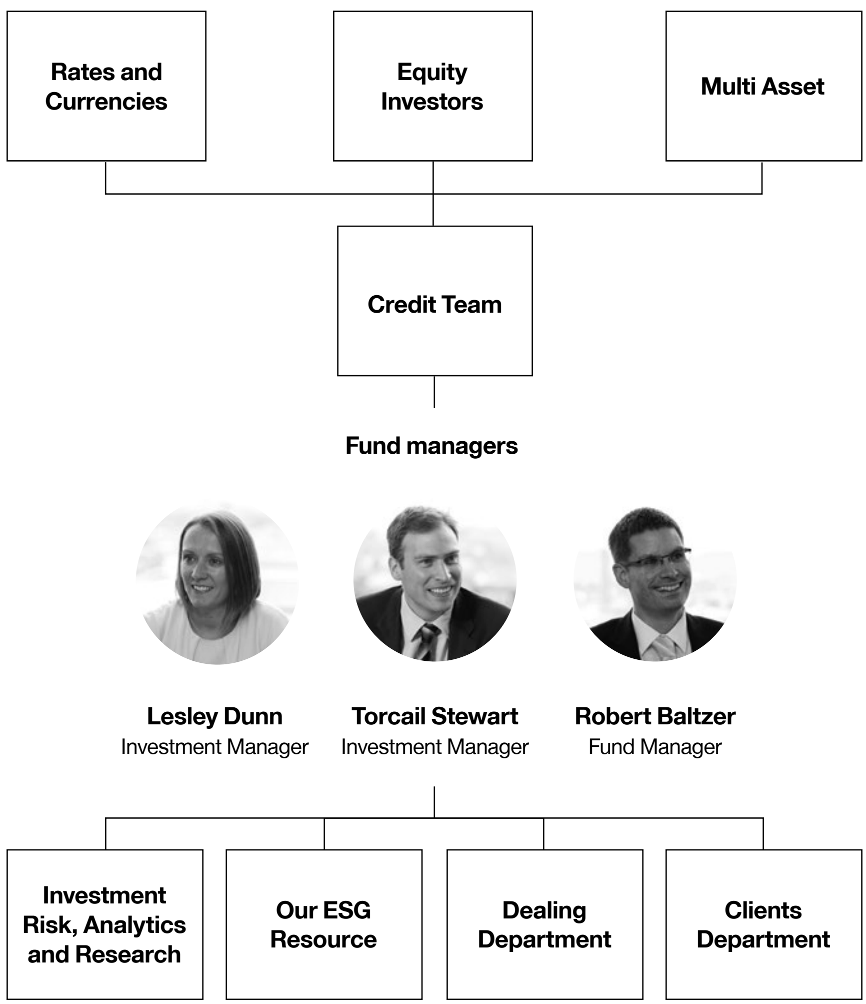
Long-term income, not short-term yield

Team

The Strategic Bond Fund is managed by Lesley Dunn, Torcail Stewart, and Robert Baltzer, all are experienced credit investors. They are part of the wider Credit Team which is responsible for bond selection and draws on the broad and deep investment expertise at Baillie Gifford.

The managers are supported in portfolio construction through structured interactions with Baillie Gifford's independent Investment Risk, Analytics and Research Department.

Strategic Bond Fund key decision makers



Investment Process

Our process is focused on identifying resilient companies which provide attractive valuation opportunities and combining them in a portfolio that is robust and rewarding.

Idea generation

As long-term investors in resilient businesses, we are very selective. Out of the many new bond ideas our team generates each year, few are selected for the portfolio. In essence, the portfolio reflects the best bond ideas we have identified from across global bond markets. The Fund typically focuses on crossover bonds; those straddling the investment grade/high yield boundary and areas of inefficiency; those parts of the global bond market where resilient issuers may fall through the cracks, offering us compelling opportunities.

Research

Every member of the team is first and foremost an analyst and spends the majority of their time analysing and debating company research. Within investment grade and high yield markets, we allocate research responsibilities by sector on a global basis. These responsibilities are rotated every 2–3 years to provide analysts with a breadth of experience, to avoid entrenched views that become impervious to challenge and to ensure that portfolio managers can draw on multiple knowledgeable voices in any discussion.

When local social, economic or political factors may dominate global sector trends, we draw on the country expertise among our regional equity investors and our sovereign debt colleagues for their perspectives.

Focus on resilience

A detailed understanding of the factors driving the fortunes of the companies in which we invest is crucial to our long-term success. The Credit Team assesses the resilience of each investment based on the analysis of three key factors: company prospects, sustainability, and capital structure. Each pillar of resilience is scored on a 5-point scale from 0–4.

To be considered for selection, a bond must attain a score of at least 1 for company prospects and sustainability. Our approach is designed to ensure our portfolios offer through the cycle resilience built from the bottom up. Together with valuation, this assessment informs portfolio position sizing and sell discipline.

Our focus on resilience provides the common language for our team, which uses a wide range of inputs to inform the overall view – from company meetings and reports to competitor and industry analysis and the work of independent research providers and academic experts.

Debate, discussion, decision

Every new investment we make follows a robust team-wide debate of an analyst's report. We value the perspectives of all our colleagues and see each company discussion as a chance for us to learn from each other as well as to find the next idea for the portfolio. The emphasis is on utilising the team's experience to identify areas for more work and explore counter-arguments to the investment case. In particular, we seek to consider and challenge the investment milestones set out by the analyst. These markers are designed to monitor the progress of the investment case and, therefore, drive our monitoring and sell discipline should we invest.

Following debate and completion of any necessary follow-up work, Lesley and Torcail express their individual views and discuss the merits of the investment in the context of the overall portfolio. There is always a creative tension between new versus existing investments in the portfolio. If the managers believe the new bond offers a higher risk-adjusted return, then it will enter the portfolio. Both investment managers have an equal say in investment decisions. However, due to the capped upside of bond returns, if one of them vehemently disagrees with the other, this will usually result in the bond not being included in the Fund.

Defining Resilience

We choose to focus on resilience as the key to companies' likely success or failure over the long term. Resilience ensures that companies adapt as technologies and societies change; as economies wax and wane. Resilient companies are built to last.

Our evaluation of resilience is summarised using three key factors:

Company prospects

How good are the prospects for this company on a multi-year horizon? Are the products or services it provides in growing demand? Does innovation provide an opportunity or threat? What edge does it have over competitors, and why might this last?

Sustainability

Is the company compatible with a sustainable economy? What is the carbon intensity of the company's operations? Does it demonstrate awareness of its impacts and dependencies on the environment, society and key stakeholders? Is appropriate management of these relationships built into the company's strategy?

Capital structure

Is the company appropriately financed considering its capital intensity, growth ambitions and cyclicality? How robust is its liquidity? Is the company cash generative? What are the margins of safety – how strong a headwind could the business withstand before becoming uncomfortably stretched? What can we learn from past capital allocation and financial policy decisions?

We do not expect perfect answers to every question. We want to understand strengths and weaknesses so that we have a good idea of what to expect if the going gets tough. We are focused on understanding how the future might look, acknowledging that the recent past is often not the best guide.

Sustainability

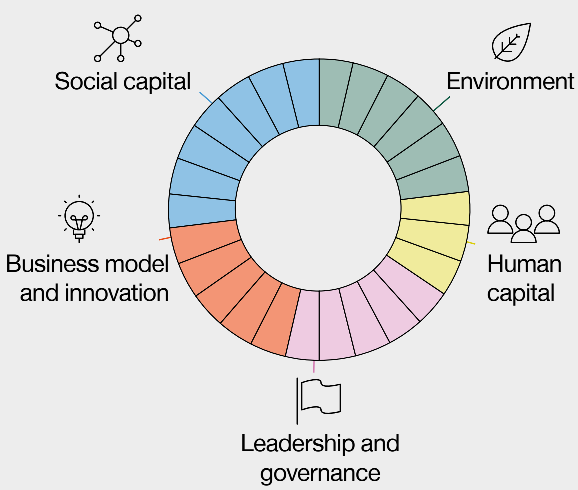
In our view, the transition to a sustainable economy, one which achieves a balance between economic, environmental and social needs, has begun. We believe this is a material shift that will affect all companies, creating long-term investment opportunities as well as risks. As stewards of our client's capital, we regard it as our responsibility to steer businesses away from destructive practices and towards activities that create genuine economic value.

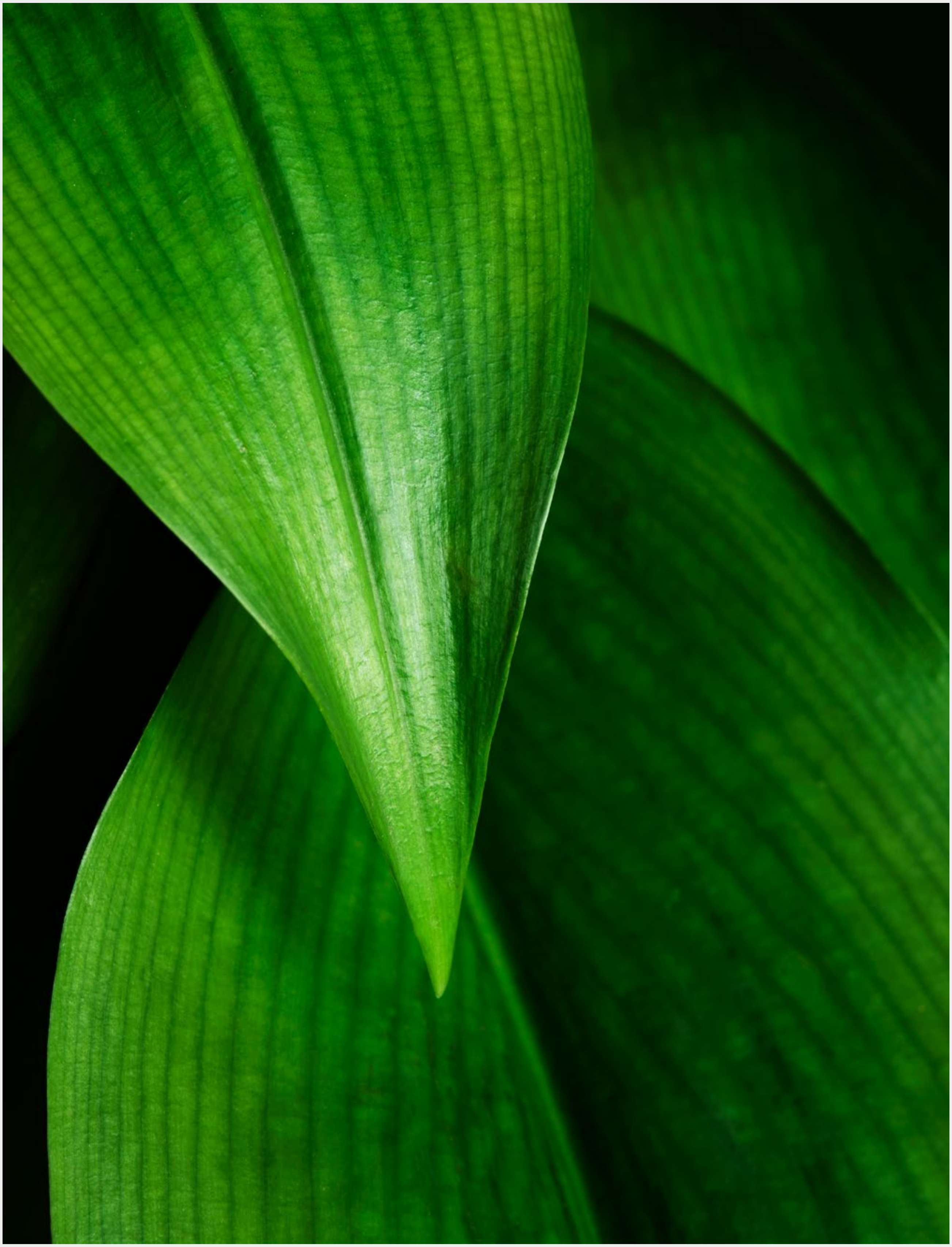
Sustainability assessment

To determine sustainability, we seek to answer the question: is the company compatible with a sustainable economy? To help formalise our response and to ensure consistency of analysis, we consider five dimensions of materiality in our assessment. This approach is designed to encourage in-depth, forward-looking analysis and identify sustainability risks and opportunities as an input to our overall assessment of a company's future resilience.

Five sustainability dimensions

SASB materiality map





Portfolio Construction

Our Strategic Bond portfolio construction process is aimed at building a diverse and rewarding portfolio, where idiosyncratic opportunities drive long-term risk-adjusted performance.

A focused portfolio of 60–85 issuers means we have a detailed and comprehensive understanding of each individual issuer's risk profile and the likely drivers of performance. We seek to understand these factors and how they might interact with the risks and drivers of other holdings across the portfolio.

We believe a diversified portfolio helps us hold our nerve and make better decisions in periods of market volatility, understanding that no single bond's performance will dominate returns, and so our typical holding size is 1–2 per cent of portfolio value.

Strategic asset allocation

The starting point for portfolio construction is a strategic asset allocation of 70% investment grade credit and 30% high yield credit. Our analysis has found that this combination provides an attractive balance of risk and reward over the long term.

Asset allocation flexibility

Asset allocation decisions are made by the management team based on their assessment of macroeconomic and valuation conditions. Our goal is to use asset allocation flexibility strategically, rather than tactically, to support the delivery of through-the-cycle excess returns by adjusting risk at portfolio level. Up to half of the Fund can be invested in bonds rated below investment grade if we see outstanding value in lower-rated companies. We also have scope to preserve capital and keep powder dry in higher-quality investment grade holdings when appropriate, with no upper limit on our exposure to investment grade bonds.

There are three key inputs to asset allocation decisions. We monitor global bond valuations by geography, sector and rating to assess current valuations relative to history and market fundamentals. Macroeconomic views are considered through structured interactions with colleagues in the Rates and Currencies and Multi Asset teams at both quarterly Macro Challenges and Credit Asset Allocation meetings. Finally, our ongoing assessment of risk and return opportunity at company level is a key input, acting as a barometer for the broader market.

Sell discipline

If a particular investment is not performing in line with expectations and is hitting negative milestones, or if the portfolio managers believe investors are no longer being appropriately compensated for the risk of a particular bond, then we will sell.

Currency and interest rate risk

The Strategic Bond Fund does not take currency risk relative to the client's base currency and uses limited duration flexibility only when there is a strong case for doing so.

Risk Management

Our risk management processes ensure we know the risks we are taking, that we are only taking risks that we choose to, and that we have informed challenge and oversight of our decision making.

There are three pillars to our management of investment risk:

— Knowing our companies well

— External review and challenge

— Clear investment guidelines

Knowing our companies well

Knowing the risks associated with each investment and how these risks interact with those of other investments within the Fund is our first line of defence. Our initial research is thorough, our debate is rigorous, and we continually review and monitor the investment cases for each company we invest in by monitoring investment milestones and valuations on a continuous basis.

External review and challenge

Peer review sees the team 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. The main forums for this peer review are quarterly meetings with the Strategic Bond Portfolio Review Group and our Investment Risk, Analytics & Research Department.

Our independent Investment Risk, Analytics & Research Department uses a range of tools and measures to monitor portfolio style exposures, diversification, tracking error and thematic risks. The Risk Team's formal quarterly independent check provides challenge to the investment managers and is used in internal reporting to the firm's Investment Risk Committee. We can also stress test the strategy using scenario analysis tools such as Bloomberg PORT.

Clear investment guidelines

We manage the Strategic Bond Fund within a range of clear investment guidelines aimed at ensuring sufficient diversification while providing protection against unwanted thematic risks that might swamp idiosyncratic bond returns. Our sector level restrictions are an example. They have no lower bound, but a maximum of 20 per cent overweight per sector is designed to protect against concentration, without forcing the strategy to allocate capital to parts of the market where idiosyncratic opportunities are few or where the credit risk is not being well rewarded.

Number of bond issuers (guideline range)	60—85
Index	70% ICE BofA Sterling Non-Gilt Index (UN00) 30% ICE BofA European Currency High Yield Constrained Index (HPC0)
Maximum investment in an individual company	+3% relative, capped at 5% absolute
Duration	Reference index +/-1 year
Sectors	Reference index +20%. No minimum
High Yield	Maximum 50%. No minimum
Currency	Hedged to sterling
Guideline tracking error range	Maximum 4%

The Fund uses derivatives principally to reduce unwanted risks such as foreign currency exposure. Foreign currency bond holdings will typically be hedged back into sterling. In addition, we may use bond futures, interest rate swaps and credit default swaps to manage portfolio exposures to interest rate and credit spread movements.

People

Our Credit Team

Lesley Dunn, Head of Credit, Partner

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

Robert Baltzer, Head of Credit Research

Robert is Head of Credit Research and co-manager of the Strategic Bond and High Yield strategies. He joined Baillie Gifford in 2001 on the graduate scheme and became an Investment Grade Bond manager in 2004. Robert has managed high yield portfolios since 2010 and crossover portfolios since 2012. He graduated MMath from Durham University in 2001 and is a CFA Charterholder.

Investment managers

Torcail Stewart, Investment Manager

Torcail is an investment manager in the Credit Team, co-managing the Strategic Bond Strategy. He joined Baillie Gifford in 2008. Torcail graduated BA in Geography from the University of Cambridge in 2002 and MPhil in Management, Economics and International Relations from the University of St Andrews in 2005. He is a member of the CFA Society of the UK (CFA UK).

Arthur Milson, Investment Manager

Arthur is an investment manager in the Credit Team, co-managing our High Yield Bond Strategy. Before joining Baillie Gifford in 2022, he worked for abrdn/Standard Life Investments for 16 years. Arthur graduated BSc in Biological Sciences from the University of Edinburgh in 1992, has a postgraduate diploma in commerce from the University of Wollongong and is a Chartered Accountant.

Faisal Islam, Investment Manager

Faisal is an investment manager in the Credit Team, co-managing our High Yield Bond Strategy. Before joining Baillie Gifford in 2018, he worked for four years at PwC where he qualified as a chartered accountant in corporate finance, before moving to Aberdeen Standard Investments in 2016 as a high yield credit analyst. Faisal graduated BSc in Economics from the London School of Economics and Political Science in 2011 and is a CFA Charterholder.

Nektarios Chatzilefteris, Investment Manager

Nektarios is an investment manager in the Credit Team, co-manging the Investment Grade Bond Strategy. He joined Baillie Gifford in 2020. Prior to joining Baillie Gifford, Nektarios served for 8 years as an artillery officer in the army followed by 4 years in a variety of banking and insurance roles. He graduated BSc in Military Operations Management and Battle Science from the Hellenic Military Academy in 2008 and MBA from the University of Macedonia in 2017. Nektarios also completed the CFA Program in 2019.

Paul Dilworth, Investment Manager

Paul is an investment manager in the Credit Team, co-manging the Investment Grade and Sterling Aggregate strategies. He joined Baillie Gifford in 2019. Before joining the firm, Paul worked for almost 13 years at Kames Capital where he was responsible for managing a broad range of fixed income mandates, including Global Financial Credit, Global Absolute Return and Investment Grade Credit. Paul graduated BSc (Hons) in Mathematics from Heriot-Watt University in 2006 and is a CFA Charterholder.

Investment anaylsts

Deni Kasa, Investment Analyst

Deni Kasa joined Baillie Gifford in 2022 and is an investment analyst in the Credit Team. He was previously a postdoctoral fellow at Oxford University and Tel Aviv University, having completed a PhD in Early Modern Literature at the University of Toronto.

Ellie Lewis, Investment Analyst

Ellie is an investment analyst in the Credit Team, she joined Baillie Gifford in 2020. Ellie graduated with a BSc in Economics and Finance from the University of York in 2020.

Olivia Knapp, Investment Analyst

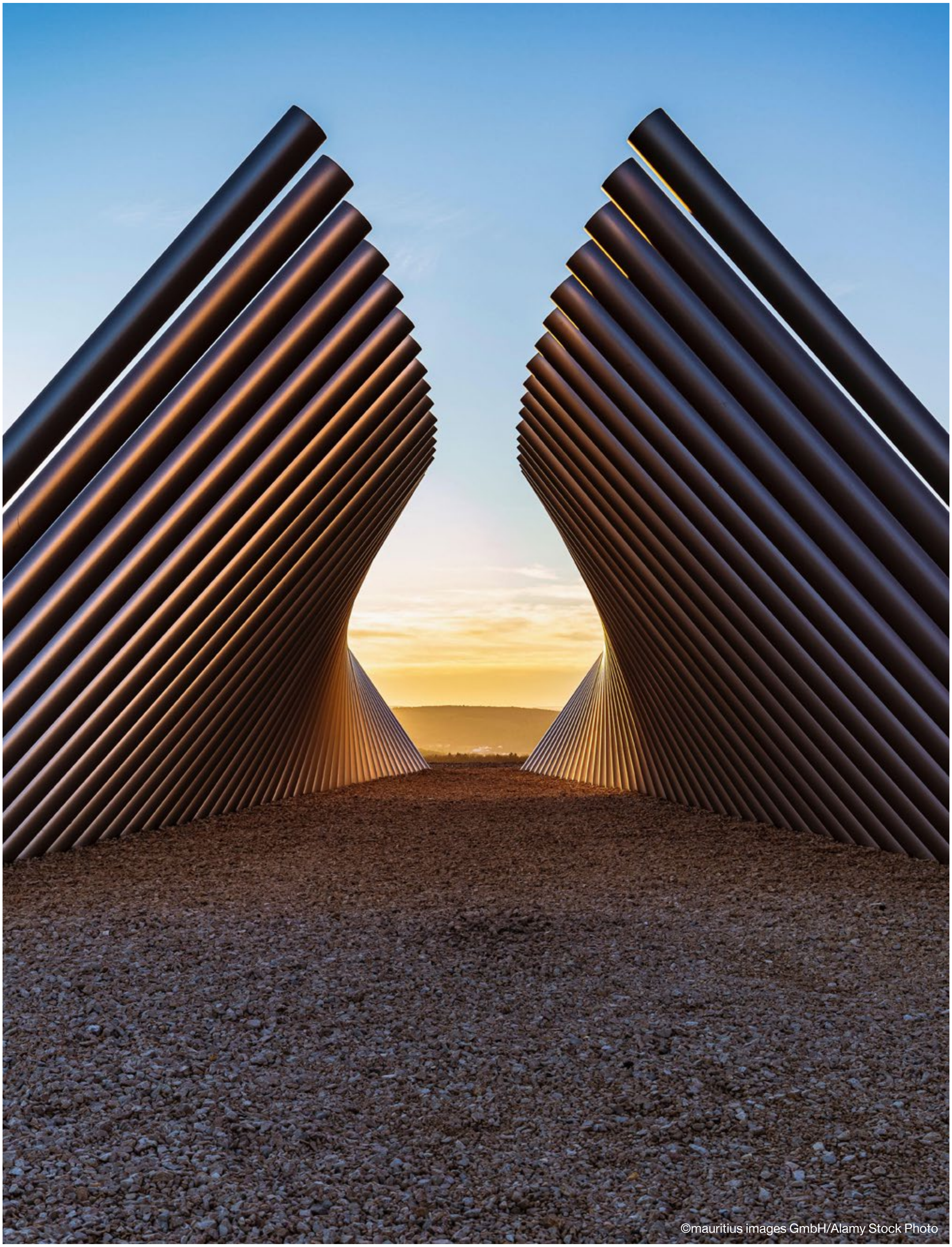
Olivia is an investment analyst on the Credit Team and joined Baillie Gifford in 2023. She previously completed a PhD in Chemistry at the University of Manchester, and prior to that obtained a First Class Honours in Chemistry MChem from the University of Oxford.

Theo Golden, Investment Analyst

Theo joined Baillie Gifford in 2021 and is an investment analyst in the Credit Team. Previously, they worked as a financial journalist at Bloomberg, Business Insider and Mergermarket. Theo graduated from Durham University in 2020 with BA(Hons) in Music.

Saorla Whelan, Analyst (Research and Engagement)

Saorla is an ESG Analyst aligned with our Credit Team. Saorla joined Baillie Gifford in 2014 and has been an ESG Analyst since January 2020. She previously worked in the Investment Risk, Analytics and Research Department upon completing the Investment Operations Graduate Programme in 2016. She graduated BComm (Hons) in Economics from University College Cork in 2014. In 2022 she also completed an MSc in Global Challenges in Environment, Development and Health from the University of Edinburgh.



Why Invest with Baillie Gifford?

Over 100 years of independent, long-term and client-focused investment.

People

Our people are fundamental to our success, and our partnership structure brings sustainable advantages in the recruitment and retention of staff.

Baillie Gifford's partnership structure has provided the foundation for an enviable record of corporate stability and firmly aligns us with the long-term interests of our clients. We have no outside shareholders who might have different priorities to those of our clients. Our structure is also a significant factor in our ability to attract and retain the very best investment talent. Our selection policy is based on intelligence, leading to the recruitment of individuals from a wide range of academic disciplines with usefully different perspectives and approaches to analysis. Most of our analysts and investment managers are trained in-house, our aim being to combine a common culture with an atmosphere that encourages vigorous debate. The firm's values and beliefs are clearly communicated and, coupled with low staff turnover and long service, the firm has been able to capture a strong team spirit while growing steadily in recent years.

Investment

Our competitive advantage lies in differentiating between what matters and what is simply market noise. Then it is our ability to wait patiently to take advantage of periodic market mispricing – both at asset class and security level.

Baillie Gifford's investment decisions are based on thorough research, though we have the capability to act quickly if necessary. The investment managers and analysts of our Multi Asset and Fixed Income teams focus on asset allocation, macroeconomic policy, and credit research, while the global and regional equity teams primarily conduct stock research.

Clients come first

Our primary aim is to add value for clients. We always put our existing clients first. We have frequently closed our most successful investment strategies to new business to protect their integrity. We think that asset growth purely follows from doing a good job for clients and we look to cultivate relationships with potential new clients who will share our long-term investment horizon.

Actual ESG

At Baillie Gifford we have not inserted climate change or social equity as separate factors in our investment processes across the firm; they have always been there as considerations within our long-term investment horizon. We don't generally expect environmentally damaging or socially irresponsible companies to escape unscathed by regulators or customers, so we don't see them as attractive long-term investments. Consideration of ESG factors is embedded into our investment activities.

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