

**Baillie Gifford™**

# Japanese Equities

Philosophy and Process



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# Introduction

**As a company with over a century of experience of patient investing, run by partners whose only task is to seek out long term success, we understand the approach Japanese businesses take to find positive returns, because it mirrors our own.**

Our Japanese equity business is defined/ differentiated by its heritage, people and consistently applied philosophy of bottom up, patient long-term investing. We believe these hallmarks have underpinned our consistent track record of creating value for clients over the long term.

## Heritage

We have been managing Japanese equity mandates for over 40 years, during which time we have experienced various bubbles (Japan's own along with the dot.com one, that burst at the turn of the century), and several natural disasters (including the great Hanshin & Tōhoku earthquakes). We have also witnessed a near transformation of the Japanese equity market from one dominated by major banks, telecoms, and utility companies to something far more tech orientated. This has helped weather our approach to growth investing, into one that works against all backdrops.

## People

Original investment ideas and differentiated thinking are the ultimate drivers of our investment returns. That process is enriched by the diversity of the Japanese Equity Team, one that combines stability and experience, with fresh thinking and change; a team with expertise in business analysis, made up of individuals with contrasting experiences; that combines regional insight with a global perspective.

## Patience

Adopting a long-term investment horizon allows us to capture unrecognised growth in all of its guises by overcoming the vagaries of cycles and short-term share price movements. At the same time, it allows our clients to benefit from the value created by Japan's most successful companies.

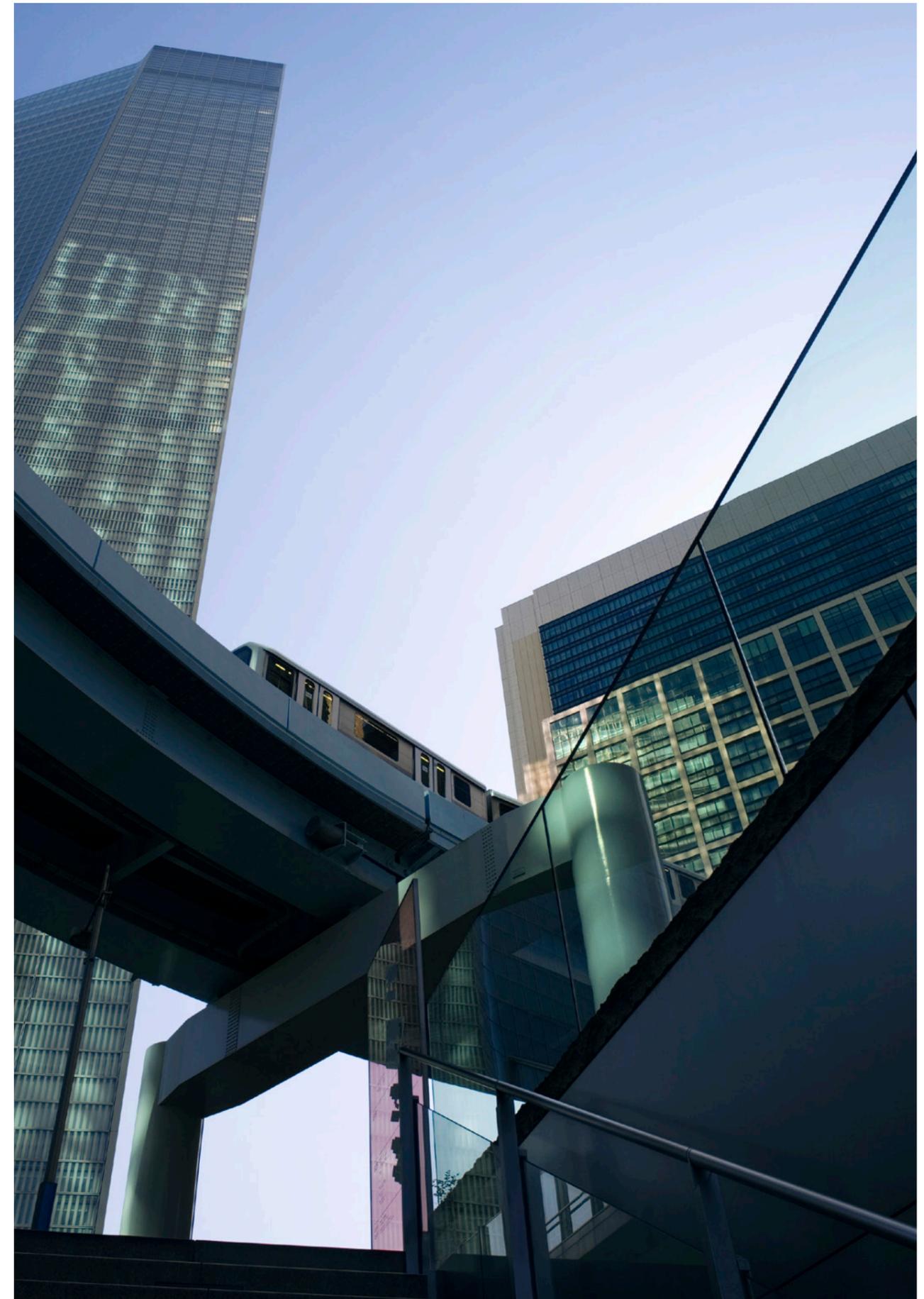


# Japanese Equities strategies

	Japan Growth	Japan All Cap	Japan Inc. Growth	Japan Smaller Cos
<b>Inception</b>	2009	1984	2016	1983
<b>Time horizon</b>	5 years+	5 years+	5 years+	5 years+
<b>Typical annual turnover</b>	10–20%	10–20%	10–20%	10–20%
<b>Index</b>	TOPIX	TOPIX	TOPIX	MSCI Japan Small Cap
<b>Guideline no. of holdings</b>	35–55	45–65	45–65	40–80
<b>Max stock position</b>	10%	10%	10%	10%
<b>Min effective no of stocks</b>	20	25	25	N/A
<b>Min effective no of industries</b>	7	7	7	N/A
<b>Min Market Cap Guideline</b>	>¥200bn	>¥100bn	>¥75bn	N/A

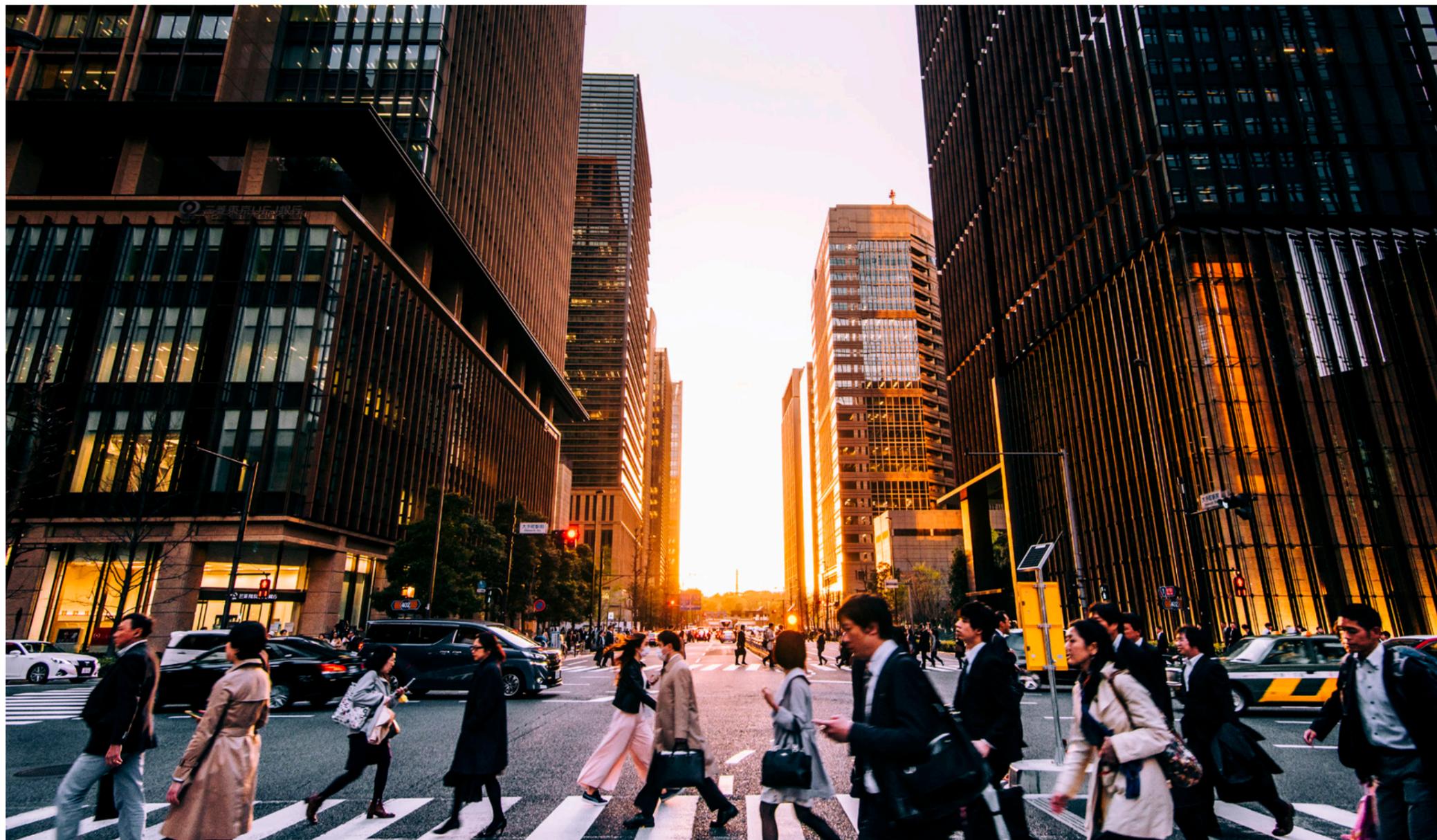
The strategy aims to achieve a targeted outperformance above benchmark of at least 2% for Japan All Cap, Japan Growth and Japan Small Cos and 1.5% for Japan Income Growth per annum over rolling five year periods. As the strategy is not constructed with any great reference to an index, we are happy to be measured against Topix, MSCI Japan or FTSE Japan Indices.

The performance target is aspirational and is not guaranteed. We don't use it to compile the portfolio and returns will vary. A single performance target 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.



# Opportunity

Finding opportunities consistently from the 1980's to the 2020's



Japan is the world's third largest economy, home to unique technologies and an emerging class of digital disruptors. Our 40+ years of experience managing Japanese equity mandates, combined with a patient long-term approach allows us to benefit from those at the vanguard of innovation and entrepreneurialism.

There are plenty of examples to be found in areas such as robotics and automation, or in the manufacturing of complex electronic components, where Japan retains its technical edge. Less obvious, are the emerging class of entrepreneurs that are helping the country tackle its digital transition. Japan is also home to some of the world's best-known brands, many of which are primed to benefit from the premiumisation trend within Asia, from rising wealth across the region.

These are just some of the opportunities emerging for bottom-up, selective stock pickers within Japan.

# People

Meet the team that has backed Japan the longest.



**Donald Farquharson**

Donald is Head of the Japanese Equities Team at Baillie Gifford, which he joined in 2008. He is currently the co-manager of the Japan Growth Strategy, which he has run since its inception, and also a member of the International Alpha Portfolio Construction Group. Donald has over 35 years of investment experience, almost all dedicated to Japan, having worked in Tokyo, London and now Edinburgh. Prior to Baillie Gifford, Donald spent 20 years working for Schroders as a Japanese specialist and latterly Head of the Pan Pacific Equity Team. Between 1991 and 1995, he headed Schroders' Japanese Research Team in Tokyo. He graduated with MA (Hons) in Arabic Studies from the University of St Andrews in 1987 and is a CFA UK Charterholder.



**Matthew Brett**

Matthew is an investment manager in the Japanese Equities Team. He joined Baillie Gifford in 2003 and became a partner in 2018. He is manager of the Japanese Fund (and related All Cap Strategy segregated accounts), manager of the Baillie Gifford Japan Trust and co-manager of the Japanese Income Growth Fund. Matthew graduated BA (Hons) in Natural Sciences (Psychology) from the University of Cambridge in 2000 and holds a PhD in Psychology from the University of Bristol.



**Iain Campbell**

Iain joined Baillie Gifford in 2004 and became a partner in 2020. He is a member of the Japanese Specialist Team. He manages various specialist Developed Asia portfolios and is a member of the International All Cap Portfolio Construction Group. Iain has been a member of the Managed Team since 2014. Prior to joining Baillie Gifford, Iain worked for Goldman Sachs as an analyst in its investment banking division. He graduated BA in Modern History from the University of Oxford in 2000.



**Praveen Kumar**

Praveen is an investment manager in the Japanese Equities Team. He is the manager of the Japanese Smaller Companies Fund and the manager of related Japan Small Cap Strategy segregated accounts, manager of the Shin Nippon Investment Trust Plc, and deputy manager of the Baillie Gifford Japan Trust Plc. He is also a founder and member of the International Smaller Companies Portfolio Construction Group (PCG). He previously worked for FKI Logistex before joining Baillie Gifford in 2008. Praveen graduated BEng in Computer Science from Bangalore University in 2001, and completed an MBA from the University of Cambridge in 2008.



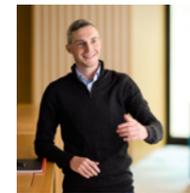
**Tolibjon Tursunov**

Tolibjon is an investment manager in the Japanese Equities Team. He is co-manager of the Japan Growth Strategy (and related Growth Strategy segregated accounts). He joined Baillie Gifford in 2011 and spent time working on our regional as well as large and small cap global equities teams. Prior to joining Baillie Gifford, he worked in the corporate finance department of an FMCG company, before founding a price comparison website in Central Asia covering insurance, banking, and telecom sectors. Tolibjon graduated LLB in Law from Queen Mary University of London in 2008 and is a CFA Charterholder.



**Karen See**

Karen is an investment manager in the Japanese Equities Team. She is a co-manager of the Japanese Income Growth Fund. She joined Baillie Gifford in 2012. Karen graduated BSc (Hons) in Economics with Japanese from University of Birmingham in 2011 and is a CFA Charterholder.



**Jared Anderson**

Jared joined Baillie Gifford in 2016 and is an investment manager in the Japanese Equities Team. Prior to this he worked in the Global Alpha, UK Equities and Fixed Income Team. Before he joined Baillie Gifford he spent two years as an Assistant Economist at the Scottish Government. Jared graduated MA (Hons) in Economics from the University of Edinburgh in 2012.



**Mirbahram  
Azimbayli**

Mirbahram joined Baillie Gifford in 2018 and is an investment manager in the Japanese Equities Team. He graduated BSc in International Relations from the Middle East Technical University (METU) in 2016 and MPhil in Russian and East European Studies from the University of Oxford in 2018.



**Tia Chen**

Tia is an investment analyst on the Japanese Equities Team. She joined Baillie Gifford in 2022 and has previously spent time with the Discovery Team. Tia graduated BA (Hons) in Land Economy from the University of Cambridge in 2021 and completed an MPhil in Real Estate Finance at the University of Cambridge in 2022.



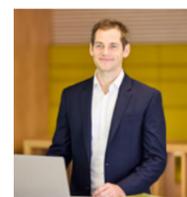
**Jack Torrance**

Jack is an investment analyst in the Japanese Equities Team. He joined Baillie Gifford in 2019, initially in the Clients' Department as an investment specialist in the Health Innovation Team, before moving roles. Prior to this, he worked for an NGO in the Middle East, following a career as an Infantry Officer in the British Army for eight years, completing two combat tours in Afghanistan and Iraq, and other deployments in the Levant and Central Asia. Jack graduated BA in Middle Eastern Studies from the University of Exeter in 2011 and speaks fluent Arabic.



**Eric Hertz**

Eric is an ESG analyst working with the Japanese Equities Team and the International All Cap Team. He joined the firm in 2022 and first worked with the International Alpha Strategy after earning an MSc in International Business and Emerging Markets from the University of Edinburgh. Eric has previous experience working with impact communication, stakeholder integration, and sustainable value chains through his work with a Ugandan coffee start-up. Eric grew up in Kenya, Bangladesh, and Uganda.



**Thomas Patchett**

Thomas is an investment specialist in our Japanese Equities Team and a member of the Japan Product Group. Thomas maintains a close relationship with the Japanese Investment Team, participating in stock discussions and portfolio meetings, as part of his investment specialist role. Thomas joined Baillie Gifford in 2015. Prior to joining Baillie Gifford, Thomas worked as a Private Banker at Barclays Wealth & Investment Management. Thomas graduated BSc (Hons) in Business Management from Kings College London and is also a CFA Charterholder.



**Sarah Clark**

Sarah is an investment specialist in our Japanese Equities Team. Sarah maintains a close relationship with the Japanese Investment Team, participating in stock discussions and portfolio meetings, as part of her investment specialist role. Prior to joining the Japan Team, Sarah spent four years with the Long Term Global Growth Team, responsible for existing clients. She joined Baillie Gifford in 2010. Sarah graduated BA (Hons) in Business Studies from Edinburgh Napier University in 2007.

**The Japanese Equities Team also employs two Tokyo based researchers, Satoko Ishino and Akiko Hirai, who provide additional insight and input into the investment process.**

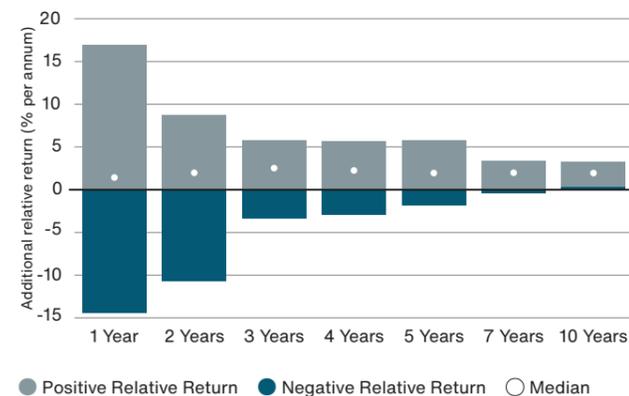
# Philosophy

We aim to create value for our clients by finding and investing in Japan's most promising growth companies. We do so, by employing a flexible approach to growth investing, and using time to our advantage.

## Time is our greatest asset

Adopting a long-term approach allows us to frame investment opportunities differently to the rest of the market. We consider the unique attractions of individual companies, and we do so over five-year time periods and beyond. This long-term focus enables us to eschew the ephemeral vagaries of markets, cycles and share prices – to unearth exploitable and under appreciated opportunities that will ultimately deliver long-term outperformance.

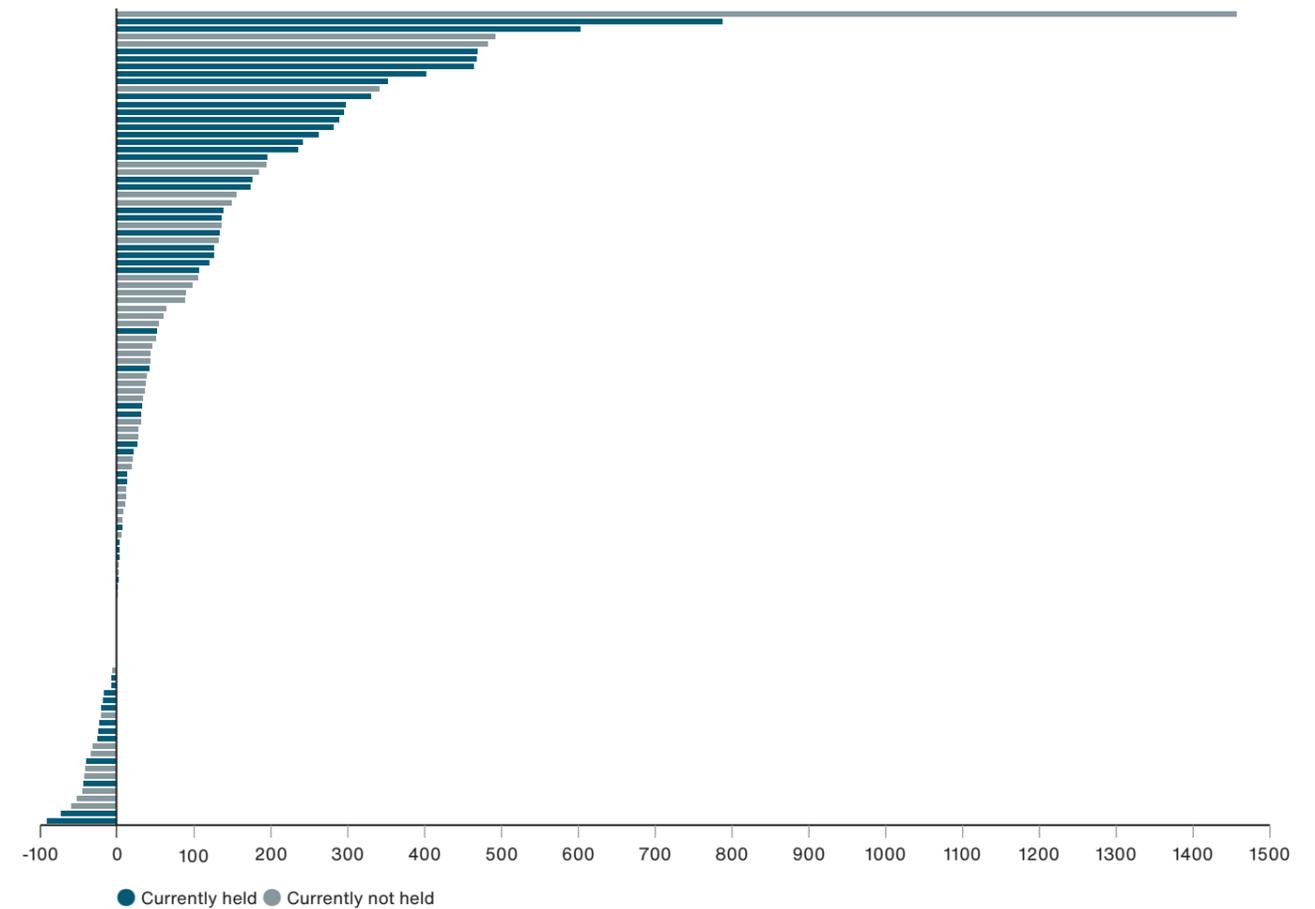
## Range of returns over rolling periods



Source: StatPro, Japan Exchange Group. As at 31 December 2022, net of fees. The figures above show results after analysing annualised returns over each quarter for the Japan Growth Composite vs TOPIX.

Past performance is not a guide to future returns.

## Cumulative absolute return of Japan Growth Stocks – 10 years to 31 December 2022



Source: StatPro. Japan Growth composite. Returns in Yen. Some stocks were only held for part of the period.

For our clients' portfolios, long-term returns are determined, by seeking out, investing and continuing to back a relatively small number of exceptional businesses which grow to multiples of their starting size. This approach will inevitably lead to some mistakes along the way, but by focusing on opportunities for major upside potential and supporting them for significant periods of time – by running our winners – we are able to capture the inherent asymmetry of equity market returns.

## Flexible approach to growth investing

Our experience has highlighted that growth can come in various guises, from companies of all shapes and sizes. As such our portfolios are invariably built, from the bottom-up, with a diversified mix of companies from across all sectors and industries.

The commonality is that each investment must present a plausible pathway to doubling over a five-year period. But of course, there are various ways to climb a mountain. Be that through a gradual (compounding) approach, or via a more vertical (exponential) axis.

By focusing on businesses with attractive structural growth opportunities, with strong and sustainable competitive positions, high-quality earnings and aligned management we will optimise our exposure to Japan's best of breed growth opportunities.

# Process

## We see Japan differently to others

### Idea generation

In pursuit of Japan's most attractive growth companies, we aim to generate original investment ideas by utilising a variety of sources. In addition to the more conventional inputs such as meetings with senior management and scrutinising company reports and accounts, we utilise private company analysis, bespoke and thematic reports from our independent researchers in Tokyo, investment trips (not limited to Japan), links with academia and industry experts.

### Research and debate

Companies that pique our interest are subject to our four-factor investment framework analysis. This process is intended to focus attention on key fundamentals that we believe are most pertinent to delivering long-term growth.

### Opportunity

#### How big is the opportunity over 5-10 years?

First, we look at the favourableness of the environment in which the company operates.

Is this a blue ocean opportunity in terms of the addressable market? Are there favourable industry dynamics, such as weak incumbency? Is the industry or market undergoing structural change? What will be the effects of environmental and technological shifts in the long-term and which companies are likely to benefit?

### Resilience+

#### How durable/adaptable will the competitive advantage be in five years' time?

We then explore whether the company has identifiable qualities that we believe will allow it to thrive in the complex environment in which it operates.

One way of thinking about Resilience is as dynamic and durable competitive advantage. How replicable is their edge, and is it sustainable? Another view is from the customers' perspective. How much value is the company adding? If it did not exist how much would it be missed? We are less interested in their competitive moat right now than, how deep it will be in five years' time and whether it will get deeper from there.

Another important aspect is the competence and alignment of management. Are leadership able to organically create new value organically? Is there a strong record of execution that gives us confidence in the future decisions? Can we see evidence of genuine ambition and vision? Are they aligned with wider stakeholders?

A business with high resilience should also have excellent future financial characteristics. An ideal investment will see its returns improve as it grows, and profits will be effectively converted to free cashflow. For those businesses that are more economically sensitive we look for evidence that profits and returns can rise through capital cycles and ideally make investments for our clients at what we believe to be favourable entry points.

Together these factors help us to identify whether we think the company in question will successfully execute on the opportunity that exists.

### Sustainability

#### Taking in turn environmental, social, and governance factors, which do you believe are important and relevant to the investment case?

We believe that ESG factors can have a material impact on a company's ability to generate long-term value. As such, we explicitly address these issues within the research framework.

Here we explore how the company intends to address environmental, social, and governance factors. The relevance of each is based upon the perceived materiality to the long-term sustainability of the company's business. As a result, key ESG considerations will vary depending on the industry sector, and core business activities of each company.

### Upside

#### What is the likelihood of over 2x upside?

This dimension brings the investment case together, indicating to us whether a holding meets the high bar that we look for. We prefer to focus on the return we might realistically expect to make if we invest in the shares, aiming off conventional valuation metrics, which often tell us very little about the upside potential.

We assess the probability weighted average upside, considering both realistic base case scenarios as well as blue sky outcomes.

### Decision

The final decision will lie with the manager(s) of the strategy, depending on individual conviction and broader portfolio context, whilst taking any relevant guidelines into account.

To assist in this process, the investment managers meet formally fortnightly to review the portfolio and prospective investments.

# How we think about ESG

We believe that by considering each company's environmental and social impact, and their governance practices, we will not only mitigate any financial risk from their activities but also help companies become more robust and contribute to long-term returns. As such there are two core ways in which we integrate ESG considerations:

## 01

### Embedded into our research process

Each member of the team integrates ESG into their analysis via an explicit question within the four-factor investment framework, which is boosted by the specialist input of the team's dedicated ESG analyst.

Not just seeking out the best Japanese companies, but those with the best practices

## 02

### Ongoing engagement

We seek to deliver long-term returns for our clients and to benefit society. Therefore, we have a responsibility to behave as supportive and constructively engaged long-term investors. Our approach favours a small number of simple principles which help shape our interactions with companies. These stewardship principles are as follows:

- Alignment in vision and practice
- Governance fit for purpose
- Sustainable business practice

### Additional considerations – applicable to the Worldwide Japanese Fund

#### Screening

We apply the UN Global Compact principles screen; excluding businesses that are inconsistent with the set of ten responsible business principles that cover human rights, labour, environment and anti-corruption.

#### Avoiding controversial investments

We avoid companies involved in activities that cause environmental or social harm that are likely to face increasing regulatory pressure and disruption. This includes companies with significant exposure to armaments, tobacco, thermal coal, tar sands, and arctic drilling. For further details of how exclusions apply to the Worldwide Japanese Fund please see the Prospectus.



# How we manage risk

We believe that permanent loss of capital is the most important risk to any portfolio, over and above model-based risk measures and historic share-price behaviour. We attempt to mitigate this risk in various ways:

## Fundamental analysis

Our first line of defence is extensive due diligence. New buy ideas - and current holdings - are subject to thorough reviews by the Japanese Equity Team, with input from a plurality of Baillie Gifford research teams.

## Portfolio risk

We seek to maintain an appropriate level of diversification at the overall portfolio level by embracing pragmatic risk guidelines which are formally reviewed on a regular basis.

## Liquidity risk

We maintain a Product Group rule that we will not hold more than 10 per cent of the portfolio in stocks where we hold more than 8 days' trading volume at time of purchase. This ensures that the portfolio remains sufficiently liquid to enable positions to be exited or client cash flows to be managed with minimal impact.

## Risk. Going beyond box ticking

### Independent Oversight, beyond box ticking.

We have an independent Investment Risk Team at Baillie Gifford which provide value-added analysis on portfolios, that goes far beyond the concept of an investment risk function being only adversarial risk police. While part of their toolkit includes an ability to disagree and constructively oppose based on various oversight mechanisms and risk guidelines, they also play a role as engagers of portfolio managers: providing perspectives on the portfolios (on capital allocation, behavioural biases and decision making analysis for example) with the aim of improving the investment process, to achieve better outcomes and minimise opportunity costs.

This reflects our pragmatic approach to risk management.

### Investment risk philosophy

<b>Patience is a virtue, and fundamentals dominate long-term returns</b>	Short-term volatility shouldn't unduly influence long term decisions
<b>Focus on value-adding relationships with Investment Teams</b>	Provide bespoke analytics and research
<b>Focus on downside risk as well as on potential upside foregone</b>	
<b>'Risk' is not a single number solution</b>	We recognise the limitations of risk model and use critical thinking to interpret outputs
<b>Beyond box ticking</b>	Value adding and engaging analysis drawn from a variety of measures and perspectives

# Why invest with Baillie Gifford

**Long term. Patient. Consistent ownership. Sharing the same values as great Japanese companies also allows us to share in their success.**

Baillie Gifford was founded in 1908 in Edinburgh where it continues to have its headquarters and is an investment partnership, wholly owned by the people who invest for and look after our clients. Through each successive generation of partners our sole focus on generating superior long-term investment results for our clients has been the bedrock of our growth.

### Partnership defines us

Our structure allows us to put our clients' needs first rather than dance to the tune of external shareholders. It brings stability and a long-term time frame to everything we do in our business, whether choosing the best investments for our clients' portfolios or continually investing in the firm and developing our people. Partnership also brings independence, allowing us to be truly active investors. Our portfolios are shaped by where the best investment opportunities lie, rather than where the index dictates. We encourage personal responsibility, creating a strong culture of inquisitiveness, debate and respectful trust in which our investors are nurtured, and thrive.

# Conclusion

Our unique organisational culture allows us to add value for our clients after fees over the long-term through the consistent application of a highly distinct investment philosophy. We are proud of our record but at the same time always strive to improve and like the companies we invest in, have a stated goal of being world leading in what we do.

## Periodic performance

	Composite Net (%)	TOPIX(%)
<b>1 Year*</b>	10.8	20.0
<b>5 Years</b>	2.9	6.8
<b>10 Years</b>	3.9	5.4
<b>Since Inception</b>	6.2	6.3

Annualised periods as at 31 December 2023. \*Not annualised. US dollar. Figures may not sum due to rounding. Source: Revolution, Japan Exchange Group.

## Discrete performance

	31/12/18 – 31/12/19	31/12/19 – 31/12/20	31/12/20 – 31/12/21	31/12/21 – 31/12/22	31/12/22 – 31/12/23
<b>Composite Net (%)</b>	21.3	26.5	-3.5	-29.8	10.8
<b>TOPIX (%)</b>	19.2	13.0	1.1	-14.9	20.0

Source: Revolution, Japan Exchange Group. US dollars. Japan Growth Composite. The Japan Growth Strategy is more concentrated than the TOPIX.

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