



# Sustainable Emerging Markets Bond Fund

Philosophy and Process

**Baillie Gifford™**

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## Our Vision

**We aim to deliver excellent returns for our clients by investing in countries and companies contributing to a sustainable future.**

**Countries that develop their environmental, human, social and institutional capital will strengthen their resilience and build positive economic momentum.**

**Sustainable investing therefore contributes to the achievement of the UN Sustainable Development Goals and offers attractive long-term returns.**









## The benefits of our approach

### **Resilient income and attractive returns**

We aim to provide attractive returns by delivering a resilient income stream and minimising drawdowns. Our approach allows our clients to invest in emerging markets through the business cycle.

Our objective is to outperform the hard currency index JP Morgan EMBI Global Diversified.

### **Supporting countries progressing towards achievement of the UN Sustainable Development Goals and Paris Agreement targets**

Most of the world's population lives in countries that are classified as emerging markets. By lending capital to countries that can deploy it productively, our clients can support economic development, raise standards of living and drive the transition to a low-carbon global economy.

### **Flexibility to pursue opportunities**

We use a broad lens to look for emerging market income opportunities, investing in hard currency bonds issued by a wide range of governments and companies, and at times lending in local currencies when this enhances return prospects.

# Our Beliefs

## Time sorts winners from losers

Over the short term, emerging market bonds tend to trade closely together, swayed by changes in global sentiment, oil prices or US monetary policy. These factors create a lot of market noise but are extremely hard to forecast accurately. Over longer time horizons, countries' fortunes – and the prices for their bonds – diverge significantly and create investment opportunities for patient investors.

## Good stewardship is critical

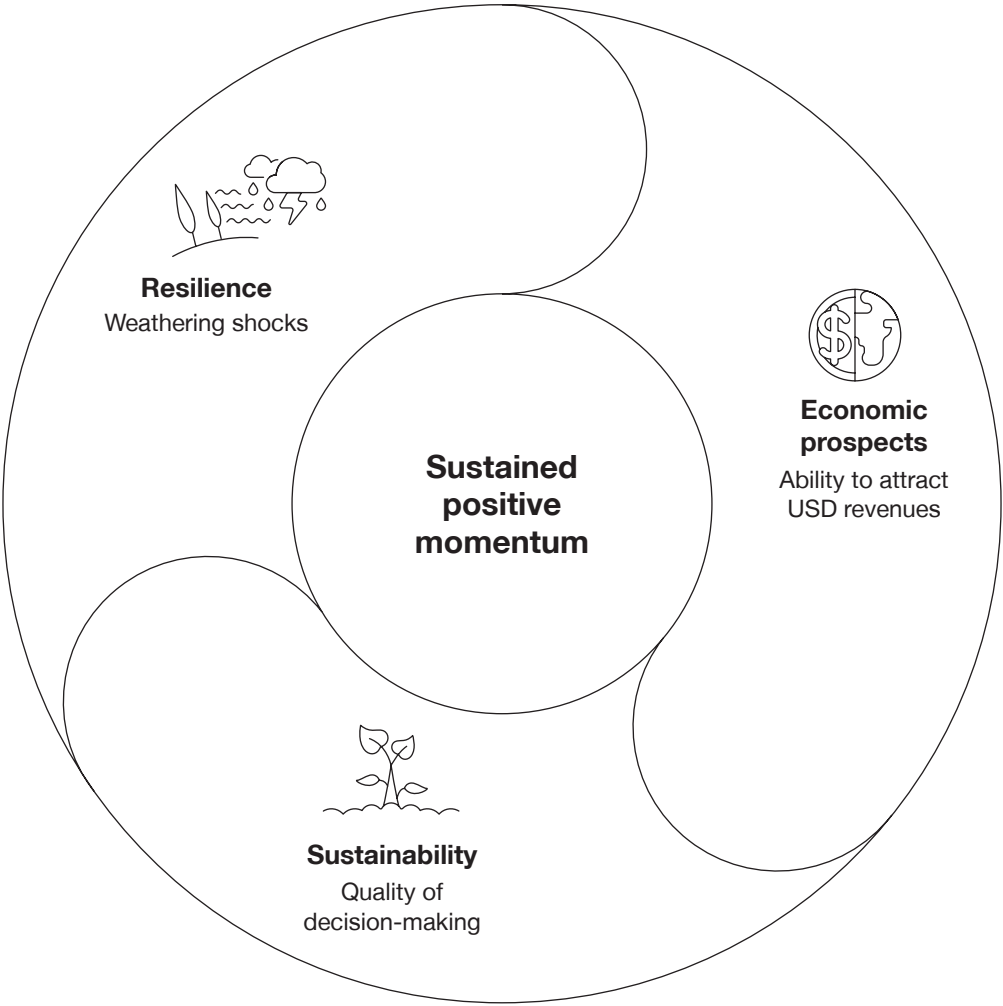
Countries' future prospects depend on the decisions they take today. Investment in human, environmental, social and institutional capital can drive persistent and self-reinforcing advances in prosperity and resilience. Thoughtful sustainability analysis can reveal whether such advances are likely to be achieved, or conversely if short-termism will lead to increased fragility and greater risk.

## Thinking around corners

To paraphrase Hemingway, countries go bankrupt gradually then suddenly. The market often assumes that existing trends will continue, however the erosion of debt sustainability rarely follows a straight-line trajectory. To successfully identify countries which might default we need to ground our analysis in available data, but also apply experience and creativity to anticipate the tipping points which can lie ahead.



We believe that investment in human, environmental, social and institutional capital drives advances in prosperity and resilience – and better investment returns over the long term.





# The Importance of Resilience

We prioritise investments which will prove resilient when tested by future shocks. Yet excessive risk aversion will not deliver the returns our clients need – instead we are looking for sources of resilience that are misunderstood or underappreciated, such as an institutional framework which promotes counter-cyclical policy-making, or sources of financial support which are reliable at times when the market is not. While such resilience is unlikely to significantly enhance returns over short time periods, over the long term avoiding economic fragility and vulnerability tends to lead to divergent returns as higher default rates would lead to greater losses of client capital. And if we are confident in an investment's resilience, we can invest with conviction and increase the size of our position.



# Our Edge

## Patient

Although the long-term approach has clear advantages, it is not easily followed. The most enticing short-term opportunities are frequently the least sustainable over the longer term. Baillie Gifford's partnership structure and our culture encourages us to focus on fundamental analysis and ignore high-yielding but ultimately unsustainable opportunities. We are patient, unwilling to invest until we are sure that we are adequately compensated for risk, and then happy to hold during periods of market volatility. This is founded on the confidence derived from the robustness of our research process, helping us avoid selling investments when they are being tested – a rapid way to lose client capital.

## Disciplined

Our approach rests on a deeply held belief in mutually beneficial lending. We consider whether the rate of interest on offer is financially, socially and politically worthwhile for the *borrower*, and believe that where it is not, the risk of default is often underestimated. We look for virtuous circles, where capital is used to drive higher productivity, thereby reducing the risk to future lending. We believe that such virtuous circles tend to be overlooked by the market given the length of time they take to play out.

## Country-focused

We prize curiosity, and are obsessed with learning about the countries in which we invest. We pay particular attention to the quality and structure of the institutions through which a country is governed, as we believe that this is critically important over longer time horizons.

We continually make comparisons between a wide range of countries, aiming to identify relative value opportunities, and more generally stimulate ideas. We do not divide our team into silos but instead rotate country coverage to enhance debate. Given the ebb and flow of international capital markets we use our proprietary macroeconomic analysis to consider our investments in the global economic context.

A broad range of resilient investment ideas requires a diverse opportunity set. In each country we consider which investments offer the best risk-adjusted return, looking beyond sovereign hard currency credit to include corporate credit, local rates and FX. To do this we draw on our long experience investing in local markets and our emerging markets corporates research capability.









# Our Investment Process

Our investment process is designed to reinforce and capitalise on our investment philosophy. It aims to blend creative idea generation with a systematic framework to ensure that every investment does its part in contributing to the outperformance of the portfolio as a whole. As such it balances fundamental research with imagination, and valuation analysis with behavioural safeguards. It is both patient and continuous, given our strong belief that fundamental factors take time to play out, versus our certain knowledge that we will sometimes get things wrong. Our disciplined position sizing limits losses when this happens, and portfolio outperformance is driven by the aggregation of a broad range of ideas, rather than by putting all our eggs in any one basket.

## 1. Understand

We develop our country ideas further using our “Growth, Sustainability and Governance” fundamental research framework. This focuses us on the longer-term structural direction of a country, its sustainability characteristics, its cyclical position and how we expect it to evolve over the coming years. This involves forecasting growth and inflation, and how fiscal and external debt sustainability will evolve. We bring together quantitative analysis with an understanding of how political decisions are taken and policies enacted, and how these will affect economic and social outcomes. We seek information from a diverse range of sources, and particularly prize the expertise of academics and commentators who can help us understand how each country actually works. This analysis forms the basis for our estimates of fair values in hard currency spreads, local currency bonds and FX, and help determine where the best risk-adjusted return is available from current market levels.

Our corporate debt analysis is grounded in our country research. Working together in one team, we use our country analysis to form an understanding of the sovereign backdrop and the impact it can have on company’s performance. We take a long-term view on companies we lend to. Some of the questions we ask include: what is the company’s competitive position? What edge does the company have in its field? What are its weaknesses? What growth opportunities and challenges will the company face in the next three years? We put a contribution to sustainability at the heart of our company analysis, contemplating both the company’s contribution to the UN Sustainable Development Goals (SDGs), as well as its treatment of stakeholders, while acknowledging the complexities of emerging markets.

### How do we approach sustainability?

Sustainability analysis is an integral part of our research process. Country analysts are responsible for sustainability assessment, leaning on the expertise of our dedicated ESG analyst and the broader ESG team within Baillie Gifford.

Our in-house country assessment has two parts:

- Climate action: Will the country be on course to achieve Paris targets on Climate Change in three to five years' time?
- Sustainability progress: Will the country deliver sustainable development, as measured by the UN SDGs? Is the country's governance good or improving?

When we invest in companies we ask that:

- They contribute to a sustainable future. We look at their products and services and how they contribute to achievement of the UN SDGs in the countries where they operate.
- They treat stakeholders fairly. We use the sustainability dimensions of the Sustainability Accounting Standards Board (SASB) matrix to assess the sustainability credentials of their operations.

### Investment restrictions

We do not invest in countries that are subject to UN Sanctions, have not ratified the Paris Agreement, or are on the Financial Action Task Force (FATF) blacklist for terrorist financing and money laundering. We do not invest in companies with significant revenues from production of armaments, tobacco and thermal coal or in breach of UN Global Compact.

### Monitoring

Our sustainability research seeks to understand the direction of travel, so we set milestones to monitor progress and recognise when we might need to reconsider our view.

### Engagement

We use our position as capital providers to engage on selected issues directly and through industry bodies.

## 2. Value

Given our understanding of the issuer, we think about its current valuation relative to the countries or companies which we consider will be its peers *in the future*. We use scenario analysis to assess the impact of a range of endogenous or exogenous factors on the investment's value, giving significant emphasis to ideas with the capacity to withstand stress. In some cases, where we believe an investment has underappreciated resilience, we are happy to earn excess compensation over the life of the bond, while in others where we see a positive catalyst for market to reassess the instrument's creditworthiness, we aim to make returns through capital gain.

### 3. Discuss

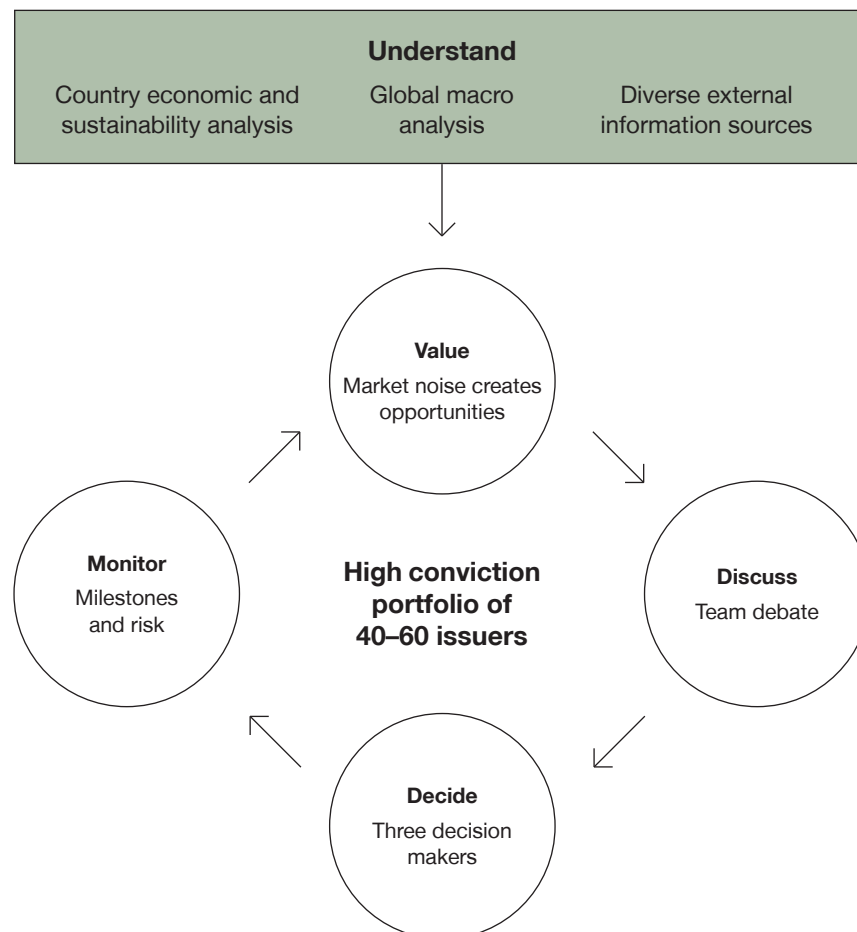
Once fundamental research has been carried out, ideas are presented to the team and discussed. We allow for the rotation of geographic coverage within the team, and the resulting high level of background knowledge helps elicit informed questions and a more insightful debate. Follow up avenues and sources of information are identified.

### 4. Decide

Following team debate, each investment is considered and decided by a group of three decision makers. The proposed investment is rated for its risk level, performance prospects and diversifying properties, with the combination of these factors determining potential position sizing.

### 5. Monitor

For each investment we establish milestones and risks for our investment case, and monitor and update these regularly, highlighting key changes at fortnightly analyst meetings. The aim is to give early warning if our investment thesis is not playing out, or conversely to signal if market movement has taken an investment above our assessment of fair value. This monitoring process also provides opportunities to identify new ideas and commission further fundamental research.

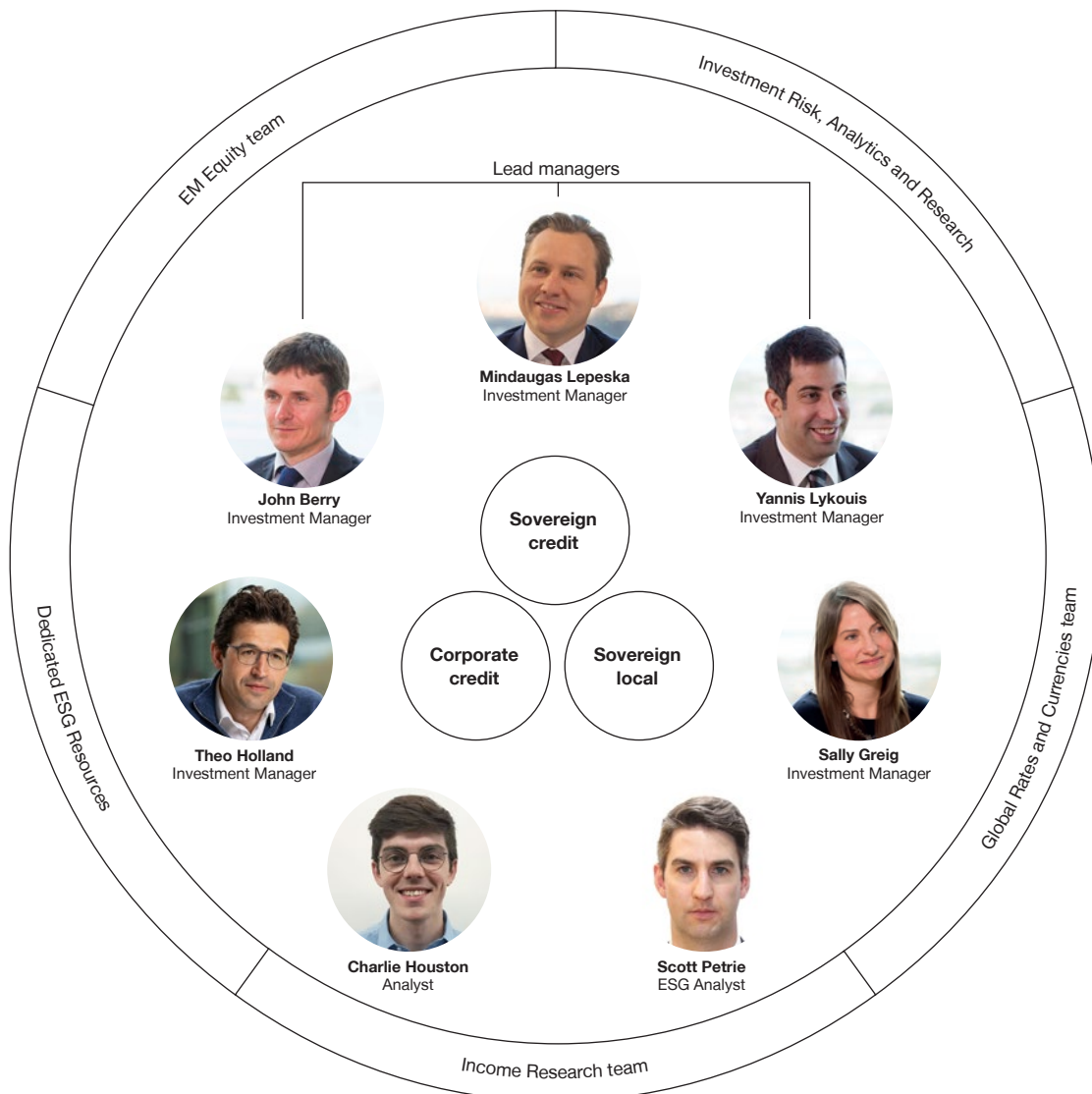




# The Team

Our five investment managers, each with more than a decade's experience in Emerging Market debt investing, work together with a dedicated ESG analyst, and investment management analysts. All investment managers also work as analysts with specific geographical coverage responsibilities.

The team draws on a range of academic backgrounds and personality characteristics to ensure a diversity of viewpoints and avoid the risks of groupthink. Roles and responsibilities are clearly demarcated to ensure efficient portfolio management and to expedite decision making. The team further draws on the expertise of our global bond, credit, EM equity and multi-asset investors, as well as our broader ESG team.



# How We View Risk

Emerging Market debt is predominately a credit asset class, with the majority of the fund invested in hard currency bonds, where the potential loss of capital in the event of default is usually larger than the discounted value of the future coupons promised by the issuer. Our risk management process is shaped by this “downside asymmetry”. It protects the value of client capital by ensuring exposure to individual issuers is limited through diversification. Furthermore, the process is also designed to ensure the portfolio is not vulnerable to specific thematic or factor risks. While we believe that good investment analysis is the best defence against loss, these limits provide a critical fail-safe.

## Implementation

- All investments are categorised within one of our four risk bands based on risk of capital loss. Position sizing depends on the risk band and our conviction level, with reduced positions for investments with higher default risk
- Regular risk analysis is conducted to reveal the portfolio’s exposure to a range of possible macroeconomic and other scenarios. This involves back-testing using historical data, and qualitative assessments of current and future sensitivities.
- The reference benchmark (JP Morgan EMBI Global Diversified) is used for risk and performance measurement. While the index itself is already diversified, with 70 countries, none with a weight larger than 5%, investment guidelines permit the fund to be highly active, allowing us to completely avoid countries where ESG or investment analysis indicates this is desirable. Conversely, we are able to hold off-benchmark positions in countries, companies or currencies which we believe offer attractive return or portfolio diversification properties.

## Review and challenge

Our independent Investment Risk, Research & Analytics team 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 also stress test the strategy using scenario analysis tools such as Bloomberg PORT, and conduct regular analysis to confirm the liquidity of the portfolio.

Strategy name	Baillie Gifford Sustainable Emerging Markets Bond
Benchmark	JPM EMBI Global Diversified
Number of issuers	40–60
EM credit (sovereign and corporate)	At least 80%
EM local currency	Maximum 20%
Maximum exposure	10% to any one country 5% to any one company 10% to any currency ex USD
Duration	+/-2% relative to benchmark
Tracking error	0-5%
Base currency	USD





# People

**Mindaugas Lepeska**

Mindaugas joined Baillie Gifford in June 2019 and is an Investment Manager in the Emerging Markets Debt Team. Prior to joining Baillie Gifford, he worked as an Emerging Markets Strategists and Economist at Columbia Threadneedle for eight years before being promoted to lead EM Local Currency Debt Strategy. Mindaugas began his career in 2009 as an Economic Advisor for RBS. He graduated BSc in Economics from the University of Southampton in 2008 and MSc in Economics from the London School of Economics in 2009.

**John Berry**

John joined Baillie Gifford in 2009 and is an Investment Manager in the Emerging Markets Debt Team. He also Chairs the Multi Asset and Fixed Income Review Group. Prior to joining Baillie Gifford, he spent eight years working for businesses and aid agencies in Emerging Markets. He graduated MA in Geography from the University of Edinburgh in 1999 and MSc in Development Practice from Oxford Brookes University in 2003.

**Yannis Lykouris**

Yannis joined Baillie Gifford in June 2011 and is an Investment Manager in the Emerging Markets Debt Team. Yannis is a CFA Charterholder. He graduated BSc (Hons) in Accounting & Finance from the Athens University of Economics & Business in 2008 and MSc in Financial Economics from the University of Oxford in 2010.

**Sally Greig**

Sally joined Baillie Gifford in 2005 and is Head of the Emerging Market Debt Team and Chief of Investment Staff for the Multi Asset and Income area. Prior to joining Baillie Gifford, she worked at the Bank of England from 2001 as an economist in the Foreign Exchange Division and provided regular analysis to the Monetary Policy Committee. Sally 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.

**Theo Holland**

Theo is an investment manager in the Emerging Market Debt Team. Before joining Baillie Gifford in 2021, he spent the first nine years of his career working as a credit analyst at Schroders and portfolio manager at Ashmore before moving to Switzerland to head up Emerging Market Corporates at Fisch Asset Management. Theo graduated MA in History from Edinburgh University in 2007 and is a CFA Charterholder.

**Charles Houston**

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Charles joined Baillie Gifford in 2020 and is an Investment Analyst in the Emerging Markets Debt Team. He graduated MEng Aeronautical Engineering in 2016 and PhD Computational Biology in 2021 from Imperial College London.

**Scott Petrie**

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Scott is an ESG analyst in the Multi Asset & Income team. Before joining Baillie Gifford in 2022, he was an associate analyst for the Responsible Investing team at T. Rowe Price. Prior to this role, he was a Senior Portfolio Analyst in the Fixed Income Division both in London and Hong Kong. His earlier experience includes working at Lloyd's of London as an actuarial analyst and at Lloyds Banking Group in a similar role. Scott earned a B.Sc. (with honors) in mathematics and financial economics at the University of Dundee. He is a CFA charter holder.

**Lucie Majstrova**

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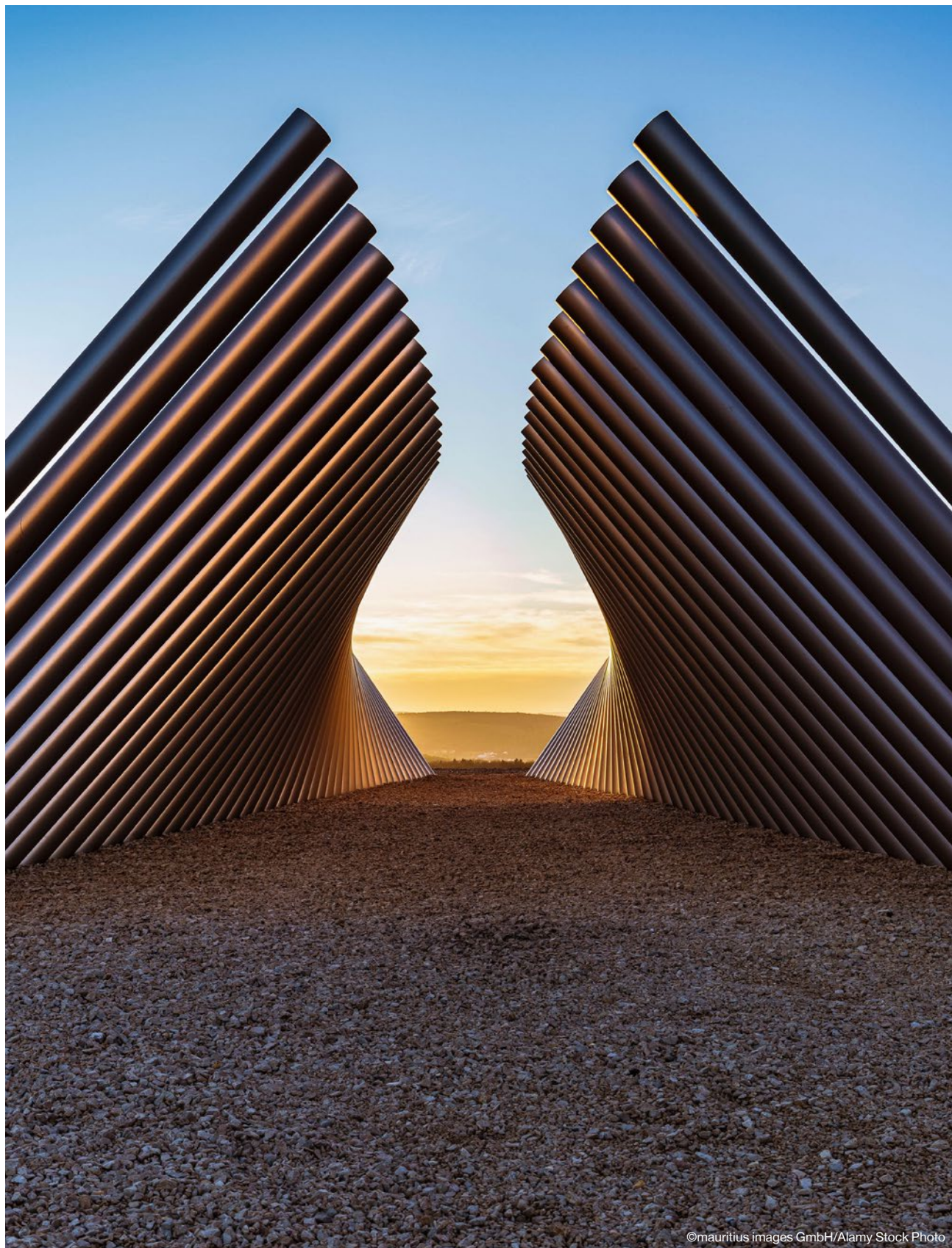
Lucie is a Multi-Asset and Income Product Specialist in the Clients Department. She joined Baillie Gifford in 2021 after 9 years at HSBC Private Banking where she focused on investment advice for private clients. Lucie has an MA in International Economics from IHEID in Geneva and is a CFA Charterholder.

**Alexander (Sandy) Jones**

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Sandy is an Income Product Specialist in the Clients Department, specialising in corporate credit. He joined Baillie Gifford in 2020 after six years as a product manager at Aegon Asset Management. He graduated MA (Hons) in International Relations from the University of St Andrews in 2006.







# Why Invest with Baillie Gifford?

*We are focused on delivering income strategies that will stand the test of time. We believe our structure and culture provides the environment necessary to deliver excellent and repeatable investment outcomes.*

## Our partnership structure

We believe that no investment firm, however rigorous in its approach, can consistently achieve great things for clients if the right corporate conditions are not in place. Baillie Gifford is an independent investment manager, wholly owned by 51 partners who work in the firm. The partnership structure has prevailed for over 110 years and enables us to take long-term views. It has provided the foundation for an enviable record of corporate stability and firmly aligns us with the long-term interests of our clients. We see it as a key strength because successful investment management is not easy. It requires dedication, independent thought, and a long-term perspective.

We are not a faceless corporation. We ensure individuals can thrive and ideas flourish. Our satisfaction comes from the pursuit of knowledge and its application to investments, knowing that if we do a good job, as well as achieving outperformance for clients, we will have also contributed to society's progress.

## Our people

Our people are fundamental to our success. The partnership structure creates a collaborative culture and one in which people stick around. We can 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.

## Our investment approach

We are long-term investors in everything that we do and this philosophy permeates the firm. Imagining what the future may hold requires mental flexibility. We need to imagine the potential implications of dramatic change and embrace uncertainty. We need to be ready to let go of preconceptions, while continuously learning and adapting our thinking to consider what we have learned. Our competitive advantage lies in understanding what matters and what is simply market noise, and in our ability to wait patiently to take advantage of periodic mispricing.

## Our location

The majority of our staff and decision-makers are based in Edinburgh. Being predominantly based in a single location lets us share investment views and ideas, and facilitates the efficient management of the strategy. It also provides perspective in a global environment, a key factor in our investment approach.

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