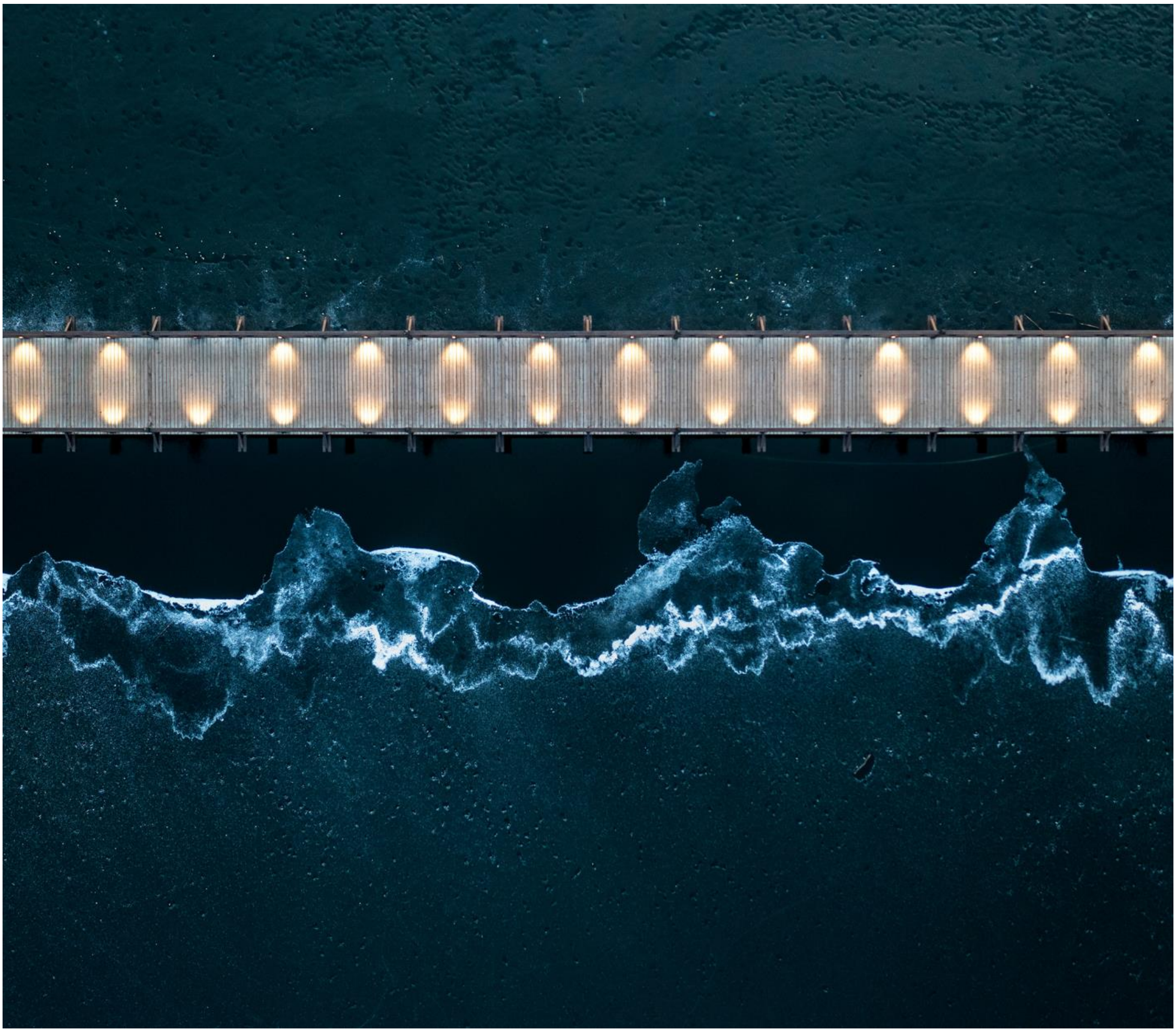
Diversified Return Quarterly Update

31 December 2023



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Past performance is not a guide to future returns. Changes in investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio. Material market or economic conditions will have an impact on investment results. The returns presented in this document are gross of fees unless otherwise stated and reflect the reinvestment of dividends and interest.
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Potential for Profit and Loss

All investment strategies have the potential for profit and loss.

Stock Examples

Any stock examples, or images, used in this paper are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual examples will represent only a small part of the overall portfolio and are inserted purely to help illustrate our investment style. A full list of portfolio holdings is available on request.

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Product Overview

Diversified Return invests across a broad range of asset classes with the aim of achieving dual objectives:

Return
Targeting attractive portfolio returns: 3.5% p.a. over cash*, net of fees, annualised over rolling five-year periods.

A positive return over rolling three-year periods.

Risk
With lower volatility than equity markets: annualised volatility of less than 10% over rolling five-year periods.

The performance objectives stated are not guaranteed.

*Cash rate applicable to base currency.

As expectations of a 'soft landing' became the dominant economic narrative, markets rapidly repriced their interest rate expectations for the year ahead

The portfolio delivered a strong return over the quarter, with long duration investments performing particularly well

We have reduced our government bond allocation but retain meaningful allocations to structured finance, emerging markets, and infrastructure

Baillie Gifford Key Facts

Assets under management and advice	US$287.6bn
Number of clients	674
Number of employees	1831
Number of investment professionals	395

Market environment

Markets can be very fickle over the short-term, and so it proved across the last three months of the year.

October began with most indices in retreat as concerns over the strength of US economic data led traders to continue to worry about how much higher policy rates would remain and for how much longer. US ten-year yields touched 5%, their highest level in fifteen years, pushing bond prices down. Other assets sold off too.

However, by late October, the dominant narrative had begun to swing around. Weaker economic data and trading updates from companies saw traders stop worrying about 'higher for longer' and the guessing game became how much lower could policy rates go, and how soon. With this abrupt change in narrative, yields tumbled, falling below 4% by December, pushing bond prices sharply higher. Other assets were buoyed by this easing of financial conditions, despite the implications for weaker earnings and fundamentals, and most rallied into year end.

By year end, a 'soft landing', whereby inflation falls neatly into central banks' target range, and growth softens but not so far as to herald a recession, had been clearly priced in.

Our view over 2023 has been that a soft landing or recession were the two most likely outcomes for the United States, and many other developed markets, and so we have maintained a long duration position across the portfolio, with meaningful allocations to government bonds as well as investment grade bonds and property.

Looking ahead to 2024, our view is that it seems likely that markets have become overconfident about a soft landing. There are still inflationary impulses in the economy that need to be quelled and, so long as those exist, it is always possible that underlying economic strength or another unexpected event could allow pricing pressures to re-emerge.

Or, perhaps more likely, there is no guarantee that growth will soften out just neatly at a low but not recessionary level. As we have commented on before, the interest rate hiking cycle over 2022-23 was exceptional in its speed and extent and, policy transmission lags being what they are, the impact of the latter rate rises are yet to be fully felt in the real economy, by companies, their owners and lenders.

Performance

We have maintained a long duration position across the portfolio through 2023, with meaningful allocations to government bonds, in both developed and emerging markets, as well as to other yield-sensitive asset classes such as investment grade bonds and property.

This investment position has very clearly benefited from the change of tone and these asset classes led a strong performance result over the quarter. Our investments in industrial logistics property assets, such as Prologis and Segro, alongside Australian government bonds were particularly strong contributors.

Throughout the course of 2023, we have generally preferred fixed income assets to equities for the portfolio, judging the asymmetry of returns to be better in the current economy climate. Equity indices have increasingly become dominated by a small handful of companies that trade at high multiples and require lofty expectations to be met to continue to deliver strong performance. Consequently, where we have owned more economically-sensitive assets, we have generally preferred those that we see as offering better value, either because we see them as outright good value, or because they come with a large yield, that can act as a substantial buffer against price weakness.

As it has happened, equities went on to have a very good quarter (and that small handful of companies has become even more richly priced). However, our 'better value' economic assets have also generally had very good quarters. Our high-yielding structured finance investments performed particularly well, as did our property investments, which delivered on rental growth and saw their capitalisation rates – the rate at which expected future cash flows are discounted – fall. Meanwhile, our actively-selected equity, infrastructure, commodity, and high yield investments also all made positive contributions.

Finally, other main diversifying asset classes, such as core infrastructure and cash, also turned in modest but positive performances. This meant that, in a rare turn, all major asset classes made a positive contribution over Q4.

Portfolio

Investment markets have moved to price in very firmly a ‘soft landing' for the US economy in 2024. For example, the Treasury yield curve implied six rate cuts at the end of December, when US policymakers continued to preach caution and only saw three to four cuts as likely.

We have taken the opportunity to reduce some of the portfolio's duration exposures into the recent market rally. In particular, we have completely sold the Swedish government bonds held (Sweden's ten-year yield fell from above 3% in October to below 2% in December) and substantially reduced our long-dated US Treasury investment. We are also considering the value of other duration exposures, such as investment grade bonds and local-currency emerging market debt. Both appear much less attractive on our latest Long Term Return Expectations (LTRE) than they had in mid-2023.

We retain our caution around mainstream equity markets. Estimates for earnings growth have already been falling despite the increase in equity prices. Were economies to tip over into a 'hard landing', we could see a substantial impact on both earnings and valuations. Consequently, we prefer to take economic risk through asset classes such as property, where we see substantial latent earnings growth built into industrial warehouses through rental renewals. Structured finance also remains appealing, where double-digit yields and credit enhancement provide a reasonable layer of protection against economic weakness. Within equities, we increasingly see Emerging Markets as offering the most attractive valuations and least demanding set of earnings expectations and have been increasing the size of the allocation.

After a relatively poor year, infrastructure assets are again looking increasingly attractive to us. We already added to our allocation late in 2023, taking advantage of sizable discounts amongst operational renewable energy investment trusts. However, we increasingly see other core infrastructure assets as having been left behind by the recent rally and are actively looking to increase the size of our holding.

Macroeconomic volatility remains likely to persist into 2024 as markets try to second guess short-term inflation and growth data and what central banks will do next. With this in mind, the portfolio remains well-diversified and somewhat cautiously positioned. However, reviewing our LTRE, we see plenty of asset classes that have the potential to produce above-target returns over the coming years and within our asset class groups are finding plenty of individual opportunities in which to invest. Consequently, we look forward to the year ahead with optimism and excitement about what is possible.

This commentary is based off a representative Diversified Return portfolio

Performance Objective

To outperform the Federal Funds Rate by 3.5% per annum (net of fees) annualised over rolling five-year periods with an annualised volatility of less than 10% over rolling five-year periods.

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.

Periodic Performance

	Composite Net (%)	Benchmark (%)
3 Months	6.6	2.2
1 Year	6.3	8.6
3 Years	-1.6	5.8
5 Years	3.0	5.4
Since Inception	2.4	5.3

Annualised periods ended 31 December 2023. 3 Month & 1 Year figures not annualised.
Inception date: 30 April 2017.
Benchmark is Federal Funds Rate +3.5%.
Source: Revolution.
US dollar.

Discrete Performance

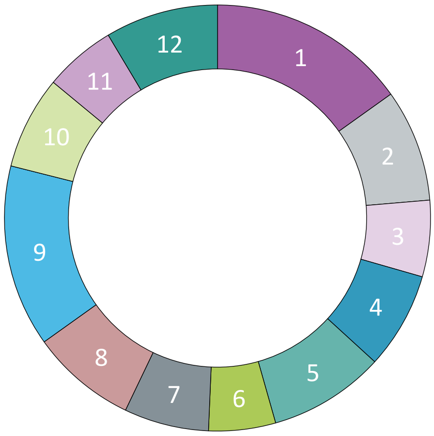
	31/12/18-31/12/19	31/12/19-31/12/20	31/12/20-31/12/21	31/12/21-31/12/22	31/12/22-31/12/23
Fund	14.5	6.1	7.7	-16.7	6.3
Benchmark	5.7	3.9	3.6	5.2	8.6

Benchmark is Federal Funds Rate +3.5%.
Source: Revolution.
US dollar.

The Diversified Return composite is more concentrated than the Federal Funds Rate +3.5%.

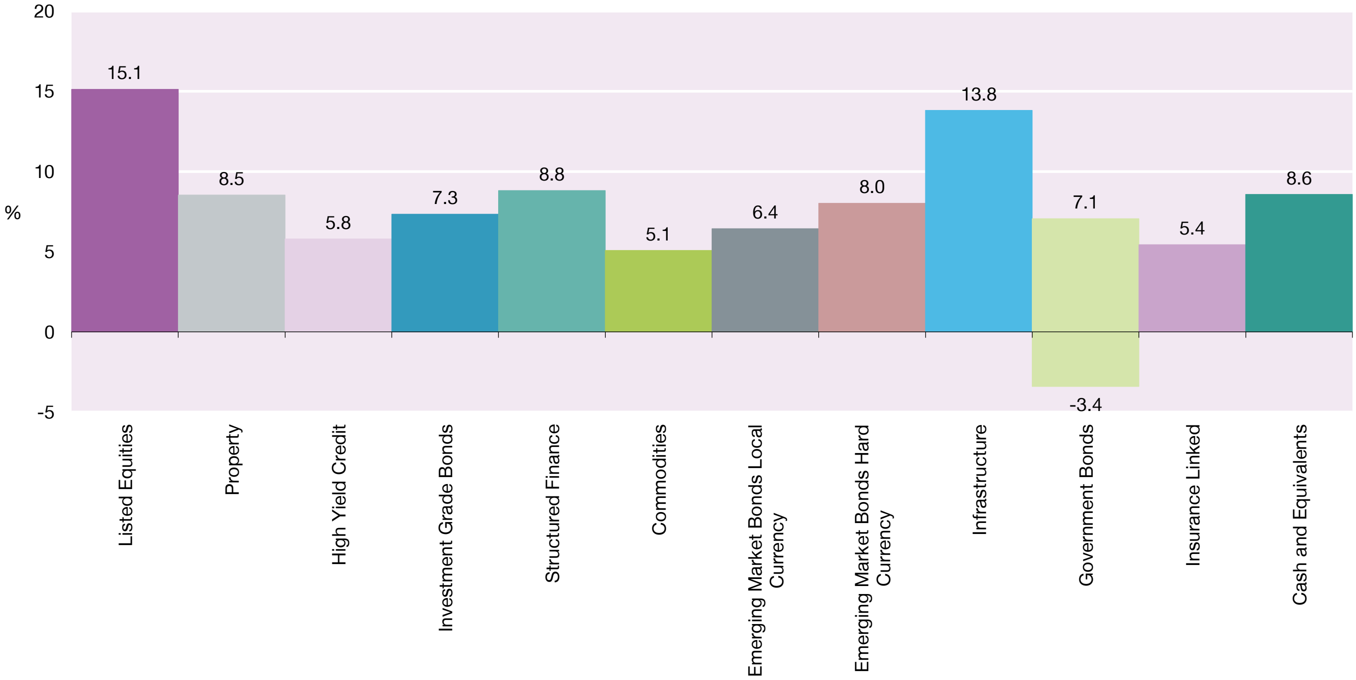
Asset Allocation at Quarter End

		(%)
1	Listed Equities	15.1
2	Property	8.5
3	High Yield Credit	5.8
4	Investment Grade Bonds	7.3
5	Structured Finance	8.8
6	Commodities	5.1
7	Emerging Market Bonds Local Currency	6.4
8	Emerging Market Bonds Hard Currency	8.0
9	Infrastructure	13.8
10	Government Bonds	7.1
11	Insurance Linked	5.4
12	Cash and Equivalents	8.6
	Total	100.0



As at 31 December 2023. Total may not sum due to rounding.
When calculating the asset class weightings, all futures positions are included at 0% weight.
In addition to the asset class weightings shown, the portfolio held short positions in government bond futures.

Asset Class Exposures at Quarter End



As at 31 December 2023. Figures may not sum due to rounding
Futures positions are included at their net exposure weight and cash includes collateral held to back all long futures positions, therefore total portfolio exposure may not sum to 100%.
Any difference between asset class exposures at quarter end and the asset allocation (as shown above) relates to futures positions, as do any negative exposures.
Futures positions are included at their net exposure weight and cash includes collateral held to back all long futures positions, therefore total portfolio exposure may not sum to 100%. Cash & Equivalents includes the net unrealised profit or loss of open currency positions in the Fund.

Company	Engagement Report
NextEra Energy, Inc.	Objective: To follow up on a set of wildfire risk exposure questions we sent to the US-regulated utility NextEra Energy, to discuss how it approaches and mitigates physical climate risks. We specifically sought to address the themes of (1) risk exposure, (2) preventative measures and accountability (3) customer electricity rates and regulatory cost recovery limitations. Discussion: Reliability is the key focus for the company's customers, followed closely by electricity bill affordability. With Floridian hurricane exposure in mind, the company has been focused on grid hardening (resilience) measures for well over a decade and the increasing challenges from a changing climate - including wildfires - have naturally become an extension of this well-established effort. We discussed the range of operational and maintenance efforts employed strategically by the company, alongside cost recovery mechanisms via regulatory rate setting and grid hardening priorities over the much longer term. Outcome: This engagement forms part of a group of multi-asset engagements that have been taking place over the course of Q4 2023, focusing on wildfire risk exposure for our North American utility holdings. Written responses received from this group will be analysed alongside the direct conversations that have taken place, including this one, to build up a more detailed portfolio wildfire risk exposure picture based both on regulatory and geographic asset locations. This assessment and analysis will continue into the start of 2024.
Prologis, Inc.	Objective: We met with the Vice President of Global ESG of Prologis, Suzanne Fallender, to discuss aspects of the company's 2022-2023 ESG report. Our discussion mainly focused on Prologis's climate strategy. Discussion: We discussed progress on firming up the company's existing Science Based Targets for decarbonisation alongside its commitment to carbon-neutral construction by 2025. While we believe the company has the procurement heft to help drive change more deeply through the construction supply chain, it appears to be early days. That said, there is increasing evidence of Prologis using its leverage to drive change, including its participation in the White House's supply chain taskforce and Massachusetts Institute of Technology's Climate and Sustainability Consortium. The company's venture capital investments through Prologis Ventures are also supporting climate-related innovation in the real estate industry more broadly. Outcome: The execution of the company's decarbonisation plan is currently on track, and we expect the verification process for its updated targets to be completed in 2024. Its top 25 customers have ESG goals, and they recognise customer centricity as a driver of business growth.

Predicted volatility is based on a snapshot of the portfolio at the end of the quarter, and provides a one-year prediction of the volatility of returns.

Risk Statistics (%)

Predicted Volatility	7.3

Source: Baillie Gifford & Co, Moody's Analytics UK Limited

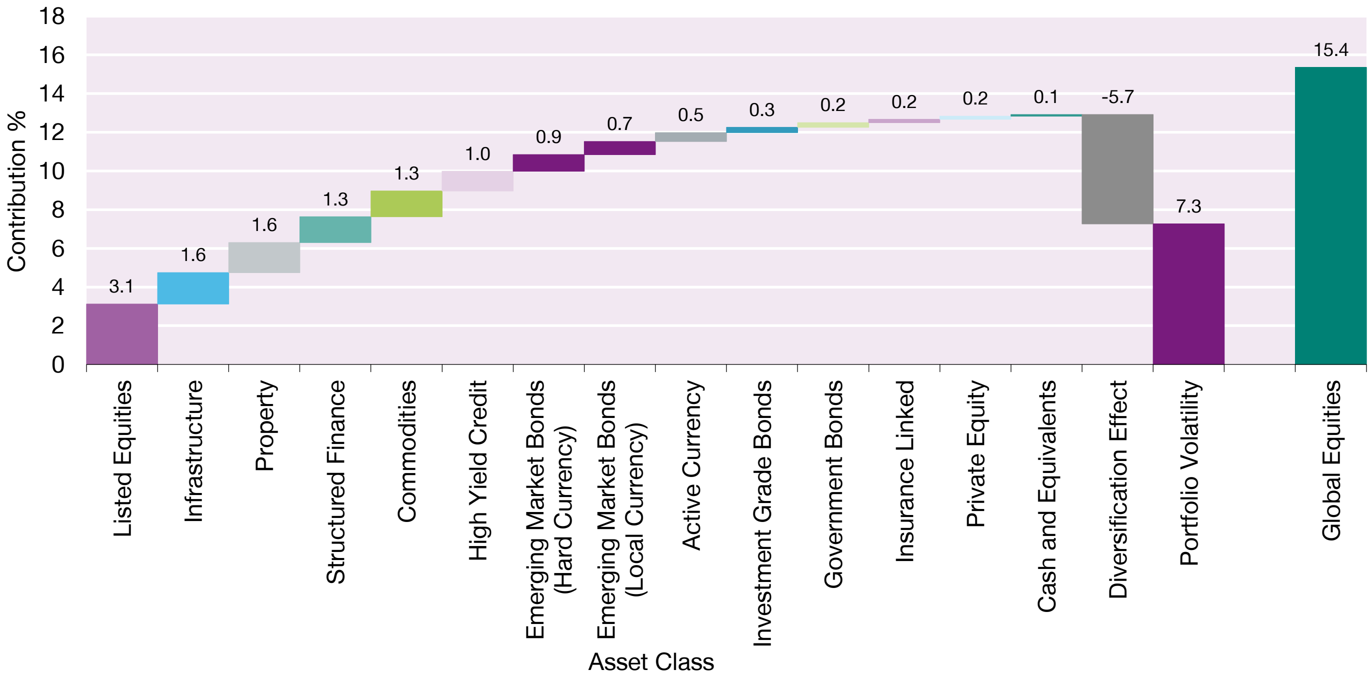
Macroeconomic volatility remains high as markets attempt to second-guess the path of interest rates

While equities have performed very well, a small handful of companies have driven index returns

Economies could yet tip over into a 'hard landing' with a substantial impact on earnings and valuations

The risk attribution chart shows the contribution to predicted volatility of each asset class held in the portfolio at the end of the quarter. The diversification offset bar depicts the benefits of diversification, reflecting that asset classes are not perfectly correlated and therefore do not fluctuate in precisely the same manner over time. Therefore, the overall volatility of the portfolio is lower than the sum of the standalone volatility for each asset class. The blue bar shows the one year predicted volatility for global equities and is provided for context only.

Predicted Volatility – Attribution by Asset Class



Source: Baillie Gifford & Co, Moody's Analytics UK Limited and relevant underlying index provider(s).
Total may not sum due to rounding.
Global Equities: MSCI World Index.

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