MACRO UPDATE: OUR VIEWS ON INFLATION

Please remember that the value of an investment can fall and you may not get back the amount invested.

With uncertainty continuing to reign over the global economy, at the heart of the debate lies the evolving question around inflation: is it structurally embedded, or is it on the wane?

The Multi Asset Team believes the most probable path is a continued easing of inflation through 2023 and into 2024. However, many market participants have views to the contrary.

Central banks' decisions are vital forces that push inflation up and down. What they choose to do and say, their interpretation of data from vastly complex models and their decisions to alter monetary policy accordingly all have significant real-world implications. They also create plenty of short-term noise, with markets flipflopping from one day to the next.

Most important to us, however, is continuing to look beyond what is happening next week, next month or even next quarter and more toward the likely outcome for the next year and beyond.

On that basis, to us at least, the outlook is becoming ever more apparent: while progress is not smooth (and we shouldn't expect it to be), inflation is coming down and will continue to do so.

The US Federal Reserve (the Fed) and the Federal Open Market Committee (FOMC) are currently running US monetary policy very tightly, combining a relatively high policy rate – created by 5 per cent of interest rate hikes since last March – with much more restrictive financial conditions.

These tighter financial conditions come from a deterioration in credit standards (ie, the willingness of banks to lend) and banking weakness (as evidenced by several recent high-profile blow-ups). They are worth the equivalent of another 1 per cent of tightening in addition to what we've already seen in the underlying policy rate.

Therefore, high policy rates, the tightening of credit conditions and a worsening economic outlook point us towards a US-led developed market recession and inflation falling in line with the Fed's target.

What is the response to this sharp fall in inflation? Well, given where we are in the cycle, it's likely too early to tell: too much easing and you set yourself up for a 1970s-style inflation rebound. This is one risk we think the Fed will be particularly mindful of. More likely, given the strong employment data, we believe that US growth will be forced to slow and the economy will be tipped into a recession before we see rate cuts.

Given that basic narrative fits our central expectation, we believe we should have a lower level of absolute risk in the portfolio.

And, where we do have exposure to assets with inherently higher levels of economic risk, it should be in areas we regard as particularly attractive and different, either because of some distinctive long-term fundamental driver or some obvious cheapness.

For example, in Chinese equities we see growth in a cheaper market with reasonably good fundamentals (despite the more challenging very recent backdrop). In economic infrastructure we see a significant renewable's tailwind, and in structured finance we are being paid a very attractive yield for the level of risk. This selective 'active' exposure is our primary way of taking economic risk.

A good part of the rest of the portfolio has a diversified range of duration exposure (ie, government and corporate bonds, in both developed and emerging markets) on the basis that as inflation comes down we expect bond yields to follow in response to a slowing economy.

We're also maintaining a relatively high cash weighting as we expect further volatility in the coming months and hence better, or at least cheaper, entry levels across a range of attractive investments.

RISK FACTORS

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication was produced and approved in June 2023 and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

POTENTIAL FOR PROFIT AND LOSS

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

IMPORTANT INFORMATION

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial Intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018. Baillie Gifford Investment Management (Europe) Limited is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. Baillie Gifford Investment Management (Europe) Limited is also authorised in accordance with Regulation 7 of the AIFM Regulations, to provide management of portfolios of investments, including Individual Portfolio Management ('IPM') and Non-Core Services. Baillie Gifford Investment Management (Europe) Limited has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. Through passporting it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Similarly, it has established Baillie Gifford Investment Management (Europe) Limited (Amsterdam Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in The Netherlands. Baillie Gifford Investment Management (Europe) Limited also has a representative office in Zurich, Switzerland pursuant to Art. 58 of the Federal Act on Financial Institutions ('FinIA'). The representative office is authorised by the Swiss Financial Market Supervisory Authority (FINMA). The representative office does not constitute a branch and therefore does not have authority to commit Baillie Gifford Investment Management (Europe) Limited. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 and a Type 2 license from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at Suites 2713-2715, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. Telephone +852 3756 5700.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a 'wholesale client' within the meaning of section 761G of the Corporations Act 2001 (Cth) ('Corporations Act'). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a 'retail client' within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755–1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Copyright © Baillie Gifford & Co 2023. Authorised and regulated by the Financial Conduct Authority.

CO1586855 MA – Macro update_WP3 0523
46724 10021191