Responsible Global Equity Income Fund

BAILLIE GIFFORD | Investment managers

Risk Factors and Important Information

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This communication was produced and approved in June 2020 and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

Stock Examples

Any stock examples and images used in this document 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.

This document contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned.

Investment markets can go down as well as up and market conditions can change rapidly. The value of an investment in the fund, and any income from it, can fall as well as rise and investors may not get back the amount invested. The fund has exposure to foreign currencies and changes in the rates of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested.

The Responsible Global Equity Income Fund (the Fund) invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.

The Fund invests according to responsible investment criteria and with reference to the ten principles of the United Nations Global Compact for business. This means the Fund will not invest in certain sectors and companies and may experience a higher level of volatility than a fund which has no such restrictions.

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

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Introduction

Baillie Gifford's commitment to responsible stewardship is as old as our firm. Our clients trust us to oversee and manage their investments for the long term, and stewardship of their holdings is a core part of this commitment.

All of our equity teams share certain beliefs. We are patient investors who seek to invest in companies which can deliver sustainable growth. Our genuinely long-term perspective is evidenced by our low portfolio turnover.

This commitment to the long term stems from the fact that, as a multi-generational partnership, we are entirely focused on ensuring our clients' interests are best served over many decades. There are no outside shareholders encouraging us to prioritise short-term interests.

We can only invest effectively if we invest responsibly. In analysing companies and deciding where our clients' capital should be invested, it is essential to consider all the factors which might affect long-term outcomes, whether that is management's alignment with shareholders' interests, how ethical their behaviour is, or how the company cares for the environment. Investing responsibly is an intrinsic element of our investment approach.

As long-term investors we have an opportunity to engage constructively with the companies we invest in and be active stewards of our clients' capital. All our investment staff are involved, not just in deciding which stocks to own, but also in the stewardship of our holdings. We do this because we believe that engaging with companies effectively, as well as voting thoughtfully, supports investment performance.

To assist our investment teams and help improve outcomes for our clients, Baillie Gifford has a dedicated, 20-strong team of governance and sustainability specialists who work closely with colleagues across the firm.

Baillie Gifford's over-arching ethos is that we are 'actual' investors. 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.

Baillie Gifford's Stewardship Principles

Prioritisation of long-term value creation

We encourage company management and their boards to be ambitious and focus their investments on long-term value creation. We understand that it is easy for businesses to be influenced by short-sighted demands for profit maximisation but believe these often lead to sub-optimal long-term outcomes. We regard it as our responsibility to steer businesses away from destructive financial engineering towards activities that create genuine economic value over the long run. We are happy that our value will often be in supporting management when others don't.

A constructive and purposeful board

We believe that boards play a key role in supporting corporate success and representing the interests of minority shareholders. There is no fixed formula, but it is our expectation that boards have the resources, cognitive diversity and information they need to fulfil these responsibilities. We believe that a board works best when there is strong independent representation able to assist, advise and constructively test the thinking of management.

Long-term focused remuneration with stretching targets

We look for remuneration policies that are simple, transparent and reward superior strategic and operational endeavour. We believe incentive schemes can be important in driving behaviour, and we encourage policies which create alignment with genuine long-term shareholders. We are accepting of significant pay-outs to executives if these are commensurate with outstanding long-run value creation, but plans should not reward mediocre outcomes. We think that performance hurdles should be skewed towards long-term results and that remuneration plans should be subject to shareholder approval.

Fair treatment of stakeholders

We believe it is in the long-term interests of companies to maintain strong relationships with all stakeholders, treating employees, customers, suppliers, governments and regulators in a fair and transparent manner. We do not believe in one-size-fits-all governance and we recognise that different shareholder structures are appropriate for different businesses. However, regardless of structure, companies must always respect the rights of all equity owners.

Sustainable business practices

We look for companies to act as responsible corporate citizens, working within the spirit and not just the letter of the laws and regulations that govern them. We believe that corporate success will only be sustained if a business's long-run impact on society and the environment is taken into account. Management and boards should therefore understand and regularly review this aspect of their activities, disclosing such information publicly alongside plans for ongoing improvement.

At Baillie Gifford we take our responsibilities seriously. We will encourage focus on the building of lasting competitive advantage, and we will enthusiastically support those with a thoughtful approach, using voting to support our five core principles. At a time when the word 'activism' is synonymous with those targeting short-term gains, we would like to reclaim the term for the long-term growth investor.

Investing Responsibly For Income

Many clients seek a dependable income stream as well as real growth in income and capital. Some clients have an additional requirement: that these investment objectives are met responsibly, with a process that takes account of the needs of a broader range of stakeholders than just the shareholders. Baillie Gifford's Responsible Global Equity Income Fund aims to meet the exacting standards of such clients who have a particular concern for the sustainability of their investments.

We are confident that we can meet the needs of these clients for three reasons:

— We have a robust process for identifying companies that can deliver both sustainable growth and dependable dividends, reflected in the long and successful track record of our Global Income Growth strategy. Sustainability considerations are fully integrated into the stock-picking process, with the dedicated input of our Governance and Sustainability team. This portfolio of growth businesses is the key building block of our Responsible Global Equity Income Fund.

— To give our clients additional comfort, we apply two types of exclusions: we exclude companies which sell certain harmful products altogether; and we apply a thoughtful process to ensure that all holdings reflect the principles of good business conduct embedded in the UN Global Compact.

— We engage in a constructive, targeted way, to help address major challenges and ensure our holdings thrive over the long term.

Sustainable Growth

— Only invest where both growth and dividends are sustainable over the long term

— ESG integrated within our 9 question stock research framework

— Pre-decision analysis by Governance and Sustainability specialist, with right of veto

Exclusions

— Exclude certain harmful products

— Apply the UN Global Compact Principles

Engagement

— Constructive engagement with companies to deliver better outcomes

— Annual engagement plan, focused on the most material areas for improvement

Firm Foundations

The Search For Sustainable Growth

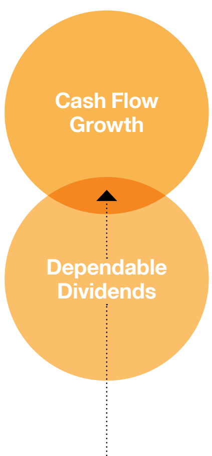
By investing responsibly, we aim to deliver two outcomes to our clients over the long term:

— A dependable income stream

— Real growth in income and capital

To help meet our objectives, the typical company we are looking for is cash-generative, its cash flow is resilient through cycles, and its growth is capital-light. This is how a company can both grow and pay a dependable dividend. We strongly believe that such businesses are the best investments for a long-term income investor, who seeks growth in the future as well as income today.

Philosophy



We look for exceptional companies that can persistently deliver both of the above

Research

We focus on the long-term opportunities

ESG is integrated into our team's 9 Question Stock Research Framework

— Q2. Does it have durable competitive advantages? Is the business model sustainable?

— Q6. What most encourages and concerns us about management?

Specialist Input

Pre-decision analysis from Governance & Sustainability specialist

Addresses 3 key questions:

— **Structures**
Are governance structures aligned with long-term investors?

— **Stakeholders**
Are stakeholders aligned with the company's long-term success?

— **Sustainability**
What are the key sustainability challenges and opportunities for the investment case?

Right of veto for Governance and Sustainability specialist

This long-term focus forces us to be rigorous in making sure the management teams we back behave in a responsible way that is consistent with our long-term ambitions for the business. It also requires us to think hard about the sustainability of the business models we choose to invest in – and this focus on sustainability is embedded in our stock selection framework and so is at the very heart of our research process. Many of the businesses we invest in are growing because they are leaders in industries we believe will change society for the better.

We complement the investment team's research with the input of our dedicated Governance and Sustainability team, who provide input throughout the investment process. This input is at both the stock level, and across the portfolio as a whole.

At the stock level, before any new investment decision is made, the Governance and Sustainability team undertakes a detailed analysis to address three key questions:

— **Structures** – are governance structures aligned with the interests of long-term investors?

— **Stakeholders** – are stakeholders aligned with the company's long-term success?

— **Sustainability** – what are the key sustainability challenges and opportunities for the investment case?

Their pre-decision analysis also considers whether a business's operations are consistent with the principles embedded in the UN Global Compact (discussed in more detail below).

The Governance and Sustainability research is discussed with the investment team ahead of a purchase of any new stock for the portfolio. This ensures that any potential challenges are thoroughly understood and engagement priorities agreed upon. That different perspective frequently helps identify areas for further research.

Schneider Electric: Governance And Sustainability Pre-Decision Research

The Governance and Sustainability team's pre-buy analysis of Schneider Electric identified corporate governance structures that are supportive of shareholders' long-term interests. Equal treatment of all shareholders is enshrined in the company's Articles of Association and there are no anti-takeover provisions or artificial measures in place to shield the board of directors or management from accountability by shareholders.

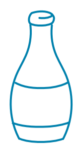
Stakeholder alignment is demonstrated by Schneider Electric's full and public commitment to the United Nations Global Compact Principles, led by the board and its chairman and CEO, Jean-Pascal Tricoire. Comprehensive corporate reporting sets out how Schneider Electric works with its key stakeholder groups – employees, suppliers, customers and the communities in which it operates – to deliver long-term sustainable growth opportunities.

Our review of the key sustainability challenges and opportunities concluded that Schneider Electric is making a positive impact, as its business lines offer solutions to customers seeking a transition path to a lower carbon world.

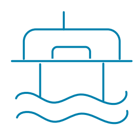
Rule-Based Exclusions

Exclusions based on product harm

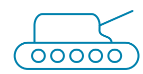
Whilst we strongly believe that a focus on sustainability is intrinsically linked to consideration of the good that companies can do, it is clear the avoidance of harm is a legitimate concern for those who wish to invest responsibly. Therefore, in managing the Responsible Global Equity Income Fund, we exclude companies that derive more than 10 per cent of their annual revenues from:



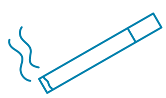
Production or sale of alcohol



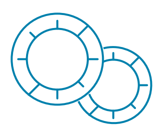
Fossil fuel extraction



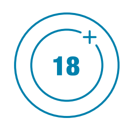
Production or sale of weapons and armaments



Production or sale of tobacco



Gambling



Adult entertainment

These sector exclusions are both widely recognised and used across the investment industry. They provide clarity and reassurance to clients who require additional certainty on responsible investment.

Principle-Based Exclusions

Applying The Principles of The United Nations Global Compact in a Thoughtful Way

A key feature of our approach is the application of the United Nations (UN) Global Compact's Ten Principles in selecting investments for the Responsible Global Equity Income Fund. These principles set out to ensure that companies operate in ways that, at a minimum, meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption.

Human Rights

1. Businesses should support and respect the protection of internationally proclaimed human rights; and
2. Make sure that they are not complicit in human rights abuses.

Environment

7. Businesses should support a precautionary approach to environmental challenges;
8. Undertake initiatives to promote greater environmental responsibility; and
9. Encourage the development and diffusion of environmentally friendly technologies.

Labour

3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4. The elimination of all forms of forced and compulsory labour;
5. The effective abolition of child labour; and
6. The elimination of discrimination in respect of employment and occupation.

Anti-Corruption

10. Businesses should work against corruption in all its forms, including extortion and bribery.

Process in Action

The Ten Principles of the UN Global Compact serve as a framework to assess the responsibility of a company's business practices. However, whilst we use third-party research, including an external screening service (Sustainalytics), we recognise that such third-party research is a blunt instrument for understanding the real features of a business. The number of issues flagged at any given company is strongly correlated with how big the company is, meaning that smaller companies may well be given a generous treatment while large ones get disproportionately penalised. We also note that the output of different providers' screens at the stock level can vary enormously. We therefore believe that a thoughtful approach is needed, requiring the exercise of our own judgement and close collaboration between the investment and Governance and Sustainability teams.

As outlined earlier, all companies which are considered for the portfolio are the subject of an independent analysis by the Governance and Sustainability team who also discusses them with the investment team. Any potential investment that is deemed to breach or not meet the spirit of the ten principles is excluded from the portfolio. The Global Income Growth team works with a dedicated Governance and Sustainability specialist who has the right of veto with respect to which companies are excluded. The decision to exclude a company based on assessment against the ten principles does not mean the company's area of operations is intrinsically harmful, but rather that it is operating in a manner which may not meet the legitimate expectations and aspirations of responsible investors.

China Mobile: Crossing The Line

China Mobile is the largest Chinese mobile telecoms operator, with a controlling (72%) stake owned by the Chinese state. State controlled companies such as China Mobile have little discretion to decline requested involvement in monitoring of the civilian population in China, particularly in provinces such as Xinjiang.

China Mobile's national mobile platform and state control brings the risk of complicity in human rights abuses, running against the spirit of United Nations Global Compact Principle 2. We exclude China Mobile from the Responsible Equity Income Fund as a means to safeguard the portfolio from complicity in human rights abuses.

We will retest our exclusion with any published statement on human rights and civilian monitoring by China Mobile. We will also continue to engage with company management to better understand how they seek to manage human rights risks.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Monitoring and Engagement

We continue to review and monitor the stocks in the portfolio to ensure they remain consistent with the objectives of the Fund. We undertake three main types of engagement.

Firstly, we engage with those companies where there is a potential question around whether their operations are consistent with the principles of the UN Global Compact. We will encourage them to provide better disclosure and seek to form a rounded view of their operations. During 2019 we spent time seeking to understand supplier codes of conduct at several of our holdings with Chinese manufacturing operations, for example, and suggested areas of improvement.

Secondly, we continually engage with companies we invest in to ensure their corporate governance is robust and that remuneration is appropriate and aligned with long-term investor's interests. We engage with boards to ensure remuneration structures do not incentivise short-term thinking by management teams. By providing constructive input early in the process, we are often able to help effect improvements over time.

Finally, and most importantly, at the start of each year we set an engagement plan. This seeks to highlight the most significant environmental, social or governance challenges across the portfolio, where we believe constructive engagement and research can make the greatest difference. These engagements can be led by either the Governance and Sustainability team or the Global Income Growth investment team. The engagement plan is best viewed as a framework to be built on over several years and is jointly agreed by both teams.

In our engagement we:

— Prioritise a business's long-term needs over short-term considerations

— Focus our efforts on where we can have impact

— Encourage each company to consider their broader impact on society

— Support their strengths and achievements

CURIOUS ABOUT THE WORLD

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