Baillie Gifford™

Baillie Gifford Strategic Bond Fund

31 December 2023

Baillie Gifford Update

Philosophy	Long-term investment horizon A growth bias Bottom-up portfolio construction High active share
Partnership	100% owned by 57 partners with average 20 years' service Ownership aligns our interests with those of our clients Enables us to take a thoughtful, long-term view in all that we do Stability, quality and consistency

Investment Proposition

Performance is driven by bond selection. Ideas are sourced across both investment grade and high yield and are driven by our fundamental, bottom-up stock analysis. The portfolio is well diversified with exposure typically between 60-85 companies. The portfolio could be characterised as comprising the "best ideas" we can find across the high yield and investment grade markets.

Fund Facts

Fund Launch Date	26 February 1999
Fund Size	£548.9m
IA Sector	£ Strategic Bond
Current Number of Issuers	68
Typical Number of Issuers	60-85
Duration	5.1
Tracking Error	1.8%
Tracking Error Range	0-4%

Fund Manager

Name	Years' Experience
Lesley Dunn*	22
Torcail Stewart	18

*Partner

This document is solely for the use of professional investors and should not be relied upon by any other person. It is not intended for use by retail clients. All investment funds have the potential for profit and loss. Past performance is not a guide to future returns.

Fund Objective

To produce monthly income. Opportunities for capital growth are also sought, subject to prevailing market conditions.

The manager believes that appropriate comparisons for this Fund are the Investment Association Sterling Strategic Bond sector average, given the investment policy of the Fund and the approach taken by the manager when investing and a composite index comprising 70%: ICE BofA Sterling Non-Gilt Index and 30%: ICE BofA European Currency High Yield Constrained Index (hedged to GBP) being representative of the strategic asset allocation of the Fund.

Periodic Performance

	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)
Class B-Inc (%)	7.2	9.1	-3.0	1.5
Index (%)*	6.9	10.2	-2.7	1.7
Sector Average (%)**	6.7	7.8	-1.1	2.4

Source: FE, Revolution, ICE Data Indices. Total return net of charges, in sterling.
Share class returns calculated using 10am prices, while the Index is calculated close-to-close.
Baillie Gifford operates a single swinging price for the Fund and, therefore, may apply a dilution adjustment to the price to protect long-term investors from the costs associated with buying and selling underlying investments that result from other investors joining or leaving the Fund. This adjustment will affect relative performance, either positively or negatively.
*70% ICE BofA Sterling Non Gilts Index / 30% ICE BofA European Currency High Yield Constrained Index (Hedged to GBP).
**IA £ Strategic Bond Sector.

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
Class B-Inc (%)	11.5	6.2	-0.6	-16.0	9.1
Index (%)*	10.4	6.7	-0.9	-15.5	10.2
Sector Average (%)**	9.3	6.6	0.8	-11.0	7.8

Source: FE, Revolution, ICE Data Indices. Total return net of charges, in sterling.
Share class and Sector returns calculated using 10am prices, while the Index is calculated close-to-close.
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Market environment

The final quarter of the year brought a sharp recovery across nearly all asset classes. The prior narrative was that economic growth was not slowing enough to bring inflation down to target levels quickly. As a result, interest rates would need to remain higher for longer. From late October, the story morphed into ‘immaculate disinflation’ as we saw inflation rates fall without a sharp growth slowdown. Several benign inflation releases in Europe and the US prompted a sea change in opinion among central bankers and investors that inflation was indeed falling towards target levels relatively quickly. This led to a relief rally in global bond markets, both sovereign and corporate, with markets expecting multiple interest rate cuts in 2024.

Although economic growth in the US remains relatively strong, the rest of the world has slowed. Core European markets are moribund, with high energy prices continuing to bite along with decreased demand from overseas, particularly from China. Chinese authorities are adding stimulatory measures but there has been limited visible improvement in either the real economy or financial markets. This is largely because of the morass that their real estate sector is in, which is a large component of China’s economy.

The performance of financial markets this year highlights how fickle they can be. Although current data point towards a ‘soft landing’ next year, we see significant probabilities of two other scenarios during 2024. One is that central banks keep interest rates high because growth remains positive. In other words, they would sense no urgency to cut while inflation is falling but its outlook is uncertain. Bond yields would likely rise again in this situation given they are priced for interest rates to fall. The other scenario we consider is where something in the economy ‘breaks’, which damages consumer and business confidence, kickstarting a negative feedback loop that leads to recession. Yields may well fall in this scenario, but we would expect corporate bonds to underperform safer government bonds.

In conclusion, the events of recent months have been fundamentally positive for financial markets, with growing evidence that inflation is under control in developed and emerging markets. However, markets are now pricing in rapid interest rate cuts in 2024, and there is scope for asset prices to disappoint if central banks do not proceed down this path.

Performance

The Fund’s total return was positive over the quarter. Falling government bond yields and tightening credit spreads were the key drivers (there is an inverse relationship between falling yields and bond prices). The Fund outperformed the comparator index and peer group average return in the final quarter of the year. The Fund’s investment grade overweight added value as the asset class outperformed high yield on a total return basis given the asset classes increased sensitivity to interest rate risk. Bond selection was largely flat, with no positive catalysts playing out in the fourth quarter.

Over 2023 as a whole, the fund outperformed the peer group and underperformed the comparator index. In terms of index relative performance, the strategy was penalised for reducing risk early in 2023 when the market outlook was highly uncertain. In the event, the Federal Reserve has convinced markets that it has engineered a soft landing, leading credit risk and, therefore, high yield to outperform. In addition, few positive catalysts emerged to boost returns at bond level. We believe the portfolio continues to hold significant potential in this respect, leaving us optimistic about the year ahead.

Given the diversity of the peer group it is hard to directly attribute outperformance. Key factors are likely to include the value added from the portfolio’s strategic allocation to high yield as well as the Fund’s sterling duration position. The Fund’s interest rate exposure is primarily to the United Kingdom, where government bond yields ended the year only slightly higher than where they started. UK government bonds outperformed US government bonds, as US growth continued to surprise to the upside.

Positioning

As the market backdrop improved over the quarter, we added credit risk to the portfolio. This was achieved by reducing exposure to supranational bonds and A-rated bonds where the investment case had played out, such as those issued by leading online travel company Booking Holdings. New purchases included UK discount retailer B&M and Japanese multinational car manufacturer Nissan. B&M’s BB-rated new issue offered a yield of c. 8% in sterling terms, an extremely attractive proposition from a highly cash-generative company whose business model is well-positioned to weather the impact of the cost of living crisis in Britain. Following several years of weak performance, we believe Nissan's new corporate structure and refreshed product proposition provide a platform to grow volumes and margins. Their long-dated BBB-rated bonds trade at an attractive valuation for the rating and have the potential to add further value through spread tightening should the company's turnaround succeed.

Credit markets rallied strongly in the final quarter of 2023. This leaves high yield bond valuations, in particular, looking high relative to history. In this context, we continue to maintain a c. 70% allocation to investment grade bonds where absolute yields remain appealing. Here, BBB-rated bonds, the lowest quality investment grade bonds, offer the most attractive risk-adjusted return potential given their low probability of default and £ yields of c. 5.4%. At sector level, value can be found if investors are selective. For example, senior bonds issued by property companies are still available on elevated yields despite their recent rally. Given recent pressure on the sector as a whole, the strong have sold off with the weak providing attractive opportunities for bond selectors. The portfolio holds a range of bonds issued by resilient companies that trade at low cash prices. Given their sensitivity to inflation, property bonds, representing c. 9.5% of the portfolio, have the potential to be top performers should inflation continue to fall.

The Fund continues to outyield its index, offering a gross redemption yield of 5.7% at year end. This is primarily driven by a 12.4% overweight to BBB-rated bonds. Asset allocation remains broadly neutral. High Yield exposure is 29.3% (just below the Fund's typical strategic allocation of 30%), with an underweight allocation to lower-quality B-rated issuance and no CCC-rated bonds, which are more sensitive to bad news. The fund continues to hold dry powder in the shape of a 32.8% allocation to A-rated and above investment grade bonds, ready to deploy into the high yield market in the event of future volatility.

During the quarter, we increased interest rate risk using 10-year gilt futures. 10-year gilts offer attractive yields relative to history and offer protection in the event that economic conditions become more challenging. The Fund ends the quarter with duration of 5.1 years, representing a small overweight relative to the index.

Distribution of Portfolio by Asset Class

	Fund Weight* (%)
Sterling	
Conventional Sovereign	0.0
Conventional Non Sovereign	63.7
Index Linked	0.0
Total Sterling	63.7
Cash & Derivatives	
Total Cash & Derivatives	1.4
Foreign Currency	
Conventional Sovereign	0.0
Conventional Non Sovereign	34.9
Index Linked	0.0
Total Foreign Currency	34.9
Total	100.0

*Shows exposure to bonds in the currency before any hedging is applied

Distribution of Portfolio by Sector

	Fund Weight (%)
Industrials	41.4
Financial	36.9
Quasi & Foreign Government	9.4
Securitized	6.9
Utility	3.9
Covered	0.0
Cash & Derivatives	1.4
Total	100.0

Distribution of Portfolio by Credit Rating Band

	Fund Weight (%)
AAA	9.4
AA	3.5
A	18.5
BBB*	37.9
BB*	24.6
B*	4.7
CCC-D*	0.0
Cash & Derivatives	1.4

*Includes BG internally-rated bonds where there is no official rating.

Distribution of Portfolio by Region

	Fund Weight (%)
United Kingdom	35.9
Europe	30.8
North America	13.6
Emerging Markets	11.9
Supranational	3.8
Developed Asia	2.6
Cash & Derivatives	1.4
Total	100.0

Company Engagement

Engagement Type	Company
Environmental	Accor SA, Admiral Group plc
Social	Accor SA, Netflix, Inc.
Governance	Admiral Group plc, Ubisoft Entertainment SA, Victoria PLC
Strategy	Victoria PLC

For further details on company engagement please contact us. You can also find further information on how we integrate environmental, social and governance (ESG) matters into our investment approach, here.

Asset Name	Fund %
Sterling Bonds	
Conventional Sovereign	
Long Gilt Future 10yr Mar 24	-0.06
Total Conventional Sovereign	-0.06

Asset Name	Fund %
Conventional Non Sovereign	
Abrdn 5.25% 2026 Perp AT1	0.71
Admiral Group 8.5% 2034 T2	2.19
Annington Finance 3.935% 2047	0.53
Annington Funding 2.308% 2032	1.78
Annington Funding 2.924% 2051	0.65
B&M European Value Retail 4% 2028	0.81
B&M European Value Retail 8.125% 2030	1.03
Barclays 1.7% 2026	2.27
Barclays 7.09% 2029	0.44
Barclays 7.125% 2025 Perp AT1	0.59
Berkeley Group 2.5% 2031	0.67
Berkshire Hathaway 2.375% 2039	1.53
Berkshire Hathaway 2.625% 2059	0.60
Canada Pension Plan 1.25% 07/12/2027	1.21
Co-operative Group 5.125% 2024	1.30
CPI Property 2.75% 2028	1.56
Delamare (B-1) 6.067% 2029	0.49
Delamare 5.5457% 2029	0.94
DNB Bank 4% 2026/27	2.42
EDF 6% 2026 Perp	2.47
EDF 6% 2114	0.33
EIB 3.875% 2037	2.17
EIB 4.625% 2054	1.42
ENEL 5.625% 2024	1.07
IBRD 5.75% 2032	0.23
Investec 2.625% 2026/32 T2	2.26
J.P. Morgan 1.895% 2033	2.25
KFW 5% 2036	1.62
KFW 5.75% 2032	1.52
Mitchells & Butlers 5.574% 2030 (A2)	0.16
Mitchells & Butlers 6.469% 2030 (C1)	0.22
Nationwide BS 10.25% Perp CCDS	0.26
NatWest Gp 2.875% 2026	3.33
Ocado 0.75% 2027 Convertible	0.13
Ocado 3.875% 2026	0.53
Pension Insurance 3.625% 2032 T2	0.29
Pension Insurance 4.625% 2031 T2	0.80
Pension Insurance 5.625% 2030 T2	0.83
Pension Insurance Corp 8% 2033 T2	1.21

Asset Name	Fund %
Rothesay Life 8% 2025	2.70
Santander 1.5% 2026	1.80
Santander 6.75% 2024 Perp AT1	1.20
Telefonica 5.375% 2026	3.20
Telereal (B-4) 6.1645% 2031	1.36
Telereal (C1) FRN 2031	1.66
Tesco Property Finance 3 5.744% 2040	1.15
Tesco Property Finance 6 5.4111% 2044	0.95
University of Cambridge 2.35% 2078	0.34
University of Oxford 2.544% 2117	0.97
Weir Group 6.875% 2028	1.97
Zurich Financial Services 5.125% 2032-52 T2	1.55
Total Conventional Non Sovereign	63.69
Total Sterling Bonds	63.62

Asset Name	Fund %
Foreign Currency Bonds	
Conventional Sovereign	
Euro-Bobl Future Mar 24	-0.01
Euro-Bund Future Mar 24	0.03
Euro-Schatz Future Mar 24	-0.01
US 5yr Note Mar 24	0.00
US Long Bond (CBT) Mar 24	0.00
US Ultra 10yr Note Future Mar 24	0.01
US Ultra Long (CBT) Mar 24	0.00
Total Conventional Sovereign	0.02

Asset Name	Fund %
Conventional Non Sovereign	
Accor SA 2.625% 2025 Perp	0.49
Accor SA 7.25% 2029 Perp	0.79
AMS 10.5% 2029	0.82
Bath & Body Works 9.375% 2025 (144A)	0.80
Bharti Airtel 5.65% 2025 Perp	1.89
Burford Capital 9.25% 2031 (144A)	0.54
Caixabank 6.75% 2024 Perp AT1	0.64
Cellnex Telecom 2% 2033	0.77
Cirsa Finance 10.375% 2027	0.75
Concentrix 6.65% 2026	0.75
Ctp N.V. 0.5% 2025	0.18
Ctp N.V. 0.75% 2027	0.70
Ctp N.V. 1.25% 2029	0.46
Ctp N.V. 2.125% 2025	0.17
Darling Ingredients 6% 2030 (144A)	0.51
Heimstaden Bostad 0.25% 2024	1.10
Helvetia 2.75% 2031/41 T2	1.76
Infopro Digital 8% 2028	0.62

Asset Name	Fund %
InPost 2.25% 2027	2.37
LeasePlan 7.375% 2024 Perp AT1	2.86
Marks and Spencer 7.125% 2037 (144A)	0.04
MercadoLibre 3.125% 2031	1.62
Netflix 3.625% 2030	0.13
Netflix 4.625% 2029	1.07
Nissan Motor 4.81% 2030	0.52
NTT 1.162% 2026	0.89
OCI 4.625% 2025 (144A)	0.25
OCI 6.7% 2033 (144A)	0.27
Pershing Square 3.25% 2031 (RegS)	0.25
Pershing Square Holdings 3.25% 2030	0.40
Prosus 3.832% 2051	0.82
Rabobank 6.5% Perp	0.26
Realty Income 5.125% 2034	1.66
Santander 4.75% 2025 Perp AT1	0.33
TD Synnex Corp 1.25% 2024	0.58
Temasek 0.5% 2031	0.60
Temasek 3.5% 2033	0.63
Townsquare Media 6.875% 2026 (144A)	0.73
Ubisoft Entertainment 0.878% 2027	0.34
UPC 3.625% 2029	1.40
UPC 3.875% 2029	0.54
Venture Global Calcasieu 3.875% 2029 (144A)	0.04
Venture Global Calcasieu 3.875% 2033 (144A)	0.51
Venture Global Delta LNG 8.125% 2028 (144A)	0.06
Veritext 8.5% 2030 (144A) (144A)	0.62
Victoria 3.75% 2028	0.70
Virgolino De Oliveira 11.75% 2022	0.00
ZhongAn 3.125% 2025	0.12
ZhongAn 3.5% 2026	0.54
Total Conventional Non Sovereign	34.89
Total Foreign Currency Bonds	34.90
Cash & Derivatives	
Forwards	
EUR Fwd Asset 18-Jan-2024 S	-22.10
GBP Fwd Asset 18-Jan-2024 P	35.58
USD Fwd Asset 18-Jan-2024 S	-12.89
Total Forwards	0.58
Swaps	
IRS GBP PAY FLT 06/03/25	-7.94
IRS GBP REC FIX 06/03/25	7.91
Total Swaps	-0.03

Asset Name	Fund %
Cash	
Collateral Account Memo	-0.57
EUR Futures Initial Margin Account	0.09
EUR Uncommitted Cash	0.01
GBP BNY Revenue Uncommitted Cash	-0.94
GBP CCP Initial Margin	0.11
GBP CCP Variation Margin	0.03
GBP Futures Initial Margin Account	0.34
GBP Uncommitted Cash	1.51
USD Futures Initial Margin Account	0.30
USD Uncommitted Cash	0.05
Total Cash	0.91
Total Cash & Derivatives	1.47
Total	100.00

Active Share Classes

Share Class	Share Class Inception Date	ISIN	SEDOL	Annual Management Fee (%)	Ongoing Charge Figure (%)
Class B-Inc	26 February 1999	GB0005947741	0594774	0.50	0.52
Class B-Acc	21 June 2000	GB0005947857	0594785	0.50	0.52

The table displays the primary shares classes. Other share classes may be available for those investors who have a separate arrangement. Charges will reduce the value of your investment. Please refer to the Prospectus and Key Investor Information Document for further details.

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Additional Geographical Location Information

Israel: This Report, as well as investment in the Fund described herein, is directed at and intended for Investors that fall within at least one category in each of: (1) the First Schedule of the Israeli Securities Law, 1968 (“Sophisticated Investors”); and (2) the First Schedule of the Investment Advice Law (“Qualified Clients”).

The Fund’s share price can be volatile due to movements in the prices of the underlying holdings and the basis on which the Fund is priced.

As with any investment, the clients’ capital is at risk. Past performance is not a guide to future returns.

Throughout the report all figures are rounded, so any totals may not sum. Not all stocks mentioned may be held by the portfolio.

All information as at 31 December 2023 and source is Baillie Gifford & Co unless otherwise stated.

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