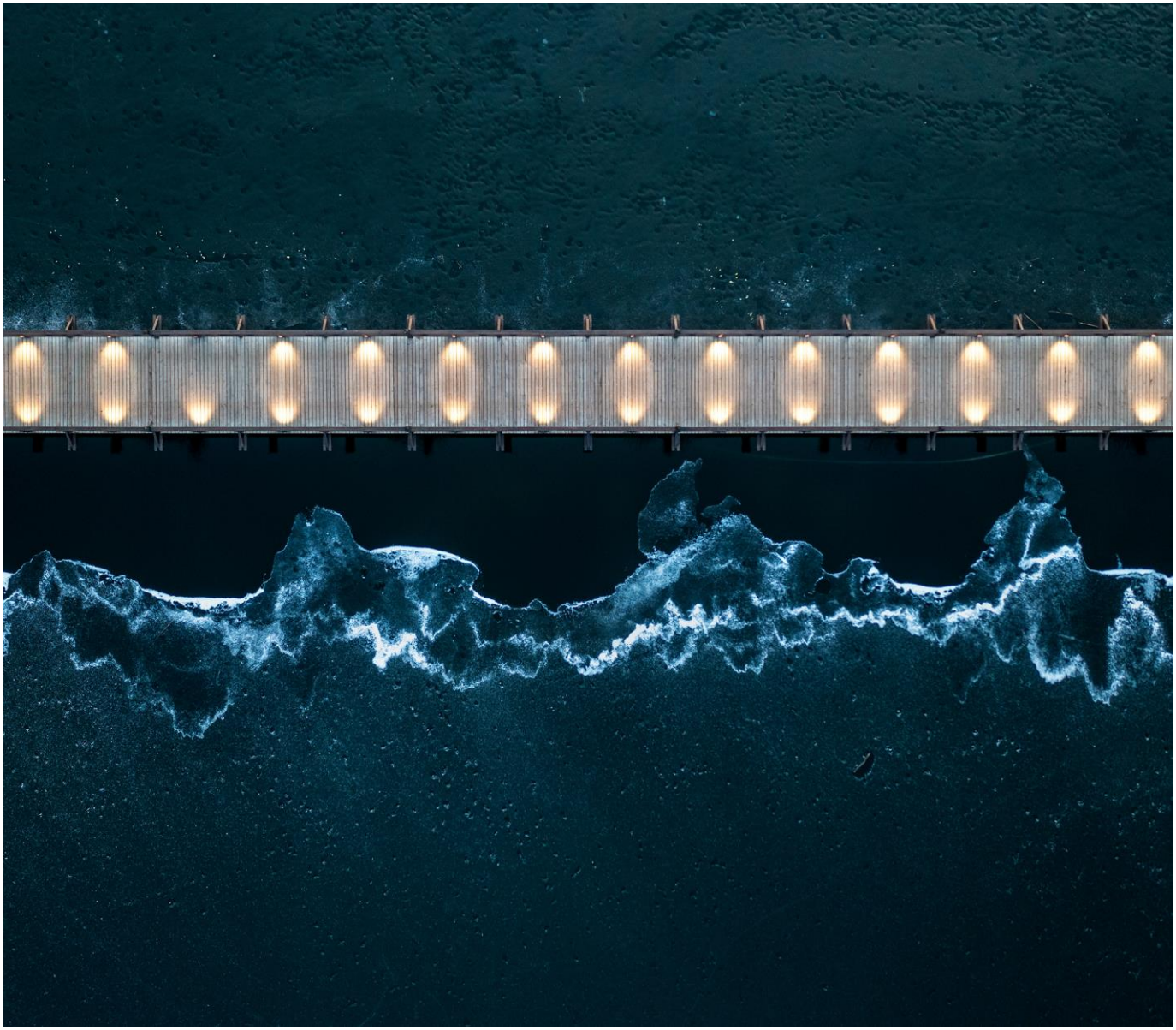
Baillie Gifford™

Global Strategic Bond Quarterly Update

31 December 2023



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Potential for Profit and Loss

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Product Overview

Global Strategic Bond is a best ideas corporate bond strategy where bond selection is driven by company fundamentals. The strategy is highly differentiated from its benchmark and peers, investing in a focused portfolio of 60–85 companies' bonds.

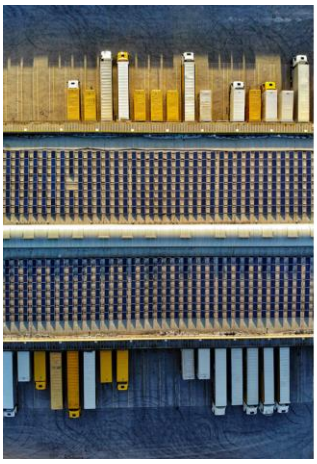
Risk Analysis

Key Statistics	
Number of Issuers	81
Typical Number of Issuers	60-85
Tracking Error	1.5%
Tracking Error Range	0-4%

Markets are now pricing in a `soft landing' scenario where inflation falls to target, interest rates are substantially reduced and economic growth begins to recover

Government bond yields fell as continued, falling inflation rates led to expectations of significant interest rate cuts from central banks in 2024

Financial markets have fully bought into the most benign `goldilocks' scenario, which supports all asset classes



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

The final quarter of the year brought a sharp recovery across nearly all asset classes. Last quarter, the 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', we see the potential for two other scenarios playing out in 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 Portfolio'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 Portfolio performed broadly in line with the index in the final quarter of the year. Relative returns from asset allocation and bond selection were largely flat, reflecting neutral risk positioning and few positive catalysts playing out at bond level in the fourth quarter.

Over 2023 as a whole, the Portfolio slightly underperformed the index. The strategy was penalised for reducing risk early in 2024 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. Underperformance from asset allocation was largely offset by positive contributions from bond selection, with many of the Portfolio's corporate hybrid bonds performing strongly.

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 B rated bonds issued by kidney dialysis services provider DaVita. The company's bonds have materially underperformed following concerns that new weight-loss drugs will affect the profitability of DaVita's US dialysis business. We believe these fears are overblown, with such concerns presenting an equity tail risk rather than a significant creditor concern. Dialysis operators in the US operate under an oligopoly-like structure, and DaVita's cash generation is impressive for a B rated credit. We also added bonds issued by Japanese multinational car manufacturer Nissan. 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 high 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. 6.8% of the portfolio, have the potential to be top performers should inflation continue to fall.

The Portfolio continues to outyield its index, offering a gross redemption yield of 5.8% at year end. This is primarily driven by an overweight to BBB and BB rated bonds. Credit risk remains broadly neutral. High Yield exposure is 33.2% (just above the Portfolio's typical strategic allocation of 30%), with this overweight concentrated in very safe short-dated BB-rated bonds (those at the top tier of the high yield credit rating spectrum). The strategy is underweight lower-quality B-rated issuance and no CCC-rated bonds, which are more sensitive to bad news. The Portfolio continues to hold dry powder in the shape of a 32.0% allocation to A-rated and above investment grade bonds, ready to deploy into the high yield market in the event of future volatility.

Periodic Performance

	Composite Net (%)	Benchmark %	Difference (%)
3 Months*	7.1	7.1	0.0
1 Year*	9.1	10.2	-1.1
3 Years	-2.2	-1.4	-0.8
5 Years	3.0	2.9	0.1
10 Years	3.4	3.3	0.1
Since Inception	3.8	3.2	0.6

Annualised periods ended 31 December 2023. *Not annualised.
Inception date: 30 September 2012.
Figures may not sum due to rounding.
Benchmark is 70% ICE BofA Global Corporate (Hedged to USD), 30% ICE BofA Global High Yield (Hedged to USD). Prior to 15/01/21 the composite's benchmark was Bloomberg Barclays Credit (Hedged to USD).
Source: Revolution, Bloomberg Barclays, ICE Data Indices.
US dollars

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
Composite Net (%)	12.9	9.8	0.6	-14.7	9.1
Benchmark (%)	12.1	7.5	0.3	-13.2	10.2

Benchmark is 70% ICE BofA Global Corporate (Hedged to USD), 30% ICE BofA Global High Yield (Hedged to USD). Prior to 15/01/21 the composite's benchmark was Bloomberg Barclays Credit (Hedged to USD).
Source: Revolution, Bloomberg Barclays, ICE Data Indices.
US dollars

Top Ten Physical Bond Holdings†

	Holdings	%
1	J.P. Morgan 6.4% 2038	2.1
2	Citigroup 4.412% 2031	2.1
3	NTT 1.162% 2026	2.1
4	MSCI Inc 4% 2029 (144A)	2.0
5	EIB 4.875% 2036	2.0
6	Investec 2.625% 2026/32 T2	1.9
7	KFW 0.375% 2025	1.9
8	Helvetia 2.75% 2031/41 T2	1.7
9	NatWest 7.472% 2026	1.7
10	Avient 5.75% 2025 (144A)	1.7

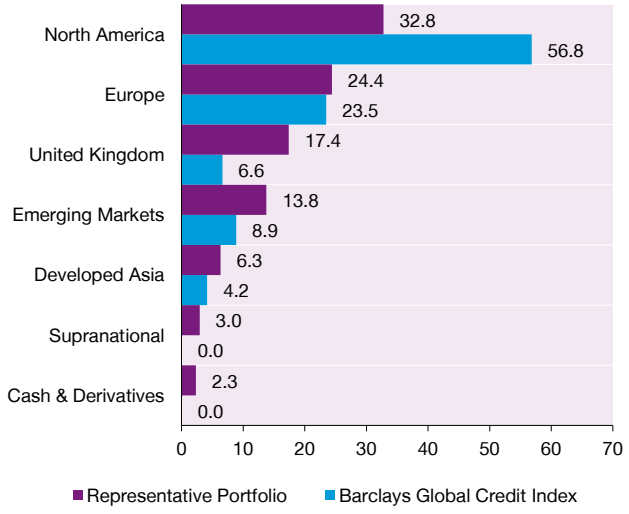
†The portfolio may also hold derivative positions for hedging purposes.

Credit Ratings (%)

	Fund weight (%)	Benchmark weight (%)
AAA	7.0	0.6
AA	4.5	6.1
A	18.1	30.6
BBB	34.9	32.7
BB*	23.7	16.9
B	9.4	10.3
CCC-D	0.0	2.7
Cash & Derivatives	2.3	0.0

*Includes BG internally-rated bonds where there is no official rating. Benchmark is 70% ICE BofA Global Corporate (Hedged to USD), 30% ICE BofA Global High Yield (Hedged to USD). Prior to 15/01/21 the composite's benchmark was Bloomberg Barclays Credit (Hedged0.

Regional Split (%)



Totals may not sum due to rounding.
Source: Baillie Gifford & Co, ICE Data Indices.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	None	Companies	None	Companies	None
Resolutions	None	Resolutions	None	Resolutions	None

Company Engagement

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

Company	Engagement Report
Accor SA	Objective: As part of our ongoing monitoring of Accor, we engaged with the company to discuss hiring practices, health and safety, and management of its environmental targets. Discussion: Hotel Group, Accor was mentioned in a French government report as having discriminatory hiring practices. We asked management for more details. While management explained that staff continue to be trained on the matter, there do not appear to be formal mechanisms to prevent this issue. We shared with Accor how other companies implemented public-facing, proactive, anti-discrimination policies for hiring and encouraged it to consider adopting improved policies. Accor's reporting of health and safety metrics is excellent; however, the scope of reporting in the most recent report has been narrowed to focus only on legal requirements. Given the importance of staff wellbeing to Accor's operations, we queried this. Management outlined that health and safety metrics have been difficult to compare over recent years due to Covid-19, and disclosure from managed hotels can vary. We explained the importance of having access to clear health and safety metrics when we assess the company's health. In previous discussions, Accor acknowledged there needs to be a greater focus on food waste reduction and water consumption in water-stressed regions in China. Accor provided an update explaining that it continues to work on these issues. Finally, Accor is developing its scope 3 goals, and we can expect a commitment shortly. Outcome: We will continue proactively encouraging Accor to address its discriminatory hiring practices. We will continue to discuss health and safety metrics with management to understand better the overarching trends rather than the short-term adjustments. Scope 3 goals are a welcome development, and we will continue monitoring progress.
Yara International ASA	Objective: We engaged with management to monitor progress on decarbonisation efforts and to understand recent positive signals that green ammonia is becoming a viable product offering. Discussion: Yara is one of the world's largest producers of nitrogen-based fertiliser. The highly carbon-intensive nature of Yara's business model introduces financial risk to the business as tighter climate policies will likely have a structural impact on end markets, particularly agriculture. The discussion focused on Yara's progress since we last met, noting several key developments. Yara is actively working with industry groups, specifically the Science Based Target Initiative (SBTi), to develop viable decarbonisation pathways for the sector. Progress is being made. However, management signalled that SBTi-aligned commitments are unlikely in the near term. Yara outlined that it works closely with customers to understand individual decarbonisation requirements, which is instrumental for Yara to anticipate future demand. Outcome: We continue to monitor Yara for decarbonisation targets aligned with SBTi and its progress on alternative product offerings.

Votes Cast in Favour

We did not vote in favour of any resolutions during the period.

Votes Cast Against

We did not vote against any resolutions during the period.

Votes Abstained

We did not abstain on any resolutions during the period.

Votes Withheld

We did not withhold on any resolutions during the period.

New Purchases

Stock Name	Transaction Rationale
Accor SA 7.25% 2029 Perp	These subordinated bonds issued by the French hotel group Accor offer an attractive running yield for a BB-rated bond with 5.5 years to maturity. Accor's fundamentals have improved and it has proved resilient, despite the impact of the pandemic on the business. It was upgraded earlier in the year on the back of its disciplined approach to deleveraging.
AMS 10.5% 2029	Switching into this AMS new issue to pick up yield and add duration.
Bath & Body Works 9.375% 2025 (144A)	Bath & Body Works is a stable and cash-generative UK speciality retailer with strong brand recognition in the beauty and fragrance sector. These short-dated high-coupon bonds were offered on a >7% yield. Given the company has sufficient cash on its balance sheet to cover this up-coming bond maturity we are very comfortable lending to this business almost regardless of any future macro-economic pressures. We have therefore taken a small position for the strategy.
CaixaBank 6.684% 2027 (144A)	Addition to an existing position in CiaxaBank.
Concentrix 6.65% 2026	Concentrix is a US outsourcing company, specialising in business processes which involve customer service. Notwithstanding the long-term threat from artificial intelligence, we believe Concentrix has sufficiently robust competitive positions with its clients and generates ample free cashflow to survive at least a decade. These 2026 bonds are not impacted by those medium-term threats. Given the attractive valuation on these bonds, which are trading at a wider spread than US dollar BBBs, we decided to buy a position.
DaVita 4.625% 2030 (144A)	DaVita bonds had underperformed materially following concerns about GPT1 weight-loss drugs potentially affecting the profitability of its US dialysis business. We believed these fears were overblown with such concerns presenting an equity tail risk rather than a significant creditor concern. Dialysis operators in the US operate under an oligopoly-like structure and DaVita's cash generation is impressive for a single-B credit. As such, we decided to take a position.
Ford Motor Co 7.2% 2030	Ford has a clear path to return to investment-grade status after the challenging Covid years, which have pressured its profits and cash flows. Consolidating its internal combustion engine-powered (ICE) vehicle range has reduced costs and allowed profits to begin a strong recovery. These profits are being applied to make significant investments in electric vehicle production, future-proofing Ford's business. The company has a very strong balance sheet, and its bonds have scope to appreciate further as and when Moody's joins S&P in returning Ford to investment-grade status.
IQVIA 6.25% 2029 (144A)	IQVIA is a company that we've lent to previously. It is a business that combines leading global clinical trial research, combined with being one of the leading healthcare and data analytics providers. A powerful and highly cash-generative combination. Recently issued bonds trade on an appealing yield leading us to return to this bond issuer again.
Nissan Motor 4.81% 2030 (144A)	Nissan is recovering from weak financial performance in recent years, hampered by slow decision-making during a period of management turmoil. We believe that Nissan's strategy and tactics today are clear and appropriate and will propel its credit metrics back to unambiguously investment-grade territory in the quarters ahead. A fresh slate of electric vehicle offerings becoming available in the near term should help to revive sales, improve fixed cost coverage and drive the business forward. We see worthwhile spread compression potential should the company succeed in returning to the investment grade-rated fold.
OCI 4.625% 2025 (144A)	OCI is a leading low-cost producer of fertilisers and chemicals. Given weakness in its end markets, its bonds have underperformed US dollar BBBs for reasons that we think are unjustified given the quality of the business. Short-dated bonds were offered at yields comparable to strong US dollar BBs despite OCI's investment grade rating so we decided to take a position.
Pension Insurance Corp 8% 2033 T2	Pension Insurance Corporation, one of the leading UK pension buyout providers, issued new, high-coupon subordinated bonds to maintain the maturity profile of their capital-providing liabilities. At the same time, they tendered for short-dated bonds recently held by the portfolio at an attractive premium to market prices. We participated in this new issue, remaining invested in a core holding with attractive return potential.
Phoenix Group 7.75% 2033/53	Phoenix Group, the UK savings business, is offering an attractively priced new subordinated bond issue to partially refinance similar existing bonds which become callable in the near future. We are tendering the existing holding of 2025-dated Phoenix bonds with the target of achieving a significant pick-up in spread as a result of the two transactions.

Santander 9.625% 2029 Perp AT1	Santander have recently successfully issued new AT1 bonds which will very likely allow for the redemption at par next year of the existing holding. Prices have increased to reflect this likelihood. We are switching the proceeds into the recently issued, higher-coupon and higher-potential bonds.
STORE Capital 2.75% 2030	STORE Capital is a US real estate investment trust (REIT) owning a large and well-diversified portfolio of properties let to tenants in a wide variety of industries. STORE's focus is on Single Tenant Operational Real Estate. This means that each property is let to one tenant, whose quality is carefully assessed. Each property is 'operational' real estate. This means that the property is critical to the operations of the business, either as a store for selling to clients or a production or service facility. STORE does not own headquarters-type office property that can be vacated by tenants with less disruption to their functioning. This disciplined underwriting has led to strong returns and a market position whereby it is a first-choice call for companies seeking to sell and leaseback operating property or partner in its acquisition. STORE itself has recently been acquired by GIC, the Singaporean wealth portfolio, and Oak Street Real Estate. This take-private transaction has spooked bond investors, though we view the consequences as limited, given GIC's very significant investment, long-term investment horizon and ability to earn returns through time, without excessive financial engineering. We expect STORE to retain its investment grade credit ratings and for the credit spread on its bonds to compress closer to REIT peers, providing attractive upside for the Portfolio.
TD Synnex Corp 1.25% 2024	TD Synnex Corporation is one of the world's largest distributors of IT hardware, software and systems. It distributes over 200,000 technology products to resellers, system integrators and resellers. The company's balance sheet is in a very healthy position for a BBB-rated company. The combination of cash and cash generation is sufficient that it can easily cover its forthcoming bond maturity in 2024. For this reason, we have decided to switch out of lower-yielding and longer-dated Booking Holding bonds into these higher-yielding, one-year-to-maturity TD Synnex bonds.
Tegna Inc 4.75% 2026 (144A)	Tegna is a highly cash-generative TV broadcast media company in the US. Bonds had weakened given poor sentiment towards the sector, despite the company's low leverage and strong local competitive position. Given the valuation of these bonds was attractive - with a spread wider than US dollar BBs despite its robust balance sheet - we decided to take a position.

Complete Sales

Stock Name	Transaction Rationale
Amgen 5.6% 2043	Bonds have performed strongly, and with the valuation no longer compelling we have decided to switch to IQVIA bonds.
AMS 0% 2025 Convertible	Switching into this AMS new issue to pick up yield and add duration.
Antofagasta 5.625% 2032	We have sold one of the two bond holdings issued by Antofagasta, the London-listed copper miner principally active in Chile, to meet redemptions from the Portfolio. We have retained the larger of the positions.
Berkshire Hathaway 2.85% 2050	Berkshire Hathaway bonds have performed well and are now trading at expensive levels, therefore we decided to sell.
Booking Holdings 4.625% 2030	Booking Holding bonds have performed strongly recently. With the valuation looking less compelling, we have decided to sell.
Cushman & Wakefield 6.75% 2028 (144A)	Cushman & Wakefield bonds have rebounded strongly since our initial purchase as concerns about the Real Estate sector have somewhat dissipated. We thought these concerns were overblown given Cushman's asset-light service-orientated business model, however, we are cognisant of market volatility if these concerns resurface. As such, the valuation was no longer compelling and we decided to exit the small position.
EDF 6% 2026 Perp	EDF hybrid bonds have performed strongly during the market rally in the fourth quarter. Given some tail risks, including the potential for credit rating downgrades or a change in regulatory approach from the French government, we decided to sell EDF to buy Accor hybrid bonds with a similar yield.
EIB 0.375% 2024	We sold this very short-dated and high-quality holding as a cash-like source of funds.
Infopro Digital 8% 2028	Infopro bonds have rallied strongly in recent weeks and now price at a notable premium to par, offering limited further scope for appreciation. We no longer believe they offer an appropriate risk premium to account for the relatively limited availability of information about the business and the still low credit rating. Therefore we decided to sell.
Millicom 4.5% 2031	The portfolio has benefited from a recovery in Millicom's bond prices following an opportunity provided by an overreaction to difficulties in its Colombian joint venture. Having recovered, we see limited incremental gains to be made from current pricing and have sold the small holding.
Santander 7.5% 2024 Perp AT1	Santander have recently successfully issued new AT1 bonds which will very likely allow for the redemption at par next year of the existing holding. Prices have increased to reflect this likelihood. We are switching the proceeds into the recently issued, higher-coupon and higher-potential bonds.
Temasek 3.375% 2042 RegS	We are using the most expensively valued of the Temasek holdings as a source of funds, retaining bonds with more upside potential.
Verisk Analytics 5.75% 2033	Verisk's bonds have performed very well since purchase earlier this year and now offer limited value, therefore we decided to take profit and sell.
Volkswagen 4.625% 2028 Perp	Volkswagen hybrid bonds have rebounded strongly during the market rally during the fourth quarter of 2023, based on expectations of a soft landing of the economy. As a result, these no longer offer compelling value and we used the bonds as a source of funds for better ideas.

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