Baillie Gifford™

Multi Asset investment update

April 2024

Are we on a path to ‘immaculate disinflation’? How wide is the investment opportunity from decarbonisation? What are the key market catalysts for 2024/25? Investment manager Scott Lothian and investment specialist Barry Templeton reflect on these questions and give an update on the Multi Asset Strategy’s portfolio.

Your capital is at risk. Past performance is not a guide to future returns.

Barry Templeton (BT): Good morning, everyone, and welcome to Baillie Gifford's Multi Asset update for the end of Q1 2024. My name is Barry Templeton, and I work in the Multi Asset Team here at Baillie Gifford. I'm delighted to be joined by Scott Lothian. Scott is a portfolio manager in our Multi Asset Team.

Our plan today, for those of you who joined in the past, you'll be familiar with this; we'll spend the first half going through three main points, a quick reflection on what's happened over the last three months in terms of market background. Then we'll spend some time reflecting on performance, just touching on some of those key drivers of performance. And then we'll turn on to the portfolio itself, talking about some of the interesting, exciting opportunities that we've invested into on your behalf over the last few months.

Then onto the second part of the webinar, and that is Q&A. So, it's over to you to ask your questions. Please do use the text box at the bottom of the screen, type your question in, and we will get to as many of them as we possibly can.

I do have some pages which I'm going to pull up on the screen just a moment. Again, as ever, for those of you who have joined in the past you’ll be familiar with the fact that we do use Diversified Growth data on the screen. That's just to keep things simple, but where there are any key differences between DG [Diversified Growth] or any of our other multi-asset portfolios, I'm sure Scott will highlight those differences. Lastly just before I hand over Scott, I will say that this webinar is being recorded, that allows us to send out a recording post the event. That’s enough from me, I will work on getting the pages up on screen, Scott I'll hand over to you.

Scott Lothian (SL): That's great thanks very much Barry and hello everybody. Thank you very much for tuning in. As Barry said, there're three points that we'll, three big topics, we'll look to cover today. That's the economic and market background, an update on performance, and then some new developments in the portfolio.

Now, I'm sure you all have heard a lot about markets and economics of late, so I'm planning to spend most of the time this time around on the portfolio. But kicking off, 2024 started much as 2023 had ended. Increased market confidence of a soft landing and, at one point, as many as six Fed rate cuts priced into bond markets back in January. Through the quarter we saw equity markets rising, credit spreads tightening and government bonds selling off, all of that serving to fuel a pretty confident sentiment through what was a relatively benign opening quarter.

Now things have clearly changed a bit over the past couple of weeks, with inflation again appearing a bit stickier in recent updates. So, we've seen government bond yields going up even further, with the US 10-year back above 4.6 per cent today. Our central macroeconomic case is that the relatively benign backdrop continues. Growth remains reasonably robust in 2024 and near-term fears of recession, well, those fears are receding a bit. We still expect the Fed to start cutting, albeit gradually, later in the year, and that will help markets and households. But of course, that soft landing is quite a tightrope, it requires most things to continue to go right.

Interestingly, the second most probable scenario that we were looking at in the first quarter was one of stickier developed market inflation, which we've seen a bit of that coming through now. Now, that comes with an increased risk of weakening growth and possible recession into 2025. That scenario impacts markets more negatively and for us highlights the virtues of running a well-diversified portfolio.

Coming on to the performance, the multi-asset funds benefited from that rather calm start to the year. Not massively so, but a modest positive return. I'll come back to the attribution in a second, and you'll see the detail over the quarter and over the 12 months. Overall, however, while it's going in the right direction and building on the positive fourth quarter and end of last year, it's not yet adding enough into those longer-term lagging numbers that you see here. That five-year number is our main focus and while part of the way to get back on track is avoiding pitfalls, the more compelling part of the equation and what we're aiming to do is to make the most of the opportunities that's given to us by markets and investment ideas.

Volatility is the second objective and the trailing five-year figure we see here is still elevated compared to where it had been over most of the past decade, but still well within the 10 per cent limit. It's modestly higher than our currently predicted volatility, which is sitting at about 7.5 per cent.

I'll move on to the performance attribution, and hopefully you'll recognise these charts that we'll often refer to looking at the different component parts of our portfolio's different asset classes and how they make up the returns. You may recall quarter four of 2023 was one of those unusual ones where almost everything was a positive contributor. This quarter, as you see on the left-hand side of the page here, not so much and neither for the 12-month period shown here on the right, these are more normal. And actually, as we go through some of the most interesting movements we've seen over the first quarter of 2024, and indeed over the past year, are those ones that have gone against us. Infrastructure for example, it's really rare, it's the kind of light blue colour on the right-hand side of both charts. It's really rare to see that contributing so negatively over these periods as we see now, but that's really giving us a great opportunity to be adding there, and I'll come back to that when we're talking about the portfolios. We kept our allocations to some of the period’s best performing asset classes; structured finance, emerging market bond exposures which continue their good run, and you can see those featuring in both charts. After a rather difficult 2023, high-yield credit also contributed well at the start of 2024. And we managed to cut duration within portfolios in a timely manner during the first quarter and so we're not too damaged by those yield rises that I mentioned a moment ago.

We've added to listed equities and that's seen the highest positive contribution to performance over the course of that first quarter with growth-oriented stocks leading the way as was the case through 2023. As many of you will be very aware, it's a small number of mega cap stocks really powering this rally, the likes of NVIDIA and Amazon, providing stellar returns. We have exposure to some of those companies through our underlying Baillie Gifford growth equity funds. As you might expect with a portfolio of this type, with exposure to lots of different underlying risks, some of the asset classes face challenges.

And at the start of this year, as you can see on the right-hand side of the three-month chart, it's those real assets grouping of property, infrastructure, and commodities, which were the biggest detractors. Infrastructure in particular, for its long duration characteristics were unhelpful as bond yields were rising and pricing pressure on UK investment trusts also damaged those near-term results. For us, that took those assets quite clearly into cheap territory and we've added substantially to those during the quarter as the prices have fallen.

Within commodities, despite rallying at the end of the quarter and indeed into this month, our commodity holdings disappointed. Here we've got exposure to copper and aluminium, which were generally stable over that three-month period, and rare earths, which sold off due to fluctuating demand and increased production in China. That said, this is a short period. We're still very positive there. And over the longer term, that decarbonisation theme and the role that these commodities and these companies play remain important for our portfolio.

Speaking of the portfolio, I'll come on to this now. You'll recognise the very well diversified portfolio here, good representation for all of the asset classes for which we have the highest long-term expected returns, and of course a controlled mix of different risks. You'll see a few segments pulled out in the diagram. Those are ones that we've got some exciting developments in. I'm going to come on to talk about in a moment. But first I highlight some of those other changes already mentioned.

Infrastructure up from 13 per cent as at the end of December [20]23 to 21 per cent, as you see here on the page. Property, again, remember that was one that had struggled over that first quarter, up from 9 per cent to 11 per cent, so adding there. Structured finance, one of those areas which has been doing very well over the course of the past year, and that gives us some increased confidence. We see that now growing from 12 per cent at the end of the year to 14 per cent as we sit here today.

The flip side of that is government bonds gone from 7 per cent at the end of last year to 4 per cent today. Investment grade credit, which that doesn't actually feature in the chart here, was 5 per cent of the portfolio and is now zero. And cash, you may recall at the end of December, was at 7 per cent and that's been brought down to a working balance of 3 per cent at this point. So those

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changes were asset allocation changes largely made on the back of our updated long term return forecasts as at the end of the year and put into effect in January and February.

So those are very top-level changes and they're important for the shape of the overall portfolio, but don't always capture all of the developments going on within the portfolio, but don't always capture all of the developments going on within the portfolio. And I want to take some time to run through some examples of what our research within the different asset classes has borne fruit and brought new investments into the portfolio. And we start off with carbon credits, which we brought into the commodities part of the portfolio. This is an interesting idiosyncratic story here. It's completely new for the portfolio. This is the first time we've added it across our multi-asset portfolios. With much of the world engaged in the effort to tackle climate change, there's a need for policy response. We think it's very likely that carbon pricing will play a central part in that. The premise is pretty straightforward. Polluting activity creates environmental damages and there's not often any economic incentive to reduce that activity. Carbon pricing creates that and encourages greater uptake of mitigation measures and so on. Why invest now? Why did it suddenly get interesting? Well, quite simply, we've been looking at this over the course of the past few years, building up our understanding of the market here, which has continued to evolve and mature over that time. We've found ourselves over the course of the first quarter in an increasingly attractive entry point in terms of recent policy developments, but also where the market was pricing us, giving us a good point to get in.

Next, Egyptian bonds. Well, those of you who've followed the portfolio for a while, remember that we have held Egyptian T-bills in the Diversified Growth Fund before. This is a really good example of ideas coming in from the Global Bonds Team that we sit alongside here at Baillie Gifford. Look, Egypt has been in a difficult position over the course of the past few years and bond markets have effectively been closed. Foreign investors have been put off by high levels of inflation, unsustainable exchange rates, and too low interest rates. So, what's changed here?

Well, we saw a near 60 per cent currency devaluation last month, so it got cheaper. And we also saw a substantial investment from the UAE, which gives the Egyptian authorities a lot more room to manoeuvre and actually allowed the central bank to hike policy rate by 600 basis points bringing it much closer to the neutral rates needed. Now that doesn't mean that the Egyptian model is permanently fixed but that support from the UAE provides the opportunity for endorsement of large scale development projects, stimulates growth, creates jobs, gives a very attractive, relatively short-term position, and for which our base case return is about 20 per cent over the course of the next year.

Finally, on this page, insurance-linked securities. You'll be aware that we've invested in ILS catastrophe bonds for many years for this within this this portfolio and we're very mindful of the ebbs and flows of the reinsurance cycle. Last year insurance linked securities were an important positive contributor to fund returns and as always, a very strong diversifier. This trend persisted in the first quarter, although we started really ramping up our allocations here towards the end of 2022. We've continued to do that at the start of this year by participating in new issuances over the first quarter. So, bringing that allocation from about 6 per cent at the start of the year to about 9 per cent today. And that's across a diversified range of underlying risks.

The final point I wanted to talk about, and this is very hot off the press, is within emerging market equities. I'm saying it's hot off the press because we've actually added these after the end of the quarter. So, you won't see these in the portfolio as at the end of March. But we've invested within the emerging market equity segment into new positions directly in Indian and Vietnamese equity markets. These are two very different markets, attractive here for quite different reasons. India, relatively well established as a broad and deep equity market and really is a story of long run continuing economic growth. It's obviously a massive country, very healthy domestic growth story and doing very well. This one is no secret. So, it's not particularly cheap but we think with underlying economic and corporate earnings expected to continue, we've got positive expected return even if we see some valuation pullback so we've added a position there alongside our exposure to Baillie Gifford's emerging market equity funds, expecting this to be a relatively long-term position in order to capture that growth.

Vietnam, on the other side, is much smaller. It's actually a frontier market, one notch below emerging. It's got great economic potential, but unlike India, this is mostly from industrialisation and exporting and with deepening ties to both China and to the USA. It's very well positioned to benefit over the coming years from filling gaps in the supply chain. Now, the Vietnamese market has been a horrible place to be over the course of the past 12 to 18 months, and that's given us a good entry point. This one's much more about value. I'm less sure that this is one for the really long run in our portfolio. I don't think it'll fly below the radar for terribly long. Indeed, our Emerging Market Team, we work closely with and putting this one together have been writing some notes on Vietnam more recently but I think over the course of the next three to five years, this is one that can make really good investment returns as that industrialisation potential is tapped.

Now, none of those new things that we've talked about there are huge portfolio positions at this point, they may well grow to be so, and the fund remains well diversified, as you'd expect. I really wanted to share those to highlight what our underlying research has uncovered, and that we've got the conviction to be bringing these into the portfolio. As I said, some of these can be, you may see being larger in future reports, and we look forward to keeping you up to date with all of their progress.

I've talked for a while there, so happy to wrap up my comments and I'd like to welcome any questions that we have coming in, thank you.

BT: Okay, thank you very much Scott. So, I am just going to quickly scan through some of these questions to see if there's a bit of a theme here. So, I'll start with one of the macro ones here. What will happen to the portfolio if inflation stays elevated for the next 12 months?

SL: Yeah, certainly a good question. It's one that's been prominent in our team discussions. You know, if inflation, and thinking here predominantly about US inflation but as it pertains to the rest of the world, stays elevated it could be a challenging time for many asset classes, we've been looking at that in our scenario analysis. And especially if central banks stay hawkish to try to counter that. Now here I'm thinking about inflation staying at the kind of two and a half to three and a half percent range, not necessarily going back to 2022 levels, but staying at those levels above target. That doesn't necessarily have to be a total game changer. I think we may see near term volatility within the portfolio, but I think that could give us an opportunity to lean into some of those longer-term opportunities, which perhaps have been a little bit pricey recently.

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BT: Okay. Scott, I think this is clearly linked to that, but it's just a question on the latest inflation data out of the US. Is the latest inflation data out of the US proof that we're seeing more than a short-term bounce. Maybe the case that inflation and interest rates will be higher than the market and you expect it to be through 2024?

SL: Yeah, quite possibly. As I mentioned, we've seen that at the start of this quarter a few prints now. This is really why we test the resilience of the portfolio on a regular basis. Stickier inflation, higher for longer rates, they would likely follow that, would pose a challenge to some of those duration-sensitive asset classes. We've seen some of that over the course of 2024 so far. And some of those investments that were the difficult end of the attribution charts, recall; property, infrastructure, even equities, for example, we've got those in the portfolio for long-term structural reasons and perhaps can take a bit of that near-term volatility if coming from higher inflation. Has it become slightly more probable than at the start of the year? Yes. Yes, it has. Does that potentially store up problems for the future, as I mentioned in our second most likely scenario? Yes, I think it does as well. So, I'd be far more concerned about 2025 and 26 if we saw that persisting.

BT: Okay, so I think that actually answers another one of the questions about how our most likely scenario over the next 12 to 24 months, how is it materially different now versus the update we gave in January? It's really then just the development of that scenario that we spoke about in January, looking a little bit more about what's happening over the next 12 months and not having that higher probability attached to a recession but still seeing that as a possibility through 2025 into 2026.

SL: Correct, yes, absolutely. And I think what we've seen is that those recessionary fears being pushed back and pushed back in time. As we were sitting here at the start of last year, for example, there was a much higher expectation in the market of difficult times ahead in 2024. I think that's continued to be pushed.

BT: So, there's a few questions as well on the portfolio itself, which I'm going to come to in a second. I suppose one, overarching question about the portfolio is, are we over diversified? I know it's one of your USPs (unique selling points), but do you think you're missing out on returns because you've in allegiance to a well-diversified portfolio?

SL: Okay. Nicely put, one of our USPs. You know, I'd argue that we argue that we're appropriately diversified. And that's a result of the way that we, how we look to build a portfolio and to add value. This is predominantly a top-down strategy. I've talked a little bit about some of those kind of bottom-up opportunities, but predominantly it's which asset classes do you have in the portfolio in different sizes and the way that we capture those asset classes that we're looking to get. What we don't want to do is to, to overly pollute those top-down calls with specific security risk in terms of sort of volatility and liquidity and so on. So, you know, sometimes when you look at the portfolio, you'll see on a look-through basis lots of very, very small positions. There's a bit of hindsight in this as well. And we'll always look back and say, oh, we should have far more of the portfolio and things that we know have done well. But at the end of the day, we have that volatility constraint to bear in mind as well.

BT: OK. Moving from the sort of economic risks and over to a geopolitical one, to what extent do Israel and Iran developments change or adjust our views?

SL: This is an interesting one. It's one that we've been discussing, obviously, over the course of the past few months. At this point, it hasn't had a huge impact. We've been thinking about being a bit more cautious in portfolios and bringing in things which may provide a hedge against further escalations there. Now, we've seen some of those escalations over the course of the past month, or even just the past week as we're sitting here today. So, at the moment we're not seeing that as having a huge impact on global markets and this is a globally diversified portfolio but obviously one that we're keeping an eye on with keen interest and think it will feature in our upcoming scenario analysis again.

BT: Okay, and possibly alongside the US election.

SL: There's that one as well to think about and those things are not completely independent of course.

BT: No, indeed. So, two questions on the equity addition that's been made, actually three questions. I think you alluded to this point in your conversation but it's basically; India's a very crowded trade, very expensive; Vietnam is seriously hampered by political infighting. So, first point is do we factor in these kinds of things to our analysis, and the second question is how we are accessing India and Vietnam? And while you've got your pen out, Scott, I'll just clip one other one off here. So, in mentioning EM (emerging market) equities, that's part of the reason why we added these valuations. What about Chinese equities? Have valuations come down enough for us to look to add Chinese equities back into the portfolio?

SL: Okay, good. I'll try and take those in order but keep me right. So, India, Vietnam, I think that kind of hits on some of the points I was trying to make before. It draws out the differences between these two markets. At a basic level you can see India is that long-term growth story; positive demographic, strong domestic market, it's not cheap. That's why you know when we've been running our numbers over this, we've allowed for a little bit of de-rating to come through and we can still get strong returns from the underlying earnings over the course of the next five-to-ten years. Vietnam is a value story and some of the challenges of this value opportunity are presented because of that potentially difficult political narrative. We've seen change in senior leadership over the course of the past month. I think in January, the General Secretary was declared dead a couple of times. He's not dead. You're seeing this coming in.

And Vietnam is a frontier market, India is an emerging market. It comes with volatility. For Vietnam, we've got a few key catalysts in place for re-rating. There's, what I talked about before, about ties with US and China. There's also the potential for it to graduate from being a frontier market to an emerging market over the course of the next few years. And again, that one might not be such a long-term position, but something we see good prospects for over the next few years.

How we've accessed those? Well, in both cases here, we're using externally managed active investment funds, investment trusts, actually, listed in London to get exposure there. This is a good example of working together with our Emerging Markets Equity Team, who, although they invest in those countries directly, there's not a standalone fund within Baillie Gifford, so where we don't have that capability, we're very, very able to look externally. And so that's what we've done here. In fact, the couple of funds that we've added to in Vietnam are well known to our Emerging Markets Equity Team, you know, through sort of investing alongside them for many years. So that's been a useful way to add there.

Final point was on China, you mentioned. And yes, good observation. So thank you. Yes, we've sold out of our direct Chinese equity positions towards the end of 2023. We've held those positions for a number of years. And you remember that those are index plus instruments that give us exposure to the local market plus a spread. One of the things that we look at in terms of allocations to the Chinese market is where domestic flow is going and how much of an impact is that having on the markets and, you know, we saw sort of heavy selling by domestic markets, where it's a retail driven market predominantly and so that's together with the challenges to growth within the Chinese market, that led us to remove those exposures. It's not yet back to a position where we're saying it's either sufficiently cheap, nor are we seeing sufficient momentum from those domestic investors to get back in, but it's one that we're monitoring closely with a view to perhaps at some point those metrics that we monitor align and give us a prompt to come back in.

BT: Okay, Scott, I want to just turn briefly away from equities and macro for a couple of minutes. There were a couple of questions on the carbon credits. The one that hits it on the head is why are carbon credits a tradable asset? Who do you buy them from? And who ultimately will you sell them to?

SL: Very, very good question. So, we've invested in this using a listed vehicle. So, this trades very like an ETF, an exchange traded commodity, it's holding the actual contracts. So, the EU issued contracts; the EU issues those to industry and then there's a market for the underlying companies to trade those. To say our forecast emissions over the course of the next period is X and we have an allowance for Y and so either we need to buy more or we need to sell some of these carbon contracts and that creates the market. So, you know, by participating in that we are in effect, buying some of those carbon contracts, taking those off of that natural market for it, buying those contracts from companies which are going to emit less. And then ultimately, and this is a really good point as well, ultimately, when we come to sell these, when it hits our price level, for whatever reason, we may be selling those on to other investors (we sell our exposure to the ETF which triggers a sale of the underlying contract) they get sold on to other investors or it gets sold onto somebody in the corporate world who wants to use them to permit them to make additional emissions. At that point, what it's doing is it's providing an economic disincentive for companies to emit more than they've committed to, than they bought the carbon credits for.

BT: Right, I think that gets to the question that's been asked Scott. I'm conscious that it's actually just ticked past 10.30 so with apologies, I've not got to every single question. There's a couple left there which I will be in touch with the individuals. So, thank you very much for posting those questions. Thank you everyone for joining us this morning. Like I say, there'll be a recording of this coming out shortly and you should have your quarterly report, if not already, then very soon indeed. In the meantime, I will say again, thank you very much from me and very much the same from Scott, I'm sure. Please do get in touch if you have any more questions and we'll look forward to speaking again soon. Thank you, goodbye.

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	2020	2021	2022	2023	2024
Diversified Growth Fund (Class B-Acc)	-8.8	17.6	3.3	-8.7	3.2
Index (UK Base Rate)	0.7	0.1	0.2	2.4	5.1
Target (UK Base Rate +3.5%*)	4.2	3.6	3.7	5.8	8.6

*Per annum over rolling five-year periods.

Source: Baillie Gifford & Co, FE, Revolution. Total return, sterling. Share class returns calculated using 10am prices, while the Index is calculated close-to-close.

The manager believes that Base Rate (UK Bank of England) +3.5% is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing.

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