GLOBAL INCOME GROWTH Q2 INVESTMENT UPDATE

Investment specialist Seb Petit and investment manager Ross Mathison give an update on the Global Income Growth and Responsible Global Equity Income strategies covering Q2 2023.

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

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

Seb Petit (SP): Hello, and welcome to this quarterly investment update for Baillie Gifford Global Income Growth Strategies. I am Seb Petit. I'm the investment specialist on this strategy, and I am delighted to be joined today by Ross Mathison, one of the portfolio managers.

Now, as a reminder, by focusing on dividend growth, our strategy seeks to invest in long term compounders, and by that we mean companies which we expect to deliver steady earnings and dividend growth for the next decade or more. Hi, Ross.

Ross Mathison (RM): Hi, Seb.

SP: Starting with performance, we had a strong start to the year, how has performance been in the second quarter when we have seen quite a narrow market driven by anything AI (Artificial Intelligence) related?

RM: So that is the story of the second quarter: you can list seven names, AI and tech related, that have pretty much explained the whole of the performance of the benchmark. And within these seven, you have two that have low yields, Microsoft and Apple, which we do own, but because of low yields it's hard to own in extreme size, and five that have got next to no yield.

So, the part of the market that has been really growing in the first or second quarter was not one that was available to us. We had a very strong first quarter, though, and so, when you put the two together at the halfway point, we are roughly in line with the benchmark.

SP: And in terms of looking at our own performance in Q2, what were the main drivers? Was there any big theme in there?

RM: If you were to try to pull a theme, I think what you would say is that the positive contributors were a number of our industrial companies, Atlas Copco, Fastenal, Watsco. And what these companies had seen was some earnings downgrades through last year and early on this year on the back of people worrying about interest rates, an economic recession and what would that mean for these industrial companies.

And in fact, they had results in April, which were very positive and led to earnings upgrades again. So that would be a theme if you were to try and take one of the positives.

And then on the negative side, I would say it was some of our companies at the more cyclical end, whether that's Analog Devices and semiconductor companies that the markets were worried about, or UPS the parcel delivery company, with the market worrying about volumes perhaps coming off, they haven't seen a very strong period and what that means for earnings.

So these would be the themes if you were to try and define them.

SP: Staying with UPS, which is quite a large position in the portfolios, is that a worry or a concern you have as well, in terms of the short-term outlook for that company?

RM: So this is not going to be where we're going to add value, trying to pick out what's going on in short term economic cycles. We are focused on what can happen to this company over the next ten years. We see a company that has one of the best networks globally, a very, very strong incumbent position. But importantly, we have had a management change with Carol Tome coming in as CEO, recognizing that this is a bureaucratic organization, an organization with an inflexible approach to capital expenditure and who has decided to make some quite dramatic changes.

We have had a really radical cultural transformation, which they are currently going through. We have seen a really different approach to deploying technology and really getting this business back to the basic principles of working out what are the customers' frustrations, solving those and also think about what do employees want. And just by returning to these basics, communicating better with staff, I think you have got an organization which is starting to see a flywheel hum.

And so, we are very excited about what this can become a decade from now. We think the returns on this network will be far higher and so, we are very happy to ride out any short-term economic cycles.

SP: So, UPS is staying in the portfolio. Was there any particular big change in the portfolio in the second quarter?

RM: One new name has gone into the portfolio, Eurofins. It is a European lab testing business company we started working on last year, but it has been known around Baillie Gifford for far longer.

I have now been to six different labs to see this business and just in June, myself, James and Toby were in Belgium and Netherlands seeing other labs and meeting with the founder and other members of management team.

This is a company that we have always thought, part of the testing inspection sector, which is an attractive fit with what we do. Itis a very dependable source of revenue. But we had not really found the company that we thought could drive real growth. And what wehave found here is a company with a visionary leader, a different way of building a testing business and one that has gained a lot of market share. And we can see a network that is now at a point where that market share growth can accelerate from here.

So, very excited about this business. It starts at a small position as this is our way of getting to know companies better and build positions when we see the investment case working. But that is the one change in the last quarter.

SP: Thank you. Now I want to change tack a little bit. And you touched on the potential risk of recession. The bond market, in particular, is telling us that maybe a recession is coming. How do you feel the portfolio is positioned in case such a risk materializes?

RM: So, we are feeling very good about the portfolio. And I would reflect that in my time at Baillie Gifford, this has been the most comfortable I have felt with the portfolio that we have.

It is in a very, very good place. Our philosophy and our process lend us towards finding companies that are dependable and resilient in tougher economic times. We have got less than half the financial leverage of the wider benchmark. So, the desire to find companies that are high quality, capital-light and with low financial leverage means that we are in good shape.

And when you look at past tough economic times, we have seen our companies actually act counter-cyclically. And these times have been some of the greatest opportunities for acquisitions, when maybe competitors are more financially levered and struggle. So, a big part of our research process focuses on understanding the management. We have got what we call a management scorecard. We try to assess adaptability, how visionary, how long-term they are.

And I think we have got management teams that we would back to take advantage of a tougher economic time.

SP: Thank you. I want to change tack and move to research. In particular, I want to mention a stock discussion we had in the quarter around Fastenal, using the report that Hatty Oliver, our investigative researcher, published. Did that lead to any sort of decision or action by the team?

RM: So, the origin of this was: we spotted in a report which analyses Glassdoor data that there were a couple of cultural signals that gave us slight concerns. We have known Fastenal for a long time. We have met them multiple times. I was visiting them last March and we have known it has been a hard culture, but we wanted to check in on these signals and make sure that hard culture was not going to lead to bad outcomes or an inability to attract future talent.

And so Hatty, our investigative researcher, went away and she spoke with a dozen former employees to try and build a picture of how real is that signal and what are the root causes. And we feel like we have got a good handle on that. And because of our relationship with the company, we felt in a position where we could actually share that report with the CEO.

He subsequently wanted to have a conversation, so I had a conversation on Zoom with him and the CFO, and then we followed that up with an in-person meeting a couple of months ago in

Edinburgh where we discussed this further. So, there's quite a lot of hard truths in there. And the report, I think, took them aback a little bit, but they recognized that there were real issues there and we think they are on a path to resolving some of these and making changes, which is very encouraging. And for me, this is where you can have a real impact with engagement if you are a long-term aligned shareholder.

SP: That's great, thank you. A great example of engagement. I want to stay with research. I noticed on LinkedIn the other day your post from Japan. Is that because Japan is very much in vogue at the moment and have you found any potential opportunity you want to talk about?

RM: Thank you for looking at my LinkedIn posts, this is well outside my comfort zone. But the idea is to try and make it more accessible to clients, to show what we are doing to try and build these research investment cases. So, Japan was one half to meet with an existing holding, USS, our Japanese car auction business. Just to try and understand how their growth case is evolving, but then my trip was also about scouting for new ideas.

So, I am really encouraged by the companies I met, companies where I think there is genuine growth, there is a durable competitive advantage and perhaps most surprisingly was the commitment and dependability of the dividends. That, in part, is related to the kind of corporate governance initiatives and changes from the Tokyo Stock Exchange, but really encouraged and excited to come back and try and flesh out those investment cases and see whether one of those four names could be a good addition for the portfolio.

SP: Thank you, Ross. That's great. For me, there are three key takeaways from this conversation with Ross. The first one is that at half point in the year, portfolio returns have been positive and in line with global equity markets. The second takeaway is that although there haven't been too many additions to the portfolio, there is definitely a lot of research happening on the ground. And the third takeaway is that, as we possibly enter a more challenging macroeconomic environment, the quality growth and resilience characteristics of the strategy should be helpful for our clients.

Thank you everyone for joining and thank you Ross for your time.

RM: Thank you, Seb.

Annual past performance to 30 June each year (net %)

	2019	2020	2021	2022	2023
Global Income Growth Composite	8.7	4.4	39.0	-14.2	17.7
Responsible Global Equity Income Composite*	NA	4.9	38.0	-13.6	19.6
MSCI ACWI	6.3	2.6	39.9	-15.4	17.1

Annualised returns to 30 June 2023 (net %)

	1 year	5 years	10 years	Since Inception
Global Income Growth Composite	17.7	9.8	9.1	NA
Responsible Global Equity Income Composite*	19.6	NA	NA	13.3
MSCI ACWI	17.1	8.6	9.3	8.9

Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.
*Inception date: 31/12/2018
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