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Rob Baltzer: The key message I want you to take away from this update, as we enter 2026, is that current conditions are supportive for credit, but the future is always uncertain. In this context, we've positioned the portfolio to be robust and adaptable, offering an attractive yield and ready to take opportunities as they emerge.

So let's start with the market backdrop. There is a lot going on in the world just now, which can be hard to make sense of. Despite that, markets have been in an ebullient mood, capping off 2025 with a strong final quarter.

It's increasingly obvious that the world order that has prevailed in recent decades is being upended. The political choices being made in the US just now are an important factor in this change. Geopolitical change is happening against a backdrop of accelerating technological progress, inequality and climate change, and the range of possible consequences as these forces interact is very wide.

While these long-term factors rightly consume our attention, they don't necessarily feed quickly into market pricing. But then neither do the big political events of the moment.

Despite much angst in advance of the UK budget announcement in November, and the longest ever US government shutdown, the apparent stabilisation in inflation at acceptable levels in both countries allowed the Bank of England and the Federal Reserve to continue cutting their policy rates and for government bonds to rally.

In the short term, markets have focused on the positives of growth stimulus from data centre construction, which combined with continued deficit spending and falling monetary policy rates provides plenty of reason to cheer, whatever fireworks may be going off in the political arena.

As a result, the 70-30 composite of investment grade and high yield bonds that we monitor returned more than 2 per cent in the fourth quarter, taking returns for the year as a whole to around 7 per cent. Our strategy was slightly ahead of this composite over both the quarter and the year net of fees.

The environment of low spreads and low volatility of spreads led to less dispersion among corporate bond valuations than usual, and that reduces the opportunity set for active managers to capture value through capitalising on market inefficiencies. Given that backdrop, we were very pleased that the strategy added value for our clients, with bond selection continuing to be the key driver of that outperformance.

Looking ahead, what do we expect the key themes to be in 2026, and how is the strategy positioned? Two of the hot topics in markets currently are private credit and AI-related spending.

These are impacting on credit markets at opposite ends of the credit quality spectrum. Private credit refers to the provision of financing to smaller, more aggressively financed businesses away from public markets. This has been a rapidly growing part of the corporate financing landscape.

So far, the returns delivered by private credit managers have been good, but two recent high-profile borrower bankruptcies in the US led to renewed fears of what might lurk beneath the surface, given the opacity that is inherent in private activities.

Private credit has competed with high-yield markets to provide financing, so one consequence has been an improvement, actually, in the quality of high-yield bond markets by removing some higher-risk borrowers. The private credit funds themselves have also become large borrowers, using debt capital to supplement the money they raise from their investing clients.

That growth means they've become a much bigger part of the market, paying relatively wide spreads. So what does all that mean for our fund positioning? We view the spreads on these bonds as attractive on a longer-term view.

Having been long-term lenders to the largest of these funds, Blackstone's private credit fund, we recently added to the position. AI-related data centre construction has been a major cause of new borrowing in recent months.

Many of the infrastructure builders here are very large, profitable and highly rated companies like Google, Amazon and Meta, and they can pay for a lot of investment from their current cash flows.

But the level of their spending has outstripped even their high profits, leading them to borrow more than usual, and more speculative developers are expected to come to market in the future. We fully expect to be presented with opportunities in this space in 2026.

We will stay focused on the facts and the covenants in this area, looking beyond simple, shiny sales pitches. Today, we see the best credit opportunities in the crossover part of the market that spans the boundary between investment-grade and high-yield bonds.

We've added several diverse names in this area, including the fast-growing fintech business Wise, Australia's Brisbane Airport, which is set to benefit from the 2032 Olympics, and Southern Water, a laggard among UK water companies, but one which is getting the shareholder support that it needs to strengthen its balance sheet, invest in its assets, and do a better job for customers and the environment.

We believe our portfolio is robust and adaptable, offering an attractive yield, and we are ready to take opportunities as they emerge.

Baillie Gifford Strategic Bond Fund

Annual past performance to 31 December each year (net %)

	2021	2022	2023	2024	2025
Class B-Inc	-0.6	-16.0	9.1	6.7	7.3
Index*	-0.9	-15.5	10.2	4.2	7.0
Sector Average**	0.8	-11.0	7.8	4.6	7.0

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.

*70% ICE BofA Sterling Non Gilts Index / 30% ICE BofA European Currency High Yield Constrained Index (Hedged to GBP).

**IA £ Strategic Bond. Sector

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.

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