Baillie Gifford

Your capital is at risk. Past performance is not a guide to future returns. The following update is based on a representative portfolio. As such, stock examples may not be held in every client portfolio, and performance may differ.

Robert Baltzer: After a turbulent second quarter, the corporate bond market was more stable in Q3.

We saw the US Federal Reserve cut interest rates for the first time this year and September saw the strongest supply of new corporate bonds this year, while demand remained high. These dynamics, paired with good economic data and company results, saw credit spreads continue to grind tighter over the quarter.

Another important emerging theme is that investors have become relatively more comfortable with corporate bonds as opposed to government bonds due to the concerning trajectory of sovereign creditworthiness. We think this trend is here to stay, supporting corporate credit as an asset class.

In Q3, the returns on UK government bonds were slightly positive for short-dated bonds but negative for longer-dated bonds. Corporate bonds kept up their outperformance of government bonds, notching up around 1% extra return in the quarter, continuing a nearly unbroken streak stretching back more than three years. The Strategic Bond strategy kept pace with the market, delivering around 1% in the quarter and nearly 5% YTD. In relative terms, the strategy performed in line with the index, reflecting neutral risk positioning overall.

As investors in corporate bonds, we don’t pretend to have a crystal ball that tells us exactly where the economy or markets are headed. Predicting the future is notoriously difficult, and this year's events have confounded many forecasters.

We adopt an attitude of cautious optimism and constant curiosity to face a future that we must humbly acknowledge is always uncertain.

We are cautious on two fronts—first, that the strong momentum in credit markets has driven spreads to relatively low levels, and second, that cracks are starting to show at the more speculative end of the market.

Spreads are low because companies, generally speaking, have proven very resilient to an environment of modest growth and higher-than-usual inflation. This is justified but means that the margin for error is lower-than-usual.

Some companies that are both financially geared and are either more cyclical or have complex, cross-border trading relationships, have been struggling. These include companies in the housebuilding, commodities and automotive sectors.

Reflecting this caution, we have reduced holdings of lower-rated bonds across the quarter, preferring to invest in our traditional sweet-spot of BBB and BB-rated issuers.

We are optimistic, firstly because of the resilience that companies and individuals continue to show and secondly because we have been diligent in continually reassessing the strength of our portfolio companies. The capacity to thrive in different market environments characterises the companies we choose to invest in.

We are constantly curious. That means that we are future-focused, keen to support adaptive businesses and to steer away from declining and disrupted ones.

A recent purchase that exemplifies this is the US company Axon Enterprise. This founder-led business is focused on helping police forces and security services to be safe, trusted and efficient in their work. Their Tasers have become the gold-standard product in the industry. The company has not rested on its laurels and has moved ahead of the curve by investing in body camera and drone technology as well as software solutions that support real-time operations. We see a path to investment-grade credit ratings for Axon and good value in its bonds.

So, we are cautiously optimistic and always curious to find the next opportunity for your portfolio. Momentum in markets continues to be strong, and the yield available in corporate bonds suggests a solid return outlook over a multi-year investment horizon. We are not relying on things staying the same, because that feels an ever-riskier bet. We are avoiding speculative excess and continue to seek out companies that will deliver for our clients through thick and thin.

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Strategic Bond

Annual past performance to 30 September each year (%)

	2021	2022	2023	2024	2025
Strategic Bond Composite (gross)	4.6	-20.2	8.5	13.0	6.1
Strategic Bond Composite (net)	4.0	-20.6	7.9	12.4	5.5
Strategic Bond Benchmark*	2.8	-20.0	9.1	11.1	5.1

Annualised returns to 30 September 2025 (%)

	1 year	5 years	10 years
Strategic Bond Composite (gross)	6.1	1.7	4.1
Strategic Bond Composite (net)	5.5	1.1	3.5
Strategic Bond Benchmark*	5.1	0.9	3.2

*The composite's benchmark is composed of the following: 70% ICE BofA Sterling Non-Gilt Index, 30% ICE BofA European Currency High Yield Constrained Index (Hedged to GBP). The benchmark is re-balanced quarterly.

Source: Revolution, ICE. sterling. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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