Baillie Gifford™

Strategic Bond Q2 investment update

July 2025

Investment manager Theo Golden gives an update on the Strategic Bond Strategy covering Q2 2025.

Your capital is at risk. Past performance is not a guide to future returns.
Theo Golden: Welcome to the Q2 2025 update for the Baillie Gifford Strategic Bond Strategy. My name is Theo Golden, and I'm a co-manager of the strategy, alongside Lesley Dunn and Robert Baltzer.

Uncertainty was the word flying about in Q2, driven by the huge shift we saw across the geopolitical landscape, with limited room for error in valuations. This was, in part, due to Trump's Tariff agenda, which threw the global world order upside-down.

On one day during April, the S&P 500, Oil and the US dollar all saw large declines, on the same day that the interest rate on the US 30-year rose substantially. In the last 40 years, that has never happened to the degree it did. Investors were dealing with some truly abnormal correlations. For credit spreads, we saw Crossover protection – a proxy for our broad universe – widen almost 150bps.

The market has seen a V-shaped recovery over the rest of the quarter following the announcement of a "90-day pause", and as the US administration struck deals with counterparts.

In Q2, the strategy generated a positive total return of just over two per cent and slightly trailed its benchmark. This reflected small position sizes in two bonds that struggled under the tariff-induced market volatility and saw a deterioration in fundamentals. These positions have started to rally back, and we remain excited about their ability to positively contribute to performance going forward.

We also saw the investment hypotheses for several of our larger-sized positions play out, including a handful of event-driven holdings that I'll talk to in a moment, but also some material outperformance from some of the newer names like **Cheplapharm** that I mentioned last time.

Just as a reminder, when we take a market view, the key factors we consider are the macroeconomic backdrop (growth and inflation), valuations and company fundamentals. We believe that corporates broadly remain resilient, albeit with some deterioration in the lowest-rated part of our investment universe, but that is slightly contributing to our weariness of adding too much risk at this point.

Whilst the geopolitical backdrop is very volatile, we generally think that growth remains supportive for issuers, albeit with an expectation that the UK might be slightly weaker than the US and Europe. Inflation, particularly if prompted by tariffs, remains a lingering concern; however, we still believe price increases should generally continue to fall, which is supportive for the fixed income asset class.

Our main concern remains valuations. High Yield credit spreads – the measure of extra compensation you receive for lending to companies rather than governments – remain tight relative to history and leave little scope for downside risks. Therefore, we remain selective in our risk positions. However, more broadly, the asset class remains very compelling for asset allocators, with these high all-in yields offering a compelling opportunity versus other, riskier asset classes. Hence, we expect supply and demand dynamics to continue to favour corporate credit going forward.

Pulling that altogether, the strategy continues to outyield the index, with our significant overweight to BBB-rated bonds and our enthusiasm for that total return opportunity for investors. However, we remained disciplined, and therefore, in terms of risk, we are neutrally positioned to the benchmark index level, reflecting those expensive spread valuations in High Yield, and the potential for some further volatility from here. In practice, that means we are underweight High Yield Bonds to a slight extend and have no exposure to the lowest quality CCC-rated bonds.

Part of our strategy's core characteristics is our ability to scour the market for mispricing in under-appreciated opportunities. These often have event-driven catalysts that can unlock value for bondholders. By their nature, their timing is unknowable, and they don't happen every quarter, but when they do, we like to highlight them.

We had three examples this quarter in large positions:

1. **CK Hutchinson**, which, following the completion of the merger of Three UK, which the company owned, and Vodafone UK, sought to buy back bonds below par, tempting investors with a significant premium to market value – a very positive outcome for investors like us. We think there's still more to go for here, and like we did with **Annington**, we tendered a fraction of our position to take advantage of the catalyst. There remains value on the table for bondholders, and we believe there should be a better offer from the company for the balance.

2. **OCI Glass** also delivered strong performance. Again, following a large disposal and a large influx of cash, the company tendered for bonds (in other words, it offered to buy bonds back) well above market prices.

3. Lastly, UK parcel delivery company **Evri** saw a strong rally. A business that we saw as under-appreciated and over-discounted by the credit market when it first came and did a bond raise. This quarter, we saw industry heavyweight DHL, an investment grade company, take a significant minority stake in the business, validating our investment hypothesis.

To finish, I'd like to leave you with three key takeaways for this quarter:

- Firstly, the strategy is roughly flat to its benchmark index, net-of-fees and year-to-date. With several large holdings performing well as our investment hypotheses played out.
- Secondly, we remain neutrally positioned in terms of credit risk versus our benchmark index due to tight credit spread valuations we see, particularly in High Yield.
- Thirdly, we remain constructive on the asset class, seeing strong demand for the high all-in yields on offer, matched with resilient company fundamentals in high-quality issuers.

Thank you for your time, and if you have any further follow up questions, please do get in touch with your Baillie Gifford contact.

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Strategic Bond

Annual past performance to 30 June each year (%)

	2021	2022	2023	2024	2025
Strategic Bond Composite (gross)	7.5	-14.7	-1.2	12.0	8.3
Strategic Bond Composite (net)	6.9	-15.1	-1.7	11.4	7.7
Strategic Bond Benchmark*	4.9	-13.2	-2.2	10.5	6.8

Annualised returns to 30 June 2025 (%)

	1 year	5 years	10 years
Strategic Bond Composite (gross)	8.3	1.9	3.9
Strategic Bond Composite (net)	7.7	1.3	3.4
Strategic Bond Benchmark*	6.8	1.0	3.1

*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.

Past performance is not a guide to future returns.

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