Baillie Gifford™

Managed Fund manager update

October 2023

Joint manager Steven Hay joins investment specialist Philip Scott to reflect on the year so far, challenges for growth investors and why the team maintains confidence in the Managed Fund's long-term growth potential.

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

Philip Scott (PS): Good afternoon, and welcome to this update on the Baillie Gifford managed fund. My name is Philip Scott, and I'm a Managed Fund Specialist here, at Baillie Gifford. It's been another very volatile year for equity and bond markets, and whilst the managed fund is in positive territory over the last 12 months, we're acutely aware that from the peak in 2021, performance still looks very weak.

And we know that you, our, clients value the inputs of the fund managers at times, such as these, and I'm delighted, therefore, to have Steven Hay with me today, to provide you with an update. I'm sure you're familiar with Steven, but as a reminder, he is one of the lead managers on the fund, and has been doing that for more than a decade now, alongside Iain McCombie.

The plan for today is to take about 20 minutes, where I will ask Steven some of my questions, but they are questions, which I know are frequently asked ones, and many of them are ones that you have, as well. And then for the next 20 minutes, we'll follow up with your questions. Some of you have already submitted questions ahead of time, so thank you for doing so.

But please do feel free to use the Q&A function at the bottom of your screen, and I'll field those questions and fire them at Steven. And our hope today, really, is to leave you with confidence, the confidence that we have in the fund's ability to perform on a long-term view from here. So, Steven, thanks for your time this afternoon.

We were saying, nine to 12, 18 months or so ago, that we're really optimistic for the companies in the fund, but we've not really seen that come through yet in share prices, it's fair to say. So, I wonder if, to begin with, you could give us a bit of a sense, a bit of an overview of the reasons for the lacklustre returns that we've seen over the last year or so.

Steven Hay (SH): Yes, thanks, Phil. Hi, everyone. I think it's a little bit more of the same, what we thought we saw through 2022, as well. It's just that backdrop of inflation still lingering, of interest rates going up, and, in fact, it's been increasing expectations of where they're going to go. And that's just a real headwind that we're labouring against at the moment. It won't go on forever, but that's been the backdrop for last year, and certainly, part of this year, and latterly, especially the last few months.

So, it's not a great environment for growth businesses. We know that the types of companies we invest in, often they've got long duration cash flows, they've got cash flows that are coming further out in the future than other companies. And the market tends to discount those cash flows by more, when rates go up, and not appreciate the opportunities for those cash flows to go.

So, the market always over does the negativity, as a reaction to rates moving up, and that's exactly what we're seeing. So, it's just not been a great time for growth equities. And indeed, for bonds, where yields have been rising. So, it's been a difficult macro environment, and I think it's really that rates of macro background that have been the main adverse factor behind the muted returns for equities and bonds over the last 12 months.

Having said that, there have been some encouraging signs this year. We've seen a lot of the names that have had a really tough 2022. Finally, we're finally seeing some positive sentiment again, so that's good to acknowledge. We've seen it in NVIDIA, well known to many, but probably, the most obvious one to mention. It's up 200 per cent, at least to the end of August, and it's had a big boost from the trend towards AI.

Shopify, another key holding in the fund, up 95 per cent, also pivoting towards AI, but benefiting from a general continued move into e-commerce, which we see continuing. And they've had to make some hard decisions, including cutting headcount. So, it has been pleasing to see their adaptability, and we see that as a strength.

Also, some of the more of the traditional names, Cemex, the Mexican cement maker, up 80 per cent. You've seen the traditional names, like Marks & Spencer, up 85 per cent, 90 per cent, so contributing to returns, and there are others, so it's definitely not all doom and gloom. But it doesn't take away from the fact that there's work to get done to get back to the highs of 2021.

And ultimately, what will get us there is company fundamentals. And we know it won't be a smooth ride. There may be challenging times to come, if rates stay very volatile, so keeping a longer-term horizon is absolutely key through this period. But looking at holdings today, we have every confidence that this fund can continue to add value in the long run.

PS: That's great, thanks, Steven. And I think particularly encouraging to hear the likes of and NVIDIA and Shopify. If we'd had this discussion a year ago, they were probably at the very bottom of the list of performers, so good to see something of a reversal. So, some companies have done well, but clearly, that's not entirely the case. So, what are we doing about companies whose share prices have been on the much weaker side?

SH: Well, one thing I would say, Phil, is we know the best performing companies of the last decade were also the most volatile. So, it's important not to just extrapolate from volatility to meaning something about the fundamentals of the companies. So, that's the first thing I would say. But it is important, there are a lot of changes going on in the macro background, so it is important that we do reassess the holdings individually.

Have their prospects changed? Do they have a lot of debt, for example? That's obviously more important, when yields are higher. And are they adapting to the growth environment that we see going forward? At the aggregate level, it's really important to note the companies in the portfolio are more resilient than the index. In other words, they have a lot less debt.

They are mostly earnings positive, and at least self-financing with positive free cash flow, and they're growing faster than the index. So, we need to be upfront, but the nature of active investing means we will see volatility in some of these names. We also need to accept that we will make mistakes from time to time. We recently sold Embracer, it’s a gaming business, and Just Eat Takeaway, it does food delivery, they just didn't work.

They were businesses that didn't do well, where we had to hold our hands up and we get it wrong. And that will always be the case that we'll get some things wrong. But if we talk to the individual regional equity managers that build this portfolio, they would say that share prices have often become detached from fundamentals. So, the operational performance, in many cases, is exceptionally good, but they’re just out of favour, for one reason or another.

So, in many cases, we've added, Amazon being one example that springs to mind, so we've added, in times of weakness. So, turnover is still pretty low, it's well within our 10 per cent to 20 per cent average range, because we still really like the portfolio, as a whole.

PS: Great. Thanks, Steven. Now, taking, I guess, a bit of a step up, you've alluded to this new backdrop that we're in versus, say, three years ago, starting point from today of rates at 5 per cent plus, bonds, therefore, maybe more exciting than they have been for a long time. Even cash looks quite appealing. I think if you'd asked me that three years ago, I would have said, definitely not.

It didn't look like that was happening. But cash now looks perhaps more appealing. So, how are you and the policy setting group that looks after asset allocation thinking about the positioning of the fund in that context? And, I suppose, most importantly, have you made any changes as a result of it?

SH: Yes. More interesting, lots of debates, or interesting things to talk about. Just as a reminder, there are three asset classes in the managed fund. The equities, the bonds, and the cash. So, we keep things simple. We think that's one of the secrets of success of the fund. And we have a process where we meet quarterly to discuss that split. We actually have a meeting on Monday. But I think it's fair to say that there's been more debate than the normal of late.

And it's obviously true that bonds and cash look, on the face of it, more appealing than they did, because they've moved up significantly. And so, we have been making some changes as a result of that. So, we had, to a degree, correctly anticipated inflation being a bit higher, and that rates would need to go up, and we had reduced our fixed income, we'd reduced our bond weighting in the portfolio.

And as yields have moved up, gradually been adding back to bonds. So, bonds are still a little bit underweight, our strategic weight, but they've been moving in that direction, so the case for bonds has become more attractive. Meanwhile, we actually see the case for equities having got more attractive, as well. So, over the last year or two, we've been increasing the weight to equities. So, we are actually overweight our strategic weight in equities at the moment.

And so, we actually see the opportunities there as more attractive than cash. So, cash, despite the fact that it's moved up, we remain underweight at a strategic level on cash, round about the 2 per cent mark. And when we debate this within the strategy, our approach to asset allocation is very much to go on the enthusiasm of the underlying managers. So, I'm coming from the fixed income side, so I'm representing that.

So, as you say, I'm saying, well, bond yields are higher, cash yields are higher, why aren't we moving a little bit into these areas? Aren't they more attractive? And I am putting those arguments to the policy setting group. But it's fair to say that my equity colleagues across the board have remained resolutely enthusiastic about their portfolios. They think valuations are really attractive, as I was saying earlier, operationally, things are going well.

Often, companies are building a bigger, competitive moat around their operations. And so, it's just that valuations are just out of favour. And so, they're still really keen on their portfolios and wanting to be overweight. So, at the moment, despite the fact that you might think there are some macro headwinds and yields are higher, actually, the way it pans out for us, taking everything into the round, is that we still want to be overweight equities, and think that's where the greater returns will come from.

PS: Great, Steven. A quick follow-up, I think it would be remiss of me not to ask, and I know our clients are always interested, where to next, in your view, for inflation and interest rates?

SH: Well, you know, Phil, that my view has been that I did think inflation would be higher. I didn't realise how high it would go. And I think it will be stickier and slightly higher than we've seen over the last decade or so, so that's a structural view of mine. For me, that means it's quite difficult for central banks to declare the war on inflation, won, and therefore to bring interest rates back down again.

So, my bias on things is that interest rates will stay around these levels for some time. Nobody knows exactly what the right level is. It's very hard to call it a top for bond yields, because as we're seeing, the US economy has been remarkably resilient to these interest rate rises. And clearly, the transmission mechanism, monetary policy to the economies, is happening with lags that we didn't expect, and maybe isn't happening as strongly as we expected.

Therefore, it makes it difficult for the Fed, the Federal Reserve, let alone us, to know exactly what the right level is. But obviously, I think we're approaching a level of yields that we should, more or less, stop at. But for me, I don't think yields are coming back down anytime soon, unless we tip into recession. There’s always a chance of that, but it’s not our central case.

PS: Thanks, Steven. I want to take a little bit of a step back, I suppose. It sounds, and I think it’s clear, we've not made big changes to what we do over the last three years. But actually, taking a step back, we've not changed much about what we do in the last four decades. We've had a very consistent process, and the fund has weathered many, many a crisis along the way, and we've not changed what we do in that time. So, we've stuck to our philosophy that we believe works.

But I think it’s important to highlight, our process does evolve, and we're continuing to challenge ourselves and how we do what we do as well as we can. And there are some upcoming changes to process in the fund, particularly around the way we apply ESG. So, I wonder if you could run us through the changes that are coming up.

SH: Yes, absolutely. So, you're right, we have a track record of just managing this fund through lots of different environments, market environments, economic environments, and even times of panic, we know that we'll get through this, and the fund does well. So, we launched six months before Black Monday in 1987, and what a time to launch a fund. But we weathered that, and we’ve weathered many crises since then.

So, that's a really important point. Nothing's broadly changing in how we do things. We’ve not really changed anything significant. It’s just small evolutions. And one small evolution that's coming down the track is the addition of a net zero commitment, as you say. And that commitment is to have the whole portfolio to be net zero aligned by 2050.

And that's an objective that the whole firm is pursuing, and this is bringing the Managed Fund in line with that. And we've got an interim target to help us get there, so to have 75 per cent of the portfolio aligned by 2030. And this is something we've been asked a lot about by clients, and a huge amount of work has gone into making sure that what we’ve put in place is robust. And if you remember, the Managed Fund takes a building block approach to asset allocation.

And we know that different regional blocks may have different speeds for getting to net zero alignment, and we have to have a balance between putting in place an interim commitment that will push us, but not constrain the investment opportunities that we've seen in different blocks, particularly in emerging markets, where things are behind developed markets, in terms of that net zero alignment.

So, in terms of the immediate outcome, we plan to sell one holding, which is less than 0.5 per cent of fund, because we don't deem it to be in the spirit of net zero. And that's all. So, really, very, very small changes to what we're already doing. And it's very important to stress, Phil, our investment objective is unchanged, so it's capital growth over rolling five-year periods, and this won't interfere with that.

And so far, well, you can confirm, but it's a development that's been well received by clients, and we think it's a positive change for the fund. And it helps to just make a little bit clearer what we're doing already. And this will be put in place formally in mid-November.

PS: Great. Well, at the end of the day, Steven, we're discussing some of the high-level process here, but we're bottom up stock and bond pickers, that's the bread and butter. So, thinking about the individual names that we hold in the fund, what are some of the team's highest conviction ideas in the portfolio just now?

SH: Well, as you'd expect, we have a very broad portfolio, 200 odd stocks. We have got a lot of variety in there. If I pick a few, so The Trade Desk. It's a programmatic advertising business. Now, in terms of economic uncertainties, often advertising budgets that get slashed first, but The Trade Desk is actually bucking this trend, because what it does is it applies data analysis to advertising.

So, it allows its customers to make ads much more targeted, and therefore, they get more bang for their buck when they are spending on advertising. So, it's a go to for companies under pressure. So, that's one we really like. I'll go back to NVIDIA, because it's obviously done very well. And NVIDIA, for us, it could be summed up, I think it's your term, Phil, as the AI picks and shovels, if you like.

So, we know that AI requires immense computing firepower, and NVIDIA builds the graphic, the hardware, if you like, the graphics processing units that help makes this happen, and it makes the best ones, which is why it's had a really strong run, of late. But what we like about it is that we don't know exactly what's going to happen with AI, and which areas it's going to really transform. But we know that NVIDIA is a foundational hardware, if you like.

So, we know that no matter which direction things really take off, it will just be a key part of that, that is, I guess, the picks and shovels part, which I think is why we like it so much. So, Kirsty, the US portfolio manager, she's been, with her team, having another look at it, after its strong run, just to make sure that it still meets our return hurdle on a five year view, and they're really confident on it. They reckon it's still got a long way to go, and it's an essential part of this AI trend.

So, that's one there. And then maybe moving to EM, you've got MercadoLibre, which is, if you like, the Amazon of Latin America. And it's with that tailwind of increasing Internet penetration, they're still behind where the US and the UK are, so there's a really good tailwind for MercadoLibre. And in the UK, Iain wouldn't like it if I didn't mention Bunzl, which has been a holding for almost 25 years in the fund. It's definitely one of our longest standing holdings.

And it isn't really doing anything glamorous. It's making disposables, like napkins, wooden coffee stirrers, those kinds of things, but it's got a fantastic culture. It buys smaller players, and integrates them really well. In fact, the current CEO was part of a family business, which was bought by Bunzl in the mid-1990s, and he's progressed to the very top of the company, and that speaks to the culture they have. And maybe on the face of it, a dull company, but underneath, a very special culture.

And if I go to bonds, closer to home for me, we've got United Rentals, which is a company, which is renting industrial equipment in the US. And there's a real trend towards not owning equipment, but renting it. I think, with the cost of capital rising, that trend will continue. So, this company is very well pleased to benefit from that overall trend. And the market thinks it's very cyclical, but we think it's not, so at 7 per cent yield, we think that offers a lot of value.

And on the government bond side, one we like is Indonesia, which is a really well managed emerging market. Debt to GDP, 40 per cent. Could you imagine if we had that in the UK and the US? We'd all be feeling a lot happier. Again, yields of about 7 per cent. Well-managed inflation, under control. Lots of reforms going on. So, there's a lot in there. Lots of, as I said, turn [?] equity holdings, more than 100 bond holdings, so lots of diversity right across the fund, but lots of excitement.

PS: Brilliant. Thanks, Steven. Maybe that's a really neat place to pick up a final question then, just on excitement. We've had some questions coming through from the audience, so thank you. Please keep those coming. And some questions around prospects from here. What excites you? What are the reasons to continue to hold? Maybe you could give us a sense of what you're most excited about in the fund just now.

SH: It is the wealth and diversity of ideas, but let me pick out a few trends. It's not just about tech in the fund. Let's look at energy transition, we know this is happening. There's widespread acknowledgement that in the long term, we need to be weaned off fossil fuels. Not to say there's not a place for them in the short run, but the transition is what really gets us excited, from an investment standpoint. So, Tesla is the obvious one that we've talked about in the past for energy transition.

But you also get exposure to BYD, a relatively new holding in the fund, which is the largest manufacturer of EVs. A Chinese company with a real advantage in battery technology and provision. So, that's an exciting one. And thinking about how you harness the renewable power back onto the grid. You need cabling, especially from offshore wind. And Nexans is a French company, it's a cable company, which has been around for over 100 years, and it's absolutely...

There are not many players in this market, but we need good cabling, and there's a lot of demand for it to get this offshore power back into the grid, and Nexans is really well placed to do that. So, around that theme of energy transition, we've got a few things going on. We've touched on artificial intelligence and NVIDIA, but there's quite a lot in that bucket, as well.

I would put ASML, which is a Dutch business that makes the machines that build the semiconductor chips that we need to power AI. You've also got TSMC, which is in Taiwan, a big semiconductor manufacturer. It's doing extremely well. And then Shopify, which is the e-commerce platform, and it's been pivoting towards AI recently. So, it's not always about the ones that are providing the hardware that are the building blocks, it's who can use it the best.

We are looking very closely at that. And a new holding, as well, which is an interesting one, which is called Oddity, and it uses AI to colour match makeup. I'm not the biggest user of makeup, maybe I should be, but I'm not, but I am assured, by those that are, that it's a really effective way of doing this. And it's a disrupter, so it's a real challenge and a disrupter, and it's a very exciting idea.

I'll give you one last theme, if I've got time, it's just one of enduring brands, might be the best way to talk about it. So, in the managed fund, you're getting exposure to companies at the luxury end of the market, which tend to be very resilient, even in times of economic stress, because the average buyer's got a lot of spare cash. So, we've got companies, like Richemont, owner of Cartier Watches.

We've got Kering, which owns the Gucci brand, amongst other things. And more recently, the LVMH, which owns Louis Vuitton and Dom Perignon Champagne. I know you're a big drinker of Dom Perignon Champagne, Phil...

SH: Then maybe slightly at the other end of the spectrum, within that category, is Greggs. Sometimes, that name raises a few eyebrows in the fund, but it's actually been one of the best [UK] growth stocks over the last decade, and is known for being low prices, value for money, decent quality, sausage rolls and vegan sausage rolls have done particularly well, pizzas, etc. But it's been expanding its opening hours into the evening. It's opening drive throughs, to tap into new areas of the market.

It's been a great growth story. So, there's quite a long list of really exciting thematic exposures, but I think probably one of the biggest points we should leave everyone with is that there's no one right way to do growth. So, we know that the macro environment is going to make things different over the next ten years. It's not going to be the same.

We need to look for those companies that can grow in that environment, and that's what we're continually doing. So, yes, we do like disruptive high tech heavy stuff, there is that in the portfolio, but we also value the steady Eddies, and the compounders that can also grow in a more defensive way. So, given where valuations are, it's a great time to be investing in growth, when you take a step back and look at it with a broader lens.

PS: Brilliant. Thank you very much, Steven. Well, that that concludes my questions, so I want to move on to some audience Q&A, and thanks to those of you who are already sending these through. I think probably, the most efficient way for me to answer these is to try and group them, to some extent. But the first one is quite a foundational question, first of all, are bonds still a good diversifier versus equities?

SH: This is an interesting one, and one we discuss within our policy setting group on a regular basis, because that's really what the bonds are there for. Yes, we're picking bonds that we think are going to give the best return within bonds, but bonds are there, really, to get some balance and diversification to the portfolio. And they haven't been doing that over the last year, that moves the same way as equities.

Although with less volatility, that is there, so they have helped improve the risk adjusted returns in the portfolio. But I think, as rates have moved up to a more, what you might call normal level, I think you will see bonds start to provide more diversification again, and they'll move in a different way to equities. So, I think that will start to come in, that lower correlation with equities again.

And you're getting that higher yield. So, with bond yields, for one, it was very hard to make the case to my equity colleagues that we should be holding a big weighting in bonds in the portfolio. But now you are picking up that higher yield, to take account of inflation there, but higher yield. And there's much more potential for capital gain there. We can rally significantly.

We could rally significantly from this area, and if equities were to fall significantly, if we hit a recession, then the bonds would do well in that situation, and would help balance the returns in the portfolio.

PS: Brilliant. Thanks, Steven. Another audience question here is you mentioned an overweight to equities earlier, and the question is, are you talking about a particular geographical sector, or equities, in general? And the root of the question is a lot of fund managers feel the US is especially expensive just now.

SH: It's a fairly broad equity overweight, to be honest, Phil. When we look at it, it's concentrated within our UK portfolio, our US portfolio, and our emerging market portfolio. That's really where the overweight stands. But to be honest, with broad enthusiasm across all the equity managers, and real enthusiasm for the stocks that we hold within the portfolio.

So, often, it's not thinking about what the index is doing, it's looking at our holdings, and looking at where we value them, relative to the operational performance and the growth profile that we see for them. So, broad enthusiasm. And obviously, that extends to the US, as well, where Kirsty remains very enthusiastic about the whole, and we see lots of disruption going on there.

PS: Yes. I think that's a really important point, actually, where some of the names that have sold off the most heavily are exactly the types of names that we're invested in. As you say, it's not a case of buy the US or sell the US, for us, it's the individual ideas. I think that's a really, really important distinction. A fairly general question here, what changes have been made in the last 12 months?

You've touched on it a little bit, in terms of the overs and unders, but in terms of other changes that we've made?

SH: Certainly, from the bond side, first, if I just mention that, it's definitely been adding to bonds within the overall asset allocations. So, from a 15 per cent level, up to towards the 20 per cent level, so adding to that, and adding a bit more duration back within the bonds. So, we're a little bit more interest rate sensitive than we were during that period when yields were going up, and inflation concerns were really front of mind. So, that's definitely been one thing.

As I said, we had been, if you go back a year or two, we were quite overweight cash. Cash levels were up about 10 per cent, and we were just feeling a little bit, thinking equity valuations were a bit overdone, and we were attracted to bonds, so cash levels were very high, about ten. Now they're down about two. Now it's really telling you that we've moved to be much more enthusiastic about asset markets, increasing the bond and increasing the equities, moving to that overweight equity position.

So, sitting about 3 per cent overweight [versus] our strategic weight. So, about 78 per cent in equities, and in those regions that I mentioned. But broad enthusiasm across that area, and as I said, even though you might think, looking at index levels, things are a bit tough, you might worry about growth and so forth, I think it's the fact that companies typically don't have much debt.

And so, the higher interest rates, yes, it can maybe slow economic growth, but it's not really that important for the companies that we are holding. So, we can sit reasonably comfortably with that higher rate position, and often, it's a case of the secular tailwinds, secular growth stories that we're trying to harness, rather than just GDP going up. That's not really what you get from Managed Fund equity portfolios. They tend to be much more idiosyncratic, secular growth stories.

PS: And so, I suppose, Steven, then it's fair to say that a big part of our enthusiasm and confidence in the portfolio going forward is actually, fundamentally what companies are doing, rather than we think the macroeconomic backdrop is going to suit the fund or the portfolio itself. It's really about companies and what they're doing.

SH: I think that's absolutely right. That's, first and foremost, what you get from the managed fund. It's just trying to pick the best companies that will do well over the long run. And we do know that over five year periods, company share prices will follow fundamentals. They follow earnings.

But over shorter periods, the market is very volatile, very fickle, very sentiment led, and that's just something we can't hope to predict. So, we just stick to our knitting, keep our head down, keep picking those companies that we're really confident about the growth profile for earnings. Yes, we kick the tyres and check the resilience, but that's the day job, which we just spend all our time doing.

PS: Great, thanks. We ought to move into your comfort zone, to some extent. We've had some questions about fixed income. Interested hear your view on duration, and how we're thinking about duration in the fixed income portion of the fund.

SH: So, duration of the portfolio is roundabout seven years, as I said. If we want to think about the duration exposure, which is really, it's the exposure of our bond portfolio to rising rates, that's what the duration exposure is. And obviously, it matters how much we have in that portfolio. So, as I said, we've been increasing the amount of bonds that we have in the portfolio out of cash, and so, that's increased our duration, effectively, by doing that.

And then within the portfolio, we have been increasing duration, particularly in emerging market bonds, and I'll explain why. We're very selective, but we can find some emerging markets, and particularly, it's been in Latin America, in the likes of Mexico and Peru, where unlike developed markets, where inflation has been a real problem, and the central banks haven't been aggressive enough to manage it, these countries got ahead of the game. Inflation wasn't as embedded.

They hadn't had all the policy easing that predated it, and caused a lot of the problem. And so, they're actually in a much better position, and yields have risen ahead of developed markets, whereby Mexico and Peru are at 7 per cent, 8 per cent, 9 per cent yields. And so, they were a really attractive way to find good yields and opportunities for capital gain in the bond portfolio. So, the duration we were adding in the portfolio is coming through those types of ideas.

And also, in high quality credit, in corporate bonds. So, that was where we saw some opportunity, spreads are still wide. Now we're a little bit more muted. Corporate bond spreads have come in quite a bit. It could be a bit of a bumpy road, in the short run, so we're fairly neutral on corporate bonds, at the moment. But duration, I would say we are still a little bit cautious about adding to it.

So, when I make the case to my policy setting colleagues, I say, yes, bond yields have risen, and they're better than they were, but actually, yields could stay up here for a while, maybe they've got a little bit more to go. So, there's not a strong call for me Phil, that this is absolutely the top in yields, and that from here on, yields are coming down, and we should be massively overweight bonds. It's definitely not that. It's saying these are a more attractive, but let's just ease into it.

PS: Yes, okay. A few questions here, overlapping in some ways, really around, and it's a big question, of timing of recovery. When are we going to see things pick up, do you think? And another question, which I think is part of this. What needs to change, before things turn in a more positive way? Because we are seeing, as we've said, positive operational progress, but as yet, it's not reflected in share prices. So, do you have any sense as to when that might change?

SH: Well, I think there's a couple of things there. One of them is the equity markets need stability. And, obviously, through last year, we had this enormous shock of first, inflation, and then interest rates having to rise significantly. And there was that, whoa, everything's changed, how do we reassess this? What does this mean? And as I think I've explained before, because the companies that we hold, their profits are coming further in the future, typically, they're growthier companies, the first thing the market does is discount those earnings by those higher rates.

And so, you see a big fall in share prices. The market doesn't anticipate the fact that some of the reasons that rates are going up is because inflation is a bit higher. So, we would expect the companies that we hold to have pricing power, and to be able to raise their earnings, at least in line with inflation. So, in the immediate reaction, the market doesn't give much weight to that.

And that’s a typical thing, when we've had our risk team to look at this, it’s a typical thing the market does, it discounts growth immediately, whereas actually, that's unfair, and it comes back over time. But until we get that stability, in terms of where we are, and rates, and inflation, then I think it's going to be a little bit difficult to see real progress on the broad swathe of growth companies, if you like.

So, we're waiting for that, and obviously, we've had a second burst of yields moving up over the last few months, and that's just caused a little bit of a wobble, and made growth perform a little bit less well over that period. For me, I don't think it matters to our companies where rates settle. As I explained before, the indebtedness is not a problem. We're not changing the return profile of the companies that we're investing in, as a result of this.

We’re not changing the earnings growth because rates are higher. We’ve looked at it, and we've thought about it, but that's not that's not what's happening, if you look under the hood. It's just that stability. So, you're clearly seeing inflation come down, and in the US, inflation is surprising to the downside. We're moving into territory, where I think inflation will be off the headlines. There won't be that same sticker shock. It won’t be in the news all the time.

And I think we're pretty close to the peak. So, I think we're not far away from a point where we get stability, and I think that's the first thing that you need for a lot of companies, for the stock market to give better valuations for them. Obviously, a huge kicker would be if we see yields rally significantly from here, which you might see, if inflation was to come down more significantly, or if growth were to slow significantly. That would be an extra tailwind.

But we don't really have a lot of conviction or knowledge about that. So, I think it's just that stability. We will get there. We'll definitely get the stability, at some point, and probably sooner, rather than later. And that'll be a good thing, I think, for the fund.

PS: So, lots of confidence, I think, among equity teams, as you've said. I think that's very, very clear. And I can certainly echo that from being with them. In some ways, the optimism we're seeing now is more than we've seen for a long time, which I think is a real positive. But what sort of environment would we need to be in for you to suggest to the policy setting group that we go underweight in equities?

Or, indeed, is there an environment where we would say, given that bonds and cash are the other legitimate options, there's always that trade off. So, what would be a scenario, where we decide here, let's maybe go underweight equities?

SH: I think always looking at the relative trade-off between these asset classes. So, bonds are more attractive than they were. So, if they were to rise, I don't think they’ll rise significantly more, but if they were to, then we would look at them, and see what that's telling us. Clearly, equities are a beta to growth. Now, short-run moves and growth, we will just tend to look through. We're looking, very much, in a three to five-year horizon, and we'll cope with little macro ups or downs.

But I think what comes through to me is really from the underlying regional equity guys, if they are feeling much less confidence about the growth profile for their companies, allied to where they see valuations in the market, then that would be the trigger for us to move underweight. It's really thinking not at the general levels of equity markets versus bonds, but much more from the underlying portfolio, from the enthusiasm from the managers.

They're saying, and from time to time, we've definitely had this, we've had our managers saying, look, I don't really want any more money to invest in my side. I think you'd be better putting it somewhere else. I could actually raise cash here. We're looking to sell some names. That's the way it works for this fund. That's the way we would move to being underweight equities, and then we're going to see where to put it, based on the enthusiasm of the bond managers.

PS: Great. Steven, thinking about risk, just at a high level in the fund, what have been some of the recent discussion points among the team about risk? For example, I know there has been some discussion about the contribution from different regions, and that sort of thing, so I don't know if you could say something about recent discussions to give us a flavour of that.

SH: We're certainly well aware that the delivered volatility of the portfolio to our clients has been very high over the last 18 to 24 months. And I think a lot of that is down to extreme market moves. We saw a huge period of outperformance, and then a significant period of underperformance thereafter, so it was an extremely volatile market period. I think we need to try not to necessarily take too much from that one period.

What I would say is we have extensive discussions with our risk team about trying to analyse this across different portfolios, because obviously, risk has gone up, and it's a thing clients do mention to us. What we notice, and what is factual, if you like, is that the contribution to risk coming from our US equity portfolio, and to a degree, our European equity portfolio, is higher than it's been in the past.

So, that's of interest to us, and we've had discussions about that with the underlying managers. We've talked to Stephen Paice, who runs our European portfolio, and talked to Kirsty, who runs the US. For them, nothing's changed, in terms of for what we're doing. We're still picking the stocks the same way, but they're finding more opportunities to be different from the index than they would have been in the past. More disruptors.

More enthusiasm for early-stage companies. So, the portfolios, on a risk level, look more different to the index. That's coming through in the overall thing. And for us, we're well within all the ranges that we've set for ourselves on the fund. But we do keep thinking about the relative contribution to risk from different areas, and what's appropriate in the fund, and whether we should do anything about that. But for the moment, it's just been discussion and understanding why different bits are contributing, more or less.

PS: Brilliant. Thanks, Steven. A question that comes up relatively frequently is about China. I don't know if you can, in a couple of minutes, give us the team's current thoughts on China exposures.

SH: China is an interesting one. Big picture, huge amounts of opportunity. There's an awful lot going on, a lot of exciting things going on. EVs would be one clear example. We've also got a research office in Shanghai, so bringing ideas from there, and that's been really helpful. You couple that with enthusiasm and the opportunity, inevitably thinking about some of the bigger geopolitical and governance risks surrounding some of those, and not necessarily being clear about the direction of policy in certain areas.

So, while we do have the likes of Tencent and Alibaba, and they are big platforms, they are in the portfolio, but they're unlikely to become any bigger in the portfolio. We're probably more excited by the likes of Meituan, which is the food delivery business, or BYD that I mentioned earlier, the EV player. Overall, fairly neutral, if you like, in China.

We have about a 4 per cent position is the overall, and for a big (the world's second biggest) economy, it's not a huge position, but it's there. We see opportunities, but we're very mindful of the risks, and are always thinking about them and discussing them. So, in a nutshell, that's roughly where we are.

PS: I'm putting you on the spot, a wee bit, with this next live question from the audience. Steven. This person has asked about views on high real yields on offer. I might say, and I suppose in emerging markets more generally, this person has mentioned South Africa and Brazil specifically.

So, I don't if you have particular views on those two, but if not, what about the broader backdrop?

SH: Those, we do have small overweights in both of those markets, for exactly the reason real yields are up. And it's that theme that I was mentioning earlier about in emerging markets, some economies have been better managed, and yields have moved up ahead of developed markets, and actually, they offer a lot more value.

So, that's been the positioning, it's been to be attuned, to have small, overweight positions, or positions in some of the markets in Brazil and South Africa, we've been trimming those recently, as yields have been falling.

PS: An interesting one here. We've touched on AI, there are a few questions that have come in on AI, but I want to pick up this one, which is does it scare or excite you?

SH: That's a great question. Well, obviously, there are aspects of AI that scare me. How its controlled, how its regulated, and the potential. We've all watched some sci-fi movies, and it definitely could scare you. I'm an investor, and thinking of the investment side, there's just so much potential. You're seeing drug discoveries, an area we haven't even touched on, but we have a number of holdings, the likes of Exscientia, the UK, which is a drug discovery company.

They're using AI to massively speed up that drug discovery process. So, these things are hugely exciting, and there are huge opportunities. My background is an economist, and you can be quite negative about where's growth going to come from? We've got an ageing population globally, particularly in the developed world, ageing population, productivity seems to be fairly poor. We're seeing more strikes and industrial unrest, etc.

But where is the excitement about growth on an aggregate level coming from? And I think something like AI is one that is a regime change, if you like. I think it's a huge technological shift, which will play out over many years. But it is very exciting, in terms of the potential, but I wouldn't, for one minute, think that it's all upside and there's no downside, especially for society and how we harness the benefits of it. But yes, hugely exciting, and one that we're always talking about.

And one of the things we try and do to get a different perspective from the market is, as you know, Phil, we've got an extensive network of academics that we often sponsor or fund, our programmes, and we have access to them, to think about how they're thinking about AI. And so, we're really using them to try and get as forward thinking as we can about how this will play out for society, what the key aspects are to think about.

PS: Great. Thanks, Steven. That's all we've got time for, so thank you for your time. And thanks, especially, to you, our audience, for tuning in today. Sorry, we didn't manage to get around to all of the questions, but maybe a final message I would leave with you is that we're here to help, so if you do have any other questions, or you'd like to chat with a management specialist, then please get in touch with your Bailie Gifford contact, and we'd be delighted to assist you.

But in the meantime, I hope you have a great afternoon.

Baillie Gifford Managed Fund

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

	2019	2020	2021	2022	2023
Baillie Gifford Managed Fund B Acc	3.6	26.9	16.5	-28.2	6.4
IA Mixed Investment 40%-85%	4.5	-0.5	16.8	-9.6	5.1

Source: FE, Revolution, net of fees, total return in sterling. Class B Acc Shares.

Past performance is not a guide to future returns.

The manager believes an appropriate comparison for this Fund is the Investment Association Mixed Investment 40-85% Shares Sector median given the investment policy of the Fund and the approach taken by the manager when investing.

Investment markets can go down as well as up and market conditions can change rapidly. The value of an investment in the Fund, and any income from it, can fall as well as rise and investors may not get back the amount invested.

The specific risks associated with the Managed Fund include:

- Custody of assets, particularly in emerging markets, involves a risk of loss if a custodian becomes insolvent or breaches duties of care.

- The Fund has exposure to foreign currencies and changes in the rates of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested.

- The Fund invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.

- Bonds issued by companies and governments may be adversely affected by changes in interest rates, expectations of inflation and a decline in the creditworthiness of the bond issuer. The issuers of bonds in which the Fund invests, particularly in emerging markets, may not be able to pay the bond income as promised or could fail to repay the capital amount.

- Derivatives may be used to obtain, increase or reduce exposure to assets and may result in the Fund being leveraged. This may result in greater movements (down or up) in the price of shares in the Fund. It is not our intention that the use of derivatives will significantly alter the overall risk profile of the Fund.

- The Fund's share price can be volatile due to movements in the prices of the underlying holdings and the basis on which the Fund is priced.

Further details of the risks associated with investing in the Fund can be found in the Key Investor Information Document, copies of which are available at **www.bailliegifford.com**, or the Prospectus which is available by calling the ACD.

Important information and risk factors

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