

# Synthesis in Risk Management

November 2025

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Discover how Baillie Gifford balances modern risk analytics with long-term growth investing. James Taylor, Tom Coutts, Tom Walsh and Nick Wood explore the firm's new Investment Analytics Team, behavioural insights and portfolio construction techniques.

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

**Nick Wood:**

Welcome, everybody to the afternoon session. I'll start by introducing you to the panel. First of all, we have James Taylor. James heads up our newly formed Investment Analytics Function. The Investment Analytics Function is an important enhancement in how we think about integrating risk management and portfolio construction into our investment process. I'm also joined by Tom Walsh. Tom Walsh is a portfolio manager for our International Alpha Strategy. This is our largest diversified international equity strategy. I also have Tom Coutts, who's a portfolio manager for our International Growth Strategy, which is our largest concentrated growth strategy.

Lastly, my name is Nick Wood. I'm a director in our Clients Department. I was also in our investment risk team when we set it up in 1999. I was our second head of investment risk in 2007 and both Tom Coutts and I serve on our Investment Risk Committee, which is the committee that oversees our approach to risk management.

The title of today's session is Synthesis in Risk Management. Now, what we mean by synthesis in risk management is balancing our healthy obsession with bottom-up stock selection and risk management and portfolio construction. I'm going to spend a couple of minutes talking about the core underpinnings of our approach to risk management, why we have the approach that we do and then James and the two Toms will go into more detail and talk about some of the enhancements that we've made over the past five years. We'll probably talk for about 25 to 30

minutes, and then we'd love to hear from all of you via questions. Let's begin with what are the foundations of our approach to risk management.

First and foremost, our approach must be entirely consistent with our edge, with how we go about outperforming in the long term for the benefit of everybody in this room. First of all, we are growth investors. We firmly believe that superior operational growth delivers superior returns. Second, we are very patient owners of businesses. But there is a trade-off here. High growth companies are typically more volatile than average. Thirdly, factors and fundamentals. Risk factors, risk models help catch or can explain short-term volatility, but it is really long-term fundamentals that drive share price returns over the long term. I'll just touch on these in a little bit more detail. This graph on the left here is a thing of rare beauty. It is absolutely wonderful. What this shows is that since 1995, so for the past 30 years, this yellow line here, if you successfully invested in the top quintile of companies by earnings growth over rolling five-year periods, you would outperform by somewhere between 5 per cent and 15 per cent per annum. Our main aim is to get you as much exposure to those exceptional growth companies as possible. But as always, there are very few free lunches in finance, excluding what you've just been served over the past couple of days, of course. But this is represented by the pink line here. The pink line here shows that these same exceptional companies are typically more volatile than average. And you can even see over the past five years or so, they've been yet more volatile still. That is the trade-off. And what does this mean for our approach to risk management? It means that our approach to risk management must be tolerant of and even embrace higher than average stock volatility at an individual company level.

Now, the chart on the right is less beautiful, but it's nevertheless very important. What this shows is that over periods of up to a year, risk factors, risk models do a pretty good job of capturing what drives stock volatility. But if your investment horizon, your holding periods, are five years plus, like ours are, you can see that the pink line there fades away. By the time you get to five years, only about 30 per cent of volatility is captured by factors and it is fundamentals that are really driving share price returns. That is why there is no simple solution to the whole subject of risk management for us. We certainly cannot outsource it to a risk model, although we are expert users of them. For us, what we're always trying to do, and have always tried to do, is balance a very healthy obsession with capturing great long-term growth for your benefit at an individual company level with risk management

checks and balances, but this can never come at the expense of independent thought, thinking very differently to the rest of the market, thinking very differently to the index and an obsessively long-term time horizon and investment approach. Hopefully that just gives you some insights into why we have the approach that we do.

And what I'll do now is hand over to James to talk through some enhancements we've made over the past five years, and indeed how he interacts with our portfolio managers. We'll bring that to life for you for the next 20 minutes or so.

**James Taylor:**

Thanks, Nick.

**Nick Wood:**

Thank you, James.

**James Taylor:**

And thank you all for being here. Thank you for joining us. I'm really excited to talk to you about how we go about balancing stock selection, portfolio construction as part of risk management framework. Now, given you've all just had a great lunch, I thought I'd kick us off with a bit of a story to check that you're all still awake. I was out walking the other day and there were two fish swimming along the Potomac River and an older fish passes along the other way and says, "Morning chaps, how's it going? How's the water?" Two fish swim past. "What on earth is water?" Now the point of the story is that like the water for those fish, as equity investors, risk is all around us.

It's inherent in what we do. It is the key in many ways to long-term value creation. But unlike water, it's not quite see-through. It's a bit more difficult to understand. In theory, there's no difference between theory and practice. In practice, there is. Portfolio construction, therefore, is a constant process of refinement, of learning, of evolution, to the point that our managing partners made this morning. It's about constantly trying to improve at the core task. Now, when we think about this, we have to bear in mind that no two market drawdowns are ever the same. We're not the same investors and it's not the same market.

With that in mind, the conversations that myself and others have been having with managers like Tom in the past 18 months have centred on things like greater intentionality around the exposures that we're taking in portfolios. Where do we want to be deliberate in the exposures we've got and where might unintentional exposures be creeping in? Where might behavioural biases in our decision-making processes be leading us to leave some returns on the table, or worse, leading us to sacrifice some returns for clients? And crucially, how do any changes that we're thinking about making tie into those core beliefs that Nick mentioned at the outset, which is we are return-seeking, long-term growth investors and we must make sure that we're taking risk appropriately and not giving up on it. Now the other reason I'm really excited to be here and talking to you today is I can now talk more formally about the launch of investment analytics at Baillie Gifford. Those of you who have heard us talking before will know that the risk of Baillie Gifford and the way we go about things has always extended far beyond the outputs of traditional risk models. Investment analytics has really been an investment function with a single purpose, to help our investors improve their decision making and get it better at the core task for you, our clients. The investment risk team remains led by Tim Alcorn and is a crucial part providing independent challenge and oversight within our risk management framework. You might think of it as the offence and the defence, as it were, within that risk management.

I head investment analytics, providing specialist expertise on improving client outcomes. Investment risk is providing the independent oversight and challenge. Together we provide offence and defence so that managers like Tom and Tom have a stronger governance and oversight framework. Now I'm going to talk to you in a bit more detail about the elements that investment analytics have brought into this process. And I focus on three key areas. The first of which is the behavioural insights. The things beyond just portfolio returns that give us an insight into the skill of the investment decision makers and how they're going about doing things. The returns that we deliver for you, our clients, can be thought of as the decision hit rate. How frequently are we correcting the decisions that we're making? And the decision payoff. What's the impact of those decisions on the overall portfolio returns? You'll see from the coloured lines, which represent five percentage point increments of performance, that the same level of outperformance can be delivered either with a very high hit rate and a lower payoff, or with a lower hit rate and a much higher pay off by tying into that returns asymmetry. And indeed, across the range of strategies that you have invested in with us, we might expect different characteristics along these pathways, despite all

seeking consistent outperformance. The second element is feedback loops. We are long-term investors after all, but we don't want to be waiting five or 10 years to be finding out whether an investment case has played out appropriately. We're constantly scrutinising the bottom-up details. An example of that might be thinking about where is the share price in a particular security moving in relation to the underlying fundamentals, the balance sheet metrics and to estimates from the third parties. And if we see opportunities where share prices are halved, but fundamentals are holding up resolutely, we can have greater confidence in holding on to those businesses.

To return to the chart that Nick outlined earlier, if we can navigate that factor volatility that often dominates shorter term market performance, and we can hold on to exceptional growth businesses like these, we're as confident as ever that we can deliver great returns for you, our clients. And the final element is what I take most pride in is the embedding of analytics within the investment process, working alongside the investors. Malcolm, who's kindly joined us sitting in the second row, I didn't realise he was going to be here, so I'm feeling under the cosh slightly, sits just opposite me on the Global Alpha desk. We're sharing information and discussing things in real time. And you didn't know this, but I've stolen this quote from a conversation we had a few weeks ago, which is around some of the tools that we're bringing into the process. And he kindly said, as the tools we use to assess a company improve, so does our ability to use them to our advantage. There is a wealth of data out there, external vendors and services that we can use. Everything that we do has to be tied into our process and our unique philosophy and sharing the knowledge with investors so that anything we add to the process is organic, it's collaborative, it's holistic with what we're doing to deliver returns for you. Tom, your team is another one of the ones who's been a kind of key element in some of the pilot programs we've done with analytics, particularly with some of the behavioural providers. What have been the key takeaways for you on some of these behavioural insights?

**Tom Walsh:**

I think before I launch into that, one thing I was very keen to emphasise and we indeed are keen to emphasise, is we're very aware that as you dig into the details and into the data, you need to strike a balance between that and your ability to step back and still see the big picture. We know that our superpower, I think if you like, at Baillie Gifford over the years, has been our ability to step back from the

detail, to avoid the noise, to remain focused, on the long term. And that is what's been key in our ability to deliver high performance for our clients. We're very, very focused on making sure we maintain that strength and we continue to double down on that strength.

I think one of the other strengths of Baillie Gifford though is that we are a learning organisation. We know we're not the finished article; we're continually looking to learn from others around us within the industry and outside the industry to try and make ourselves better. And that's the context in which I put our work with these behavioural analytics companies that James references, Essentia and Inalytics being the two we've been working with. These companies have been very helpful in their work with us. What they've been able to do is apply new lenses to what it is we're doing, to our portfolio construction and stock selection.

And they dispassionately are able to look at the raw data that sits behind the performance that we've delivered through different environments and tell us where it is we're adding and where it is we're subtracting value for our clients through our portfolio construction and decision making. They've also been very useful in telling us how we compare to our peers across the industry. Now there's two things particularly through my interactions with these two organisations that I've really taken away. The first one would be that there really is a Baillie Gifford way. So, as I sit on the investment floor, I look across the different teams, I see different investors with different investment styles, I see different decision-making structures, different portfolio construction approaches, and different investment universes. I can see lots of differences. When Essentia look at the data across our different teams and Inalytics look at the data across our teams in a dispassionate way, they say, actually, it's remarkably consistent how you all add value for your clients. You add value because through stock selection, through position sizing and through long-term holdings. That's where we add value.

The second thing I took away from my interactions with these two organisations is that that Baillie Gifford way, it's quite different from the rest of our industry. The Inalytics told me on a number of occasions now that they know of no other investment manager for whom the first year strike rate, that is the percentage of new holdings that outperform in their first year, they know of no other manager where that is such a poor indicator of long-term outperformance. That doesn't surprise me. In fact, it actually reassures me quite a lot. I'd rather every stock we

bought shot the lights out in the first year. But the reality is that's not what we've optimised our process for, for the reasons that Nick's already outlined above. In the first year, it's not fundamentals that dominate in share price returns. Over the long term in fundamentals that dominate share price returns. And what their data shows, again, completely dispassionately, is that's where we add value. It's three years, three to five, and beyond.

We've optimised for the long term and that is how we've turned out to deliver performance for clients. There's a couple of images up on the slides here that hopefully add a little bit of colour to the points we've been trying to make. The first one on the left is really to make the point about that willingness to maintain an eye on the long term and not to be distracted by short-term volatility. It's a share price chart for MercadoLibre. Many of you in the room will have heard of MercadoLibre. You'll have heard us talk about it before, but if there's anyone who hasn't heard about them at this point, MercadoLibre is Latin America's leading ecommerce and fintech platform. It was acquired for the International Alpha Strategy, my strategy, back in July 2010. Now, at that point, it was a fraction of its current size. Its future prospects were uncertain. The future of Latin American (Latam) ecommerce was pretty uncertain.

But we saw a large opportunity. We saw a company that was doing something very interesting. And we took a holding. Within the first six months, the share price had fallen by 20 per cent. We held on. In 2011, the share price would rebound before falling. I'd be able to set new highs before falling by another 40 per cent. Now, if we sold at the low point during that first 18-month period, our clients would have missed out on the 44x return that they've enjoyed in the period since. Indeed, had we sold in any one of the 19 occasions since we first took a holding when the share prices had a 20 per cent drawdown or greater, our clients would have missed out on the single largest contributor to their own performance over that period. Being willing to look through short-term volatility is fundamental to delivering extraordinary returns.

Of course, I've given you a good example. I could give you other good examples, TSMC, Atlas Copco, other names that we've held for many years. But there will be stocks which don't have such a nicely charted 15 years. There are stocks where that initial wobble is actually a warning sign. It's a sign that we've got the initial investment case flat wrong. It's a sign that we've got it right, but actually the

market's caught up with our view, or the operational progress that we were investing for has started to plateau. And that's what the chart on the right is showing you, really. And that's data from Essentia based on analysing our portfolios. What they show is that we add value from stock picking, from position sizing and from entry time. And those are the first three bars that are sitting there.

Where we lose it is on exit timing. We are not the best sellers of stocks. Now, that's something we're aware of, but what's been really helpful in working with Essentia is they've been able to really crystallise the cost of that exit timing. And that enables us to really focus on how can we mitigate that, but how can we maintain our strengths, but also offset the weakness that detracts from the fork.

**James Taylor:**

Yeah, we've had some fascinating conversations. I'm happy to pick up at any separate instances after this. What have been the key takeaways for your process, though, when we think about that sale discipline, the stock selection, how do you balance that? What have you brought in in the process that we can do to try and eke out a bit of extra performance for our clients?

**Tom Walsh:**

I think, again, one of the big things we've been working on is around feedback loops and tracking investment cases against our initial hypothesis. Of course, that's something we've always done. Qualitative assessment of how companies are developing against our investment case is something we've done since the dawn of time. One of the advantages of having our proprietary research reports that we store centrally in our research library is that ability to go back years, sometimes decades and compare how a company is developing against its initial investment case. That's something that remains core to our process and continues to be something we do every day in the office. But it's something that we can enhance and supplement with qualitative techniques. And that's where working with the investment analytics team has been really helpful, as they've been working to bring through, as you know, different ways of visualising our stocks within the portfolio, different ways of drawing in new data points to track how companies are developing and introduce better feedback loops into our investment process.

The charts here, we've got two examples, just two examples of the many things they've provided for us. The first one on the left is a chart that shows the top



performers and bottom performers in the portfolio over the last five years and disaggregates the returns that they're delivering into earnings growth, re-rating, dividends and foreign exchange (FX). What you'll see from there on the left-hand side is the dominance, generally, of earnings growth.

That's the orange part of the bar for companies like TSMC and ASML. It's almost all about earnings growth for TSMC. You've had a slight re-rating on top of that. For ASML, actually, it's de-rated over the last five years. You do, however, also see some stocks which look a little bit odd and Nintendo's one that would jump out from there where it's been very much about the re-rating of the stock over that period. Now, that's not something that forces us into action, but it's a useful prompt to say, well, what's going on here? Why is it that earnings growth hasn't come through as perhaps we might have expected? Because we are not, after all, value investors. The second chart on the right shows something slightly different. This is really about plotting out price-implied expectations.

It's a simple way of tracking that. What it's trying to plot there is the required earnings growth over the next five years in order to deliver a doubling of the share price if you assume the valuation multiple, the key multiple in this case, reverts to its long-term median. What you see here is the stocks in the top right, Nintendo and SAP we've called out specifically. These are stocks that have performed well. They have seen their share prices rise, but they're now pricing into pretty punchy earnings growth assumptions for the near-term and long-term. By contrast, companies down at the bottom left and there's certainly more than one Chinese name down there, but again, we've called out Tencent. That's where the markets become a little bit more pessimistic about these stocks. Nothing has to be done on the back of this. There's no mechanistic input into our portfolio process.

But these sorts of prompts have been incredibly useful for us to crystallise sometimes what are already sort of qualitative concerns about the development of companies or development of share prices. And in this case, actually, we have taken money out of Nintendo and we have been recycling it into stocks like Tencent. That has been supportive to the portfolio over the last year or so.

**James Taylor:**

Great, and it's been great for me working with Tom and others how we can provide different lenses for the portfolio managers to look at their stocks in the same way.

We're not changing the core task, we're seeing what can we add on top of that to give them more information to help make better decisions for you, our clients. We've been doing work with our internal innovation function around artificial intelligence, large language models, how we can bring greater qualitative inputs on structured data from our research content, from other bits of information we can provide, to think about feedback loops in another sense, in terms of the causal inference from our research notes, in terms of our meeting minutes, in terms of tracking our investment cases in as many different ways as possible.

Now, Tom's talked for a while and I'm conscious I've left you out of the conversation, Tom, and I'm right in saying, if you don't mind me sharing with the audience, that you were at Baillie Gifford with Nick at the start of our investment risk team a short while ago. At that time, we were going through a period of extreme technological change, market concentration but this was in the UK market, where you were sitting on the UK desk. I wonder if that's a vantage point from which you could share any insights on the changes we've seen in that intervening period and then maybe some of the bits that you think have stayed the same.

**Tom Coutts:**

Yeah, yeah, of course. I'm doing a bit of a history lesson on failing different attorneys. I was in our UK team in 2000 when I think the top three companies were about a quarter of the index. Vodafone was 13 per cent of its peak. You know, I guess the point, you know, there are cycles in stock markets, there are cycles in risk tolerance as well. That kind of illustrates the first part of the slide. Back in 99, when Nick was involved in setting up our dedicated risk team, which partly is prompted by the Mercury Unilever court case in the late 90s that some of you may remember. That risk team brought in really useful tools, really useful analytical rigor, helped improve the quality of our discussions and our thinking. But over the next couple of years, I think, and it's not any fault of the risk team at the time, but we became a bit too risk-averse.

We got to a point where we were taking insufficient risk, in some cases, to do a good job for our clients. But within Baillie Gifford some people recognise that and we established some more ambitious investment strategies and I would call out our UK Alpha team, our Long Term Global Growth Strategy, International Growth which I'm now involved in, Global Alpha, a couple of years after that. Some of the clients in this room today were involved in helping us really build those strategies

back in the day and I feel very proud that you're still involved today. That's the early 2000s and then over the following 15 years or so, I think you saw us do a good job for clients through a more unconstrained approach to investing, really across all of our portfolios on the equity side but you can have too much of a good thing and I think gradually we push the risk envelope a little bit too far in small increments over that period, such that by 2018, 2019 maybe. For the high growth strategies like I'm involved in, we were a bit too concentrated. For some of the more balanced growth strategies, we became a bit too imbalanced. That wasn't obvious at the time because market volatility was low. Then when COVID hit, we did extremely well, as you all know, and then poorly. The enhancements you've been hearing about from Nick and Tom and James are the output of us reflecting on that period, not just the past five years, but I think the last 15 or 20 years.

That history does matter in providing some of the context there. I guess the point I really want to make is that these things go in cycles. There is a bit of a pendulum. And our job as investors and the job of Nick and me and others on the Risk Committee, is to make sure the pendulum doesn't swing too far, that we don't get back to the point in the early 2000s where we were taking insufficient risk and inhibiting our ability to do a good job for clients. I've spent a long time on that because I think that history does matter as contextual background. My other reflections, I'll sort of rattle through a bit more quickly. No silver bullet to much better tools. Life is lived forward. There's no silver bullet to risk management. We all know this.

It's just about making sure we have a range of measures, always looking for new tools. I think of the portfolio as something you turn around and you're looking at different lenses, different lights that fall on it and trying to get different perspectives that help you cumulatively come up with a perspective on how the portfolio is positioned. The second point is that the analytical tools are always improving and they're improving and pedalling faster than ever. We've talked about this. That's critical, but the tools are only as good as the investor's willingness to use them. There's an important behavioural aspect there that I think we should challenge us on in all of your interactions with us. It's not just having these tools, it's how do you embed them in your investment process? How do you bring them as close as possible to the investment decision makers? And that's absolutely critical. I think that's part of the separation into risk and investment analytics will help drive that process internally.

The final point that life is good forwards is obvious in some way, but it's also, I think, the most important point. It's critical to emphasise that we operate in a world of profound uncertainty. Our job on behalf of clients, the role we play in that world, is to identify companies that can evolve and adapt and grow and add value for clients and their beneficiaries within the guidelines they set us. That doesn't require blind optimism, but it does require us to have conviction and to back our judgment and to ask, what if? What if this really works?

If you'll indulge me, I'll do a slight detour. I don't know if anyone noticed the name of the room we're in. This is the Hamilton room. At the weekend I was watching the movie of Hamilton, the theatrical production with our 12-year-old daughter. When I think about the risk of not backing up Jefferson, I think of Aaron Burr. And I think particularly of the moment where Hamilton decides to back Jefferson in the election of 1800. And his concluding line is, when all is said and done, Jefferson has beliefs, Burr has none. And I think that's when Burr has none encapsulates what we're trying to avoid in having too much risk oversight.

We do a good job for our clients by backing our beliefs. As Amy said this morning, we have to have the courage to be different. And I think that's really important. And it's an important balance in everything we're doing. When I look out over the next decade, what should guide us? One, we've got to be very aware of the role we play for clients' portfolios. Two, we've got to use all the tools we can, in the way you've heard us talk about, to keep our portfolios aligned with client expectations.

We operate in a super competitive industry. Nobody owes us a living. We've always got to be getting better and challenging ourselves. And three, we mustn't lose sight of what it is we're here to do and how it is we add value for clients. We've got to back our beliefs to find the next generation of great growth companies that can hold them in scale. I'll leave it there and hand over to Nick to see where we want to go.

**Nick Wood:**

Well, great. Thanks very much to the three of you. I trust that's given you a good overview of how we approach the complicated subjects of risk management and portfolio construction. It is a process of continuous enhancement, improvement. You never have the outcome. But also, I hope it's been very clear that we are acutely aware of what makes us different, what our edge is. It is that obsession

with five-year earnings growth and revenue that sounds easy, but it's actually very difficult to deliver on when we're all faced with so much noise in our daily lives. Well, thank you very much for your time and for your engagement.

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