Baillie Gifford™

Investment Grade Bond Fund Q1 investment update

April 2025

Investment manager Paul Dilworth and investment specialist Paul Roberts give an update on the Investment Grade Bond Fund covering Q1 2025.

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

Paul Roberts (PR): Hello, and welcome to this first in a series of quarterly updates on the Baillie Gifford Investment Grade Bond Fund. My name is Paul Roberts. I'm an investment specialist on the fund, and I'm joined by Paul Dilworth, co-manager of the fund. So, Paul, I think it'd be useful to start with an overview of our approach. So, could you give a brief summary of how you think about managing the fund?

Paul Dilworth (PD): Thanks, Paul. Good question. First and foremost, I think it's important to recognise the role that Investment Grade bonds play in our clients' broader portfolio, acting as a stabiliser to those higher-risk elements such as equities. They tend to be issued by blue chip companies and so come with very low risk of default while generating a regular high-quality stream of income.

So, to your question, we're balancing two things. First, the portfolio needs to behave like the Investment Grade bond market, because ultimately that's what our clients are seeking to invest in. So, we stay true to the asset class by managing a diversified, benchmark-aware portfolio. And the second thing is understanding why it is our clients choose to partner with Baillie Gifford. They back our ability to add excess returns over and above those of the benchmark through our deeply researched stock selection process and our willingness to back our ideas with conviction.

PR: So it's an actively managed portfolio. Now there are various different ways bond managers can go about that, trying to add value over time. What's distinctive about our approach?

PD: Well, as you know, Baillie Gifford is renowned for its research expertise. So that really underpins our whole philosophy and process, which allows us to run a relatively concentrated portfolio, typically lending to between 70 and 90 issuers, which is significantly less than our benchmark and far fewer than many of our peers.

But it means that each investment has the potential to add real value at portfolio level. We also look to dial the aggregate credit risk around in the fund, subject to our outlook on how the economy

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interacts with our valuation framework. So, when we believe the market offers good value, we'll dial that risk up a little bit. And similarly, when things look a little bit tighter, we'll rein it back in. And finally, what I think really differentiates us in our approach is our mindset. We're willing to be both patient and dynamic in our approach to capture value for clients. In contrast, markets are often very short-sighted, which risks missing those longer-term opportunities.

PR: Sure. So there are two main levers we use. So, it's that bottom-up security selection based on our own fundamental research and a more of a top-down credit allocation based on our market outlook. If we look back over the last 12 months, how have those two factors contributed to the good performance of the fund?

PD: Yeah, so over the past year or so, corporate bonds have outperformed government bonds. We were constructive on corporate credit through that period, and so the fund benefited from having an overweight credit risk. But what's really driven the performance of the fund has been that bottom-up stock selection. We've enjoyed healthy stock selection across sectors, but it's been our investments in the real estate sector that have really led to charge.

PR: Absolutely. And could you share a couple of the standout examples in that sector over time?

PD: Yes. So, one example would be CPI Property Group. It's a company that specialises in income-generating commercial properties across Germany and Central Eastern Europe. And it grew very quickly in the lead up to what was an aggressive rate hiking cycle beginning in 2022, which caused a lot of pressure to be put on the balance sheet, and spreads widened, bonds underperformed quite significantly. At which point, we conducted a deep dive, feet-on-the-ground analysis, and were confident that CPI was far more resilient than the broader market believed. Our faith in that business had been rewarded through the course of 2024. And furthermore, CPI is well positioned to benefit from that reindustrialisation of Europe that we expect to see. And so expect further value to come from that over the coming period.

Another example would be Arrington Finance. That's another property company that has performed handsomely for the portfolio, but for entirely different reasons. So, Arrington Finance bought and then leased back the Married Quarter's estate from the Ministry of Defence back in 1996. it turned out to be a pretty bad deal for the government. And when we reviewed the investment case in early 2022, we concluded that a sale of that estate back to the Ministry of Defence, or back to the government, was highly likely and would result in the early redemption of our bonds, driving potential material upside. So you fast forward three years, that's exactly what's happened. And it's a great example actually of how our long-term patient approach can really add value for our clients.

PR: Indeed. If we look at the other side of the coin though, investing in bonds means that the potential upside is limited, but you can lose all of your money. So, a key feature of our approach is identifying and avoiding those more troubled borrowers.

PD: That's an excellent point, Paul. Investing in credit isn't all about finding those great opportunities. Often, avoiding those falling knives is equally, if not arguably, more important. So, in that vein, avoiding Thames Water last year was a great call for us. The UK water sector had been under pressure for a while through both financial and operational challenges. And we'd been monitoring that sector as it deteriorated from an underweight position. We then conducted a deep dive on Thames

Water as its bonds just became too cheap for such a highly regulated crucial service to ignore anymore.

But despite the cheap valuations, after much discussion, we just couldn't get confident or comfortable with the view that the required capital would be supplied by shareholders. And so we opted to stay away, which proved ultimately to be the right decision, as a couple of months later Thames was heavily downgraded, its bonds dropped out of our benchmark, leading to further capital loss for those that held on.

PR: Indeed. It's always pleasing to look back over a period of good performance, but if we look ahead, what do you think we can expect from here?

PD: So overall, we remain really constructive on corporate credit. All in, yields are just too attractive to ignore, and the fundamentals remain sound.

Having said that, corporate spreads themselves don't really leave a lot of room for error. So, we have been dialling back that overall aggregate risk in the portfolio, seeking refuge in shorter-dated bonds with those that mature sooner and therefore offer more price stability. We've also dialled back risk in the higher-beta elements of the market, like subordinated financials.

And so we believe that leaves us well-positioned to just gently out-yield the benchmark while being less vulnerable, let's say, to a broad market sell-off. In the meantime, it will continue to be those bottom-up idiosyncratic ideas that really add value to the portfolio.

PR: Sure. And on that note, where do you see the most exciting potential in the portfolio today?

PD: Well, there's many credits we could talk to, but maybe one example would be a UK pub landlord. We've got a strong position in Mitchells & Butlers. As a business, it's adapted very well to changing consumer preferences, transitioning from a wet-led to a more balanced restaurant-pub model. We believe it's a resilient business, but the main reason we have that investment is similar to our Annington investment case. We believe in the years ahead that it will restructure and buy back our bonds at a premium.

PR: Okay. Thank you, Paul. That's very clear. So, it's our skill and investment research trying to identify those relatively few bonds that will outperform their peers, which adds value over time. In the past 12 months, that's been rewarded. The fund has been close to 2% ahead of its index benchmark over that period. If we look ahead, we may have more unsettled global politics and economics. Valuations are quite high. But we're very optimistic there's plenty of potential in the fund to keep delivering those good returns and that steady outperformance over the long term.

Thank you for listening.

Baillie Gifford Investment Grade Bond Fund

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

	2021	2022	2023	2024	2025
Baillie Gifford Investment Grade Bond Fund*	8.6	-5.0	-11.5	6.9	4.7
Index*	7.0	-5.1	-10.3	6.1	2.5
Target**	7.5	-4.6	-9.7	6.9	3.4
Sector Average***	9.0	-4.3	-9.1	7.4	3.2

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. Class B Inc.

*ICE BofA sterling Non-Gilt Index.

**ICE BofA sterling Non-Gilt Index plus +0.50% to 16 September 2022;thereafter ICE BofA sterling Non-Gilt Index plus +0.75% per annum, over rolling three-year periods. The indices have been chain-linked for performance figures above.

***IA £ Corporate Bond Sector

The manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund is the Investment Association Sterling Corporate Bond Sector.

Past performance is not a guide to future returns.

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

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