

As with any investment, capital is at risk. Past performance is not a guide to future returns.

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For definitions of some of the key terms referenced in this communication, please go to the end.

Hello and welcome to this programme from Baillie Gifford. The latest in a series of webinars where we talk to the managers of the business' different investment funds. Today, we're talking to Steven Hay. Steven is comanager of the Baillie Gifford Managed Fund. My name's Richard Lander of Citywire and we're going to be talking for about 25 minutes about he runs the funds. Along the way, we'll try to answer three questions. Why active? Why growth? Why now? Stephen, welcome, very nice to see you.

First of all, Richard, I think we'll get to why active? Why growth? Why now? But I think first of all, why invest in a managed fund? Full stop. For me it makes life simple for the client. It's only three asset classes. We've got equities, bonds, and cash. Really, it is a one-stop-shop for access to the best of Baillie Gifford stock picking and bond picking. One of Baillie Gifford's longest standing funds. It's been going for over 37 years now. My comanager, Ian McCombie and I have been working together for over 20 years. We've got a very clear philosophy and process for finding the best growth companies. That's been consistent right since the launch of the fund. We balance that with an active bond portfolio and a small allocation to cash.

We do the asset allocation for you. We've got deep bottom-up knowledge of every stock and bond in the portfolio. So, making judgements about trade-offs between different holdings, rather than generic top-down equity views. Lastly, as well as keeping it simple for the investor, the managed fund is very good value. It's OCF is only 0.43%. If you did it yourself, it would probably be a much higher fee and our fee's less than half the median in our sector.

What you're essentially saying is you've got asset allocation and stock picking all wrapped up in one

Exactly.

Let's have a look at where the fund is now. Over the past few years, we've had the shocks of 2022 when both asset classes really sank in unison. That's fading away into the rearview mirror. Are we now back to the conventional role of such a portfolio where stocks and bonds act as counterweights to each other and balance the volatility out for investors?

Richard, I'm going to give you a slightly caveated answer, which is probably yes. Let me explain why. People often think that because bonds and equities have been negatively correlated, in other words bonds go up and equities go down for most of the last 25 years, then that's the normal state of affairs. If you go back to the 1970s, 1980s and even part of the 1990s when I was cutting my teeth as a young Bank of England economist, you'll find they were actually positively correlated for much of that time. Bonds would fall at the same time as equities. What's going on? The answer is, it's all about inflation. For most of the last 25 years inflation hasn't really been an issue. Bonds have reacted to growth rather than inflation, which results in that negative correlation with equities.

When inflation's an issue and bonds are reacting to inflation more than growth, then the correlation flips and bonds become positively correlated with equities. In other words, they're not a good hedge. That's exactly what we saw in 2022. Now, the key question is, what happens from here? We don't think inflation's completely dead, but we do think it's unlikely to dominate the picture as much as it has done in the last few years. Therefore, probably, bonds will act as a good counterweight to equities. Certainly, will provide more balance to equities than they did in 2022. They do so with a much more attractive all-in yield than they had before. Our bond fund yields nearly 7%. For us, bonds are definitely worth having in a balanced fund like the managed fund.

You mentioned inflation there and we'll come back to that because as you say, it's not dead and there's various pressures on economies round the world that will probably see inflation nearing a floor, if not exactly there yet. You make a great case for such a portfolio and the counterweights and so on. I think there's a danger that some investors see it, that everything gets cancelled out. Making it harder to get real growth. What would you say to people who think that way?

I think the long-term returns on the fund refute this completely. Since inception, we've delivered 8.7% per annum versus 6.8% for the peer group. Overwhelmingly, this has been driven by equities, which are the real driver of growth in the portfolio. The bonds are there to provide the balance in the portfolio, but they can still absolutely provide a good return in their own right. Although everyone maybe focuses on the times when you want the correlation to be negative, times of crisis, a lot of the time both asset classes are just earning a nice return as they're going on. So maybe you shouldn't overly focus on those times of crisis. For us, our bonds are actively managed and they're the best bonds that we can find across government bonds and corporate bonds.

So, plenty of opportunity to add value there. We know from the risk analysis in the fund, that the presence of bonds has improved our risk-adjusted returns over time. That's reassuring and we're also mindful that if we think bonds are going to be less useful in providing balance, then we can asset allocate away from them. For example, in 2021 we did view inflation as an emerging risk and

with that very low starting point for yields, we didn't think bonds were as attractive in the portfolio. So we reduced our bond position significantly through asset allocation. Overall, I think the record speaks for itself over the longer-run. If you'd invested £10,000 at inception of the managed fund, you would have £100,000 more than the average in the peer group, which I think really speaks for itself.

You mentioned there, dialling down the bonds in times of stress. Right now, broadly speaking, you're about 80% stocks and 20% bonds and cash. Is that generally a default position of the fund?

It's not far from that. Our strategic benchmark is 75% in equities, 20% bonds and 5% cash. It's really because we believe equities to be the driver of long-term returns. My colleague, Ian, is fond of saying that equities offer a return to human ingenuity. Which sounds a bit highfalutin, but I think he's actually got to change it because now, we have to adapt it to it's a return to AI augmented human ingenuity because the world is changing so fast with the advent of AI, that I think we really have to rephrase the returns to equities. Then, we've got the bonds to provide the balance.

That cash to offer diversification and a bit of an option value. When things go down, we can take advantage of that and buy assets when they're cheaper. We can flex those strategic weights, plus or minus 10%. Really, for the managed fund, the dominant source of returns is the stock and bond selection within the portfolio.

You have this ability to flex the weights. Right now, looking at the situation, is there anything that suggests you should be changing the tilt or you might expect to change the balance over the next year?

We've got a policy setting group that decides on changes to our asset allocation. We've five regional equity managers and two bond teams that feed in their views of how attractive they see their own portfolios at the moment and whether they're pushing for more cash to be allocated to them or not. Maybe we're a little bit different to how other managers do it. It's this bottom-up enthusiasm. Experienced managers knowing how enthusiastic they are about the assets within their bit of the portfolio. That's what really drives our asset allocation bottom-up enthusiasm. Now, we will discuss the broader macro trends as well. Most of the time, it will be that bottom-up enthusiasm that is a driver for our asset allocation decisions. We're not always positive on equities.

Just before the pandemic, for example, we were down at 73% in equities, 16% in bonds, with cash up at 11%. Neither the bond nor the equity managers felt a lot of enthusiasm for valuations at that time. Where are we at the moment? Our current positioning is that we have 77.5% in equities, which more than our strategic weight. That reflects our continued enthusiasm for equities and our bond weighting has notched back up to 20%, to reflect the decent level of yields available. Running
a

little bit lower on cash at the moment. We're always discussed this. At the moment, equity managers seem very enthusiastic about their portfolios and the opportunities for disruption and the companies that we hold to take market share. That's where we are at the moment and no changes foreseen at the moment.

You talking about the equity managers and their enthusiasm. The one thing you can say about the holdings in your portfolio, is they're very eclectic. You've got giant turnaround companies like Marks & Spencer and Sony on the one hand and then, you've got the tech sector players. Giant ones, smaller cutting-edge ones. There's a lot of different types of due diligence to balance there. How do you manage that?

As a reminder, the equity regions in the managed fund are managed autonomously by the respective regional investment teams. It means that nobody's having to cover all 200-plus stocks alone. Rather, they're covered within teams with in-depth knowledge of their market. Quite often, we just present a particular opportunity set. For example, the US is home to most of the big tech disrupters. Nvidia, Trade Desk, Shopify, etcetera. Whereas, the UK for example, is arguably a more defensive flavour of growth. Marks & Spencer, as you mentioned. Manager experience of their region goes a long way to ensuring adequate rigour. Secondly, our investors at Baillie Gifford are overwhelmingly generalists. They all have specific areas of interest, but we don't have a tech desk or an energy desk, for example.

Our investors are not unduly narrow in their areas of expertise. Because we run relatively concentrated portfolios within each region, obviously, for the managed fund as a whole, it becomes a very diversified portfolio. Within each region, it's relatively concentrated. We are able to give each holding good cover while not spreading ourselves too thin. Lastly, I would also mention that fact that because almost all of our investors are based on the same floor of our Edinburgh office and they upload their research to one centralised research library. Very often you'll see our investors leveraging the research of one team or another team or their experience of investing in similar or competing companies. I think we're actually very well setup to deal with looking at different companies in different sectors and assessing their growth prospects.

I'm just trying to bring out what is the common thread? You've got companies selling air fryers, food retailers, absolutely cutting-edge companies in the tech sector. What is the one thing that says that is a great company for this fund?

I think what really unites the teams is the focus on finding great growth companies with a longer-term investment horizon. For us, it's not about choosing companies on rich valuations with really

speculative investment theses. It is about earnings growth and seeking to understand what the market might be missing in terms of the extent or the longevity of that earnings growth. All our investors are trained to look for the same thing, which is sustained earnings and sales growth over the long-run. We know from academic evidence and from our experience, that above average earnings growth is reflected over time, in above average share price returns. It doesn't mean we only look for very rapid growth companies, the likes of Nvidia with earnings growing north of 20%.

In contrast to that, we don't expect Marks & Spencer to blow the lights out, but we do think it can generate solid earnings growth for a long time. In a core fund like the managed fund, that's an excellent holding for us to take on our clients' behalf. The companies may look really quite different in terms of their operations or their pace of growth, but we think a fund like this should have a broad spectrum of growth flavours. The uniting factor is that all the companies we invest in have that ability to grow in the long-run and we believe that's not fully appreciated by the market at this point.

We're seeing Baillie Gifford adverts out there, talking about future stocks. You've talked about some of the established names there. What role do these future stocks that perhaps, haven't come to fruition yet, play in the managed portfolio?

I think one of the points of future stocks is to really remind people the types of businesses that we're investing in and why we're so excited about them. We know that some clients over the last few years, depending when they invested in the fund, having a bit of a rough ride. Performance has been challenging over certain periods and I think it's very important for us-, as we're coming out of a good year and performance is top quartile over three months and 12 months. We know from a few years before that, people have had a tough time. We think it's really important for us to get on the front foot and remind people the kinds of stocks that we're excited about. Names they may not know or some they may be familiar with.

I can give you a couple of examples if we have time to do that. One I particularly like is Sweetgreen has actually outperformed Nvidia this year, which is no mean feat I can tell you. Sweetgreen is a listed US company which is making salads and healthy foods, but to a fast-food model. It's getting quite a following in the US from people that like these things. It's an attractive offering. It's health for a start and it's outing people first. It's the way they're managing the robotics in the kitchen that's particularly attractive to us. They've got a robo-kitchen that makes all these salads. Not only is it way faster than humans, I think they can make 500 salads an hour in these robo-kitchens, but they don't get the order wrong. These salads come with chicken and steak.

It's not that you order chicken and you get steak. They just don't make mistakes. There's a real attractiveness in the way they operate and that's allowed it to have really high margins for the sector. It's got a huge growth runway when you think about the amount of stores that the likes of McDonalds have across the US. I think Sweetgreen has less stores than McDonalds has got even in one state like Texas. So huge runway for growth for Sweetgreen and one that may be not that well appreciated by people.

Let's talk to your specialist subject if you like, fixed income. You've talked a little earlier about we're getting some really attractive yields there. Now, obviously, where there's attractive yields, everybody follows. You talked recently in a commentary piece about stretched valuations because everyone's piling in and just the margins are getting too low there. For example, between high yield and investment grade stocks. Which areas do you see as particularly overvalued?

I would class fixed income broadly as fairly valued now, rather than overvalued. It had a recent backup in yields, which has helped that. We also went through a period of government yields rising really quite dramatically from where they'd been and then, corporate yields having an additional significant spread on top of that. That was really attractive. We were overweight corporate bonds for that period and we saw those additional corporate yields really compress quite a bit. We think it's fairly valued, maybe fully valued, but we don't see any great value in corporates relative to governments at the moment. We have a strategic balance within our bond portfolio. 50% government bonds, 50% corporate bonds and we're round about that at the moment because we think both look about right.

Still find attractive valuations in the new issue market. In particular, within high yield. We're active bond pickers so, this is really where being discerning and differentiated comes to the fore. Not just chasing any extra yield on offer without doing that enhanced due diligence. One example that might resonate with people is Motel One. This is the first debt issue from this group. This is a family run German hotelier. Over the last two decades the company's grown really fast. From 2,000 rooms in Germany alone to 94,000 hotel rooms internationally. What's been quite impressive is that's all been entirely self-funded. There is a bond issue. The management is looking at an IPO in the medium-term. So, the leverage has gone up a little bit.

The management is guiding that the leverage will come down. The drivers being that free cashflow generation and earnings growth. It's a great story. We think there will be upgrades to the credit rating over time and the potential for yields to come down. We're still finding examples of exciting things to invest in, but it's probably fair to say that the extreme levels of value that we saw earlier in the year have dissipated somewhat. I think on the government yields, we had thought the market had got a bit ahead of itself and how many rate cuts were priced in. That's maybe contributing to the comments

a month or two ago, saying that the markets were fully valued. We've obviously backed up quite a bit in yields since then.

We're pricing in maybe only three rate cuts of 25 basis points in the US and the UK. A bit more in Europe. That feels much more reasonable to us. It looks fairly priced and that all-in yield of nearly 7% I think is still pretty attractive. We still like them.

Just talking about the government bond yields there. There is a feeling, yes, the interest rate cycle has turned. There's going to be cuts. We don't know how many, but probably not anymore official rate rises. On the other hand, you've got these pressures weighing down on governments. Defence, extra spending on social projects. Ageing populations. The energy transition and so on. When you look at government bonds, does this weigh heavily on you that they're going to keep having to borrow more and more as we move forward?

It's a good point. I think you're right that there are plenty of demands in the public purse and you're starting level for debt is pretty high. That is something that's topical and I think in the UK and France and to a degree, the US, markets have been beginning to care about it a bit more. We saw the reaction to the Truss budget in the UK before, but then with the recent Labour budget there was a bit of a market reaction to that as well. Not hugely significant, but you can tell the market is beginning to pay more attention. Whereas in the years of very low inflation and QE, people didn't care about the amount of government debt. It didn't feature on bond managers' radar at all. Maybe it's the bond vigilantes beginning to come back again. I think that's a genuine concern and we need to be aware of it.

We'll see, but obviously, they're trying to hammer through a French budget at the moment. The markets not liking what it's seeing. I think it's when there's the fiscal loosening, but also, the political uncertainty, that's what the markets really hate. That's what you're seeing at the moment in particular, in France. We do have to look at that. It's also true that the easy part of bringing inflation down-, that's already happened and maybe the inflation battle isn't completely over. We're alive to that and we need to keep an eye on it, but our central case is growth is fairly robust. Different regions a little bit, but it's still reasonably robust. We're not about to go into recession or anything. Inflation remains relatively well behaved. At least by comparison with where it's been in the last couple of years.

This outlook allows central banks to continue bringing rates down and maybe, not that much more, but keep bringing them down. Certainly, from the managed funds point of view, rates falling is a helpful tailwind for our funds. Definitely, helpful. Our portfolio is operationally very robust to

higher rates. It's not something we're particularly worried about. If rates do have to go up a little bit, we've got much, much lower debt levels of our holdings than the index, for example. Typically, as rates fall it's more favourable for valuations of growth companies. To be honest, I think the number one thing is stability and for the economics not to be on the front page all the time. Now we've got Trump coming into power...

Well I was going to say good luck with that.

I'm sure we'll have something else on the front page from time to time that might affect economics, but hopefully not too much.

You mentioned uncertainty there and the political dimension in France. We've got the mother of all uncertainties coming in with Trump. What happened when you realised that Trump was going to be elected as the next President? Did you all sit down and say we've got to alter the portfolio or we're just steady as she goes?

You'll be surprised how little we focus on it. That's not to say that parts of his agenda may be relevant, but for us, we are investing with that longer-term horizon. While Trump can change some things round the margin, for us it's really about the longer-term trends and the disruption. So, what's happening with EVs, what's happening with battery technology? What's happening with technology within pharmaceuticals. It's all of those things that are not really changed by what Trump does. We're not ignoring it, but it hasn't led to any changes in the portfolio or anything, but it's something that people are bearing in mind. We don't know what we're going to get. He's so unpredictable, we don't know. We presume we'll get some deregulation and lower taxes if anything.

Those things are probably positive for business and the economy. It's a probably a good environment for continued disruption, continued growth, and that's the kinds of companies that we are really focused on. It certainly doesn't go against the environment that we would like to see, but I wouldn't overstretch the impact that he will have. A lot of it will be noise no doubt, but we have to just wait and see what he actually does and see if that does make a difference.

We've got one or two questions about this from viewers. One is, "Trump doesn't like ESG, it's drill baby drill, get more oil going. He's very anti certain health and pharmaceutical things. Does that not blow you off course slightly? At least for the short-term?"

I don't really think so. There's a lot of bluff and bluster. Let's actually see what he actually does on this. There's a lot of negative comments about ESG, but you'll find that a lot of the companies are actually just going ahead and doing their own thing anyway and making sure they're securing green energy and clean energy sources for all their operations. You saw the recent Microsoft news on that front. The nuclear power. I think there's a Trump Federal angle with some noise, but again, go back to my previous comments. Let's see what he actually does on some of these things. We've got such

a broad spread of holdings within the managed funds. The US is only 18%-ish of the portfolio. We've got lots of other stuff going on in other regions which shouldn't be that much affected by Trump.

Talking about the US, another question we've got from one of the viewers is, "You've got Nvidia in there, but it's a fairly small stake in the portfolio." It's easy to ask this with the benefit of hindsight, "Why don't you have a bigger stake in Nvidia?"

It's one of those things, because we have these regional portfolios. The US portfolio is only 18% of the overall fund at the moment. Actually, Nvidia's a big holding within that 18%. So, the US model, if you like, have had a big holding in Nvidia. We've actually been taking money out of Nvidia recently because we're not entirely sure that the valuation is reflective of some of the risks that Nvidia faces. The chip industry is very cyclical and people may have forgotten about that a little bit. I think on the inferencing side as well, you're seeing companies like Amazon, who've got the ability to take market share. You're seeing more competitors come up. With hindsight, arguably you might have had more in Nvidia, but within the US portfolio we've actually had quite a big holding of Nvidia.

It's one of the things that we have to accept, that within the managed fund, it is a really broad church. It's a very diversified portfolio across lots of different regional equity portfolios and that's one of the things that happens.

A related question from one of the viewers is, "Why only 18% in the US. It's 60%, 70% of world market-cap now. The home of innovation. The home of amazing companies. Shouldn't you be investing more in the States?"

Then you become a very US dominated fund. We really wanted to have that broader diversification across the globe and across opportunities. We can certainly overweight these regions. We can be overweight the US relative to other areas. We're not really at the moment. We're not really reflecting much greater enthusiasm for US stocks than we are for other stocks. Also, remember that the stocks that we hold within the US portfolio, there's a lot of disruption, a lot of tech. A lot of early-stage companies in that portfolio. We're getting really good exposure to the best of the US stocks within that. Otherwise, we see plenty of opportunities in other areas.

That's all the questions we've got time for at the moment. Just to sum up, we're going to go back to the title of the webinar. That question that you swerved around when I first said it. Why active? Why growth? Why now?

I think it was just helpful to go through some of the arguments before summing it up. We know that statistically, the companies that grow their earnings the most, have the best share price

returns in the long-run. There are lots of different types of growth in lots of different sectors, but we're seeing enormous innovation and opportunity. Technology dramatically changes whole industries. So right now, is a great time to be a growth investor. Why active? You have to be different from the index to beat it. The index is made up of companies of the past and the present. We're looking to what will be the companies of the future. The ones that will benefit from that disruption.

Our portfolios can look very different from the index. That's what our clients pay for and since inception, we've delivered around about 2% per annum ahead of the peer group. Remember, you're getting that with a fee that's less than half the median. Why Now? Growth is attractive. This year some of the extreme undervaluation has been removed, but the sentiment on many growth companies is still quite negative. Valuations are still very attractive for many businesses which are operationally doing very well. We're overweight equities in our asset allocation. We're not in control when the market will fully reflect what we believe the valuations to be. Macro stability should help in that regard.

We know it's been a volatile five years and depending when investors invested with us, they may have different experiences. I would just remind them of the excellent long-term record of the fund. The simplicity and consistency of our investment process and the enthusiasm of the managers for the stocks and bonds in the portfolio.

That's all we've got time for I'm afraid. Thank you, Steven, for your time and insights and thank you to you all for watching and for your questions. We do have more sessions like this coming up. So please do keep an eye out for those if you found today useful. Until the next time, good bye and thank you for joining us.

Definitions:

Yield – return on investment expressed as a percentage

Risk Adjusted Return – measures investment profit accounting for the level of risk taken to achieve it

IPO – initial public offering, when a private company first sells shares of its stock to the public

ESG – environmental social governance

QE – quantitative easing, the introduction of new money by a central bank

Margin/s – the rate of profit a company makes on a product

High Yield/ Investment Grade – investment grade bonds tend to be less risky than high yield bonds

Leverage – the use of debt, as opposed to equity or cash, to fund further business expansion

Basis Points – a unit of measure used to describe the percentage change (100 basis points = 1 per cent)

Annual Past Performance to 30 September Each Year (net %)

	2020	2021	2022	2023	2024
Baillie Gifford Managed Fund B Acc	26.9	16.5	-28.2	6.4	16.0
IA Mixed Investment 40-85 per cent Shares Sector Median	-0.5	16.8	-9.6	5.1	13.8

Source: FE. Total return net of charges, in sterling.
Share class returns calculated using 10am prices.

The managers believe 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.

Past performance is not a guide to future returns.

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- The Fund invests in emerging markets where difficulties in trading could arise, resulting in a negative impact on the value of your investment.
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- 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.
- Where possible, charges are taken from the Fund's revenue. Where there is insufficient revenue, the remainder will be taken from capital. This will reduce the capital value of your investment.

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 Baillie Gifford on 0800 917 2112.