Baillie Gifford™

Upfront: Tariffs, minerals and Managed

April 2025

Financial journalist Cherry Reynard and investment manager Steven Hay explore Trump's tariffs, interest rates and Baillie Gifford Managed Fund's bond holdings

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Cherry Reynard (CR): Good morning, I'm Cherry Reynard, your host for Upfront, where we give you the latest insights on Baillie Gifford's UK funds. Today, I'm speaking with Steven Hay, head of Income Research, who'll be answering your questions live, so do send them in by clicking on the drop-down menu on your screen. Before Steven, we have investment specialist Richie Vernon, talking on Alnylam Pharmaceuticals, whose mission is to make a brighter future for patients. But first, client manager Megan Rooney is here to answer some of the questions that have been filtering into the team over the last few weeks. Welcome to Upfront. So, hi, Megan, and welcome back.

Megan Rooney (MR): Hi, morning.

CR: Now, it's our first programme of 2025, and it's been quite a start to the year. Let's begin with what everyone's talking about, so the two dreaded words, Trump and tariffs. The tariffs have sent the stock market all over the place, and have even raised the risk of a US recession, so what's Baillie Gifford's thinking on that?

MR: Morning, it's great to be back. So, look, we're not political commentators and, as you know, and the audience knows, we are long-term, bottom-up active investors, so in regards to our equity allocations, we're not really doing a huge amount. That being said, myself and my colleagues have been inundated by client questions on this, so it's only right that we spend this episode and answer some of those questions for them.

CR: Absolutely, and I understand the US team has done a standalone webinar on this, which will be available soon.

MR: Yes, it'll be on our website and, if you're signed up to our mailing list, you'll get a recording of that sent out to you.

CR: Okay, brilliant. Now, a real focus of Trump's tariffs have been on China, and it looks like more tariffs are planned on top of the 20% that are already there. I understand there's been a lot of client questions on that as well, so perhaps we can just talk a little bit about Baillie Gifford's thinking about China at the moment?

MR: Sure. So, to begin with, we saw in Trump's first presidency that initial round of tariffs, and the jury was out on whether or not they were actually effective. Lots of economic studies suggest that it was actually US consumers who felt that the most. And when you look at that initial trade war with China in the first Trump presidency, as I mentioned, what's important to remember is that the Chinese renminbi depreciated by 7% against the dollar during that time.

Now, why is that important? Well, it's important because, for US importers of Chinese goods, that really took the bite out of the tariffs. It's estimated it reduced the impact by two-thirds, so it really reduced their impact. And it shows the impact that currency swings and valuations can have dampening tariffs, so that's something certainly to bear in mind. That being said, tariffs will have an impact in the short term, especially from companies who are making revenues in the US.

Now, for Chinese companies, it shouldn't come as a massive surprise, lots of people have been anticipating a second trump administration, and as a result they've been pivoting their sales. If you looked at intra-EM trade, for example, it's at an all-time high, and the direction of travel is only likely to travel in that way. And that could be a really great story that underpins the growth of emerging markets, especially if it takes them off their dependence on the dollar over time.

CR: Okay, but you mentioned that it is more difficult for Chinese companies to make money in America, is that something that concerns you, does that impact any of the companies that you're holding?

MR: Not particularly. We've looked at the revenue breakdown from that, so for our Pacific fund, Chinese companies that are getting their revenues from the US, that equates to 4% of the revenue of the portfolio. And when we look at our China-only fund, that's 5%. So really small. At Baillie Gifford, we much prefer companies that have got a strong, entrenched domestic market and tend to be more insulated from geopolitical trends, so things like EV manufacturers like BYD and Li Auto, Tencent, the technology conglomerate, or Moutai, which is a spirit brand.

CR: Okay, tell me about Moutai. I know about the other ones.

MR: So, I think it's a great example that shows that, you may not be aware of it, the audience might not be aware of it, but it's a great example that shows that we can sit here on the couch and we see things from a western lens, and we forget about the utter scale of the Chinese economy. So, Moutai's the world's largest spirit brand, and it produces a prestigious spirit called baijiu. It is China's national drink and, last year, it had over $20 dollars of revenue, and 95% of that was domestic in China.

If we also look at something every difficult, ByteDance, for example, which is the parent company of TikTok. Lots of headlines, as you'll be aware, about the TikTok ban in the states, so one would assume it's got massive users in the US. Which it does, it's got 50 million, but when we look at user numbers outside of the US, Brazil has double that, Indonesia has 126 million, but when we look at the Chinese domestic market, it's even bigger. The app TikTok is actually called Douyin in China, and daily users surpass 750 million people. That is ten times the amount of people that live in the UK. So it's massive. And both of those companies just show the opportunity set and scale in China.

CR: Absolutely. Now, over the past few months, we've had to get used to a blizzard of executive orders emerging from the White House. This weekend, there was one invoking wartime power to look for alternative sources of rare earth minerals, away from China. Now, why are those minerals so important?

MR: So, to begin with, rare earth minerals are neither rare, and they're not actually earths, they're a group of 17 metallic elements, commonly known as the lanthanides, and two other elements. And if you remember your periodic table from school, they're that kind of weird annexed second-from-the-bottom row that runs along the bottom of them. They are found all over the world, but it is quite rare to find them in large quantities, and it's quite rare to find them alone. They're more often than not mixed up with other materials and minerals, and that makes them really hard to extract.

Each of these 17 have got their unique properties, they're magnetic, electrochemical properties that you don't find in other elements, and they're crucial in the modern industry. They are everywhere, all around us. So, the colour in the TV screen, for example, from rare earth minerals. If you want to sit down and listen to your favourite podcast or album on Spotify, the sound waves travelling, rare earth minerals. Even the transfer of data across the world, the fibre optic cables. We invest in a company called Nexans, they lay those cables across the sea floor. Again, that wouldn't be possible because of rare earth minerals. And of course, they're also at the front of the AI revolution. They are critical components in the semiconductors of TSMC and the GPUs of Nvidia. So they are everywhere, all around us.

CR: Okay, that's really interesting. And why is there such a focus on them now? I've heard them mentioned in relation to Ukraine and Greenland, for example.

MR: Yes, they're a really hot topic right now, and that reason is because when we look at the supply of them, countries are looking to diversify. China absolutely dominates the rare earth market. It's responsible for 60% of production and 90% of the processing. So with that, countries have been looking for the domestic supply lines. Obviously, there's heightened geopolitical tensions, so that's coming to the forefront. And on top of that, they're also essential in the defence industry, things from night-vision goggles to radar and sonar, so they're really strategically important for governments, hence the renewed focus.

CR: Okay, interesting. And then just before we move on to hear from Richie Vernon, who's coming up next, do they create any investment opportunity?

MR: Typically, the mines can take decades to come online, which has been very difficult to find opportunities, but for active investors, you can find them. So, we've got two examples. Our Mult Asset team and Global Discovery team invest in a company called MP Materials, which is based in Nevada, and our Multi Asset team also invest in an Australian miner called Rare Earth Minerals. And both of these companies are responsible for mining two really important elements, praseodymium and neodymium, and they're essential for high-powered magnets.

And they are critical components in wind turbines, for example, and also in EV cars and electric batteries. And they are super-strength magnets, and if you want to fall down a rabbit hole, there's lots of videos you can watch online. But they are strategically important, as I mentioned, for governments, so both of those companies have got defence contracts from the US Department of Defense. So that underpins the long-term structural growth. And more importantly, from us as investors, they're performing really well operationally as well.

If you like at Lynas, the share price is up 500% in five years. MP Materials, revenues were up 48% year on year. This year, price is up over 90% over the last 12 months. And there's a really exciting story there as well, because not only are they trying to extract those minerals, they want to start creating those magnets that I mentioned, and create a full supply chain in the US.

And finally, before we finish, it also creates a real opportunity to create a circular economy and recycle these elements, because they're in such supply, so we invest in a private company in Scottish Mortgage called Redwood Materials, and that's exactly what they're doing. They are getting lithium-ion batteries from cars and they're extracting that neodymium, along with essential minerals and metals, and reusing them again in the cycle.

CR: Great, okay, plenty to keep an eye on there.

MR: Indeed.

CR: Absolutely. All right, thanks so much for joining us this morning, Megan. Now, for those of you watching live, if you have any questions, simply click on the Ask a Question tab. Now, as part of each programme, we feature an in-depth look at some of the transformational companies Baillie Gifford invests in. Today, we're learning about Alnylam Pharmaceuticals, which uses RNAi technology to treat rare diseases.

Richie Vernon (RV): Imagine a drug that can navigate through the body and into your cells, selectively switching off the faulty, disease-causing parts of your gene like a light switch. These revolutionary drugs aren't science fiction. They're transforming patients' lives today. And Alnylam Pharmaceuticals is the pioneer of this new drug class. The company was founded in 2002 by a group of leading scientists who based their work on the Nobel Prize-winning discovery of RNA interference, or RNAi. Over the last two decades, they turned this scientific breakthrough into safe and effective medications.

Taking a drug from the initial discovery stage to approval for use in patients is the business equivalent of a well-funded expedition to walk over a thin layer of ice covering the world's largest lake. It's long, it's expensive, and it's rarely achieved. The value of Alnylam's RNAi technology is that it makes this task more repeatable than traditional drugs. After success with one RNAi drug, reordering the molecule allows it to be programmed to target other disease-causing genes. This effectively marks a safe path across the ice for others to follow.

This process has meant Alnylam's drug development track record is six times better than the industry average. And it's not just the company's drug research that makes it special. The commercial expertise it has built over the years enables Alnylam to challenge some of the largest Big Pharma companies. Alnylam has spent its first two decades proving its RNAi drugs can work. Its approved drugs have already changed the lives of patients who suffer certain rare diseases. This success has also provided a consistent stream of cash that Alnylam is investing to deliver treatments for more common diseases, such as hypertension, fatty liver disease, and Alzheimer's. If Alnylam can maintain its impressive drug development track record in these more common diseases, the potential rewards for patients, the company and its shareholders are extensive.

CR: That was investment specialist Richie Vernon introducing Alnylam Pharmaceuticals, which has just gained its second FDA approval for its drug Amvuttra, a sign that the company has plenty of room to grow. Now, to move on, we're joined by Steven Hay for a fund update. So, welcome, Steven. Now, you have a long career in the financial sector, you've been at Baillie Gifford for over 20 years, and you're the head of income research and a joint manager for the Managed Fund. Now, before that, you provided research for the Bank of England's monetary policy committee, so with that in mind, if we could kick off with a look at monetary policy? So, the Bank of England and the Fed have decided to keep rates on hold over the last week. Growth has been revised down, inflation revised up. That all has a whiff of stagflation, does it, or not?

Steven Hay (SH): Well, you might think that, because, as you say, growth's down a little bit, inflation's up a little bit, and this is really the Trump effect that was referred to earlier, and it's that uncertainty about what's going to happen about tariffs. Which countries are going to be affected? How long are they going to be on for? What size are they going to be on? Nobody really knows, and that uncertainty affects markets. Markets don't like it. And companies don't like it in terms of their investment plans.

So, it looks like Q1 GDP for example, and the US is likely to be about zero, but that's really because they've brought forward a load of imports because they anticipated the tariffs coming in. So huge imports coming in in Q1, and that detracts from GDP. So actually, the underlying rate of growth in the US is probably still close to 2% at the moment. And so it just really depends what happens with the tariffs.

And if you think about the worst case, and think about all that he said about what might, how many countries would be affected and the rate of the level of tariffs, we're still only talking between 0.5% and 1% on inflation. Now, that might seem significant, but relative to where we were a few years ago, with huge increases in inflation, it's really not that big. So the market's very worried. And even the worst case, it's not so bad.

And again, the effect on growth, even in the worst case, should really knock about 0.5% of growth in the US, and you'd be aware of it, but maybe it's not quite as big a deal as the market's thinking about. And it's difficult to know, there's a lot of uncertainty, and we're watching it closely. But clearly Trump likes tariffs because he can impose them without having to go to congress. But we know there's a philosophical alignment in his administration towards resetting trade relationships, so we're watching very closely. My personal bias is that we end up, he rolls back from the worst case because deals are done and people bow down to him a little bit, and we end up with something that's not as bad as the market is fearing.

CR: Okay. And what about US fiscal policy? If anything, that appears to have been a bit more restrained that markets were expecting.

SH: I think that's right. I think everyone expecting him to come in with big tax caps and come in blazing, and actually, at least for the moment, they've been going more on the cutting expenditure. Everyone knows about all the DOGE cuts to federal employees, etc. And there's talk about the tariff revenue and those things. So they've emphasised those bits first, but there are still big tax cuts coming down the line, most likely, so let's wait and see. It may just be a sequencing thing, that it feels that way, but I think you're right, they have been talking a lot more responsibly about the deficit. And to be honest, they need to, because the US running a deficit of between 6% and 7% GDP at a time when growth has been good is just not sustainable in the long run. So they need to do something about it.

CR: Yes. Now, it's been all change in Europe as well, so we've had this huge stimulus package coming out of Germany, it's got rid of its debt break and it looks like a huge amount is going to be spent on infrastructure and defence. What are the implications of that?

SH: Yes, this is significant. We're talking about the UK and the US maybe slightly moving towards the stagflation side of things, but in Europe, there's a big stimulus. In Germany, we're talking about potentially adding 1% to GDP every year. For a region that has grown slowly for many years, this is really significant. And one of the potential good things is that spending on infrastructure and defence tends to have big multiplier effects and spreads through the economy more than, for example, a big tax cut or something. So it is significant.

One of the things, as a fixed income investor, I'm thinking about is the impact on bond supply. Obviously, bigger deficits, the German government, and probably other European governments, have to borrow more, so there are more bonds out there. You've already seen bond yields in Europe rise by about half a per cent, which is quite a significant move, as the market tries to think about digesting that extra supply. And just linking that with the US situation as well, there are more government bonds out there, these days, with not really an increase in buyers. And I think what that means is that the old bond vigilantes have a bit more control over things. And I think you'll probably see that coming in the next few years, you will see episodes of the market testing countries whose fiscal situation isn't looking at robust as it should do.

CR: And there's already been quite a dispersion in the movements of government bond markets in recent months. As you say, European yields have gone up, US yields have actually come off slightly, has that created any interesting opportunities for you in sovereign debt markets?

SH: It has, actually, because there's so much uncertainty around what's happening in the US, but in Mexico, which has obviously been a bit affected by concerns about Trump and what happens thereafter, we see a big weakness in the Mexican currency, and bond yields have risen significantly. And partly, that was uncertainty about the new president, Claudia Sheinbaum, coming and what policies she would enact. The market was worried about that, and then worried about the Trump impact as well. So Mexican bond yields have been yielding 9% to 10%.

And what we've seen recently is that inflation has come down significantly, very well managed central bank, and there's a big fiscal consolidation package coming in, so the market's fears have been unfounded, and we actually like what's going on, but the yield hasn't reflected that yet. So that's an opportunity for us to get in there, so we've been buying Mexican bonds yielding 9%, 9.5%, and we've seen that yield gradually come down. So yes, opportunities there.

CR: Yes. Let's talk a bit more about what you're doing in the portfolio. Can you just talk me through some of the conversations and debates that you're having in the Policy-setting Group at the moment?

SH: So, the Policy-setting Group, we would typically get together quarterly to discuss our asset allocation within the managed fund, think about our weighting between equity regions and between equities and bonds and cash, and we've had a couple of ad hoc meetings recently, because there's so much going on. And it's not that we've got very clear views on what's happening, but we have to be aware of how that might be changing the outlook for equities or for bonds.

And our equity manager is still very optimistic on the underlying potential of each of the companies, so no downgrade of enthusiasm there, but we're seeing just a little bit the uncertainty is making us just a bit more cautious, and thinking now is maybe not the time to be massively overweight equities. And so we've been reducing equities over the last three to six months, and we've now gone back to our strategic weight, which is 75% in equities, so back to that slight reduction in equities over the last few months. And increasing cash, because we think now's a good time to have a bit of firepower. If the market sells of in an unreasonably fashion, then we've got firepower there to deploy and buy into the companies that we do like. And in the fixed income side, we're roundabout our strategic weight of 20. And the opportunities for fixed income look fairly good from here.

CR: Okay, great. And just before we turn to the audience questions, you mentioned not being overly concerned about inflation, or the inflation risks, what's your thinking there?

SH: Yes, there are a few things, there. I think you're seeing growth being a little bit weaker in some of the countries, and that tends to bring down inflation a bit. We've still got fairly tight central bank policy, so I think that's something that will keep inflation contained. And I think one of the things for me is the impact of AI over time, and we're seeing it at work. It's impacting a lot in the way that we're working already, lots of efficiency gains, able to do things a lot quicker. And we're seeing that in the companies that we hold. A company like Shopify, for example, is able to do so much more using AI than it could before, so it'll be able to sell more services to its customer base, let's say, for the same price, which effectively is disinflationary.

So I think the impact of AI is being underestimated by people. Yes, it's difficult to know exactly how quickly this impact is going to come through, but I think, over the next number of years, this'll be a huge impact. So that's probably in the back of my mind, it's giving me confidence that inflation will be reasonably well contained.

CR: Okay, great. All right, thanks, Steven, stick with us for the Q&A. Now, to answer the questions that have been coming in over the programme. So, a tough question to start with. Do you think you have put the poor performance in recent years behind you? And what have you learnt from those periods of disappointing returns?

SH: So, yes, absolutely, but it behind us. But it was a difficult period, very volatile period. We saw a very strong performance in 21, and then in 22, when interest rates went up significantly, that did hurt the portfolio, really because our longer-dated growth stocks had more of an impact from rising rates than other things. So that was definitely a difficult period, and we did reflect, and we looked at the resilience of all the companies that we hold, and we've upped the quality of the resilience of the companies.

So we have half the debt of the index in terms of our individual holdings, and we actually got 90% of the companies in the portfolio are already profitable, whereas a few years ago it was only 70%. So taking cognisance of the impact that big macro moves can have on the portfolio. And so, earnings are forecast to be double that of the index. So in a really good position now, and we've seen that come through in performance. Last year was another good year, so we're well set with a very diversified portfolio and a very resilient portfolio.

CR: Okay, great. Second one, why did the recent reduction in equities not also coincide with a reduction in corporate bonds?

SH: Yes, that's a good question, because sometimes equities can be quite correlated with bits of the corporate bond market, especially the high-yielding or the riskier elements of the corporate bond market. I think two reasons. One is that, within the corporate bond portfolio, we had been reducing risk without actually reducing the weighting.

So you can buy better quality companies, so more of the investment-grade, higher quality rather than the high yield, and buying shorter-dated corporate bonds, which have less risk. So a bit of that has been going on, because we see valuations in the corporate bond market's pretty full. The additional spread you get on top of a government bond yield for the corporate, it's really quite low relative to history. So the valuations are not super-attractive in that area.

The other reason is that the overall bond yields are much higher than they have been in the past, so the return from the corporate bonds is better than it's been in the past, taking into account the government yield plus the additional spread. So that's an addition feature that's keep corporate bonds to be still attractive in the overall portfolio.

CR: Okay, great. Now, another question on corporate bonds, obviously somebody's fond of them. How do you manage risk and opportunities within the corporate bond allocation?

SH: Very much like on the equity side, it's all about stock-picking and bottom-up analysis of companies, and that's exactly the same on the corporate bond side. So that's the first way that we manage risk, just to know our companies really well and be aware of all the risks, and then to think of what opportunities you're taking. So, the opportunities we've been taking recently had been more in the investment-grade space. As I said, valuations are tight, so it is about stock-picking and finding the individual cases that look particularly attractive.

One recent example would be Yorkshire Water. As you know, back in the autumn last year, there was quite a bit of negative press in the water industry in the UK, mainly from Thames Water, but actually that affected the valuations across lots of different water companies, Yorkshire Water being one. And our analysis showed that, actually, we're very confident in the future path for Yorkshire Water, but the market, the spread you were getting, was much higher than it should have been. So that's the opportunity that we like to see.

The Mexican example I gave earlier, when the yield is higher than you think it should be for the quality of the investment, that's the thing that gets you to want to invest. So Yorkshire Water we took a position in. That's the kind of opportunity that we're looking for.

CR: Okay, great. And then, sort of a process question. What criteria does the fund use to decide when to exit a position?

SH: We're looking at every investment to at least double its earnings over five years. So that's the minimum criteria. So always reassessing that, and if we lose confidence in that, for whatever reason, and it might be to do with the tariff picture of geopolitics, but it's less likely, but it may be to do with the execution of management or the discipline on the capital structure and those things. But if it changes our view of the company's ability to grow its earnings, at least double its earnings within five years, then we will look to exit that position and find something else that will provide that.

CR: Okay. And then, I think time for just one more. In the context of the Managed Fund, how does geopolitics feed into your selection process?

SH: Well, not really much, to be honest with you. We're very bottom-up, very focused on thematic things that are driving the portfolio. And we've heard before about developments in medicine and drug discover, etc., within chip-makers, within AI, lots of those things, so we try not to get too involved in geopolitics. But of course, we have to be aware of these things, and if there's a ceasefire coming in Ukraine, what does that mean? Does that reduce gas prices in Europe? And how might that affect individual holdings? So it's more a case of thinking about how our individual holdings might be affect, but geopolitics is so difficult to predict, it's certainly not our strong point. Our strong point is in the bottom-up stock selection. So it's an awareness rather than trying to predict it, I would say.

CR: Brilliant. Okay, great, thank you so much for joining us today, Steven. And thank you, all, for joining us as well. To find out more about the topics we've discussed on the programme, please do go to the Baillie Gifford website, bailliegifford.com. UK Intermediaries team are here to help, so do get in touch if you have any questions. Until next time, goodbye.

Baillie Gifford Managed Fund

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

	2020	2021	2022	2023	2024
Baillie Gifford Managed Fund B Acc	33.9	4.3	-24.3	10.7	8.9
IA Mixed Investment 40%-85%	5.1	11.1	-9.5	8.1	9.1

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.

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