HIGH YIELD BOND FUND – MANAGER SNAPSHOT

Malcolm Borthwick, managing editor at Baillie Gifford, talks to Rob Baltzer, joint manager of the High Yield Bond team. In this manager snapshot, Rob and Malcolm discuss headlines of the past, opportunities of the future and how we approach bond investing.

The value of an investment in the fund, and any income from it, can fall as well as rise and investors may not get back the amount invested.

This film was produced and approved in March 2020 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.

Malcolm Borthwick (MB): Hello and welcome to your first six-monthly update about Baillie Gifford's High Yield Bond Fund. I'm Malcolm Borthwick, managing editor Intellectual Capital at Baillie Gifford. And in these updates we'll be talking more about our new ideas and also giving you an insight into how we approach bond investing.

I'm joined by Rob Baltzer. Rob is joint manager of the fund. He's also head of our high-yield team. Rob, let's start with the headline from the New York Times earlier this year: The Great Bond Party of 2019 is Ending. Is it?

Rob Baltzer (RB): I think on the evidence of 2020 so far, I think it's a little bit soon to say that, but it's absolutely right that 2019 was a great year for bond markets generally, including the high yield bond market. So, the High Yield Bond Fund returned almost 12 per cent, which was an excellent result.

It's much easier to explain one year's performance in hindsight than it is to predict the next year's performance. Our focus is very much more on the long term. So, for me, what's most interesting is that 2019 capped a really strong decade of returns for bond markets generally, including high yield bonds, and it didn't feel like a party.

That was my experience of it at least. Certainly, as we started the decade, coming out of the financial crisis, things got pretty hairy. We've had further crises along the way and no shortage of concerns to keep us worrying. Nevertheless, government bonds and high yield bonds have performed very well.

MB: So, plenty of crises there, Rob, but what about opportunities?

RB: So, I think high yield is full of opportunities, and that's what makes it a fascinating asset class to invest in and has made it a rewarding place over time. So, lending to high yield companies, you are taking a little bit more credit risk than in investment grade bonds, which are more blue-chip companies, or indeed government bonds, which typically don't really have very much credit risk to speak of.

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That risk that you're taking has, over longer time periods, been very well rewarded. That's what makes it fascinating. For us, though, it's the individual companies that we get excited about, where we spend our time.

MB: So, with that risk, do you find that you need to be more long term in your approach?

RB: Our time horizon is three or so years. That's due to the nature of the asset class, because the companies that we're investing in will typically have the option to redeem the bonds, to buy back the bonds, that they issue after two or three years, typically. Or those companies who do struggle, and a minority of companies do struggle over a three-year time period, those struggles will become evident.

So, the longer-term factors for us are really important in scene setting, in setting our research agenda, in questioning companies over their leadership or whether they may be lagging in those big societal and economic trends, whether it be around automation, artificial intelligence, climate change, food supply, whatever these factors may be. Those set the scene. But our time horizon is naturally a little bit shorter.

MB: And Rob, give me an example of one of your recent new ideas.

RB: Sure. So, one of our recent new ideas is EDP, a Portuguese utility company, which features in that sweet spot for us, the crossover space. Crossover here referring to the boundary between the high yield asset class, where we're investing off slightly less creditworthy companies, the boundary of high yield and investment grade on the other hand, which are blue chip, more creditworthy companies.

Companies that are close to that boundary have a strong incentive to maintain or improve their creditworthiness to try and access the lower cost of funding that investment grade companies have. EDP, quite unusually, is genuinely straddling that divide. It has senior bonds, which are investment grade rated, and subordinated bonds, which we own, which still have some investment grade, high yield rating.

It's a bit like you or I on the one hand, having a mortgage, which is, from the lender's point of view, quite safe. It's secure on assets. And another lender may give you a credit card, which is an unsecured credit risk. So, it's the same borrower, but two different, slightly different types of risk. EDP is very focused on improving its creditworthiness. It has a clear plan to do that, including through the use of proceeds from asset sales they intend to make. And what's more, they are leading the transition in Portugal to cleaner energy by focusing their portfolio of power generation assets on renewables, specifically the wind power generation.

MB: Rob, thanks very much for joining us.

RB: Very welcome.

Annual Past Performance to 31 December Each Year (%)

	2015	2016	2017	2018	2019
Baillie Gifford High Yield Bond Fund	0.2	10.1	8.1	-2.5	11.9
Investment Association Sterling High Yield	0.1	11.0	6.2	-3.2	10.9

Source: FE and relevant index providers. Single pricing basis, total return in sterling. B Inc shares.
The managers believe an appropriate comparison for this fund is the Investment Association Sterling High Yield Bond sector average 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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Bonds issued by companies and governments may be adversely affected by changes in interest rates, expectations of inflation and a decline in the creditworthiness of the bond issuer. The issuers of bonds in which the fund invests may not be able to pay the bond income as promised or could fail to repay the capital amount.

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