Inside Thornburg Long/Short Equity Fund

A conversation with portfolio manager Connor Browne, CFA, on Thornburg's new liquid alternative product

Connor worked on Thornburg's growth portfolios before being named managing director and portfolio manager of Thornburg Value Fund in 2006. He was also sole manager of the predecessor fund to Thornburg Long/Short Equity Fund since its 2008 inception. Connor began his career at Thornburg as an intern in 2000 and joined the investment team full-time in 2001. He graduated cum laude from Princeton University with a BA in economics and a certificate in finance.

Q: What is Thornburg Long/Short Equity Fund?

Connor Browne: The fund invests long in securities that we think are underpriced and should go up in value. Meantime, it invests a smaller portion of the portfolio in shorts—companies that we believe are overvalued and will likely drop in price. The fund is a long-bias liquid alternative fund which maintains a net long exposure because markets have historically gradually moved higher. By investing both long and short, we not only add value with active management, but we can also provide for significantly less volatility than the overall market.

Q: What are the fund's key benefits, and how does it fit in a portfolio?

CB: Liquid alternative funds like this are mostly used for their downside protection. So, they can be used as a diversifier, especially to help manage overall risk within a larger portfolio.

In terms of fit, we feel it's a great complement to diversify a portfolio with its lower correlation to traditional asset classes and lower beta, as well as the potential for full market cycle returns without a lot more additional risk.

Q: What makes this fund different from hedge funds?

CB: It's an approach that aims to blend the risk management orientation of hedge funds with the advantages of a mutual fund: liquidity, transparency, SEC oversight, and lower fees. The traditional hedge fund compensation structure, which charges 2% of total asset value and 20% of earned profits, is expensive. And costs are something investment professionals are very watchful of right now.

Q: How did the new fund come about?

CB: It's actually the oldest new fund we've ever launched. That is, it's a conversion of a private hedge fund that we started back in 2008. But we closed that fund on December 29, 2016, and moved the assets to launch this new mutual fund the following day.

And, because the new fund is managed identically to the old fund, its returns include the old fund's entire 8-year-plus track record.

Q: Are you the sole manager of the fund?

CB: Yes. And, like all of our other funds, I'll leverage the entire investment team for ideas on both the long and short side. Bimal Shah, an associate portfolio manager for Thornburg, has played a very active role researching shorts over the last two years. He spent five years working at a long/short equity hedge fund before joining Thornburg.

Q: Is this a focused portfolio, like many other Thornburg strategies?

CB: Yes. We usually will hold only about 30-40 long and 30-40 short positions. On the long side, our top 10 holdings will average about 40% of the portfolio, with the largest single weights between 5% and 10%. Within the short book, we'll work to keep the largest weight of a single short below 3%.

Q: Where do you get ideas for Long/Short Equity Fund?

CB: From the entire investment team. We invite everyone to pitch stocks that will go into the strategy on either the long *or* short side. And even though ours is the only Thornburg strategy with a short book, it's exciting to get so much participation from the team to generate leads for shorting possibilities.

Q: How do ideas get into the portfolio?

CB: It's actually pretty straightforward. We start with a broad universe and employ the same active, fundamental security selection process that we use for all of our products. For this fund, however, we invest both long and short based on what the research uncovers for each security. For example, if other managers think a stock might be overvalued based on their work, they let us know, and we can do more research to flesh out a short thesis.

Q: Do you use a three-basket approach like some of Thornburg's other funds?

CB: Actually, we use six baskets—three for the long side and three for the short book. The long book broadly could be described as "growth at a reasonable price" (GARP). On the short side, we use baskets that identify companies as cycle victims, stumbling stalwarts, or falling stars. We construct long and short portfolios that are separately diversified, and that are further diversified in similar ways to protect the fund in different types of markets.

Q: You also manage Thornburg Value Fund. How do you allocate your time between that fund and Long/Short Equity Fund?

CB: The same research and security selection efforts on the long side can serve both funds very efficiently, so it's not like I'm entirely splitting all my time. On the short side, I get a lot of help from Bimal, who mainly focuses on short ideas for me to consider.

Q: Is there a lot of holdings overlap with Thornburg Value Fund?

CB: Yes. Stocks that make up about half of Value Fund represent about three quarters of the long book (position sizes are bigger in Long/Short Equity Fund). Given my growth background and the GARP nature of the longs in Long/Short Equity Fund, you might expect consistent earners and emerging franchises in Value Fund to make up most of the overlap with Long/Short Equity. It makes sense that stocks that I like enough to own in one fund would show up in another fund that I manage.

Q: In what type of markets should the fund do well, and vice versa?

CB: Long/Short Equity Fund is designed as a risk diversifier. So it's more likely to do better on the downside during volatile markets. When the markets are way up, we may not do as well as the broader indexes. Over a full market cycle, however, we strive to generate broad equity index-like returns with less risk.

Q: What is the fund's benchmark?

CB: The S&P 500 Index, which is generally the industry standard for long/short funds. We won't necessarily always outperform it, because we're only about 30% net long in the fund today, vs. the benchmark's 100% exposure. But we're not too concerned about that. I think that we've done a good job of adding value with active management through stock selection in what has not been the ideal market environment for a low net-exposure strategy. This can be seen if you view our results on a risk-adjusted basis versus the S&P 500.

Q: Which generates more alpha: long or short?

CB: Both have contributed significant alpha, especially over the last five years. We've had a tougher recent period on the long side and a better recent period on the short side. But over the longer-term, we've had good alpha generation on both sides of the book.

Q: What is the approximate annual turnover?

CB: It's been averaging about 70% for the entire book (both long and short). ■

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Investments carry risks, including possible loss of principal. Additional risks may be associated with investments outside the United States, especially in emerging markets, including currency fluctuations, illiquidity, volatility, and political and economic risks. Investments in small- and mid-capitalization companies may increase the risk of greater price fluctuations. A short position will lose value as the security's price increases. Theoretically, the loss on a short sale can be unlimited. Investments in derivatives are subject to the risks associated with the securities or other assets underlying the pool of securities, including illiquidity and difficulty in valuation. Non-diversified funds can be more volatile than diversified funds. Investments in the Fund are not FDIC insured, nor are they bank deposits or guaranteed by a bank or any other entity.

The S&P 500 Index is an unmanaged broad measure of the U.S. stock market.

Alpha – A measure of the difference between a portfolio's actual returns and its expected performance, given its level of risk as measured by beta. A positive alpha figure indicates the portfolio performed better than its beta would predict. In contrast, a negative alpha indicates under-performance, given the expectations established by the beta.

Shorts (or short position) – When shorting, an investor sells a borrowed security with the expectation its price will fall. At a future time, the investor purchases the security (ideally at a lower price than borrowed) and returns it to the original broker. A short position refers to a security that has been borrowed and sold (shorted), but not yet repurchased.

Before investing, carefully consider the Fund's investment goals, risks, charges, and expenses. For a prospectus or summary prospectus containing this and other information, contact your financial advisor or visit thornburg.com. Read them carefully before investing.

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