

Behind the Success of a Top-Performing International Fund

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by Robert Huebscher

Greg Dunn is portfolio manager for Thornburg Investment Management. He manages Thornburg International Growth Fund (TINGX) and Thornburg Core Growth Fund (THIGX), in addition to the International Growth Strategy, International Growth ADR Strategy, and All Cap Growth Strategy.

Greg joined Thornburg in 2002 as research communications director for the marketing department and was promoted to equity research associate in 2005, associate portfolio manager in 2008, and portfolio manager in 2012.

Prior to joining Thornburg, Greg was an investment management analyst for Smith Barney. Greg holds a BS in business with a concentration in finance from Colorado State University and an MBA from Duke University's Fuqua School of Business.

I spoke with Greg on August 11.

Bob: What is your background and what led to becoming manager of the Thornburg International Growth Fund?

Greg: I have the typical industry background. I have an undergrad in business with a concentration in finance, and an MBA. I started as an equity analyst working with the growth team here at Thornburg, which at the time just had a domestic growth fund. In 2007 we decided to launch the Thornburg International Growth Fund. By that time, I had been here for five years. We launched the fund and I became an associate PM. In 2012 the portfolio manager I was working with retired, and I became co-portfolio manager.

Bob: What is the mandate of TINGX? Can you also describe the portfolio construction and risk-management processes?

Greg: Our mandate is growth and we have a flexible perspective. We are a multi-cap international growth fund. That means what you get as an investor is exposure to growth across a broad spectrum of international markets, and across different sized companies. What you see is a portfolio that doesn't look like a benchmark or like a lot of our peers, but it has very consistent growth with reasonable valuations in a portfolio that's pretty concentrated and typically holds 50 to 60 stocks.

We follow a bottom-up, fundamental research-driven process. We are collaborative and work very closely together to source and screen new ideas. We perform in-depth fundamental bottom-up research. We build a financial model and strive to understand the pros and cons of the business that we are analyzing, including its business model, revenue model, the competition in its space, and what its ultimate opportunity is. Then we compare that with our view on the valuation. We need to believe it's a reasonable valuation, because we are growth investors, but we are sensitive to valuations. We like growth, but we don't want to overpay for it.

Bob: What is your approach to currency exposure?

Greg: We are reluctant currency hedgers. At the moment, we aren't hedged in any currencies. In the past, we've hedged anywhere from 50% to 100% of our exposure to the pound, the yen or the euro. In recent history, say over the last five



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years or so, the main driver behind hedging our currency exposure has been driven by a government's mandate to weaken their currency, which we've seen in Japan and in Europe, and we saw in the UK as well. During those periods, we partially or fully hedged some of those currencies. Those are inexpensive currencies to hedge, and very liquid positions to get in and out of.

Outside of those unique situations, we are generally not hedged.

Bob: As of August 9, TINGX had a 10-year return of 7.08%, versus 1.68% for its Morningstar benchmark (the MSCI ACWI ex USA index). What has been the primary source of that 540 basis point outperformance?

Greg: The primary source of the outperformance has been stock selection. It's been a function of having a fairly concentrated portfolio and being focused on our

bottom-up stock selection. We don't look like the broad indexes, and we don't need to. We don't own some of the big companies that make up the indexes that have stagnated or been in structural decline. We are out in the market looking for interesting, new growth opportunities.

We are a big fan of secular drivers, and over the lifetime of the fund there have been some prominent secular drivers across the markets that have driven some of our bottom-up stock selection, and some of our outperformance. Some of those were in the technology space, the Internet-based businesses, whether in search or online commerce or online travel. We have done well in those different spaces.

Another one that is not quite as prominent, but has been a good driver for many years, has been the payment space. We've owned several payments-processing businesses over the years. They have directly benefited from the secular trends of transactions moving from cash and check to electronic processing, and commerce moving from brick-and-mortar retail to online.

But it really does come back to the work we are doing on a stock-by-stock basis, and staying true to our bottom-up process of looking for, identifying and owning good businesses that are growing fast and are reasonably priced.

Bob: In your latest quarterly commentary, you noted that valuations in Europe are attractive, particularly following the election of Emmanuel Macron as the next president of France. You have over 60% of your portfolio invested in Europe. How attractive are those valuations?

Greg: Europe is an interesting place. If you look at the MSCI Europe index, it is trading at about a 20% discount to the S&P 500, which is a little bit wider than where it generally is historically. That adds to the attractiveness a little bit. But the other big thing you've seen that hasn't happened in Europe but has happened in the U.S. is an earnings recovery since the Great Financial Crisis. Maybe it's not even appropriate to call it an earnings recovery, but there's been earnings growth in the U.S., and you haven't had that in Europe on a broad market basis.

There are always companies that are growing, and that's what we're trying to find. From that perspective, Europe is a little bit cheaper than normal relative to the U.S., and they haven't experienced much earnings growth really in the last 10 years. There's an opportunity with economies gradually improving there, maybe a little more stability with the French election behind us, and no big disruption coming out of that like we saw with Brexit last year, and an opportunity for Europe to recover and get a bit of earnings growth.

We've seen good earnings revisions there over the past year or so, so the market is up a little—not a lot—and all of that is on better earnings. Maybe there are some green shoots there. But for us, it really does come back to not the broad market view so much as what we are finding on an individual stock basis

Bob: So on an individual stock basis, is there a specific company that illustrates why you like Europe?

Greg: One of our larger holdings, and it's been a long-time holding for us, is Wirecard. That's a

Germany-based payments-processing business. It's been a very good stock for us for the last five years and continues to be a big weight. We think there is still quite a bit of opportunity there.

It is a payment processor that specializes in online payment processing. It has some off-line business as well, but the bulk of its growth comes from its online payment processing. It is one of the early payment-processing businesses that has established itself with a nice foothold in online payment processing, so it is getting the benefit of both secular trends of commerce moving from off-line to online, and the trend of cash and check to electronic, because obviously, when you buy something online there is no option of paying with cash or check generally. It gets that double benefit. That has driven pretty consistent growth rates in the 20% to 30% range. Its earnings multiple right now is about 25x, which is reasonable for its growth and for the opportunity it has to grow in the future.

Bob: Are you seeing any opportunities in Asia now?

Greg: Asia, especially China, is an interesting place right now. Obviously, a lot of Chinese stocks have performed really well this year, especially growth stocks, and especially the big dominant technology and Internet players that everyone knows, like Alibaba, Tencent, and Baidu. We own and like those businesses and the opportunities in front of them.

With that being said, I wouldn't be surprised if the stocks need a little breather to absorb some of the big runs that they've had.

We own Galaxy Entertainment and Sands China, which are both

Macau casino stocks. These are big businesses with really attractive margin profiles with EBITDA margins in the 30% range that have been depressed over the last few years mainly due to a government corruption crackdown in China. That leads to people going to Macau and gambling less than they have in the past, especially in the VIP space. That seems to have run its course, and these are businesses that are generating revenue about 25% below where they were at the peak. But they have managed their business in a way that's maintained high margins.

People are coming back to Macau, and will continue to come back to Macau. There's an interesting gradual runway of growth in front

You said "consumer cyclicals." It's probably just Morningstar's categorization, but "consumer discretionary" is our big exposure, along with technology. That's where we find the most growth opportunities on a sector basis.

Within technology, it's the big things. It's the fast-growing Internet businesses. It's the companies like Wirecard which falls under technology, and the technology services business that are also growing fast. On the consumer-discretionary side, there is a little bit of overlap there too, because I believe some of our e-commerce businesses get categorized in that space. We're not invested in the traditional retailers, but we've found interesting unique retail op-

example of a fast-growing consumer-discretionary business that we like.

Bob: Stepping back, what are the risks that keep you up at night?

Greg: As a growth investor, we always worry about the correction risk in the market, the downturn risk. Volatility has been lower the last few years, but it's the big corrections, like in 2008, and the volatility we experienced, especially in the first few years after that, and some corrections we've had over the last few years, when volatility creeps up. For some of our businesses that are growing very fast and have expensive multiples, those risks are amplified by that volatility.

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of them as gamblers and people return, and also as they diversify from being focused on gambling to providing more of a family-type experience, similar to what Las Vegas has done over the last, say, 20 years to broaden its appeal. There is a lot of appetite in Macau for what Sands provides, and there is a lot of opportunity for them to grow into the future at very high margins and attractive valuations.

Bob: Your two largest sector concentrations are consumer cyclicals (23.7%) and technology (22.1%), well above the index allocations (11.0% and 11.4%, respectively). Why are those sectors attractive? Is there a company or two that illustrates why you like those areas?

Greg: The easy answer is growth.

portunities, one of which is Zalando in Germany.

Zalando is an online-commerce business. It replicated a department store online, and the clothing niche is one that Amazon doesn't serve that well, especially in Europe. It is a business where you can establish yourself like Zalando has as the early leader and the place to go to buy clothes. There is a lot of opportunity there. It is still very underpenetrated in terms of how much people are buying online, and it is a little more complicated model because of the returns to manage. That creates a barrier to entry. Zalando has been operating in that space for a long time and developed the expertise necessary to run the business and do it successfully. That's a good

That's the risk we worry about, but that's also the risk we embrace, because it presents opportunities for us to buy good businesses at really attractive valuations. It's a risk and it's also an opportunity, and we try to be mindful of that and take advantage of it.

The other things that keep us up at night are the individual risks of the stocks that we own. That is why we focus so much on individual stock selection, and the fundamental work we are doing on a stock-by-stock basis to minimize that risk by understanding what we own, and what the risks and opportunities are, and avoiding some of those things.

Bob: What role should your fund play in a typical asset allocation?

Greg: Thornburg International Growth Fund is a very good diversifier for a client's portfolio. Like I mentioned before, our portfolio looks very different than the benchmark, and it looks very different than many of our international

peers, whether it is a growth, core, or value-oriented international fund. We are investing across small-, mid-, and large-cap stocks, and we are going off the beaten path to identify opportunities, providing our clients exposure to these opportunities that they are not going to find in other portfolios. We think that is pretty valuable.

If you look at the active share of the fund, which is a measure of how lit-

tle we look like the benchmark, it is very high. So that is something we think is valuable from an asset allocation standpoint. We think we pair very well with someone's international exposure if they've got a big, core-type international fund, or even just a benchmark ETF.

Bob: What about your fund makes it unique?

Greg: It is the things I mentioned,

like very high active share and the fact that we are putting together a fairly concentrated, 50 to 60 stock portfolio. We are very focused on our fundamental bottom-up research process to identify unique opportunities that are growing fast but have reasonable valuations, and give our investors exposure to growth in a way they would be hard pressed to find elsewhere—across market capitalizations and geographic areas.

Thornburg International Growth Fund Average Annual Total Returns (as of 9/30/17)

	YTD	1-YR	3-YR	5-YR	10-YR	SINCE INCEP.
A Shares TIGAX (Incep: 2/1/07)						
Without sales charge	31.22%	24.12%	9.60%	10.36%	6.16%	8.00%
With sales charge	25.30%	18.51%	7.93%	9.35%	5.67%	7.54%
I Shares TINGX (Incep: 2/1/07)	31.68%	24.66%	10.05%	10.80%	6.68%	8.55%
MSCI AC World ex-U.S. Growth Index (Since 2/1/07)	24.82%	17.68%	6.43%	7.87%	1.89%	3.38%

Returns are annualized for periods greater than one year.

Performance data shown represents past performance and is no guarantee of future results. Investment return and principal value will fluctuate so shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than quoted. For performance current to the most recent month end, visit thornburg.com or call 877-215-1330. The maximum sales charge for the Fund's A shares is 4.50%. There is no up-front sales charge for class I shares. The total annual fund operating expenses are as follows: A shares, 1.39%; I shares, 1.00%. Thornburg Investment Management and/or Thornburg Securities Corporation have contractually agreed to waive fees and reimburse expenses through at least April 10, 2018, for some of the share classes, resulting in net expense ratios of the following: I shares, 0.99%. For more detailed information on fund expenses and waivers/reimbursements please see the fund's prospectus.

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. Investments in the Fund are not FDIC insured, nor are they bank deposits or guaranteed by a bank or any other entity.

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There is no guarantee that the Fund will meet its investment objectives.

Any securities, sectors, or countries mentioned are for illustration purposes only. Holdings are subject to change. Under no circumstances does the information contained within represent a recommendation to buy or sell any security.

Top ten holdings as of 8/31/17: Paysafe Group plc, 4.5%; Bayer AG, 3.3%; Worldpay Group plc, 3.1%; Wirecard AG, 2.8%; MasterCard, Inc., 2.8%; Galaxy Entertainment Group Ltd., 2.6%; Fresenius Medical Care AG & Co., 2.4%; Sands China Ltd., 2.3%; Fomento Economico Mexicano SAB de CV ADR, 2.2%; KOSE Corp., 2.2%.

As of 9/30/17, Wirecard is 2.8% of Thornburg International Growth Fund; Galaxy Entertainment is 2.8% of Thornburg International Growth Fund and 3.8% of Thornburg Global Opportunities Fund; and Zalando is 2.0% of Thornburg International Growth Fund.

EBITDA – Earnings Before Interest, Taxes, Depreciation and Amortization. An approximate measure of a company's operating cash flow based on data from the company's income statement.

Exchange Traded Fund (ETF) – A security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. ETFs experience price changes throughout the day as they are bought and sold.

Multiple – A valuation multiple reflects an investment's market value relative to some key metric. Price to earnings ratio (P/E) is a commonly used multiple. It's calculated by dividing a stock's price by the company's earnings per share.

The MSCI All Country (AC) World ex-U.S. Growth Index is a market capitalization weighted index that includes growth companies in developed and emerging markets throughout the world, excluding the United States.

The MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. The MSCI Europe Index consists of the following 15 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

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

The performance of any index is not indicative of the performance of any particular investment. Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index.

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.