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July 2018

Secular Trends in an International Portfolio

In a globalized economy, secular growth trends find their way to more than one market. Thornburg International Growth Fund was created with the aim to provide exposure to these growth trends outside of the U.S. Portfolio Managers Greg Dunn and Sean Sun employ a consistent bottom-up process to seek quality companies that not only have attractive growth prospects but are also trading at reasonable valuations.

What is the history of the fund? How has it evolved since inception?

While running a domestic growth portfolio at Thornburg, we were finding more opportunities, particularly in the international space, in the 2005-2006 timeframe than we could reasonably put into that strategy. So, we took the necessary steps and launched this fund at the beginning of 2007 and employ the same approach to investing and stock picking that we used successfully in the domestic growth portfolio. We've stayed consistent in our approach, philosophy and process since inception.

What is your investment philosophy?

We employ rigorous, bottom-up fundamental analysis to invest in high-quality growth companies with attractive growth prospects and reasonable valuations. We manage a fairly concentrated portfolio, which typically has 50 to 60 stocks. We have a multi-cap approach, in which the capitalization exposure is driven by our bottom-up fundamental research.

As a result of our process, we are able to identify interesting opportunities. We are benchmark agnostic; what matters is the stock selection. This is an international growth portfolio, which is uncorrelated to peers and benchmarks. Despite investing in a relatively small number of stocks, the portfolio is diversified.

We manage about $2.5 billion in the strategy, with about $1.8 billion in the mutual fund and about $700 million in separately managed accounts.

What is your geographic footprint?

We invest in developed international markets, in emerging markets, and in businesses that are based in the U.S. but generate the majority of their revenues and profits outside the U.S. We avoid frontier markets because they generally do not offer enough liquidity.

How do you implement your investment process?

Our process starts with narrowing down our large investable universe with screens. We visit companies, attend conferences, and talk to sell-side analysts; we follow the markets and the news on a daily basis. We constantly refine our research list and narrow it down to identify the opportunities that deserve attention. Then we start a fundamental research process on these companies.

Our screening approach is not a black box; there are certain characteristics that we look for. Before we become interested in a stock, we have to see five to ten characteristics. We have a relatively flexible process, which is rooted in identifying companies that we believe are high-quality businesses with attractive growth prospects and reasonable valuations. These three broad tenets drive our thinking.

What factors do you screen for as part of your process?

Most importantly, we screen for growth. The other metrics include cash flow profile, valuation, improving fundamentals and margins, accelerating growth rates, etc. Then we do rigorous research on the individual stock level. We examine qualitatively and quantitatively the factors that matter, most importantly, the quality and the sustainable competitive advantages.

Greg Dunn
Portfolio Manager and Managing Director

Greg Dunn is portfolio manager for Thornburg Investment Management. 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.

Sean Sun
Portfolio Manager and Managing Director

Sean Sun is portfolio manager for Thornburg Investment Management. He joined the firm in 2012 as an equity research analyst and was promoted to associate portfolio manager in 2015 and portfolio manager in 2017. Sean holds an MBA with concentrations in finance and entrepreneurship from the University of Chicago Booth School of Business and a BA in economics from the University of California at Berkeley, where he was a Regents' and Chancellor's Scholar. He is also a CFA charterholder. Prior to joining Thornburg, Sean held portfolio analysis and modeling positions at Bank of America. Prior to business school, he was a product manager at HSBC.

Once we identify a stock that we feel is worth fundamental research, we start by building a model. We use a template that helps with the consistency of our process. We build up the idea within that template, which helps us share the idea. Every time someone pitches a stock, it's pitched and built up in a similar fashion.

We do qualitative and quantitative work to understand the business model, opportunities, threats, and revenue flow through profit and loss. Next, we build a forward model, which is based on the qualitative and quantitative work. The goal is to derive what we think future earnings power and future cash flow would look like. Before we invest in a business, we need to have expectations for the future that are better than the current consensus.

By doing this, we have a better understanding of companies and their valuation. We are growth investors and we are not scared of expensive companies, but the valuations need to be justified and reasonable on an absolute or relative basis. After we analyze all the information, we sit down as a team for the stock pitch to decide if the stock meets our criteria.

Would you illustrate your research process with a couple of examples?

One of our largest holdings is Wirecard AG, a German digital payment solutions provider. We have owned the stock for a long time. It incorporates secular tailwinds that are an important part of the investment thesis. When we discovered Wirecard, it was a small-cap company, growing very fast on an organic basis and benefiting from the secular tailwinds of payments moving from cash to card. Wirecard does a lot of payment processing online and thus benefits from e-commerce tailwinds as well.

Because of our long-term focus, we assess what earnings, revenue and growth would look like in several years, what business value the company could create over time, and how big it could be in several years. We also evaluate if it is trading at a discount to the potential future value or to the underlying intrinsic value over time.

At the time, we saw Wirecard as a long-term business value compounder. Because it is a digital payments processing company, it has the quality profile that we like to see, good operating leverage, and expanding margins. The company is profitable, has positive cash flow, and is well positioned in its space.

Why is Wirecard more successful than other financial services providers?

Wirecard's platform is better than others in the industry. It can be difficult to observe from the outside, but the company is acquiring and linking together merchants, e-commerce companies, and customers. In Europe, there are different currencies and regulatory jurisdictions, so it is complicated to get everything seamlessly working together. For instance, a person selling online wants a merchant acquirer and processor that not only handles currency translation and cross-border regulatory issues, but also takes the complexity out of the process.

Wirecard has built a leading and technologically robust online processing platform. Scale matters because every incremental processed transaction leverages the platform that they have built.

Could you give another example from a different industry?

We like the theme of e-commerce. Since we have the perspective of simultaneously managing a domestic portfolio, we often look at secular themes and trends that have occurred in the U.S. and apply them internationally when appropriate. We often look at the business cycles of international companies or at their positions on the technological curve.

With people buying more products and services online and less offline, e-commerce is a clear secular trend. It occurred earlier in the U.S., but some places in China actually caught up to the U.S. and exceeded it. However, in Europe the levels of e-commerce penetration are much lower than in the U.S. We see that as a secular tailwind that will occur within Europe.

Moreover, the structure of the European e-commerce market is more attractive. In the U.S. e-commerce is fragmented and the only big player is Amazon. In Europe, there are multiple public companies that focus on different niches with a great deal of success such as fast fashion e-commerce company ASOS in the UK, luxury focused Yoox Net-A-Porter in Italy, or more marketplace models like Zalando in Germany.

Some of these European businesses have managed to tap into consumer demand in a way that Amazon hasn't been able to capture. Amazon tends to focus on basic apparel and is a platform that emphasizes transactions rather than the entire experience of browsing for fashion. The European fashion e-commerce companies are meeting needs that exist and are building solid businesses over time.

Why is fashion e-commerce more popular in Europe than in the U.S.?

I think that there is more demand for online fashion and fast fashion in Europe. For example, ASOS in the UK is a fast-fashion brand. Its online presence is a clear advantage over brick-and-mortar retailers, because ASOS is able to leverage data, stay on trend, and bring products quickly to the market. Their consumers love it. In fact, we've begun to see the people who built these businesses in Europe entering the U.S. market with their brands.

How do you build your portfolio? What is the role of diversification in the process?

The key element is our basket structure of growth industry leaders, consistent growers, and emerging growth companies. We loosely target about a third of the portfolio in each of these three baskets. The characteristics of the stocks within each basket are quite different yet complementary.

That structure helps to maintain a growth portfolio that's balanced across the entire spectrum of growth. It includes the more conservative or defensive stocks in the consistent grower basket, the more aggressive growth ones in the emerging growth basket, and the growth industry leaders at the core of the portfolio.

In that way, we achieve a balanced portfolio that doesn't tilt towards the more aggressive growth stocks or towards the more defensive ones. That balance gives us an opportunity to perform well in different market environments. It also gives us a slightly different perspective on the portfolio risk and helps manage that risk through the cycle.

The three-basket approach translates into the all-cap approach. The stocks in the emerging growth basket tend to be smaller- to mid-sized companies; the consistent growers tend to be mid-to-large-sized companies; the growth industry leaders tend to be the larger-sized companies, which have consistently compounded their competitive advantage and have strong positions within their sectors.

During the financial crisis, our emerging growth basket was shrinking, but our consistent growth basket was getting larger because of the developments in the market. That was a good indicator to add to the emerging growth stocks or to look for new opportunities in an environment, which didn't feel good for risk taking. Our process helped us maintain the balance and put us in a position to perform well coming out of that crisis.

Do you have any limits on position sizes at the industry, country, or individual stock level?

We are benchmark agnostic and the fund looks different than the benchmark and our peers. Because we want the portfolio to be diversified, our largest positions are between 3% and 4%. The initial position sizes are typically between 1% and 3%, depending on the type of stock and liquidity. Small-cap, high-growth, and high-volatility stocks have smaller weights than well-established, large-cap growth industry leaders.

In terms of sector and industry exposure, we are comfortable looking different from the benchmark. We tend to have higher exposure to technology than the benchmark, because investing in technology is part of being a growth fund. Currently our technology exposure is approaching 30% because that's where we are finding attractive opportunities. We make sure that the bottom-up process is driving the portfolio exposures and, second, we make sure that we keep the exposures in check to avoid concentrating our risk.

The geographic exposure is a similar story. If we find a lot of opportunities in one individual country, we'll have higher exposure to that geography. As long as the underlying stocks make sense, we are not bothered by the higher exposure.

It is important to understand that this is a truly active portfolio. We don't look like the benchmark or like our peers. We have a stringent, bottom-up driven, fundamental research process, which we follow consistently. The goal is putting together a portfolio of diversified stocks and providing attractive exposure to growth outside of the U.S.

What is the portfolio turnover and the fund's stated benchmark?

The portfolio turnover has historically been about 100%, partially because we are adding and trimming, but over the past year the turnover has been in the range of 60% to 70%. Our stated benchmark is the MSCI AC World ex-U.S. Growth Index.

How do you define and manage risk?

Since this is a concentrated, high-conviction portfolio, the key element is the understanding, in-depth knowledge, and monitoring of our investments. We constantly talk to management teams, as well as check and stress test the investment thesis. Even before a stock goes in the portfolio, there is rigorous financial statement analysis every quarter with the release of new data. First and foremost, we make sure that we don't permanently impair capital. We spend a lot of time trying to understand what the risks are and where destruction can come from.

We use our basket approach as a form of diversification and risk management. Also, we leverage the broader team at Thornburg because everyone has different expertise, viewpoints and experiences. They help us stress test our investments and stocks as they come to the portfolio.

At the top level, we manage risk through the research process. At the portfolio level, we manage risk through our baskets and through diversification. We also utilize quantitative risk tools to generate risk reports and understand our exposure to various factors and other metrics. T

Thornburg International Growth Fund

Adviser	Thornburg Investment Management
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Source: Company Documents

Thornburg International Growth Fund

Total Returns (as of 6/30/18)

	YTD	1-YR	3-YR	5-YR	10-YR	SINCE INCEP.
A Shares TIGAX (Incep: 2/1/07)						
Without sales charge	3.90%	14.61%	9.92%	8.53%	8.35%	8.04%
With sales charge	-0.77%	9.46%	8.24%	7.53%	7.85%	7.61%
I Shares TINGX (Incep: 2/1/07)	4.04%	14.95%	10.34%	8.94%	8.87%	8.57%
MSCI AC World ex-U.S. Growth Index (Since 2/1/07)	-2.28%	9.90%	6.56%	7.18%	3.01%	3.45%

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, 1.06%. Thornburg Investment Management and/or Thornburg Securities Corporation have contractually agreed to waive fees and reimburse expenses through at least June 15, 2019, 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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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.

As of 6/30/18 the top 10 positions of the fund were: Wirecard AG, 3.0%; Fresenius Medical Care AG & Co. KGaA, 2.6%; Galaxy Entertainment Group Ltd., 2.6%; Bayer AG, 2.6%; Worldpay, Inc., 2.5%; Astrazeneca plc, 2.5%; Auto Trader Group plc, 2.4%; Fomento Economico Mexicano S.A.B. de C.V., 2.4%; Just Eat plc, 2.4%; Domino's Pizza Group plc, 2.3%.

Funds invested in a limited number of holdings may expose an investor to greater volatility.

Intrinsic value – Reflects Thornburg's estimate of a company's value, encompassing our collective investment judgment.

Price/Cash Flow – The measure of the market's expectations regarding a firm's future financial health. It is calculated by dividing price per share by cash flow per share.

The MSCI All Country (AC) World Index is a market capitalization weighted index that is representative of the market structure of 47 developed and emerging market countries in North and South America, Europe, Africa, the Middle East, and the Pacific Rim. The index is calculated with net dividends reinvested in U.S. dollars.

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.

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8/20/18
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