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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Generating Attractive Returns Through Stock Selection in a Long/Short Fund

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**BIMAL SHAH** is an Associate Portfolio Manager for Thornburg Investment Management, Inc. He joined the firm in 2014 as an Equity Research Analyst and was promoted to Associate Portfolio Manager in 2016. Prior to his joining Thornburg, Mr. Shah was a senior investment analyst at Waterstone Capital Management and a research analyst at Macquarie Securities Group. He also held various management positions at Citigroup in New York. Mr. Shah began his career as an associate at Standard & Poor's. He holds an MBA from the University of Maryland.

**SECTOR — GENERAL INVESTING**

**TWST: Please introduce Thornburg with a view to your goals and differentiated strategy.**

**Mr. Browne:** Thornburg Investment Management is based in Santa Fe, New Mexico. We're a mutual fund and institutional account manager with around $50 billion in client assets under management. The goal of the Thornburg Long/Short Equity Fund is to provide investors with a key long/short equity component within their portfolio that can produce equity index-like returns over the cycle driven by stock selection, but with much better risk characteristics than broad equity indices.

I think there are a couple of things that really differentiate Thornburg. One, we have a flexible perspective. Two, we're truly collaborative in our investment work. And three, being based in Santa Fe, we're far from the herd, which makes it easier for us to think more clearly since we aren't part of the New York, Boston or San Francisco grind.

**TWST: Tell us more about your flexible perspective and how, for example, it works in the current environment amid rising trade tensions.**

**Mr. Browne:** At Thornburg, we have a flexible perspective in the organization of our investment team. So rather than having investment team members focus just on one industry and one country, our whole team, across both equity and fixed income professionals, is organized to invest anywhere in the world. We train team members to look at different sorts of companies across different geographies throughout their entire career. Especially in a world where trade is very important and we've got the ongoing risk of a trade war. Even more so in a world where large technology companies like **Amazon** (NASDAQ:AMZN) are competing in more and more areas, not just in the internet sector but across other industries and across many geographies. We think our holistic approach to stock investment research and our flexible perspective is different and perhaps better.

**TWST: Can you exemplify how some particular stock selections or sector weightings relate to your goals and guiding strategy?**

**Mr. Browne:** I'll start with a brief overview of how we construct the portfolio. It's a long/short equity fund, which simply means that we are trying to use fundamental bottom-up stock research to find stocks that we believe are trading at a discount to our calculation of intrinsic value, and those we'll buy long. But also using our fundamental bottom-up stock research to try to find stocks that, based on our work, are overvalued, and those securities we'll short, betting that the stock price will move lower. We use fundamental bottom-up stock picking on both sides, with 30 to 40 stocks long and 30 to 40 stocks short.

So if you invest $100 with us, we'll take a little bit more than $100, and we'll invest it on the long side of the book. Today, we have about 104% gross long exposure or $104 invested long for every $100 invested with us. And we'll take $70 and invest it short. Today, we have 72% gross short exposure. If you subtract 72% gross short from 104% gross long, you get what we call our net exposure, which sits at just over 30%. And we'd expect over time, as has been our experience, that the downside capture of the portfolio, or the equity market beta of the portfolio, is about in line with our net exposure — that is, about a third of the overall market downside. But by doing a good job of selecting stocks both long and short, we have been able to generate, over the cycle, more than just a third of the market's return.

**Mr. Shah:** An important part of the portfolio construction is limiting our net exposure to between 30% and 50%. As Connor pointed out, right now, our net exposure is closer to 30%. And structurally, we have decided to limit the net market exposure of this fund to between 30% and 50%. By doing that, we're reducing the downside capture of the portfolio. But at the same time, we are generating attractive risk-adjusted returns through security selection and alpha generation on both longs as well as shorts.

One of the reasons why we have limited our net exposure between 30% to 50% is that it limits our ability to make market calls. During our careers, both of us have seen many hedge fund managers make big market calls and either go dramatically net long or go net short. And in our opinion, a lot of times that hurts investors' total return. We are trying to give a consistent set of expectations to our investors in terms of our market exposure.

### Highlights

*Connor Browne and Bimal Shah discuss the Thornburg Long/Short Equity Fund. The goal of the fund is to provide investors with a long/short equity component in the portfolio that can produce index-like returns over the cycle. This is driven by stock selection and has better risk characteristics than broad equity indices. Mr. Browne and Mr. Shah use fundamental bottom-up research to make their stock selections. When they identify stocks trading at a discount to their intrinsic value, they'll buy them long. They'll then short stocks they believe to be overvalued, betting that the price will move lower. Mr. Browne and Mr. Shah also limit their net exposure to between 30% and 50% because it limits their ability to make market calls.*

*Companies discussed: Amazon.com (NASDAQ:AMZN); Alphabet (NASDAQ:GOOG); Facebook (NASDAQ:FB); Netflix (NASDAQ:NFLX); Comcast Corporation (NASDAQ:CMCSA); Walt Disney Co. (NYSE:DIS); Twenty-First Century Fox (NASDAQ:FOXA) and Alkermes Plc (NASDAQ:ALKS).*

**TWST: What are the typical fluctuations in your net exposure? Does it fluctuate in response to different market conditions?**

**Mr. Shah:** Our net exposure is driven most by what kind of opportunities we find in the market. To the extent we are finding great opportunities to short stocks, our net exposure would gravitate toward 30%. But if we start finding more interesting long opportunities, our net exposure could gravitate toward 50%. Over the last five years, we have had great opportunities to short stocks, so our net exposure has been toward the bottom end of our range; that is to say, we've had an easier time finding short investment opportunities than long opportunities.

So you might conclude that we expect the market to go down. And eventually, we do expect the market to go down. Calling the timing on that is much trickier, but it does seem to us like valuations, especially in the U.S. stock market, seem somewhat high. And at some point, whether it's a trade war or who knows what else, something will get in the way of this really strong economic growth that we're experiencing today. And we really want the portfolio to be prepared and well-positioned when that happens.

**TWST: Are there any particular sectors that currently are heavier-weighted in the long and/or the short sections of your portfolio?**

**Mr. Browne:** This may differentiate us from some of our competitors, but we think it's important to have books on the long side and the short side that look similar to each other. We don't want to make a big bet that health care is going to win versus financials. That would mean we'd have all of our outperformance in the portfolio driven by whether health care stocks outperform financial sector stocks. We think making those sorts of calls is very difficult. We're much better at picking individual stocks within sectors and allowing our stock picking to drive portfolio results.

So we want a balanced book on both sides. We have a growth-oriented investment style across the portfolio, which has led us both on the long side and the short side to invest in more companies within health care, information technology and consumer discretionary versus sectors like materials or energy.

**Mr. Shah:** As Connor pointed out, we try to generate some of our returns through our market exposure, which right now is in the low 30% range. But the bulk of our returns are generated because of idiosyncratic stock selection. To that end, what we try to do is limit any major exposures to any particular factor, sector or market cap.

One of the ways we do this is through our unique six-basket approach to portfolio construction. We believe that's a significant contributor to our effort to generate equity-like returns with much lower downside capture. More specifically, we divide the long portfolio into three baskets: growth industry leaders, consistent growers and emerging growth companies. On the short side of the portfolio, it's the mirror image of the long baskets: cycle victims, stumbling stalwarts and falling stars. By ensuring that we represent different kinds of stocks across these six baskets, we create systemic diversification across the portfolio.

**TWST: What have your results been over the past year or so? How well would you say these results validate your approach?**

**Mr. Browne:** Since inception and over the last five years, we've done a good job of generating returns well-above our net exposure, or our risk-adjusted exposure to the equity indices. In fact, since inception of the portfolio, we've nearly generated the full S&P 500 annualized return with less than half of the market exposure. Importantly, we've driven those returns on both sides of the book. I think many of our competitors, both long/short equity mutual funds and long/short equity hedge funds, have tried to short stocks and have failed in this environment. They have not been able to generate alpha, and often, they don't even try. They're just shorting ETFs or market futures. So they're not even trying to generate stock selection value on the short side of the book.

return. In the same period, the S&P 500 generated a return of 8.9%. That's over 10 years of performance, very close to that S&P 500 index return, but again with much lower risk characteristics, with a net exposure and a beta of less than half of the market over that time.

**Mr. Shah:** One way we measure that is through our Sharpe ratio. Sharpe ratio is essentially our return divided by the volatility. So if you look at the history of this fund, we have had a better Sharpe ratio than both the S&P 500 as well as our peer group.

**TWST: Is there anything else about the long/short fund that distinguishes itself from its peers? Is there anything unique about your investment approach?**

**Mr. Browne:** Yes, especially relative to the mutual fund competitors or our liquid-alternative peers. For one, we believe we offer a true hedge fund investment experience in a mutual fund format. Many of our peers seem to offer a watered-down version of their investment approach when they construct a long/short equity fund in a mutual fund vehicle. And importantly, I think people are looking for long/short equity funds to provide downside protection in a tough market environment. That's what the short book is all about.

In our work on the competitive set, we've noticed that while our net exposure is around 30%, the average long/short equity mutual fund in the Morningstar category actually has over 60% net exposure, so more than twice the net exposure that we do. And therefore, we think we'll fare better in a down market. In a rising market environment, that higher net exposure will help a fund's performance. We've done very well against the peer group even though we've had much lower net exposure.

***"Of course, Thornburg has a strong reputation of selecting securities on the long side of the portfolio. We have been doing that for more than 30 years. What we have figured is that the same research process also leads to a lot of good investment opportunities on the short side of the book. And that has been very fruitful for us."***

Importantly, over the last five years and since inception, we've done a great job of generating alpha on both the long side and on the short side of the book. Over the last five years through the end of March of 2018, our long book total return is around 130% relative to an S&P 500 total return of about 90%. Even more interesting, had you shorted the S&P over the last five years, you would have lost 90% of your money, just as it would have made 90% on the long side. Our short book has lost money for us, but only around 40% cumulatively over the last five years. We consider the difference between 40% and 90% alpha generation on our shorts.

The mutual fund had been a hedge fund in its previous life. We converted it into a mutual fund at the end of 2016. If I add back just the 20% incentive fee, which we no longer charge in the mutual fund vehicle, since inception, we have generated an 8.6% annualized net

And where that will really play out is when we get a pullback. We like to call it "cheating the hedge." We feel like many of our competitors in the long/short equity peer group are cheating the hedge because they have a much higher net exposure than investors are perhaps expecting.

**Mr. Shah:** Connor mentioned the difference between us and peers from a structure perspective. I would also like to highlight this from a process perspective. There are a couple of key things which really differentiate our research process and allow us to find compelling investment opportunities on a consistent basis. First of all, we do bottom-up fundamental research.

And secondly and probably most importantly is what Connor pointed out earlier, which is our collaboration amongst the entire investment team. Of course, Thornburg has a strong reputation of selecting securities on the long side of the portfolio. We have been doing that for more than 30 years. What we have figured is that the same research process also leads to a lot of good investment opportunities on the short side of the book. And that has been very fruitful for us. Secondly, another important aspect of our differentiation is that we look at everything through the consumer's lens, and we pay a lot of attention to a company's reason for being, which enforces a very strong analytical rigor and discovery of long-term potential of a company.

**TWST: Can you give us a closer look at some of the compelling investment opportunities in your long basket? And what's going on in your short basket — maybe exemplify with one or two holdings?**

**Mr. Browne:** Our growth industry leaders basket has recently driven performance in the portfolio. One area where we've successfully invested over time is in the FANG stocks. We've done work on the digital advertising space from the beginning. I did our work on **Google** (NASDAQ:GOOG) at the time of its IPO, and I did our work on **Facebook** (NASDAQ:FB) at the time of its IPO. We've spent a lot of time understanding the shift in advertising dollars from the linear television environment to online, and that has benefited performance of the portfolio.

That said, we sold both **Amazon** and **Netflix** (NASDAQ:NFLX) after owning them for some time at price targets last year. We remain very excited about the prospects for **Facebook** and **Google** relative to their valuation, but two of the others there, **Netflix** and **Amazon**, seem too expensive to us.

**1-Year Daily Chart of Comcast Corporation**

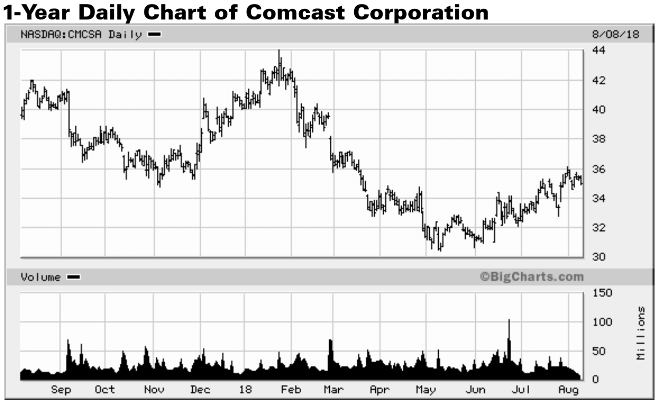


Chart provided by www.BigCharts.com

In our consistent growers basket, a stock that we're excited about today is **Comcast** (NASDAQ:CMCSA). They're in the middle of a bidding war against **Walt Disney** (NYSE:DIS) for assets at **Fox** (NASDAQ:FOXA). We're not particularly excited about the prospects of an acquisition of **Fox**, but that has given us a terrific opportunity to buy the stock because the stock has traded off due to some of this risk.

And we think what's exciting about **Comcast** is their broadband product, their ability to offer what to us looks like a near-monopolistic broadband data product within their territories. Whether you buy TV from **Comcast** or whether you're streaming your television service from **Netflix** or others, your internet connection into the home is incredibly important. And we think that's increasingly showing in differentiated performance at **Comcast** versus satellite television peers, whether independent or embedded in other providers.

An emerging growth company we're quite excited about today is a company called **Alkermes** (NASDAQ:ALKS). This is an early-stage biotechnology company that we're invested in. Our approach to biotech or pharma investing is to only give companies credit for approved on-the-market drugs. **Alkermes** has two that we're very excited about that we think will grow faster than people are expecting.

**1-Year Daily Chart of Alkermes Plc**

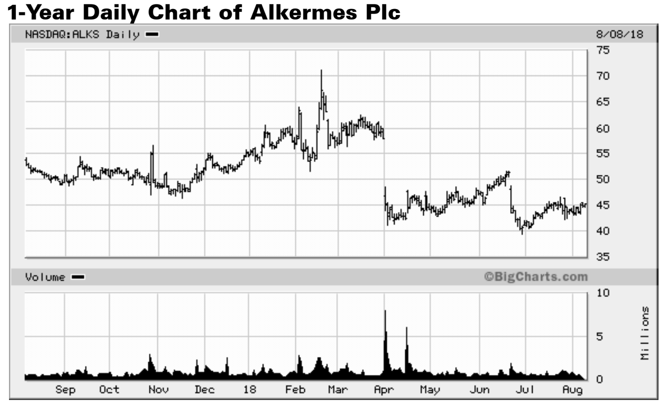


Chart provided by www.BigCharts.com

One to highlight is called Vivitrol. It's a shot that you can take that blocks you from getting high off an opiate. While this isn't a treatment for everyone that is suffering from opiate addiction, it is an important treatment for some. You can't get high for 30 days after this shot. It's a really exciting potential treatment in this war on an epidemic that's ravaging the country. **Alkermes** also has an antipsychotic drug on the market. On top of that, they've got an incredibly exciting pipeline of drugs, which we think creates wonderful optionality should any of those pipeline drugs work out.

**Mr. Shah:** On the short side of the book, I would like to highlight a couple of areas where we had good success in finding interesting opportunities. One area where we have found some good opportunities is looking across industries through our flexible lens and figuring out where companies get misclassified from the way we look at it. For example, a lot of companies want to be classified as technology companies because you get much better valuation as a technology company versus a finance company.

Three years ago, we were looking at an online lending platform. Every other investor on the Street was thinking of this as a technology company that would disrupt bank financing, but our fundamental research work led us to believe otherwise. When we looked at this through our flexible lens, what we figured was this is just another wholesale-funded finance company, which should trade on earnings, not on a multiple of sales. And that resulted in a very interesting short opportunity for us.

Other examples include newer companies or new IPOs that get valued like a technology company. But when you look at the underlying business closely, it appears that their technology and processes are not very different from their competitors. Those opportunities are fantastic in our opinion.

The second area where we have gotten really good traction is generating good short leads from the broader equity and fixed income investment team. For example, if a member of our investment team looks at a long opportunity and, after doing some work, does not think that it's a good long opportunity, then they come to us and say, "Hey, could you guys look at this as a short." An example is a global airport concessions operator that one of our investment team members passed on to us. We looked at it, and we figured that the trajectory of revenues and expenses are not lining up. Based on our collaborative teamwork, we figured that the profitability of this company would deteriorate, and that turned out to be a great investment opportunity.

**TWST: Can you also share a closer look at some of the cycle victims in the short basket? Are there any particular sectors where you're finding more of these?**

**Mr. Shah:** I wouldn't say we are finding them in one particular industry. One of the names I could highlight is a chicken producer. When we started looking at this company last year, we figured that this was a very commoditized industry where demand and supply is very cyclical. From a demand perspective, there are prices of competing meats that matter. And from a supply perspective, it's an industry with very low barriers to entry.

Our fundamental research work led us to believe that this company was generating abnormal profits, and the market was ascribing a very high-valuation multiple to an already-high profit number when they should do exactly the opposite. When a company is over-earning, you should ascribe a lower multiple. Based on our forecast, we figured that the abnormal profits that this company is generating should normalize within a year or two because demand would normalize, which it did because the prices of competing meats went down. On the supply side, it's not very difficult for producers to increase the supply of chickens given the fragmented nature of the industry. So profits normalized, and that was a good success story for us.

**TWST: To conclude, are there any topics we've missed? Is there anything else you would like investors to know about the fund?**

**Mr. Shah:** From my perspective, I think one of the important aspects that I would like to touch upon is our risk management capabilities. One of the many beneficial aspects of managing this long/short portfolio under the broader Thornburg umbrella are the risk management resources that the organization provides.

First of all, we have a risk committee. Our CIO, Brian McMahon, sits on that committee as well as Global Fixed Income PM Jeff Klingelhofer, who has previous experience working as a risk manager at a large asset manager. We meet at least on a monthly basis to go through our portfolio construction, our portfolio performance and our risk exposures to make sure that we're doing what we tell our investors we are doing. Apart from this meeting, we have a lot of checks in place from a risk management perspective.

In particular, I would like to highlight risk management on the short side because we are very mindful that the downside on a short position is much higher and could be much higher than the upside. For example, we cap our single name exposure on the short side at about half of what we would have on the long side. On the long side, we cap the long position at 10%. So on the short side, a single name exposure cannot be more than 5%. In reality, we hardly ever let it go to about 3%. That's one example of how we try to manage the risk on the short side of the book.

**TWST: Thank you. (VSB)**

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## Thornburg Long/Short Equity Fund
## Total Returns (as of 6/30/18)

| | YTD | 1-YR | 3-YR | 5-YR | 10-YR | SINCE INCEPTION |
|---|---|---|---|---|---|---|
| I Shares (Predecessor Fund Incep: 2/1/08) | 0.97% | 8.34% | 4.33% | 7.74% | 7.79% | 7.17% |
| S&P 500 Index | 2.65% | 14.37% | 11.93% | 13.42% | 10.17% | 9.06% |
| Morningstar Long-Short Equity Category Average | -0.66% | 5.43% | 2.91% | 4.11% | 2.37% | 2.23% |

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. There is no sales charge for class I shares. The total annual fund operating expenses are 3.81%. Thornburg Investment Management and/or Thornburg Securities Corporation have contractually agreed to waive fees and reimburse expenses through at least June 15, 2019, resulting in a net expense ratio of 3.46%. For more detailed information on fund expenses and waivers/reimbursements, please see the fund's prospectus.*

Performance prior to 12/30/2016 is from the predecessor fund, which was managed in a materially equivalent manner to Thornburg Long/Short Equity Fund. The predecessor fund was not a registered mutual fund and was not subject to the same investment restrictions as the Long/Short Equity Fund. If the predecessor fund had been registered under the 1940 Act, the performance may have been different.

Class I shares may not be available to all investors. Minimum investments for the I share class may be higher than those for other classes.

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 views expressed are subject to change and do not necessarily reflect the views of Thornburg Investment Management, Inc. This information should not be relied upon as a recommendation or investment advice and is not intended to predict the performance of any investment or market.

Portfolio attributes and holdings can and do vary.

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.

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The Fund may invest in shares of companies through initial public offerings (IPOs). IPOs have the potential to produce substantial gains and there is no assurance that the Fund will have continued access to profitable IPOs. As Fund assets grow, the impact of IPO investments on performance may decline.

Morningstar Long/Short Equity Category – Long/short portfolios hold sizeable stakes in both long and short positions in equities, exchange traded funds, and related derivatives. At least 75% of the assets are in equity securities or derivatives, and funds in the category will typically have beta values to relevant benchmarks of between 0.3 and 0.8 over a three-year period.

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.

Beta – A measure of market-related risk. Less than one means the portfolio is less volatile than the index, while greater than one indicates more volatility than the index.

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.

Sharpe Ratio – A risk-adjusted measure developed by Nobel Laureate William Sharpe. It is calculated by using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe Ratio, the better the fund's historical risk-adjusted performance. The Geometric Sharpe ratio is calculated for the past three-year period by dividing a fund's annualized excess returns by its annualized standard deviation.

As of 6/30/18 the top 10 positions of the fund were: Gilead Sciences, Inc., 4.4%; US Foods Holding Corp., 4.1%; Comcast Corp., 3.8%; Alkermes plc, 3.7%; Facebook, Inc., 3.7%; Nomad Foods Ltd., 3.7%; Assured Guaranty Ltd., 3.6%; PennyMac Mortgage Investment Trust, 3.1%; Medtronic plc, 3.0%; Alphabet, Inc., 3.0%.

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

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.*