Flexibility and Risk Control

Growth investors have learned their lessons in the past years, according to Alex Motola, manager of Thornburg Core Growth Fund. He doesn't try to time the market or predict which type of stocks will be hot in the future. Instead, he runs a portfolio that is diversified across the growth spectrum and focuses on the fund's core competence – picking stocks based on in-depth fundamental research.

Q: ***What is the investment philosophy of your fund?***

A: Flexibility and risk control are our hallmarks for growth investing. Like most investors, we want to generate good returns over long periods of time, but we don't undertake excess risk. We believe that if we are in the top 40% in our peer group on an annual basis, then on a ten-year basis, we'll be in the top decile.

Flexibility means that we don't look at every stock in the same way and we don't have one rigid process for all stocks. We review a spectrum of stocks, including aggressive growth and reasonably priced stocks and use different analysis and valuation depending on what is most appropriate for the company. We believe that if you have only one way of looking at stocks, you will be less diversified than you want.

Risk control is embedded in our portfolio construction process. We have a portfolio structure that is competitive in any kind of a market environment. We believe that our core competency is picking stocks, both in terms of the upside and in controlling risk, so we try to hedge away the decisions in terms of cap size and type of stocks.

We are a research-driven shop and we believe that, at the end of the day, fundamentals are reflected in the stock price. In the growth world, there is a huge sentiment component that drives stocks in the near term, but we try to capitalize on it by taking advantage of our fundamental knowledge. That's why we focus more on certainty and less on timing.

Q: ***How do you find growth stocks?***

A: Our process is very straightforward. Probably about 70% of our stocks come from screens. We screen on growth rates and margins, return on equity, return on invested capital. Although valuation is central to our approach, we use that as a screening metric only occasionally as it can be misleading. For example, high P/E stocks may have temporarily depressed earnings and be actually pretty cheap, so we prefer to get to valuation in more of a manual process. We use the screening, our intuition and experience to narrow the list down. The other 30% of ideas

Thornburg Core Growth

Fund Facts

Symbol	THCGX
Website	www.thornburg.com
Address	Thornburg Investment Management 119 East Marcy Street Santa Fe, NM 87501
Tel. No.	505-984-0200
Inception	12/26/2000

Portfolio

Total Net Assets *	$ 169.4
Avg Mkt Cap ($ Weighted) *	$ 32,300
Average Price/Earnings Ratio	22.61
Average Price/Book Ratio	2.80
Turnover Ratio	108.5 %

Investment Information

New Investment	Open
Min Initial Investment	$ 5,000
Min Subsequent Investment	$ 100
Min Initial IRA Investment	$ 2,000

Risk (Against S&P 500 - 3 Years)

Alpha	14.12
Beta	0.93
R-Squared	63
Ann Std Deviation	15.46
Sharpe Ratio	1.55

Returns vs. Lipper Multi-Cap Growth Index

	THCGX	Index
1 Year (Cum.)	34.97 %	20.02 %
3 Year (Ann.)	27.43 %	15.03 %
5 Year (Ann.)	---	-9.00 %

Returns vs. S&P 500

	THCGX	Index
1 Year (Cum.)	34.97 %	12.55 %
3 Year (Ann.)	27.43 %	11.99 %
5 Year (Ann.)	---	-2.71 %

Fees and Expenses

Max Sales Charge - Front	4.50 %
Max Sales Charge - Deferred	0.00 %
Max Redemption Fee**	1.00 %
Total Expense Ratio	1.57 %

Portfolio Manager

Alex Motola, CFA	12/26/2000

* *millions*
** *if exchanged within the first 90 days*

Data through: 08/31/05

Source: Company Documents; Lipper

© 2005 123jump.com, Inc. Ticker.com is a publication of 123jump.com. **All rights reserved**. The entire contents of the publication are copyrighted. Reproduction in part or in whole is not permitted without written permission of the publisher. Unauthorized reprints are punishable by fines of up to $50,000. Requests for reprints or permission to copy editorial matter for other purposes, please contact the corporate office at 305-673-6339.

come from prior research, company visits, and industry sources. We are pretty agnostic about where the idea comes from as long as it is a good one.

Q: ***Would you highlight your research process?***

A: We usually start with the SEC findings and build a detailed historical financial model. We use information from the footnotes and any other filings like the proxies, not just the Ks and the Qs. The historic model gives us a detailed understanding of the business model and of the company's reaction to past events. When we talk to the management, most of our questions revolve around why certain decisions were made and how certain events impacted the financials.

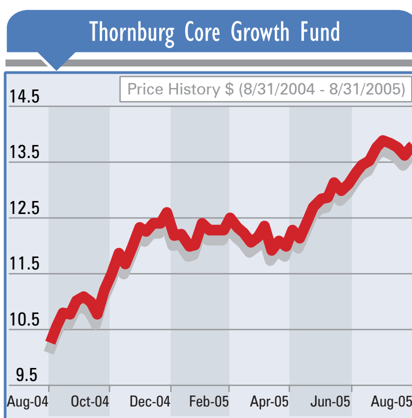
We also build a forward-looking model with the understanding that earnings forecasts are likely to be wrong, but they help us understand the sensitivity, the expectations, and how reasonable they are. A great part of investing is built on expectations and we try to have a clear picture of the aggregate of other investors who are aware of the stock.

We spend a lot of time on the earnings quality and accounting decisions analysis and on evaluating what can go wrong with the company. We actually decompose the Wall Street story because there isn't any structural interest in the investing community to talk negatively about companies and you have to tear a company down to understand what the risks are.

Once we are comfortable with the risks and the business model, we build the opposite case. To profitably invest in a company and make excess return, we need to have a more positive view than the usually optimistic Wall Street scenario. If we can't understand how the future is going to be brighter, then we don't have an investment opportunity.

We make decisions on a collaborative basis, not on a vertical reporting basis. With only 36 stocks in the portfolio, we are able to know our investments really well, not only me but also the people that I work most closely with. In the mutual fund industry, usually the analysts are experts in a specific industry, but the portfolio manager knows nothing about the details. In our fund, we want to use our collective heads, to eliminate analyst bias and just understand the company. This approach also enables us to substitute for each another if urgent decisions need to be made.

Since we run a concentrated portfolio of 36 stocks, we know we are going to have high standard deviation of returns. But we believe that knowing the companies better, helps to react better in a volatile world and is a way of controlling risk. The volatility in the market can be your friend as you can capitalize on the fundamental knowledge.



Q: ***What is your approach to portfolio construction?***

A: We have three baskets of stocks, each of them representing about one-third of the portfolio. The baskets help control risk and ensure that we have stocks that are participating in whatever market we are in. The first basket is comprised of growth industry leaders, which are larger companies that are leaders in their market or niche or are taking share. These stocks tend to be bigger, less volatile and do very well when the market is going up and not too bad when the market is going down.

The second basket represents consistent growth companies, which tend to have predictable or recurrent revenue models. They usually are well-diversified companies that are not exposed to any one product or customer at any time. These stocks tend to do well when the market is going up and relatively better when the market is going down. These are the quality names that people want when they are worried about the market, but still want to be invested on the growth side.

The companies in the third basket are emerging growth companies. Typically, they are growing faster and have some type of advantage, a technology, management or execution advantage. These companies experience high growth rates, they are bit riskier and we tend to buy relatively small percentage of them.

We are also a multi-cap fund. We have between 25% to 40% of the stocks in each capitalization bracket. We don't know which market-cap range is going to perform better or worse over the next 3 months, 2 year, or 10 years, and that is why we are invested in each category.

The idea of the basket portfolio structure is to benefit from a specific market trend and to control the risk at the same time. For example, in 2000 and 2001 the market was a very tough place to be and the consistent growth basket helped us generate outperformance relative to the peers and the benchmarks.

If one basket reaches 40% of the portfolio, most probably some of the stocks will hit their price targets. Then we sell some of the stocks to reinvest the money in the lower-weighted basket. The same applies for the capitalization ranges. In a way, we are actively re-balancing the portfolio in the areas that have underperfomed the market, which works very well for us.

Q: ***Can you give us some examples of each of these types of companies?***

A: Growth industry leaders include companies like Gilead Sciences, which is a dominant HIV biotech company, or Chicago Mercantile Exchange Holdings.

The consistent growth basket includes companies like DirectTV, which

© 2005 123jump.com, Inc. Ticker.com is a publication of 123jump.com. **All rights reserved**. The entire contents of the publication are copyrighted.
Reproduction in part or in whole is not permitted without written permission of the publisher. Unauthorized reprints are punishable by fines of up to $50,000.
Requests for reprints or permission to copy editorial matter for other purposes, please contact the corporate office at 305-673-6339.

has 13-14 million subscribers, each writing a check of $50 per month. It is a very predictable business - people do not usually terminate their broadcast TV, they only occasionally switch from provider to provider. DirectTV is getting more subscribers than all other satellite and cable providers together. Another very predictable business is FedEx. They handle more than 2 million packages per day; it's a very high volume business encompassing the globe. If some customers leave them for DHL or UPS, it wouldn't have a great impact.

In the emerging growth basket, there is a broad range of companies – from Imax, which does the big screen theaters to Sportingbet PLC, which is a London-based bookmaking and online gaming service.

Q: *How do you handle the stock-specific risk?*

A: We model a GAAP and a pro forma income statement, which is reflective of how Wall Street arrives at their numbers. We have our own pro forma, which reflects our analysis and shows the earning power of the company. Often our analysis of the earnings quality, together with the analysis of the balance sheet and the cash flow, will raise certain flags in advance. For example, if are worried that a company is selling a lot of its products into the distribution channel but recognizes it as revenue to make a quarter, we know that accounts receivable will rise relative to sales.

We try to be proactive and sell stocks ahead of earnings disappointments. When we are right, we may sell early by a quarter or two. The growth stocks come with high expectations and when they miss the earnings expectations, they may go down by 20% or 30%. Our average position size is about 3%, and a 30-percent drop in one stock will decrease total return by 90 basis points, which we want to avoid. We spend a lot of time trying to eliminate the blow-up side of the equation and to figure out the upside at the same time, because the winners are those that generate benchmark and peer outperformance.

We are usually pretty confident on a stock selection, but the timing issue is a lot more difficult. We still think that Comcast is a great company to own, even though we've lost 3% in that investment over the two and half years. Our fundamental thesis continues to track what we expect. Eventually, we'll be right on keeping it, but it has been a long time waiting.

> "We believe that knowing the companies better helps us to make better decisions in a volatile world and is a great way of controlling risk. The volatility in the market can be your friend as you can capitalize on your fundamental knowledge."

about Alex Motola

Alex Motola joined Thornburg Investment Management in 2000 as a Managing Director and Portfolio Manager of the Thornburg Core Growth Fund. He holds B.A.s in English, History and Medieval Studies and graduated with Honors and Distinction from the University of California, Santa Barbara. He also holds an MBA from the Haas School of Business, University of California at Berkeley. Alex began his financial career as an Investment Specialist with CoreLink Financial and later served as a Portfolio Manager with Insight Capital.

Alex has earned the Chartered Financial Analyst® designation and is a member of CFA Institute. Alex is directly responsible for the Thornburg Core Growth Fund, which he has managed since inception.

Q: *Do you set price targets on the stocks you own?*

A: We use price targets in two ways. First, companies with more finite opportunities may be a great investment, but may not be long-term winners. For example, a local community bank that is growing its earnings at 10% or 15% may be an attractive investment, but it is not going to become Citigroup. You may be able to capture a move with that bank from $10 to $22, but it is not going to $500. So at $22, we are happy to be a seller.

With other stocks, like Gilead Sciences, the dominant HIV franchise, we know that from time to time the stock is going to be expensive. But if we are confident on the fundamentals, we compensate for the high valuation by trimming back at price target and maintaining exposure to the position. If it trades down, we'll take the opportunity to buy more stock. It is an example of how volatility can be a friend if you are confident on the fundamental work.

Cisco, which we don't own, returned 85,000% in the decade of the 90's. The stock had an average P/E of 80, which I would consider pretty high. But if you sold Cisco the first time it got expensive, you would leave great return on the table. If we find the biggest winner of our time, we don't want to sell it when it get expensive. We want to trim it and buy more when it comes down.

The reality of running a mutual fund is that you cannot make 85,000% on Cisco because if you capture that much return, by the end of the decade Cisco will represent 99% of your portfolio. People buy mutual funds because they want measured diversification and our position size is typically 2% to 4%. ▮

TICKER Staff

© 2005 123jump.com, Inc. Ticker.com is a publication of 123jump.com. **All rights reserved**. The entire contents of the publication are copyrighted. Reproduction in part or in whole is not permitted without written permission of the publisher. Unauthorized reprints are punishable by fines of up to $50,000. Requests for reprints or permission to copy editorial matter for other purposes, please contact the corporate office at 305-673-6339.