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FUNDMANAGERPROFILE

Not How, But How Much

Thornburg Investment Income Builder seeks out income everywhere. By Ilana Polyak



DIVIDEND-PAYING STOCKS ARE USUALLY a good bet. Securities in the S&P 500 that consistently initiated or boosted dividends gained 10.4% on average since 1972; those that didn't returned 8.2%,

according to Ned David Research.

Today, however, one after another, companies have cut or suspended their dividends—particularly those in the financial services sector. That sector alone accounted for 30% of dividends paid out in the S&P a year ago. In the first quarter of 2009, S&P reports, 367 companies cut or eliminated dividends, 342% more than in the first quarter of 2008. It's the first time that cuts outpaced increases since S&P began tracking the data in 1955.

For a fund whose strategy is finding securities with rising income streams, like the \$2.6 billion Thornburg Investment Income Builder, this has been a big blow. For the year ended May 11, the fund is down 26%, in the bottom 46% of world allocation funds tracked by Morningstar. Things look slightly better longer term. For the three-year period the fund is off an annualized 3.3%, putting it in the top 39% of the category; over five years it's up an annualized 5.7% and in the upper

29%. Over the past 12 months the fund generated a 7.5% income stream.

CASTING A WIDE NET

As difficult as the recent market has been for

BRIAN MCMAHON

*Thornburg Investment
Income Builder*

Age: 53

Credentials: B.A. in economics and Russian studies, U. of Va.; MBA, Dartmouth

Experience: chief executive officer and chief investment officer, Thornburg Investment Management (2008-present); portfolio manager, Thornburg Investment Management (1984-present); vice president, corporate finance, Northwest Bank (1979-1984).

Ticker: TIBAX

Inception of fund: December 2002

Style: World Allocation

Assets under management: \$2.6 billion

Three- and five-year performance as of May 22, 2009: -3.3%, 5.7%

Expense ratio: 1.25%

Front load: 4.5%

Minimum investment: \$5,000

Alpha: 0.51% vs. Dow Jones Moderate Portfolio

dividend payers, managers Brian McMahon and Jason Brady were able to take advantage of the fund's flexible strategy to find income in other places. Today, just 55% of the portfolio is in dividend-paying stocks, a far cry from the 85% that the fund held a year ago. The remainder is in corporate, government, municipal and international bonds and preferred stocks—just about anywhere income can be found.

"Our shareholders want income," says Brady, who is responsible for the fund's fixed-income portion, while McMahon oversees the stocks. "We search across the globe, looking for fixed-income securities and dividend-paying equities to create a portfolio with the potential to grow income over time."

So Brady and McMahon shifted their attention to fixed income. "There's gobs of income right now like we've never seen in the bond sector and even in some preferreds, which is fortunate because the income in large chunks of dividend-paying stocks has dried up," Brady says.

Beginning last fall, when Lehman Brothers dumped billions of dollars of its securities in order to liquidate, Thornburg loaded up on non-stock fare. "For the market to absorb that kind of volume, something had to give and that was prices," McMahon says.

Bonds were too cheap to pass up. The fund owns so-called perpetual bonds issued by reinsurer Swiss Re. (They do not have a maturity date.) The prices on the bonds had fallen so much in late 2008 that they were yielding 20%. "If nothing moves, we make 20%, so they're

attractive on an income basis,” Brady says. “But the price may rise, so they’re attractive on a total return basis too.”

Similarly, the team added bonds issued by Deutsche Telecom, the German wireless company, to the portfolio. “In scary financial times, companies like these turn to financial support from their governments,” Brady says.

What’s more, the bonds were had for a 10% yield. “We will take that 10% yield and provide it to our shareholders for a long period of time, maybe over the next 10 to 15 years,” he adds. The finds were so good that Thornburg Investment Income Builder was able to increase its own dividend to fund shareholders to \$1.02 in 2008 from the 91 cents it paid in 2007. “I would never suggest that we can continue to increase it at the rate we were able to increase it last year,” McMahon says. “That was unusual.”

MAKING THE CUT

To be sure, Thornburg Investment Income Builder still likes dividend paying stocks. They think it’s a smart move for management to share its profits with shareholders rather than be tempted into ill-advised mergers. After drug maker Pfizer moved to

buy Wyeth in January for \$68 billion in cash and stock, it announced a dividend cut shortly afterward. “If people have capital discipline, that’s a better indicator of good executive and boardroom behavior than holding retained earnings,” McMahon says.

The companies that are good dividend payers and raise their payouts over time also tend to be highly focused on their business segment. Consider how diffuse Citigroup had become under ex-CEO Sanford Weill before it was split up into separate banking and investment units earlier this year. Citi was one of the first of the big banks to slash its dividend when it did so in January 2008.

One stock the managers like is Eli Lilly. It’s down 9.7% in 2009 through May 11 due to concerns about its impending patent expirations. But McMahon and Brady think Lilly’s pipeline is healthy enough to replace old drugs such as its antipsychotic Zyprexa, which will come off patent in 2011. In the meantime, the company posts impressive growth numbers. For the first quarter, Lilly’s sales rose 3% and profits were up 36%. And the stock’s valuation looks impressive with a

price-earnings ratio of just eight times 2010 earnings.

INTERNATIONAL NAMES

Another recent performance detractor is the fund’s global holdings. Thornburg’s non-U.S. holdings range from one-third to half the portfolio’s assets, most of which are equities. Despite global stocks’ poor performance, the managers believe overseas dividends hold appeal. “I don’t know why Nestlé or Unilever pays a better dividend than General Mills,” says McMahon. “They just do.”

For that reason, the team likes Telefonica, Spain’s top telecom provider and the third largest in the world. The stock is down 5.1% in 2009 due to Spain’s double-digit unemployment and generally weak economy. “Telefonica is doing better than anyone else in Spain, and they’re doing reasonably well in the rest of Western Europe—like the U.K., Germany and the Czech Republic,” McMahon says. And its 5.1% dividend will boost the stock’s total return when the economy rebounds. **FP**

Ilana Polyak is a frequent contributor to Financial Planning.

Thornburg Investment Income Builder Fund Total Returns, Class A

	As of 3/31/09				
	YTD*	Since 12/24/02			
	As of 5/31/09	1-Yr	3-Yr	5-Yr	Inception
Without sales charge	10.50%	-34.40%	-6.93%	1.57%	6.42%
With sales charge	5.50%	-37.36%	-8.35%	0.64%	5.64%
Blended Index	5.80%	-32.96%	-8.92%	-1.40%	2.89%
S&P 500 Index	2.96%	-38.09%	-13.06%	-4.76%	0.18%

* Not annualized for periods less 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 www.thornburg.com/iib. Class A shares carry a maximum sales charge of 4.5% and a 30-day redemption fee of 1%. The total annual operating expense ratio of class A shares is 1.31%, as quoted in the most recent prospectus.

Thornburg Investment Income Builder Fund 30-day SEC Yield as of 3/31/09: 8.09%. Yields quoted in the article are as of 12/31/08.

Morningstar rankings for Thornburg Investment Income Builder Fund – 1-yr: 49% out of 207 funds; 3-yr: 35% out of 133 funds; 5-yr: 22% out of 98 funds. Based on total returns before sales charge, as of 5/31/09.

Investments in the Fund carry risks including possible loss of principal. Investing outside the United States involves additional risks, such as currency fluctuations. Additionally, the Fund invests a portion of the assets in small capitalization companies, which may increase the risk of greater price fluctuations. As with direct bond ownership, funds that invest in bonds are subject to certain risks including interest-rate risk, credit risk, and inflation risk. The principal value of bonds will fluctuate relative to changes in interest rates, decreasing when interest rates rise. Investments in the Fund are not FDIC insured, nor are they deposits of or guaranteed by a bank or any other entity.

The views expressed by the portfolio managers reflect their professional opinions and are subject to change. Securities mentioned are presented to illustrate companies in which the Fund has invested. Portfolio holdings are subject to change daily. Under no circumstances does the information contained within represent a recommendation to buy or sell securities.

Alpha – A measure of the difference between a fund’s actual returns and its expected performance, given its level of risk as measured by beta. A positive alpha figure indicates the fund performed better than its beta would predict.

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

The Dow Jones Moderate Portfolio (DJ 60%) is one the Dow Jones Relative Risk Indexes, which are designed to systematically measure various levels of risk relative to the risk of a global all-stock index. The DJ Moderate Portfolio is comprised of multiple subindexes representing a portfolio with target of 60% equity securities and 40% bonds/cash (rebalanced monthly).

The performance of an 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.

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2300 North Ridgeway Road
Santa Fe, NM 87506
800-847-0200
www.thornburg.com

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