

BEST MUTUAL FUNDS 2019

Loomis Sayles Growth Fund Tops Market Repeatedly; Here's Its Keys

FUND MANAGER Q&A

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INVESTOR'S BUSINESS DAILY

Do you dream of putting your money to work in a mutual fund that outperforms the broad stock market with relaxing regularity? Then consider one of the best mutual funds, \$8.7 billion Loomis Sayles Growth Fund^{LSGRX}.

The fund, with Aziz Hamzaogullari at the helm for nearly nine years, topped the S&P 500 in calendar 2018. It also beat the broad-market bogey on an average-annual-return basis for the three, five and 10 years ended Dec. 31.

How does Hamzaogullari do it? He seeks stocks whose earnings growth is not only high but also shows the endurance of the Energizer Bunny. And he aims for stocks whose upside potential dwarfs their downside risk. Oh, and he does not want to pay a hefty price for his stocks.

One more thing: Hamzaogullari's strategy requires lots of patience.

Of course, many fund managers talk that talk. Hamzaogullari, who is about to turn 50 years of age, spoke with IBD from his Boston office about how he walks the walk — how he executes on a strategy that keeps his portfolio among the best mutual funds industrywide.

IBD: How does this fund differ from other growth stock mutual funds?



Gretchen Ertl/IBD

Loomis Sayles Growth Fund's Aziz Hamzaogullari sticks with stocks he likes. He's owned Amazon since 2006.

Hamzaogullari: The biggest difference comes down to time horizon. We invest in businesses rather than trade stocks. (Stock mutual funds average 107% annual portfolio turnover, says Morningstar Inc.) Since inception, we have been about 10%.

IBD: So your strategy requires patience?

Hamzaogullari: Look at Amazon^{AMZN}. We originally invested in it in 2006 in our institutional strategies. We've owned it since then. More than 6,500 active funds owned Amazon for some period from July 1, 2006, through June 30,

2018. But only about 1.3% of them held Amazon the entire period like we did. And our median position was seven times larger than the median position of those 1.3%.

IBD: Why is a long time horizon important for investors looking for the best mutual funds?

Hamzaogullari: When you combine a longtime horizon and position size, those become key differentiators. Trading in and out of a stock is actually detrimental to your returns. That's because it shows overconfidence in your ability to maneuver around short-

term volatility.

IBD: In other words, even pros tend to buy higher than they want and sell lower than they wish?

Hamzaogullari: Yes. We owned Amazon, Visa^V, Google (and its parent Alphabet^{GOOGL}), Facebook^{FB} and Oracle^{ORCL} for long periods. Compare our results to people who traded in and out. We got better results owning them for long periods.

IBD: Of course, that only works with certain companies, right?

Hamzaogullari: Of course. You still need to invest in businesses that are high quality

— meaning that are durable franchises, with sustainable growth — and that are trading at a significant discount to their intrinsic value.

IBD: How much of a discount?

Hamzaogullari: We look not only at its discount to value, which shows upside potential, but also its downside, which shows reward to risk.

Our ratio has to be at least 2-to-1 and ideally 3-to-1. Typically, the discount to intrinsic value we look at is 35% to 50%. And the reward-to-risk ratio helps determine our position size.

We sell when a company reaches our estimate of intrinsic value. Or we sell when we find a better risk-reward opportunity. We also sell when we conclude there is a structural problem, causing a permanent change in the value of the business.

IBD: And you also have a fairly concentrated portfolio.

Hamzaogullari: Historically, we have around 33 companies. From 2013 to 2016, we bought between one to three companies a year. In 2017 we didn't initiate any new positions. Last year we initiated only two positions. So far this year we have only one new position.

IBD: Alibaba's ^{BABA} earnings growth has slowed due to increased spending. Still, its share price has rallied so far this year. Are you comfortable with the earnings growth slowdown?

Hamzaogullari: Operating margins continue to be pressured by ongoing investments in four strategic areas, including local services through recently acquired delivery company Ele.me, globalization, "new retail," and the consolidation of lower-margin logistics affiliate Cainiao.

We believe these investments are consistent with Alibaba's long-term strategy to strengthen and extend its competitive positioning across commerce, advertising, and cloud computing, while expanding its addressable market both internationally and through its "new retail"



Gretchen Ertl/IBD

Facebook has dodged any big damage from its privacy practices, says Loomis Sayles' Aziz Hamzaogullari.

initiative. The company benefits from secular growth in China e-commerce, as well as advertising growth, digitizing offline retail, cloud computing, and international expansion. We believe the current market price embeds expectations for key revenue and cash flow growth drivers for Alibaba that are well below our long-term assumptions.

IBD: Why have you trimmed your share count in some recent quarters?

Hamzaogullari: We have been trimming to manage maximum position size only per fund guidelines. It does not reflect any change of view on our valuation of Amazon.

IBD: And that remains positive?

Hamzaogullari: The company has significant competitive advantages. In e-commerce, it has breadth, scale, network advantage, a technology, logistics and a distribution system. Scale of course lets them offer lower prices.

We are still in the early stages of the shift from brick-and-mortar to e-tail. It is dominant in e-commerce, and over the next decade e-commerce can

exceed 20% of the global retail market vs. 9% today.

In AWS (which is Amazon's on-demand delivery of computer power, database storage, applications, and other IT resources through the cloud, or the internet, instead of customers' in-house computers), it has breadth, a technology platform and economies of massive scale. We believe AWS can grow almost 20% annually over the next decade. And e-commerce has higher margins than Amazon's e-commerce business.

Both of its ecosystems are growing. Both are growing faster than their underlying markets.

Lastly, there's Amazon's expansion into new categories and geographies.

The embedded expectations in Amazon's stock price show a lack of appreciation for its long-term growth opportunities and sustainability. So it sells at a big discount to its intrinsic value.

IBD: Looks like you made a big addition to your Starbucks^{SBUX} stake last year ahead of the stock's 20% jump this year. Why did you add shares?

Hamzaogullari: It was one of

two companies we purchased last year. It was in the first quarter.

It's high quality because of its brand, scale, culture and digital engagement with consumers through its rewards program. And we believe the combination of away-from-home coffee consumption growth, pricing power, premium-ization (move toward more expensive products), loyalty program and opportunities to expand food sales will enable Starbucks to generate mid-single-digit U.S. store sales growth.

China is another important component. It's their second-largest market and can become the largest over the long term. Per capita coffee consumption can grow in the mid- to high teens as young, urban consumers grow as a percentage of China's consumer pool.

With over 3,000 stores today, the number of China stores can reach 10,000 in the next decade.

With all of those factors, Starbucks trades at a big discount to our estimate of their intrinsic value. It's a compelling risk-reward opportunity.

IBD: Why do you prefer Visa over Mastercard^{MA}?

Hamzaogullari: A trusted brand is very important to users of electronic payments and services. And Visa has one of the most recognizable brands, which took decades and a significant investment to build.

Its client relationships also create a substantial barrier to entry for competitors. Visa has over 16,000 card-issuing banks, 3.3 billion cards outstanding and the card is accepted by over 54 million merchants worldwide.

More than three-quarters of partner banks have been customers over 10 years and have typically signed long-term, five- to seven-year contracts.

The virtuous cycle among banks, cardholders and merchants creates a powerful network effect. Each part makes the whole more attractive

to individuals in other parts. Its scale provides large cost advantages. It's very difficult for competitors to replace those advantages.

The shift to electronic payments is a big growth driver. Visa captures about 60% of global electronic payments by dollar volume outside of China, where it does not currently operate. Representing only 17% of global personal consumption expenditures (PCE), we believe Visa's growth opportunities remain very large.

IBD: So far, complaints about privacy policies have rolled off Facebook's back without causing meaningful harm. What's your assessment?

Hamzaogullari: You're right about the privacy controversy. We see more growth. Its

active users represent about 50% of the world's internet user population. Excluding China, it's about 75%.

It has a powerful network effect. Margins and cash flow generation are strong, sufficient to finance future growth. The shift to online advertising is a large driver.

Facebook has about 5% of global advertising, about 22% of global online advertising. Its brand, its network will drive revenue and cash flow growth to a global market share of 10% of the total advertising market from today's 5%.

IBD: Is Oracle successfully shifting from a legacy business model to a new, cloud-based one?

Hamzaogullari: Yes. While Oracle remains the world

leader in its largest segment — enterprise database software used in customers' on-premise IT environments — the company continues to transition to a cloud computing, subscription-based revenue model.

While there is near-term pressure on year-over-year revenue comparisons as software license revenue shifts to subscription revenue, we expect this to lead to faster growth over time due to higher customer lifetime value.

Because market expectations for key variables such as revenue and cash flow growth are well below our estimates, shares are trading at a significant discount to our estimate of intrinsic value. That offers a great reward-to-risk opportunity.

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Loomis Sayles Growth Fund: Equity securities are volatile and can decline significantly in response to broad market and economic conditions. **Foreign and emerging market securities** may be subject to greater political, economic, environmental, credit, currency and information risks. Foreign securities may be subject to higher volatility than US securities, due to varying degrees of regulation and limited liquidity. These risks are magnified in emerging markets. Investments in **small and midsize companies** can be more volatile than those of larger companies. **Growth stocks** may be more sensitive to market conditions than other equities, as their prices strongly reflect future expectations. **Currency** exchange rates between the US dollar and foreign currencies may cause the value of the Fund's investments to decline.

Average Annual Total Returns (%) as of 9/30/19[†]	YTD	1 Year	3 Years	5 Years	10 Years
Loomis Sayles Growth Fund Class A at NAV	19.82	5.81	13.78	13.48	14.91
Loomis Sayles Growth Fund Class A with 5.75% maximum sales charge	12.90	-0.28	11.55	12.13	14.24
Loomis Sayles Growth Fund Class Y	20.07	6.09	14.06	13.75	15.19
Russell 1000 [®] Growth Index ¹	23.30	3.71	16.89	13.39	14.94

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Loomis Sayles Growth Fund Gross expense ratio 0.90% (Class A share) / 0.65% (Class Y share). Net expense ratio 0.90% (Class A share) / 0.65% (Class Y share). As of the most recent prospectus, the investment advisor has contractually agreed to waive fees and/or reimburse expenses (with certain exceptions) once the expense cap of the fund has been exceeded. This arrangement is set to expire on 1/31/20. When an expense cap has not been exceeded, the gross and net expense ratios may be the same.

¹ **Russell 1000[®] Growth Index** measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000[®] Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000[®] represents approximately 92% of the US market. The Russell 1000[®] Index is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are reflected.

IBD's Best Mutual Funds 2019 Awards spotlights funds that beat their benchmark indexes over the past one, three, five and 10 years. All returns as of December 31, 2018. The summary list of award winners highlights the top five funds in each of 13 categories and subcategories. To be eligible for IBD's Best Mutual Funds 2019 Awards, funds in all categories must have at least \$100 million in assets and a track record of at least 10 years. Among US diversified stock mutual funds, 111 earned Best Mutual Funds Awards, meaning just 10% of the 1,087 eligible funds outperformed the S&P 500 in all four time frames measured.

Loomis Sayles Growth Fund – Top 10 Holdings as of 9/30/19

Security	% of Net Assets
Visa, Inc.	6.75
Amazon.com Inc.	6.14
Facebook, Inc.	5.42
Oracle Corp.	4.97
Alibaba Group Holding Ltd.	4.89

Security	% of Net Assets
Microsoft Corp.	3.99
Autodesk, Inc.	3.92
Procter & Gamble Co/The	3.53
Monster Beverage Corp	3.44
Qualcomm, Inc.	3.25

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