

# Global Growth Fund

## FUND FACTS

### OBJECTIVE

Seeks to produce long-term growth of capital

Share class	Y
Inception	3/31/2016
Ticker	LSGX
CUSIP	63872T224

## Portfolio Review

- The fund outperformed its benchmark, the MSCI ACWI Net Index, largely due to stock selection in the information technology, consumer discretionary, consumer staples, industrials, financials and healthcare sectors as well as our allocation to the energy and consumer discretionary sectors. Stock selection in the communication services and energy sectors as well as our allocation to the financials and consumer staples sectors detracted from relative performance.
- The fund is an actively managed strategy with a long-term, private equity approach to investing. Through our proprietary bottom-up research framework, we look to invest in those few high-quality businesses with sustainable competitive advantages and profitable growth when they trade at a significant discount to intrinsic value (our estimate of the true worth of a business, which we define as the present value of all expected future net cash flows to the company).
- All aspects of our quality-growth-valuation investment thesis must be present for us to make an investment. Often our research is completed well in advance of the opportunity to invest. We are patient investors and maintain coverage of high-quality businesses in order to take advantage of meaningful price dislocations if and when they occur. During the quarter, Novartis completed a spinoff of its Alcon eye care division to shareholders. As a result of our ownership of Novartis, we received an approximately 26 basis point allocation in Alcon, Inc., which trades on both the New York and Swiss stock exchanges. We also

### CLASS Y PERFORMANCE AS OF JUNE 30, 2019 (%)

	CUMULATIVE TOTAL RETURN		AVERAGE ANNUALIZED RETURN			
	3 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	SINCE INCEPTION
<b>FUND</b>	5.34	24.13	13.40	16.07	--	16.04
<b>BENCHMARK</b>	3.61	16.23	5.74	11.62	--	11.02

**Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results. Investment return and value will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For most recent month-end performance, visit [www.loomissayles.com](http://www.loomissayles.com).**

Additional share classes may be available for eligible investors. Performance will vary based on the share class. Performance for periods less than one year is cumulative, not annualized. Returns reflect changes in share price and reinvestment of dividends and capital gains, if any. You may not invest directly in an index.

Gross expense ratio 1.32% (Class Y). Net expense ratio 1.00%. As of the most recent prospectus, the investment advisor has contractually agreed to waive fees and/or reimburse expenses once the expense cap of the fund has been exceeded. This arrangement is set to expire on 3/31/2021. When an expense cap has not been exceeded, the fund may have similar expense ratios.

The Class Y inception date is 3/31/2016. Class Y shares are sold to eligible investors without a sales charge; other Classes are available for purchase.

**TOP TEN EQUITY HOLDINGS (%)**

Amazon.com Inc	6.3
MercadoLibre Inc	5.6
Facebook Inc.	5.0
Alibaba Group Holding Ltd	4.9
Visa Inc	4.8
Oracle Corp	4.7
Roche Holding AG	4.0
Yum China Holdings Inc	4.0
Alphabet Inc	3.7
Deere & Co	3.7
<b>Total</b>	<b>46.6</b>

*Data is based on total gross assets before any fees are paid; any cash held is included. The portfolio is actively managed and holdings are subject to change. References to specific securities or industries should not be considered a recommendation. Holdings may combine more than one security from the same issuer and related depository receipts. Portfolio weight calculations include accrued interest. For current holdings, please visit our website.*

added to our existing positions in Ambev, Baidu, Schlumberger and Tencent as near-term price weaknesses created more attractive reward-to-risk opportunities. We trimmed our position in MercadoLibre as it approached our maximum allowable position size.<sup>1</sup>

## Contributors

- The largest online commerce platform in Latin America and a fund holding since inception, **MercadoLibre** was among the largest contributors to performance during the quarter. The company reported above-expectations quarterly results that demonstrated strong revenue growth and accelerating market share gains. While operating margins continue to be impacted by elevated investments and a 2018 change in revenue recognition standards related to the company's free shipping initiative, the investments in logistics have yielded substantial benefits in delivery time, and the company reported positive operating income for the first time in five quarters and earnings per share (EPS) that was well above consensus expectations.

MercadoLibre's competitive advantages include its network and ecosystem, brand, and understanding of local markets. The company operates in 18 countries representing over 95% of Latin American GDP, and its 267 million registered buyers as of December 31, 2018 represented approximately two-thirds of the region's 400 million internet users. The company's brand and understanding of local-market challenges have contributed to its leadership position in each market it serves. With continued growth in internet access, increasing availability of credit, and the company's continuing investments to improve the ease and convenience of transacting online, we believe MercadoLibre is well positioned for sustained growth over the next decade, driven by the secular growth of e-commerce in Latin America.

Gross revenue of \$548 million grew by over 60% year over year in constant currency – the 20th consecutive quarter in which growth exceeded 60%. The services provided by MercadoLibre generally fall into two distinct revenue streams. "Marketplace" includes MercadoLibre's core e-commerce business and accounts for around 60% of gross revenue. "Non-marketplace" accounts for around 40% of gross revenue and includes items such as financing fees, off-platform payment fees, and ad sales. Gross Marketplace revenue of \$327 million rose 29% year over year on a reported basis and by a greater amount in constant currency. Total gross merchandise volume (GMV) of \$3.1 billion rose 27% year over year on a constant currency basis. Unit volume sales, which remove the impact of currency and inflation, rose 3% year over year, impacted by the imposition of shipping charges in Brazil, the company's largest market which accounted for approximately two-thirds of gross revenue. In response to significantly higher postal costs, the company recently imposed a flat fee of R\$5 on items under R\$120 and restricted the sale of items under R\$6 to improve its unit-level economics in Brazil. Despite a resulting 15% decline in Brazilian units sold, Brazil GMV grew 18% in constant currency, well above the rate of growth in Brazil e-commerce. Firm wide, the company continues to focus on expanding its product categories and deepening its selection. Live listings increased 50% to 201 million in the quarter, demonstrating the breadth of offerings available through the company's marketplaces. Non-marketplace revenue of \$221 million grew 22% on a reported basis and 65% in constant currency, driven by payment processing, ad sales, and other ancillary offerings. Total platform payment volumes settled through MercadoPago reached \$5.6

<sup>1</sup>Quarter-to-date transactions as of June 30, 2019.

billion and rose 83% year over year. Off-platform payment volumes rose 194% and accounted for approximately 45% of total payment volumes, benefitting from 260% growth in mobile point-of-sale (POS) volumes.

We believe MercadoLibre continues to have an attractive financial model which is being impacted by an elevated investment cycle intended to strengthen the company's ecosystem and long-term competitive positioning. Operating margins of approximately 2% rebounded from -9% in the prior-year quarter. Margins received a positive benefit from operating leverage as sales and marketing, product development, and general and administrative expenses each grew more slowly than revenues. Management has demonstrated its long-term focus and commitment to investing everywhere needed to add value for users, including greater selection, frictionless payment options, and reduced cost and increased speed of delivery. During the quarter the company reported that it had raised \$2 billion of equity capital, including a \$750 million investment from PayPal, to improve its balance sheet flexibility. The capital is expected to fund ongoing growth in payments, logistics capabilities, and other general corporate purposes. While the increased investments have pressured near-term profits, management remains focused on balancing the investments needed to further improve user experience and extend the company's leadership in ecommerce and payments with maintaining a sustainable and profitable financial model. We believe the current market price embeds expectations for revenue and cash flow growth that are well below our long-term assumptions. As a result, we believe the shares trade at a significant discount to our estimate of intrinsic value and represent a compelling reward-to-risk opportunity.

- A fund holding since inception, **Qualcomm** designs, manufactures, and markets digital telecommunication integrated circuits (chipsets) and services. The company is the global market share leader in 3G and 4G integrated circuits and the leading contributor to 5G global cellular connectivity standards through its extensive portfolio of intellectual property (IP). The QTL segment (Qualcomm Technology Licensing) collects license fees from manufacturers for the right to use Qualcomm's IP, which is essential to or useful in the manufacturing of cellular wireless devices, as well as follow-on royalty fees on the worldwide sale of mobile devices and other devices that incorporate cellular connectivity. This highly profitable segment historically accounted for approximately 20% of revenues and 80% of operating profits. The QCT segment (Qualcomm CMDA Technologies) is a leading manufacturer and supplier of chipsets enabling cellular communication, particularly in mobile devices. QCT collects revenue from the sale of its chipsets to device manufacturers, historically representing approximately 80% of revenues and 20% of operating profits.

Qualcomm shares rose sharply in response to news that Qualcomm had entered a new licensing agreement with Apple, and that the two companies were ending all related litigation worldwide. The agreement ends a two-year dispute in which Apple had challenged the validity of Qualcomm's licensing model and instructed its contract manufacturers to withhold billions of dollars in royalty payments owed to Qualcomm. Under the agreement, Apple will make back payments for the royalties withheld over the past two years, and entered a six-year patent licensing agreement with an option to extend the agreement a further two years. Apple also agreed to make QCT its supplier of chipsets for the next few years, as Intel, Apple's only supplier, announced that it was exiting the business. Intel's decision to exit the smartphone modem business not only removes a potentially

viable competitor, but also illustrates the difficulty companies face in competing with Qualcomm's decades of cumulative knowledge and IP. While the agreement removes a great deal of uncertainty for Qualcomm and provides further opportunity for the company's chipset business, in May, Qualcomm received a negative ruling in a two-year-old anti-trust lawsuit filed by the US Federal Trade Commission (FTC). The FTC case alleged that Qualcomm used its dominant chipset position to force customers to sign unreasonable license contracts with excessive royalty rates. The ruling provides that Qualcomm may not restrict the sale of its chips to mobile OEMs (original equipment manufacturers) that do not currently license its patents, and that it must offer its standard essential patents (SEP) to other modem manufacturers. The company is seeking a stay of the ruling and an expedited appeal to the U.S. Court of Appeals for the 9th Circuit. While the ruling is negative for the company and holds the potential that Qualcomm could be required to renegotiate its existing contracts and accept lower royalty rates, our investment thesis remains unchanged. We believe proactive changes to Qualcomm's licensing model in the past year that mirror the model recently validated by Chinese regulatory authorities may have addressed many of the critical requirements of the ruling. Further, with Intel's recently announced exit from the market leaving no other US chipset provider and few credible global competitors to Qualcomm, we believe it is less likely that the existing model will be discarded.

As we have previously observed, challenges to Qualcomm's business model and royalty rates by regulators and customers are not new, and the company has successfully defended its business model numerous times over the last 10 to 20 years. The industry-standard business model for mobile OEMs has been in place for decades and withstood much scrutiny and many challenges. The model is that innovators are fairly compensated for their contribution to the evolution of cellular technology via patent royalty rates that are based on the value of the total device, not the value of the communication chipset itself. Qualcomm has demonstrated that a material amount of the perceived value of a mobile device is due to the capability of the cellular connectivity, as distinct from the non-cellular communication features and characteristics. The phone is primarily valuable because of its communication capability, including movement of data. Demonstrating the value of its contribution, Qualcomm has successfully argued in the past that it must be allowed to recoup its research and development investments in order to fund ongoing innovation. One positive aspect of the FTC ruling is that it does not suggest moving away from device-level royalties to chipset-level pricing. Innovation in high-quality cellular communications benefits all players in the value chain, including phone manufacturers, mobile service providers, and players in emerging business models. We believe that Qualcomm's licensing royalty rate, which is the highest in the industry, is commensurate with its market-leading contribution to global cellular technology standards.

In our view, the current challenge to Qualcomm's business model by the FTC is similar to one it recently faced in China. In 2015, Qualcomm prevailed in China, where the NDRC (National Development and Reform Commission) had the opportunity to rewrite local industry rules for IP royalties, but instead validated Qualcomm's business model. The settlement of this and previous cases has not only repeatedly upheld and validated Qualcomm's business model, but established a body of legal precedent in a variety of jurisdictions around the world. Further, in early 2018, Qualcomm announced a revised global licensing structure, similar to the China model, which covers 3G, 4G, and the first release of 5G. Customers have the option of a portfolio-wide patent license at a royalty rate of 5%, similar to the current model, or pay a 3.25% royalty covering only SEPs. While the

revised global structure has lowered quarterly royalties by approximately 10%, we believe the benefits include greater transparency and simplification, and the revised structure has proactively addressed many of the critical requirements of the ruling. Qualcomm has signed over twenty 5G licensees under the new structure, including Meizu, Motorola, Lenovo, and now Apple, providing further industry acceptance of the handset-level pricing model and extending the company's annuity payments. We believe Qualcomm's agreement with Apple provides support for the company's business model and bodes well for the ultimate settlement of its outstanding regulatory cases. Further, Intel's exit leaves Qualcomm as the only remaining US chipset provider, and the other three Asian providers have always had access to Qualcomm's SEPs.

As the pioneer of first 3G and then 4G wireless communications technologies, we believe Qualcomm possesses difficult-to-replicate competitive advantages in the engineering, design, and manufacturing of the basebands and modems used in mobile devices, and the company's extensive portfolio of industry-leading IP has enabled it to operate as a near monopoly. Typical of its long-term approach, the company has been investing in and driving the next generation of cellular technologies, including 5G global standards. While full adoption could take five-to-ten years, Qualcomm is working with over 20 OEMs that will launch 5G handsets using Qualcomm chips in 2019, which should drive an accelerated refreshment cycle as 5G products are fully introduced over the next few years. We continue to believe that the body of legal precedent established in multiple jurisdictions worldwide over the past twenty years supports Qualcomm's current royalty business model. While the recent ruling in the FTC case is a negative for the company, we do not believe that it will materially alter the economics of Qualcomm's business model and we believe the company will ultimately prevail in its litigation. Leveraging its pioneering technology, cumulative IP, and engineering skill, we believe Qualcomm remains well positioned to maintain its leadership and benefit from the long-term secular growth in mobile devices. We believe the shares continue to sell at a significant discount to our estimate of Qualcomm's intrinsic value. Further, with the Apple agreement removing a significant amount of uncertainty, we believe the shares still represent a compelling reward-to-risk opportunity.

- **Facebook** is an online social networking platform that allows people to connect, share, and interact with friends and communities. The Facebook platform allows message exchange, photo and video sharing, and common-interest user groups, and the company also owns leading global social and messaging applications Instagram, Messenger, and WhatsApp.

A fund holding since inception, Facebook was among the top contributors for the quarter. Facebook reported strong growth that was above consensus expectations for quarterly revenue and earnings per share. Despite negative publicity from the media and concern over potential regulatory actions by governments regarding its privacy and data security policies, the company continues to grow its global user base, and user engagement, measured by daily and monthly active users, has remained solid. In addition, demand from advertisers remains robust and we believe the long-term secular shift from traditional media to online advertising remains intact. Following the strategy it laid out in 2018 to place increasing emphasis on Instagram and FB Stories, "experience" products, and to increase its investments, Facebook reported that three million of its seven million active advertisers used stories to reach consumers across Facebook's family of apps during the quarter, up 50% from the previous quarter. Facebook's elevated investments have been targeting core product development, safety and security, private communications, virtual reality,

marketing, and content acquisition. Management also modestly lowered its prior guidance for core expense growth of 40% to 50% in 2019, after which it expects expense growth in line with revenue growth. Capital expenditures (capex) have also accelerated meaningfully over the past few years and are expected to reach \$17 to \$19 billion in 2019, up from \$6.7 billion in 2017 and \$13.9 billion in 2018. The company has been making significant investments in its data center capacity. Today the company operates six data centers, up from just one in 2011, and is building eight more to support the growth in the business. As a result, expenses will increase faster than revenue over the near term, pressuring margins.

For the quarter, revenue grew 33% year over year in constant currency to \$15.1 billion, with advertising revenue accounting for 99% of total revenue. User data, coupled with the scale and frequency of engagement, allows Facebook an unprecedented ability to specifically target direct marketing. Advertising revenue per user (ARPU) for the quarter of \$6.42 was up 16% year over year, reflecting improved monetization per user in all regions. ARPU ranged from \$30 per user in North America to approximately \$2 per user in the company's rest of world (ROW) category, with the US experiencing the greatest year-over-year increase of 28%. This improvement in monetization per user is a continuation of a secular trend where annual monetization improved globally from \$4 per user in 2012 to over \$24 in 2018, a compounded annual growth rate (CAGR) of 35%, reflecting Facebook's strong pricing power. Year over year the number of Facebook users rose 8% to almost 2.4 billion global users. Users outside of North America account for 2.1 billion or 90% of Facebook's global user base, while the US and Canada accounted for about 10%, or 243 million users.

During the quarter, Facebook announced that it had accrued a \$3 billion reserve related to an ongoing Federal Trade Commission (FTC) inquiry into the company's platform and user data practices. As a result of the accrual, reported EBIT (earnings before interest and taxes) margins were 22%. Excluding the one-time expense, operating margins would have been 42%, above consensus expectations. Despite the accrual and near-term increase in investments, Facebook continues to have an attractive financial profile. Free cash flow during the quarter of \$5.3 billion rose 6% year over year despite elevated capex, and represented 35% of revenue. Capex of \$3.8 billion grew 36% and remained elevated at 25% of revenue, up from 23% in the prior-year quarter. Capex was driven by investments in servers and data centers that should support future growth for the company, as well as office facilities and network infrastructure. During the quarter, Facebook repurchased \$500 million of its shares and its outstanding share count is down approximately 2% year over year. The company's balance sheet is robust, with net cash of \$45 billion, or \$16 per share.

We believe Facebook is a unique, high-quality company, benefiting from the secular shift from traditional advertising to online advertising and positioned for strong and sustainable growth over our investment time horizon. We believe management's decisions and actions illustrate their commitment to preserve platform integrity and to sustain its leadership and long-term growth. We expect that corporations will continue to allocate an increasing proportion of their advertising spending online, and Facebook remains one of very few platforms where advertisers can reach consumers at such scale. We also believe it is a natural part of the life cycle of companies such as Facebook to undergo investment cycles that focus on the long-term opportunity rather than timing investments based on near-term results in any given quarter.

We believe Facebook's unique attributes such as its brand, network, and targeting advantage position the company to take increasing share of the industry's profit pool and

grow its market share to approximately 10% of the total global advertising market over our investment time horizon. We believe shares of Facebook continue to be priced at a significant discount to our estimate of intrinsic value, offering a compelling long-term reward-to-risk opportunity.

## Detractors

- **Baidu** is the leading online search and advertising provider in China. A holding in the fund since inception, Baidu was among the leading detractors for the quarter. The company reported quarterly results that were fundamentally solid and mainly in line with consensus expectations. However, shares responded negatively to management's lowered outlook for the coming quarter. The company cited weakening macroeconomic conditions and lower advertising spending, government regulations which have impacted the company's healthcare, gaming, and financial services verticals, and ongoing elevated investments to strengthen its ecosystem. While we acknowledge these issues could continue to impact the company's financial performance in 2019, we believe Baidu is a high quality company whose sustainable competitive advantages include its strong brand recognition, economies of scale, a powerful network and business ecosystem, and strong distribution. Baidu's brand was rated the eighth most valuable brand in China in 2019 by MillwardBrown's annual BrandZ study. The Baidu family of over 20 apps, which includes search & feed, video, tools, location-based services, and industry-specific verticals, reaches approximately 1.1 billion monthly average users and over 800,000 advertisers, illustrating the scale of the platform. Within this application ecosystem, Baidu continues to be driven by its core search and feed app where the company continues to dominate China's internet search market, capturing about 80% share of search revenues. We believe Baidu's family of apps positions the company to benefit from long-term, secular growth in China online advertising.

Total revenue from continuing operations grew 21% year-over-year to RMB 24 billion. Accounting for 73% of Baidu's total revenue, online marketing services associated with the company's core search business increased 3% year over year. Cyclical and regulatory-driven weakness in gaming and financial services end markets contributed to the lower rate of growth, as did proactive steps to further upgrade the quality of its healthcare search results. Daily average users on the Baidu App, which is the company's focus for search and personalized news feed services, reached 174 million during the quarter, a 28% year-over-year increase, and monthly active users reached 1.1 billion in March. Other revenue, predominantly subscription revenue from iQiyi, Baidu's majority-owned online video site, as well as cloud revenue, accounted for 27% of total revenue and grew 73% year over year. Baidu reported that its cloud services revenue grew over 133% year over year and represented approximately 5% of total revenue. In early 2018, Baidu completed an initial public offering for a minority interest in iQiyi, which raised \$2.3 billion and valued the subsidiary at approximately \$12 billion. iQiyi ended the quarter with 97 million subscribers and added over 9 million new members during the quarter. Baidu remains the largest shareholder with an approximately 59% ownership stake. The company is also in the process of spinning off its Baidu Financial Services Group to an investor group led by The Carlyle Group and TPG. The spinoffs are part of Baidu's increasing emphasis on leading with artificial intelligence (AI), which it is employing to improve its search efforts and enable a number of other commercial ventures. In Baidu's core search business, AI is leading innovation in voice recognition and digital search, thereby generating better-targeted, predictive, and more-personalized results – yielding benefits to both users and

advertisers and allowing the company to command higher pricing. Beyond search, two of Baidu's key AI products are its voice interaction system, DuerOS, and Apollo, its open-source autonomous driving platform. The company's strategic path to commercialize these AI technologies is through robust ecosystems with developers and partners. With its DuerOS technology, the company has built partnerships with over 130 companies and now has over 50 DuerOS-powered hardware devices on the market, including TVs, speakers, smartphones, and appliances, with a focus on improving the consumer experience with high-usage home items. The company reported its installed base of DuerOS products expanded to 275 million devices in the quarter, up 279% year over year. In autonomous driving, where Baidu's ecosystem includes 100 partners, the company's Apollo software, which supports complex urban driving, has generated over ten times the number of autonomous test miles as its next nearest competitor. Baidu previously announced that it had been designated as the national autonomous driving platform by China's Ministry of Science and Technology, and now has over 50 licenses for open road testing in municipalities and provinces in China. The company is working with municipalities to pilot a robo taxi service in the second half of 2019. These initiatives are part of Baidu's mission to "make the world a simpler place through technology," and to lead with AI.

Baidu's adjusted EBIT (earnings before interest and taxes) declined 93% year over year to RMB 401 million, reflecting its continued investments to drive growth. EBIT margins of 2% declined from 26% margins in the prior-year quarter. Baidu core margins of 12% declined 27 percentage points over the prior-year quarter. The company increased marketing and promotional expenses by 94% year over year to grow users of Baidu's family of apps, including the Baidu App, maps, and newer short and flash video apps Haokan and Quanmin, as well as for marketing campaigns around Chinese New Year. We expect this investment cycle will continue, reflecting Baidu's significant growth opportunities and targeting accelerated user growth for its family of apps, further growth of DuerOs, and ongoing investments in Apollo. Adjusted EPS declined 80% year over year, slightly better than consensus expectations. While free cash flow of RMB -1.3 billion declined from RMB 5.9 billion in the prior-year quarter on continued investments, Baidu maintains a strong balance sheet with net cash of RMB 130 billion or approximately \$20 billion. During the quarter the company announced a new \$1 billion share repurchase plan, which now increases the company's repurchase authorization to a total of \$1.5 billion. The company also announced that Hailong Xiang, Senior Vice President for the search business, had resigned and would be replaced by Dou Shen, who will oversee the company's mobile business, including search. Mr. Shen was previously Vice President of mobile products, where he was responsible for the development of the Baidu App and Haokan, and held previous roles across search, display advertising, and financial services since joining Baidu in 2012. Prior to joining Baidu, Mr. Shen worked in Microsoft's adCenter Group and later co-founded Buzzlabs, a social media monitoring and analysis platform that was sold to IAC. We continue to believe Baidu is a high quality company with sustainable competitive advantages that is poised to benefit from secular growth in China online advertising. We believe the assumptions embedded in Baidu's share price show a lack of appreciation for the company's significant long-term growth opportunities and the sustainability of its business model. We believe the shares sell at a significant discount to our estimate of intrinsic value and offer a compelling reward-to-risk opportunity.

- **Alibaba Group**, launched in 1999, is a leading China e-commerce and consumer engagement platform provider. The company operates several increasingly connected

businesses across commerce, technology, advertising, digital media and entertainment, logistics, payments, and local services. Collectively these businesses form a powerful ecosystem, providing Alibaba with unique insights that facilitate e-commerce and enable merchants and brands to engage with customers across the entire consumer lifecycle via an unparalleled platform.

A fund holding since inception, Alibaba was among the biggest detractors during the quarter. The company reported strong quarterly results that reflected continued market share gains and were above consensus expectations. However, ongoing concern over trade tension between the US and China broadly weighed on shares of Chinese internet companies. Revenue growth of 51% year over year was well above growth in China consumer spending, indicating the company continued to expand its market share. Operating margins declined year over year due to significant ongoing investments in four strategic but currently loss-generating 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” initiative. Reflecting the magnitude of these opportunities, management indicated in late-2017 that it expects to invest \$30 billion in logistics and research and development over the next five years. In September 2018, the company announced that founder and Chairman Jack Ma intends to retire in September 2019, which will mark Alibaba’s twentieth anniversary. Mr. Ma will remain on the Board through 2020 to ensure a successful transition. Replacing Mr. Ma as chairman will be CEO Daniel Zhang, an 11-year veteran of Alibaba who has served as CEO since 2015. Mr. Ma continues to own a significant stake in the business and will remain part of Alibaba’s partnership. The partnership consists of 36 members from management or affiliated companies and is focused on promoting Alibaba’s mission, vision, and values and helps to ensure the company is managed with a long-term focus. In his role as a partner, we believe Mr. Ma will remain engaged with Mr. Zhang and other senior management of Alibaba and its affiliates around issues of leadership and strategic vision.

With GMV (gross merchandise volume) of \$853 billion on its China retail marketplaces in its latest fiscal year, Alibaba is the world’s largest retail platform. The company continues to be driven by its core commerce segment, which accounted for 84% of Alibaba’s \$13.9 billion of total quarterly revenue and grew 54% year over year. China commerce retail accounted for 74% of core commerce revenues and grew 45% year over year. Mobile monthly active users grew 17% to 721 million, aided by additional investment in content and technology to drive strong user engagement. Data gathered from strong consumer engagement on Alibaba’s e-commerce and digital media sites provide powerful insights into consumer behavior. Alibaba is thereby able to deliver more personalized content, which enables a growing number of merchants to better target and engage customers throughout the consumer lifecycle and drives improved e-commerce monetization. A growing initiative within the China commerce retail segment is Alibaba’s “new retail” strategy, in which it seeks to leverage its data, scale, technology, and network ecosystem to digitize the entire retail value chain and create a seamless consumer experience between online and offline retail. The initiative, which includes the company’s acquisition of China department store Intime and Freshippo (Hema) grocery stores, accounts for approximately 10% of core commerce revenue and is growing at a multiple of the overall core commerce

business, growing 132% year over year in the most recent quarter. Core commerce revenues also benefited from the company's substantial focus on international and cross-border commerce, including global e-commerce marketplaces AliExpress, Tmall Global, Tmall World, southeast Asia-focused Lazada Group, recently consolidated Turkish e-commerce platform Trendyol, and Daraz, which focuses on Pakistan and Bangladesh. In total, the core commerce segment grew adjusted operating profits by 24% year over year. Adjusted operating margins of 35% declined 800 basis points year over year due to ongoing strategic investments. We believe the company's core marketplace business continues to generate stable and attractive operating profit, and that its currently loss-making newer businesses will become profitable over time and contribute to earnings and free cash flow growth. Absent elevated investments in the four strategic areas, adjusted operating profit would have grown 38% year over year.

Well positioned for the secular migration to cloud computing, Alibaba's cloud-computing revenue rose 76% year over year, well above the single-digit growth in China IT spending, and accounted for 8% of total revenue. Growth was driven by an increase in the number of customers and greater penetration of higher-value-added products and services. The cloud-computing business is in investment mode, focusing on geographic and product expansion, and generated operating margins of -2%, which improved from the -8% margins in the year-ago quarter. Comprising approximately 6% of total revenue, digital media and entertainment revenue grew 8% compared with the year-ago quarter, due to an increase in mobile value-added services such as mobile search from UC Web and game publishing. Media offerings boost the length of user sessions and user stickiness, expand the ecosystem for customer acquisition and brand building, and improve Alibaba's overall consumer value proposition. The segment remained in investment mode, focused on increasing original content and securing licensing rights, and reported operating margins of -50%, in line with -49% in the prior-year quarter. Innovation initiatives and others accounted for 2% of revenue and rose 22% year over year. This segment includes early-stage businesses for mobile device operating systems, cars, Internet of Things (IoT), AutoNavi, enterprise messaging, and others. Adjusted operating margins of -160% declined from margins of -87% in the year-ago quarter.

Alibaba's adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) rose 29% over the prior-year quarter, and EBITDA margins of 32% declined 1,000 basis points due to strategic investments. For the quarter, free cash flow of \$1.6 billion rose 22% year over year. Alibaba continues to execute well on its business model, allowing it to expand its already dominant market position and invest to strengthen its competitive advantages. 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. With its shares trading at a significant discount to our estimate of intrinsic value, we believe Alibaba offers a compelling reward-to-risk opportunity.

- **Alphabet** is a holding company which owns a collection of businesses, the largest and most important of which by far is Google. Google is the global leader in online search and advertising and also offers online cloud solutions to businesses and consumers globally, with a goal of organizing the world's information and making it universally accessible and useful. Non-Google businesses comprise approximately 1% of Alphabet revenues and are held in

the company's Other Bets segment.

A holding in the fund since inception, Alphabet was among the top detractors for the quarter. The company reported fundamentally strong quarterly results that were mixed versus consensus expectations. Total revenue of \$36.3 billion represented a 19% increase year over year in constant currency but decelerated from recent quarters and lagged consensus expectations by 2.6%. Alphabet's Google subsidiary represented 99% of total Alphabet revenue, while the company's Other Bets segment accounted for 1%. Advertising revenue accounted for 85% of Google revenue and grew 15% compared with the year-ago quarter, powered by the secular shift of advertising to online and mobile platforms. With growth well above that of traditional advertising, Google continued to take market share. Google sites accounted for 71% of total Google revenue and grew 17% compared with the year-ago quarter, reflecting strong growth in mobile search, followed by YouTube, and desktop search. YouTube has over 1.8 billion users on a monthly basis, with localized versions in 90 different countries and 80 different languages, and the YouTube Go app has been expanded to over 130 countries. Network advertising revenue, driven by Google's programmatic offering, accounted for 14% of total Google revenue and grew 8% year over year. Other revenue accounted for 15% of Google revenue and grew 25% year over year, driven by Cloud and Google Play. Google's cloud business includes Google Cloud Platform (GCP), the company's Infrastructure- and Platform-as-a-Service offerings, and G Suite, the company's software-as-a-service offerings such as Gmail, Docs, Drive, and Calendar. The company recently announced that Google Drive now has one billion users, making it the eighth Google product to exceed that mark. Google's key revenue drivers of mobile search, YouTube, programmatic advertising, and an emerging cloud business that is growing at three-to-four times faster than the core search business, each continue to benefit from secular factors around increased mobility, video advertising, better use of advertising technology to drive performance, and increased penetration of public cloud services. Alphabet's Other Bets segment reported revenue growth of 14% in the quarter. Many of these businesses are still in pre-revenue stage and results likely will be volatile on a quarterly basis. Revenue in this segment is currently driven by Fiber and Verily.

During the quarter several media sources suggested that the Department of Justice (DOJ) plans to investigate Alphabet along with other technology leaders regarding its compliance with antitrust laws. We believe the regulatory history of Microsoft, a company we have owned since inception of our strategy, provides insights and perspective into the potential for a heightened regulatory environment for technology companies. Over the past three decades, Microsoft has faced antitrust lawsuits and regulation from the Federal Trade Commission, the Department of Justice, 20 different US states, the European Commission, and other countries regarding its business practices. Ultimately, after nearly a decade following the start of the investigative process, Microsoft settled and adjusted some of its business practices. While this did create short term challenges for the business and stock price, Microsoft continued to create long-term business and shareholder value, driven by its competitive advantages and long-term approach in managing the business. Microsoft did not change its strategy of focusing on innovation and investing to drive long-term growth, despite these business changes. In similar fashion, we believe Alphabet continues to be managed by visionary founders who invest to drive long-term innovation and growth, as evidenced by the more than \$20 billion of R&D spending and \$25 billion in capital expenditures in 2018 alone. We believe this approach should enable Alphabet to continue to create long term shareholder value. These types of regulatory inquiries are backward

looking by their nature, and the period under analysis may no longer reflect the current, dynamic environment. Consider that in 2007, Facebook commanded less than 1% market share in online advertising, but as of 2018 now captures 22%, second only to Google. Amazon is also an emerging player in online advertising by charging companies to promote their products on Amazon properties. In the coming years, this could again reshape the competitive landscape in online advertising.

These investigations can take on a life of their own, and may take several years before any findings are published. And then there can be an appeals process. Recall in July 2018, the European Commission (EC) announced the findings of its three-year investigation into Google's practices in licensing its Android operating system. Echoing a preliminary view issued in April 2016, the EC concluded that certain contractual provisions between Google and its Android partners infringed European competition law, and levied a \$5.1 billion fine against the company. This action does not currently impact our view on Alphabet's quality or growth outlook, and the company has previously indicated it will appeal the ruling. The fine represents approximately one quarter of free cash flow for the company and a small percentage of the company's \$124 billion of cash and investments. We will continue to monitor and assess any potential impact on the company's market share or growth.

Of course, such announcements alone can weigh on stock prices over the short term. And while there are historical cases where we do see that investigations can result in changes to business practice, business models, or regulatory environments, we have found that the outcomes tend to create higher barriers to entry for an industry, thereby benefitting the largest players. As we did with the earlier EC action versus Alphabet, we will continue to monitor and assess any potential structural impact on our investment thesis for Alphabet and on the company's market share or growth. We believe Alphabet remains well positioned to benefit from the secular shift of the \$1 trillion in global annual advertising and marketing expenditures to online and mobile advertising from traditional advertising media.

Alphabet continues to have a high quality financial profile and strong financial position. The company reported an 80 basis point year-over-year contraction in gross margins to 56%. The contraction was the result of higher other costs of goods sold, which primarily reflected increased costs for data centers and YouTube content, which were partially offset by lower traffic acquisition costs. Adjusted operating margins of 23% declined 165 basis points compared with the year-ago quarter, reflecting higher cost of goods sold, an increase in R&D expense focused on hiring technical talent, and higher general and administrative expenses, offset in part by operating leverage in sales and marketing expenses. At a segment level, Google's operating margins declined 200 basis points year over year to 30%. Alphabet's Other Bets segment posted an operating loss of \$1.2 billion, up from a loss of \$650 million in the year-ago quarter, as most opportunities are pre-revenue. Adjusted EPS of \$11.90 rose 25% year over year and exceeded consensus estimates by 12%.

Google's attractive financial model generates strong free cash flow and earns high returns on invested capital, enabling it to reinvest significantly in its business. Over the past five years, Google has invested over \$60 billion in R&D, an amount very few could replicate. In the quarter, Alphabet generated \$9 billion in free cash flow, up 108% year over year due to the purchase of a building in New York that was included in the prior-year quarter. Capital expenditures declined by 36% year over year to \$4.6 billion. The company's capital expenditures continue to focus on infrastructure spending required to support growth,

including 20 new data centers under development. The company's investments are reflective of the company's overall growth opportunities, particularly in the core advertising business, additional computing power to support YouTube users globally, rapid growth of GCP, and increasing computing power required to support the intensity of machine learning across all of Google's products. We believe the company remains well positioned to benefit from the secular shift of the \$1 trillion in global annual advertising and marketing expenditures to online and mobile advertising from traditional advertising media. We believe market expectations underestimate Alphabet's long-term sustainable growth rate. Therefore, we believe the company is selling at a significant discount to our estimate of intrinsic value and offers a compelling reward-to-risk opportunity.

## Outlook

- Our investment process is characterized by bottom-up, fundamental research and a long-term investment time horizon. The nature of the process has led to a lower-turnover portfolio in which sector positioning is the result of stock selection.
- The fund ended the quarter with overweight positions in the consumer discretionary, consumer staples, communication services and information technology sectors and underweight positions in the financials, energy, industrials and healthcare sectors. We did not own positions in the materials, utilities or real estate sectors.

## About Risk

**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. **Currency** exchange rates between the US dollar and foreign currencies may cause the value of the fund's investments to decline. **Investments in small and mid-size 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.

*MSCI All Country World Index (Net) is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.*

*Outlook as presented in this material reflects subjective judgments and assumptions of the portfolio team and does not necessarily reflect the views of Loomis, Sayles & Company, L.P. There is no assurance that developments will transpire as stated. Opinions expressed will evolve as future events unfold.*

***Before investing, consider the fund's investment objectives, risks, charges, and expenses. Please visit [www.loomissayles.com](http://www.loomissayles.com) or call 800-633-3330 for a prospectus and a summary prospectus, if available, containing this and other information. Read it carefully.***

*Natixis Distribution, L.P. (fund distributor, member FINRA|SIPC) and Loomis, Sayles & Company L.P. are affiliated.*

*LS Loomis | Sayles is a trademark of Loomis, Sayles & Company, L.P. registered in the US Patent and Trademark Office*