

Growth Fund

FUND FACTS

OBJECTIVE

Seeks to produce long-term growth of capital

Share class	Y
Inception	5/16/1991
Ticker	LSGRX
CUSIP	543487110

Portfolio Review

- The fund outperformed its benchmark, the Russell 1000® Growth Index, largely due to stock selection in the consumer staples, information technology and financials sectors as well as our allocation to the industrials sector. Stock selection in the consumer discretionary, healthcare and energy sectors as well as our allocation to the healthcare and information technology 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 22 basis point allocation in Alcon, Inc., which trades on both the New York and Swiss stock exchanges. We also added to our existing positions in Nvidia and Regeneron Pharmaceuticals as near-term price weaknesses created more attractive reward-to-risk opportunities. We trimmed our position in FactSet Research Systems.¹

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

	CUMULATIVE TOTAL RETURN		AVERAGE ANNUALIZED RETURN			
	3 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR
FUND	5.19	21.96	15.44	17.66	14.36	16.80
BENCHMARK	4.64	21.49	11.56	18.07	13.39	16.28

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.

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 0.65% (Class Y). Net expense ratio 0.65%. 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 1/31/2020. When an expense cap has not been exceeded, the fund may have similar expense ratios.

The Class Y inception date is 5/16/1991. Class Y shares are sold to eligible investors without a sales charge; other Classes are available for purchase.

¹Quarter-to-date transactions as of June 30, 2019.

TOP TEN EQUITY HOLDINGS (%)

Visa Inc	6.8
Amazon.com Inc	6.7
Facebook Inc	5.9
Oracle Corp	5.1
Alibaba Group Holding Ltd.	4.9
Alphabet Inc.	4.8
Autodesk Inc	4.2
Microsoft Corp	3.8
Monster Beverage Corp	3.5
Starbucks Corp	3.4
Total	49.1

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.

Contributors

- A long-term fund holding, **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 its initial public offering (IPO) in the second quarter of 2012, 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.

- **Visa** is the largest payments technology company in the world, with a comprehensive offering of digital payment products, including credit cards, debit cards – which Visa invented – and transaction security services known as tokenization. Visa has one of the world's most recognized brands, which took decades and significant investment to build. Through its open-loop, multi-party network, Visa has built a massive global network, orchestrating transaction settlements between merchants, merchants' banks, card-issuer banks, and cardholders in more than 200 countries. Visa does not issue cards or extend credit. It provides processing capabilities, each day authorizing hundreds of millions of transactions by cardholders, the exchange of financial information, and the settlement of funds to merchants. Visa receives fees for these services from both the card issuers and merchant banks. The company has extensive client relationships, partnering with over 16,000 card-issuing banks. A growing global network with more than 3.3 billion Visa-branded cards outstanding that are accepted by 54 million merchants worldwide creates a powerful virtuous cycle, reinforcing Visa's difficult-to-replicate competitive advantages.

A long-term fund holding, Visa reported healthy year-over-year growth in both revenue and earnings per share (EPS) that was above consensus expectations. Net operating revenues grew 9.5% in constant currency to \$5.5 billion, benefiting from mid-teens payment volume growth in India, Central Europe, Eastern Europe, Southeast Asia, and Latin America, as well as prior-year pricing increases which benefited its data processing revenues. EPS increased 17% and Visa upwardly adjusted its 2019 fiscal year EPS growth expectations to the high end of mid-teens from its prior outlook for mid-teens EPS growth and reiterated its prior revenue outlook.

Total payment volumes increased 8% compared with the same quarter last year, which represents a deceleration from the prior quarter. Country-specific weakness in the UK, where growth declined 2% year over year, contributed to the slower rate of growth. Visa operates in a large addressable market and continues to benefit from a long-term secular shift from cash and checks to digital payments. We believe the company's addressable market is the approximately \$47 trillion of global personal consumption expenditures (PCE). Of this amount we estimate that just under 50% of the dollar volume and over 70% of the transaction volumes are still paper-based. While Visa captures an estimated 60% share of global electronic payments outside of China, where it is not currently operating, Visa's share represents only about 18% of global PCE, and we believe its growth opportunities remain very large.

Attractive operating margins of 66% rose 50 basis points from the prior-year quarter. Year-to-date free cash flow of \$5 billion was down 7% year over year but represents a high free cash flow conversion rate equal to 46% of revenue. Management continues to be active in returning capital to shareholders and repurchased about \$2 billion in outstanding shares during the quarter. The company's balance sheet is strong, with \$15 billion in cash and investments and a net debt position of \$1.6 billion after raising debt to fund its 2016 acquisition of Visa Europe. Visa ended the quarter with 3.36 billion cards globally, up 3% year over year. We expect Visa to generate low-double-digit revenue growth over our investment time horizon as the company continues to benefit from the secular growth in digital payments. We believe the assumptions embedded in Visa's share price underestimate the company's significant long-term growth opportunities and the sustainability of its business model. We believe the company's shares currently sell at a significant discount to our estimate of intrinsic value and thereby offer a compelling reward-to-risk opportunity.

Detractors

- Purchased in the third quarter of 2016, **Regeneron Pharmaceuticals** is a fully integrated biopharmaceutical company that discovers, develops, manufactures, and commercializes medicines for the treatment of serious medical conditions. The company was among the leading detractors for the quarter. Regeneron reported quarterly financial results that reflected continued penetration for its leading revenue generator, Eylea, and were approximately in line with consensus expectations for revenue. However, heightened investments to support its pipeline and growth products as well as continued investment in Eylea contributed to earnings per share (EPS) that was approximately 20% below expectations. We believe the increase in investments is reflective of Regeneron's ongoing innovation and differentiation and should ultimately lay the groundwork for long-term revenue growth. In the interim, Regeneron's share price continues to be volatile in response to market expectations regarding potential competition for Eylea. While we expect Eylea

to face heightened competition in the future given the likely approval of competitor RTH-258 from Novartis, we believe Eylea's competitive advantages remain intact. Eylea has established itself as the leading branded therapy in treating a broad and expanding range of diseases of the back of the eye. Its leading efficacy over both the short and long term, long-term durability of results, and attractive safety and side effect profile, have made it the market leader and choice of physicians across multiple indications - a position that will be difficult for new competitors to replicate.

Regeneron was established in 1988 with the vision of empowering scientists to shape the path of the business by advancing long-term scientific outcomes over short-term results. Regeneron-invented technologies include VelocImmune, a patented technology for creating fully-human monoclonal antibodies, enabling rapid discovery and development of viable candidates for clinical trials. With this accelerated process, the time and capital required for pre-clinical research is reduced, allowing Regeneron to significantly outpace its competition in bringing new therapies to trial, and ultimately to market. As a result, Regeneron was able to negotiate risk-mitigating collaborations with larger biopharmaceutical company partners which fund early-stage research and development (R&D) in exchange for a share of potential profits and research cost reimbursement, and through which Regeneron accesses scale and distribution strength. We believe that Regeneron's science-driven culture, unique technology, and long-term focus on delivering innovative medical solutions will result in substantial value creation over our investment horizon.

For the quarter, revenue increased 13% year over year to \$1.7 billion. Earnings per share declined 5% year over year to \$4.45, below consensus expectations of \$5.48. The timing and booking of R&D expense reimbursements between Regeneron and its collaboration partners can skew revenues, margins, and earnings per share from quarter to quarter. While the timing of these partner payments and reimbursements can result in meaningful swings in the profitability of the business over the short term, the revenue results from each of the products provide insight into the underlying structural performance of the overall business. US sales of Eylea were up 9% year over year to \$1.1 billion as the therapy continues to penetrate the patient population in its two primary indications and gained share against competitor Lucentis. Outside of the US, where Regeneron splits profits with marketing partner Bayer AG, sales for Eylea were \$0.7 billion, up 7% year over year. Sales were driven by continued adoption of the therapy, and we estimate that Eylea continued to gain market share in the period. Regeneron's revenues from its partnership with Bayer were \$276 million, up 11% over the prior-year quarter, with sales of Eylea representing the majority of that revenue. In addition to its existing indications, we believe Eylea will continue to address new diseases impacting the back of the eye. During the quarter, the therapy received FDA approval for use in a subset of patients with diabetic retinopathy, opening up a population of approximately one million patients at long-term risk of blindness. The company continues to invest in Eylea-related therapies, with a higher-dose therapy entering the clinic this year and pipeline products that include both antibody and gene therapy combinations to improve on the treatment's already market-leading efficacy. While the therapy will likely face competition later this year, its long-term safety profile, demonstrated by over 25 million injections, will be difficult to displace for a new entrant lacking a comparable safety history.

In its sixth full quarter on the market, Dupixent generated sales of \$374 million, up 54% over the prior-year period. The treatment experienced continued penetration in its first-approved atopic dermatitis market, with new patient prescriptions growing by over 900

per week versus over 700 per week in the prior-year period, and continues to evidence high patient retention rates. In addition to atopic dermatitis, Dupixent was recently approved for use in allergic asthma, and is being studied for use in a number of other indications, including nasal polyps, eosinophilic esophagitis, and chronic obstructive pulmonary disease (COPD). We continue to believe that the drug could receive approval for multiple disorders, thereby expanding its addressable market. Regeneron also reported that Libtayo, the company's PD-1 therapy for previously untreatable cutaneous squamous cell carcinoma (CSCC) and its first approval in the field of immuno-oncology (IO), generated \$27 million in its second quarter following approval in the US. While the therapy addresses a small patient population and is currently a modest contributor, the proof of concept for its PD-1 therapy and initial IO market entry could open a potentially meaningful new revenue opportunity for Regeneron. Libtayo is awaiting its initial launch outside of the US and undergoing clinical trials for other, larger IO indications.

Regeneron also reported meaningful progress in its growing pipeline which contributed to the increase in investment spending. The company highlighted late-stage programs for expanded approval of Dupixent and Libtayo within existing indications as well as for additional indications. Also during the quarter, Regeneron reported strong early-stage results for REGN 1979, a bi-specific therapy for patients with non-Hodgkin's lymphoma who fail to respond to frontline treatment and have no other therapy options. Bi-specific antibodies can address two targets simultaneously, potentially increasing their effectiveness in fighting disease while reducing off-target effects and improving their safety profile relative to traditional monoclonal antibodies. While the clinical data reflects a small patient sample size, the news was promising for both REGN 1979 as well as Regeneron's bi-specific platform, which includes two additional molecules in clinical trials.

Finally, Regeneron announced a restructuring of its IO partnership with Sanofi that would exclude candidates other than Libtayo and two bi-specific antibodies currently under development. With Regeneron's attainment of adequate commercial scale and cash flow generation and Sanofi's rejuvenated internal development initiatives, we believe the restructuring reflects the natural maturity of the two companies and provides both companies with greater flexibility in their ongoing R&D programs.

We believe Regeneron is among the highest quality businesses in healthcare, with both broad-based established therapies and meaningful pipeline assets, which include 19 product candidates in clinical development that were generated using the company's proprietary VelocImmune technology. We believe the share price embeds a lack of appreciation for the company's multiple growth opportunities and the uniqueness of its business model. As a result, the company's shares trade at a significant discount to our estimate of intrinsic value, and represent 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 long-term fund holding, 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.

- **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 its initial public offering in 2014, 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.

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 staples, consumer discretionary, financials and energy sectors and underweight positions in the information technology, industrials, communication services and healthcare sectors. We did not own positions in the real estate or materials 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. **Investments in small and mid-e 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.

***Russell 1000® Growth Index** measures the performance of the large cap growth segment of the US equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth Index is constructed to provide a comprehensive and unbiased barometer for the large cap growth segment. Indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.*

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 or call 800-225-5478 for a prospectus and a summary prospectus, if available, containing this and other information. Read it carefully.

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