Growth Fund

Portfolio Review

• The fund underperformed its benchmark, the Russell 1000® Growth Index, largely due to stock selection in the information technology, healthcare, industrials, consumer staples and energy sectors as well as our allocation to the energy, consumer staples, financials and industrials sectors. Stock selection in the consumer discretionary and financials sectors contributed to 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, we trimmed our existing position in Amazon as it approached our maximum allowable position size.

CLASS Y PERFORMANCE AS OF SEPTEMBER 30, 2018 (%)

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<th>CUMULATIVE TOTAL RETURN</th>
<th>AVERAGE ANNUALIZED RETURN</th>
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<td>3 MONTH</td>
<td>YTD</td>
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<tr>
<td>FUND</td>
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<td>10.37</td>
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<tr>
<td>BENCHMARK</td>
<td>9.17</td>
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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 0.66% (Class Y). Net expense ratio 0.66%. 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 1/31/2019. 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.
Contributors

- Online retailer Amazon offers millions of products – sold by Amazon or by third parties – with the value proposition to consumers of selection, price, and convenience. Amazon’s enterprise IT business, Amazon Web Services (AWS), offers a suite of secure, on-demand, cloud-computing services, with a value proposition to clients of speed, agility, and savings. In both of its core markets, Amazon possesses strong and sustainable competitive advantages that would be difficult for competitors to replicate. In e-commerce, these include its brand, scale, technology platform, network advantage, and logistics and distribution systems. AWS benefits from its massive scale, which allows it to pass along cost savings while continuing to innovate. Growing well in excess of their underlying markets, both of Amazon’s businesses are gaining market share. Led by visionary founder Jeff Bezos, Amazon invests aggressively to expand and leverage its customer base, brand, and infrastructure, targeting businesses with strong financial returns that are anticipated to offer large and enduring growth opportunities.

A long-term fund holding, Amazon reported strong quarterly financial results that exceeded management guidance and were substantially above consensus expectations for operating profit and earnings per share (EPS). Net sales of $53 billion increased 39% year over year. E-commerce and related revenue, including third-party services, advertising, and retail subscription services such as Prime membership and digital media subscriptions, accounted for approximately 80% of total net sales. We estimate that gross merchandise volume (GMV) grew in the low-20% range, well above our estimate of growth in the teens for US e-commerce and low-to-mid single-digit growth in global retail sales, indicating that Amazon continued to gain market share. Revenue from Amazon’s physical stores, primarily Whole Foods but also including 12 Amazon book stores and other store-based purchases, was $4.3 billion and accounted for 8% of total net sales. Since the acquisition closed in August 2017, Amazon has launched Whole Foods private label products on Amazon, added Amazon lockers to select Whole Foods store locations, started to integrate Prime benefits into a Whole Foods customer rewards program, and is taking steps to integrate Whole Foods with its other food and grocery initiatives such as Prime Now and Amazon Fresh. Most recently, the company announced it was expanding its free two-hour grocery delivery from ten cities to over twenty cities. While we expect Amazon to continue to grow its presence in the food and beverage category, our investment thesis for Amazon is not dependent on the acquisition’s success. North America accounted for approximately 69% of e-commerce and physical store sales, while Amazon’s international segment contributed approximately 31%. Comprising 12% of total net sales, AWS revenue increased 49% compared with the year-ago quarter, significantly faster than our low-single-digit growth estimate for global enterprise IT spending. The AWS annual revenue run rate is now over $24 billion.

With Amazon’s sales mix shifting increasingly to higher-margin product categories such as third-party e-commerce sales, AWS, and advertising, gross margins improved 400 basis points year over year to 42%. Gross income increased 53% year over year. Overall, Amazon reported adjusted operating income of $4.5 billion, up 150% compared with the year-ago quarter. Amazon continued rapid investment in key areas that capitalize on its strengths, focusing on businesses with high, durable growth prospects and strong financial returns. The company’s “Alexa” voice-enabled devices remain an area of focus. Amazon is launching Alexa in France, India, and Japan, and expects to do so in Italy, Spain, and Mexico later...
this year. The company is investing in new machine-learning tools which will further enable developers around the world to build new skills for the device. Amazon’s rapid pace of investment was reflected in part in higher operating expenses, but overall operating margins rose 370 basis points from the year-ago quarter to 8.4% due to the expansion in gross margins. AWS grew operating income 79% to $1.6 billion, with operating margins of 25.7%, up 140 basis points versus the year-ago quarter. Overall operating cash flow increased 22% compared with the previous trailing 12-month period to $22 billion, while free cash flow grew 9% in the period to $10.4 billion.

On a global basis, e-commerce represents approximately 9% of an estimated $15 trillion global retail market. Amazon’s GMV represents about 20% of global e-commerce and just less than 2% of the global retail market. We believe a long-term, secular transition from traditional brick-and-mortar retail to e-commerce is still in its early stages and that e-commerce will come to represent a significantly higher portion of the global retail market. A disruptive force, we believe Amazon’s structural operational advantages, network effect, and relentless focus on customer service position the company to grow faster and more efficiently than its traditional or online retail competitors. Also a disruptive force, we believe AWS is well positioned in the nascent and underpenetrated cloud-computing services market. We estimate the segment can realize compounded annual revenue growth of approximately 20%, with operating margins improving to the mid-30% range. As a result, we believe AWS operating profit potential can approach 50% of the company’s core retail opportunity over the long term. Over our investment time horizon, we believe Amazon can generate attractive and sustainable revenue growth, operating margin expansion, and free cash flow growth that is not currently reflected in the share price. As a result, we believe the company is selling at a significant discount to our estimate of intrinsic value and offers a compelling reward-to-risk opportunity.

• Oracle is a leader in the enterprise software market, with a strong market position in database, infrastructure and application software, and high-end appliance hardware. The company’s competitive advantages include its direct sales force, a founder-driven management team that reinvests relentlessly to maintain a differentiated product suite and leading intellectual property portfolio, and a large installed base of clients where it consistently achieves client renewal and retention rates in the mid-90% range. The company is well positioned to benefit from the continuing growth in data storage and enterprise software solutions. A long-term fund holding, Oracle was among the largest contributors to performance during the quarter. The company reported quarterly results that were generally in line with management guidance. While year-over-year total revenue growth was in the low-single digits, several key cloud products such as enterprise resource planning (ERP), industry-specific (vertical) products, and SaaS (Software-as-a-Service) and PaaS (Platform-as-a-Service) grew at a much faster rate, demonstrating the company’s progress in transitioning to a cloud-based model and positioning the company to improve its growth rate over time. The model transition is contributing to the quality of the business. Recurring revenue has grown over time and represented 72% of total revenue and 88% of software revenues over the trailing 12 months, and the company reported modest year-over-year operating margin gains. As the subscription-based cloud-computing services model matures and increases in sales mix, we believe Oracle will realize stronger revenue, margins, earnings, and free cash flow growth.

Total revenue for Oracle rose 2% year over year in constant currency to $9.2 billion,
slightly below consensus expectations. At $7.5 billion, software sales represented 81% of total revenue and rose 3.5% year over year. Oracle changed its software segment reporting to reflect the success of its “bring your own license” strategy, which enables existing clients to transition on-premise database licenses to the cloud but was resulting in cloud growth being captured as “on-premise” revenue. Reflecting the increasingly hybrid nature of the company’s database product offerings, software revenue has now been segmented into services and support revenue, and new license revenue. Cloud services and license support accounted for 88% of software revenue and aggregates the company’s SaaS, PaaS, and IaaS (Infrastructure-as-a-Service) offerings, along with on-premise software updates and product support. Driven by its Fusion applications, a suite of cloud-enabled enterprise software solutions Oracle began developing ten years ago, cloud services and license support revenues grew 4% year over year in constant currency. Accounting for 12% of software revenue, cloud licenses and on-premise licenses was flat year over year. While Oracle remains the world leader in its largest business segment, enterprise database software used in customer on-premise IT environments, the company continues to focus on transitioning its business from a traditional on-premise, up-front software licensing and maintenance revenue model to a cloud-computing subscription-based model where software revenue is recognized over the life of the client’s contract. While there is near-term pressure on year-over-year overall revenue comparisons as up-front license revenue shifts to subscription revenue, we expect this to lead to faster growth over time due to a higher customer lifetime value. The cloud model also allows Oracle to monetize its services and technology more efficiently and yield savings to the customer. In its hardware segment (about 10% of total revenue), Oracle reported a 3% year-over-year decline to $1.2 billion. The company’s latest generation database 18c offers enhanced speed, performance, and analytic advantages, as well as a multi-tenancy option which allows clients to convert on-premise applications to cloud applications, but we expect the upgrade cycle to take a number of years. In its services segment (about 9% of revenue), revenue of $813 million was down 4% compared with the same quarter last year.

Even though the company is in the midst of a major business model transition, Oracle’s financials remain strong. Adjusted EBIT (earnings before interest and taxes) of $3.8 billion rose 3% over the prior-year quarter. While operating margins improved 20 basis points to 41%, the business model transition continues to impact current profit levels, which we believe remain below normalized levels and which we expect to approach 50% over time. Over the trailing four quarters, Oracle generated $13.9 billion in free cash flow which grew 10% year over year and represented 35% of revenue, demonstrating the company’s strong cash generation ability. The company’s balance sheet is robust, with net cash of $2 billion after substantial share repurchase activity in the quarter of $10 billion which reduced outstanding share count by 7%. Management continues to return capital to shareholders through share repurchases and dividends, and the board of directors increased the company’s repurchase authorization by $12 billion. We believe Oracle’s stock price embeds free cash flow growth well below our forecasts and is selling at a significant discount to our estimate of intrinsic value, offering a compelling reward-to-risk opportunity.

- **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 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.

A long-term fund holding, Qualcomm reported stronger-than-expected quarterly results, led by the QCT segment, which is benefiting from strong product innovation in its high-end chipsets, especially in China. The company also announced it would terminate its proposed offer for Netherlands-based chip manufacturer NXP Semiconductors after concluding it was unlikely to receive regulatory approval from Chinese authorities. The Board of Directors subsequently authorized a $30 billion stock buyback program which it expects to complete over the next five quarters. While we viewed the NXP acquisition as potentially complementary and accretive to shareholder value, our investment thesis for Qualcomm was not predicated on its success. 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 enables 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, even though their full adoption could be five to ten years away. Leveraging its pioneering technology, cumulative IP, and engineering skill, we believe Qualcomm is well positioned to maintain its leadership over the long term.

With respect to the ongoing contract dispute with Apple, we believe the following. The industry-standard business model for mobile OEMs (original equipment manufacturers) has been in place for decades and withstood much scrutiny and many challenges. The model is that patent royalty rates 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 that it must be allowed to recoup its research and development investments in order to fund ongoing innovation. 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.

Challenges to Qualcomm’s business model and royalty rates are not new, and the company has successfully defended its business model numerous times over the last 10 to 20 years. In a particularly successful case, Qualcomm in 2015 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. In early 2018, Qualcomm announced a revised 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, similar to the current model, at a royalty of 5%, or pay a 3.25% royalty covering only standard essential patents. While the revised structure is anticipated to lower quarterly royalties by approximately 10%, we believe the benefits will include greater transparency and simplification, which are likely to be well received by regulators. Qualcomm has signed over ten 5G licensees under the new structure, providing further industry acceptance of the handset-level pricing model, which should strengthen its position versus Apple. The signing of new 5G licensees also extends the company’s annuity payments over the next decade, further reducing uncertainty, but given extensive ongoing use of 3G and 4G technologies and the importance of backward compatibility, single mode 5G is unlikely to be prevalent over the next decade. Qualcomm also announced that an unnamed licensee, which along with Apple had stopped making payments to Qualcomm, made a good-faith partial payment of $500 million as negotiations continue. While this represents a fraction of our estimate of the total sum owed by the licensee, it suggests Qualcomm’s strategy may be yielding positive results.

In our view, the current challenges to Qualcomm’s business model involving Apple are no different from previous challenges, except for Apple’s aggressiveness in its pursuit. This is not necessarily indicative that Apple has a strong case. We believe Apple is trying, as others have, to lower its royalty payment to Qualcomm. Because the royalty fees paid by mobile device manufacturers to Qualcomm are not insignificant, it is a rational decision to attempt to try to force the fees lower. Apple has previously taken a similarly aggressive approach with other IP providers. For example, in January 2015, after two years of negotiation with Apple, Ericsson filed a lawsuit against Apple for nonpayment of royalties. In December 2015, Apple settled the suit with Ericsson, which subsequently reported a significant increase in IP revenue, signaling to us that the basis of the agreement remained intact. Qualcomm expects that some of the patent infringement actions it has initiated against Apple in the US, Germany, and China will go to trial this year, potentially restricting Apple’s ability to import products in key markets and forcing it back to the bargaining table – not dissimilar to prior extended royalty disputes it has faced. We believe the decades-long industry practice that has been repeatedly validated, and is backed by regulations around the world, is not likely to be overturned. We continue to stay informed of the situation.

For the quarter, overall revenue rose 6% year over year to $5.6 billion, at the midpoint of management guidance when excluding the unexpected $500 million payment. Operating income rose 16% over the prior-year quarter. Qualcomm’s chip-making business, QCT, reported segment revenue increased 1% year over year to $4.1 billion. Shipments rose 6%, above the midpoint of management guidance, reflecting strong performance in China where local manufacturers are incorporating more premium content in devices. Implied average selling prices fell 5% due to the geographic mix and lower Apple sales. Segment margins of 15% were at the high end of management guidance and represented the ninth consecutive quarter of year-over-year margin improvement. Despite the improvement, margins remain below our long-term expectations for margins in the mid-to-high teens. Royalty revenue in the QTL patent licensing segment rose 25% year over year to $1.5 billion. QTL segment margins of 72% benefited from the $500 million payment, but would still have been above the high end of management guidance. Even with the payment, segment margins remain depressed versus our long-term expectations due to the loss of top-line revenue, coupled with heightened legal expenses from Qualcomm’s litigation strategy against Apple.

We continue to believe that the body of legal precedent established in multiple jurisdictions
worldwide over the past twenty years supports Qualcomm’s royalty business model. We like the long-term positioning of Qualcomm as a standalone company to benefit from the long-term secular growth in mobile devices. We believe the shares are currently selling at a meaningful discount to our estimate of Qualcomm’s intrinsic value, offering an attractive reward-to-risk opportunity.

Detractors

- **Facebook** is an online social networking platform that allows people to connect, share, and interact with friends and communities. People register to use the site, set up personal profiles, and add other users as friends. The basic platform allows message exchange, photo sharing, and common-interest user groups.

A fund holding since its IPO in the second quarter of 2012, Facebook was among the top detractors for the quarter. Although Facebook reported solid overall growth and market share gains during the most recent quarter, revenue came in slightly below expectations. Of more significance was management’s guidance for a near-term deceleration in revenue growth, coupled with a multi-year acceleration in investments. The company noted that revenue in the last half of 2018 will be negatively impacted by currency headwinds, its decision to provide users more choices around privacy, as well as its decision to increase focus on Instagram and FB Stories, “experience” products which the company believes will drive improved engagement but where monetization is currently lower. Facebook also announced a 50% - 60% increase in investments for 2018 targeting core product development, safety and security, virtual reality, marketing, and content acquisition, and expects total expenses will grow faster than revenue over the next few years. Capital expenditures have accelerated meaningfully over the past few years and are expected to reach $15 billion in 2018, up from $6.7 billion in 2017. 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.

We believe Facebook remains a unique, high-quality global 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. With 2.5 billion people worldwide using its apps – Facebook, Messenger, WhatsApp, and Instagram – and more than 80 million global businesses with Facebook pages, the scale and reach of Facebook’s network is unrivaled. When excluding China, where Facebook is not yet operating, the active user base represents almost 70% of the world’s internet population. Further, a virtuous cycle between Facebook users, advertisers, and partners strengthens the network advantage. We also believe 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.

Although the increased investment cycle over the next several years resulted in a slight decline in our estimate of intrinsic value, it does not change our view of the attractiveness of the long-term reward-to-risk opportunity. 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 and supporting our portfolio position
size.

- **Alibaba Group**, launched in 1999, is a leading China e-commerce and consumer
eengagement 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 IPO in the third quarter of 2014, the company was among the
biggest detractors for the quarter. Alibaba reported fundamentally strong quarterly financial
results. Revenue growth of 61% year over year exceeded expectations and represented
the ninth consecutive quarter of growth in excess of 50%. However, operating margins
were pressured by ongoing investments and the consolidation of lower-margin logistics
affiliate Cainiao and recently acquired local delivery services company Ele.me. 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 the addressable market through its “new retail” initiative. Reflecting the
magnitude of these opportunities, management has previously said that it expects to invest
$30 billion in logistics and research and development over the next five years. In September,
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, who is an 11-year veteran of Alibaba and 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 $768 billion and 552 million active annual
consumers on its China commerce retail sites 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 86% of Alibaba’s $12.2 billion of total quarterly revenue and grew
61% year over year. China commerce retail accounted for almost 80% of core commerce
revenues and grew 47% year over year. Mobile monthly active users grew 20% to 634
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 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 Hema grocery stores, accounts for approximately 10% of core commerce revenue and is growing at a multiple of the overall core commerce business. Core commerce revenues also benefited from the company’s substantial focus on international commerce, including global e-commerce marketplaces Lazada Group and AliExpress, and cross-border trade, where Tmall Global now provides 18,000 brands from 74 countries with a platform on which to build awareness and access the Chinese market without making substantial in-country investments. In total, the core commerce segment grew adjusted operating profits by 22% year over year. Adjusted operating margins of 47% declined 1,600 basis points versus the year-ago quarter, driven by a greater contribution from lower-margin new retail business, the consolidation of Cainiao and Ele.me, and continued investments in new retail, global expansion, and enhancing user experience.

Well positioned for the secular migration to cloud computing, Alibaba’s cloud-computing revenue rose 93% year over year and accounted for 6% 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 -10%, below the -4% margins in the year-ago quarter. Comprising approximately 7% of total revenue, digital media and entertainment revenue grew 46% compared with the year-ago quarter, due to an increase in subscription and advertising revenue from Youku Tudou, a leading online video platform in China, and mobile value-added services such as news feeds and mobile search from UC Web. 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 and reported a decline in operating margins to -52% from -43% in the prior-year quarter. Innovation initiatives and others accounted for 2% of revenue and rose 64% 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 -114% declined from margins of -98% in the year-ago quarter.

Management continues to use strong cash flows generated by Taobao and Tmall to invest in cloud computing, digital media and entertainment, and other initiatives. During the quarter, Alibaba completed its acquisition of online food delivery services company Ele.me, in which it previously held a minority interest. Alibaba will combine Ele.me with Koubei, an affiliated local-services platform focused on in-store consumption in China. The platform will also include Ant Financial and SoftBank as outside investors.

Alibaba’s quarterly adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) rose 17% year over year, and the EBITDA margin of 36% was down 1,400 basis points, as gains from operating leverage were more than offset by the consolidation of Cainiao and Ele.me and continued investments in new retail, global expansion, and enhancing user experience. For the quarter, free cash flow of $4 billion grew 22% year over year and represented 33% of quarterly revenue. Alibaba continues to execute well on its business model, allowing it to expand its already dominant market position and to 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.

- **Schlumberger** is the world’s leading supplier of technology, equipment, integrated project management, and information solutions to the international oil and gas exploration and production industry. A long-term fund holding, Schlumberger was among the largest detractors from performance during the quarter. The company’s most recently reported financial results were generally in line with expectations, but stocks in the oil services sector came under pressure due to short-term concerns around slowing activity in North America due to insufficient takeaway capacity in the Permian basin and potential impacts on demand from trade disputes and emerging market weakness. Over its 90-year history, Schlumberger has built a brand and reputation for delivering consistent service and product excellence across the spectrum of exploration, drilling, and production. Only a few companies can compete with the scope of Schlumberger’s integrated suite of products and services, and even fewer can compete with the scale and depth of its technology and service execution. Secular growth in the long-term global demand for oil, arising from increasing emerging markets consumption and the need to replace naturally depleting reserves, is driving the need to extract hydrocarbons from harsher environments that are increasingly difficult to reach or extract from. Because oilfield services companies are key to making difficult-to-reach resources more accessible, we believe services like those Schlumberger provides will become an increasingly larger portion of the overall cost of extracting energy resources and that Schlumberger will disproportionately benefit from this shift.

Quarterly revenue of $8.3 billion grew 11% year over year and 6% over the prior quarter. Schlumberger’s results reflected an ongoing recovery in North American activity, while the company reported a slight decline in its larger international operations, where industry spending has been flat. North America revenues, which have historically accounted for approximately 25% of total revenues, comprised almost 40% of total revenue in the period and rose 43% compared with the year-ago quarter, and 11% sequentially. After experiencing the sharpest decline in revenue among Schlumberger’s reporting segments during the downturn which began in mid-2014, the region is now seeing the fastest recovery. Year-over-year growth compared favorably with overall growth in North America rig count, which rose approximately 14% year over year, as well as with wells drilled and completed, which each rose by approximately 30%. Versus the previous quarter, the company saw strength in offshore activity, which grew in excess of 20%, while land revenues grew in the high single digits. International markets, about 60% of total revenue, declined 1% year over year due primarily to weakness in Latin America, which declined 12% over the prior-year quarter. While management has been prematurely optimistic about a recovery outside of the US, their recent commentary suggests that recovery may be starting. Management commented that, based on contracts it has already won, Schlumberger’s international equipment capacity would be fully utilized by the end of 2018, and that international growth in 2019 would be in the double digits.

Consolidated operating margins for the company were 10.3% for the quarter, up 80 basis points year over year and up 100 basis points versus the prior quarter. The company generated free cash flow of $250 million in the quarter, up 160% year over year, and ended the quarter with $14.6 billion in net debt, and cash and investments of $3 billion. We believe Schlumberger has maintained exemplary revenue, margins, and cash flow for this point in the cycle. Over a two-year period, which began in 2014 and saw industry
spending fall by over 50%, Schlumberger gained share and maintained leading margins, while several competitors posted losses or very thin margins. Schlumberger was one of the few companies to generate positive free cash flow during the downturn, and continued to invest to strengthen its ability to offer integrated solutions to clients, making several acquisitions, notably Cameron International, and increasing its total addressable market by 50% in the process. We believe Schlumberger will continue to execute well and that the company is well positioned to drive growth as the demand for oil services rebounds globally. The company is showcasing its industry-leading products and services, which we believe will result in long-term pricing power and market share tailwinds. We believe shares of Schlumberger are selling at a significant discount to our estimate of intrinsic value, offering 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 leads 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, energy, financials and healthcare sectors and underweight positions in the industrials, consumer discretionary and information technology sectors. We did not own positions in the real estate, materials or telecommunication services 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-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. 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.

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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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