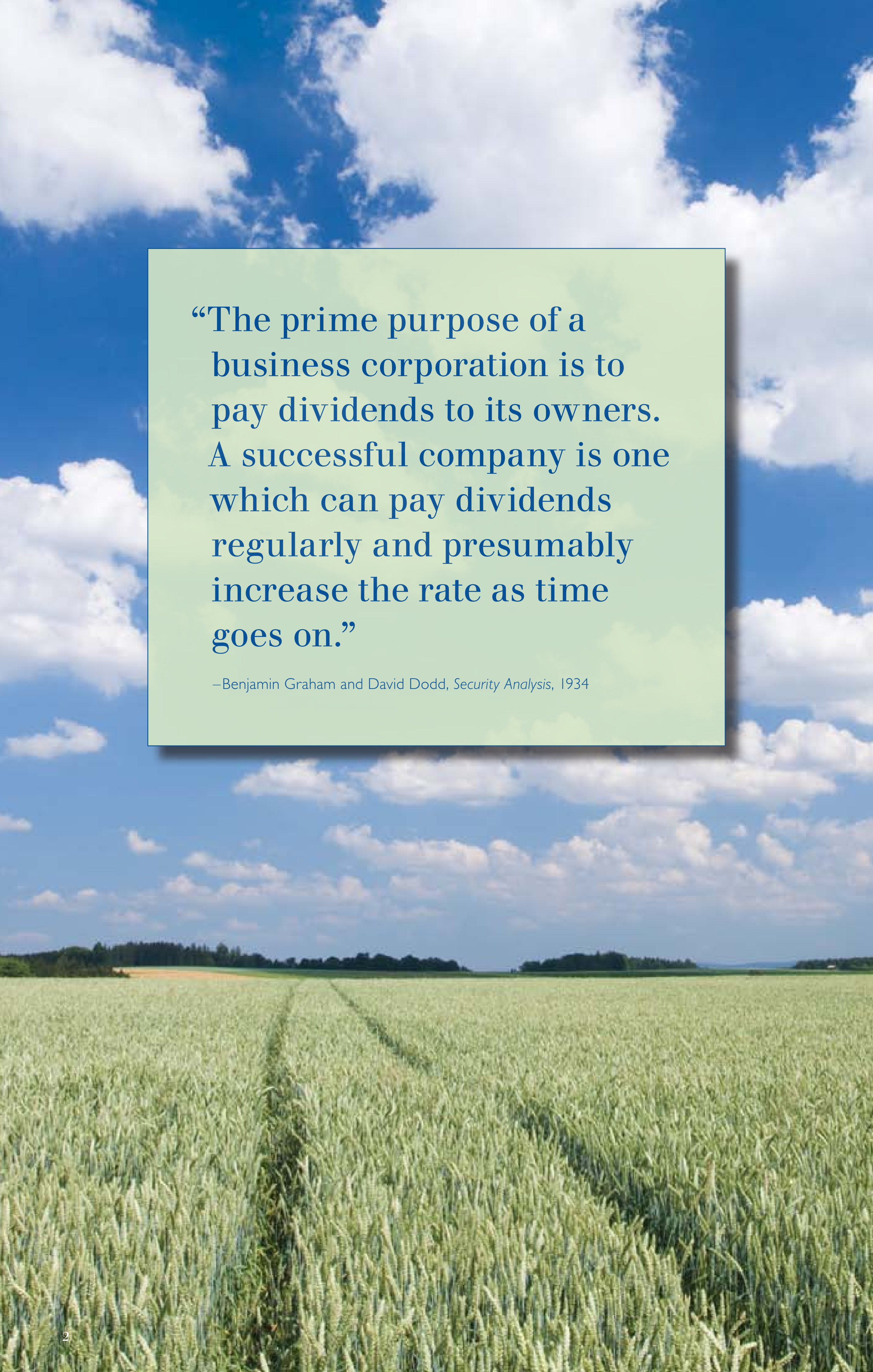
Thornburg Investment Management®

Strategies for Building Real Wealth

Cultivating the Growth of the Dividend



> "The prime purpose of a business corporation is to pay dividends to its owners. A successful company is one which can pay dividends regularly and presumably increase the rate as time goes on."
>
> –Benjamin Graham and David Dodd, *Security Analysis*, 1934

Investors often focus their sights solely on stock prices – dwelling on the quick reward or painful loss that comes from movements in share prices. However, this ignores an important source of return for equity investors: the capital returned to investors through dividend payments. In the past, dividend payments were the primary aim of equity investors, and today, dividends can serve a critical role in investors' portfolios.

Putting Dividends into Perspective

It is sometimes hard to imagine today, but early in the 20th century, stocks were not seen as capital appreciation vehicles. Investors did not purchase stocks with an aim of selling them at a substantially higher price, but for the dividends that they were expected to pay.

At that time, accounting standards were weak at best, and oversight of the securities markets was embryonic. Earnings reports issued by corporations were infrequent and provided very little helpful information. One of the only true measures of the health of a company was the dividend it paid. Not surprisingly, corporate managers were much more willing to return profits to investors in the form of dividends, and payout ratios were substantially higher than those we are seeing today. In fact, by 1951, the dividend yield on the S&P 500 Index had exceeded the 10-year bond yield for eighty straight years.[1]

1 Jack Gray, "Avoiding Short-Termism In Investment Decision Making", Global Perspectives on Investment Management: Learning from the Leaders, December 2006.

Figure 1: Dividends have historically been an important part of total return

Decade	Price Appreciation	Income Component
1871 – 1880	2.8%	**6.1%**
1881 – 1890	-2.1%	**4.8%**
1891 – 1900	4.2%	**4.5%**
1901 – 1910	2.5%	**4.6%**
1911 – 1920	-2.6%	**6.1%**
1921 – 1930	**6.7%**	5.6%
1931 – 1940	-2.8%	**4.9%**
1941 – 1950	**6.7%**	6.4%
1951 – 1960	**10.2%**	5.0%
1961 – 1970	**4.7%**	3.5%
1971 – 1980	4.0%	**4.5%**
1981 – 1990	**9.3%**	4.6%
1991 – 2000	**14.9%**	2.6%
2001 – 2009	-1.9%	**1.9%**

Sources: Jack W. Wilson and Charles P. Jones, "An Analysis of the S&P 500 Index and Cowles's Extensions: Price Indexes and Stock Returns, 1870–1999", Journal of Business, 2002, vol 75 no 3. Data after 1990 is from Bloomberg, Confluence, and FactSet. Calculated by Thornburg Investment Management. Returns are annualized.

Based on investor preferences for dividends and the lack of information with which to value businesses, dividends were the primary source of return for equity investors. The relatively recent focus on capital appreciation masks the fact that over the past 130 years, dividends have actually contributed more to return than price appreciation (see **figure 1**).

The Benefits of Dividend-Paying Stocks

Although the focus of U.S. equity investors has shifted from income generation to capital appreciation, dividends remain a significant component of total return, and dividend-paying equities can fulfill an important role in investor portfolios. Several simple, straightforward and compelling reasons can be shown for making dividend-paying equities a cornerstone of any investor's portfolio.

DIVIDENDS HAVE HISTORICALLY PROVIDED A GROWING INCOME STREAM

As the investment landscape changes, Americans are increasingly looking for investments that can generate income – not just steady income but one which has potential to grow over time and keep pace with inflation. Financial services providers are launching a large number of complex financial instruments to address the growing need for income; however, many of these are costly and untested.

Meanwhile, a straightforward strategy focused on dividend-paying equities has the potential to solve the needs of many of these investors.

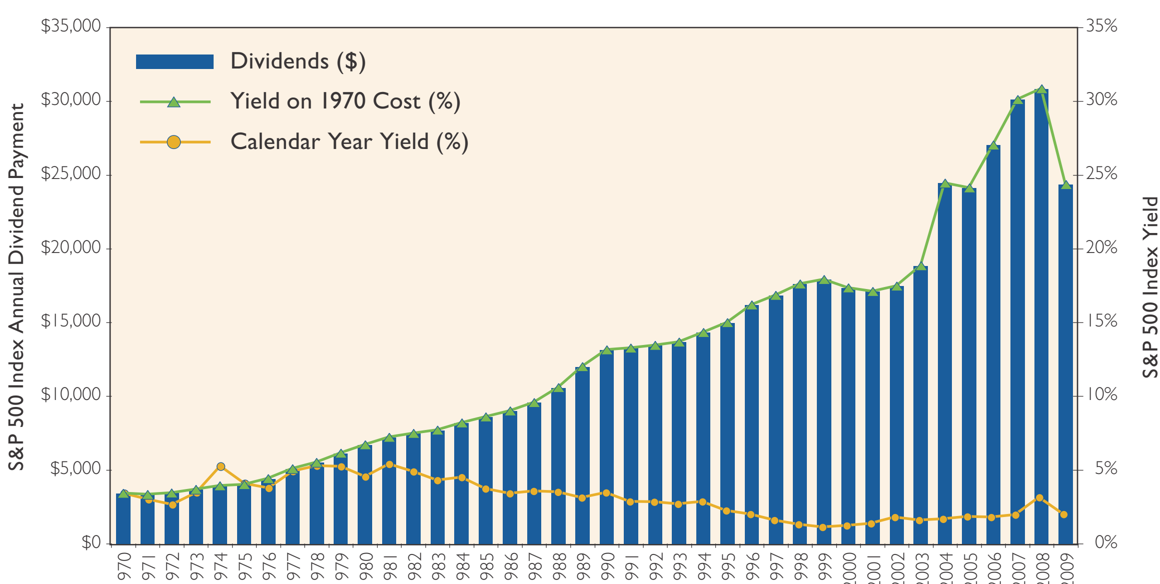
Look no further than the S&P 500 Index. A hypothetical share of the S&P 500 Index provided dividends of $5.65 in 1979. Even though annual yields have been declining, dividends paid on that single share would have grown to $22.41 in 2009, even assuming preceding dividends received had been spent along the way (see **figure 2**). If those interim dividends were reinvested through 2009, the amount of income generated once payouts commenced would have been much higher.

While there is no guarantee that dividends will grow every year, dividend-paying equities provide the opportunity for an increasing income stream. The yield on equities may be falling on a percentage basis (as the prices on stocks have grown faster than the dollar amount of dividends). However, the fact that the actual income from dividends has risen dramatically over the past 30 years is indisputable. That growth in income is becoming especially important as baby boomers enter the retirement phase and look for vehicles which can provide income to keep pace with inflation over a long retirement.

Many investors turn to bonds for income. Bonds generally provide a fixed coupon rate for their life, and at any given time, the yield on bonds may be higher than that of equities. While their relatively stable returns balance the volatility of equities, the fixed nature of their coupon generally precludes growth in income (see "Seeking Income?" on page 6).

Figure 2: Annual Dividend Growth on a One-time Hypothetical $100,000 Investment vs. Yield

(based on performance of the S&P 500 Index, dividends not reinvested)

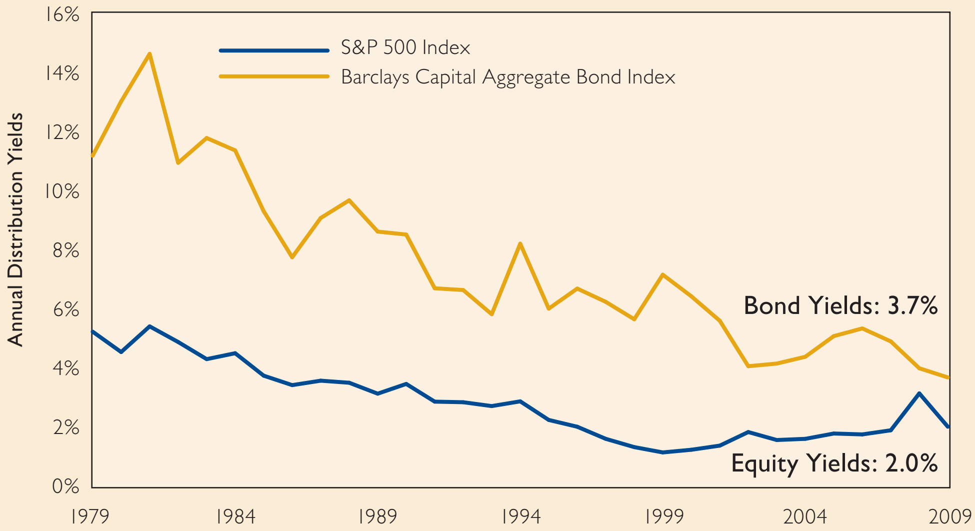


Source: Bloomberg, Standard & Poor's, and FactSet. Dividends are not reinvested. The performance of any index is not indicative of the performance of any particular investment. Investors cannot invest directly in an index.

Seeking Income?
Don't Count on Yield Alone

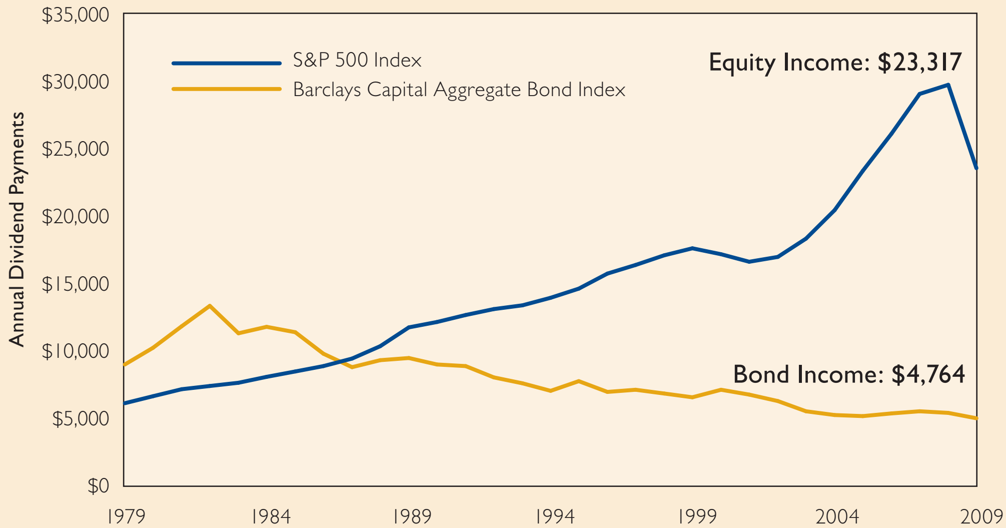
When evaluating income-producing investment vehicles, investors tend to focus their efforts on an investment's yield, or current income divided by current price. While yield is an important statistic, an overemphasis on that one measure can mask the actual dollar amount paid to investors over time.

Yields on Bonds Tend to be Higher than Yields on Equities



However . . . Dividends from Stocks have Growth Potential

Income from hypothetical investment of $100,000, beginning on 12/31/78, dividends not reinvested



Bonds are debt investments in which an investor loans money to an entity (corporate or governmental) which borrows the funds for a defined period of time at a fixed interest rate. Bonds are subject to certain risks including, but not limited to, loss of principal, interest rate risk, credit risk, and inflation risk. The value of a bond will fluctuate relative to changes in interest rates; as interest rates rise, the overall price of a bond falls.

A stock (equity) is a share in the ownership of a company. As an owner, investors have a claim on the assets and earnings of a company, and in some cases, voting rights with the shares. Historically, stock investors have been subject to a greater risk of loss of principal compared to bond investors. However, both stock and bond prices will fluctuate, and there is no guarantee against losses. There is no guarantee a dividend-paying stock will continue to pay dividends.

Dividends and gains on investments may be subject to federal, state, or local income taxes as well as the alternative minimum tax.

The performance of any index is not indicative of the performance of any particular investment. Index returns do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index.

Source: Bloomberg, Barclays Capital, and FactSet

DIVIDENDS AND GROWTH ARE NOT MUTUALLY EXCLUSIVE

A key factor in the migration of equity investor focus from dividends to capital appreciation is the misconception that the two are mutually exclusive goals. Conventional wisdom is that companies paying a dividend are not able to identify projects which could generate high rates of return. Because they cannot find attractive opportunities for excess cash, they choose to return profits to investors in the form of dividends. In fact, during the bull market of the late 1990s, dividends were viewed as a signal to the markets that you did not have confidence in your ability to grow the company.[2]

More recent research is showing that the opposite is true – that dividend-paying companies actually demonstrate higher, not lower subsequent growth rates.

Figure 3: Average Subsequent 10-Yr EPS Growth

Starting Payout Quartile	Worst	Average	Best
One (Highest Payout)	0.6%	4.2%	11.0%
Two	-1.1%	2.7%	6.6%
Three	-2.4%	1.3%	5.7%
Four (Lowest Payout)	-3.4%	-0.4%	3.2%

Source: Robert D. Arnott and Clifford S. Asness, "Surprise! Higher Dividends = Higher Earnings Growth?", Financial Analysts Journal, Jan/Feb 2003. Data analyzed: 1946-2001. This is the most recent data available. Inclusion of subsequent periods could change the results.

Why does this seemingly counterintuitive relationship exist? The study that brought this relationship to light[3] provides several explanations, one of which is that companies which pay a dividend impose upon themselves a form of fiscal discipline. In an ideal world, companies will only retain those profits which can be invested in projects that exceed their cost of capital; if the money cannot be invested at that rate, then it should be returned to shareholders in the form of dividends. Unfortunately, many managers are overly confident in their ability to find these projects and grow their earnings, and many invest in projects which do not reflect this economic reality. As the authors contend, "An otherwise benign coincidental policy of earnings retention may encourage empire building by creating an irresistible cash hoard in the corporate pocket."

Conversely, those that pay a dividend impose on themselves a form of fiscal restraint: as there is less money on hand, they are more thorough in their evaluation of projects to undertake. Only those that can provide the highest returns warrant investment. Keep in mind, there is no guarantee that a dividend-paying company will have better performance or grow earnings.

2 Clifford Asness, "Rubble Logic: What Did We Learn from the Great Stock Market Bubble", Financial Analysts Journal, September 2005.

3 Robert Arnott and Clifford Asness, "Surprise, Higher Dividends = Higher Earnings Growth", Financial Analysts Journal, January/February 2003.

"Having a large cash hoard in the corporate till is akin to having a pocket full of money – it encourages you to spend."

– Jeremy J. Siegel, *The Future for Investors*, 2005

"Historically, dividends are not simply an important part of total stock returns, they are an important aspect of corporate governance. Not a bad combination."

–Clifford Asness, "Rubble Logic: What Did We Learn from the Great Stock Market Bubble"; *Financial Analyst Journal*, September 2005

DIVIDENDS, VALUATION, AND CORPORATE GOVERNANCE

Corporate managers are loath to cut dividends, based on the signal it sends to the market about the business' health. A cut in the dividend is seen by the market as a sign of troubled corporate health, and the price of that company's stock is often traded down significantly.

Managers' willingness to increase the dividend sends the opposite signal – that they are confident in the long-term earnings prospects of the firm. Pioneering research published in 1956 showed that managements believe that the market prefers stable, or gradually growing dividends to those that fluctuate in lockstep with changes in earnings. As such, managements avoid making changes in the dividends that may have to be reversed down the road and only increase the dividend when they believe that those increases can be supported over the long term with higher, sustainable earnings.[4] Not only do increases in dividends provide additional cash to investors, they also signal to the market that management has confidence that strong, sustainable earnings may be ahead for the company.

Finally, dividends provide a tangible method of valuing a company. Although accounting standards have improved since the days when the dividend was the primary sign of the value of a company, dividends remain a straightforward method of determining value. Companies are able to manage earnings by their accounting choices, and the motivations for managing earnings range from the costs associated with raising future capital to executive bonuses. Often the decisions company executives make when managing earnings are value-destructive. A survey of chief financial officers conducted in 2003 showed that an amazing 78% would admit to sacrificing a small, moderate, or large amount of value to achieve a smoother earnings path.[5]

While these accounting choices are usually within generally accepted accounting principles, they make valuing a company based on its reported earnings per share problematic. Dividends, on the other hand, are money in investors' pockets. The value of this is not subject to estimation.

The fiscal discipline displayed by companies paying dividends, combined with the confidence shown to the market in their ability to maintain or increase their earnings, have made these vehicles attractive investments historically. Managements following reasonable dividend policies often demonstrate to the market their commitment to enhancing long-term shareholder value. Please note, changing economic conditions could affect a company's ability or willingness to pay dividends.

> **"Nobody knows how to measure true earnings. Everybody knows the precise amount of a dividend declaration."**
>
> –Peter L. Bernstein, "Dividends and the Frozen Orange Juice Syndrome," *Financial Analysts Journal, Reflections*, March/April 2005

4 John Lintner, "Distribution of Incomes of Corporations Among Dividends, Retained Earnings, and Taxes", The American Economic Review, May 1956.

5 John Graham, Campbell Harvey, Shiva Rajgopal, "Value Destruction and Financial Reporting Decisions", The Journal of Accounting and Economics, September 6, 2006 (updated from an earlier version in 2005).

Dividend-Paying Equities as an All-Weather Strategy

Despite the fact that U.S. investors have recently focused their sights on capital appreciation, dividends continue to be a key factor in building wealth. In a shallow bear market, dividends can cushion overall market declines, sometimes meaning the difference between positive and negative returns. In addition, the reinvestment of dividends in falling markets can accelerate and magnify the recovery of investor portfolios when markets rise.

As **figure 4** shows, the S&P 500 Index did very well from January 1970 through December 2009, even without accounting for dividends. One share of the S&P 500 grew to over $1,115 by the end of 2009, an annualized return of 6.66%.

However, one can see that the additional return generated by reinvesting those dividends would have dwarfed the return earned by simple price appreciation. By continually accumulating additional shares through reinvesting dividend payments, the S&P 500 Index would have grown to over $3,900 by the end of 2009, an annualized return of 10.10%.

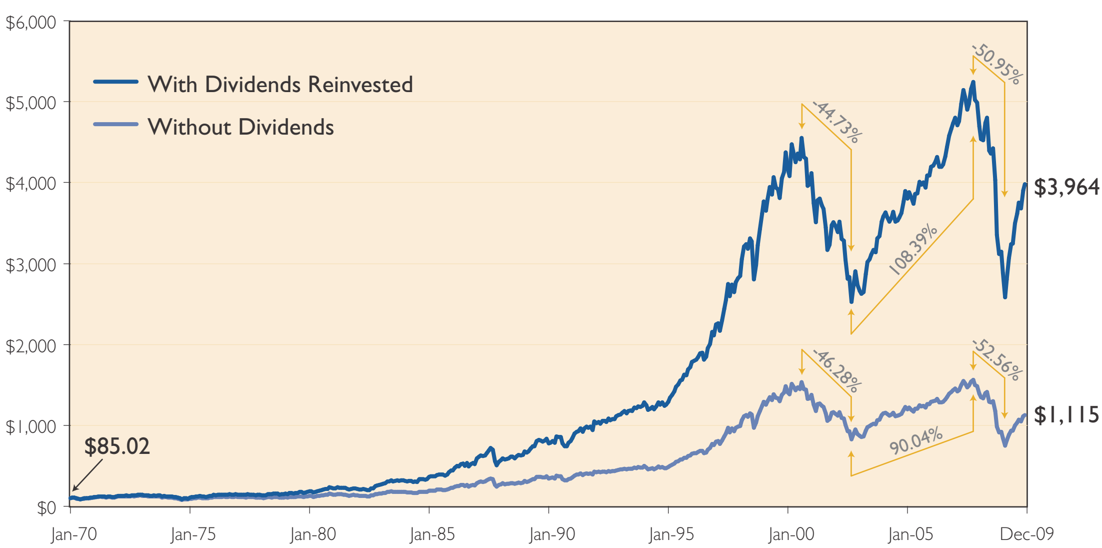
These principles can be especially important in periods of anemic or negative equity returns. Even when the economy is struggling, or the markets are in turmoil, company managements are often reluctant to announce dividend cuts due to the negative signal it sends to the market. While there is no guarantee a company will continue to pay dividends in a declining market, far-sighted investors are able to take advantage of market downturns by staying invested and accumulating additional shares as prices fall. This form of dollar-cost averaging is something that noted market researcher Jeremy Siegel refers to as a return accelerator.

Take as an example the bursting of the dot-com bubble. Looking at monthly index values, the S&P 500 Index reached a peak of 1,518 in August of 2000. Equity prices subsequently declined, with an average annual loss of 25.79% when dividends were not reinvested (from 8/31/00 to 9/30/02) and an average annual loss of 24.77% when dividends were reinvested (see **figure 4**).

Reinvesting dividends during this market downturn would have resulted in the accumulation of more shares at lower prices, enhancing returns when markets staged a recovery in 2003. Reinvesting dividends earned an average annual total return of 15.54% from the low point on 9/30/02 to the peak on 10/31/07, compared to 13.46% if the dividends were not reinvested over that time period. Much has been made of the fact that dividends can cushion the decline in prices during falling markets. However, they can also set the stage for stronger performance when markets do recover. Please note, past performance does not guarantee future results and investors can lose money when following a dividend-focused strategy.

Figure 4: Contribution of Dividends to Total Return

S&P 500 Index growth (January 1970 to December 2009)



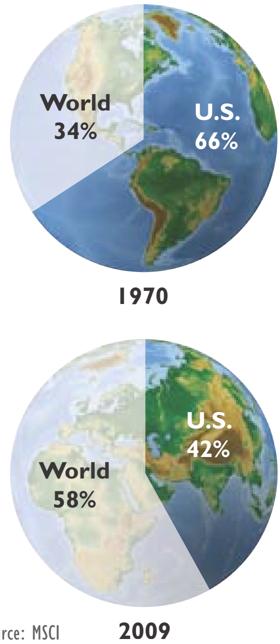
Source: Bloomberg and Standard & Poor's. Return with dividends represents the growth of one share, including the reinvestment of dividends. Data without dividends is the monthly closing price. Return percentages on the chart are cumulative (not annualized). Past performance does not guarantee future results. The performance of any index is not indicative of the performance of any particular investment. Investors cannot invest directly in an index.

The Global Dividend Landscape

As the world's economies globalize and U.S. investors place more of their money in international equities, they are finding that dividend-paying equities can provide three important benefits to U.S. investors.

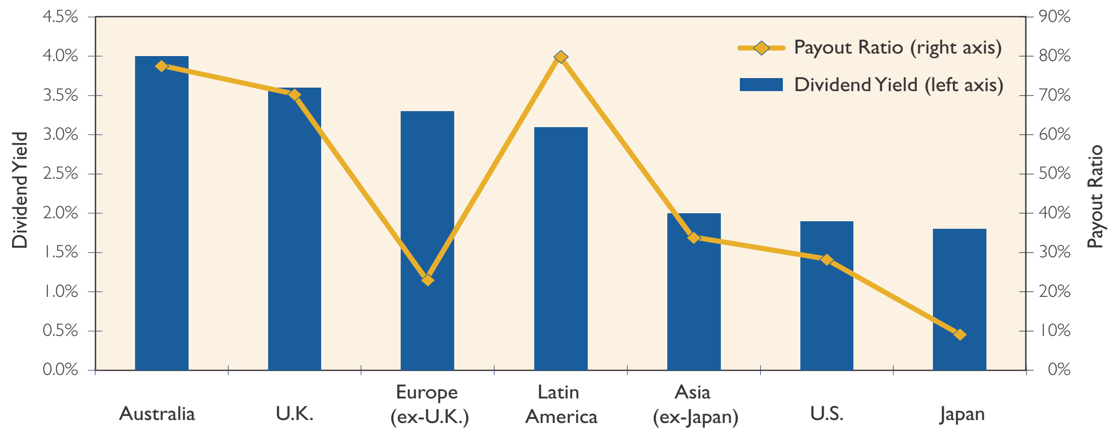
First, capital markets outside of the United States continue to develop. Countries such as Japan, Germany, the United Kingdom, and France are home to some of the world's largest publicly traded companies. In addition, many developing economies exhibit higher growth rates than those here in the United States, and as they develop their capital markets, new opportunities for investors are being created. In fact, companies domiciled overseas now account for a larger percentage of global market capitalization than U.S. companies. U.S. investors avoiding these firms are limiting themselves to less than half of all of the world's publicly traded companies.

Figure 5: Shift in U.S. and World Market Capitalization



Source: MSCI

Figure 6: Average Dividend Yields of Markets Around the Globe



Source: FactSet, as of December 31, 2009; Countries and regions above, except the United States, are represented by MSCI indices. The United States is represented by the S&P 500 Index. The dividend payout ratio is a fraction that expresses dividend payments as a percentage of per-share earnings.

Second, simply going overseas may improve portfolio yield. In many areas of the world, when compared to the United States, corporate cultures are oriented more towards returning capital to investors in the form of dividends. Often, major overseas corporations are more closely controlled by a majority shareholder who seeks repatriation of profits. By investing a portion of their portfolio overseas, U.S. investors are in many cases able to improve their overall portfolio yield.

Third, for investors seeking income-producing equities, international stocks provide greater opportunities to diversify at the individual security and sector level. In the United States, companies with attractive payout ratios and yields are usually confined to a few specific areas of the market, including telecommunications and financials. As international firms, on average, demonstrate higher payout ratios and yields, U.S. investors seeking income from foreign equities are provided more opportunities to diversify their portfolios, at both the individual security and sector levels.

Figure 7: Willingness to Pay Dividends Varies Across Sectors and Geographies

2010 dividend yield estimates

	United States	Europe	Asia (ex-Japan)
Financials	1.8%	**3.1%**	**2.6%**
Banks	1.3%	**2.7%**	**3.0%**
Diversified Financials	1.1%	**3.3%**	**2.1%**
Insurance & Other	2.2%	**4.3%**	1.3%
Real Estate	**5.0%**	4.9%	2.2%
Materials	1.8%	**2.0%**	1.8%
Telecom	5.5%	**6.3%**	4.2%
Utilities	4.4%	**4.8%**	2.4%
Industrials	2.2%	**2.7%**	1.7%
Consumer Staples	**2.9%**	**2.9%**	1.8%
Consumer Discretionary	1.4%	**2.7%**	**1.5%**
Energy	2.1%	**4.1%**	**2.2%**
Health Care	2.0%	**3.5%**	0.9%
Information Technology	0.9%	**2.3%**	**1.8%**
Composite	2.0%	**3.5%**	**2.3%**

Source: FactSet, December 31, 2009. Average 2010 yield estimates for all stocks in a given geography that have USD market caps greater than $500 million.

International investing involves special risks, including currency fluctuations, government regulation, political developments, and differences in liquidity. Diversification does not assure or guarantee better performance and cannot eliminate the risk of investment losses.

Putting Dividends to Work for You

There are numerous reasons why dividends make sense for investors, including:

- Dividends have historically been a major component of total return for stocks.
- Dividends provide a measure of value not subject to manipulation by corporate management; earnings are subject to the vagaries of accounting, but dividends are tangible.

- Dividend-paying equities provide income which has potential to grow over time.
- Historically, companies which pay dividends have been shown to grow their earnings at rates faster than companies which do not, and total returns have been higher for dividend-paying equities.

- Dividends can provide a cushion in bear markets, and reinvesting dividends can accelerate returns when markets rebound.

Following a dividend-focused strategy does not assure or guarantee better performance and cannot eliminate the risk of investment losses. There is no guarantee that a company paying dividends in the past will always pay a dividend in the future.

Thornburg Investment Income Builder Fund

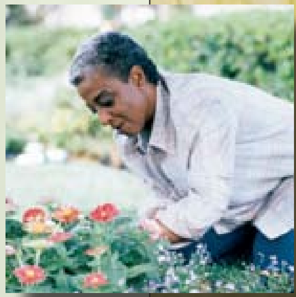
Thornburg Investment Income Builder Fund was conceived to enhance all phases of an investor's life – whether it be accumulating and growing capital or generating income. The fund focuses on high-quality, dividend-paying companies and seeks to generate a growing dividend that can be reinvested or paid out quarterly. A side benefit may be some capital appreciation.

DESIGNED FOR INVESTORS SEEKING . . .

- Exposure to the stock market in the form of dividend-paying equities.
- A diversified portfolio consisting of domestic and foreign equities with a fixed income component constructed to ease volatility.
- Investment in international equities in the form of established, dividend-paying companies.
- An income-oriented portfolio built on the bottom-up, fundamental research for which Thornburg Investment Management is known.
- Capital appreciation potential.

CO-PORTFOLIO MANAGERS

- Brian McMahon
  CEO and Chief Investment Officer
  Responsible for equity component
- Cliff Remily, CFA
  Managing Director
  Responsible for equity component
- Jason Brady, CFA
  Managing Director
  Responsible for bond component



For additional information regarding the fund, please visit www.thornburg.com/iib

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

There is no guarantee the Fund will meet its objectives.

Before investing, carefully consider the Fund's investment goals, risks, charges, and expenses. For a prospectus containing this and other information, contact your financial advisor or visit thornburg.com. Read it carefully before investing.

Thornburg Investment Management®
Strategies for Building Real Wealth

2300 North Ridgetop Road
Santa Fe, New Mexico 87506

www.thornburg.com

1.800.847.0200

Headquartered in Santa Fe, New Mexico, Thornburg Investment Management advises nine bond funds, seven equity funds, and separate portfolios for institutions and high net worth individuals.

We focus on preserving and increasing the real wealth of our shareholders after accounting for inflation, taxes, and investment expenses. Thornburg offers strategies for building real wealth emanating from our disciplined investment style focused on risk management and investors' long-term goals.

Barclays Capital Aggregate Bond Index – An index composed of approximately 8,000 publicly traded bonds including U.S. government, mortgage-backed, corporate and Yankee bonds. The index is weighted by the market value of the bonds included in the index.

MSCI All Country Asia ex-Japan Index – A free float-adjusted market capitalization index that is designed to measure equity market performance in Asia. As of March 2008, the MSCI All Country Asia ex-Japan Index consisted of the following 11 developed and emerging market country indices: China, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore Free, Taiwan, and Thailand.

MSCI Country Indices (Australia, U.K. and Japan) – Free float-adjusted market capitalization indices that are designed to measure equity market performance in that specific country.

MSCI EM (Emerging Markets) Latin America Index – A free float-adjusted market capitalization index that is designed to measure equity market performance in Latin America. As of June 2007, the MSCI EM Latin America Index consisted of the following emerging market country indices: Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

MSCI Europe ex-U.K. Index – A free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. As of June 2007, the MSCI Europe Index consisted of the following 15 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.

Standard & Poor's 500 Stock Index (S&P 500) – An unmanaged index generally representative of the U.S. stock market.

Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index. The performance of any index is not indicative of the performance of any particular investment.

Coupon Rate – The interest rate stated on a bond when it's issued. The coupon is typically paid semiannually.

Duration – The measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows.

Earnings per Share (EPS) – The total earnings divided by the number of shares outstanding.

Yield-on-Cost – The yield earned on the original cost of an investment and is defined as the yield earned in the period divided by the original cost of the investment. This measure differs from the traditional yield measure, which divides the yield by the current price. In a market where a security has risen in price and the dividend yield has remained consistent or increased, the yield-on-cost will tend to be higher than the current yield.

Thornburg Securities Corporation,® Distributor

4/29/10
TH1731