Thornburg Investment Management®

Strategies for Building Real Wealth

Thornburg Investment Management Bond Funds

# A Tradition of Disciplined Bond Management

# Our History

Thornburg Investment Management was founded by Garrett Thornburg in Santa Fe, New Mexico, in 1982 on the belief that fixed income investment managers could do a better job of preserving the real wealth of shareholders – after inflation, taxes, and investment expenses. Since that time, Thornburg has sought, via a comprehensive and responsible approach to portfolio management, to provide bond fund shareholders with attractive returns and relative stability of principal.

Since our founding, Thornburg has launched a total of nine bond mutual funds to meet the income needs of a wide range of investors. While each Thornburg bond fund follows a unique mandate, all nine share a focus on comprehensive portfolio management and seek to capitalize on the expertise of a team built over the course of more than 25 years of fixed income investing.

## Thornburg manages nine bond mutual funds.

### SEVEN CORE FUNDS

The core bond funds are managed fairly conservatively, to minimize risk and provide attractive, stable levels of income.

Limited Term Municipal Fund
Intermediate Municipal Fund
California Limited Term Municipal Fund
New Mexico Intermediate Municipal Fund
New York Intermediate Municipal Fund
Limited Term Income Fund
Limited Term U.S. Government Fund

### TWO STRATEGIC FUNDS

Recognizing that some investors may seek additional income, Thornburg offers two strategic funds, which complement the core offerings, but with a more flexible mandate in pursuit of a higher level of income.

Strategic Income Fund
Strategic Municipal Income Fund

Thornburg Investment Management's View:

# The Role of Bonds in a Portfolio

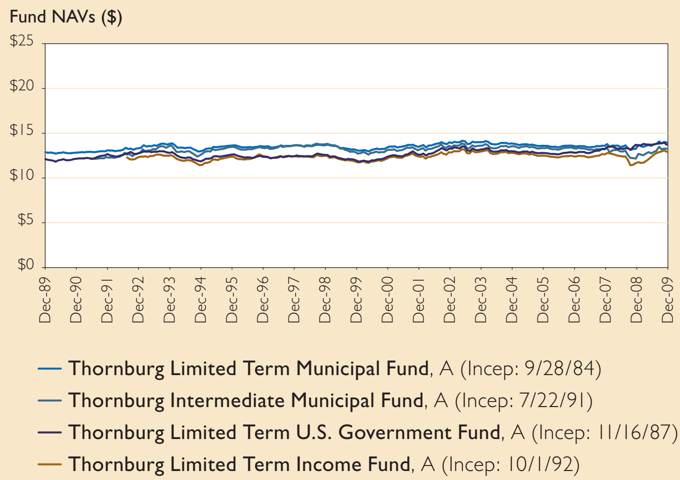
## PRESERVE PRINCIPAL OVER THE LONG TERM

***One of the many roles that bonds play is to help preserve an investor's principal.*** Whether as a stand-alone bond investment whose primary intent is to generate regular income, or as part of a diversified portfolio that includes other asset classes, a prudently managed bond portfolio may help ensure that principal values remain relatively stable over time.

The chart at right demonstrates how Thornburg's *core* bond funds have mitigated risk in order to maximize stability of principal over time. Even during periods of bond market volatility, the funds experienced only small fluctuations in net asset values (NAVs), the price at which shareholders sell their mutual fund shares.

**Aiming to Preserve Principal in Multiple Market Cycles**

Even through periods of turmoil, historically, our per share net asset values have remained remarkably stable.




Source: Thornburg.

## PRODUCE STABLE, PREDICTABLE INCOME STREAMS

Investors have many options when seeking income from their investments. Equity dividends are an attractive income source, with the potential to grow over time, but are subject to reduction or elimination at the discretion of a corporation's board of directors. High-quality bonds are established obligations which companies are required to pay, and while defaults are a possibility, bonds have historically provided a more reliable and stable income stream than dividend-paying equities.

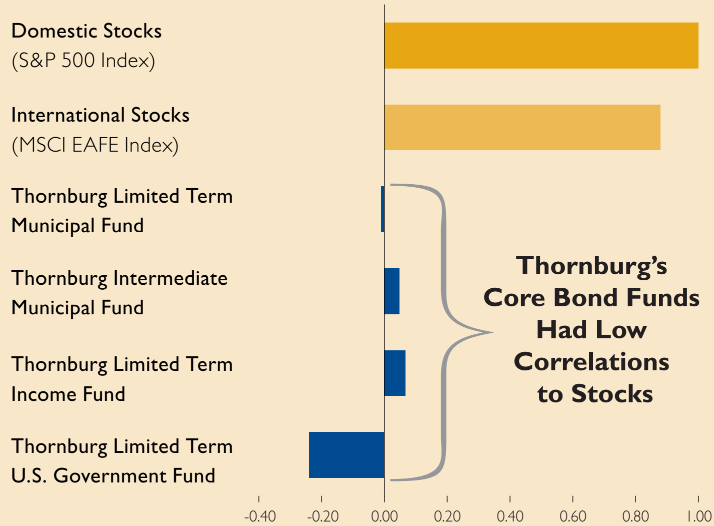
> Rather than incur unforeseen risk in an attempt to stretch for yield, we focus our efforts on providing investors with what they expect over the long term: portfolios that provide attractive income streams, given a certain level of risk, and genuine diversification away from more volatile asset classes.

## OFFSET THE PRICE FLUCTUATION OF EQUITIES

The performance of some asset classes, such as stocks and bonds, tends to react independently to varying market conditions. Historically, in years when one asset class was down, the other has tended to be up. This relationship is expressed as a correlation. As shown on the right, bonds generally have low or negative correlations to stocks, meaning they fluctuate in value at different times and to varying degrees.

**Diversification Depends on Non-Correlated Investments**

10-Year Correlations vs. the S&P 500 Index as of 12/31/09




Correlation measures the degree to which two variables move together. A correlation coefficient of 1 (the highest) would indicate the returns of the mutual funds and/or indices move in the same direction to equal degrees. A correlation of 0 indicates that there is no relationship between returns. And a correlation of -1 (the lowest) would indicate the performance moved in opposite directions by equal amounts. Sources: Standard & Poor's, MSCI Barra, NASDAQ, Morningstar, and Thornburg Investment Management.

The low correlation between high-quality bonds and equities makes fixed income an important part of a well-diversified portfolio. But not all fixed income investments provide the same level of diversification. Aggressive fixed income strategies can incur greater volatility in times of economic stress and often behave more like equities.

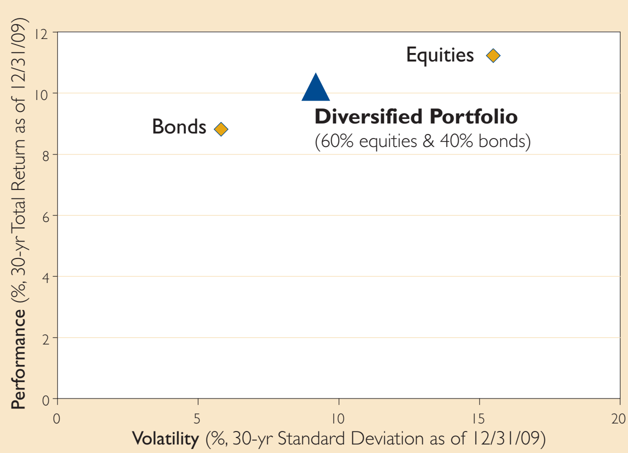
Unfortunately, during the most recent period of easy credit, many investors lost the diversification benefits of a fixed income allocation by adopting riskier strategies in an attempt to maximize yield. Believing they were combining uncorrelated assets into a diversified portfolio, some investors saw deep losses. Careful risk mitigation is key to keeping correlations to equities low.

## PROVIDE LOW VOLATILITY AND ATTRACTIVE RISK-ADJUSTED RETURNS

High-quality bond holdings not only exhibit lower volatility, but after adjusting for risk, they can provide returns on par with equities over the long term. And when combined with equities, bonds can guard against unwanted swings in a portfolio's value.

The chart at right portrays a mix of 40% bonds and 60% stocks. *Note that over the past 30 years, the diversified portfolio provided 90% of the return of the all-equity portfolio, with only 59% of the volatility.*

**Bonds Can Decrease Portfolio Volatility**




*Past performance does not guarantee future results.* Equities are represented by the S&P 500 Index, and Bonds are represented by the Barclays Capital Aggregate Bond Index. Investors cannot invest in an index. Standard deviation is a statistical measure of dispersion about an average which, for a mutual fund, depicts how widely the returns varied over a certain period of time. When a fund has a high standard deviation, the predicted range of performance is wide, implying greater volatility.

# Types of Bonds

**Municipal** bonds are debt obligations issued by states, cities, counties, and other governmental entities – and are generally exempt from federal and, in some cases, state and local taxes, but may be subject to the alternative minimum tax. Because of these tax features, the yield on a muni is usually lower than that of a taxable bond, but when the taxation of other bonds is taken into account, municipals may actually have an advantage in yield. For example, an investor in the highest marginal tax bracket (35%) would have to hold a bond with a 4.62% yield to equal the after-tax return of a municipal bond yielding 3%.

**Government** bonds, or Treasuries, are obligations of the U.S. government, secured by its full faith and credit, and issued at various schedules and maturities. By virtue of the federal government's almost unimpeded taxing and borrowing authorities, U.S. Treasuries are considered to have virtually no credit risk, although they can still be subject to other risks of fixed income investing. Income from Treasury securities is exempt from state and local, but not federal, taxes.

**Corporate** bonds are debt securities issued by a foreign or domestic corporation, are fully taxable, and typically carry more credit risk (the risk that the issuer will not fulfill its obligation to repay principal and make timely interest payments) than Treasuries. Because of higher risk levels, corporate bonds tend to pay higher rates than otherwise comparable Treasuries.

**Mortgage-backed** securities (MBSs) are debt obligations that represent a claim on the cash flows from a group of mortgage loans, usually on residential property. Most MBSs are issued by the Government National Mortgage Association (Ginnie Mae), a U.S. government agency, or the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Many mortgage-backed securities – so called "private label issues" – have been originated by corporations not affiliated with the federal government or its agencies.

# The Risks of Investing in Bonds

Events over the past few years have laid bare the potential risks in bond investing and have alerted investors to the necessity of employing a comprehensive approach to risk management.

There are several types of risk inherent in every bond portfolio.

## INTEREST RATE RISK

The price of a bond fluctuates with interest rates; in general, as interest rates rise, the prices of bonds fall. This is referred to as interest rate risk. The sensitivity of a bond to changes in rates depends on various features such as maturity, coupon rate, and call or put options. All other things being equal, the longer a bond's maturity, the greater its sensitivity to changes in rates.

## REINVESTMENT RISK

Reinvestment risk is the risk that the proceeds from a maturing bond would have to be reinvested in much lower yielding bonds. In short, it's the possibility of having a bond mature, and then having no alternative to reinvesting proceeds at much lower rates. In low interest rate climates, reinvestment risk is very real. It can threaten income levels for extended periods of time.

## CREDIT RISK

Any investor who lends money by purchasing a bond assumes one or both types of credit risk. *Default risk* is the risk that an issuer will fail to make timely payments of interest and principal because of financial problems. *Credit spread risk* is the risk that the market value of a bond will decline and the price performance of a bond will be worse than that of other bonds against which it's compared. If the credit spread increases, or widens, then the market price of the bond will decline. The risk that a bond's market price will decline due to a widening spread is *credit spread risk*.

## LIQUIDITY RISK

Liquidity risk is the risk that an investor will have to sell an individual bond below its fair value because of infrequent, spotty trading or lackluster demand.

## A NOTE ON LEVERAGE

There is no free lunch in investing, and the bond world is no exception. Fixed income investors need to be cognizant of the risks outlined above.

Many managers compound these risks by employing leverage in an effort to maximize yield. While leverage may enhance returns in favorable environments, it can quickly compound losses when markets come under stress.

The Thornburg Family of Bond Funds:

# Complementary Styles Grounded in Common Sense

Since its founding in 1982, Thornburg Investment Management has consistently applied a comprehensive approach to managing risk. We seek to balance the various uncertainties in fixed income investing in a common-sense way. It's a process that has proven itself over a quarter century – not only in stable, tranquil times, but also in times of market upheaval and disruption.

Our experience has reinforced that the best course of action is to balance the risks inherent in bond investing and remain vigilant to each, even when some may appear less threatening than others. Recent events in the bond market have demonstrated that taking a complacent attitude towards risk may work for a short period of time. However, it usually does not work for investors seeking responsible, long-term strategies.

### COMMON SENSE APPLIED FROM THE TOP DOWN . . .

Our top-down view begins with an analysis of the profile of each portfolio. Every Thornburg bond fund is examined for its exposure to credit qualities, industries, sectors of the bond market, and individual issuer.

Each portfolio is unique but flexible, giving the managers the opportunity to tactically overweight sectors as deemed appropriate. When an individual sector is unattractive, we avoid it in favor of others. When certain sectors are particularly out of favor, Thornburg managers keep a watchful eye for good buys in those areas. At times, areas of the market may be impacted by exuberance or pessimism. We believe that our common-sense approach focused on relative valuation has served investors well in the past.

Diversification is a critical component of portfolio construction. Since fixed income investments are, in effect, loans, there is not only the risk of an issuer's failure to make interest payments, but also the risk of the issuer's failure to repay the principal amount due at maturity. Most bond funds can invest up to 5% of the portfolio in a single position, and many do. Thornburg's view is that it makes no sense to risk the equivalent of a year's worth of the portfolio income on a single position. So we typically limit positions to less than 1% of the portfolio. Rarely does one position exceed 2%, although we do tend to concentrate positions a bit more in the strategic funds (thus the name) and the single-state municipal funds.

The bottom line is this: the smaller each individual bond's position in the portfolio, the less impact a negative event can have on shareholders.

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> **In bond investing, nothing is more important than attempting to determine whether or not the party to whom you propose to lend money has the ability and willingness to pay you back in full.**

## . . . AND FROM THE BOTTOM UP

For over 25 years, in both fixed income and equity investing, Thornburg has built its reputation on fundamental, bottom-up analysis. In bond investing, nothing is more important than attempting to determine whether or not the party to whom you propose to lend money has the ability and willingness to pay you back in full. This simple proposition requires diligence and expertise, and leaves no room for mistakes.

We conduct fundamental credit research on issues under consideration. The goal in this research is twofold: thoroughly understand the ability of the issuer to repay their obligations and ensure that investors are being adequately compensated for the risk of investing in the issue.

For both our core and strategic portfolios, the credit approval and monitoring process follows the same discipline:

- We assess both the bond issuer and the individual bond indenture, scrutinizing offering documents to evaluate the issue's security, collateral, and covenants
- We assess industry risk and look at an issuer's competitive position within its industry
- We employ financial analysis, both historical and projected
- We leverage Thornburg's entire investment team, in an effort to get perspective on other areas of the capital markets

## THE BENEFITS OF ACTIVE, PROFESSIONAL MANAGEMENT

Throughout our 25 years of fixed income investing, Thornburg has developed relationships with over 200 bond dealers, with access to a wide variety of bonds – from sources often unavailable to individual investors. We are actively engaged in the market on a daily basis, with a level of awareness regarding price and trading trends that cannot be matched by individual investors attempting to construct their own portfolios.

Many investors prefer to invest in bonds directly. However, the best of the bonds we see are typically snapped up by institutional investors and often do not filter down to the retail level. And since very few bonds are active enough to maintain transparent, quoted markets, it is very easy for individual investors to overpay for the bonds that they *do* get access to, or to sell bonds too cheaply. An active manager monitoring trading levels can do much to ensure the best possible pricing of purchases and sales for the fund shareholder.

# Thornburg
# Core Bond Funds

The Thornburg core bond funds are founded on a careful understanding of risk and are prudently managed, investing for a *reasonable* rate of return, given that risk.

### LIMITED AND INTERMEDIATE MATURITIES

Since long-term bonds with maturities of 20 to 30 years generally offer relatively little additional yield as compensation for their increased price volatility, the Thornburg core bond funds buy bonds with short- and intermediate-maturities only. Historically, sticking to the limited and intermediate segments of the yield curve has allowed Thornburg managers to limit the volatility of the portfolio as a whole, while capturing *most* of the yield of long-term bonds. At the same time, we believe that it does not unduly constrain our managers. Within the universe of taxable bonds for example, approximately 85% of the Barclays Capital Aggregate Bond Index is captured by securities with maturities under 10 years.

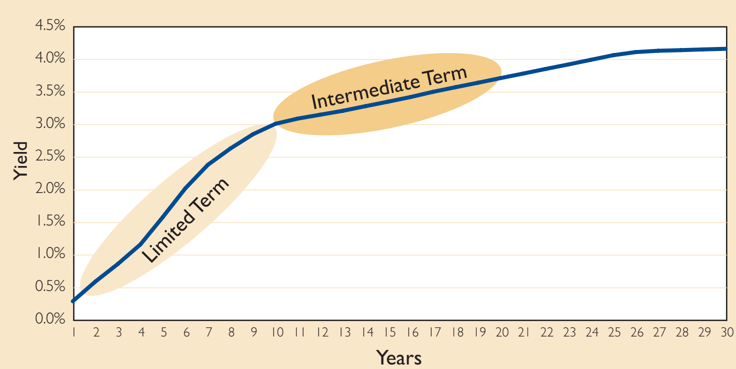
### LADDERING

A laddered structure involves staggering the maturities of a portfolio so that a roughly equal dollar amount matures each year. It's an effective tool that allows Thornburg portfolio managers to balance the types of risks discussed previously. We view laddering as, among other things, an effective means to manage portfolio duration (a measure of a bond or a portfolio's sensitivity to interest rate changes). This allows us to position the portfolio where the optimal risk/reward tradeoff lies for a given investment climate.

### INVESTMENT-GRADE CREDIT QUALITY

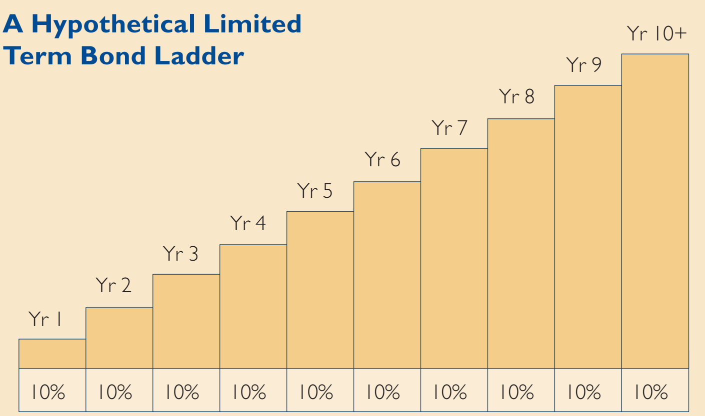
Since the Thornburg *core* bond funds seek a high degree of stability of principal and relative freedom from oversize price fluctuations, management focuses almost exclusively on investment-grade bonds (those with ratings of BBB or better from a nationally recognized ratings agency such as Moody's or Standard & Poor's). High credit quality bonds tend to exhibit a greater degree of price stability than low-rated bonds. Note that we do not rely on ratings agencies, but use their opinions as starting points for our own credit research.

**Limited and Intermediate Maturities are Less Volatile**




Sources: Municipal Market Data and Thornburg, as of December 31, 2009.

**A Hypothetical Limited Term Bond Ladder**




For illustration purposes only.

# Thornburg Strategic Bond Funds

Where Thornburg's *core* funds seek to minimize risk and provide a *reasonable* rate of return, the strategic funds assume relatively more risk in exchange for a higher level of income.

## FLEXIBLE INVESTMENT MANDATES

The Thornburg strategic income funds employ flexible investment mandates, casting a wide net in the search for income-producing securities. Both funds search a wide range of maturities and credit qualities.

A global income-oriented fund, **Thornburg Strategic Income Fund** searches for income-producing securities of all types from around the world. The majority of assets are in fixed income, but the fund also invests in dividend-paying stocks (the fund assumes more credit, currency, and equity market risk than the Thornburg core offerings).

**Thornburg Strategic Municipal Income Fund** can invest up to 50% of assets in municipal bonds rated below investment grade, and is otherwise diversified among sectors, issuers, credit qualities, geographic regions, and segments of the yield curve.

## MORE ATTRACTIVE YIELD

The scope to search a wide range of investment territory provides the opportunity to capture higher yields for both funds. With that ability comes greater price volatility, however.

# Where do Thornburg Bond Funds Fit Into Your Asset Allocation Strategy?

More than 25 years ago, Thornburg Investment Management launched its first mutual fund for investors, seeking to provide as high a level of current income as is consistent with preservation of capital. Since then, we have developed a suite of products to address the varying needs of investors. We believe that each strategy is grounded in solid financial principles and common sense.

With goals ranging from income and preservation to high income, Thornburg offers an array of fixed income products to complete a prudent asset allocation solution.

# Thornburg's Bond Investment Spectrum

| | Fund | Objectives | Strategy |
|---|---|---|---|
| High Income | **Thornburg Strategic Income Fund** | Primary: High level of current income<br>Secondary: Some long-term capital appreciation | Thornburg Strategic Income Fund has a flexible mandate focused on paying an attractive, sustainable yield. The portfolio invests globally in a combination of income-producing securities with an emphasis on higher-yielding fixed income. The fund may also invest in dividend-paying stocks. |
| | **Thornburg Strategic Municipal Income Fund** | Primary: High level of current income exempt from federal individual income tax | Thornburg Strategic Municipal Income Fund has a flexible mandate to invest across a wide range of municipal obligations, with varying maturities and credit qualities. The portfolio team will not invest more than 50% of the portfolio in bonds rated below investment grade at the time of purchase. Also, the portfolio will be diversified among sectors, issuers, credit qualities, geographic regions, and segments of the yield curve. |
| Income and Preservation | **Thornburg Limited Term Income Fund** | Primary: Provide as high a level of current income as is consistent with safety of capital<br>Secondary: Reduce changes in its share price compared to longer term portfolios | These core funds employ a comprehensive management approach that includes laddering high quality, short- and intermediate-term bonds; bottom-up credit research; and maintenance of well-diversified portfolios. |
| | **Thornburg Limited Term U.S. Government Fund** | | |
| | **Thornburg New Mexico Intermediate Municipal Fund** | Primary: Obtain as high a level of current income, exempt from federal individual income tax, as is consistent with preservation of capital<br>Secondary: Reduce expected changes in its share price compared to longer term bond portfolios | |
| | **Thornburg New York Intermediate Municipal Fund** | | |
| | **Thornburg Intermediate Municipal Fund** | | |
| | **Thornburg California Limited Term Municipal Fund** | | |
| | **Thornburg Limited Term Municipal Fund** | | |

There is no guarantee the funds will meet their objectives.

# Bond Management Team

For more than a quarter century, our experienced fixed income team has put comprehensive risk management into practice – in periods of rising rates, in periods of falling rates, in tranquil times, and in troubled times. The team has remained remarkably stable over time but has grown with success.

Back row: Josh Gonze, Lon Erickson, Chris Ihlefeld, Jason Brady; Front row: George Strickland, Yvette Garcia, Chris Ryon.

## Lipper Inc.'s Best Fixed Income Fund Family of 2008

LIPPER FUND AWARDS US 2008

While it's gratifying to gain recognition from third-party sources such as Lipper, Inc., and Morningstar, Inc. on an individual-fund basis, we believe it's greater validation of our approach to have been recognized as a top fixed income *family*.

Thornburg Investment Management ranked number one of 41 eligible firms in Lipper, Inc.'s fixed income large-fund universe for the three-year period ended 12/31/07, based on risk-adjusted returns. Past performance does not guarantee future results. Thornburg did not win this award for the most recent period.

# Thornburg Family of Bond Funds

## MUNICIPAL BOND FUNDS

Co-managed by George Strickland, Josh Gonze, and Chris Ihlefeld

- Thornburg Limited Term Municipal Fund (LTMFX inception: 9/28/1984)
- Thornburg Intermediate Municipal Fund (THIMX inception: 7/22/1991)
- Thornburg California Limited Term Municipal Fund (LTCAX inception: 2/19/1987)
- Thornburg New Mexico Intermediate Municipal Fund (THNMX inception: 6/18/1991)
- Thornburg New York Intermediate Municipal Fund (THNYX inception: 9/5/1997)

Co-managed by George Strickland, Josh Gonze, and Chris Ryon, CFA

- Thornburg Strategic Municipal Income Fund (TSSAX inception: 4/1/2009)

## TAXABLE BOND FUNDS

Co-managed by Jason Brady, CFA, and Lon Erickson, CFA

- Thornburg Limited Term Income Fund (THIFX inception: 10/1/1992)

Managed by Jason Brady, CFA

- Thornburg Limited Term U.S. Government Fund (LTUSX inception: 11/16/1987)

Co-managed by George Strickland and Jason Brady, CFA

- Thornburg Strategic Income Fund (TSIAX inception: 12/19/2007)

Investments in the Funds carry risks, including possible loss of principal. Bond funds have the same interest rate, inflation, and credit risks that are associated with the underlying bonds. The principal value of bonds will fluctuate relative to changes in interest rates, decreasing when interest rates rise. This effect is more pronounced for longer term bonds. Unlike bonds, bond funds have ongoing fees and expenses. Funds invested in mortgage backed securities may bear additional risk. Investments in lower rated and unrated bonds may be more sensitive to default, downgrades, and market volatility; these investments may also be less liquid than higher rated bonds. Investments in derivatives are subject to the risks associated with the securities or other assets underlying the pool of securities, including illiquidity and difficulty in valuation. Investments in equity securities are subject to additional risks, such as greater market fluctuations. Special risks may be associated with investments outside the United States, especially in emerging markets, including currency fluctuations, illiquidity and volatility. Investments in the Funds are not FDIC insured, nor are they deposits of or guaranteed by a bank or any other entity.

*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.*

Lipper's large firm universe is comprised of fund families with more than $28 billion in total net assets. Only fund families with at least five bond funds were eligible for the fixed income fund family award. The individual funds may not have ranked number one in their categories. Thornburg's fixed income fund family did not receive this award in subsequent years.

Thornburg Investment Management®
Strategies for Building Real Wealth

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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.

Diversification does not assure or guarantee better performance and cannot eliminate the risk of investment losses.

The laddering strategy does not assure or guarantee better performance than a non-laddered portfolio and cannot eliminate the risk of investment losses.

Basis Point (BPS) – A unit equal to 1/100th of 1%. 1% = 100 basis points (bps)

The Barclays Capital Aggregate Bond Index is 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.

The MSCI EAFE (Europe, Australasia, Far East) Index is an unmanaged index. It is a generally accepted benchmark for major overseas markets. Index weightings represent the relative capitalizations of the major overseas developed markets on a U.S. dollar adjusted basis. The index is calculated with net dividends reinvested in U.S. dollars.

The S&P 500 Index is an unmanaged broad measure of the U.S. stock market.

The performance of any index is not indicative of the performance of any particular investment. 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.

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