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INTERVIEW WITH WILLIAM V. FRIES, CFA
Portfolio Manager Thornburg Value and Global Value Funds

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With the SEC passing new rules requiring mutual fund companies to report both pre and post tax total return, increased scrutiny of how portfolio managers manage tax liabilities is to be expected. Even with the advent of so-called "tax managed" portfolios, there can be no assurance that returns will be maximized when faced with investment decisions that may be tainted by tax considerations. Bill Fries has been managing mutual funds for well in excess of twenty years during which period there has been a constant focus on managing tax. Following is an interview with Bill, wherein he explains his philosophy about managing portfolios with a focus toward tax efficiency.

Q. Why do some portfolio managers downplay the importance of tax efficiency?

A. They say that they don't want to be inhibited or cause activity that would be detrimental to total return. At the same time, they never want to explain a lack of total return by explaining that they were managing for tax. The reason that some portfolio managers don't pay much attention to it is because many shareholders are in individual accounts.

Q. Are these legitimate arguments?

A. First, I don't think that managing for tax efficiency and total return are mutually exclusive. Second, you don't really know the shareholder's total circumstances. My wife does my taxes and I know that she is always concerned about getting a 1099 that has an unexpected large capital gain distribution, especially if it is a short-term gain. I make the presumption that a significant portion of our shareholders are going to be sensitive to taxes. I don't focus on total return, but I always have the tax implications of any trade in the back of my mind.

Q. Isn't the Securities & Exchange Commission making tax efficiency an issue?

A. Yes. Managers may want to downplay tax efficiency, but they won't be able to downplay it in the future. The SEC has approved a rule requiring funds to reveal after-tax returns for one-, five- and 10-year periods in their prospectuses. Effective April 1, 2001, funds will adjust returns using the 39.6% tax rate and display the results in three ways. One assumes that investors hold their shares for the entire period, paying taxes on capital gains at the end of the period. The other assumes shareholders sell their fund at the end of the period and pay capital gains taxes. Money market funds and 401-(k) plans are exempt from the rule.

Q. What are some tax efficiency strategies?

A. All other things being equal, it would make no sense to sell shares before they're long term, especially when approaching the anniversary. There have been cases where I have held stocks longer just to make sure I'm recording long-term capital gains instead of short-term capital gains. I don't think that takes a significant amount of time for a portfolio manager. If you only pay attention to total return, then you won't be aware of anniversary date. It's a conscious awareness of tax considerations to make a decision to wait another day or another week to hold until it's long term.

Q. At what point in the year do you focus on tax issues?

A. Beginning in June, I will become aware of my capital gains distribution potential. As I make judgment on what stocks to own, what stocks to reduce and what stocks aren't working, I will have done my level best to

neutralize and eliminate any short-term capital gains by taking losses. By Oct. 31, I want to have record capital gains that I'm going to take for that fiscal year. I want to be as close to tax neutral as possible, ce neutralizing short-term gains since many shareholders are in high brackets. Since we run a focused port names instead of 100-150 like most mutual funds, it's a lot easier to do tax planning.

Q. Isn't this disruptive to the portfolio?

A. My experience has been that it's actually productive to the portfolio, not disruptive. When you have a term capital gain, it forces you to go in and examine your portfolio very closely. If I have a loss in a stock, I take a short-term loss to offset a short-term gain, and buy another company that's either equivalent or better than the prospects, then I've helped the portfolio by that activity.

Q. What about long-term capital gains?

A. You try to eliminate all gains, but if a stock has appreciated and I think the value has been taken out, it for a long-term capital gain shouldn't be a problem for most shareholders. In 2000, I took all the reas losses that I could take. I didn't offset all of the gains, but I only distributed about 30 cents per share in long-term capital gains, or about 1% of total return.

High Tax Efficiency

Average Annual Returns: Pretax and After-Tax (Periods Ended February 28, 2001)

	Pretax	After Tax	Tax Efficiency
3 Year Thornburg Value Fund - A	15.9%	15.1%	95%
3 Year Average Fund*	5.7%	3.9%	69%
5 Year Thornburg Value Fund - A	23.9%	22.3%	93%
5 Year Average Fund*	13.5%	11.1%	83%

**Based on data from Morningstar, Inc. for 1112 Large Cap Blend Funds*

Q. How would you interpret this chart?

A. Over the past three and five year periods, Thornburg Value Fund A achieved a 95.6% and 93.6% tax efficiency respectively. In 2000, the Fund achieved a 64.9% (2.57/3.96) tax efficiency calculated as follows: the Fund return was 3.96% and we paid out a capital gain equal to 1.39% of net asset value to arrive at an after-tax return of 2.57%. That's much better than the average mutual fund, which posted a loss and generated taxable capital gains. That happened because in the early part of 2000, portfolio managers realized a lot of taxable gains, selling stocks when the NASDAQ was 5000. The cash had to be redeployed, only to see the total return of the market go down for the rest of the year. There was no way that they could offset all the gains that they realized at the market by selling everything out at the bottom.

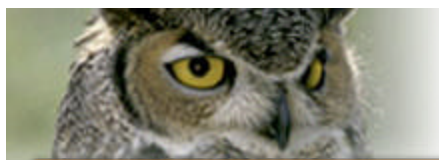
Q. Is a fund with the best after-tax return always tax efficient?

A. Not necessarily. A fund with a 10% pretax return and a 4% after-tax return would have a 40% tax efficiency. Another comparable fund with a 20% pretax return and a 6% after-tax return would have a 30% tax efficiency. latter fund has a worse tax efficiency but a higher after-tax return.

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July 23, 2001:
 Financing the Future: Something for Students of All Ages



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Scott Tuck
 CEO

For most people, saving for college is a long-term proposition that requires systematic savings and investment. Many people buy mutual funds that invest in aggressive growth stocks, knowing that the money won't be needed for many years. At some point, of course, mutual fund shares have to be sold to pay tuition, generating capital gains taxes, and thus, less money for college. But the new tax law, signed by President Bush a few weeks ago, takes away some of this burden.

That's because many of the provisions permit investments to build tax-qualified accounts. For example, allowable contributions to Education IRAs have been expanded from \$500 to \$2,000. Money can accumulate tax free in these accounts which can now be used for grades K-12 as well as higher education. The new Education IRA is available for married taxpayers with adjusted gross income (AGI) under \$220,000, although it begins to phase out at \$190,000. For single taxpayers, the benefit begins to phase out at AGIs of \$95,000 and completely phases out at \$110,000.

You may have heard about prepaid tuition plans. That's where you contribute money to an account that is earmarked for college. Under the old law you could only set up such an arrangement with state schools. The new law makes such arrangements possible with private colleges. That's certainly helpful, since most private college tuition is several times greater than at a public school. Here's another big improvement. Regardless of the type of college, the money grows tax free. Under the old law, money grew on a deferred basis, meaning that it was taxed when withdrawn.

Several new provisions help you with education associated expenses. a new tax deduction for "qualified higher education expenses" which is available for single taxpayers with AGIs below \$65,000 (\$130,000 for taxpayers). It could be used for parents who pay their kids' expenses college students who are on their own working their way through sch



Let's say your employer reimburses you for college courses you take a You are allowed to exclude \$5,250 per year from income. That provisi slated to expire in 2001, but the law extends it indefinitely. In additio can take graduate school courses and receive this tax benefit, a provi that was suspended in 1996.

In addition, student loan interest write-offs have been expanded. The level at which eligibility for the deduction begins to phase out increas \$40,000 for single taxpayers to \$50,000, and from \$60,000 for marrie taxpayers to \$100,000. In addition, interest deductions can be taken a as the loan is outstanding, rather than being limited to five years as v case under the old law.

In short, you'll benefit from the new law if you're saving for college, p to pay those steep private elementary school bills, paying current coll expenses for yourself or your child - or if you're trying to take night c to make yourself more marketable.

At Montgomery we realize investing for college can be confusing so w provide a detailed section on our site that covers issues in depth. Noti College Financial Planning: Part One. Take a look and remember - sch expenses will arrive quicker than you think.



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