

# Artisan Small Cap Fund (ARTSX) – December 2011

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## A Mutual Fund Observer “Star in the Shadows” fund

*The views and opinions expressed in this article are those of David Snowball of Mutual Fund Observer and do not necessarily reflect the views of Artisan Partners or its affiliates. Artisan Partners is not affiliated with David Snowball or the Mutual Fund Observer.*

### Objective and Strategy

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The fund pursues “maximum long-term capital growth” by investing a broadly diversified portfolio of small cap growth stocks. For their purposes, “small cap” means “under \$2.5 billion in market cap at the time of purchase.” As of 9/30/11, they held 70 stocks. They cap individual positions at 3% of assets, though some might appreciate past that point. The managers look for companies with at least two of the following characteristics:

- Low cost production capability,
- Possession of a proprietary asset,
- Dominant market share, or a
- Defensible brand name.

If the stock is reasonably priced and they have reason to believe that the firm’s prospects are brightening, it becomes a candidate for acquisition.

### Opening date

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March 28, 1995.

### Adviser

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Artisan Partners of Milwaukee, Wisconsin. Artisan has five autonomous investment teams that oversee twelve distinct U.S., non-U.S. and global investment strategies. Artisan has been around since 1995. As of 9/30/2011 Artisan Partners had approximately \$52 billion in assets under management. That’s up from \$10 billion in 2000. They advise the 12 Artisan funds, but only 5% of their assets come from retail investors.

### Manager

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The fund is managed by the same team that manages primarily-midcap **Artisan Mid Cap Fund (ARTMX)** and primarily-large cap **Artisan Growth Opportunities Fund (ARTRX)** funds. The marquee name would be Andy Stephens, founding manager of ARTMX and, earlier, co-manager of Strong Asset Allocation. Craig Cepukenas has been an analyst with the fund since 1995 and a co-manager since 2004. The other team members (Mr. Stephens plus Jim Hamel, Matt Kamm, Jason White) joined in the last two years. Their work is supported by five analysts.

### Management’s Stake in the Fund

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Each of the managers invests heavily in each of the three funds. Mr. Hamel has over a million in each fund and Mr. Stephens has over \$2.5 million spread between the three, while the other managers (generally younger) have combined investments well over \$100,000.

### Minimum investment

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\$1000 for regular accounts, reduced to \$50 for accounts with automatic investing plans. Artisan is one of the few firms who trust their investors enough to keep their investment minimums low and to waive them for folks willing to commit to the discipline of regular monthly or quarterly investments.

### Expense ratio

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1.3%, on assets of \$376 million (as of September 2011).

## Comments

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ARTSX was Artisan's first fund, launched as a vehicle for Carlene Murphy Ziegler to showcase her talents. Ziegler had been a star at Strong, and her new fund returned 40% in its first year, about 50% better than its peers. In under a year, the fund had gathered \$300 million in assets. It closed to new investors in February of 1996, a decision for which it was rightly lauded.

And then, something happened. The fund, mild-mannered by growth fund standards, lagged its peers during the "hot" years of the late 1990s, rallied briefly at the turn of the century, then settled back into a long decade of mediocre returns. Artisan tried to reignite the fund by bringing in Ziegler's former co-manager, Marina Carlson, but nothing seemed to work. Even in its worst years the fund was never awful, but it was also never really good again. Ziegler retired from managing the fund in 2008 and Carlson in 2009.

Then, in 2009, Artisan found the fix. They gave management responsibility to their Growth team. Artisan's fund management is structured around a series of teams. Each team has a distinctive style (U.S. Value, Global Value, Growth, Global Equity and Emerging Markets) and each has a distinctive, consistent investment discipline. As each team proves its ability to provide strong, consistent, risk-conscious performance in one arena, Artisan allows them to extend their process to another. The U.S. Value team, for example, started with **Artisan Small Cap Value Fund** (ARTVX), which was wildly successful and closed to new investors. They began managing **Artisan Mid Cap Value Fund** (ARTQX) in 2001, posted a series of exceedingly strong years and decided to add the predominantly large cap **Artisan Value Fund** (ARTLX) in 2006. The Growth team started with **Artisan Mid Cap Fund** (1997), added **Artisan Growth Opportunities Fund** (2008) and then **Artisan Small Cap Fund** (2009).

## Bottom Line

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Artisan has an entirely admirable culture. Their investment teams tend to stick together for long periods, with occasional promotions from the analyst ranks to recognize excellence. They are uniformly risk conscious, deeply invested in their funds and singularly willing to close funds before asset bloat impairs performance. As of December 2011, roughly half of Artisan's retail funds (five of 11) are closed to new investors.

The practice of keeping teams together for the long term, allowing them to perfect and then gradually extend their investment disciplines, has produced consistently strong results for Artisan's investors. With the exception of the Artisan Emerging Markets Fund (which is not available to retail investors), over the last three years every Artisan fund has earned four or five stars from Morningstar and every one is ranked above average in Lipper's ratings. Regardless of the time period you check, no Artisan fund (excepting, again, Artisan Emerging Markets Fund) has a Morningstar rating below three stars.

The managers' discipline is clear and sensible. One part of the discipline involves security selection: they try to find companies with a defensible economic moat and buy them while the price is low and the prospect for rising profits looms. Philosophically, they are driven to hunt for accelerating profit cycles. Their edge comes, in part, from their ability to identify firms which are in the early stages of an accelerating profit cycle. Their intention is to get in early so they can benefit from a long period of rising profits. The other part is capital allocation: rather than pour money into a new holding, they begin with small positions in firms whose profits are just beginning to accelerate, increase that toward their 3% asset cap as the firm achieves sustained, substantial profits, and then begins selling down the position when the stock becomes overvalued or the firm's profitability slips.

Since taking charge of Artisan Small Cap Fund, the fund has performed exceptionally well. \$10,000 invested when Mr. Stephens & co. arrived would have grown to \$13,800 (as of 11/29/11) while their average peer would have returned \$12,700. The fund posted weak relative and strong absolute returns during the "junk rally" in 2010, making 20.5% for its investors. In 2011, the fund finished the first 11 months in the top 1% of its peer group with a return of 10.9% (compared to a loss of nearly 3% for its average peer).

The Growth team follows that same pattern, and has posted strong records in their other charges and in their two-plus years here. Investors looking for a rational small cap growth fund – one which is competitive in rising markets and exceptionally strong in rocky ones would be well-advised to look at the reborn Artisan Small Cap Fund.

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#### AVERAGE ANNUAL TOTAL RETURNS

As of 30-Nov-11	YTD <sup>1</sup>	1 Yr	3 Yr	5 Yr	10 Yr	Inception <sup>2</sup>	Expense Ratio <sup>3</sup>
Artisan Small Cap Fund (ARTSX)	10.88%	16.62%	26.25%	1.94%	5.67%	7.45%	1.66%/1.31%
Russell 2000 <sup>®</sup> Growth Index	-2.69%	4.70%	21.21%	2.08%	5.14%	5.56%	
Russell 2000 <sup>®</sup> Index	-4.80%	2.75%	17.56%	0.09%	6.18%	7.87%	

  

As of 30-Sep-11	YTD <sup>1</sup>	1 Yr	3 Yr	5 Yr	10 Yr	Inception <sup>2</sup>	Expense Ratio <sup>3</sup>
Artisan Small Cap Fund (ARTSX)	-2.67%	11.18%	6.90%	0.75%	5.80%	6.69%	1.66%/1.31%
Russell 2000 <sup>®</sup> Growth Index	-15.57%	-1.12%	2.07%	0.96%	5.45%	4.71%	
Russell 2000 <sup>®</sup> Index	-17.02%	-3.53%	-0.37%	-1.02%	6.12%	7.06%	

Source: Artisan Partners/Russell. <sup>1</sup>Returns are not annualized. <sup>2</sup>Fund inception 28-Mar-95. <sup>3</sup>For the fiscal year ended 30-Sep-10. The Fund's direct operating expenses are 1.31%, which is reflected in the Fund's "Financial Highlights" in the statutory prospectus and financial statements. The expense ratio noted above includes "Acquired Fund Fees and Expenses," which are indirect expenses the Fund may incur from investing in an investment company (acquired fund); such indirect expenses are not paid from the Fund's assets but are reflected in the return realized by the Fund on its investment in the acquired funds.

**The performance quoted represents past performance, which does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For current to most recent month-end performance information, call 800.344.1770 or visit [www.artisanpartners.com](http://www.artisanpartners.com).**

**Investors should consider carefully before investing the Fund's investment objective, risks and charges and expenses. For a prospectus or summary prospectus, which contains that information and other information about the Fund, please call us at 800.344.1770. Please read the prospectus or summary prospectus carefully before you invest or send money.**

**Securities of smaller companies tend to be more volatile and less liquid than those of large companies, may have underperformed the securities of large companies during some periods and tend to have a shorter history of operations than large companies. Growth securities may underperform other asset types during a given period.**

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