An Interview with Lewis Kaufman, Founding Portfolio Manager of The Artisan Developing World Strategy

by Devesh Shah

This is a condensed version of an interview and discussion originally published in Mutual Fund Observer, April 2023

Mutual Fund Observer

Lewis Kaufman

I've spent a huge amount of time over the past six months talking with a cadre of the industry's best emerging markets managers.

Home Bias

Investors worldwide have a powerful bias toward investing disproportionately in their home country. A lot of my columns on EM investing and strategies are my endeavor to unearth interesting portfolio managers and strategies for me to diversify.

This month I'm delighted to continue that journey with you by reviewing my conversation with Artisan's Lewis Kaufman, demonstrably one of the best of the best.

Topic one: Who is this guy?

Artisan Partners and Lewis Kaufman

Artisan has a distinctive partnership model. It starts by adding partners, generally entire management teams, that Artisan believes are phenomenally talented.

Lewis Kaufman is one of the most distinguished emerging markets managers in the industry. He has been an investment professional for more than two decades.

Topic two: What does he do?

The **Artisan Developing World Strategy** launched in July 2015 under Mr. Kaufman's leadership. Mr. Kaufman pursues a compact, primarily large-cap portfolio. He's willing to invest in firms tied to, but not domiciled in, the emerging markets. The strategy currently has nearly $4 billion in assets.

"In adverse periods, people tend to lose their process. I am trying to be very consistent with my investment program. Historically, and I have invested for 24 years, the portfolio has a strong track record and emerged very well coming out of a crisis."

Topic three: *How* does he do?

Since inception, Artisan Developing World has returns that are in the top 1% of its peers.

We know investing internationally has been a tough neighborhood, but the Artisan strategy has produced excellent absolute and relative results.

Topic four: What does he believe about the current state of EM investing?

Question: how have the emerging markets as an asset class evolved?

Early on, Kaufman believed that the demographic dividend plus high productivity potential might lead to high potential GDP across EM countries. China's entry into the WTO and the commodity boom of the first decade in the 21st century benefitted many EM countries.

"Many investors still think of EM as being a low penetration, high growth area, but since 2009, I have operated with a different thesis. Emerging Markets are not progressing in an optimal way, which is constraining the growth and demand opportunity. The countries want to grow but they are unable to manifest this growth for many reasons." Understanding those constraints has helped Kaufman decide what to invest in and what to avoid.

"Starting the year 2015, it was becoming obvious that potential GDP was falling. Instead of investing in human capital, many countries had engaged in fiscal transfers and caged themselves in the middle-income trap."

Kaufman now sees Emerging Markets as large latent pools of domestic demand. He believes different tools are needed to invest in this EM world, and for him those tools are to find Scalable Companies and Passport Companies. These companies have the "potential for disproportionate equity outcomes," a phrase he keeps revisiting many times. Scalable companies are able to transcend the constraints and Passport companies are able to cross borders easily to meet customer demand.

This thesis has led Kaufman to assemble a portfolio that looks very different than a MSCI EM Index or even a typical EM actively managed portfolio.

"The Passport companies (like NVIDIA and Airbnb) are bringing the innovation and capital formation to the EM. Of course, in the case of NVIDIA, they have a meaningful part of their business coming from the EM already. And Airbnb fits in the aspirational category as the EM population desires travel and experiences in the same way that the developed market population does. With the prevalence of the economic constraints in the EM, we find Passport Companies to be an important tool.

What about scalability and tapping large pools of latent demand? "We believe that businesses with scalability are uniquely able to transcend those constraints. So, in the case of MercadoLibre, Brazil and Argentina might not be progressing in an optimal way.

However, MELI's ability to generate revenues from multiple sources with favorable business economics is allowing them to extract value from that latent demand pool.

Question: how do you see the role of China in an EM portfolio?

"Economically, for the reasons discussed (skilled labor and domestic capital formation), China is more attractive than the other EM countries. However, external risks have risen. Given this backdrop, we have allowed our weights to come down naturally, kept alignment to our highest conviction companies in China while using the China reduction to add to other opportunities (at periods of low reinvestment risk).

Related question: what then is the role of India?

With a country of over a billion people, India would seem like a natural place for the strategy to invest. However, HDFC Bank is one of the only investments the strategy has there.

“We know the companies well in India. Define all of them by constraints of affordability. Define all of them as expensive due to demand by foreign direct investors and domestic mutual fund investors.”

India needs to create more high value jobs outside of agriculture. Right now, investible India is a population closer to 200–300 million people for the services that can be sold and for the company in which he can invest that sell those services. India needs more capital formation, needs companies to invest in jobs, which can create consumption, which creates the ability to lever up.

According to Kaufman, “India hasn't been a trustworthy partner for foreign investors. Sometimes, the goal post moves. Regulations change and are altered to be favorable to domestic players. We want to be involved in India, but we need stocks and capital formation, and we are not going to invest in India just to meet a benchmark number.

Question: at the other end of the spectrum are the frontier markets countries. Do you have much interest in them? If not, why not?

Perhaps I learnt the most from one sentence Lewis Kaufman said, “There is just not a lot going on.”

When there is not a lot going on, supplying capital as equity holders makes little sense for us to do. Especially, if valuations are not super low, like in India.

Topic five: What we've learned and what we might do

The Artisan Developing World Strategy warrants our attention. Lewis Kaufman and his team have generated substantial total returns in a complex market environment. When I listen to him, I find a rational, thoughtful, long-term investor who understands why people need to hold equities in their portfolios.

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Clarifications: Artisan Partners Developing World Strategy holds two companies in India, HDFC Bank Limited Sponsored ADR and Apollo Hospitals Enterprise Limited.

Investment Results as of 31 March 2023 (%)	YTD	3YR	5YR	ITD
Artisan Developing World Strategy Composite (Gross)	**22.87**	9.88	8.34	**9.68**
Artisan Developing World Strategy Composite (Net)	**22.57**	8.74	7.21	**8.54**
MSCI Emerging Markets Index	3.96	7.83	-0.91	2.62

Source: Artisan Partners/MSCI Emerging Markets. Returns less than one year are not annualized. Fund Inception: 1 July 2015.

Past performance does not guarantee and is not a reliable indicator of future results. Returns for periods less than one year are not annualized.

All performance results are net of commissions and transaction costs, and have been presented gross or net of investment advisory fees. For performance presented net of fees, fees may be higher for certain pooled vehicles and the composite may include accounts with performance-based fees. Dividend income is recorded net of foreign withholding taxes on ex-dividend date or as soon after the ex-dividend date as the information becomes available to Artisan Partners. Interest income is recorded on the accrual basis. Performance results for the index include reinvested dividends and are presented net of foreign withholding taxes but, unlike the portfolio's returns, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the indices.

Investment Risks: Current and future portfolio holdings are subject to risk. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in emerging markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations. Securities of small- and medium-sized companies tend to have a shorter history of operations, be more volatile and less liquid and may have underperformed securities of large companies during some periods. Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal.

For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the portfolio. The discussion of portfolio holdings does not constitute a recommendation of any individual security. The holdings mentioned above comprise the following percentages of a representative account within the Composite's total net assets as of 31 March 2023: NVIDIA Corp 6.5%, MercadoLibre Inc 6.4%, Airbnb Inc 6.0%, HDFC Bank Ltd 3.1%, Apollo Hospitals Enterprise Ltd 1.1%. Securities mentioned but not listed here were not held as of the date of this report. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

Net-of-fees composite returns were calculated using the highest model investment advisory fees applicable to portfolios within the composite. Fees may be higher for certain pooled vehicles and the composite may include accounts with performance-based fees. All performance results are net of commissions and transaction costs, and have been presented gross and net of investment advisory fees. Dividend income is recorded net of foreign withholding taxes on ex-dividend date or as soon after the ex-dividend date as the information becomes available to Artisan Partners. Interest income is recorded on the accrual basis. Performance results for the Index include reinvested dividends and are presented net of foreign withholding taxes but, unlike the portfolio's returns, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the indices.

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