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‘This industry’s dirty little secret is most PMs are momentum orientated’

Artisan Partners Lewis Kaufman has benefitted from backing out-of-favour ideas. But, he is conscious of being accused of style drift.

By CHRIS SLOLEY

‘We own Sea, which was down substantially last year. We own MercadoLibre, which was down substantially last year. We own NVIDIA, which was down substantially last year. We own Airbnb, which was down substantially last year. In fact, those are our four biggest holdings.’

Anyone would think Lewis Kaufman was in a pit of despair. But the Artisan Partners manager is reeling off his largest positions with relish, as the short-term troubles for the key positions for his $3.7bn Developing World Strategy help reflect his overarching investment process.

During a flying visit to London, Kaufman outlined how these four positions – which accounted for more than 25% of net assets at the end of the first quarter – have rallied strongly in 2023 and are up an average of 65% year-to-date, according to his own numbers.

‘Our risk management framework is about achieving a level of permeance through value capture,’ he told Citywire Selector. ‘We use that to execute our investment programme in different market environments and that means we were able to capitalise on the opportunities presented over the past year.

‘I think there’s incredible consistency to the investment programme and the way that we execute it; we’re not the type of strategy that will pop in 2020 and tell you we have a keen focus on 2020. Then, in 2023, turn around and say, “Well, actually we now have ExxonMobil and Royal Dutch Shell as top five holdings for reasons XYZ”. We think there’s an incredible consistency to what we do.’

His comments come at a time when strategy buyers have raised concerns about a long-running problem – style drift. When asked about significant market moves, as was seen with energy stocks soaring in 2022, Kaufman is conscious of a need to assert what his strategy is not – as much as what it is.

‘Because we own a lot of stocks that have had historically “higher valuations”, it is assumed we are momentum driven. What we are, in fact, is looking at contrarian stocks that can go in and out of favour. I think the dirty little secret in our industry is that most managers are incredibly momentum orientated.

‘There is a desire that when there is dispersion from the benchmark – when you’re not participating in an area of the market that’s doing well, such as energy or financials, you see managers move in that direction and start to try to align their themes or trends.

‘I think people have gravitated towards them for whatever reason – some people may say “value” – but we have been relatively consistent.’

Alignment of ideas

Kaufman is keen to assert the idea of alignment in the stocks they hold. He name-checked Latin American retailer MercadoLibre, which is the strategy’s third largest position at 6.4%, as being aligned to long-term economic and aspirational growth in Latin America as a whole.

The company has grown steadily, Kaufman said, which comes at a time when there was increased pressure on firms to exhibit accelerated profitability. ‘Companies like MercadoLibre have been able to actually pull back on the subsidised parts of their businesses – such as free shipping – without having a major impact on revenue generation.’

Speaking to Citywire in late 2020, Kaufman had championed the opportunities presented by the Chinese market. The region, however, only represents 22% of strategy exposure at the end of March 2023, which the San Francisco-based portfolio manager acknowledged is towards the low-end of his historical allocation to the country.

‘It is at the low end. Now it’s not so much that we outright sold down the country but we have had opportunities elsewhere. So, recently we have increased our allocations to MercadoLibre and we have also increased allocation to NVIDIA, and in doing so we have used China as a way of funding those investments at moments of low re-investment risk.

‘We’re very selective about the moments when we do that and we have been able to rescue the strategy’s dependence on China as a result and I would say we have been able to do that without compromising the integrity of the process,’ he added.

Developing not emerging

While Kaufman was keen to highlight he isn’t momentum driven, there is another lingering element that needs clarification. While the strategy is named Developing World, it isn’t an emerging market equity strategy, in the truest sense of the word. The strategy has 56% developed market exposure, primarily within the US.

‘The concept of a Developing World Strategy is meant to connote or suggest flexibility. I would say around 70% of the revenue for the portfolio is generated in the emerging markets. I think that is a very different picture to the one painted by looking solely at the country representation on a factsheet, for example.’

Kaufman cited the fact that many EM strategies have around 80% tied to the Asian market – a correlation previously highlighted by Citywire Selector, which also pinpointed the Artisan Developing World Strategy as having less than 50% here.

However, citing an internal document, Kaufman showed 45.8% of the strategy’s revenue is drawn from the Asia region, while only 57% of revenue in the EM index is from here despite the larger absolute weighting.

The Artisan Developing World Strategy returned 8.74% (net) over three years ending 31 March 2023, which compares to a 7.83% return by the MSCI Emerging Markets Index over the same period, both measured in US dollar terms.

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Annual Returns (% USD) 12 months ended 31 March	2019	2020	2021	2022	2023
Composite — Net	3.81	6.15	92.61	-25.06	-10.92

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. Returns less than one year are not annualized. Composite Inception: 1 July 2015.

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