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Seven Questions with David Samra and Dan O’Keefe

Our Manager of the Year winners share their thoughts on opportunities today.

Fund Spy | 01-22-08 | By Russel Kinnel

After a brutal year, foreign equity markets are brimming with great opportunities and more than a few land mines. So far, our International-Stock Managers of the Year have proved adept at separating one from the other. I posed a few questions via e-mail to Artisan International Value (ARTKX) managers David Samra and Dan O’Keefe to see how they are tackling these challenges.

1. What makes your strategy different from the typical value manager’s?

Like many value managers, we focus on buying businesses at a meaningful discount to their underlying intrinsic value. This is the most important component of what we do, as we generate the majority of our returns from the unwinding of that discount. However, we are also extremely focused on managing the potential risks to intrinsic value. We like to invest only in businesses where we believe that intrinsic value is likely to be stable at worst but in most cases growing. This means that we gravitate to companies that are financially strong, have meaningful competitive advantages, and are run by great management teams. We have a particular aversion to companies that employ significant financial leverage in their operations. We think that all these characteristics together maximize our chances of generating attractive returns and minimize our chances of permanent loss of capital.

2. What helped performance in 2008?

We are always hesitant to talk about our successes and failures over any short time frame because we don’t want to mislead anyone about our approach. We think about our investment process over a long time horizon, and we want to encourage our investors to do the same. However, there are certainly a few factors that played into relative success in 2008.

As we mentioned earlier, we are not focused merely on statistical valuation. We require our companies to meet certain quality and financial strength characteristics as well. Over the last several years, we witnessed what to us looked like a dangerous deterioration in the balance sheets of many companies around the world, particularly banks and insurance companies. In 2008, these highly leveraged companies were amongst the hardest hit.

In addition, we had very little exposure to other hard-hit sectors of the market, commodities and materials. In general, we tend to shy away from commodity-oriented businesses, given their cyclicality, low returns, and capital-intensive nature. Our analysis led us to conclude that commodities had formed a bubble in 2007. Despite evidence of declining economic growth and a weakening demand environment, commodity prices continued to ascend at an incredible pace. It seemed to us like the triumph of hope against reason. In any event, we did not own any commodity stocks when the bubble burst in 2008.

The strong relative performance in 2008 was not just about what we did not own. In a very tough year, we also had a few bright spots in the portfolio. We think it’s important to understand that the high-quality characteristics that are our focus can be very attractive to investors when times get tough. We think this factors into any explanation of 2008’s performance. In fact, in a quiet year for mergers and acquisitions, two of our investments attracted bids from corporate acquirers.

3. How have you positioned the fund?

While the environment is always changing around us, what we do stays very constant. We are focused on finding those companies that meet our four key characteristics: cheap relative to intrinsic value, financially strong, competitively advantaged, and run by able and honest management teams. At any given time, our research will lead us to—or keep us away from—certain sectors of the market. But this is always a function of our bottom-up, stock-by-stock research rather than any particular macroeconomic perspective.

The current environment is abundant with opportunity, in our view. Valuations in many cases are some of the lowest we have seen in our careers. Moreover, the opportunities are more broad-based than we have ever seen in our careers. During most periods, opportunities tend to be centered in one or two industries or one or two geographies. Today, we see interesting opportunities almost everywhere we look.

4. What kind of discounts to intrinsic value have recent purchases been?

Broadly speaking, we are seeing high-quality businesses trading at valuations we have not seen in our careers. We have, however, been very selective as the hurdle rate for new investments has increased. Right now our hurdle rate sits at about 40%, which means that a new investment must be trading at about a 40% discount to intrinsic value to unseat an existing holding. Even considering our high hurdles, over the last quarter we were able to purchase several outstanding businesses that have seldom been available at current price levels.

One recent addition to the portfolio is Julius Baer. Julius Baer is the leading wealth manager in Switzerland with a premium private banking franchise and an asset-management business. The stock has been more than cut in half over the past year as the fees it earns on client assets are tied to the capital markets. However, it has maintained a strong reputation among clients as it has had no exposure to many of the toxic assets held by its peers. We believe this creates a market share opportunity for Julius Baer. While earnings are likely to fall this year, we think the stock is extremely cheap even under dramatically lower earnings scenarios.

5. What leads you to think Signet Jewelers will survive the recession?

We have been investors in Signet Group since the inception of the fund and have followed the company since 1997. In the third quarter Signet Group changed its name to Signet Jewelers (SIG) and changed its primary listing to the NYSE.

The pullback in consumer spending in the U.S. and U.K. is undeniable and is impacting Signet. We have been forecasting a big decline in earnings over the short term, and, frankly, the downturn in consumer spending has been even worse than what we had assumed. We remain investors in Signet for several reasons. Signet is extremely cheap, trading at a modest multiple of even currently depressed earnings. In addition, even though Signet is seeing big declines in demand, its competitors are faring much worse. Many are in fact going out of business. As a result, we think Signet will take market share and emerge out of the downturn much stronger. We also think very highly of the management team. The CEO, Terry Burman, is recognized as one of the best retailers in the business, and the recent holiday results demonstrate the degree to which Signet is outperforming its peers. Finally, the balance sheet looks sufficiently strong to weather the downturn.

6. You own a few financials. How do you get comfortable with their balance sheets in light of all the hidden messes we've seen?

As of year-end we had a little over 20% of International Value Fund invested in financials, broadly defined. It's important to understand that this is not a monolithic categorization. We own a range of financial and financial-services companies that fall under this heading, including a private bank, a retail broker, two financial holding companies, a couple of insurance and reinsurance companies, and a credit card issuer. We do not currently own any traditional banks or any of the distressed investment banks that have been under such duress over the past year. We continue to believe that gaps in disclosure and significant financial leverage are unquantifiable risks, even considering what look like cheap valuations. That said, we have taken advantage of the market's aversion to everything related to financial services to very selectively add holdings in what we think are some very high-quality, enduring franchises with strong balance sheets. We already highlighted our addition of Julius Baer to the portfolio. In addition, we recently added Japanese retail brokerage firm Daiwa Securities. We were able to initiate a position in the company near the end of the year at well below book value.

7. Now that you're buying U.S. stocks for your global fund, which markets are offering the most attractive investments?

Six months ago we would have answered this question differently. At that time, the U.S. was ground zero for the recession and the aftershocks of the bursting of the housing bubble. Investors still held out hope that European, Asian, and emerging markets in general would resist the downdraft of a U.S. recession. As a result, it was our view that valuations in non-U.S. markets tended to reflect a more optimistic outlook. At that time, we were finding more opportunities in the U.S. In the third and fourth quarter, however, it became clear that this was a global recession and no part of the world would be spared. As a result, international markets lost any valuation premium they held up to that point.

Today we are finding opportunities all over the world across industries. The psychology has shifted so completely over the past 18 months. House prices, oil prices, and corporate earnings seemed like they could do nothing but rise far into the future. It seemed impossible to imagine that anything bad could happen. Now we are in the opposite situation. All the news is terrible, and it seems hard to imagine that anything good could happen. Focused as we are on the long term, and believing as we do that the economic and financial environment will normalize at some point, we are extremely excited about stocks today.

Russel Kinnel is Morningstar's director of mutual fund research.

Investment Returns (as of 12/31/08)

	1 Mo[1]	QTD[1]	1 Yr	AVERAGE ANNUAL TOTAL RETURNS 3 Yr	5 Yr	Since Inception[2]
Artisan International Value Fund	**5.04%**	**-15.87%**	**-30.11%**	**-2.27%**	**6.33%**	**13.85%**
MSCI EAFE® Index	6.01	-19.95	-43.38	-7.35	1.66	7.85
MSCI EAFE® Value Index	5.63	-19.81	-44.09	-8.25	1.79	8.71
Artisan Global Value Fund	**2.75%**	**-18.12%**	**-29.26%**	**–**	**–**	**-30.44%**
MSCI All Country World Index℠	3.62	-22.37	-42.19	–	–	-42.17

Source: Artisan Partners/MSCI. [1] Returns are not annualized. [2] International Value Fund inception: 9/23/02; Global Value Fund inception: 12/10/07.

Artisan International Value Fund Expense Ratio for the fiscal year ended 9/30/08 .... 1.23%

Artisan Global Value Fund Expense Ratio estimated based on the fiscal year ended 9/30/08:

Subsidized .... *1.44%[3]*

Unsubsidized .... *3.53%[3]*

[3]Artisan Global Value Fund's unsubsidized expense ratio is 3.53%. The subsidized expense ratio is 1.44%, which reflects Artisan Partners' voluntary undertaking to limit the Fund's expenses, which may be terminated at any time, has been in effect since the Fund's inception and has had a material impact on the Fund's performance. In addition, the outside directors of Artisan Funds have voluntarily waived that portion of their fees allocable to Artisan Global Value Fund for the first six months of the fiscal year ended September 30, 2008.

The performance quoted represents past performance, which does not guarantee future results. The investment return and principal value of an investment in the Funds 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. Artisan Global Value Fund's performance information reflects Artisan Partners' undertaking to limit the Fund's expenses, which may be terminated at any time, has been in effect since the Fund's inception and has had a material impact on the Fund's performance, which would have been lower in its absence. For current to most recent performance information, call 800.344.1770. The performance information shown does not reflect the deduction of a 2% redemption fee on shares held by an investor for 90 days or less and, if reflected, the fee would reduce the performance quoted.

Investors should consider carefully before investing a Funds' investment objective, risks and charges and expenses. For a prospectus, which contains that information and other information about a Fund, Financial professionals should call 800.344.1770 or visit www.artisanfunds.com. Please read the prospectus carefully before investing or sending money.

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