Where We Are Finding Growth
The Rise of Emerging Markets Consumers

ARTISAN PARTNERS
Insights

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Where We Are Finding Growth—The Rise of Emerging Markets Consumers

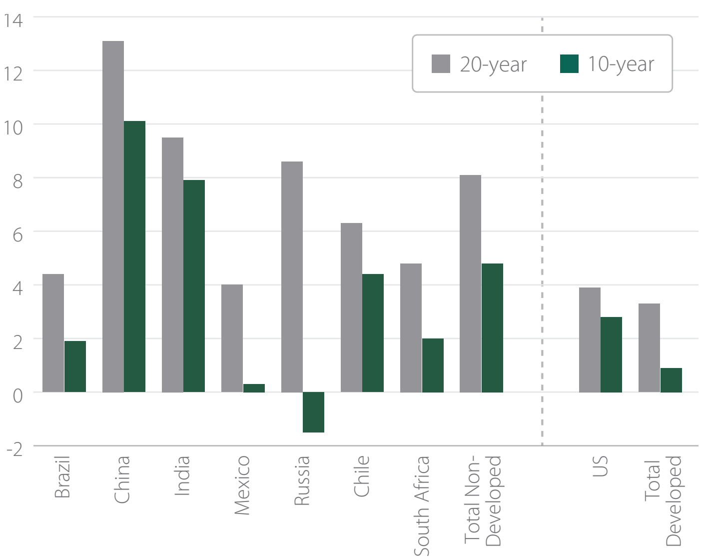
Artisan Partners Growth Team is committed to finding accelerating profit cycles globally and investing in reasonably valued companies that are positioned for long-term growth. The team's experience and broad knowledge of the global economy are key attributes helping them identify growth opportunities, wherever they occur, for the four portfolios it manages—Artisan Global Opportunities Fund, Artisan Global Discovery Fund, Artisan Mid Cap Fund and Artisan Small Cap Fund.

Currently, the team has identified a number of compelling secular trends that it believes can be catalysts for profit acceleration, driving growth for some time to come. Herein, the team discusses one of these trends—rising consumption in emerging markets.

The Emerging Markets Growth Opportunity

Over the past 20 years, emerging markets economic growth has significantly outpaced the developed world. And while economies globally have decelerated somewhat over the past decade, emerging markets in aggregate continue to outpace developed. (Exhibit 1)

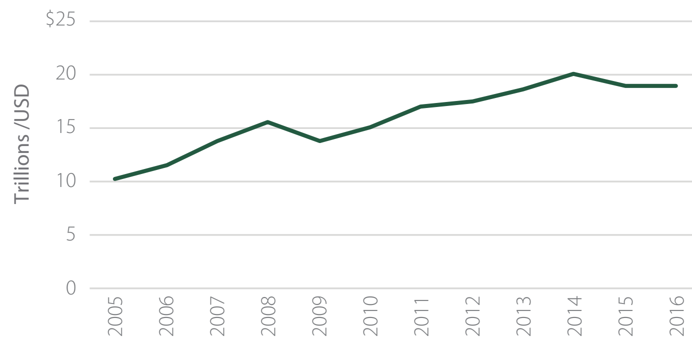
Exhibit 1: Developed vs Non-Developed GDP Annualized Growth Rates



Source: International Monetary Fund, World Economic Outlook Database as of April 2018.

Though economic growth has tempered from more heady rates in recent years, it is expected to accelerate over the next several years thanks to a combination of factors in both the developed and emerging worlds. One positive factor has been the US's recent corporate tax reform, which has contributed to increased corporate reinvestment. Another has been the recovery in commodities prices, which has provided emerging markets economies in particular a boost. A final factor has been global trade—which, despite an uptick in protectionist rhetoric, has nonetheless increased in recent years (Exhibit 2).

Exhibit 2: Total Global Trade



Source: World Trade Organization, as of 5/31/2018.

Further, emerging markets overall are expected to continue growing at a more rapid clip than the developed world over the next five years—with consumer spending projected to contribute meaningfully as economic growth creates an ever-larger pool of consumers.

This economic growth, combined with liberalization in many emerging economies allowing improved capital deployment, greater trade and freer flow of technological innovation, has yielded a growing middle class. As these new consumers graduate to income levels consistent with increased spending, they have been and should continue to be a powerful driver of accelerating profits for well-positioned firms—particularly share-leading retailers offering a compelling product mix and/or those with strong mobile e-commerce platforms.

Importantly, thanks largely to the Internet, which allows new consumers to explore and purchase goods in ways that barely existed 10 years ago, the current and future emerging consumer class now has exposure to global brands. As such, we expect that in addition to growing demand for more complex diets, health care and personal care products, emerging markets consumers will increasingly demand more aspirational and luxury non-domestic brands.

Our team has long recognized the growth of emerging markets consumers as a meaningful tailwind capable of powering compelling growth stories—and over the last several years, we've capitalized on that growth to invest in a number of compelling franchises. Over time, we've witnessed an accelerating pace of technological progress noticeably impacting the consumer evolution in emerging markets. For example, whereas several years ago we saw some of the biggest opportunities in emerging markets were retailers focused on understored geographical regions, we are currently finding compelling growth opportunities among innovative companies that are finding ways to go direct to their consumers via robust e-commerce platforms. As we've seen in previous instances of emerging markets development, this is effectively allowing many of these economies to "skip a step"—i.e., bypassing the intermediate steps developed economies have historically taken on their way to technological progress and change. Among the trends we're currently finding in this regard are the rise of online consumption, the shift to digital payments platforms, and consumers' luxury brand preferences.

The Rise of Online Consumption

A decade ago, companies were largely focused on penetrating emerging markets via a physical presence. In contrast, today we find that much of that focus has shifted to penetration via online platforms. One of the reasons is the rapid progress of smartphone penetration in emerging markets—itself a function of rapidly growing broadband and cellular penetration.

Combined, smartphone and cellular/broadband access allow consumers even in some of the remotest areas to interact online—whether to purchase goods and services or to interact via social media, messaging, gaming and other platforms. Several Chinese companies highlight well this phenomenon. Tencent, a holding in the Artisan Global Opportunities Fund, is a good example of the myriad growth engines high-quality Internet companies currently have. Tencent is one of China's largest Internet firms, providing gaming, social media platforms and other wireless value-added services, as well as advertising and e-commerce services for enterprises. In addition to its e-commerce platform, Tencent is capitalizing on the appetite of China's enormous population for online gaming, driving solid growth in smartphone games. It has concentrated on driving engagement across its popular messaging platforms and is effectively monetizing this high user engagement with advertising and subscription-based revenue models. Tencent also continues growing revenues via heightened adoption of its payments and cloud platforms. Given the breadth of its reach and Chinese demand which shows few signs of abating, we believe the runway ahead of Tencent remains meaningful.

Digital Payments: The Way of the Future

As mentioned earlier, one benefit emerging markets may have over developed world peers is their ability to "skip a step" from a technological progress standpoint. The area of online payments is a good illustration of this phenomenon. Many emerging markets economies remain underbanked—or even relatively unbanked altogether—complicating the retail growth picture, whether online or in person. Enter the world of digital payments, which is revolutionizing the way in which consumers globally can purchase goods.

One company capitalizing on this emerging markets trend is Visa, a holding in the Artisan Global Opportunities Fund. Visa is driving accelerating organic growth against a backdrop of rapidly increasing digital transactions thanks to several secular trends—including growing cross-border transactions, global travel, e-commerce and technological innovations that simplify cash transactions, such as the Square. Emerging markets represent a sizeable source of future growth for Visa. For example, while not yet necessarily a meaningful contributor to Visa's bottom line, India saw a rapid uptick in digital transactions following 2016's demonetization, which eliminated large-denomination rupee bills from circulation. While that growth has slowed, we anticipate the ongoing opening of India and other emerging markets will contribute to the ongoing global growth of digital transactions.

Over time, we anticipate an increasing number of companies will find ways to similarly penetrate emerging markets with increasingly sophisticated payments technology, thereby further enabling while simultaneously capitalizing on growing emerging markets consumption trends.

Shifting Preferences in Luxury Consumption

Higher-end and luxury retailers are capitalizing on the shifting preferences of emerging markets consumers as they graduate into higher income levels. Among the companies we currently find interesting are Treasury Wine Estates, a holding in the Artisan Global Opportunities, Global Discovery and Mid Cap Funds; Shiseido, a holding in the Artisan Global Opportunities Fund; and Canada Goose, a holding in the Artisan Small Cap and Artisan Mid Cap Funds.

Treasury Wine Estates (TWE) is a leading global wine producer and distributor. China is a source of meaningful and growing demand for "masstige" wines—premium brands at the $20 USD and above price-point per bottle. In 2016, TWE acquired Diageo's US and European wine business. With a large, scattered number of inefficiently run brands, each with its own vineyard and operations, Diageo saw wine largely as an afterthought. Since TWE's purchase, management has eliminated many of the smaller brands, preserving only the most valuable and skewing those remaining toward the most marketable. This process has also allowed TWE to consolidate production and realize meaningful cost synergies. Importantly, the Diageo acquisition gave TWE access to higher-quality grapes, including from California, allowing the company to continue shifting its portfolio toward higher-priced wines to meet China's growing demand. We believe TWE is well-positioned to capitalize on the Chinese middle class's growing desire to consume aspirational wines—a trend we anticipate will accelerate over time as more consumers move into China's middle class.

Shiseido is also capitalizing on shifting preferences among emerging markets consumers—particularly in China. Shiseido is a leading Japanese beauty brand that has executed impressively against a backdrop of solid demand for prestige beauty products in Asia. We first purchased Shiseido in 2015 in the Artisan Global Opportunities Fund due to several positive, internal strategic developments—including a contemporaneous change in senior management. The company had hired a new CEO with prior experience from Coca-Cola, and at the beginning of his tenure, he brought in a number of brand managers from outside the company. From a strategic and cost-cutting standpoint, Shiseido's management team articulated a clear plan to renew its focus on more profitable product lines and bolster the company's global presence with targeted R&D and marketing investments. It also outlined an e-commerce strategy aimed at building its online presence. As the company successfully executed on its initiatives, it positioned itself to capitalize on growing Chinese tourism—when many Chinese consumers make high-end purchases, including cosmetics. In the period since first introducing it to the portfolio, China's demand has defied expectations of decelerating growth. On the contrary, China demand continues accelerating, in turn driving impressive margin improvement for Shiseido and showing little sign of abating. While its results have been impressive to date, we believe there remains an attractive runway ahead of Shiseido as other emerging markets eventually catch up with China's progress.

Canada Goose is an interesting case of a luxury brand—a premium outerwear brand—that is building its presence, particularly in emerging markets, almost solely via its online presence. It is largely skipping a physical presence altogether, preferring the real estate-light and direct-to-consumer approach—decisions which result in lower costs and higher margins. With brands such as Burberry and Moncler already generating a meaningful share of their sales in China, we anticipate Canada Goose's online presence and luxury appeal will similarly catch on, contributing to an attractive profit cycle.

Where We Are Finding Growth

An important consideration when investing in companies with exposure to emerging markets is the potential for higher volatility. These stocks may face lower liquidity levels, higher informational friction and/or restrictions on non-domestic investors—capital markets features that can vary greatly country by country. Regulatory, political and monetary constructs can also vary significantly, as can strength of rule of law. Then, even within a single country, the amount of regulatory and political scrutiny can vary from industry to industry.

Rather than approaching emerging markets-exposed companies with rigid top-down country-specific criteria, we consider how the political/regulatory climate may impact our visibility into future profit growth on an individual company basis. Analysis of country-specific factors can also factor into how we risk-adjust position sizes.

When considering firms exposed to rising emerging markets demand, we start where we always do: Identifying solid franchises with decided competitive advantages tied to a proprietary product or process, leading market share and/or low-cost advantages. We then look for the potential for profit acceleration supported by compelling internal and/or external drivers. And we attempt to buy those future profits at a reasonable valuation we can understand.

Among firms domiciled in emerging markets, this often entails identifying high-quality firms, preferably with an asset-light model and lower capital intensity that is free cash-flow generative. We also look for share-leaders and/or those with first-mover advantages being levered into scale and network advantages, with compelling product offerings and, often, a mobile ecosystem trusted by its users. Rising emerging markets demand can also play a role in our investment theses for firms domiciled in developed markets.

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Carefully consider the Fund's investment objective, risks and charges and expenses. This and other important information is contained in the Fund's prospectus and summary prospectus, which can be obtained by calling 800.344.1770. Read carefully before investing.

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. 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. Growth securities may underperform other asset types during a given period.

This summary represents the views of the investment team as of 30 Jun 2018 and is subject to change without notice. Security examples are for informational purposes only and are not representative of the entire portfolio. There is no guarantee that investment within the securities mentioned will result in profit. While the information contained herein is believed to be reliable, there is no guarantee as to the accuracy or completeness of any statement in the discussion.

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Free Cash Flow is a measure of financial performance calculated as operating cash flow minus capital expenditures.

For the purpose of determining the Funds' holdings, securities of the same issuer are aggregated to determine the weight in the Funds. Securities named in the commentary; but not listed here are not held in the Fund(s) as of the date of this report. The holdings mentioned above comprised the following percentages of the Funds' total net assets (including all share classes) as of as of 30 Nov 2018: Artisan Global Opportunities Fund—Tencent Holdings Ltd 2.1%, Visa Inc 6.0%, Treasury Wine Estates Ltd 1.8%, Shiseido Co Ltd 1.2%. Artisan Global Discovery Fund—Canada Goose Holdings Inc 1.8%, Treasury Wine Estates Ltd 1.7%. Artisan Mid Cap Fund—Canada Goose Holdings Inc 1.8%, Treasury Wine Estates Ltd 0.9%. Artisan Small Cap Fund—Canada Goose Holdings Inc 3.3%. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities. Securities named but not listed here are not held in the Fund as of the date of this report.

Portfolio holdings develop through three stages: Garden℠, Crop℠ and Harvest℠. Garden℠ investments are situations where we believe we are right, but there is not clear evidence that the profit cycle has taken hold, so positions are small. Crop℠ investments are holdings where we have gained conviction in the company's profit cycle, so positions are larger. Harvest℠ investments are holdings that have exceeded our estimate of intrinsic value or holdings where there is a deceleration in the company's profit cycle. Harvest℠ investments are generally being reduced or sold from the portfolios.

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