Where We Are Finding Growth

Financials Are Investible Again

ARTISAN PARTNERS
Insights

A R T I S A N P A R T N E R S

Where We Are Finding Growth—Financials Are Investible Again

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 three portfolios it manages—Artisan Global Opportunities Fund, Artisan Mid Cap Fund and Artisan Small Cap Fund.

Here, the team discusses key attributes it is finding among financials companies it believes are poised for long-term profit growth, following several years in which most financials were largely uninvestible.

Financials Post-Crisis Challenges

Following the 2008-2009 global financial crisis, financials companies, particularly banks, faced a number of industry-specific operating challenges that weighed significantly on growth potential—in turn making a wide swath of financials sector stocks unappealing from an investing perspective.

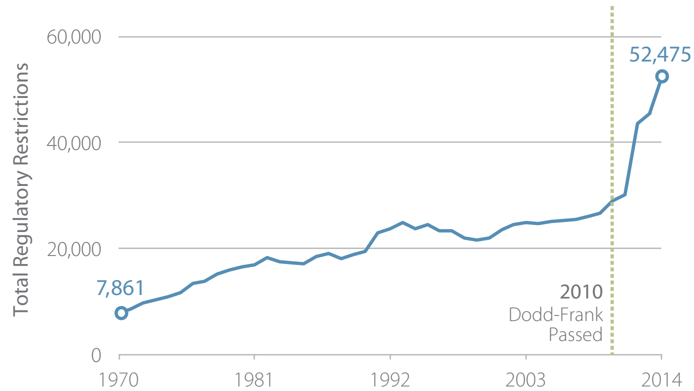
This environment had been the product of the collision of a handful of factors—namely, increasing and more complex regulatory requirements (i.e., Dodd-Frank and other global legislation); ratcheting capital requirements thanks to heightened capital standards; and a persistently low interest-rate environment as monetary authorities attempted to engineer a recovery. These factors resulted in meaningful uncertainty within the financials industry, which tended to result in banks' preference for holding onto any excess capital (if there was any to be had, above and beyond that directed to higher capital ratios), as opposed to lending it out and greasing the wheels of economic activity, as healthy banks are generally wont to do.

Though we will focus here primarily on supply side factors that have weighed on financials since the financial crisis, it's worth noting challenges from the demand side as well. Since the crisis, demand for credit has lagged as consumers have spent several years shoring up personal balance sheets after having gorged, pre-crisis, on home-equity loans and credit-card debt. Though most of these headwinds have largely abated, and loan demand is showing signs of picking up, the impact on the financials industry should not be ignored.

Heightened Regulatory Complexity

For much of the past eight or so years, the post-crisis regulatory environment had only gotten more onerous and complex as governments globally rolled out a raft of new legislation intended to increase transparency and better regulate what many perceive to be the root causes of the global financial crisis. Since that crisis, banking regulations have exploded (Exhibit 1)—forcing financial institutions to dedicate ever more resources to compliance costs while taking from management teams' focus on core operational issues.

Exhibit 1: Regulatory Restrictions in the Code of Federal Regulation, Title 12 (Banks and Banking)



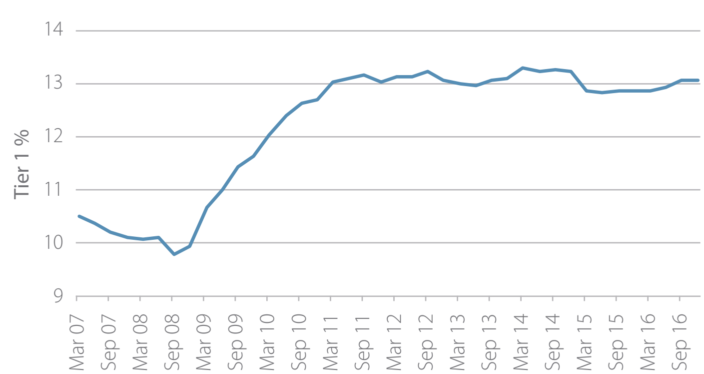
Source: Mercatus Center, George Mason University and RegData, http://regdata.org. Produced by Patrick A. McLaughlin and Oliver P. Sherouse, July 17, 2015.

Further, in many cases, the new laws' details were left to bureaucracies to write—with many rules remaining unwritten still—drawing the uncertainty out and introducing a moving target for financials from a compliance standpoint.

More Stringent Capital Requirements

International capital standards—including Basel III, which addresses bank capital levels, market liquidity risk and so on, and Solvency II, which addresses capital levels in the insurance industry, and others—not only increased required capital ratios for banks but made them more stringent. Furthermore, uncertainty caused by questions about the potential for financial companies to be held liable for the crisis's fallout compounded the issue. Those two factors together resulted in banks' capital ratios increasing significantly since the global financial crisis (Exhibit 2).

Exhibit 2: Bank Capital Ratios in the Post-Financial Crisis Era



Source: BankRegData, Monthly Tier 1 Capital Ratios, All US Banks, Mar 2007–Dec 2016.

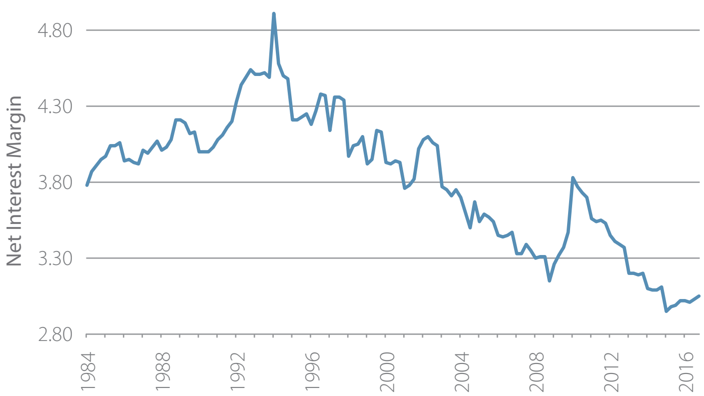
Whether higher capital ratios provide the system with needed stability or are an unnecessary burden on financials is certainly up for debate.

What is clear is that banks have spent much of the last decade meeting ever-higher standards, which has impinged on margins, diminished banks' flexibility in deploying capital and handcuffed management teams in operating their businesses.

Persistently Low Interest Rates

A third factor weighing on the financials environment over the past few years has been the persistently low short-end interest rate environment, along with compression in the long end of the yield curve. This relatively flat yield curve has hampered banks' ability to earn reasonable net interest margins (Exhibit 3)—in turn weighing on banks' return on equity (Exhibit 4) to levels well below averages seen in recent decades.

Exhibit 3: Net Interest Margin for All US Banks



Source: St. Louis Federal Reserve Economic Data, Net Interest Margin for All US Banks, Percent, Quarterly, Not Seasonally Adjusted, 1 Jan 1984–1 Oct 2016.

Exhibit 4: Return on Average Equity for all US Banks

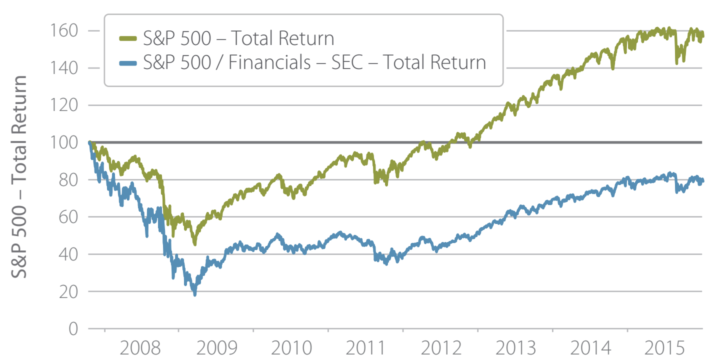
Source: St. Louis Federal Reserve Economic Data, Return on Average Equity for all US Banks, Percent, Quarterly, Not Seasonally Adjusted, 1 Jan 1984–1 Oct 2016.

The Net Effect: Uncertainty and Commoditization

The combination of these factors—increasing regulatory complexity, higher capital requirements and a persistently low-rate environment—added to a general atmosphere of uncertainty, which was an additional anchor on banks' willingness to deploy capital in growth-related ways. It also contributed to a meaningful decrease in trading volume and volatility within trading operations at many banking institutions—another drag on banks' profitability. A third byproduct has been dampened investor appetite for financials in general—particularly banks and other financials firms exposed to interest rates and/or coming under heavy regulatory scrutiny.

Yet another significant development we have seen has been what we refer to as the commoditization of the financial industry. Amid such a challenging environment, the likelihood of finding compelling growth opportunities was meaningfully diminished. As a result, we have, with rare exceptions, identified few compelling profit cycles within the sector since the global financial crisis. With the benefit of hindsight, it is not surprising to find that, until quite recently, financials sector stocks have lagged the rest of the market (Exhibit 5).

Exhibit 5: S&P Financials Sector, Total Returns



Source: FactSet, S&P 500 and S&P 500 Financials Total Return, 5 Oct 2007–31 Dec 2015. **Past performance is not a reliable indicator of future results.**

Nascent Signs of Improvement

However, more recently, we are seeing compelling evidence that the backdrop for financials is becoming more conducive to growth for well-positioned franchises.

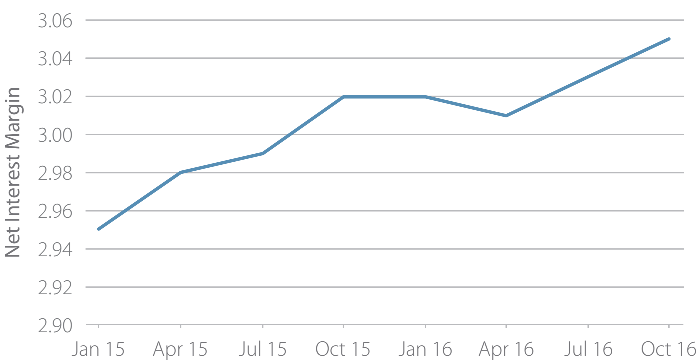
First, banks are generally much healthier than they were heading into the financial crisis. In the years since the crash, banks have shored up their balance sheets, and many of them have engaged in cost-cutting initiatives that, for some, are finally beginning to yield margin improvements.

Second, the 2016 US presidential election, the results of which caught many investors by surprise, has ushered in a new administration that is generally considered more pro-business. This introduces increased potential for corporate tax reform, the alleviation of the pace of new regulation and a generally more conducive environment many believe will spur faster economic activity—which should in turn increase financials- and banking-sector activity.

Expectations for broadening US growth combined with nascent signs of growth across much of Europe—and even some signs of improvement in long-stagnant Japan—have increased expectations for inflation and a steeper yield curve. Rising purchasing managers and new orders indices in major global economies (among other measures) speak to growing expectations for faster global economic growth.

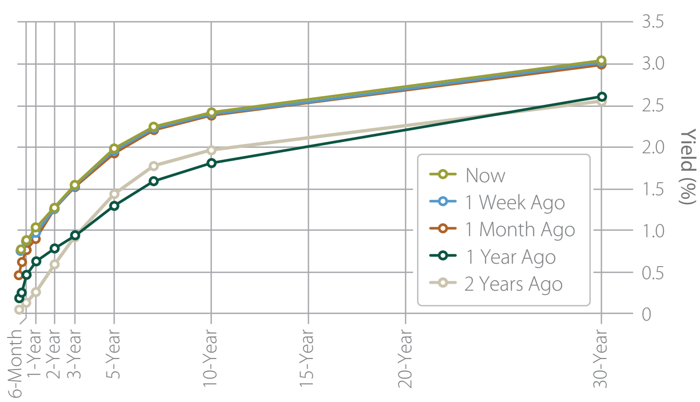
In the US, we're already seeing signs of these very improvements: Banks' net interest margins are showing signs of expanding (Exhibit 6) as the yield curve steepens (Exhibit 7)—both are generally positive catalysts for traditional banks and other interest-rate exposed financials.

Exhibit 6: Banks' NIMs



Source: St. Louis Federal Reserve Economic Data, Net Interest Margin for All US Banks, Percent, Quarterly, Not Seasonally Adjusted, 1 Jan 2015–1 Oct 2016.

Exhibit 7: US Treasury Yield Curve, as of 2/23/2017



Source: FactSet, US 1m, 3m, 6m, 1y, 2y, 3y, 5y, 7y, 10y and 30y Treasury yields, as of 23 Feb 2017.

Where We Are Finding Growth

The net effect of these developments is a financials sector that is once again investible, in our view. However, an improved macro backdrop is not enough, given our process. Certainly the alleviation of multiple industry-specific headwinds can contribute to compelling profit cycles, but our approach is selective by design.

In identifying investment candidates, we start where we always do, by confirming a company's franchise quality and competitive positioning. Then, we want to identify a profit cycle based on a catalyst or catalysts we understand. Finally, we want to purchase shares of a company when we believe they are trading at a discount to our estimate of private market value.

We believe we have found several such companies across the three portfolios we manage. While a rising interest-rate environment and improving regulatory backdrop certainly helps, we believe all of our holdings in the financials sector have additional, company-specific catalysts. Additionally, thanks to dour sentiment that has persisted for these types of companies since the financials crisis, many of these companies trade at valuations that remain very attractive.

Among the companies we believe to be in the early stages of compelling profit cycles include some of the more traditional financial institutions which have spent the last decade or so cutting costs and cleaning up their balance sheets—for example, Bank of America and State Street, both holdings in the Global Opportunities Fund.

Bank of America, one of the US's largest commercial banks, has successfully put seven years of mortgage-related problems behind it, just as the aforementioned regulatory burden is likely to ease—or at least, the pace of new regulation is set to slacken. Further, it has initiated significant cost-saving measures, which are just now starting to translate meaningfully to the bottom line. Bank of America also has a solid management team that we believe can capitalize on some of the fundamental shifts taking place in the financial industry.

State Street, which provides custody services as well as investment management, is a solid franchise we believe to be positioned well given several changing industry dynamics, including growing demand for passive investment vehicles, which State Street provides. At the company level, State Street has already begun implementing and benefiting from a cost-cutting plan under its recently named new CFO. In addition, its potential first-mover advantages with technology, including blockchain, could add meaningfully to future cost-cutting opportunities.

However, beyond traditional banks, we believe there are other companies in the financials space that can incrementally benefit from a changing backdrop. For example, First Republic Bank (FRC), a holding in the Artisan Mid Cap Fund, is one of the few mid-cap banking franchises which we consider truly differentiated, given its strong reputation for customer service, branch footprint in growing cities, solid technology and infrastructure and long history of low credit losses. Further, FRC is has been consistently gaining share of high net worth households in its chosen markets—which in turn has driven solid loan growth—with significant market share still available. The company has been investing to build out its private wealth management franchise, which enhances growth as well as return on equity. As with our other financials franchises, FRC would benefit from a rising interest-rate environment, though our thesis is not predicated solely on that expectation.

Webster Financial Corp, a holding in the Artisan Small Cap Fund, owns the US's largest health savings account (HSA) platform. Rising domestic health care costs have contributed to a modest, but likely growing, shift toward HSAs, which often incentivize consumers to make better-informed care decisions based on price. The US election's outcome increases the likelihood that HSA-funded health care spending accelerates, which should benefit Webster as accounts grow both in number and size. Aside from its HSA franchise, Webster is a well-capitalized bank that we believe is poised to benefit from the improved macroeconomic environment and the potential for accelerating economic growth.

The Evolving Intersection of Financials and Technology

For some time now, we've found interesting opportunities in companies that are capitalizing on the explosion in data within financial services—these are companies with business models that we believe are designed to thrive regardless of the macro environment. Companies like S&P Global (SPGI), a holding in the Artisan Global Opportunities and Mid Cap Funds, which is benefiting from its strategic efforts over the last several years. When we first initiated our position in SPGI in 2014 (in what was then McGraw Hill Financials), its margins were below peer averages, and it faced significant legal and regulatory fallout from the rating agencies' role in 2008's global financial crisis. However, SPGI's new management team has executed well on a clear plan to simplify the business by selling non-core assets, resolve the legal challenges and drive higher margins and efficiencies across SPGI's business. It is also beginning to realize meaningful synergies from its acquisition of SNL Financial—a mid-size but fast-growing provider of data and information services to the financial services industry.

SVB Financial, a holding in the Artisan Mid Cap and Artisan Small Cap Funds, is another unique financials franchise. We believe SVB's sharp focus on a narrow client base of start-ups and fast-growing technology and life sciences businesses allows it to provide top-notch service. Though rising rates would undoubtedly benefit SVB, rate changes are difficult to predict and are therefore only a "nice-to-have" component of our investment thesis.

We've also increasingly found solid franchises with identifiable profit cycles in a category that's broadly referred to as fintech—companies that are rapidly transforming the technology on the back-end of many typical financial transactions. We believe our holdings exposed to this trend—including Visa and Temenos in the Artisan Global Opportunities Fund, Fidelity National Information Services (FIS) in the Mid Cap Fund and Ellie Mae in the Small Cap Fund—have strong fundamentals and are in the early stages of compelling, accelerating profit cycles.

Investment Process Highlights

We seek to invest in companies with franchise characteristics that are benefiting from an accelerating profit cycle and are trading at a discount to private market value.

Security Selection

We seek to identify companies with franchise characteristics that are selling at attractive valuations and are benefiting from an accelerating profit cycle. We look for companies that are well positioned for long-term growth, driven by demand for their products and services, at an early enough stage in their profit cycle to benefit from the increased cash flows produced by the emerging profit cycle.

Capital Allocation

Based on our fundamental analysis of a company's profit cycle, we divide the portfolio into three parts. Garden investments are small positions in the early part of their profit cycle that will warrant a more sizeable allocation once their profit cycle accelerates. Crop investments are positions that are being increased to a full weight because they are moving through the strongest part of their profit cycle. Harvest investments are positions that are being reduced as they near our estimate of full valuation or their profit cycle begins to decelerate. We believe that adhering to this process increases the likelihood of delivering upside participation with downside protection.

Broad Knowledge

We overlay security selection and capital allocation with the capability to invest opportunistically across the entire global equity spectrum. It is our goal to have broad knowledge of the global economy to ensure that we are able to find growth wherever it occurs. This capability extends from the design of our team, which leverages the broad experience of the portfolio managers and the deep expertise of the analysts on the team—many of whom started their careers in their respective industries, thereby adding to their sector expertise.

Team Overview

We believe deep industry expertise, broad investment knowledge, a highly collaborative decision-making process and individual accountability are a powerful combination. Since the inception of the team in 1997, we have been committed to building a team of growth investors that retains these attributes and is solely dedicated to our process and approach.

For more information: Visit www.artisanpartners.com | Call 800.344.1770

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 June 2017, 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 no guarantee as to the accuracy or completeness of any statement in the discussion. This material is for informational purposes only and should not be considered as investment advice or a recommendation of any investment service, product or individual security.

For the purpose of determining the Funds' holdings, securities of the same issuer are aggregated to determine the weight in the Fund. 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 comprise the following percentages of the Funds' total net assets (including all share classes) as of 30 Sep 2017: Artisan Global Opportunities Fund—Bank of America Corp 2.7%, State Street Corp 2.9%, S&P Global Inc 2.9%, Visa Inc 5.4%, Temenos Group AG 1.4%. Artisan Mid Cap Fund—S&P Global Inc 3.2%, SVB Financial Group 1.4%, Fidelity National Information Services Inc 1.7%, First Republic Bank 2.1%. Artisan Small Cap Fund—Webster Financial Corp 1.7%, SVB Financial Group 1.8%, Ellie Mae Inc 1.5%. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities. All information in this report, unless otherwise indicated, includes all classes of shares and is as of the date shown.

S&P 500® Index measures the performance of 500 US large-cap companies. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment. S&P 500® Financials Index comprises those companies included in the S&P 500® that are classified as members of the GICS® financials sector.

Our capital allocation process is designed to build position size according to our conviction. 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. **Private Market Value** is an estimate of the value of a company if divisions were each independent and established their own market stock prices. **Tier 1 Capital Ratio** is a comparison between a banking firm's core equity capital and total risk-weighted assets. **Return on Equity** (ROE) is a profitability ratio that measures the amount of net income returned as a percentage of shareholders equity. **Net Interest Margins** (NIMs) measure the difference between interest received from borrowers and interest paid to depositors.

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