Where We Are Finding Growth

Internal Change Catalysts

ARTISAN PARTNERS
Insights

For Institutional Investors Only—Not for Onward Distribution

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

Where We Are Finding Growth—Internal Change Catalysts

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 Strategy, Artisan Global Discovery Strategy, Artisan U.S. Mid-Cap Growth Strategy and Artisan U.S. Small-Cap Growth Strategy.

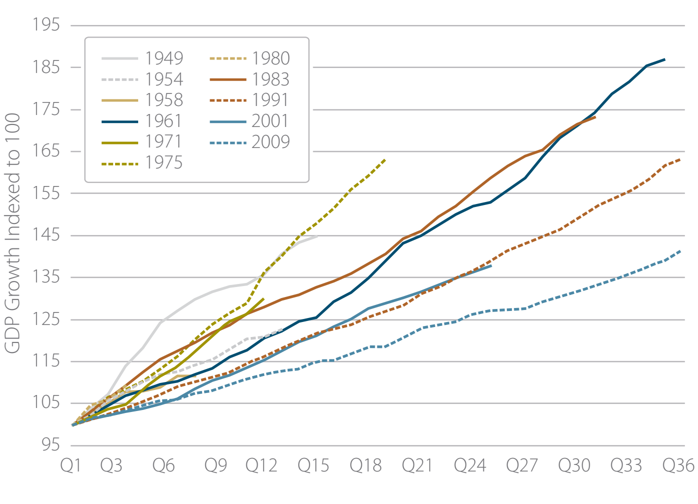
Here, the team discusses key attributes it looks for in identifying franchises that it believes can enjoy a long-term profit cycle, due primarily to compelling internal change catalysts.

A Long, Grinding Expansion

The current global bull market started on March 9, 2009, and most developed-world countries exited recession not long thereafter. Though neither length nor magnitude in and of itself indicates a bull market's end, it seems reasonable to posit that the current bull market is likely nearer its end than its beginning.

As bull markets mature, economic (and market) growth typically slows until it finally rolls over into a bear market—and most often an accompanying recession. Roughly a decade into this bull market, one would expect to see decelerating economic growth. However, this particular global expansion started slowly and has only recently picked up momentum. Exhibit 1 shows US GDP growth through various historical expansions. Despite the recent economic uptick, the current expansion is still the slowest in the post-WWII era. (Global GDP growth follows a similar pattern.)

Exhibit 1: A Historically Slow Expansion



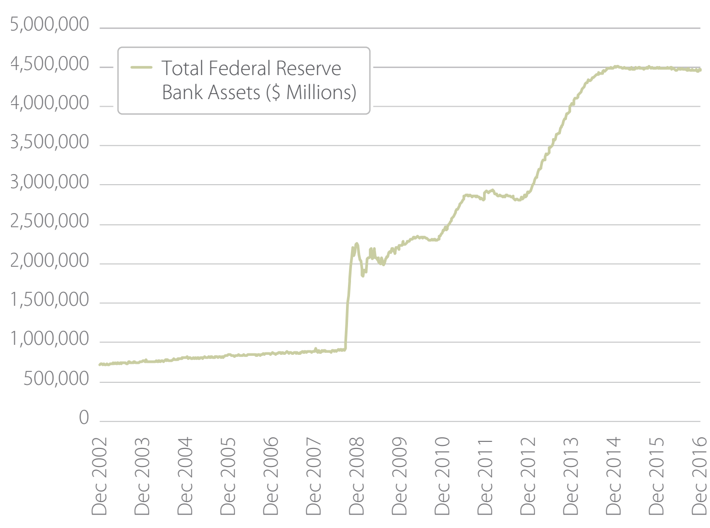
Source: US Bureau of Economic Analysis, as of 9/30/2018.

Arguably, one positive side-effect of the expansion's slow, grinding nature has also been its duration—which recently exceeded history's prior longest. With several sizeable yet potentially contradictory forces in play—including global monetary policy, trade policy and, to a lesser but not insignificant extent, expansionary fiscal policies—a natural question is how these factors impact global economies' and markets' future direction. While we do not profess to be macro prognosticators, what follows are some high-level considerations surrounding each of these factors.

Global Monetary Policy Experimentation

Prior to discussing monetary policy's potential future direction, it's worth beginning with a brief review of the policies major global central banks have pursued to date. Monetary policy has historically been a lever used to guide economies back to growth following contractions—at times more skillfully than at others. However, following the 2007 recession, which was predicated on a credit crisis, policymakers (rightly or wrongly) placed tremendous emphasis on monetary policy in their attempts to spur global growth (and, some would argue, prop up markets into the bargain). As such, global central banks pursued largely unprecedented monetary policies for much of the ensuing decade. The US Federal Reserve's years of quantitative easing and other dovish measures resulted in a balance sheet that reached a historic size (Exhibit 2). To put the Fed's balance sheet in perspective, by the end of 2016 when growth had largely tailed off, reserve bank assets amounted to roughly 25% of US GDP.

Exhibit 2: The US Federal Reserve Has Amassed a Sizeable Balance Sheet



Source: Federal Bank of St. Louis, 12/25/2002–12/28/2016.

Early in the young expansion, global monetary policies generally aligned, with most major central banks adopting increasingly and exceptionally dovish stances following the credit crisis—many going as far as deploying some form of quantitative easing. However, as global growth rates have increasingly diverged among major global economies, so too have monetary policies taken different paths. More recently, the US in particular has shifted to a modestly tighter stance. After years of vowing to keep rates low with an aim of bolstering growth, the Fed began gradually increasing its benchmark rate, with initial 25bps increases in both March and June of 2017 and a similar slow-but-steady approach since then.

The UK has arguably been the most reactive of the major global central banks, more readily shifting its monetary policy in response to the changing British economic backdrop. The Bank of England was among the first to begin tightening—ceasing new asset purchases as early as 2012, well before other global economies had begun contemplating such moves. However, in the wake of the UK's affirmative vote on the Brexit referendum in June 2016, the BoE reversed course in July of the same year. Since then, as economic growth in the UK has held fairly steady despite the uncertainties surrounding its exit from the EU, BoE Governor Mark Carney announced the UK's first interest rate hike in more than 10 years.

In contrast to the actions of both the US and UK and despite evidence of a more robust global economic backdrop, the ECB and Bank of Japan have been highly accommodative since March 2009—to the point of implementing negative interest-rate or zero interest-rate policies. Under a negative interest-rate policy, investors effectively pay banks to park their cash—and banks pay central banks for the same privilege. Officials have hoped the latter fact would incentivize banks to lend out the cash on their tremendous balance sheets in search of a better yield than the negative one at the central bank—theorizing that a sought-after increase in lending would underpin faster economic growth. While the degree to which this has happened is debatable, what is clearer is many investors have sought better yields elsewhere—potentially contributing to the current bull market's duration and helping explain why investors remain willing to invest in riskier assets.

As economic growth has shown signs of an uptick in some major global economies—led by the US—the question has increasingly become where global central banks go from here. How do they unwind the massive balance sheets accumulated over the course of the bull market? At what rate do they raise interest rates—if they begin raising them at all? Given the role oft attributed to monetary policy for arresting the 2008-2009 crisis, it's understandable the focus many place on the answers to these (and related) questions.

Global Trade Policy

Since the 2016 US presidential election, global trade policy has been top of mind for many as the US and several major trade partners renegotiate (in some cases) long-standing trade agreements. To date, the net effect of most of these discussions has been uncertainty. While there have undoubtedly been individual winners and losers within the impacted countries, global growth has thus far not been meaningfully impinged by modestly higher trade barriers. However, that doesn't preclude future impacts—deleterious or positive. Further, trade barriers are among the known potential causes of bear markets—perhaps most memorably the 1930s bear market and Great Depression, which were helped on their way by policies such as the Smoot-Hawley Tariff Act in the US, which prompted retaliatory tariffs among the US's major global trading partners.

While we remain quite a ways from the Smoot-Hawley days for now, the probability global trade tensions escalate to the point of concern is undoubtedly non-zero. Reassuringly, though, most participants have so far shown a willingness to remain at the negotiating table.

Global Fiscal Policies

As voter frustration with stubbornly slow economic growth mounted, several countries elected new administrations which promised varying flavors of legislation intended to goose economic growth. The most notable example is the US, where President Trump's administration in early 2018 enacted sweeping corporate tax reform. It has also sought to generally ease the regulatory environment across a swath of industries, including financials and pharmaceuticals, among others.

Another example is France, where President Macron has introduced various business-friendly regulations—for example, relaxing some of the country's historically strict labor regulations which make it costly for businesses to operate domestically. While these policies have met with varying degrees of success (and welcome), the stated aim is finding ways to incentivize faster economic activity.

Finding Growth in a Maturing Bull Market

Our process is intentionally built in a way which does not require us to make macroeconomic forecasts or predictions. While we certainly see reasons for skepticism about an ongoing economic expansion and bull market, we simultaneously remain cautiously optimistic, given many signs that overall corporate health remains intact. Despite the macroeconomic backdrop, we continue finding high-quality franchises that are exposed to what we believe to be durable, secular trends.

Given the current mix of market influences, such an environment may make investors question where to find growth. However, we take a different approach to finding growth—by applying a fundamental, bottom-up process for identifying solid franchises selling at reasonable valuations and benefiting from either external or internal profit catalysts, or a combination of both.

External growth catalysts need not be predicated on a particularly strong macro environment. Indeed, we believe we have identified a number of secular trends that can transcend the macro environment including:

- Health Care Innovation—New drugs, devices, diagnostics and delivery models that make health care more effective and efficient
- Next-Gen Data Analytics—Proliferating sensors and mobile connectivity is boosting the profit potential of data analytics
- Industrial Process Innovation—Precision technologies and systems that increase quality, synchronize information streams and speed throughput to lower production costs
- Emerging Markets Consumer—A rising middle class is driving demand for products, experiences and services
- Financials Are Investible Again—The combination of less onerous regulation, continued operational restructurings and recapitalized balance sheets lead to profits—with an added boost from widening spreads
- Transforming How We Work—The development and use of modern software tools to facilitate a more collaborative, efficient, mobile and secure work environment
- Digital Payments—Differentiated technology solutions are transforming digital payments, enabling the processing of secure transactions in increasingly complex and global settings

We have written about these trends in recent communications and continue to find companies benefiting from them. However, given the later-stage bull market environment, we believe internal change catalysts can also provide meaningful sources of growth for well-positioned companies.

Companies capitalizing on an internal catalyst or catalysts may be in better control of their own destinies—which is an attractive proposition when an expansionary cycle may be nearer its end than its beginning. These companies often have strong balance sheets that provide better competitive positioning, particularly during periods of economic uncertainty or duress—allowing them to take meaningful share. A sound financial position can also allow such companies to embark on profitable new strategic initiatives regardless of the macro environment. Such companies may not experience explosive top-line growth (though some certainly might). However, we consider ourselves profit-cycle hunters—not strictly revenue hunters—and therefore are just as happy to uncover a compelling margin expansion story. Therefore, we believe the current macro environment remains a good backdrop for our approach.

Identifying Internal Catalysts

That said, companies positioned to benefit from an internal catalyst may not present themselves as readily as those that can benefit from an external secular trend—partly because internal catalysts are the definition of company-specific. They also tend to be country and sector agnostic, which can require a deeper level of analysis in order to identify potential candidates.

We believe our investment process is particularly well suited to finding companies in this environment given our benchmark-agnostic approach to growth. This approach gives us the degrees of freedom we need to seek out compelling growth opportunities wherever they occur, without being hamstrung by target sector or country weights.

Among the characteristics we look for as internal catalysts are:

- New management teams
- New products
- Strategic acquisitions or divestitures
- Margin expansion or cost-cutting initiatives

Internal Catalysts in Action

To illustrate the impact internal catalysts can have on profit growth, it's best to consider a few case studies. For example, Shiseido is a leading Japanese beauty brand with a growing global presence. We first purchased Shiseido in June 2015 in the Artisan Global Opportunities Strategy due to several positive, internal strategic developments—including a recent 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 has articulated a clear plan to renew its focus on more profitable product lines and bolster Shiseido's global brand presence with targeted R&D and marketing investments. It also outlined an e-commerce strategy aimed at building its online presence—domestic Japanese distribution has historically been primarily through department stores, introducing an opportunity for strategically improving its e-commerce presence.

Internal and external catalysts often go hand in hand. For example, bolstering those internal catalysts, Shiseido is also benefiting from growing Chinese tourism, which has proved resilient despite China's recent macroeconomic deceleration. Regulatory changes, including more relaxed visa processes, and rising incomes have boosted Japan's tourism, and cosmetics are a popular purchase. While these external trends can reverse, we believe the internal catalysts driving Shiseido provide an attractive growth runway.

Nintendo—a holding in the Artisan Global Opportunities Strategy and the Artisan Global Discovery Strategy—is the original and dominant leader in gaming intellectual property. Traditionally, Nintendo has limited access to its games to its proprietary platforms, while smartphone-enabled gaming has taken massive share over the last several years. We first purchased Nintendo in April 2015 in the wake of its announced plans to monetize its tremendous IP library via a partnership with Japanese mobile-gaming company DeNA—a compelling strategic shift.

Nintendo also introduced a new CEO in September 2015 who has thus far been committed to continuing Nintendo's transition to mobile and smartphone platforms. And indeed, the tremendous initial success of the release of Pokémon Go for smartphones in July 2016, followed by a mobile platform treatment of Nintendo's popular Mario Brothers characters, and combined with further game launches in the pipeline seem a promising start for what should be a long growth runway.

Gardner Denver, a holding in the Artisan Global Discovery, U.S. Mid-Cap Growth and U.S. Small-Cap Growth Strategies, is another example of a company we believe is benefiting from an internal catalyst. Gardner Denver is a leading manufacturer of flow control and compression technologies for end markets. It has weathered a difficult energy downturn under private-equity ownership, restructuring its operations and recruiting new management from respected industrial technology franchises. The company had made notable improvements in its operations and culture, investing in a new supply center and automation across some of its manufacturing facilities to increase productivity. Against a backdrop of recently reinvigorated energy demand, we believe Gardner Denver will leverage its revitalized culture to drive strong product innovation and sales execution over the coming years.

We believe that Veeva Systems, a holding in the Artisan U.S. Small-Cap Growth, U.S. Mid-Cap Growth and Global Discovery Strategies, is also positioned to benefit from solid internal catalysts. Veeva is a life sciences software-as-a-service (SaaS) company whose highly specialized software allows its customers to address and oversee complex government-regulation compliance. At a broad level, it is helping usher in an industry-wide move to SaaS and the cloud—though it is still in the very early stages of displacing on-premise software solutions. In addition to success selling its customer relationship management software, Veeva's Vault product, which helps customers manage highly regulated marketing and clinical trial data and content, is showing signs of similarly rapid uptake.

As is often the case with internally driven companies, Veeva is also helmed by a strong management team—with a prior history at PeopleSoft, another software company known for its commitment to customer success—to which we attribute the company's strong, customer-focused culture. As a result of this attractive combination of industry-level trends and a strong management team, Veeva has driven solid operating margins at a relatively early stage of its growth, and we believe it has the potential to expand its target market beyond investors' current expectations.

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.

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

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. 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. These risks, among others, are further described in Artisan Partners Form ADV, which is available upon request.

The views and opinions expressed are based on current market conditions as of 30 Sep 2018, which will fluctuate and those views are 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 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. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

Unless otherwise indicated, the Artisan Strategy characteristics relate to that of an investment composite or a representative account managed within a composite. It is intended to provide a general illustration of the investment strategy and considerations used by Artisan Partners in managing that strategy. Individual accounts may differ, at times significantly, from the reference data shown due to varying account restrictions, fees and expenses, and since-inception time periods, among others. Where applicable, this information is supplemental to, and not to be construed with, a current or prospective client's investment account information.

For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the portfolio. Securities named in the Commentary, but not listed here are not held in the portfolio(s) as of the date of this report. The holdings mentioned above comprise the following percentages of a representative account within the Composite's total net assets as of 30 Nov 2018: Artisan Global Opportunities—Nintendo Co Ltd 2.4%, Shiseido Co Ltd 1.2%. Artisan Global Discovery—Nintendo Co Ltd 1.8%, Veeva Systems Inc 2.4%. Artisan U.S. Mid-Cap Growth—Veeva Systems Inc 3.2%, Gardner Denver Holdings Inc 1.8%. Artisan U.S. Small-Cap Growth—Veeva Systems Inc 4.5%, Gardner Denver Holdings Inc 2.3%. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

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.

This material is provided for informational purposes without regard to your particular investment needs. This material shall not be construed as investment or tax advice on which you may rely for your investment decisions. Investors should consult their financial and tax adviser before making investments in order to determine the appropriateness of any investment product discussed herein. We expressly confirm that neither Artisan Partners nor its affiliates have made or are making an investment recommendation, or have provided or are providing investment advice of any kind whatsoever (whether impartial or otherwise), in connection with any decision to hire Artisan Partners as an investment adviser, invest in or remain invested in any funds to which we serve as investment adviser or otherwise engage with Artisan Partners in a business relationship.

Artisan Partners is an independent investment management firm focused on providing high value-added, active investment strategies to sophisticated clients globally. Artisan Partners Limited Partnership (APLP) is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Artisan Partners UK LLP (APUK) is authorized and regulated by the Financial Conduct Authority and is a registered investment adviser with the SEC. APLP and APUK are collectively, with their parent company and affiliates, referred to as Artisan Partners herein.

Artisan Partners is not registered, authorized or eligible for an exemption from registration in all jurisdictions. Therefore, services described herein may not be available in certain jurisdictions. This material does not constitute an offer or solicitation where such actions are not authorized or lawful. Further limitations on the availability of products or services described herein may be imposed.

In no event shall Artisan Partners have any liability for direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) losses or any other damages resulting from the use of this material.

This material is only intended for investors which meet qualifications as institutional investors as defined in the applicable jurisdiction where this material is received, which includes only *Professional Clients* or *Eligible Counterparties* as defined by the UK Financial Conduct Authority where this material is issued by APUK. This material is not for use by retail investors and may not be reproduced or distributed without Artisan Partners' permission.

In the United Kingdom, issued by APUK, 25 St. James's St., Floor 3, London SW1A 1HA, registered in England and Wales (LLP#: OC351201). Registered office: Reading Bridge House, Floor 4, George St., Reading, Berkshire RG1 8LS.

Australia: This material is directed at wholesale clients only and is not intended for, or to be relied upon by, private individuals or retail investors. Artisan Partners Australia Pty Ltd is a representative of APLP (ARBN 153 777 292) and APUK (ARBN 603 522 649). APLP and APUK are respectively regulated under US and UK laws which differ from Australian laws and are exempt from the requirement to hold an Australian financial services license under the Australian Corporations Act 2001 in respect to financial services provided in Australia.

Bailiwick of Guernsey: The financial services referred to in this material and this document are not being made available in the Bailiwick of Guernsey (Guernsey) to more than 50 persons in Guernsey and the financial services may not be accepted by more than 50 persons in Guernsey.

Canada: This material is distributed in Canada by APLP and/or Artisan Partners Distributors LLC, which conduct activities in Canada under exemptions from the dealer, portfolio manager and investment fund manager registration requirements of applicable Canadian securities laws. This material does not constitute an offer of services in circumstances where such exemptions are not available. APLP advisory services are available only to investors that qualify as "permitted clients" under applicable Canadian securities laws.

For Institutional Investors Only—Not for Onward Distribution

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