

The Case for Large Caps

A Discussion with Artisan Value Fund Portfolio Manager George Sertl

PORTFOLIO MANAGER
Viewpoints

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In the Artisan Value Fund, what area of the market currently looks particularly interesting to you?

Relative to the market, the largest companies in the US are trading at compelling valuations—large caps are trading at a discount to their historical median, and as a group, we believe these companies present a compelling risk-reward profile.

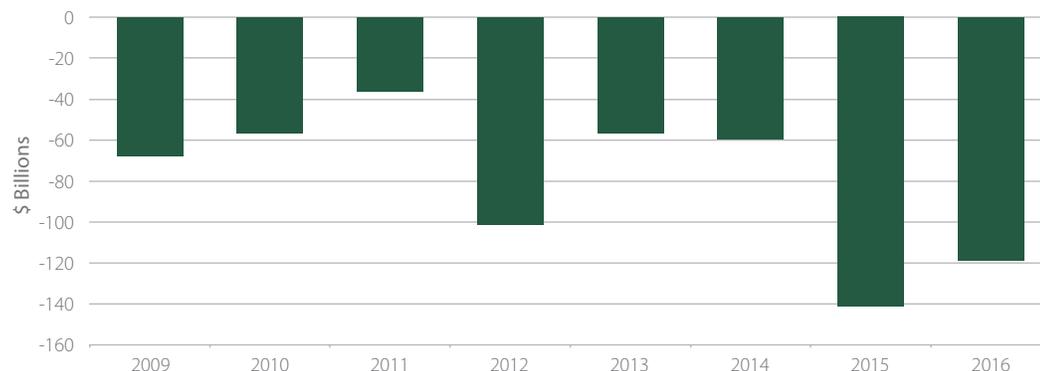
Exhibit 1: Mega Cap/Rest of the Market Price-to-Forward Earnings



Source: Morgan Stanley Research. As of 31 Dec 2016. The line represents mega cap PEs for the rest of the market. Mega caps are defined as the 30 largest companies by market capitalization in the S&P 500® Index. The rest of the market is the remaining stocks in the top 1,500 US stocks by market capitalization.

There was a meaningful spike in large-cap valuations in the late-1990s and early-2000s, when the S&P 500® Index was trading at around 30X earnings. Clearly, levels that high are not sustainable, and we saw some mean reversion following that via the tech bubble bursting and a large bear market. More recently—and perhaps more importantly—a driver of the valuation divergence has been large caps serving as a source of liquidity over the last eight or so years. This has been demonstrated by the large outflows from the large-cap value universe totaling over half a trillion dollars since 2009, representing over a quarter of total US equity net outflows.

Exhibit 2: Calendar Year Net Flows—eVestment US Large Cap Value Universe



Source: eVestment. As of 31 Dec 2016. The eVestment US Large Cap Value Equity Universe is a manager reported database consisting of 421 investment products as of 31 Dec 2016 that invest primarily in large capitalization stocks with fundamental characteristics showing them to be underpriced, or in slower growing economic sectors.



George O. Sertl, CFA
Portfolio Manager

25 Years Investment
Experience



In our opinion, these outflows haven't occurred for fundamental reasons. Rather, they have been a function of what we classify as "forceful selling"—people are mining the liquidity of the large-cap space to make forays, or allocations, into global strategies, alternative strategies, and until recently, emerging markets strategies.

How has the team responded to the forceful selling and outflows in the large-cap space?

Large-cap outflows have created opportunities for us to invest in some high-quality companies trading at distinct discounts to the broader market. Consider where we are in this market: It's the second longest bull market in history in terms of duration. Given how long in the tooth this market expansion is, it makes sense to want to skew toward quality and a valuation discount, which we believe we have in spades. Our portfolio trades at around 1.9X median price/book value, compared to the Russell 1000® Value Index at 2.3X. Our portfolio also has a strong financial profile, as represented by its fixed charge coverage ratio.

We believe you make money over the long term by going against the grain and gravitating toward areas of the market that have been shunned—that are under pressure from other investors. Studies have shown that over longer periods, if you purchased the asset class that was the most out of favor (as measured by outflows), your cumulative return generally far outpaced the return delivered by choosing the most popular asset class (as measured by inflows). This is simply a manifestation of investors' tendency to chase heat—rarely a good prescription for long-term results. It also provides justification for our preference to buy what is unloved.

Given the current backdrop, how are you positioning your portfolio?

Our portfolio decisions are always made from the bottom-up, without regard to index construction. We tend to buy what others are selling and sell what others are buying. We're invested in areas of the market that aren't always very comfortable to own. Currently, that means we have above-benchmark exposure to the materials, consumer discretionary and energy sectors. Meanwhile, we have below-benchmark exposure to what have been the more highly prized, perceived "stable" areas of the market (e.g., consumer staples, real estate, health care). Seeking stability and comfort can be tempting, but it's not our job to simply want comfort. Our job is to recognize where we are being compensated, which is why over the past few years we have sought out names living through a bear market while a broader bull market was going on.

That said, as bottom-up active investors, our sector exposures will shift based on where we are finding opportunities that meet our three margin of safety criteria. We're not closet energy, materials, etc., investors (in fact, for years we had no direct materials exposure)—we invest where we find compelling value in accordance with our disciplined approach. We aim to take advantage of volatility and mispricing in order to find quality businesses in sound financial condition trading at undemanding valuations.

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. Value securities may underperform other asset types during a given period. Investments in energy companies are subject to risks due to price fluctuations, supply and demand, taxation and potential for increased government regulation.

This summary represents the views of the investment team as of 30 June 2017, and is subject to change without notice. The views and opinions expressed are based on current market conditions at the time of publication, 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 theme or 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. 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.

Russell 1000® Value Index measures the performance of US large-cap companies with lower price/book ratios and forecasted growth values. **S&P 500® Index** measures the performance of 500 US companies focused on the large-cap sector of the market. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

Fixed Charge Coverage Ratio indicates a firm's ability to satisfy fixed financing expenses, such as interest and leases. **Margin of Safety**, a concept developed by Benjamin Graham, is the difference between the market price and the estimated intrinsic value of a business. A large margin of safety may help guard against permanent capital loss and improve the probability of capital appreciation. Margin of safety does not prevent market loss—all investments contain risk and may lose value. **Price-to-Book Ratio (P/B Ratio)** is a valuation measure used to compare a stock's market value to its book value.

eVestment Alliance (eVestment) is a global provider of institutional investment data intelligence and analytic solutions. eVestment is a manager-reported database and does not independently verify the data. eVestment categories contain investment products that invest in equity stocks within a particular style category.

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