# Artisan Mid Cap Value Fund

QUARTERLY
Commentary

Investor Class: ARTQX | Advisor Class: APDQX

As of 31 March 2016

## Investment Process

We seek to invest in companies that are undervalued, in solid financial condition and have attractive business economics. We believe that companies with these characteristics are less likely to experience eroding values over the long term.

**Attractive Valuation**

We value a business using what we believe are reasonable expectations for the long-term earnings power and capitalization rates of that business. This results in a range of values for the company that we believe would be reasonable. We generally will purchase a security if the stock price falls below or toward the lower end of that range.

**Sound Financial Condition**

We prefer companies with an acceptable level of debt and positive cash flow. At a minimum, we seek to avoid companies that have so much debt that management may be unable to make decisions that would be in the best interest of the companies' shareholders.

**Attractive Business Economics**

We favor cash-producing businesses that we believe are capable of earning acceptable returns on capital over the company's business cycle.

## Team Overview

Our team has worked together for a long time and each member has a high level of trust and confidence in each other's capabilities. Everyone on the team functions as a generalist with respect to investment research and the entire team works together on considering potential investments. The portfolio managers are supported by two research analysts who share a common mindset and focus on the key elements of our investment process.

**Portfolio Management**

James C. Kieffer, CFA
Portfolio Manager

Scott C. Satterwhite, CFA
Portfolio Manager

George O. Sertl, CFA
Portfolio Manager

Daniel L. Kane, CFA
Portfolio Manager

## Investment Results (%)

| As of 31 March 2016 | QTD[1] | YTD[1] | Average Annual Total Returns 1 Yr | 3 Yr | 5 Yr | 10 Yr | Inception[2] |
|---|---|---|---|---|---|---|---|
| **Investor Class: ARTQX** | **6.19** | **6.19** | **-6.22** | **4.29** | **7.24** | **7.09** | **10.19** |
| **Advisor Class: APDQX** | **6.20** | **6.20** | **-6.09** | **4.33** | **7.27** | **7.11** | **10.20** |
| Russell Midcap® Value Index | 3.92 | 3.92 | -3.39 | 9.88 | 10.52 | 7.23 | 9.76 |
| Russell Midcap® Index | 2.24 | 2.24 | -4.04 | 10.45 | 10.30 | 7.45 | 9.18 |

Source: Artisan Partners/Russell. [1]Returns for periods less than one year are not annualized. [2]Investor Class inception: 28 March 2001. Advisor Class performance is that of the Investor Class from 28 March 2001 through the inception of the Advisor Class on 1 April 2015, and actual Advisor Class performance thereafter. Performance has not been adjusted to reflect the expenses of the Advisor Class for the period prior to the Class's inception, and Advisor Class performance results would differ if such expenses were reflected.

| Expense Ratios (% Gross/Net) | ARTQX | APDQX |
|---|---|---|
| Annual Report 30 Sep 2015 | 1.19/— | 1.11/1.09[1,3] |
| Prospectus 30 Sep 2015 | 1.19/— | 1.05[2]/— |

[1]For the period from commencement of operations 1 Apr 2015 through 30 Sep 2015. [2]Includes estimated expenses for the current fiscal year. [3]Reflects a contractual Fund expense reimbursement agreement in effect through 1 Feb 2017.

Past performance does not guarantee and is not a reliable indicator of future results. Investment returns and principal values 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 that shown. Call 800.344.1770 for current to most recent month-end performance. Performance may reflect agreements to limit a Fund's expenses, which would reduce performance if not in effect.

## Investing Environment

The year started on a turbulent note as stocks moved largely in lockstep with crude oil prices, which plummeted before rallying off February lows to end the quarter ahead. The commodity-price rebound helped move equities higher—the Russell Midcap® Value Index returned over 9% in March after posting an over-5% decline in January, and was up approximately 4% in Q1 overall. Volatility sent investors running to safe-haven assets—gold prices posted their largest quarterly gain in years, up over 16% in Q1.

Accommodative measures from central banks—including dovish comments from the Federal Reserve—contributed to improving investor sentiment toward the back half of the quarter, despite implications of weakness in the global economy.

Areas of the market that had been unloved for some time seemed to find their footing in Q1 as the strong momentum factors that have been a headwind over the last few years abated. We've discussed in past commentaries our view that markets had become increasingly bifurcated in recent quarters, with growing differentials between sectors and styles. A number of those factors reversed in Q1, with value outperforming growth, and cyclical sectors with greater global exposure (e.g. industrials, energy, materials) outperforming non-cyclical sectors with greater US exposure (e.g. health care, financials).

## Performance Discussion

Our portfolio outperformed the Russell Midcap® Value Index during the quarter. As gold prices rebounded, shares of Goldcorp and Kinross did as well, putting them among our top performers. Both advanced in excess of the commodity price, just as they had previously fallen in excess of the commodity price despite what we consider to be numerous internal catalysts.

Arrow Electronics, a global distributor of electronic components and computer products, also aided results. The stock was boosted on news that an industry competitor agreed to be acquired at around a 39% premium. In our view, the bid highlights the industry's attractive valuations as shares trade at depressed levels. Arrow Electronics is largely driven by trends in global IT spending, which have been in a slow-growth environment the past several years. Yet, despite these headwinds, the company is increasing revenues, generating strong cash flow and repurchasing shares.

Other top performers included Coach and Ryder System. Turnaround efforts at handbags and accessories company Coach appear to be underway. The road to full recovery is long, but management is making progress on renewing its entrepreneurial focus by emphasizing higher profitability, distinctive locations, ROI, brand differentiation and reduced promotional activity—which should result in improving comps. Truck rental business Ryder System has been executing well and remains focused on organic growth and reinvesting capital. We've held shares of the stock since 2005, and had used recent weakness to add to our position before the stock rallied in the quarter. We like the company's scale, cost of capital advantages and strong service business. In our view, it's an above-average business selling at an undemanding valuation.

Our holdings exposed to energy, whether through direct or backdoor exposure, were a source of strength. We took advantage of the rebound in stock prices to exit positions in exploration and production companies Denbury Resources, SM Energy and Southwestern Energy due to concerns over their long-term financial positions. Further, we believe our remaining energy names better meet our three margin-of-safety criteria, and are well positioned to benefit as the commodity trades closer to or above marginal costs. To that end, we used the dip in commodity prices in the beginning of the year to increase our positions in Hess, Devon and Apache.

Top performer Fluor, an engineering and construction company, has backdoor energy exposure—the company primarily serves companies in the oil & gas, chemicals, mining & metals, utilities, transportation, life sciences and manufacturing industries. We believe Fluor exemplifies a quality business that is taking the right actions in the face of a challenging macroeconomic environment. Margins have moved higher as the company returns to a heavier mix of fixed-price contracts, and incorporates more vertical integration into its projects, allowing for an increased slice of the pie on each project. Fluor benefits from its scale and technical expertise. Its balance sheet is in excellent shape, and the company is returning its free cash flow to investors through dividends and share repurchases.

In terms of negatives during the quarter, our below-benchmark positioning to the index-leading utilities sector was a headwind (though our holdings in the sector outperformed those in the benchmark). A number of our bottom performers were consumer discretionary holdings, including Liberty Ventures, H&R Block and Liberty Interactive Corp QVC. We believe weakness in Liberty Interactive Corp QVC was more a function of the shifting near-term sentiment in Q1—the stock had been doing well and came under pressure as momentum reversed. Taking a longer view, we believe the company is a solid player in a niche industry—it has an attractive business model, and we have confidence in management's capital allocation skills.

Liberty Ventures owns stakes in privately and publicly-traded companies, including Expedia and Time Warner Cable. Decelerating travel trends weighed on Expedia, and uncertainties surrounding Charter's acquisition of Time Warner spurred volatility. While uncertainty will persist until a decision is made on the Time Warner acquisition, we believe the stock is attractive whether the acquisition goes through or not. Liberty Ventures is exceptionally managed, has a large pile of cash and trades at attractive valuations.

Shares of tax preparer H&R Block fell on preliminary reports showing weaker-than-expected prepared tax returns. The stock had previously run up as the company completed its long-awaited sale of H&R Block Bank, and the selloff this quarter allowed us to increase our position. In our view, H&R Block is one of the best brands in the industry, with a leading market-share position and healthy balance sheet. The company is a strong generator of cash, with much of it allocated to dividends and share repurchases.

Bank stocks were generally weak during the quarter, and ours were no exception. Fifth Third Bancorp (FITB) and M&T Bank worked against

us, as expectations for an interest rate hike faded. In FITB's case, shares were pressured as management announced an increase in expenses to support the company through a transitional year. While we acknowledge the setback, the stock currently sells at a discount to book value and at a lower asking price than its peers, while also providing incremental value in its non-banking asset Vanitv, a payments-processing company.

Shares of InterActiveCorp (IAC), a diversified media and Internet company (operating sites such as Match, Tinder and Vimeo), were pressured on concerns of slowing revenue growth. The company has a sizable stake in Match—its value tends to fluctuate more due to its higher leverage. Longer term, we're attracted to IAC's healthy cash position and solid leadership, and believe shares look undervalued on a sum-of-the-parts basis. We added to our position incrementally—we believe it's an interesting business selling at an interesting valuation.

## Portfolio Activity

Over the past few years we've discussed our dislike of the market environment, as valuations broadly appeared stretched. Position sizes in the portfolio are determined based on how well each company fits our three margin-of-safety criteria. While we had a number of holdings in sound financial condition with attractive business economics, we felt valuations were preventing us from meaningfully building our positions.

The market's backslide in January changed that to some extent, and we were the most active we've been in some time—trimming names where we felt valuations had become fair. In turn, we upgraded the capital by building some of our high-conviction holdings into larger positions.

Overall, our buying activity was largely prompted by the flushing of energy/commodity-related names, as a number of holdings fell to more compelling valuations. In addition to the names already mentioned (Hess, Apache, Devon), we added to our positions in global aircraft leasing company Air Lease and fertilizer company Mosaic. The selloff also allowed us to build our positions in a number of names outside of the commodity space, including technology holdings Keysight and Synopsys, and financials holdings M&T Bank and American Capital.

We initiated a position in AutoNation, a North American auto retailer. The company has a diversified portfolio of original equipment manufacturer (OEM) dealers spanning the domestic, import and luxury segments. AutoNation generates profits from new and used car sales, finance and insurance (F&I) and parts and services (P&S). We were able to establish our position at what we view as an undemanding price—around 12X our estimates of normalized earnings—as fears of an extended auto-cycle downturn and general market weakness pressured shares. The business is cyclical, but we believe a well-financed dealer like AutoNation will survive and potentially prosper after trough periods. Additionally, its P&S segment provides some shelter from the cyclicality, as it's less cyclical in nature and is more of an annuity on auto sales in the US, becoming more valuable as the number of auto dealers shrink. The company is exceptionally well run; its management team and board think and act like owners. Management's goal is to maximize shareholder value—it has executed well in the past, and we believe it will continue to do so in the future. Further, the company generates solid economic returns on capital, and we believe the business can compound value.

Our sales were primarily names where we believed valuations became fair. In addition to the energy names mentioned (Denbury Resources, SM Energy, Southwestern Energy), we sold food retailer Kroger, waste services provider Republic Services and utilities companies Edison International and SCANA Resources on success as shares hit our target selling range. A number of these represent holdings we had been looking to sell for some time, but didn't due to a lack of more attractive alternatives. As valuations opened up in January, we were able to trade out of these higher-value names and put the capital to work in holdings that look more compelling to us.

## Perspective

We believe that one of the best ways to find quality investments at a distinct discount is to show a willingness to go where there is fear and uncertainty in the marketplace. Unfortunately, in recent quarters, we have been contending with an environment that has been challenging for our investment approach—those stocks with momentum behind them were continually rewarded, while more unloved stocks were continually punished.

When discussing the bifurcated market last quarter, we quoted Herbert Stein, "If something cannot go on forever, it will stop." We stayed true to our philosophy and process, and were able to make upgrades to the portfolio this quarter as the momentum-driven environment that had previously put fundamentals in the backseat began to shift.

However, we are always aware that alpha doesn't know a calendar, and one quarter is a very short period of time. As such, we continue to focus on what we can control, by attempting to put the business, balance sheet and valuation on our side. And we will continue to look to take advantage of near-term volatility to upgrade the portfolio into an even more compelling collection of names.

We believe that investing in companies that meet our three margin of-safety criteria—i.e. cash producing businesses in strong financial condition that are selling at undemanding valuations—will continue to tilt the risk/reward in our favor over the long term. At this point, we believe the portfolio looks to be in better shape, with a large amount of embedded alpha. For the first time in a number of years, we feel the return potential on both an absolute and relative basis looks compelling.

**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.**

**Securities of 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.**

Russell Midcap® Value Index measures the performance of US mid-cap companies with lower price/book ratios and forecasted growth values. Russell Midcap® Index measures the performance of roughly 800 US mid-cap companies. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

This summary represents the views of the portfolio managers as of 31 Mar 2016. Those views may change, and the Fund disclaims any obligation to advise investors of such changes. For the purpose of determining the Fund's holdings, securities of the same issuer are aggregated to determine the weight in the Fund. The holdings mentioned above comprise the following percentages of the Mid Cap Value Fund's total net assets as of 31 Mar 2016: Arrow Electronics Inc 3.0%; Air Lease Corp 2.9%; Apache Corp 2.6%; The Mosaic Co 2.6%; Devon Energy Corp 2.6%; Hess Corp 2.4%; Goldcorp Inc 2.1%; Fluor Corp 2.1%; Fifth Third Bancorp 2.0%; Liberty Interactive Corp QVC Group 2.0%; Liberty Ventures 1.9%; Ryder System Inc 1.7%; Keysight Technologies Inc 1.7%; M&T Bank Corp 1.5%; Coach Inc 1.5%; IAC/InterActiveCorp 1.5%; Synopsys Inc 1.5%; AutoNation Inc 1.4%; H&R Block Inc 1.3%; American Capital Agency Corp 1.1%; Kinross Gold Corp 0.9%. Securities named in the Commentary, but not listed here are not held in the Fund as of the date of this report. 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 (except performance and expense ratio information) and is as of the date shown in the upper right hand corner. This material does not constitute investment advice.

Attribution is used to evaluate the investment management decisions which affected the portfolio's performance when compared to a benchmark index. Attribution is not exact, but should be considered an approximation of the relative contribution of each of the factors considered.

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**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. **Free Cash Flow** is a measure of financial performance calculated as operating cash flow minus capital expenditures. **Book Value** is the net asset value of a company, calculated by total assets minus intangible assets and liabilities. **Normalized Earnings** are earnings that are adjusted for the cyclical ups and downs over a business cycle. **Alpha** is a quantitative measure of the volatility of the portfolio relative to a designated index. A positive alpha of 1.0 means the fund has outperformed its designated index by 1%. Correspondingly, a similar negative alpha would indicate an underperformance of 1%. **Return on Investment (ROI)** measures the amount of return on an investment relative to the investment's cost.

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

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