# Artisan Emerging Markets Fund

QUARTERLY
Commentary

Investor Class: ARTZX

As of 30 June 2016

## Investment Process

We seek to invest in companies that are uniquely positioned to benefit from the growth potential in emerging markets and that possess a sustainable global competitive advantage.

### Sustainable Earnings

We believe over the long term a stock's price is directly related to the company's ability to deliver sustainable earnings. We determine a company's sustainable earnings based upon financial and strategic analyses. Our financial analysis of a company's balance sheet, income statement and statement of cash flows focuses on identifying historical drivers of return on equity. Our strategic analysis examines a company's competitive advantages and financial strength to assess sustainability.

### Risk Analysis

We believe a disciplined risk framework allows greater focus on fundamental stock selection. We incorporate our assessment of company-specific and macroeconomic risks into our valuation analysis to develop a risk-adjusted target price. Our risk-rating assessment includes a review of country-appropriate macroeconomic risk factors to which a company is exposed.

### Valuation

We believe that investment opportunities develop when businesses with sustainable earnings are undervalued relative to peers and historical industry, country and regional valuations. We value a business and develop a price target for a company based on our assessment of the business's sustainable earnings and risk analysis.

## Team Overview

Team experience, continuity and a rigorous investment process are the characteristics that we believe differentiate our team from other emerging markets investment managers. Research analysts have autonomy and ownership of their regions and accountability for the success of their ideas. Our team members bring deep experience and uncommon insight to their respective areas of responsibility.

### Portfolio Management

Maria Negrete-Gruson, CFA
Portfolio Manager

## Investment Results (%)

| As of 30 June 2016 | QTD[1] | YTD[1] | Average Annual Total Returns 1 Yr | 3 Yr | 5 Yr | 10 Yr | Inception[2] | Linked Inception[4] |
|---|---|---|---|---|---|---|---|---|
| **Investor Class: ARTZX** | **3.91** | **11.56** | **-3.47** | **0.74** | **-4.67** | — | **-4.09** | |
| **Linked Institutional and Investor Class[3]** | | | | | | **2.12** | | **2.69** |
| MSCI Emerging Markets Index | 0.66 | 6.41 | -12.05 | -1.56 | -3.78 | 3.54 | -2.11 | 4.22 |

Source: Artisan Partners/MSCI. [1]Returns for periods less than one year are not annualized. [2]Investor Class inception: 2 June 2008. [3]Linked performance data shown relates to the Investor Shares from 2 June 2008 forward and for Institutional Shares prior to 2 June 2008. [4]Institutional Class inception: 26 June 2006.

| Expense Ratios | Gross | Net[1] |
|---|---|---|
| Semi-Annual Report 31 Mar 2016[2] | 2.39% | 1.50% |
| Prospectus 30 Sep 2015 | 1.79% | 1.50% |

[1]Reflects a contractual Fund expense reimbursement agreement in effect through 1 Feb 2017. [2]Unaudited, annualized for the six month period.

Performance of the Institutional Shares does not reflect higher expenses associated with the Investor Shares, and if reflected, would reduce the performance quoted. 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

Emerging markets ended the second quarter basically flat in both local and US Dollar terms, but the past three months were not without intermittent volatility. Sentiment and evolving outlooks on the US Federal Reserve's next move on interest rates continues to boost or trounce emerging markets stocks, depending on the most recent comments from Fed Chair Janet Yellen. Political events in the likes of Brazil and Peru inspired investors as hope for economic progress seems naturally baked into expectations for new government leaders. China's economic growth remains in the forefront as GDP grew 6.7% in the second quarter and consumption growth is beginning to contribute to overall GDP as the country continues on its long evolution to a consumption-led economy.

Ongoing currency volatility in emerging markets was more prevalent in some countries than others this quarter. Depreciating and appreciating currencies largely offset one another, when looking at the aggregate emerging markets universe, as evidenced by the narrow difference between local and USD returns. Although Brazil's stock market rose less than 3% in local currency terms, it rose nearly 14% in US dollar terms due to the real's appreciation vis-à-vis the USD. The Russian ruble, which has been particularly volatile this year, appreciated in the second quarter but gains were muted compared to the first three months of the year. On the commodity front, emerging markets have generally been supported by rising prices in 2016—crude reached a year-to-date high of $51 a barrel in June and gold spiked in the final days of the quarter in response to the risk-off sentiment that followed the Brexit vote.

## Performance Discussion

Our portfolio outpaced the MSCI Emerging Markets Index by a comfortable margin in the second quarter, adding to our year-to-date outperformance. Stock selection was broadly positive, with our holdings in Russia, Peru, South Africa and Argentina as standouts. Russian bank Sberbank, South African gold miner Randgold Resources and Peruvian engineering and construction company Graña y Montero were among our top contributors to performance this quarter.

Sberbank, one of the largest positions in our portfolio, has delivered mid-teens ROE despite multiple headwinds (e.g., Russian recession, oil price collapse at $26/barrel, ruble devaluation, Ukraine losses, and sanctions). We regard Sberbank as one of the strongest banking franchises across emerging markets, capable of delivering even through these challenging times. The company's dominant distribution network and strong capital base should enable it to take advantage of the secular expansion of the Russian banking sector.

The continued upward trend in gold prices provided Randgold Resources with a tailwind this quarter, especially as gold prices reached a one-year high at the end of June as a result of the Brexit. Our interest in Randgold is not based solely on commodity price expectations; we are pleased to see the company's double-digit profit growth, positive cash flow and increased dividend. We continue to view Randgold as a best-in-class operator in the precious metals space. The company has a reputable management team, remarkable capital discipline, high-quality and high-grade producing assets in Africa, relatively low corporate overhead and outstanding cost control, strong government relations, and consistent production growth.

Graña y Montero advanced nearly 80% during the quarter. We believe the outsized return had more to do with optimism among investors following Peru's presidential election. Both candidates were considered pro-business and sentiment reflects president-elect Pedro Pablo Kuczynski's ability to drive the economy forward. The new administration's aggressive infrastructure spending plans also bode well for Graña given its leading market position and high level of sector diversification.

On the downside, our results were hampered by weakness in Rocket Internet and Copa Holdings. We also experienced a pullback in several of our Chinese holdings, including IT services provider Digital China Holdings, telecom company China Unicom and Internet search engine Baidu.

Rocket Internet is an Internet operating company that identifies proven online business models and builds and scales these models in emerging markets (excl. China) via its Rocket Platform. During its fiscal first quarter, the company experienced slower top-line growth in some e-commerce assets amid a challenging macro backdrop. Additionally, we think investors unfairly punished Rocket's stock in the Brexit selloff at the end of June given the company is domiciled in Germany, overlooking the fact that the majority of its revenues are derived in emerging markets countries. We believe Rocket will continue with its strategy of improving profitability, efficiency and operations, and we remain optimistic about its sustainable earnings growth potential.

Panamanian airliner Copa Holdings' stock fell sharply in early May on an earnings disappointment, but has recouped much of its losses in July as we write this commentary. Weak economic conditions in parts of Latin America have hampered Copa's revenue growth in the near term as the company has discounted ticket prices, but falling fuel costs have helped offset some of that revenue softness. We remain attracted to the company's main competitive advantages including it geographically centralized hub and market leadership in most of its markets. We believe its differentiated business model of servicing low-density connection routes will be supportive of earnings growth in the future.

## Portfolio Activity

We stepped up our activity in the second quarter as we found several opportunities that met our investment criteria—companies with unique access to growth and sustainable competitive advantages that are undervalued relative to their sustainable earnings growth potential.

During the quarter, we sold Mediclinic International, a Dubai-based private health care provider, as its stock hit our target price. We used proceeds from the sale to purchase competitor NMC Health. NMC Health owns and operates a wide network of hospitals, medical centers and pharmacies across the country, and has experienced strong organic growth over the last several years. We believe NMC is uniquely positioned to benefit from changing regulations, including Dubai's new mandatory health insurance laws, which we expect to drive growth for companies such as NMC in the private sector, as demand for health care services continues to rise.

We also sold Taiwanese financial services provider CTBC Financial in favor of Sunny Friend Environmental Technology, one of the largest

providers of medical and hazardous industrial waste treatment in Taiwan and Beijing. We believe Sunny Friend will be a prime beneficiary of increasing enforcement of proper waste treatment as medical expenditures continue to grow due to aging populations and government focus on environmental protection efforts.

We participated in the IPO of Moneta Money Bank, the banking business of GE Capital in the Czech Republic. Moneta is a niche player capitalizing on the rising lower-middle class, with a widespread footprint across the country and growth in SME business and personal loans. Competitive intensity remains high as local currency yields have come down to low single digits pressuring net interest margins, however we believe Moneta will be a key beneficiary when policy rates begin to rise again. The bank has made a commitment to return all excess capital to shareholders, which we estimate could result in a high double-digit yield over the next few years.

We reinvested in a company we know well from previous ownership—Cia Energetica de Minas Gerais (CEMIG), Brazil's largest utility company. We held a position in the stock from 2006 to 2014, when we sold after a successful investment campaign. The stock was heavily penalized this quarter, giving us a valuation opportunity to reenter the name. We like CEMIG's sustainable earnings growth prospects and the fact that the regulatory landscape is now clear and stable for the sector. Given its leading market position and diversified asset base, we believe CEMIG will be a beneficiary of a recovery in electricity demand.

Cikarang Listrindo, another new position for us in the second quarter, is Indonesia's first independent power producer. Its sustainable competitive advantages include its diversified customer base across different industries and its tariff structure, both of which provide for more stable profitability. We believe Cikarang is well positioned to benefit from Indonesia's rapidly increasing energy consumption and has a long runway for growth.

On the sale side, we exited our positions in Mexican utility company IEnova and Russian wireless operator Mobile TeleSystems as their stocks neared our price targets. We also sold Indian auto manufacturer Tata Motors and Egyptian medical lab services provider Integrated Diagnostics in favor of more attractive opportunities.

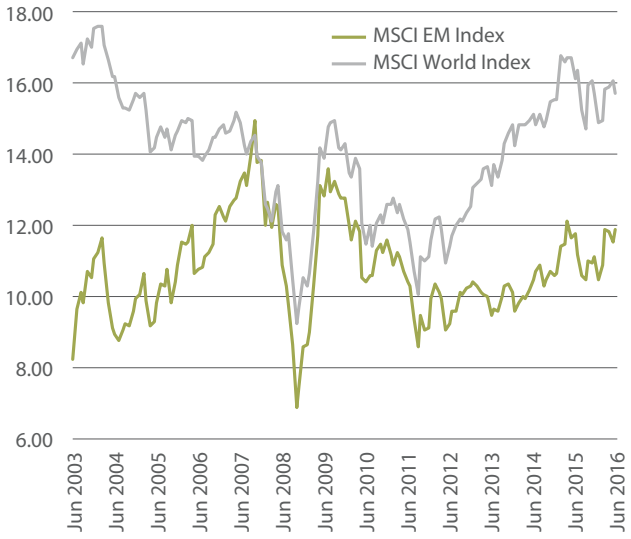
## Perspective

The end of the second quarter marked the 10-year anniversary of the launch of our strategy at Artisan Partners. Throughout the past decade, investors have endured a host of global economic events, many of which have directly and indirectly impacted emerging markets. We saw the bursting of the housing bubble in 2007, setting in motion the Global Financial Crisis; the Russian financial crisis in 2008-2009; the European sovereign debt crisis, which included a potential Greek withdrawal from the euro zone; the collapse of the Russian ruble in late 2014; the Chinese market crash of 2015; Brexit, and the list goes on.

Our fundamental investment approach that we developed nearly 17 years ago is designed to navigate a variety of market environments, which is particularly critical given the often-uncertain landscape in emerging markets and in economies around the globe. Through our process, our portfolio tends to perform relatively defensively in down markets and participates strongly in up markets. This is because our process weighs heavily on the unique core competencies of a company, that is, the relative strength of their market positioning (as we identify via Porter's Five Forces analysis) as well as a distinctive runway of opportunities that a company's long-term strategy may provide. This is, perhaps, the key reason why our portfolio looks substantially different from most emerging markets strategies out there.

**Exhibit 1:** Valuations Remain Attractive

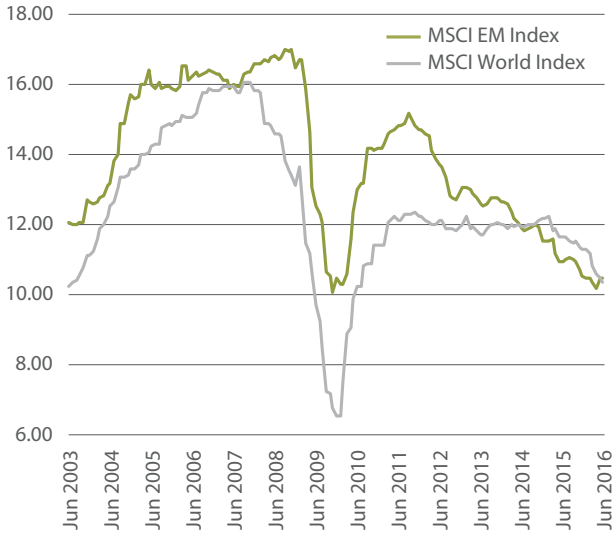
P/E - Next 12 Months




Source: FactSet/MSCI.

**Exhibit 2:** Quality at Positive Inflection Point

Return on Equity




Source: FactSet/MSCI.

Our conviction is that we are at an inflection point in emerging markets. Valuations remain attractive relative to developed markets as evidenced by forward-looking P/E or P/B and dividend yield estimates. We see developed markets bond yields at all-time lows (and even negative in some countries) while our markets, which have maintained for the most part prudent and/or orthodox fiscal and monetary policies, remain relatively underappreciated both in bonds and equities. We have noticed, over the past five years of emerging markets equities underperforming their developed market counterparts, that performance has coincided with a multi-year decline in operating margins, ROEs and EPS growth (in USD) for the asset class. More recently, however, we have observed that the trend has stabilized and has begun to revert. We observe that this trend, if confirmed, could prove to be a meaningful turning point for the asset class.

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. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations. 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.**

MSCI Emerging Markets Index measures the performance of emerging markets. 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 30 Jun 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 comprised the following percentages of the Fund's total net assets as of 30 Jun 2016: Baidu Inc 1.9%; China Unicom Hong Kong Ltd 0.8%; Cia Energetica de Minas Gerais 0.9%; Cikarang Listrindo Tbk PT 1.0%; Copa Holdings SA 0.5%; Digital China Holdings Ltd 1.1%; Grana y Montero SAA 0.7%; Moneta Money Bank AS 0.9%; NMC Health PLC 1.2%; Randgold Resources Ltd 1.9%; Rocket Internet SE 0.4%; Sberbank of Russia PJSC 2.3%; Sunny Friend Environmental Technology Co Ltd 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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**Return on Equity (ROE)** is a profitability ratio that measures the amount of net income returned as a percentage of shareholders equity. **Price-to-Earnings (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings. **Price-to-Book Ratio (P/B Ratio)** is a valuation measure used to compare a stock's market value to its book value. **Dividend Yield** is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

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