Artisan Global Value Fund

QUARTERLY
Commentary

Investor Class: ARTGX | Advisor Class: APDGX | Institutional Class: APHGX

As of 31 December 2017

Investment Process

We seek to invest in high-quality, undervalued companies with strong balance sheets and shareholder-oriented management teams.

Undervaluation

Determining the intrinsic value of a business is the heart of our research process. Intrinsic value represents the amount that a buyer would pay to own a company's future cash flows. We seek to invest at a significant discount to our estimate of the intrinsic value of a business.

Business Quality

We seek to invest in companies with histories of generating strong free cash flow, improving returns on capital and strong competitive positions in their industries.

Financial Strength

We believe that investing in companies with strong balance sheets helps to reduce the potential for capital risk and provides company management the ability to build value when attractive opportunities are available.

Shareholder-Oriented Management

Our research process attempts to identify management teams with a history of building value for shareholders.

Team Overview

Our team has worked together for many years and has implemented a consistent and disciplined investment process. Our team is organized by geographic regions, but within those regions we are generalists who look across all industries. We believe this model enables our analysts to become broad thinkers and gain critical insight across all economic sectors.

Portfolio Management

Daniel J. O'Keefe
Portfolio Manager (Lead)

N. David Samra
Portfolio Manager

Investment Results (%)

As of 31 December 2017	QTD[1]	YTD[1]	Average Annual Total Returns 1 Yr	3 Yr	5 Yr	10 Yr	Inception[2]
Investor Class: ARTGX	**3.76**	**21.58**	**21.58**	**9.11**	**12.22**	**8.95**	**8.48**
Advisor Class: APDGX	**3.76**	**21.76**	**21.76**	**9.24**	**12.30**	**8.99**	**8.52**
Institutional Class: APHGX	**3.82**	**21.87**	**21.87**	**9.37**	**12.50**	**9.08**	**8.62**
MSCI All Country World Index	5.73	23.97	23.97	9.30	10.80	4.65	4.30

Source: Artisan Partners/MSCI. [1]Returns for periods less than one year are not annualized. [2]Investor Class inception: 10 December 2007. Advisor Class performance is that of the Investor Class from 10 December 2007 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. Institutional Class performance is that of the Investor Class from 10 December 2007 through the inception of the Institutional Class on 17 July 2012, and actual Institutional Class performance thereafter. Performance has not been adjusted to reflect the expenses of the Institutional Class for the period prior to the Class's inception, and Institutional Class performance results would differ if such expenses were reflected.

Expense Ratios	ARTGX	APDGX	APHGX
Annual Report 30 Sep 2017[1]	1.25	1.10	1.02
Prospectus 30 Sep 2016[2]	1.29	1.17	1.05

[1]Excludes Acquired Fund Fees & Expenses as described in the prospectus. [2]See prospectus for more information.

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.

Market Overview: The "New Old Normal"?

We are all familiar with the "new normal" of the post-financial-crisis era. It goes something like this: Low growth, stagnant wages, low interest rates and low inflation are here to stay because of the prior downturn's severity and the aging population. For young Americans, that has meant a long sentence of living in their parents' basements, and for retirees, that has meant either not retiring or living off 10bp bond yields forever. Now, some are saying, "Not so fast—good times are here again," though the irony is not lost on us since it has taken about 10 years to get to this point.

If 2017 isn't the first chapter in a new narrative, then it may be at least a decent preamble. The US Federal Reserve hiked interest rates three times in 2017 and said that more hikes are coming in 2018 because economic strength warrants them. The 1-year Treasury ended the year around 175bps, almost double where it started the year and up more than 19X from the 2014 low. As we write this letter, the 2-year Treasury is touching 2% for the first time since the financial crisis. And while the massive expansion of central bank balance sheets in the developed world is still not in reverse, its growth rate is slowing. The Fed is now actually shrinking its balance sheet; though at a rate of $10bn per month, it will take a very long time to run down $4.5 trillion in assets.

Third-quarter US GDP grew at the fastest annualized pace since 2014, and expectations are rising—underpinned by recently enacted tax reform in the US. Despite being passed along party lines and in one of history's most (if not the most) hostile and partisan political environments, the reduction in corporate tax rates is recognized by both parties as good economic policy. The US corporate tax structure has been a disincentive for corporations to invest in this country and helps explain stubbornly sluggish business investment during the new-normal era. The new 21% corporate tax rate is now roughly in line with the 22% global average. Just as important, the new law adopts a territorial tax structure, which is in line with almost all other developed economies. This means that US-based multinational companies earning profits overseas will no longer be double-taxed upon repatriating those profits.

We are seeing evidence that the corporate tax-rate change is already having an impact. Many high-profile corporations have announced that part of the tax savings will be reinvested in higher wages for employees. We hope these announcements are not just cynical PR stunts meant to blunt partisan criticism of the bill, but instead reflect a rational and long-term commitment to reinvest given the prospect of higher after-tax returns on investment. A pick-up in wage and employment growth can help accelerate economic growth out of the low-growth phase of the past decade. Time will tell.

Investors certainly seem to believe the new normal is giving way to an old normal—one where economic growth is more in line with long-term rather than near-term history. Most major stock market indices globally were up 20% or more for the year. Emerging markets did better than developed markets, reflecting a higher appetite for risk; and foreign currencies strengthened against the dollar, favoring the returns of non-US assets in USD over US assets. Many commodities prices have also rallied, with oil up 18% and copper up more than 30% in 2017. The best performing asset that we know of was bitcoin, up about 15X in the space of one year. Crypto-currencies are a topic for another day, but suffice it to say, they reflect a risk-on mindset—a mindset that has prevailed for quite some time.

It is worth emphasizing that we are entering the 10th year of a virtually uninterrupted bull market. While there are certainly some reasons to be hopeful about global growth, it is much more difficult to be optimistic about valuations. By almost any valuation metric, equities are at or above historical valuation averages—in some cases well above. The only debate on valuation is whether or not we are at dangerous levels or merely fair levels. All we know is that it is very difficult to find value in equities anywhere in the world.

Portfolio Discussion

All but four of the portfolio's holdings were up for the year, with the top three contributors being Samsung Electronics, Baidu and Microsoft.

Samsung gained 62% in 2017 and 40% in 2016 (all returns in USD unless otherwise stated). To say the business had an exceptional year would be an understatement. Revenue and profit growth accelerated throughout the year, posting some of the best quarterly growth rates in the company's history. The largest driver of the business today is the memory semiconductor business where Samsung dominates the industry. Semiconductor profits grew 140% in Q1, over 200% in Q2 and 196% in Q3. (We are still waiting for details on Q4 results.) The industry is booming as electronic devices proliferate and require increasingly more memory solutions to operate efficiently. We don't expect industry conditions to remain this good, but we believe that this is a secular-growth business due to the long-term trend toward mobilization, artificial intelligence and data storage and handling. Mobile is the second-largest business and also had a good year, recovering from the 2016 battery issues. In addition to strong business performance, we have seen an improvement in capital allocation at Samsung. The company announced it will cancel repurchased shares and hold them in treasury. Samsung is also returning meaningful amounts of annual free cash flow to shareholders. While we believe that Samsung could be more aggressive with its shareholder returns given how much excess cash is held on the balance sheet, we are pleased with the significant progress Samsung has made in the past two years.

Baidu gained 42% in 2017—to some degree a year of recovery for Baidu. The company was hit with regulatory intervention in 2016 that required more stringent qualification of search customers, resulting in a meaningful revenue deceleration as unqualified customers were purged from the business. In addition, the company made investments in 2015 and 2016 which materially cut into margins. Sluggish revenue and margin declines are not a recipe for strong share-price performance, which is why the stock fell from a high of about $250 in 2014 to lows of around $130 and $140 in 2015 and 2016. This year has been much better. The top line returned to growth as lost revenue from the regulatory intervention was more than replaced by underlying business growth, and margins started to recover as investment spending was throttled back.

The third-largest contributor was another technology company, Microsoft—up 41% in 2017. Gains were driven by the market's increasing acceptance of Microsoft as a growing commercial software business with significant opportunities in the cloud, rather than a

consumer-software business dragged down by the death of the PC. While overall organic revenue growth continues to be modest (in the low single digits) due to the slow-growth consumer side of the business, margins are beginning to expand. This is significant because one the fastest growing areas of the business—the commercial cloud—has been at the expense of margins. The commercial cloud business is now a high-teens percentage of annualized revenue, and while margins are still below the corporate average, they are starting to expand as the business gains scale. Commercial cloud gross margins are now in the 50s vs the 40s in the prior year. The business is growing around 40%-50%, and investors are now placing a high multiple on this earnings stream.

Microsoft and Samsung were also the second- and third-largest contributors in Q4, and Qualcomm was the top contributor. Qualcomm has been a difficult investment, as many of our readers will know. Since initiating the position in 2014, we have endured market-share losses and then a rebound in the semiconductor business; royalty disputes and then resolution in China; anti-trust litigation in Korea and the US; and most recently, a dispute with Apple, the company's largest customer. In Q4, our investment received a much-needed boost when Broadcom (another semiconductor manufacturer) made an unsolicited offer of $70 per share for Qualcomm. That led to a 25% gain in the quarter. Qualcomm's board has unanimously rejected the offer and, so far, has refused to negotiate with Broadcom. We disagree with their stance and have said so publicly. We believe that a moderate increase in Broadcom's offer would present compelling value to Qualcomm shareholders. It appears to us that Qualcomm's management is simply acting to protect their jobs rather than serve the interests of shareholders.

Among the three worst performing stocks in 2017 were Imperial Oil, John Wood Group and Kia Motors. Imperial Oil was down 9% in 2017—significantly worse than oil prices, which rose 18%, and other integrated oil companies such as Exxon Mobil (Imperial's largest shareholder), Royal Dutch Shell and BP. Underperformance was due in large part to reliability issues at most of its main producing upstream assets. The most meaningful problem was at the largest development, Kearl. Kearl is producing at an average rate of 180,000 BOE, while its stated potential is for 220,000 barrels. Imperial Oil is working through the issues that are holding back reliability, but management doesn't expect to reach target production for at least another year. We believe Kearl has access to the engineering and technical talent to improve reliability, not least of all because its largest shareholder is Exxon Mobil. We believe that Imperial should be able to earn more than $4.00 per share at current oil prices once these issues are resolved. With the stock price at CAD39, we believe the shares are a good value.

Despite a rebound in oil prices in 2017's second half, shares of oil services firm John Wood Group closed the year below where they were at 2016's end. During 2017, the company merged with Amec Foster Wheeler, and the pro forma revenue and profits of the combined entity fell over the course of 2017. Until recently, the firm was still generating substantial revenue from multi-year contracts won during the recent oil bull market. As Wood finished work on these projects in 2016 and 2017, the company faced revenue and margin headwinds as it was unable to compensate for this completed work with new contracts. The company also faced pricing pressure in various parts of its business that dampened results. We believe the company's fortunes have now stabilized, and should oil prices remain near their current levels, Wood should grow profits going forward.

Kia Motors had a year to forget, and the share price declined 12% in Korean won, though in USD it was just flat. Kia is suffering from a few issues. Among them, it has lost share in the US and in its home market. In the US, the issue is primarily related to a product mix that is skewed toward passenger vehicles in a market where SUVs and trucks are in greater demand. In Korea, Kia is suffering from a poor product lineup versus competitors. China was also a notable weak spot for Kia. Diplomatic tensions between Korea and China have put Korean brands out of favor in China, and a poor-performing dealer network is compounding the issue. Kia now trades below tangible book, has a net cash balance sheet and has a single-digit PE even with margins at their lowest levels since the financial crisis. The stock is very cheap.

For the quarter, the three bottom contributors were Arch Capital Group, Baidu and Aon, though all three were down only modestly. There were no meaningful new or negative developments at either Baidu or Aon to drive down their share prices. Both were up strongly over the past year and appear to have been dragged down by some profit taking. On the other hand, Arch Capital reported terrible third quarter results. Arch suffered underwriting losses as a result of hurricanes Harvey, Irma and Maria, as well as an earthquake in Mexico. Arch has not reported such poor insurance results since 2005. However, the damage was contained due to strong investment returns, and as a result, tangible book value per share (our preferred measure of value in this case) was merely flat quarter over quarter. The share price declined 8%.

On the new investment front, there is very little to report. We purchased no new meaningful positions for the quarter. In fact, 2017 stands out in our history for the notable lack of significant new investments. We added only two new positions of 1.5% or more for the year—Yahoo Japan and Advance Auto Parts—both written about in our Q3 letter. As we mentioned in our market overview, valuations are elevated and bargains are scarce.

The Amazon Effect or how 2-1=3

It's difficult to reflect on 2017 without considering Amazon. Technology stocks massively outperformed the market this year, and Amazon outperformed most technology stocks with a gain of more than 50%. Rarely have we seen a company capture the imagination and attention of investors and the business community like Amazon—and for good reason. The company went public at a split-adjusted $1.50 per share in 1997, and today is worth nearly $1,300 a share, or $625bn in total market value. Amazon's roughly 40% CAGR in value has been about in line with the growth rate in revenues, which were $148 million in 1997 and are projected to be $178 billion in 2017. That growth is almost entirely organic rather than by acquisition. In a word: Wow.

However, unlike many technology companies, Amazon doesn't create new products or conjure new industries out of thin air like Microsoft did with Windows, Apple did with the iPhone® or Alphabet née Google did with search. Amazon mostly sells what others already do, but in a better, more convenient and cheaper way. It's in the zero-sum game business, with the zero being what the competition is left with.

Amazon is, in effect, a global disruption machine, gobbling up industries entirely or nibbling at them around the edges.

That means every investor worth her or his salt has to pay attention to this company. It has expanded from selling nothing but books online in the US in 1997 to a current range of activities united only by a philosophy of "offering customers compelling value." Today, Amazon retails hundreds of thousands of SKUS on its website, manufactures and sells electronic devices, develops and produces media content, offers global computing, storage and database services to corporations, publishes books independently for authors, and operates Whole Foods, the high-end food retailer. That matters immensely for anyone invested in any of those industries or considering an investment in an industry that Amazon has entered or may enter.

What makes Amazon even more interesting and relevant to our discussion is how this global disruption-machine is valued and how it's rewarded in the marketplace. Indeed, Amazon's explosive and relentless expansion into new markets and its valuation model are a combination unlike anything we have ever seen before.

Amazon's primary focus is not on growing annual profits, but on expansion—namely revenue growth. It seems like the faster the company grows, irrespective of profits, the more it gets rewarded by investors. That's not usually how the stock market works.

Let's look at a few facts. In the five years ended 2016 (the last year for which we have full-year financials as Amazon has not reported 2017 results yet), Amazon's operating margin averaged 1.7% and its ROE averaged 3.9%. As a point of comparison, the two largest technology companies (Apple and Alphabet) have double-digit ROEs and operating margins in the 20s and 30s. Even most retailers of significant scale, such as Wal-Mart and Target, have margins and ROEs greater than Amazon's. And yet, Amazon trades at more than 300X earnings. Alphabet seems dirt-cheap at only 35X.

Amazon's business model relies on the relentless pursuit of market share at the expense of short- to medium-term profitability. Take its recent acquisition of Whole Foods as an example. Prior to Amazon's $13.7bn acquisition, Whole Foods was struggling to grow and even to maintain its profit margins and return profile in the face of greater competition. When Amazon announced the acquisition, it gave no strategy on how it was going to turn around Whole Foods or even what exactly it was going to do with the business in order to generate a return on the $14bn price tag. We do know that immediately after closing the acquisition, Amazon slashed prices on some of the store's highest margin products, such as fresh foods. Note that the stock market reacted by bidding up Amazon's stock price.

This business and valuation model are a dangerous combination for any company competing with Amazon—or whose business is in Amazon's sights. That's why the shares of most food retailers immediately tanked on the announcement of Amazon's Whole Foods takeover. Amazon was going after the industry's profit pool—not to steal it, but to evaporate it. Just as significant is the interesting wrinkle the *acquisition* of Whole Foods adds to this risk. Whole Foods is Amazon's first multi-billion dollar acquisition of an established, "old economy" company. Up until this point, Amazon competed, not acquired, its way through the old world economy. The Whole Foods deal broke with that. And it makes sense. If your stock trades at one of the highest earnings multiples in the world, you have the currency to acquire assets that nobody else has.

This is also why we have entered a world where even a rumor of Amazon's entering a new industry immediately sends the share prices of those industry participants into the toilet. We haven't added it up, but a good number of the stocks that landed on our research list this year were suffering, at least in part, from Amazon-disruption fear. We like it when this Amazon effect creates opportunities for us. We wrote in Q3 about the investment we had initiated in Advance Auto Parts. A big part of the reason we were able to buy that stock at such an attractive valuation was the perceived Amazon risk. Similarly, the announcement of Amazon's acquisition of Whole Foods sent the share price of Tesco, a grocer in a different country, down to a very attractive valuation.

In a recent twist to this phenomenon, the Amazon narrative has taken a 180-degree turn—fear of competition from Amazon is turning into the hope of being acquired by Amazon. We got a glimpse of this recently when Target—a retailer that has suffered from Amazon's market-share gains—was touted as a likely acquisition target by a retail analyst. That helped drive Target's stock to a recent 52-week high. (If Jeff Bezos happens to get his hands on this letter, we would like to highlight that we would gladly enter into negotiations for the sale of our shares in Tesco at a similar valuation to what was paid for Whole Foods).

That would be a mixed blessing for value investors like us. Ten years into a bull market, the Amazon effect has been one of the few reliable drivers of share-price underperformance—and therefore, sources of new investment ideas. Maybe we will look back at this as another sign of the bull's aging—when Amazon's entering your market became a good thing.

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

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

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