# Artisan Value Fund

QUARTERLY
Commentary

Investor Class: ARTLX | Advisor Class: APDLX | Institutional Class: APHLX

As of 31 December 2018

## 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.

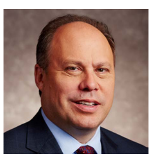
### Attractive Business Economics

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

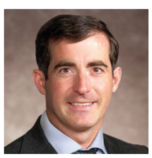
## Team Overview

Everyone on the team functions as a generalist with respect to investment research and the entire team works together on considering potential investments.

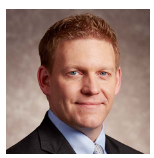
### Portfolio Management



James C. Kieffer, CFA
Portfolio Manager



Thomas A. Reynolds IV
Portfolio Manager



Daniel L. Kane, CFA
Portfolio Manager

## Investment Results (%)

| | | | Average Annual Total Returns | | | | |
|---|---|---|---|---|---|---|---|
| As of 31 December 2018 | QTD | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Inception |
| **Investor Class: ARTLX** | **-17.97** | **-14.92** | **-14.92** | **8.39** | **3.97** | **10.70** | **5.55** |
| **Advisor Class: APDLX** | **-17.85** | **-14.73** | **-14.73** | **8.53** | **4.09** | **10.76** | **5.60** |
| **Institutional Class: APHLX** | **-17.87** | **-14.70** | **-14.70** | **8.60** | **4.22** | **10.90** | **5.70** |
| Russell 1000® Value Index | -11.72 | -8.27 | -8.27 | 6.95 | 5.95 | 11.18 | 5.93 |
| Russell 1000® Index | -13.82 | -4.78 | -4.78 | 9.09 | 8.21 | 13.28 | 7.54 |

Source: Artisan Partners/Russell. Returns for periods less than one year are not annualized. Class inception: Investor (27 March 2006); Advisor (1 April 2015); Institutional (26 July 2011). For the period prior to inception, each of Advisor Class and Institutional Class's performance is the Investor Class's return for that period ("Linked Performance"). Linked Performance has not been restated to reflect expenses of the Advisor or Institutional Class and each share's respective returns during that period would be different if such expenses were reflected.

| Expense Ratios (% Gross/Net) | ARTLX | APDLX | APHLX |
|---|---|---|---|
| Annual Report 30 Sep 2018 | 1.01/— | 0.89/0.88[1,2] | 0.80/— |
| Prospectus 30 Sep 2017[1] | 1.01/— | 0.85/— | 0.80/— |

[1]See prospectus for further details. [2]Reflects a contractual expense limitation agreement in effect through 31 Jan 2020.

**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.**

## Investing Environment

Investors faced a rocky year amid heightened financial market volatility, punctuated by major price declines in February, October and December. The dominant concerns were largely consistent throughout the fourth quarter, namely ratcheting trade tensions between the US and China, tightening monetary policy, and the potential for slower global economic growth.

Most asset classes underperformed cash in 2018, and the major equity indices closed in negative territory for Q4. The US was among the bottom performers in the quarter, but led most major indices for 2018, which is an ignominious distinction since the S&P 500® Index notched its worst calendar year since the global financial crisis' conclusion.

Tighter US monetary policy was a prevalent theme as the US economy remained strong. Substantial fiscal stimulus in the form of tax cuts contributed to growth in the economy and in corporate profits. Citing strong economic fundamentals, the Federal Reserve continued normalizing policy—hiking its benchmark rate four times in 2018 and continuing to unwind its balance sheet. Even so, conflicting signals about the underlying health of economic conditions and financial markets' weakness contributed to investors' questioning whether the Fed was being too aggressive in its approach.

For the Russell 1000® Value Index, the energy sector was the big loser in the quarter as oil prices collapsed. The industrials, materials, financials, consumer discretionary and technology sectors also suffered notably. Utilities were the sole sector in the black over the quarter as investors shunned more cyclically oriented names. Value stocks generally trailed growth stocks for the year. From a size perspective, larger companies tended to hold up better for the year overall as volatility likely swayed investors' preference toward the liquidity found in larger stocks.

## Performance Discussion

Our portfolio trailed the Russell 1000® Value Index QTD. A stunning equity selloff in December rocked the energy sector amid sinking oil prices. With crude oil prices off approximately $30 per barrel over the quarter and energy the worst performing sector in the index, it's of little surprise the exploration and production firms—particularly Hess, Apache and Devon—were among our largest detractors.

Weakness in airline stocks, tensions with China and the outlook for consumer spending bled into the aircraft lessors, and Air Lease Corp was our largest detractor on the quarter. However, demand for air travel by the global emerging middle class and the rise of ultra-low-cost carriers provide secular tailwinds in the long term. Air Lease is priced at a discount to book value, and we added to the position on the weakness as we continue to believe management has positioned the company as the industry leader. We had sold the position size down somewhat earlier in the year.

Apple was a top detractor. At the end of 2018, Apple pre-announced results were going to be significantly lower than the estimates given investors two months prior. The primary reason for slowing iPhone sales is weak demand in China. While we are disappointed by the recent results, we continue to believe the market underappreciates Apple's long-term business prospects. Our view remains Apple will continue to earn outsized profits despite relying on hardware sales due to the iOS operating system, which can only be accessed via Apple devices. Looking past the current weak results we also see a rising install base of Apple devices, which contributes to rising services revenue. We believe the rising install base shows a healthy business, and Apple's ability to monetize the install base, should lead to rising profits over time. On top of what we think is an excellent business, Apple has a strong net cash position, which management is returning aggressively to shareholders.

We closed our position in Simon Property Group, a real estate investment trust, which was the top contributor QTD as the business reached what we considered full value.

Also among our top contributors in Q4 were a couple new names—SunTrust Banks and Sanofi.

SunTrust Banks, a super-regional bank with its locus in the fast-growing southeast US, is another case of low expectations. We believe it is fetching a price that reflects trough-like assumptions. This is a much different (i.e., better) bank than it was a decade ago. Management is disciplined on expense lines, and the stock offers a strong capital return yield (dividends plus buybacks).

Global pharmaceuticals company Sanofi is an off-index name. After five years of deep underperformance versus a variety of indices and peers, Sanofi's valuation is compelling. We believe their vaccines portfolio is particularly appealing, delivering steady EBIT in what is a higher-multiples business with high barriers to entry. We are encouraged by the path its new management has embarked upon since taking over in 2015.

## Portfolio Activity

In addition to closing our position in Simon Property Group, we exited Expedia and Liberty Expedia Holdings. We did not sour on the online travel agencies, but saw an opportunity to buy a better online travel business at a similar valuation to Expedia—Booking Holdings, the corporate entity behind Booking.com, priceline.com, and OpenTable, among other popular brands. The drivers of Expedia and Booking are similar, but in our view Booking has the upper hand as a business for multiple reasons. For one, Booking has a single platform which allows for a lower cost structure and less capital expenditure. Second, Booking is the dominant online travel agency in Europe, where the majority of hotels are independently owned, giving the hotel operators less bargaining power with Booking. Furthermore, Booking has a better balance sheet and generates more free cash flow on their marketing spend due to scale advantages than Expedia.

In the December swoon, international shipper FedEx—our latest acquisition—was under pressure as investors feared slowing global trade. Furthermore, FedEx indicated its integration of TNT Express was going to take longer and cost more than originally planned. We have long admired FedEx but only recently have we found the asking price of the business disconnected from our assessment of business value. FedEx operates a global network which enables the express shipment of goods to almost every corner of the globe, with time-definite delivery, in under seventy-two hours. It is the largest express air carrier in the world with industry leading speed and reliability performance. Additionally, FedEx operates a ground delivery business in the attractively structured US market. The logistics business is highly cyclical, which will lead to pressure on profits in an economic downturn. When we initiated our purchase, we assessed the market was pricing FedEx at a value which assumed a recession was around the corner. Taking a longer view, we think the majority of outcomes for FedEx in the years ahead lead to higher earnings and a better multiple as returns on capital improve once the TNT Express integration is complete and global trade fears subside.

## Perspective

Volatility begets opportunity. Our process is designed to take advantage of the discounts that can manifest when fear and uncertainty drive prices away from their intrinsic values. While recent market action may have widened that gap, discounts are not yet widely available. We like how the portfolio is positioned, and we will continue engaging in new opportunities where valuations warrant. However, at this point in the economic cycle, we believe avoiding high-valuation areas can continue be a source of alpha for the portfolio.

Managing risk is at the core of our process. We manage business risk by looking for companies that have solid return on capital and cash flow capabilities. We manage financial risk by focusing on balance sheet strength. We manage valuation risk by seeking stocks that are out of favor and are selling cheaply. We believe that sticking to our investment discipline—seeking cash-producing businesses in strong financial condition that are selling at undemanding valuations—is the best approach for compounding returns over a market cycle.

## Business Update

We are pleased to announce that Craig Inman has been named a portfolio manager for the Artisan Value Fund and Artisan Mid Cap Value Fund, effective February 1. Craig joined our team in 2012 and is being promoted to portfolio manager in recognition of the quality of his recommendations over the years, providing him an opportunity to broaden his leadership and influence on the portfolios.

His most recent promotion does not change our decision-making process. Rather, it is a reflection of our view of his abilities as a decision maker and the value he has created for our shareholders during his tenure.

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.**

Russell 1000® Value Index measures the performance of US large-cap companies with lower price/book ratios and forecasted growth values. Russell 1000® Index measures the performance of roughly 1,000 US large-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 Dec 2018. 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 Value Fund's total net assets as of 31 Dec 2018: Air Lease Corp 3.0%; Apache Corp 1.3%; Apple Inc 3.7%; Booking Holdings 2.8%; Devon Energy Corp 1.5%; FedEx Corp 2.8%; Hess Corp 1.2%; Sanofi 2.9%; SunTrust Banks 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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**Free Cash Flow** is a measure of financial performance calculated as operating cash flow minus capital expenditures. **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. **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%. **Book Value** is the net asset value of a company, calculated by total assets minus intangible assets and liabilities. **Earnings Before Interest & Tax (EBIT)** is an indicator of a company's profitability, calculated as revenue minus expenses, excluding tax and interest. **Return on Capital (ROC)** is a measure of how effectively a company uses the money (borrowed or owned) invested in its operations.

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