



# Artisan Small Cap Fund

QUARTERLY  
Commentary

Investor Class: ARTSX | Advisor Class: APDSX | Institutional Class: APHSX

As of 30 June 2019

## Investment Process

We seek to invest in companies that possess franchise characteristics, are benefiting from an accelerating profit cycle and are trading at a discount to our estimate of private market value. Our investment process focuses on two distinct elements—security selection and capital allocation. We overlay our investment process with broad knowledge of the global economy.

### Security Selection

We seek to identify companies that have franchise characteristics (e.g. low cost production capability, possession of a proprietary asset, dominant market share or a defensible brand name), are benefiting from an accelerating profit cycle and are trading at a discount to our estimate of private market value. We look for companies that are well positioned for long-term growth, which is driven by demand for their products and services, at an early enough stage in their profit cycle to benefit from the increased cash flows produced by the emerging profit cycle.

### Capital Allocation

Based on our fundamental analysis of a company's profit cycle, we divide the portfolio into three parts. Garden<sup>SM</sup> investments are small positions in the early part of their profit cycle that may warrant more sizeable allocations as their profit cycle accelerates. Crop<sup>SM</sup> investments are positions that are being increased to a full weight because they are moving through the strongest part of their profit cycles. Harvest<sup>SM</sup> investments are positions that are being reduced as they near our estimates of full valuation or their profit cycles begin to decelerate.

### Broad Knowledge

We overlay the security selection and capital allocation elements of our investment process with a desire to invest opportunistically across the entire global economy. We seek broad knowledge of the global economy in order to find growth wherever it occurs.

## Team Overview

We believe deep industry expertise, broad investment knowledge, a highly collaborative decision-making process and individual accountability are a powerful combination. Since the inception of the team, we have been committed to building a team of growth investors that retains these attributes and is solely dedicated to our process and approach.

## Portfolio Management



Craigh A. Cepukenas, CFA  
Portfolio Manager (Lead)



James D. Hamel, CFA  
Portfolio Manager



Matthew H. Kamm, CFA  
Portfolio Manager



Jason L. White, CFA  
Portfolio Manager

## Investment Results (%)

As of 30 June 2019	Average Annual Total Returns						
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception
<b>Investor Class: ARTSX</b>	<b>6.71</b>	<b>31.27</b>	<b>16.00</b>	<b>20.78</b>	<b>13.25</b>	<b>17.24</b>	<b>9.79</b>
<b>Advisor Class: APDSX</b>	<b>6.71</b>	<b>31.37</b>	<b>16.15</b>	<b>20.91</b>	<b>13.32</b>	<b>17.27</b>	<b>9.80</b>
<b>Institutional Class: APHSX</b>	<b>6.73</b>	<b>31.39</b>	<b>16.21</b>	<b>21.04</b>	<b>13.48</b>	<b>17.40</b>	<b>9.85</b>
Russell 2000 <sup>®</sup> Growth Index	2.75	20.36	-0.49	14.69	8.63	14.41	7.84
Russell 2000 <sup>®</sup> Index	2.10	16.98	-3.31	12.30	7.06	13.45	9.14

Source: Artisan Partners/Russell. Returns for periods less than one year are not annualized. Class inception: Investor (28 March 1995); Advisor (1 February 2017); Institutional (7 May 2012). 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	ARTSX	APDSX	APHSX
Semi-Annual Report 31 Mar 2019 <sup>1</sup>	1.21	1.05	1.00
Prospectus 30 Sep 2018 <sup>2</sup>	1.21	1.06	1.01

<sup>1</sup>Unaudited, annualized for the six-month period. <sup>2</sup>See prospectus for further details.

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

Despite a meaningful May correction, markets landed mostly in the black in Q2, with the US leading, followed by non-US developed and emerging markets. Investors continued mulling the potential for slowing growth in major economies, including Europe and China. Further, global trade tensions remained top of mind—though as the quarter concluded, China and the US signaled they would resume negotiations. Brexit also remained an ongoing source of uncertainty, with PM May announcing she would step down as the leader of the Conservative Party but would remain PM until her successor is chosen. As of this writing, the UK is set to leave the EU as of October 31, with the manner of the country's exit still an open question. Though corporate earnings and many economic indicators are mixed, relative resilience for now has helped soothe investor nerves and contributed to June's bounce-back.

On the monetary policy front, major global developed world central banks left interest rates unchanged during Q2 as expected. However, several—notably, the Fed—indicated they will remain accommodative as economic conditions and the ongoing trade negotiations evolve in the coming months. Interest rates were pressured following the announcements, while equity markets seemed bolstered.

At the sector level, information technology led as investors' appetite for growth-oriented stocks has remained robust, despite the aforementioned concerns about the global growth trajectory. Conversely, energy and health care were the primary laggards. Oil prices fell for much of Q2 as supply remains abundant and alternatives become increasingly competitive. Though oil prices bounced sharply in June as Middle East tensions flared, it was insufficient to lift energy from among the bottom-contributing sectors for the quarter. The health care sector has been pressured amid amplifying US political rhetoric ahead of the presidential primary, which has increased uncertainty about the future of the insurance industry and pharmaceutical pricing. From a size perspective, small stocks trailed their larger counterparts during Q2—though mid cap leads YTD, followed by large stocks and small.

### Performance Discussion

Our portfolio outperformed the Russell 2000® Growth and Russell 2000® Indices in Q2 and remains well ahead of both benchmarks YTD. We have been particularly pleased to see a majority of our Q2 and YTD outperformance the result of our bottom-up stock selection—a welcome (if admittedly short-term) vote of confidence in our philosophy and process, which have served us well throughout our team's history.

At the sector level, relative strength was broad-based, with notable contributions from holdings in what we refer to as our power alleys—health care, industrials, technology and discretionary. We also benefited in Q2 from what we *didn't* own—especially energy, where we struggle to find high-quality franchises capable of profit cycles and trading at valuations which we understand. Conversely, our financials

exposure was the sole relative headwind at the sector level—which, though disappointing, is not surprising given a still-challenging interest rate environment and ongoing net-interest margin compression.

At the individual holdings level, Veeva Systems, Tableau and DexCom were among our top contributors. Veeva Systems continues winning new life-science industry customers and selling additional software tools to existing customers, which is driving strong revenue growth. Further, the efficiency of Veeva's operating model (a modern technology platform, products that have earned high customer satisfaction and a mature sales force footprint) is translating into very impressive margin expansion. During Q2, Veeva won its first contract with a top-20 pharmaceuticals customer to capture and manage clinical trial data from the point of care. Veeva is a relative newcomer to this large market. Based on the quality of Veeva's software and the synergies between clinical data capture and the broader Vault product suite, we expect this segment to be a key driver of the company's growth in future years. While we maintain conviction in the remaining growth runway, we have begun harvesting our position as the market cap has outgrown our small-cap mandate.

Tableau is a provider of unique, interactive data visualization software allowing enterprise clients to quickly translate complex data into compelling graphics. Its acquisition by Salesforce—announced in Q2—caps a successful investment campaign, as we recognized early that Tableau's new management team was positioning the company for faster, more reliable growth by shifting to a subscription-based business model and doubling down on continually improving its analytics tools for customers. Because we expect the deal to close—and because shareholders are receiving shares of Salesforce's stock, which is far beyond our small-cap mandate—we have been harvesting our position.

Shares of DexCom have been volatile in recent quarters given competitive pressures from Abbott Laboratories' and Medtronic's competing CGM products. However, DexCom's new product, G7, is expected to launch in 2020 and represents a meaningful technological step forward (and ahead of competitors) as it has a smaller form factor than the current iteration, is less expensive and is fully disposable. We believe DexCom remains well-positioned to capitalize on a still-meaningful growth runway given the enormous size of the global diabetes market.

Among our bottom contributors in Q2 were Benefitfocus, Canada Goose and Visteon. We have held Benefitfocus, a cloud-based supplier of benefits software, for its innovative offerings such as BenefitsPlace™, which connects employers, brokers and insurance carriers on a single platform. Over the course of our campaign, the company has improved sales execution and sharpened its strategic focus under a new management team—while also navigating the volatility and political uncertainty that can impact health care-related businesses. Shares have been pressured in recent quarters by the combination of the renegotiation of a significant relationship and the

unexpected departure of the CFO and head of sales. While we believe the company remains a high-quality franchise with the potential to drive an ongoing profit cycle, we are reviewing our thesis and are prepared to pivot accordingly.

Premium outerwear brand Canada Goose delivered strong quarterly results in Q2 which exhibited continued global growth for the brand. However, investors have grown to expect even higher levels of growth and are questioning the company's ability to support off-season sales with product extensions into new categories, spring wear, accessories, etc. We don't believe the growth algorithm has changed—on the contrary, the brand continues to appear healthy, and the growth opportunities globally continue to look attractive. Hence, we have maintained our position.

Visteon is a producer of next-generation automotive dashboards. Our thesis has been largely focused on the company's new product cycle in its core infotainment business, which we anticipated would drive materially higher profits and margin expansion in the coming years. However, recent management missteps have driven costs higher and delayed product launches, weighing on the company's profit growth and outlook. Further, short-term demand for Visteon's products appears to be waning, with OEM production cuts in North America and Europe, as well as trade pressures in China, which have weighed on the country's auto demand. Absent near-term visibility into when these headwinds might abate, we concluded our campaign in favor of better positioned opportunities elsewhere.

### Portfolio Activity

Though we are keenly aware of growing concern about a raft of factors, including slowing GDP growth, high valuations, trade tensions, etc., we continue to find high-quality franchises which we believe represent the next generation of growth opportunities—companies which are disrupting industries in highly innovative ways and supplying unique products in response to demand that isn't especially tethered to GDP growth. We initiated new campaigns in several such holdings in Q2—among them Clarivate Analytics, Mesa Laboratories and LiveRamp.

Clarivate's business encompasses five data analytics and services businesses in which it has dominant market share and lacks a clear competitor. We have high conviction in its management team, which is helmed by Jerre Stead—whom we know well from his time at IHS Markit, a significant holding in our other portfolios. We believe Clarivate has a meaningful opportunity to improve execution as it reinvigorates its sales force and R&D efforts while increasing its pricing—changes which should improve the top-line growth profile over time. We also anticipate management will capitalize on efficiencies to cut costs, in turn improving margins. Finally, as the company de-levers its balance sheet, we believe it should be able to increase inorganic growth via accretive, bolt-on acquisitions.

Mesa Laboratories provides quality control instruments, consumables and services used in health care and pharmaceutical applications. The

company's relatively new CEO came from Danaher, where he successfully executed several acquisitions. In his roughly two years with Mesa Labs, the company has already experienced some early success optimizing the product portfolio, restarting organic growth, overhauling management, changing the compensation structure and building an acquisition platform. We believe Mesa Labs is capable of driving a compelling profit cycle as it grows in its niche markets via accretive acquisitions in the period ahead and capitalized on a volatile Q2 to initiate a Garden<sup>SM</sup> position.

LiveRamp is a leader in identity resolution, which allows brands to integrate and consolidate customer data from multiple sources—including online, offline, customer relationship management software, enterprise resource planning software and others—so they can use those data across their digital marketing ecosystem while complying with privacy regulations. We believe the company is well-positioned to grow its customer base as companies increasingly need to consolidate online and offline customer data. Further, heightened data privacy regulations and the growth of connected TVs—which represents a meaningful digital marketing opportunity—should drive demand for LiveRamp's product offering. While we believe the opportunity ahead of LiveRamp is significant, it remains firmly in the Garden<sup>SM</sup> while we watch for signs our thesis is taking hold as we anticipate.

We also added to our positions in Zynga and Tabula Rasa. We have been pleased with the progress of Zynga, a leading social game developer with its games played across web, mobile devices and the company's eponymous website. It has executed well in recent quarters, showcasing its ability to grow organically while incorporating recent accretive acquisitions like Small Giant Games and Gram Games. These acquisitions have added to Zynga's already attractive IP library with younger IP that we believe has along growth runway still ahead of it. With a solid balance sheet and an attractive valuation, we believe Zynga has ample room to continue driving a compelling profit cycle and capitalized on May's market pull-back to add to our position.

Tabula Rasa is a medication risk-mitigation provider serving primarily Provider for All-Inclusive for the Elderly (PACE) markets. We initiated our position in Q3 2018 on the strength of its proprietary software, which helps PACE organizations—that serve patients who prefer care in their own homes over a care facility—address adverse drug events. This in turn helps lower overall costs for patients with complex medical needs. The company's recent acquisition of PrescribeWellness, a solutions-provider to roughly 10,000 community pharmacies across the country, should drive accelerating demand for Tabula Rasa's PACE software system. Though shares were pressured modestly in Q2, we maintain our conviction in the meaningful opportunity ahead of the company and increased our position to a small Crop<sup>SM</sup> holding.

Conversely, in addition to the aforementioned Visteon, we exited our positions in HEICO, Proofpoint and Curtiss-Wright. HEICO, the world's leading parts manufacturer approval supplier to the aerospace industry, has executed very well over the course of our campaign. We initiated our position in Q4 2016 on the thesis that HEICO would build on its history of successfully growing market share via accretive acquisitions, while also driving accelerating revenue growth as airlines refurbished older airplanes, rather than retiring or replacing them. That thesis has played out well, with the company benefiting from a highly compelling profit cycle via both solid organic and inorganic growth. We had been harvesting our position over the last couple quarters as its market cap began to exceed our small-cap mandate, and we concluded the harvest in Q2, bringing to a close a nicely successful campaign.

We similarly fully exited Proofpoint, concluding a successful campaign in a leading, SaaS-based provider of e-mail security and data-protection services. Over the last several years, the company has capitalized well on its attractive position relative to the ongoing emphasis on e-mail security. Though that thesis remains intact, with the valuation near our estimate of private market value, we harvested our position in favor of earlier profit cycles.

Curtiss-Wright designs and manufactures precision electronic and nuclear components. We have held it since Q1 2018 on the thesis that its new management team would build upon early progress divesting lower-margin businesses and turn its attention to organic growth and accretive acquisitions. However, organic growth has been slower than expected, and management has signaled it will deploy nearly all the company's free cash flow toward M&A in the next several years. With our thesis at best delayed, we exited our Garden<sup>SM</sup> position in Q2.

We pared our exposure to Ollie's Bargain Outlet and Webster Financial. Ollie's Bargain Outlet is a closeout retailer of branded merchandise known for its attractive assortment of discounted products. Ollie's has defied rapid e-commerce growth thanks largely to its differentiated business model. We have been pleased by the company's progress expanding across geographies, increasing scale and improving product availability—which has translated into solid revenue and earnings growth. However, we have pared our exposure in accordance with our valuation discipline as it approaches our estimate of private market value.

Shares of Webster Financial, owner of the US's largest health savings account (HSA) platform, have primarily been pressured by heightened political rhetoric that raises questions about the future of HSAs. Ongoing indications from the Federal Reserve that monetary policy will remain accommodative for the foreseeable future have also weighed on net interest margins. Though we believe Webster remains a high-quality franchise, we pared our exposure in Q2 while we await signs the profit cycle is regaining its footing.

### Portfolio Statistics

As of June 30, we held 63 positions with a median market cap of \$5.3 billion. Our portfolio had a 3-5 year forecasted weighted average earnings growth rate of 25% and our holdings were selling at a weighted harmonic average P/E (excluding negative earnings) of 35X FY1 earnings and 33X FY2 earnings.

### Perspective

Strong earnings growth has been a nice contributor to the portfolio's attractive YTD returns. But multiple expansion has clearly played an important role as well. As we have communicated in prior letters, we entered the year (following Q4 2018's decline) believing valuations in the portfolio were quite attractive—hence, some multiple recovery was to be expected. Beyond that dynamic, we believe valuations have been boosted in recent quarters by falling interest-rate expectations and global macro concerns that have created a scarcity premium for many of our holdings (businesses whose profit growth is driven by innovation, internal initiatives and secular trends, more than by global economic expansion).

We expect the portfolio to exhibit continued solid earnings growth in the second half of the year. However, as market participants (most of whom we believe have shorter investment time horizons than we do) watch US-China trade developments, Fed actions and political indicators in an attempt to call the market's next turn, we wouldn't be shocked to see profit-taking across markets to fund bets in either more cyclical—or more defensive—equities. That said, as aforementioned, we continue to find disruptive, high-quality franchises whose growth is less correlated to GDP growth and as such anticipate some measure of insulation from ongoing macro concerns—though to be sure, should markets meaningfully turn down, our portfolio would likely not be altogether immune from declines.

While our time horizon is reasonably long—and while our investment process guides our stock selection toward high-quality franchises with visible profit cycle drivers and solid balance sheets—we're always comparing the relative attractiveness of our portfolio to what we *don't* own. Our observation today is that pockets perceived as "value"—banks, autos and cyclical industrials, for example—require investors to shoulder meaningful cyclical economic risk. On the other end of the spectrum, "defensive" stocks (those with very stable earnings trends and limited cyclicity) have experienced meaningful multiple expansion as investors have looked for safety in an uncertain global economy. So while many of our holdings have seen their valuations expand YTD, it's not obvious to us that trading down in quality for cyclical value stocks, or giving up dynamic earnings growth for expensive safety, are attractive alternatives.

So while we're maintaining our valuation discipline, we also maintain our conviction that many of the profit cycles in the portfolio offer further opportunity for long-term compounding of value. For example, software usage is steadily proliferating across the economy—a trend that benefits not only our fastest-growing Silicon Valley companies (Veeva Systems, Coupa Software, HubSpot, etc.), but also forward-looking diversified franchises across industrials (Clarivate Analytics, Cubic), financials (Virtu Financial) and consumer (Roku, Chegg). It's noteworthy that our Garden<sup>SM</sup> and emerging Crop<sup>SM</sup> holdings in biotechnology are as attractive as we've seen in the last seven to eight years. As always, a short-term market pullback would likely present us with multiple opportunities to add to high-conviction investments and add new Garden<sup>SM</sup> opportunities at more opportunistic prices.

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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. Growth securities may underperform other asset types during a given period.

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This summary represents the views of the portfolio managers as of 30 Jun 2019. Those views may change, and the Fund disclaims any obligation to advise investors of such changes. For the purpose of determining the Funds' 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 Artisan Small Cap Fund's total net assets as of 30 Jun 2019: Benefitfocus Inc 1.1%, Canada Goose Holdings Inc 1.6%, Chegg Inc 2.6%, Clarivate Analytics PLC 0.8%, Coupa Software Inc 2%, Cubic Corp 1.2%, DexCom Inc 3.3%, HubSpot Inc 2.7%, LiveRamp Holdings Inc 0.4%, Mesa Laboratories Inc 0.5%, Ollie's Bargain Outlet Holdings Inc 1%, Roku Inc 1.1%, Tableau Software Inc 1.5%, Tabula Rasa HealthCare Inc 1.4%, Veeva Systems Inc 1.7%, Virtu Financial Inc 1.2%, Webster Financial Corp 1.7%, Zynga Inc 2.8%. 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.

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Our capital allocation process is designed to build position size according to our conviction. Portfolio holdings develop through three stages: Garden<sup>SM</sup>, Crop<sup>SM</sup> and Harvest<sup>SM</sup>. Garden<sup>SM</sup> investments are situations where we believe we are right, but there is not clear evidence that the profit cycle has taken hold, so positions are small. Crop<sup>SM</sup> investments are holdings where we have gained conviction in the company's profit cycle, so positions are larger. Harvest<sup>SM</sup> investments are holdings that have exceeded our estimate of intrinsic value or holdings where there is a deceleration in the company's profit cycle. Harvest<sup>SM</sup> investments are generally being reduced or sold from the portfolios.

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