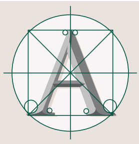


Artisan Mid Cap Fund

QUARTERLY
Commentary

Investor Class: ARTMX | Advisor Class: APDMX | Institutional Class: APHMX

As of 31 March 2020

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 also assess key environmental, social and governance (ESG) issues that could impact future stock returns. 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[SM] investments are small positions in the early part of their profit cycle that may warrant more sizeable allocations as their profit cycle accelerates. Crop[SM] investments are positions that are being increased to a full weight because they are moving through the strongest part of their profit cycles. Harvest[SM] investments are positions that are being reduced as they near our estimates of full valuation or their profit cycles begin to decelerate.

Broad Knowledge

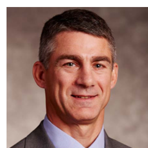
We overlay the security selection and capital allocation elements of our investment process with a desire to invest opportunistically across the entire global economy. We seek broad knowledge of the global economy in order to find growth wherever it occurs.

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.

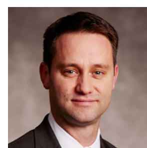
Portfolio Management

Matthew H. Kamm, CFA
Portfolio Manager (Lead)



James D. Hamel, CFA
Portfolio Manager

Craigh A. Cepukenas, CFA
Portfolio Manager



Jason L. White, CFA
Portfolio Manager

Investment Results (%)

As of 31 March 2020	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception
			Average Annual Total Returns				
Investor Class: ARTMX	**-11.55**	**-11.55**	**0.43**	**9.39**	**6.62**	**11.63**	**12.58**
Advisor Class: APDMX	**-11.51**	**-11.51**	**0.66**	**9.57**	**6.79**	**11.72**	**12.62**
Institutional Class: APHMX	**-11.52**	**-11.52**	**0.65**	**9.66**	**6.88**	**11.91**	**12.83**
Russell Midcap® Growth Index	-20.04	-20.04	-9.45	6.53	5.61	10.89	7.93
Russell Midcap® Index	-27.07	-27.07	-18.31	-0.81	1.85	8.77	8.26

Source: Artisan Partners/Russell. Returns for periods less than one year are not annualized. Class inception: Investor (27 June 1997); Advisor (1 April 2015); Institutional (1 July 2000). 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	ARTMX	APDMX	APHMX
Annual Report 30 Sep 2019	1.19	1.04	0.96
Prospectus 30 Sep 2019[1]	1.19	1.05	0.96

[1]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 relatively quiet and positive start to 2020, the COVID-19 pandemic and the threat of an oil price war decimated global equity markets in the back half of Q1. The MSCI AC World Index delivered the worst return since the global financial crisis, and massive volatility became the new norm with the CBOE volatility index hitting a record high. The energy sector lagged, followed by financials, while health care and information technology proved relatively resilient. Growth meaningfully outperformed value.

Governments around the globe have taken unprecedented actions to flatten the curve of new COVID-19 cases. In the US, many states have shut down businesses not deemed essential—airlines, hotels, restaurants, malls, sporting venues, gyms, etc.—to limit social interactions. Countries affected earlier in the pandemic—China, Italy, Spain and Germany—have taken similar or more extreme shutdown measures and have seemingly slowed the infection rate of the virus. These decisions are taking an extraordinary toll on the global economy, though it is a price many governments seem willing to pay to curtail the spread of the virus.

To help offset the economic damage and stabilize financial markets, governments and central banks are providing historic levels of fiscal and monetary stimulus. The US federal government passed a $2 trillion stimulus bill in late March, providing direct payments to individuals and families, loans and grants to businesses to help offset zero revenues, enhanced unemployment benefits and additional resources for health care providers. The Fed massively expanded its reverse repo operations—adding $2 trillion of liquidity to the banking system to help keep money markets stable, restarting quantitative easing with the purchase of ~$1 trillion in Treasurys and mortgage-backed securities, lowering bank reserve requirements to zero and lowering its benchmark interest rate 150bps to 0-25bps.

While the length and magnitude of the global economic impact from the pandemic remain to be seen, initial estimates and data points in the US alone have been eye-opening. A record 6.9 million US jobless claims were filed in the last week of March, following 3.3 million the week prior and nearly 10 to 20 times the historical average of ~350,000 weekly jobless claims. Furthermore, flagging sentiment on the Street has led to revised unemployment and Q2 GDP growth expectations. Some are forecasting unemployment will top out at 16% and Q2 GDP growth will decline up to -40%.

Performance Discussion

While our portfolio was negative on an absolute basis during the quarter, we were pleased with its resilience relative to the Russell Midcap® and Russell Midcap® Growth Indices. Our Q1 performance is not a result of a decision made in the quarter, but rather a reflection of our investment philosophy and a confluence of decisions made over recent months, quarters and years. These decisions have been governed by our team's longstanding investment process, which requires us to focus on high-quality businesses with plenty of headroom for continued growth, to concentrate our capital in our highest conviction holdings and to avoid companies lacking visible profit-cycle opportunities.

Risk management is ingrained in our portfolio construction process. While we seek companies with the greatest prospects for profit acceleration, our underlying objective is to compound the portfolio's value, and avoiding permanent capital impairment is key to the powerful math of compounded returns. We seek to manage risk by 1) investing in high-quality businesses ("franchises," in our parlance) with strong management teams and business models capable of generating cash flows through various cycles, 2) ensuring portfolio holdings have solid balance sheets—portfolio median long-term debt to capital is 27% vs. 43% for the Russell Midcap® Growth Index—and 3) exercising valuation discipline.

Once we have identified high-quality franchises that meet these general requirements, our capital allocation process is intended to concentrate capital in our top ideas. While we encourage creative risk-taking in our Garden℠ holdings in an attempt to find big future profit cycles early, stocks that become Crop℠ holdings (roughly our top 25 holdings, comprising nearly 60% of the capital in the portfolio) must have clear profit cycles underway, with clear headroom for continued growth and valuations that are still reasonable. Portfolio performance in any given period is almost always driven by our Crop℠ holdings (by design), and the strength of our Crop℠ investments was on full display in Q1: The weighted average return of our top 25 holdings was slightly flat, and only 4 of our top 25 holdings underperformed the Russell Midcap® Growth Index (-20.04% return in Q1).

While our relative performance in the quarter was supported by stock selection across software, health care and our communication services holdings, we also benefited from our underweight exposures to some of the hardest hit areas of the economy: energy, retail and credit-sensitive financials. We have consistently noted that we see more compelling profit cycle opportunities in innovative sectors of the economy rather than businesses whose growth is heavily dependent on a strong global economy. While we certainly didn't see a halt to the global economy coming, in general, this positioning helped protect capital in Q1. In fact, as we discuss in the perspectives section, some of these innovative businesses are benefiting by being part of society's response to the crisis, while some heavily leveraged low-growth cyclical businesses are being pushed to the brink by the economic shock.

Turning to individual securities, among our top contributors in Q1 were Zoom Video Communications, Zscaler and Atlassian. Video conferencing has been present in some organizations for years, but in limited, frustrating and expensive ways. While the technology has not lived up to its potential, Zoom's low-cost capabilities (cloud-based

hardware and software) and ease of use have been clear differentiators we believe could disrupt the corporate communication and collaboration landscape. More recently, our investment thesis has been bolstered by COVID-19 travel restrictions as corporations, schools, health care professionals, non-profits, etc., have been forced to conduct more or all their typical day-to-day activities remotely. Zoom's video-conferencing capabilities have been instrumental during this time, enabling people to stay connected with one another. This crisis has dramatically increased the company's brand awareness and, we believe, the likelihood video conferencing could become a more common substitute for travel going forward. While their astronomical growth (from 10MM daily users in December to 200MM in March) has presented some challenges—the need to invest in additional server capacity and the need to rapidly respond to concerns about the platform's security—we believe the long-term profit cycle remains compelling with both its legacy product offerings (Zoom Meeting, Zoom Rooms, Zoom Conference Room Connector) and recent moves into phone and chat. We did, however, trim the position during the quarter based on valuation.

Cybersecurity remains a top concern for businesses and governments alike as cyberattacks can have devastating financial and reputational consequences. Furthermore, managing the security needs of legacy on-premise applications, a growing number of cloud-based applications (Office 365, Salesforce, etc.) and a remote workforce, makes operating IT infrastructures increasingly complex. Zscaler's scalable, cloud-based security platform is a more secure and efficient way to connect users and applications, which eliminates the need for several layers of security (firewalls, VPNs, etc.) developed and built over the last couple of decades. While the pandemic crisis is likely disrupting some areas of Zscaler's new sales funnel, the company is particularly well-suited to scale and accelerate our market share-gain thesis. Ninety percent of employees are remotely connecting to the enterprise IT network in today's inverted world, as opposed to prior solutions which are geared to support 10%-20% of workers connecting remotely with the rest connecting from within the walls of a corporate network. Many employees have used traditional VPN connections to log into their networks remotely, but Zscaler's platform offers a more secure connection without exposing an entire internal network, is easier to configure and is less costly to operate at scale. Given the trend toward connecting remote devices over the Internet backbone, solid gross margins and a recurring revenue base, we added to our position during the quarter.

Atlassian, a leading provider of innovative, customizable team-collaboration software tools for organizations of all sizes, is delivering strong subscription growth. Shares have benefited as the company's business model is relatively defensive in the current environment—asset-light, a salesperson-free distribution model, a 90% recurring revenue base, excellent cash conversion and an ability to move the growth needle from smaller deal wins. We expect the fundamental outlook to remain favorable as low-cost, cloud-based collaboration tools will likely remain in high demand as teams around the world adapt to the current remote working conditions.

Among our bottom individual contributors were Exact Sciences, Aptiv and Global Payments. Exact Sciences has experienced weakened demand for its Cologuard colon cancer screenings as routine visits to physicians' offices have decreased dramatically under social distancing restrictions. While Exact Sciences is taking steps to deploy an at-home screening option to help offset some of the lost sales, we believe the company will experience meaningful declines in its near-term revenues. That said, the longer-term market opportunity remains intact for Cologuard's less invasive and highly effective colon cancer screenings—which find colon cancer at a 92% success rate. We are remaining patient given the company's solid balance sheet and our belief demand for colon cancer screenings will likely rebound naturally as people are able to resume visits to their primary care providers.

Aptiv is a leading provider of safety, infotainment and electronic control components to the automotive market. We have long believed Aptiv is the strongest, best capitalized auto supplier with strong market share and technology that positions it well as computing, electronic and electric batteries become increasingly core components of new vehicles. That said, the global COVID-19 crisis has quickly made Aptiv the best house in a terrible neighborhood. In February, China experienced an ~80% YOY decline in car sales and a 35% decline was reported in the US in March. Further downside momentum in the US is expected in April, with some estimating up to a 60% YoY decline. Aptiv's strong balance sheet offers protection other competitors may not enjoy, and we believe the long-term secular trend toward more electronics-rich vehicles is still ahead but trimmed our position given the recent supply chain disruptions and demand destruction from COVID-19.

Shares of Global Payments have been pressured amid clear indications that COVID-19 restrictions are having a disruptive impact across many of their businesses. Throughout our long holding period, we have been impressed by management's progress in building a fast-growing, diversified, more recurring business at the intersection of many strong trends in payments and software. We believe these characteristics position it quite well to weather almost any type of recession. But in the current (unprecedented) environment, many of its customers are closed or severely restricted, and its diversification across geographies such as the US, United Kingdom and Spain isn't of much benefit either. While we believe short-term earnings will fall far short of initial expectations, we have confidence in management's nimble response to challenges historically, its healthy balance sheet, and our thesis that once the economy begins to reopen, Global

Payments' positive profit cycle will resume. As such we have maintained our position.

Portfolio Activity

We tend to be most active in periods of volatility—and Q1 provided ample opportunity for activity as we drew down our cash position to initiate new positions and added to existing positions at what we believe are attractive valuations relative to our growth expectation over the next two to three years.

We started new investment campaigns in Datadog, Ameren and Halozyme in Q1. Datadog is a leading provider of monitoring and analytics for cloud-based applications. Software has become central to how organizations deliver differentiated products and user experiences and optimize business processes—fueling the disruption taking place across nearly every industry. The success of this digital transformation trend is increasingly tied to quality and performance—in turn, driving strong secular demand for IT infrastructure and application monitoring. Datadog's platform—which integrates and automates infrastructure monitoring, application performance monitoring and log management—provides real-time observability of its customers' entire technology stacks and is built to address the scale, complexity and dynamic nature of the modern cloud era. Datadog's solutions fill a void left by legacy tools built for on-premise IT infrastructures, and the company is well-positioned to exploit a lightly underpenetrated, large addressable market. We believe the company's low-touch land-and-expand customer acquisition model and attractive profit and cash flow characteristics—which are poised to expand nicely over the coming years—position it well for a solid profit cycle ahead.

Ameren is a public utility holding company which provides electric and natural gas services to customers in Missouri and Illinois. Like the other utility we recently added to our portfolio, CMS Energy, we believe Ameren will benefit from its transition away from coal and nuclear plants to a greener power-generation fleet—namely, wind and solar—over the coming decades. This transition will not only benefit the environment—35% and 80% reductions in CO_2 emissions by 2030 and 2050—but will also enable the company to use the cost savings from lower fuel input costs and operating expenses to lower costs to customers, while investing in capital projects at attractive returns on investment. As a regulated utility, Ameren will be allowed to earn a reasonable return on these higher-capital investments, which should drive years of reliably rising profits and dividends.

Halozyme is a biotechnology firm that licenses to pharmaceutical companies the use of its proprietary enzyme—its ENHANZE® platform—which aids delivery of biologics subcutaneously, as opposed to intravenously. The benefit is improved absorption and convenience to patients and physicians. The company has established partnerships with leading biopharma companies—Roche, Johnson and Johnson (JNJ), Bristol-Myers Squibb and Argenx—and ENHANZE is already used in three approved products. A fourth approval is pending for JNJ/Genmab's Darzalex SC, a subcutaneous treatment for multiple myeloma, which we believe will come through later this year and become a large driver of royalty revenue over time. Furthermore, the company decided in late 2019 to fully exit its highly capital-intensive drug-development business, which we believe simplifies the business, reduces the company's exposure to binary events and should lead to significant cash flow growth and margin expansion over time. We used the recent market pullback to initiate a position at what we believe is an attractive valuation.

We ended our campaigns in Wayfair, Canada Goose and Edwards Lifesciences during the quarter. Revenue growth has slowed dramatically for Wayfair over the last year, in part due to rising trade tariffs. Meanwhile the company has been dramatically expanding headcount as well as its advertising and logistics spend, resulting in increasing losses and pushing out our margin expansion thesis. Given our lack of visibility into when these headwinds may abate, we decided to exit our position.

Premium outerwear brand Canada Goose has experienced recent turbulence in China—Hong Kong protests, COVID-19—which has stalled our thesis that the country would be a key driver of sales growth. Aside from COVID-19, the company has shown other signs of slowdown—elevated inventory levels, slowing growth in most mature markets—and our confidence in the investment thesis has waned. With no near-term catalysts on the horizon, we decided to upgrade our capital into better-positioned franchises.

Edwards Lifesciences is the leader in transcatheter aortic valve replacements (TAVR)—one of the fastest-growing, large medical device markets globally. While we believe the company will experience further momentum in the US and European TAVR markets, other parts of the company's business are facing headwinds. Clinical trials for the company's transcatheter mitral and tricuspid therapies have been pushed out as hospitals focus on COVID-19, there is little margin expansion expected in 2020, and there is uncertainty surrounding the potential costs from a pending intellectual property lawsuit related to its PASCAL valve. Given these headwinds, its relatively high valuation, and with the market cap outgrowing our mid-cap mandate, we exited our position.

In addition to our aforementioned add to Zscaler, we also added to a number of other existing positions during the quarter, including Tradeweb and Catalent. Tradeweb operates one of the largest global over the counter (OTC) electronic trading marketplaces for institutional, wholesale and retail investors and dealers. The company pioneered trading OTC financial products electronically in 1998 and currently operates across four asset classes—rates, credit, money

market and equities. These venues provide deeper liquidity, lower trading costs, greater transparency and risk management for both the buy and sell sides. We believe the recent combination of an increase in volatility and displacement of traders due to COVID-19 could accelerate the transition of trading market share to electronic venues.

Catalent is one of the largest contract manufacturing suppliers to the pharmaceuticals industry. The company recently announced its acquisition of MaSTherCell Global, a cell- and gene-therapy contract development and manufacturing organization (CDMO). We believe the acquisition builds upon the company's capabilities as a leading CDMO for biopharma companies. Gene therapies may finally be ready to emerge as valuable treatment options for patients with certain serious conditions, in our view, and developers of these medicines will require significant help from CDMOs. Shares came under pressure during the market selloff, in part due to concerns that their business supplying clinical trial supplies could be impacted by near-term clinical trial delays. With a longer time horizon, we viewed the share price dislocation as an opportunity to add to our position.

In addition to Aptiv, we also trimmed our position in Lululemon on valuation and began harvesting our positions in Fidelity National Information Services and Boston Scientific as their market caps have reached the limit of our mid-cap mandate. Designer and retailer of yoga-inspired apparel Lululemon has delivered strong results in recent years. We have held it as we anticipated its upgraded management team would strengthen all operational functions—including supply chain, product design, e-commerce, digital marketing—and drive higher traffic in both brick-and-mortar and online stores. These efforts have borne fruit and have produced accelerating sales and profits. Furthermore, we believe the company's core women's athletic category as well as its newer initiatives (men's, international, casual wear) all have solid runways ahead. That said, the stock's performance early in the quarter (pre-COVID-19 disruption) seemed to fully reflect these expectations, and we have learned it's best to use extra valuation discipline when it comes to retail growth stocks.

Fidelity National Information Services has benefited from regional banks' outsourcing their core banking systems, and more recently, the company won of its first outsourcing deals with top banks in the US and Japan. We believe this could be a broader effort by larger banks to outsource their core systems, creating a meaningful opportunity for Fidelity National to accelerate its revenue growth. Furthermore, the company recently indicated its merger with Worldpay is going better than planned and raised its synergy expectations. While we believe the profit cycle remains very compelling, the company's market cap has grown to the limit of our mid-cap mandate, and we began harvesting our position at the beginning of the quarter as our successful campaign matures. Shares have since come under pressure due to concerns that Fidelity National—like Global Payments—faces a difficult short-term environment for payment volumes. We expect Fidelity National's earnings overall will prove relatively resilient despite these pressures and thus paused our sales.

Boston Scientific is a leading global developer, manufacturer and marketer of medical devices used in minimally invasive procedures across three segments—cardiovascular, cardiac rhythm and neuromodulation, and medsurg. Boston Scientific struggled for many years as stents and pacemakers—its legacy markets—matured. A new leadership team took the helm in 2011 and re-energized the organization with a performance-oriented culture. Since this leadership transition and throughout our investment campaign, which began in mid-2015, the company has made significant R&D investments and complementary acquisitions focused on higher-growth categories—structural heart, urology and gynecology, minimally invasive surgery, peripheral intervention—and diversifying its business. Furthermore, the company has expanded its geographic footprint into Europe and China. These efforts have driven impressive margin expansion progress and accelerated the top line toward high-single digit growth. However, with the postponement of elective surgeries in many hospitals both in the US and around the globe, and with its market cap exceeding our mid-cap mandate, we began harvesting our position early in the quarter.

Portfolio Statistics

As of March 31, the portfolio had a median market cap of $13 billion and a 3-5 year forecasted weighted average earnings growth rate of 17%. Our holdings were selling at a weighted harmonic average P/E (excluding negative earnings) of 27X FY1 earnings and 23X FY2 earnings. As of quarter end, we held 63 positions. Our top 20 holdings accounted for roughly 56% of portfolio assets as of quarter end. Our top 30 holdings represented about 71% of portfolio assets.

Our ESG Journey

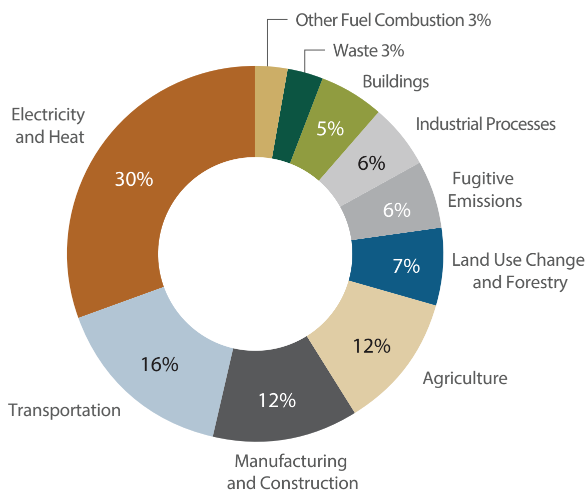
As we discussed in our Q4 letter, we plan to share ongoing updates on our ESG journey. This quarter, we would like to share two examples of how we are incorporating ESG issues into our investment research and decision-making process. We have selected two notable case studies: Zoom Video Communications and CMS Energy.

Zoom Video Communications is well-positioned to take share of the video conferencing market. Video conferencing as a tool to reduce travel and increase workplace productivity has been disappointing over the past couple of decades. Substandard technology, expensive deployments, complex interfaces and aging architectures have been barriers to improving organizational performance through better communication and collaboration among all stakeholders. Furthermore, the workplace has evolved—more mobile and flexible, global, demographics are more diverse (millennials are a video-first generation)—and demand for more advanced corporate communications has grown. Zoom's video-first, cloud-native platform

has been optimized to alleviate this demand by dynamically processing and delivering reliable, high-quality video across devices with significantly less complexity and at a lower cost. These advantages have enabled the company to rapidly capture share of a sizable corporate communications market, driving impressive free cash flow for a company early in its profit cycle and growing rapidly.

From an ESG standpoint, we believe Zoom's positive environmental impact is one of the most important considerations. Not only is transportation the second-largest contributor to human-caused greenhouse (GHG) emissions (accounting for ~16% of global CO_2 emissions in 2016) but it has also grown by 71% since 1990—the second fastest rate of growth.

Exhibit 1: World Greenhouse Gas Emissions by Sector



Source: Climate Watch. 2018. Washington, DC: World Resources Institute. Available online at: https://www.climatewatchdata.org.

We believe Zoom's face-to-face meeting system can play an integral role in reducing the transportation sector's GHG emissions as it keeps people connected using a small fraction of energy relative to cars, airplanes, etc. In addition, Zoom's utilization of the cloud also results in significant energy savings when compared to on-premise servers—primarily due to higher server utilization rates and energy efficiency from the design and operational management of large-scale data centers. The company recently disclosed data to quantify the impact for its top 10 customers, who have avoided ~685,000 metric tons of CO_2 (or annual CO_2 emissions from ~150,000 cars) in the 90 days preceding October 31, 2019. We expect this disclosure to evolve and improve over time, and it is an area we are actively encouraging management to continue to develop/communicate.

Beyond environmental considerations, Zoom's human capital and governance policies follow many best practices. The company grants stock options to virtually all its employees and has an employee stock purchase plan—an effective way to align incentives across the organization. From a governance perspective, seven of the eight board members are independent with significant operational expertise. These directors are part of the company's cohort of VC investors, but this composition is not atypical for a Silicon Valley based start-up and will sunset over time. While the company complies with California regulations requiring at least 1 female director on the board, only 1 of 8 board members and 3 of 12 top executives are female. Zoom is committed to diversifying the board as seats turn over in the future, and we'll be looking for progress on the executive level as well.

More recently, the COVID-19 pandemic has thrust Zoom into global prominence but has also created social challenges and opportunities that reveal much about the company's culture and priorities. Zoom quickly made its service free to K-12 schools in impacted countries, while investing in expensive server capacity to support these free users. This generosity, combined with its longstanding free tier of services for casual users, has certainly benefited society during these difficult, isolated weeks. However, it has also been subject to much criticism about platform security and user protections, which suggests Zoom likely underinvested in these areas at the expense of faster growth. The company's rapid response (dropping all new feature development for 90 days in order to address these issues) shows it understands the societal impact of its service and is committed to protecting users. We think how the company handles this concern in the coming months will go a long way toward shaping its brand and reputation longer term, and we are interacting with management frequently to understand and encourage progress in this area.

In addition to Zoom, CMS Energy, a utility holding we recently added to our portfolio, has been another interesting ESG case study. CMS supplies electricity and natural gas to much of Michigan (other than Detroit). Like most utilities, the company has a sizable carbon footprint—notably, the highest in our portfolio by a wide margin—and power generation for heat and electricity is the largest contributor to human-caused GHG emissions (Exhibit 1). That said, CMS has outlined explicit, environmentally friendly and regulator-approved targets to cut its carbon-emitting energy sources by 2040, including: eliminating the use of coal (~24% of the supply mix in 2018) to generate electricity, reducing carbon emissions by >40% and generating >40% of electricity from renewables (primarily wind and solar). This transition will not only benefit the environment but will also enable the company to use the cost savings from lower fuel input costs and operating expenses to lower costs to customers, while investing in capital projects at attractive returns on investment.

From a governance and human capital perspective, CMS has structured the company in a way that favors both shareholders and employees. The company has clearly defined and shareholder-aligned incentive programs—CEO compensation is in line with peers', the majority of named executive officers' pay is variable, and long-term

incentives are split evenly between trailing three-year total shareholder return and EPS growth relative to peers. Furthermore, 82% of the board is independent—including the chairman—and nearly half its members are female.

As it relates to human capital and employee relations, CMS has built a strong culture focused on health and safety. The company has high employee participation rates in health, safety and environmental training, and these efforts have yielded measurable results: OSHA incidents are down 71% since 2008.

While we suspect some ESG-focused funds may steer clear of utilities entirely (due to their current high levels of carbon emissions), we believe providing capital to help forward-thinking utilities transition to clean energy sources seems worthwhile. We believe transitioning away from a carbon-intensive power generating portfolio is not only the right thing to do environmentally but is also an effort we believe will drive a long-duration profit cycle for CMS.

Perspective

The COVID-19 pandemic has presented unfamiliar challenges our society has not had to work through in generations. Like many people, our team members' professional and family routines have been upended. From our home offices, we've quickly adapted to the new working environment, staying in close communication with each other, our portfolio holdings' management teams and our clients. While we are proud of how the team has responded, witnessing the health and economic consequences of this pandemic on our communities, friends and families has been a painful experience. It is a challenging time, and we hope everyone is staying safe and adapting well to the disruptive changes.

The current economic environment is unlike any we have seen over our investment careers. Social distancing efforts have led to dramatic short-term impacts, with businesses in the travel, leisure, lodging, retail, energy and financials sectors impacted the hardest. Relatively defensive areas of the economy are also being affected more severely than in past periods of economic duress. The magnitude of the intervention by governments, central banks and individual citizens (by social distancing) to help flatten the curve and offset the economic damage has been unprecedented. The resulting signs of plateauing COVID-19 case counts and surging fiscal and monetary stimulus have helped markets recover sharply off the lows in recent weeks. However, we believe volatility will likely remain until the pandemic's future path is more certain and investors can better assess the full impact on consumers and corporations.

We have been closely monitoring the COVID-19 trajectory and the societal debate over how to balance flattening the curve with the economic and other social costs. We have asked one of our health care analysts to lead our efforts to monitor the key virus indicators—cases, testing capacity, therapeutics/vaccines, etc.—and it has been a daily topic of discussion for the team. We are optimistic social distancing will help control the short-term crisis and the scientific and industrial communities will bring forth more medical supplies, diagnostic tests and therapeutic options in the coming months. However, we currently expect the struggle to control COVID-19 to persist, likely in waves across nations and regions, until sufficient quantities of an effective vaccine become available.

As such, while the current stay-at-home environment should represent the low point of economic activity, the recovery post an initial partial snap-back could be prolonged and frustrating. Consumers' savings (for people fortunate enough to have them) are being depleted, some small businesses will struggle to regain their footing and corporate balance sheets (which had taken on increasing levels of debt during the low interest rate-fueled economic expansion) need to be strengthened. While some level of normalcy may return as we get closer to summer, the looming prospect of returning waves of COVID-19 infections (and lockdowns) will almost certainly make both consumers and businesses extremely careful in their spending decisions. Given the likelihood the current environment further widens income inequality and threatens access to affordable health care, we would not be surprised to see meaningful political ramifications in the coming years, which introduces additional uncertainty regarding the shape of corporate profit recovery.

While crises naturally pose threats, they also present opportunities. The world is now conducting business remotely—and more digitally—and we expect this trend to be sustainably boosted even once the current restrictions are lifted. We've spoken more than enough about Zoom in this letter, but there are other beneficiaries in the portfolio as well, including Veeva Systems (whose software supports remote engagement between pharma sales reps and doctors), Atlassian (whose cloud-based team collaboration tools are even more necessary to empower a distributed workforce) and Zscaler (whose modern cloud-based security platform is well suited for more virtual organizations). Social distancing is driving increased demand for digital entertainment services, which benefits our holdings in video games (Zynga, Take-Two Interactive), music streaming (Spotify) and network traffic management (Arista Networks). The team is also doing work to understand the potential for increased future spending on infectious disease preparedness, contactless payments technology and localized supply chains, which could benefit a number of current portfolio holdings. Finally, we also suspect that within retail and restaurants, a limited number of franchises with strong balance sheets, value-based offerings and strong digital capabilities could be positioned to gain market share coming out of this crisis. We include Chipotle Mexican Grill, Burlington Stores and Ollie's Bargain Outlet in this category.

We have been active throughout this crisis, adding to many of the beneficiaries mentioned above, but also to franchises whose profits should be relatively stable in the upcoming quarters and whose longer-term growth does not depend on a strong economic backdrop. Amid the market collapse, we saw compelling prices for even these more stable businesses and took advantage of the opportunities. We've also made some cautiously brave buys of franchises such as Chipotle, Burlington and Exact Sciences, whose businesses will be severely impacted in the short term, but which should begin to noticeably recover as we begin to emerge from the harshest of lockdowns.

Leveraged, cyclical businesses in areas such as travel, hospitality, retail, energy and credit-sensitive financials have bounced sharply in recent days as the markets have regained some ground. While we expected this to play out given the extreme price dislocations during the selloff, we have not been tempted to begin investment campaigns in these types of securities. In a surprisingly rapid economic rebound, this decision could serve as a headwind for our portfolio's relative performance. But given our view the recovery will likely be slow and profit-growth scarce, we believe beyond this initial bounce, investors will continue to pay a premium for businesses who are able to grow amid a challenging global economy.

Circumstances are highly uncertain and are changing daily—it is difficult to know what the next few months will look like. We are keeping a long-term perspective and thus are confident this crisis will pass. For investors with similar time horizons, history would suggest dislocations like this serve as potent starting points for future returns. We wish everyone well and appreciate your ongoing support and patience through good and bad times.

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Current and future portfolio holdings are subject to risk. 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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Our capital allocation process is designed to build position size according to our conviction. Portfolio holdings develop through three stages: Garden℠, Crop℠ and Harvest℠. Garden℠ 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℠ investments are holdings where we have gained conviction in the company's profit cycle, so positions are larger. Harvest℠ 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℠ investments are generally being reduced or sold from the portfolios.

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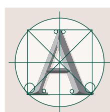
A R T I S A N  P A R T N E R S