



# Artisan Focus Fund

QUARTERLY  
Commentary

Investor Class: ARTTX | Advisor Class: APDXTX | Institutional Class: APHTX

As of 30 June 2024

## Investment Process

Our investment approach is based on idea generation, a systematic framework for analyzing companies and proactive risk management. Utilizing this approach, we seek to construct a focused portfolio designed to maximize alpha while limiting downside risk over the long term.

### Idea Generation

We believe a key element in alpha generation is finding areas where our views on industry fundamentals differ from consensus estimates. In this pursuit, we seek to identify inflections in multi-year trends which may be caused by changes in supply/demand dynamics, societal behavior, market conditions, technology, laws/regulations and business models, among other variables. We believe these inflections are often misunderstood by market participants, and can lead to powerful re-ratings of industries and companies. Identifying themes helps us develop a focused universe of companies to analyze more thoroughly.

### Systematic Analytical Framework

We apply a systematic framework for analyzing companies across sectors and themes, creating a repeatable and methodical decision-making process. Our proprietary company models focus on multi-year earnings power differentiation, expected outcome scenario analysis, return on invested capital and discounted cash flow valuations. Visual outputs are then produced through our internally developed technology solutions, allowing us to consistently evaluate positions across the portfolio.

### Proactive Risk Management

We incorporate risk management into all stages of our investment process. Metrics evaluated include crowding, correlation, volatility, stress tests, liquidity, factor analysis and macro drivers, all of which inform portfolio construction and position sizing. We also use various instruments, such as options, in an effort to magnify alpha and minimize downside.

## Team Overview

The investment team applies the same approach to idea generation and fundamental company analysis that Portfolio Manager Chris Smith has honed throughout his career. Research analysts are sector specialists with deep knowledge of their coverage areas. Our process blends a collaborative team mentality with individual accountability.

## Portfolio Management



Christopher Smith  
Portfolio Manager

## Investment Results (%)

As of 30 June 2024	Average Annual Total Returns						
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception
<b>Investor Class: ARTTX</b>	<b>3.86</b>	<b>20.33</b>	<b>24.60</b>	<b>5.64</b>	<b>12.76</b>	—	<b>17.32</b>
<b>Advisor Class: APDXTX</b>	<b>3.88</b>	<b>20.36</b>	<b>24.96</b>	<b>5.84</b>	<b>12.97</b>	—	<b>17.48</b>
<b>Institutional Class: APHTX</b>	<b>3.91</b>	<b>20.40</b>	<b>25.06</b>	<b>5.95</b>	<b>13.04</b>	—	<b>17.52</b>
S&P 500® Index	4.28	15.29	24.56	10.01	15.05	—	14.28

Source: Artisan Partners/S&P. Returns for periods less than one year are not annualized. Class inception: Investor (24 April 2017); Advisor (31 July 2018); Institutional (3 February 2020). 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	ARTTX	APDXTX	APHTX
Semi-Annual Report 31 Mar 2024 <sup>1</sup>	1.41	1.13	1.05
Prospectus 31 May 2024 <sup>2</sup>	1.31	1.13	1.04

<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. Performance reflects agreements to limit the Fund's expenses, which would reduce performance if not in effect. The Fund's investments in initial public offerings (IPOs) made a material contribution to performance. IPO investments may contribute significantly to a small portfolio's return, an effect that will generally decrease as assets grow. IPO investments may be unavailable in the future.



“Talent has a broad definition. Most of the time, it’s not about having a gift. It’s about having grit ... but in tennis, like in life, discipline is also a talent. And so is patience. Trusting yourself is a talent. Embracing the process, loving the process, is a talent.” —Roger Federer, Dartmouth 2024 Commencement Address

**Exhibit 1: Returns Since Inception Compared to Key Benchmarks**

Returns Since Inception	Cumulative	Annualized
Artisan Focus Fund (Investor Class)	215.09%	17.32%
S&P 500® Index	160.84%	14.28%
S&P 500® Equal Weight Index	107.32%	10.67%

Source: Antero Peak Group/S&P/Bloomberg. Past performance does not guarantee and is not a reliable indicator of future results. Returns greater than one year are annualized unless otherwise noted. Fund inception: 24 Apr 2017.

**Performance Review**

In Q2 2024, the Artisan Focus Fund (Investor Class) gained 3.86%, approximately in line with the S&P 500® Index’s return of 4.28%. Year-to-date, the Fund returned 20.33%, well ahead of the 15.29% return for the S&P 500® Index.

Performance for the quarter, like the year, was nicely balanced despite a further narrowing of the benchmark. In fact, market breadth, as measured by the percentage of stocks beating the S&P 500® Index on a rolling three-month basis, neared all-time lows in early June, close to the narrowest part of the tech bubble of 25% in late 1999. For us, our Transformation of the Enterprise (driven by semiconductors), Aerospace Normalization and Medical Innovations themes continued to generate good performance. On a sector basis, we saw a nice balance of contributors spanning tech, health care and consumer discretionary, among others, which is what we like to see.

We are excited about the remainder of the year and beyond. Our process continues to generate a deep opportunity set of scalable, inflecting themes, and internal competition for capital remains intense. The team is executing well as measured by modeling accuracy and keeping the pipeline rich (idea velocity).

**There Is No Perfection—There Is Only a Process and a Commitment to That Process**

Roger Federer is one of the most accomplished tennis players in the history of the sport. During his 24-year professional career, he accumulated 20 Grand Slam titles and held the No. 1 ranking in the world for a record-breaking 237 consecutive weeks. Known for his smooth and “effortless” style, Federer often didn’t look particularly tired or stressed during even the most pivotal points late in a championship match. He made it look easy. Yet, his accomplishments on the court are so vast, and were sustained for so long, that it’s clear they were supported by far more than just “talent.” There is simply something deeper within his mindset and overall process that differentiated him and enabled this kind of career to come to fruition.

On June 9, Federer was the commencement speaker at the Dartmouth graduation ceremony. His speech was beautifully delivered and resonated with us on multiple levels.

We marveled at his elegant portrayal of a simple concept that permeates our culture at the Antero Peak Group—striving to be the best with a humbleness and forward-looking mentality that thrives on grit, ongoing successes and failures with determination is key. Humility is essential to being a successful money manager, and the market has a way of proving to you relentlessly that there is no perfection. There is only a process and a commitment to that process.

During the speech Federer also stated:

*“In tennis, perfection is impossible ... In the 1,526 singles matches I played in my career, I won almost 80% of those matches. What percentage of the points do you think I won in those matches? Only 54%. In other words, even top-ranked tennis players win barely more than half of the points they play. When you’re playing a point, it is the most important thing in the world. But when it’s behind you, it’s behind you ... This mindset is really crucial, because it frees you to fully commit to the next point ... and the next one after that ... with intensity, clarity, and focus.”*

This hits home to us for multiple reasons.

First, over the years, we have written extensively to you all (here) about the mathematical need to focus on slugging percentage, or in this case, winning the “big” points in a match (which we view as an analogy to our large positions). This is a different approach than expecting to be “right” most of the time. There is empirical proof that ~50% is the most likely outcome for most stock pickers. Federer’s point that he only won 54% of the total points played, yet 80% of his matches, is a real life parallel to a reality that we have fully embraced at the Antero Peak Group. We should expect to be wrong, a lot, and to be successful we need to recognize it and move on with “intensity, clarity, and focus.”

Second, we must have a culture that not only expects to lose some points but expects us to learn from them objectively, get better and move forward. A culture of intellectual honesty. There is no room for excuses in our culture; there is only the reality of the results and a focus on the next day.

This idea is relevant today. Recently, several well-known, prominent investors have claimed that the stock market is “fundamentally broken,” citing a variety of reasons that mostly center on passive flows altering index composition, market concentration making fundamental analysis less effective, and a lack of recognition of “value” in optically low-priced securities. Although these dynamics have proven challenging, from our vantage point the actual reason many are struggling today is that they are failing in the most basic duties of an active manager—getting the fundamental work right.

This lack of accountability, we believe, stands in contrast to the mindset that carried Roger Federer to one of the greatest tennis careers of all time. It also stands in contrast to the culture we aim to create at the Antero Peak Group—full accountability and intellectual honesty.

### Economic Value Is Still in Driver's Seat

Here are the facts: Index composition mostly mirrors earnings contribution. This trend is consistent over time. The stocks that sit at the top of the indices have largely earned this through higher earnings, expanding returns on capital and consistent economic value generation. Deservingly, these kinds of companies have been rewarded with higher valuations.

This arrangement is not a result of style factor considerations, passive versus active flows or a lack of appreciation by the market of what is good "value" and what isn't. It is about economic value and earnings.

Exhibit 2 depicts the market capitalization and earnings weighting of the top 10 members of the S&P 500® Index and displays a relatively consistent ratio over the last 10 years.

**Exhibit 2: 10 Largest S&P 500® Index Members' Earnings and Market Cap Weighting Comparison**

10 Largest Stocks in the S&P 500® Index			
End of Q2	Market Cap Weight	Earnings Weight	Ratio of MC/Earnings
2017	19%	16%	1.2X
2020	26%	20%	1.3X
2022	27%	18%	1.5X
2024	35%	25%	1.4X

Source: Antero Peak Group/S&P/Bloomberg. As of 30 Jun 2024.

While the ratio of market cap to earnings has seen some mild expansion, it is important to note that the quality of the composition has steadily increased.

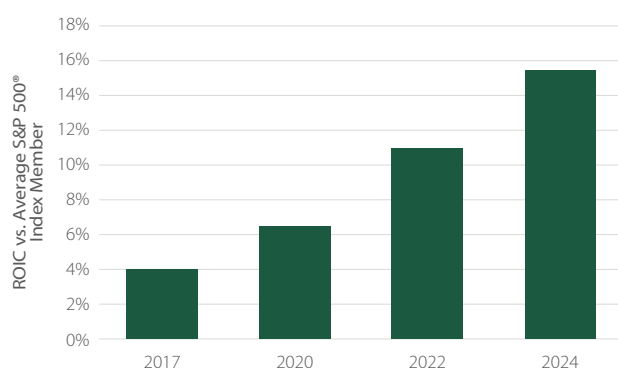
**Exhibit 3: Estimated ROE and ROIC for the 10 Largest S&P 500® Index Members**

10 Largest Stocks in the S&P 500® Index			
End of Q2	Median ROE	Median ROIC	ROIC vs. Average S&P 500® Index Member
2017	15%	14%	4%
2020	22%	17%	7%
2022	30%	22%	11%
2024	33%	27%	16%

Source: Antero Peak Group/S&P/Bloomberg. As of 30 Jun 2024.

The ROIC of the 10 largest members has expanded materially in the last 10 years while the average ROIC of the S&P 500® Index constituent has only mildly expanded. These large companies also appear to have heavily discounted real weighted average costs of capital given their enormous internal cash generation capabilities, high-quality financials and relatively low economic cyclicality. What this means is that the 10 largest companies are currently creating an exceptionally high quantity of economic value versus history, and this is occurring at an accelerating rate versus the average company in the benchmark.

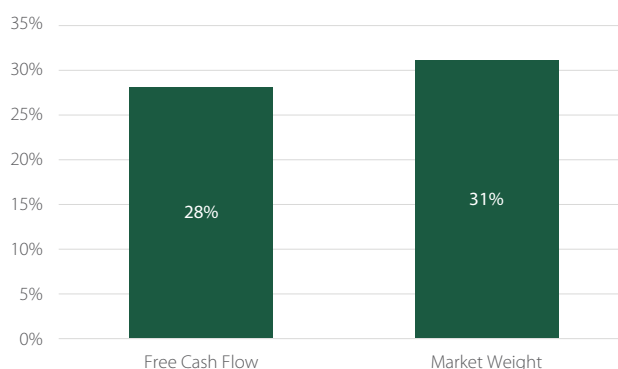
**Exhibit 4: The 10 Largest Members of the S&P 500® Index Are Generating Higher ROICs Over Time vs. the Average Member**



Source: Antero Peak Group/S&P/Bloomberg. As of 30 Jun 2024.

The great thing about cash is that it doesn't lie, given that cash flow statements are not subject to the kind of adjustments income statements are. It's a transparent part of the reporting process—there is the cash at the beginning of the quarter and the cash at the end. Big Tech represents 31% of the index and, probably not coincidentally, represents approximately 28% of the free cash flow expected to be generated by the index in Q2 2024.

**Exhibit 5: Expected Free Cash Flow Contribution of Big Tech This Quarter Is Very Similar to Its Weighting in the S&P 500® Index**



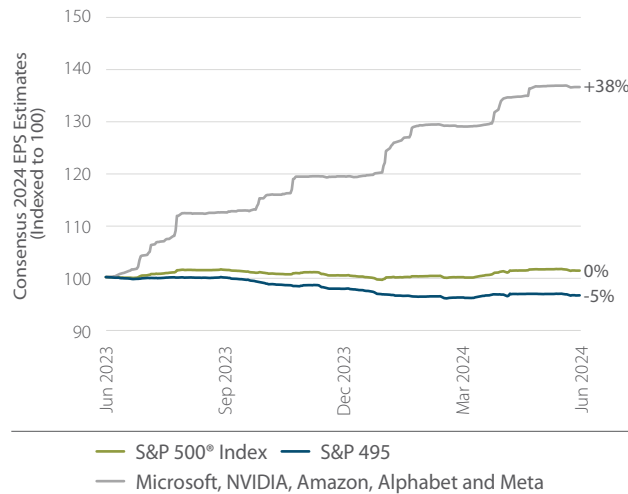
Source: Antero Peak Group/S&P/Bloomberg. As of 30 Jun 2024. "Big Tech" includes Apple, Microsoft, NVIDIA, Alphabet, Meta and Amazon.

To be successful in beating the benchmark, we believe one must recognize a couple of things. First, this expansion of concentration is correct. Sure, it may overshoot or undershoot at times, but it mostly follows fundamentals. Second, the likely reality is that this trend may continue to expand further. The largest companies in the benchmark are simply of exceptionally high quality as measured by capital

intensity, barriers to entry, cash flow, growth and overall economic cyclical when compared to the average company in the index.

This pattern is also visible during shorter time frames and through a simple earnings revisions analysis. The chart below depicts the change in 2024 consensus estimates for the largest five members of the S&P 500® Index as the end of Q2 as compared to the rest of the index constituents. The market is narrow in 2024, which can make our job harder, but shouldn't it be?

**Exhibit 6 : Year-to-Date Change in Estimate Revisions for the Top 5 Members of the S&P 500® Index vs. the Other 495 Members**



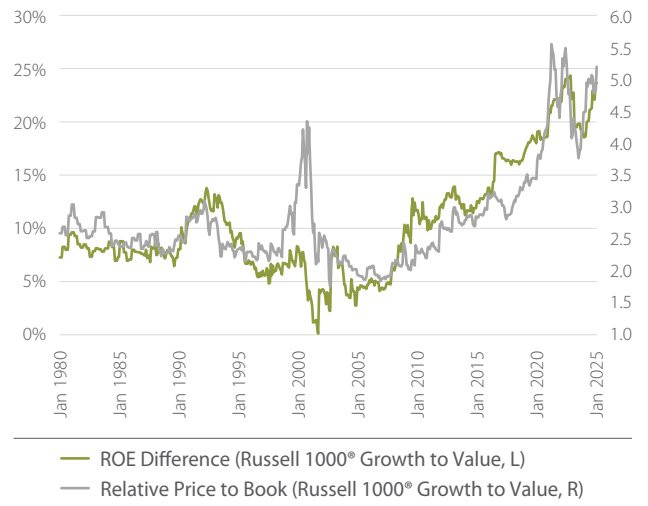
Source: Antero Peak Group/S&P/Bloomberg/MYST Advisors. As of 30 Jun 2024. The S&P 495 represents the S&P 500® Index excluding Microsoft, NVIDIA, Amazon, Alphabet and Meta.

### Understanding the Flows Argument

One of the arguments we have heard as to why the market is wrong revolves around a circularity of flows that is punishing value investors. The argument goes like this: As capital flows from active to passive strategies, “value-focused” managers face redemptions, leading to the sale of holdings and subsequent declines in value stocks. This, in turn, exacerbates the trend of “overvalued” assets gaining disproportionate weight in passive indices, perpetuating a cycle where stock prices diverge from their intrinsic values. The managers who are performing well are those who own the “overvalued” stocks that are getting flows from the indices. As a result, stocks have been diverging, rather than converging to their intrinsic values. In other words, the game isn't fair.

While these are not irrationally connected dots, the conclusion is observably wrong, in our view. The returns on capital of the members of growth indices are simply growing much higher than the returns on capital of members of value indices. That is, members of these growth indices have been creating more economic value at a relatively accelerated rate. That is why, in our view, growth has outperformed its value counterpart. Exhibit 7 depicts the relative value creation of growth and value indices, indicating an appropriate current status—nothing remotely close to the bubble of the early 2000s.

**Exhibit 7: Relative Value Creation of Growth and Value Indices**



Source: Antero Peak Group/Russell/Bloomberg/Piper Sandler. As of 30 Jun 2024.

Considering this from a different angle, the valuation of the biggest growth stocks is not extreme, nor even really stretched. Despite their significant weight in passive indices, the six big tech giants (Microsoft, Apple, NVIDIA, Amazon, Meta, Alphabet) maintain forward P/E and EV/EBITDA ratios within what we would call “reasonable” bounds. This directly undermines the assertion that passive flows indiscriminately inflate the valuations of large-cap stocks, highlighting the importance of fundamental analysis when assessing market trends. The following exhibits look at valuation multiples (historical and relative to the S&P 500® Index) of the six big tech companies as one index and, in our view, do not show an extreme valuation of any sort. In fact, it suggests a relative de-rating, i.e., the other 494 stocks have hung in maybe better than they should have.

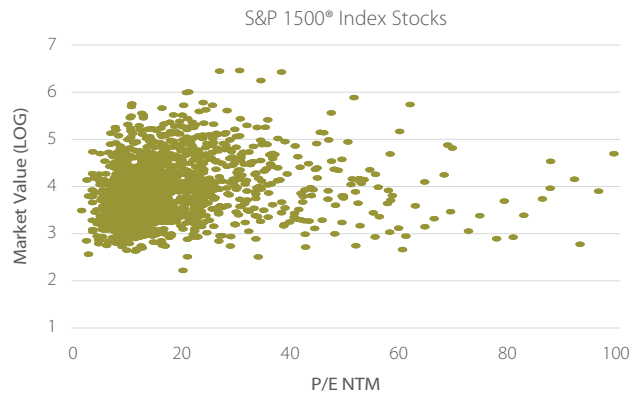
**Exhibit 8: Big Tech's P/E vs. the S&P 500® Index Has De-Rated**



Source: Antero Peak Group/S&P/Bloomberg. As of 30 Jun 2024. “Big Tech” includes Apple, Microsoft, NVIDIA, Alphabet, Meta and Amazon.

Another way to think about this is that there does not appear to be a relationship between size and valuation. If those arguing the market is “broken” were right, and that passive flows disproportionately benefit overvalued companies and the reinforcing loop, we should see a relationship. However, a comprehensive analysis of the S&P 1500® Index shows that no clear correlation between company size and valuation exists. Both large- and small-cap companies within this broad index exhibit a wide range of price-to-earnings ratios, indicating that passive flows are likely not to be the primary driver of overvaluation. There is no evidence of bias.

**Exhibit 9: No Clear Relationship Exists Between Market Value and P/E Ratio in US Market**



Source: Antero Peak Group/S&P/Piper Sandler. As of 30 Jun 2024. The S&P 1500® Index combines the S&P 500® Index, the S&P MidCap 400® Index and the S&P SmallCap 600® Index to cover approximately 90% of US market cap.

### The State of Value Investing

We also believe the concepts of “growth investing” and “value investing” have been confused from their original meaning. “Growth” stocks have indeed done better than “value” stocks, but we find this framework of thinking is too casual and simplistic.

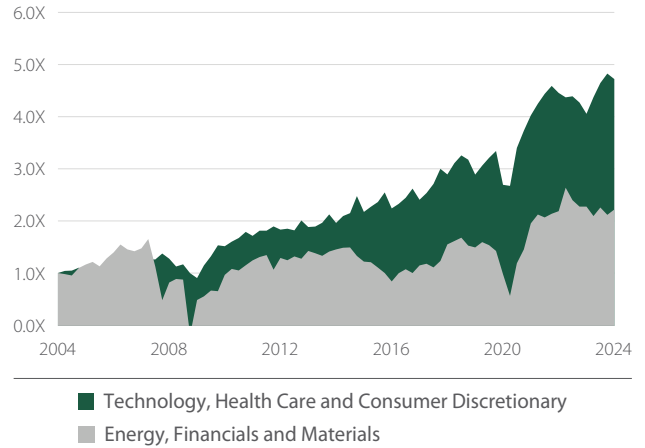
Value investing has become something far different from what Benjamin Graham laid out in his famous book “The Intelligent Investor” in 1949. This book focused on analyzing mostly businesses with a high visibility of cash flows (e.g., utilities and railroads) that accompanied the intrinsic value of hard assets that were necessary for the economy. Graham preached capitalizing on the equity portion of the capital structure when there were deep discounts to what was essentially a known cash or replacement value.

Today, however, we think the approach has devolved into mostly observing a relatively low P/E determining an equity is cheap, and the market has made a mistake. This is often followed by a backfill of short-term analysis that doesn’t contemplate future economic value generation. This is inherently a complacent conclusion, implying the collective market is “wrong” and inefficient and these equities are simply mispriced. This is not to say that equities are never mispriced, but mispricings, in our view, are only crystalized by a differentiated view of the future that eventually comes into focus, and not an observation of the present and past.

We strongly believe the market is very good at pricing securities with factual, current information. This is yet another reason why nearly all investors are right about half the time. As such, it has priced industries like energy, materials, auto manufacturers and financials at very low multiples of adjusted earnings. This is not because the market is

“broken” and flows are distorting intrinsic value; this is because these industries typically destroy immense amounts of capital by generating returns on capital below the cost of capital. They also typically contain often ignored gaping holes in a discounted cash flow analysis, i.e., periods of time that contain substantially negative free cash flows in downcycles. Yet somehow, because of their cheap P/E ratios, this is considered “value,” and these industries populate value ETFs and portfolios and are often the focus of value investors. These do not seem like a good deal to us, and Exhibit 10 explains why the market has agreed.

**Exhibit 10: Indexed Earnings of Value vs. Growth Sectors**



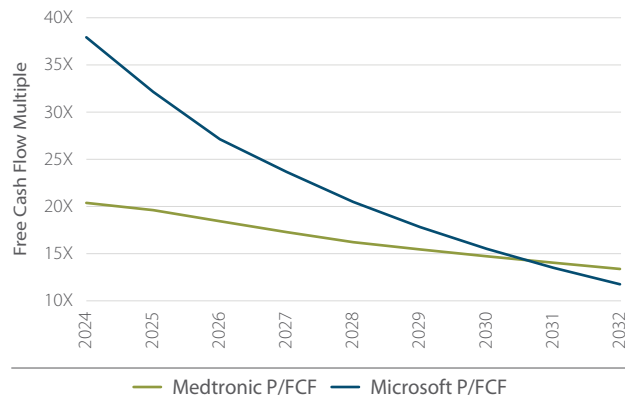
Source: Antero Peak Group/S&P/Bloomberg/DB Global Asset Management. As of 30 Jun 2024.

We think paradoxically, value investing for some has become short-term investing. This dynamic represents an inability to look far enough outward and a lack of appreciation for the compounding power of economic value creation.

This idea can be easily demonstrated by comparing a handpicked growth stock with a deeply cyclical value stock. However, let’s consider an example of something more subtle. An optically inexpensive stock today is Medtronic (MDT), the largest medical device company in the world. The stock trades at just 15X EPS, a ~30% discount to the S&P 500® Index, and universally is considered “cheap” by medical device analysts. On the other hand, Microsoft (MSFT) trades at 37X next twelve months’ earnings, and its valuation is debated as a growth stock. Microsoft’s P/E is ~2.5X that of Medtronic’s—we ask the question which stock is cheaper? We argue the answer is Microsoft.

The ability to see can only be recognized by looking out into the future. Exhibit 11 uses consensus estimates to display that rapid rate at which these valuations converge.

**Exhibit 11: Microsoft vs. Medtronic Price/Free Cash Flow (P/FCF) Convergence Rate**



Source: Antero Peak Group/Bloomberg/Goldman, Sachs & Co. As of 30 Jun 2024.

Because of the differences in their rates of growth, quality of earnings and free cash flow, the valuations of the two companies converge rapidly. Based on consensus estimates, Medtronic would become more expensive than Microsoft within just six years. But differentiation is key—we believe that Microsoft is highly likely to beat estimates, while Medtronic is likely to at best achieve consensus estimates. In our view, Microsoft's valuation will cross Medtronic's within approximately four years. At the end of the four years, Microsoft shareholders would own shares in a company with a sustainable EPS growth rate of at least 3X the rate of Medtronic and at least double the terminal growth rate. In addition, Medtronic's ROIC fails to achieve its weighted average cost of capital (WACC), so while we wait for these valuations to cross, the company will be destroying value. Meanwhile, Microsoft will be continually reinvesting capital at an ROIC that exceeds its WACC by more than 20%.

#### What This Means for Us

If the prior discussion revealed anything, it is that fundamentals matter, and finding companies with improving business models and inflection profits helps create alpha. It doesn't matter if they are "value" or "growth" companies, at the top of the index benefiting from flows or at the bottom and illiquid—active management works if you get the fundamentals right. The game may be hard, but it has not changed.

As proof, we looked back over the last 10 years and asked the question: What would returns be if we could follow our investment process perfectly—finding all the S&P 500® Index constituents that were beating estimates, outgrowing the market and posting accelerating results? The results were compelling, even during a period when passive flows consistently outpaced active.

Obviously, this is analyzed with impossibly perfect hindsight, but the point is made: Our process based on beats, acceleration and outgrowth has merit. For this reason, and the fact that we have been able to generate ~300bps of annualized alpha since our inception 7+ years ago, we have confidence going forward.

As we are trusted stewards of your capital, intellectual honesty is very important to us, and something all managers should provide you with. In that light, the competition, in our view, remains the same—our process works, the market is not broken, and it remains our job to beat it.

Thank you for your continued trust and partnership.

Lastly, as always, the team reads to further develop our perspectives. This quarter we enjoyed "What is ChatGPT Doing ... and Why Does It Work?"

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#### ARTISAN CANVAS

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This commentary represents the views of the manager as of 30 Jun 2024 and do not necessarily represent those of Artisan Partners. The views and opinions expressed are based on current market conditions, which will fluctuate and those views are subject to change without notice. While the information contained herein is believed to be reliable, there is no guarantee to the accuracy or completeness of any statement in the discussion. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

For the purpose of determining the Fund's holdings, exposures are delta-adjusted at the issuer level and may include multiple securities of the same issuer. The holdings mentioned above comprise the following percentages of the portfolio net assets as of 30 Jun 2024: Microsoft Corp 9.8%, NVIDIA Corp 6.0%, Amazon.com Inc 3.8%, Apple Inc 3.2%. 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.

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**Return on Invested Capital (ROIC)** is a measure of how well a company generates cash flow relative to capital invested in the business. **Discounted cash flow (DCF)** is a valuation method used to estimate the value of an investment based on its expected future cash flows. **Slugging Rate** measures the ratio of average gains on profitable investments versus the average losses on non-profitable investments. **Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)** is an indicator of a company's financial performance which is calculated by looking at earnings before the deduction of interest expenses, taxes, depreciation and amortization. **Earnings per Share (EPS)** is the portion of a company's profit allocated to each outstanding share of common stock. **Enterprise Value to Earnings Before Interest, Taxes, Depreciation and Amortization (EV/EBITDA)** is a measure of the intrinsic value of a business. EV is calculated as the market capitalization of the company plus its long-term debt. EBITDA is an approximate measure of a company's operating cash flow based on data from the company's income statement. It is calculated by looking at earnings before the deduction of interest expenses, taxes, depreciation, and amortization. **Enterprise Value (EV)** is a measure of a company's 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%. **Return on Equity (ROE)** is a profitability ratio that measures the amount of net income returned as a percentage of shareholders' equity. **Correlation** is a statistical measure of how two securities move in relation to each other. A perfect positive correlation is represented by the value +1.00, while 0.00 indicates no correlation and -1.00 indicates a perfect negative correlation. **Free Cash Flow** is a measure of financial performance calculated as operating cash flow minus capital expenditures. **Price-to-Book (P/B) Ratio** is a valuation measure used to compare a stock's market value to its book value. **Price-to-Earnings (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings. **Weighted Average Cost of Capital (WACC)** represents a company's average after tax cost of capital from all sources, including common stock, preferred stock, bonds and other forms of debt.

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