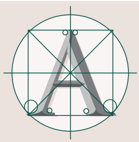


Artisan International Value Strategy

QUARTERLY
Commentary

As of 30 September 2020

Investment Process

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

Undervaluation

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

Business Quality

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

Financial Strength

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

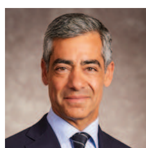
Shareholder-Oriented Management

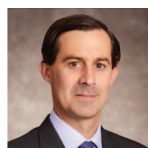
Our research process attempts to identify management teams with a history of building value for shareholders.

Team Overview

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

Portfolio Management


N. David Samra
Portfolio Manager (Lead)


Ian P. McGonigle, CFA
Co-Portfolio Manager

Joseph Vari
Co-Portfolio Manager

Investment Results (% USD)

As of 30 September 2020	QTD	YTD	Average Annual Total Returns 1 Yr	3 Yr	5 Yr	10 Yr	Inception[1]
Composite — Gross	**5.37**	**-10.15**	**-1.53**	**-0.27**	**5.96**	**8.26**	**10.73**
Composite — Net	**5.13**	**-10.79**	**-2.44**	**-1.19**	**4.98**	**7.26**	**9.70**
MSCI EAFE Index	4.80	-7.09	0.49	0.62	5.26	4.61	5.57
MSCI All Country World ex USA Index	6.25	-5.44	3.00	1.16	6.22	4.00	6.18

Annual Returns (% USD) 12 months ended 30 September

	2016	2017	2018	2019	2020
Composite — Gross	**10.52**	**21.84**	**-0.83**	**1.59**	**-1.53**

Source: Artisan Partners/MSCI. Returns for periods less than one year are not annualized. [1]Composite inception: 1 July 2002.

Past performance does not guarantee and is not a reliable indicator of future results. Current performance may be lower or higher than the performance shown. Composite performance has been presented in both gross and net of investment management fees.

Investment Risks: Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal. These risks, among others, are further described near the back of this document, which should be read in conjunction with this material.

Market Discussion

Global stock markets have now recovered from the pandemic-induced chaos of the first quarter. The world index is up over 1% year to date. The returns are not, however, consistent across geography. The US equity market has performed very well, up nearly 6%, while international developed country stock markets and emerging markets indices are down. In local currency, the MSCI Emerging Markets Index is up modestly YTD, led mainly by China and Korea, but currency devaluation has been significant, resulting in negative US dollar-based returns. The Japanese stock market is about flat in dollar terms. The real drag has been Europe. European stock markets in local currency are down 11%-12%, though US dollar-based returns are a bit better. The UK stock market year to date in British pounds is down 22%.

The divergence is significant. A big reason is the technology boom in Silicon Valley and China supports economic growth, whereas the European and Japanese economies rely more on tourism and trade, both of which have been severely impacted by the pandemic. In addition, Europe initially implemented more stringent lockdowns once the pandemic hit, which has held back economic growth. Exacerbating the issue in Europe is the fact that interest rates going into the crisis were already negative. Hence the ECB had no ability to stimulate the economy through lower rates (perhaps something for the US Fed to ponder).

The ECB has injected liquidity into European capital markets with a more than €1 trillion bond-buying program. But that pales in comparison to the $3 trillion pumped into the capital markets by the US Federal Reserve. Europe has also done less on stimulus. The US government stimulus has amounted to 13% of GDP, while European governments have spent closer to 4% of GDP. Interestingly, Japan has spent an enormous 21% of GDP on stimulus, plus another $900 billion of bond and equity buying by the BOJ. Yet, true to historical form, all that spending has not helped Japan's economy much. These liquidity programs have impacted fiat currencies, with gold up 24% YTD in US dollars.

Much of Asia, which has dealt with several meaningful viruses in the last couple decades (e.g., H1N1, SARS, Avian flu, etc.), has done a better job handling this virus. On the other hand, the number of COVID-related deaths in the euro zone rivals the number in the US, so it is not clear the stringent lockdowns created significant benefits. Nonetheless, the pandemic has had a stultifying impact globally. Based on consensus forecasts, China's economy is expected to grow just under 2% in 2020, while the US's should shrink nearly 4%, Japan's 6%, Europe's 8% and the UK's 10%. These remarkably large economic contractions stand in sharp contrast to positive stock market returns.

Portfolio Discussion

The portfolio's performance during Q3 was driven by two market trends: technology's outperformance and energy's underperformance. The three best performing portfolio stocks were technology companies, including HCL Technologies, Samsung Electronics and Alibaba. The portfolio's worst performing stocks were in the oil and gas industry, including Imperial Oil, Schlumberger and Suncor Energy.

HCL Technologies is an India-based IT consultant operating in three main areas: infrastructure outsourcing, research and development (R&D) services and software. Infrastructure outsourcing is the provision of data center-monitoring services to large corporate customers. The R&D division provides low-cost, highly technical engineering services to help customers drive efficiency in their research efforts. The software business is relatively new to HCL. Over the last few years, HCL has purchased, at very low valuations, mature and under-invested software packages from old-line software companies such as IBM. The strategy is modernizing the software while maintaining or growing the customer base. This is a complex company, and the trends in each of these underlying businesses are equally complex.

We purchased shares of HCL several years ago at a heavily discounted valuation during a period of falling growth in the company's infrastructure business. The slowdown was due to both cyclical and secular factors. The cyclical aspects included a US hiatus in outsourcing and stricter US immigration rules following President Trump's election. The secular challenge resulted from the growth and scale of cloud solutions from companies like Amazon and Microsoft. Many companies with existing infrastructure paused plans to operate their own data centers while formulating a strategy to potentially incorporate cloud-based services. At the same time, HCL embarked on its software strategy, which was complicated, opaque and unproven. But the company fit our profile of a good business with high returns, a strong balance sheet, high insider ownership and a good management track record. In addition, the company had, and still has, the ability to grow. And the shares were cheap, trading at a low-teens P/E.

For the last couple years, management's efforts to integrate acquisitions, upgrade software, manage new contracts and wait for infrastructure outsourcing to resume have largely gone unnoticed by the stock market. However, after two strong consecutive earnings reports amid the pandemic, the stock market took notice. In the third quarter, the share price rose 49%.

Samsung Electronics, the portfolio's largest investment, is one of the world's largest technology hardware businesses, with strong market positions in memory chips, foundry services, high-end handsets and consumer electronics. Samsung stands out as an outlier in what is mainly an expensive technology market. All of Samsung's businesses are growing, the company has an enormously overcapitalized balance sheet, and it is extraordinarily cheap. Although no meaningful fundamental information came out in the quarter, the share price rose 14%.

Alibaba, China's dominant e-commerce company, is a relatively new investment. We purchased shares during the Q1 market selloff. Our fundamental thesis was and remains that the company's core e-

commerce business is undervalued when other valuable investments are considered, including Ali Cloud and Ant Technologies. During the recent quarter, Ant Technologies announced plans for an initial public offering at a valuation that exceeds our conservative estimates. Further, in a recent capital markets presentation, Ali Cloud's management discussed its prospects. Unveiling the value of these two assets highlights the undervaluation of the core e-commerce business. The share price appreciated 36% during the quarter.

In sharp contrast to technology companies' share prices, those of energy companies continued drifting down, though not much fundamentally changed during the quarter. At the onset of the pandemic, demand from the industry's largest segment, on-road vehicles, collapsed. Oil prices fell briefly below zero but have since recovered and are trading around $40 per barrel.

Suncor and Imperial Oil operate upstream oil sands mining businesses in Alberta, Canada and downstream refining businesses. The upstream business is dependent on the oil price, while the downstream business depends on refined fuels demand, which has seen some modest improvement as economies slowly reopen. While both companies' share prices declined about 25% during the quarter, we believe negative sentiment was the main driver, rather than any meaningful change in fundamentals.

Schlumberger is the world's largest oil services company. The demand for oil services follows the trend in oil and gas production. As a proxy for oil and gas activity, we can look at rig count—a global count of drilling rigs used to extract oil and gas. Since the pandemic's onset, global rig count is down about 50%. This hurts Schlumberger's profit stream as it has fewer wells to service. This cyclical decline in drilling activity pushed the stock price down to attractive levels in the first quarter, when we purchased shares. The share price rallied significantly in the second quarter. But third-quarter sentiment has been negative as rig count has continued drifting down. The share price fell 15% in Q3. We purchased more shares of Schlumberger as we are encouraged by both the low valuation and the CEO's recent, sizeable stock purchases.

Over the long term, the decline in rig count is actually very good for Schlumberger. The longer the oil price remains below the marginal cost of production ($40 is well below the marginal cost of production), exploration and production companies will start fewer new oil wells and will maintain fewer still. As oil wells deplete, production will fall. As production falls below demand, or as wells simply age, two things happen. First, Schlumberger's smaller and financially weaker competitors will be forced to cut back capacity or exit the business, eventually leading to better pricing and stronger market share for Schlumberger. Second, the longer investment is delayed, the larger the investment required to restore production once demand returns.

We estimate that Schlumberger will remain profitable in this downturn, and that operating profit will double over the next few years. That should happen as the company cuts costs and demand returns. Once rig count starts to increase, we believe Schlumberger's profits will normalize at a cheap valuation of less than 10X earnings.

We made few changes to the securities owned in the portfolio. We sold all the shares of Sony as they appreciated to fair value. We also sold the small position in Wood Group and invested the proceeds in Schlumberger.

The Dog Days of COVID-19

The world has never been a better place for people's best friend. A Nielsen survey found that 20% of US respondents adopted dogs and cats between March and June, up about 5% from the year before. Naturally, sales of pet products are booming, including doggy diapers, pet food, veterinary visits and dog leashes. As the owner of a home on a popular dog-walking street, I can tell you first-hand how much poop malfeasance has increased.

The obvious reason for this canine boom is that COVID-19, and government reactions to it, has forced behavioral changes on all of us. People suddenly have time to take care of a pet, and they want companionship. Yet it's easy to imagine cases of adoption-regret once out-of-home options become more available and popular.

Which begs the question: Will all this forced behavioral change stick? That is a key question the world and the markets are grappling with. Behavioral psychologists will tell you most people don't change their ways easily. People have a tendency toward stability, and life forces tend to entrench routines. Small behavioral changes do well, but people often backslide from major changes in daily life; many habits are deeply ingrained. But COVID has challenged this accepted norm, as most people have been forced to stay at home, not travel, wear a mask, cook, do as much as possible online.

These changes are easily identifiable in the earnings reports of the pandemic winners and losers. The winners sell to the online and stay-at-home trends—they comprise the work-from-home (WFH) ETFs that are rapidly proliferating, adding passive dollars to the already meaningful momentum driving their valuations up. The losers provide services people used to love or need but that are no longer reasonably accessible. Needless to say, there aren't any back-to-work (BTW) ETFs—yet.

Because of a huge divergence in valuations, our investment dollars lean toward the losers. The stock market is assigning big multiples to growth stocks benefiting from forced behavioral change and discounted valuations to those companies that are not. Let's look at two examples: Ryanair and Peloton.

Ryanair is Europe's largest airline in terms of passengers, is its lowest cost carrier, and charges Europe's lowest fares. The company has a strong balance sheet, operating scale and the industry's most experienced and economically driven management team. We believe Ryanair is a COVID winner, yet the stock market values it as if it were a COVID loser.

How might it be a loser? Clearly, forced behavioral change due to the virus keeps people from traveling. As a result, profits have disappeared, and the business economics are unlikely to return in force until there is a COVID solution.

How might it be a COVID winner? The airline industry is a tough business characterized by high capital costs, unionized labor, subsidized national champions, volatile energy prices and competition based on marginal pricing. Most airlines earn terrible returns. But not Ryanair. Over the last 15 years, the company has earned an average return on invested capital of 20%. As a result, companies focused on cost or with other advantages (such as state subsidies) have taken market share. Since 2004, the top five airlines in Europe have increased market share from 38% to 62%. And while 62% looks consolidated, we note that in the US, the top 5 carriers held market share of 86% as of 2018. The greater competition in Europe results in lower prices and lower margins. Prior to COVID, European air fares were low, and low-cost carriers were growing capacity to drive consolidation. Market-share gains were a slog. And though most commentators believed consolidation would happen, many thought it would take 10 years. So did we.

But here is what Ryanair CEO Michael O'Leary had to say about it back in 2019:

"Frankly, if we're in a period where there's going to be attrition of fare wars for a year or two, that's good for Ryanair's business because ultimately we have the lowest cost base and we have the lowest prices. We would fill our planes as we're doing now. The profits will suffer for a year or two and I think that's what our shareholders should expect. However, it is clear in my mind that within the next four to five years, you are seeing the emergence of four or five large European airline groups led by Ryanair as the biggest, Lufthansa, BA-IAG, Air France-KLM and then question mark over whether easyJet will survive as an independent carrier or not. I think on balance, they probably will. Then most of the others from Wizz, Norwegian, Alitalia, TAP Air Portugal will, I think, over the next number of years either merge with or be acquired by one or other of those groups. And I think at that point in time, you will see Europe emerge in much the same way North America has in recent years, four or five strong airline groups, much more capacity discipline, although there will be capacity growth but at a slower rate than heretofore and some upward pricing—upward pressure on pricing because, frankly, the rate—the level of airfares in Europe are typically about 25% of the level of airfares being charged in North America at the moment. Now I don't think the airfares in Europe will get to the North America levels, but they will certainly begin to rise again because they are artificially low at the moment."

O'Leary believed it would take five years. We didn't accept that at the time, but as a result of the pandemic, we do now. The pandemic has wreaked havoc on the industry, accelerating the pace of consolidation. Lufthansa has announced the closure of its low-cost carrier; low-cost competitor easyJet is shrinking its fleet of aircraft; Air France is effectively bankrupt as is Alitalia. (It's worth noting Air France, Alitalia and Lufthansa are supported by unsustainable government subsidies in exchange for employment guarantees.) Norwegian airlines and Finnair are returning to their roots in Scandinavia. As a result, we believe Ryanair will both gain market share and have better control over pricing once the pandemic subsides.

So what is Ryanair's valuation? Well, like Peloton, it's currently unprofitable. But looking out to March 2023, consensus forecasts have Ryanair earning €1.4 billion in net income—an earnings yield of 10.7% on a market cap of €13.1 billion. That's pretty cheap for a strong business that will still have room to grow beyond 2023.

Peloton, by contrast, has traded and is valued like a COVID winner. The company's competition, like SoulCycle and gyms across the country, has been mostly shut down for months now. And people are stuck with otherwise sedentary lives at home. Peloton sells spin bikes and treadmills, along with a great app that provides fitness video instruction. The product and instructors are excellent but not cheap: $39 per month for the app and $49 per month for the bike; or you can buy the bike for $1,895. Prior to the pandemic, the company was struggling to penetrate the market. From Q2 2019 through fiscal Q1 2020, Peloton's revenue actually declined. But since COVID, the company's business and prospects have rocketed. In the June quarter of 2020, year-over-year subscriptions and revenue growth jumped 113% and 172%, respectively. Note also in that quarter, the company reported its first net profit. Management has guided that subscribers and revenue should double in the coming year. The stock is up 250% this year through Q3 with a market cap of some $32 billion. It has been a great stock. But will it stick?

A few sell-side firms forecast the company should generate $6.5 billion to $7.5 billion of revenue by June 2023. Projections for the bottom line are all over the place, from a loss of $140 million to a net profit of $600 million. So the forward earnings yield is between -44bps and 190bps—a pittance relative to Ryanair's aforementioned earnings yield in the same year. By then, one report says, the company will have sold 10.4 million units (bikes and treadmills) and will have 5.7 million subscribers. There are 64 million gym memberships in the United States (pre-COVID), so less than 10% share seems reasonable. The hard part is that gym memberships have a high attrition rate (25%-30% per year), about 60% go unused, and 82% of members only go once a week. Once the pandemic recedes, might people decide to go back to their yoga studio instead of spending money on the Peloton app and bike? Or go out to dinner? Also, the market for gym memberships, exercise studios, exercise equipment or just exercise (buy a pair of sneakers and run) is fragmented with low barriers to entry. Like the airline industry, this has historically been a tough business.

We wonder if behavior might revert to something closer to where it was prior to COVID. Will people "like" SoulCycle again? Peloton management wonders as well. From its recently filed K-1:

"There is no assurance that we will continue to experience an increase in demand for our products and services or that our current subscribers will continue to use our platform after the COVID-19 pandemic has tapered. We may see a decline in subscribers when shelter-in-place measures are relaxed, and gyms and fitness studios reopen."

I would note that this passage is not in the risk section.

In late July, McKinsey published a report discussing how new experiences delight consumers: "The US online fitness market has seen approximately 50% growth in its consumer base since February 2020; the market for digital home-exercise machines has grown by 20%. It's likely that many people who tried those fitness activities for the first time during the pandemic believed that at-home exercise couldn't meet their exercise needs. That belief has clearly changed for many of these consumers: 55% who tried online fitness programs and 65% who tried digital exercise machines say they will continue to use them, even after fitness centers and gyms reopen."

The last line presents the challenge. Could 35%-45% of the subscriber base decide they want to go back to the gym, back to the swimming pool, or back to their cycling teams? What would happen to the stock price if Peloton fails to meet growth expectations? Well, prior to the pandemic the stock was trading at 7X revenue, a lofty multiple for a company with a 14% operating margin in its best quarter. If this year's forecast revenue were to backtrack by 30% and the valuation retreated to 7X, the market cap would fall from $32 billion to $18 billion.

Evidence already suggests this forced behavioral change won't last as things reopen. Just look to China, where domestic air travel has almost recovered to pre-pandemic levels, and news reports show big crowds again at restaurants and movie theaters.

We also looked for some historical context. World War II was a period with a lot of forced behavioral change. We found a report by two academics at the University of New Hampshire on the financial performance of aircraft manufacturers during World War II. That study concluded:

"We find that (1) aircraft stocks exhibited positive abnormal returns around events associated with defense buildups and outbreaks of hostile action and negative returns around events signaling an end to hostilities, (2) the companies' accounting returns improved during the war but these higher accounting returns did not translate into higher stock returns for the shareholders, and (3) investors could have earned higher stock returns had they switched out of aircraft stocks after Pearl Harbor and reinvested the proceeds in the overall market."

I believe we are well past the modern-day Pearl Harbor.

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Attribution is used to evaluate the investment management decisions which affected the portfolio's performance when compared to a benchmark index. Attribution is not exact, but should be considered an approximation of the relative contribution of each of the factors considered.

Contribution to Return includes the securities with the highest positive and negative contribution to the portfolio's return and is calculated by multiplying a security's portfolio weight by its in-portfolio return for the period. Purchases/sales are accounted for by using end of the day prices, which may or may not reflect the actual purchase/sale price realized by the portfolio. Contribution to return is not exact, but should be considered an approximation.

Net-of-fees composite returns were calculated using the highest model investment advisory fees applicable to portfolios within the composite. Fees may be higher for certain pooled vehicles and the composite may include accounts with performance-based fees. All performance results are net of commissions and transaction costs, and have been presented gross and net of investment advisory fees. Dividend income is recorded net of foreign withholding taxes on ex-dividend date or as soon after the ex-dividend date as the information becomes available to Artisan Partners. Interest income is recorded on the accrual basis. Performance results for the Index include reinvested dividends and are presented net of foreign withholding taxes but, unlike the portfolio's returns, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the indices.

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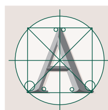
For Institutional Investors – Not for Onward Distribution

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

Artisan International Value Strategy

Quarterly Contribution to Return (% USD)

As of 30 September 2020

Top Contributors	Average Weight	Contribution to Return	Ending Weight
HCL Technologies Ltd	2.79	1.09	3.29
Samsung Electronics Co Ltd	6.73	0.85	7.11
Alibaba Group Holding Ltd	2.26	0.79	2.10
DSV PANALPINA A/S	2.57	0.75	2.62
ABB Ltd	5.35	0.74	5.14
NAVER Corp	4.43	0.64	4.28
Trip.com Group Ltd	2.37	0.45	2.64
Compass Group PLC	4.62	0.39	4.78
Bankia SA	0.95	0.28	1.00
Groupe Bruxelles Lambert SA	2.98	0.22	3.01
Cie Financiere Richemont SA	3.20	0.19	3.27
Baidu Inc	2.85	0.19	2.92
CRH PLC	2.29	0.18	2.16
NXP Semiconductors NV	1.76	0.17	1.69
Hella GmbH & Co KGaA	0.83	0.17	0.92
Ryanair Holdings PLC	1.55	0.15	1.86
Vivendi SA	1.61	0.14	1.64
IMI PLC	0.52	0.13	0.36
LafargeHolcim Ltd	2.51	0.11	2.45
Arch Capital Group Ltd	3.93	0.11	3.80
Willis Towers Watson PLC	1.41	0.09	1.43

Bottom Contributors	Average Weight	Contribution to Return	Ending Weight
Imperial Oil Ltd	1.58	-0.38	1.21
Schlumberger NV	2.34	-0.34	1.98
Suncor Energy Inc	1.21	-0.33	0.95
Tenaris SA	0.99	-0.25	0.88
Bharti Infratel Ltd	1.07	-0.22	0.97
Cash Holdings	8.47	-0.20	9.46
Telefonica Brasil SA	1.83	-0.19	1.56
Lloyds Banking Group PLC	1.39	-0.16	1.31
RELX PLC	3.28	-0.11	3.27
UBS Group AG	4.03	-0.08	3.78
Tesco PLC	1.65	-0.05	1.60
Seven & i Holdings Co Ltd	1.09	-0.05	1.07
Natwest Group PLC	0.56	-0.05	0.54
Danone SA	0.93	-0.03	0.92
Novartis AG	3.31	-0.02	3.41
John Wood Group PLC	0.00	0.00	0.00
Fresenius Medical Care AG & Co KGaA	3.62	0.02	3.57
Sony Corp	0.05	0.03	0.00
ING Groep NV	2.76	0.06	2.61
CNH Industrial NV	0.73	0.08	0.76
Sodexo SA	1.60	0.09	1.69

Source: Artisan Partners/FactSet. **Performance is historical and is not a reliable indicator of future results.** As of 30 Sep 2020. These investments made the greatest contribution to, or detracted most from, performance during the period based on a representative account within the strategy Composite. Upon request, Artisan will provide: (i) the calculation methodology and/or (ii) a list showing the contribution of each holding to overall performance during the measurement period. Securities of the same issuer are aggregated to determine the weight in the portfolio. % Contribution to Return is calculated by FactSet by multiplying a security's weight in the portfolio by its in portfolio return for the period referenced and does not take into account expenses of the portfolio. Purchases/sales are accounted for by using end of the day prices, which may or may not reflect the actual purchase/sale price realized by the portfolio.