



Investment Process

We seek to invest in issuers with high-quality business models that have compelling risk-adjusted return characteristics. Our research process has four primary pillars:

Business Quality

We use a variety of sources to understand an issuer's business model resiliency. We analyze the general health of the industry in which an issuer operates, the issuer's competitive position, the dynamics of industry participants and the decision-making history of the issuer's management.

Financial Strength and Flexibility

We believe that analyzing the history and trend of free cash flow generation is critical to understanding an issuer's financial health. Our financial analysis also considers an issuer's capital structure, refinancing options, financial covenants, amortization schedules and overall financial transparency.

Downside Analysis

We believe that credit instruments by their nature have an asymmetric risk profile. The risk of loss is often greater than the potential for gain, particularly when looking at below investment grade issuers. We seek to manage this risk with what we believe to be conservative financial projections that account for industry position, competitive dynamics and positioning within the capital structure.

Value Identification

We use multiple metrics to determine the value of an investment opportunity. We look for credit improvement potential, relative value within an issuer's capital structure, catalysts for business improvement and potential value stemming from market or industry dislocations.

Team Overview

Our team brings together a group of experienced credit analysts who are dedicated to a single investment philosophy and process. All team members conduct deep fundamental credit research as generalists with sector tendencies to identify issuers with high quality business models that have compelling risk-adjusted return characteristics.

Portfolio Management



Bryan C. Krug, CFA
Portfolio Manager

Investment Results (% USD)

As of 30 June 2024	Average Annual Total Returns						
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception ¹
Composite — Gross	1.34	2.98	12.16	3.69	6.48	6.78	6.88
Composite — Net	1.17	2.64	11.42	3.00	5.76	6.05	6.14
ICE BofA US High Yield Index	1.09	2.62	10.45	1.64	3.73	4.21	4.36

Annual Returns (% USD) Trailing 12 months ended 30 June

	2020	2021	2022	2023	2024
Composite — Net	1.42	19.46	-9.43	8.28	11.42

Source: Artisan Partners/ICE BofA. Returns for periods less than one year are not annualized. ¹Composite inception: 1 April 2014.

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. Unlike the Index, the High Income Composite may hold loans and other security types. At times, this causes material differences in relative performance. 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 on the last page, which should be read in conjunction with this material.



Performance Discussion

Our portfolio performed in line with the ICE BofA US High Yield Index during the quarter. From an asset class perspective, security selection in corporate bonds was the largest positive contributor. By rating, we added value through security selection in BB- and B-rated credit, while our overweight to CCC detracted from relative returns. Across sectors, the largest positive contributors included our overweight to insurance as well as security selection in services and telecommunications. The largest sector detractors included security selection in media and retail.

Investing Environment

The high yield bond market held relatively firm during the quarter, as attractive yields provided an income return that offset marginal spread widening and rising Treasury rates. The ICE BofA US High Yield Index gained 1.0%, bringing year-to-date total returns to 2.6%. Similar to Q1, rate volatility continue to weigh on returns as investors reduced their expectations for Federal Reserve rate reductions in 2024. In March, the Fed Funds futures market was pricing between two to three cuts by the end of the year; by the end of June, investors reduced their expectations to between one and two cuts. This market reassessment contributed to an increase in Treasury yields, with the 10-year Treasury yield ending the quarter up approximately 20bps at 4.4% (though off its peak yield of 4.7% in April).

At the headline level, spread movement was relatively modest during the quarter as the index widened 6bps. Underneath the surface, however, there is a growing bifurcation across credit qualities. The BB- and B-rated components of the index tightened by 5bps and 7bps, respectively, while CCCs widened 96bps during the quarter, resulting in the largest spread differential between BBs and CCCs since May 2023. Of particular note is that the spread on the BB-rated segment of the index is in the bottom decile since 1996 (when ICE began tracking index spread data); yet at a 53% weight the segment is close to an all-time high as a proportion of the index and nearly 10% above its long-term average. This lends significant credence to the value of active credit investing over passive in today's market, as the majority of any passive investment in high yield would—by design—be directed toward the most expensive parts of the market, relative to historical spreads.

We note with interest a recent analysis done by JP Morgan regarding dispersion in the CCC category. Despite high nominal spreads of 953bps at the overall CCC level, there is a significant amount of dispersion between higher spread and lower spread issues. The analysis suggests that roughly 40% of the CCC index trades inside of 500bps while nearly one third trades at spreads over 1,000bps—the traditional definition of distressed according to ICE BofA index inclusion rules. Our investors know that we have historically been overweight CCCs with a view that the true risk profile of certain names and sectors in the space—particularly the insurance brokerage segment—is not consistent with the level of default risk implied by a CCC rating. This data further confirms that investors should not view

the CCC space as one single, monolithic, "risky" entity; there is substantial dispersion in the CCC category, and no two CCC-rated credits are alike. Ultimately, we feel that the CCC market is not a market for "tourists"—it requires rigorous fundamental due diligence and expertise to uncover value.

While rate volatility weighed on high yield bonds, the leveraged loan market continued to perform, increasing its lead over high yield year-to-date. The Credit Suisse Leveraged Loan Index returned 1.9% for the quarter bringing its year-to-date return to 4.4%. Over the past three years, the leveraged loan market has outperformed fixed rate assets by an astounding amount, with an annualized return of 6.0% as compared to the high yield market at 1.6% and investment grade bonds (as measured by the ICE US Broad Market Index) at -3.0%. Importantly, the leveraged loan market has achieved these returns with much lower volatility than high yield and investment grade, offering valuable diversification to portfolios. Indeed, on a longer term basis, our loan allocation has added significant value and remains an area that we continue to find select attractive opportunities for our investors.

Similar to Q1, primary markets continued to fire on all cylinders. During Q2, the high yield market priced over \$78 billion in gross issuance while leveraged loan markets priced \$385 billion, with May and June registering as the two highest gross supply months in the history of the loan market. We note, however, that the vast majority of issuance continues to be refinancing/repricing related—net new credit creation is very low, consistent with an M&A market that remains well below peak volumes, and according to data from BofA, both the high yield and leveraged loan index have decreased in par amount outstanding since their 2021/2022 peak. Nonetheless, the importance of selectivity is amplified in environments where money flows freely. Given that many borrowers (healthy or otherwise) have been able to sustain their business through new issuance/refinancings or reduce their interest costs through repricing, underlying weakness or credit concerns may go unappreciated by the broader market.

Default volumes remain low relative to history, though we are beginning to see significant dispersion between calculations that focus solely on "hard defaults"—missed payments or bankruptcies—versus those that include distressed exchanges or liability management exercises (LMEs). Data from JP Morgan suggests a significant gap in trailing twelve month default rates between the two calculations—with the default rate for par-weighted "hard defaults" registering at 1.2% for high yield and 1.1% for loans, versus 1.8% for high yield and 3.1% for loans when including distressed exchanges. The more than 2% difference between calculations for leveraged loans is near a record high, well above the 25bps average difference since 2010. We believe this increase in so-called "creditor on creditor violence" may provide selective opportunities to acquire assets in the secondary market where current pricing is reflective of a severe

impact from a potential distressed exchange and we have a differentiated view on potential intermediate-term recovery.

The rise of private credit and its impact on credit markets continues to be widely debated. We discussed our views in detail at our recent 2024 Artisan Partners Investment Forum, with a view that pricing and terms across public and private credit are effectively converging, and corporate borrowers—unlike allocators—don't necessarily view these markets as three distinct buckets; they will simply borrow in the market that gives them the best deal. We are seeing these impacts in real time as the sponsored direct lending market is once again facing stiff competition from banks in the primary high yield and loan market. As a result, the illiquidity premium (as measured by spreads) for sponsor-backed direct lending appears to be declining, with recent data from Pitchbook LCD suggesting a material reduction in spreads for direct lending deals issued in the first half of 2024 versus the second half of 2023.

Portfolio Positioning

From an asset class perspective, our positioning remained relatively consistent over the quarter, with our split between bonds and loans at roughly 75%/16%, respectively (with the remainder invested primarily in cash and cash equivalents). Though only 16% from a headline weight perspective, our loan allocation continues to provide a significant yield pickup over bonds, with the segment providing potential for attractive returns at current yield levels. By credit quality, our BB exposure increased slightly during the quarter—primarily driven by upgrades rather than new purchases—while our exposure to CCCs declined mainly driven by the retiring of insurance broker NFP's outstanding debt following its acquisition by Aon.

The average price of our portfolio was approximately \$90.3 at the end of June, nearly three points below the high yield index. The portfolio's yield remains comfortably above the benchmark and offers the potential for attractive returns, both in absolute terms and relative to other asset classes. This is particularly relevant at a time when the narrative for the broader equity market continues to be one of concentration risk driven by the Magnificent Seven stocks (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia and Tesla) and a lack of market breadth.

Our largest sector allocations continue to be insurance brokerage and recreation and travel—namely, cruise lines. We retain conviction in the near term on our cruise lines exposure and would note that across sectors that are traditionally thought to be more consumer sensitive, this segment still remains on solid footing. Occupancy rates remain high (in excess of 100%), and the gap in pricing between land-based vacations and cruises has widened significantly in recent years—with cruise lines representing a bargain for the end consumer in a time period where wallets may become more restrictive.

In the near term, we view the TMT space—technology, media and telecommunications—as the area of the market most prone to potential disruption through LMEs. Already in 2024, we have seen

multiple high-profile names undergoing various forms of LMEs, resulting in both the media and telecommunications subsectors of the index lagging behind the rest of the market. However, a rise in LMEs also brings the potential for increased opportunities to purchase select assets that are attractively discounted in the secondary market.

Perspective

The first half of 2024 has brought increased interest rate volatility, a rise in distressed exchanges and “wide open” capital markets, while investors continue to face uncertainties surrounding the economy, monetary policy and geopolitics. Despite all of these headlines, leveraged credit continues to perform, buoyed by strong income returns and yields that are attractive relative to historical levels. We continue to view high yield bonds and leveraged loans as a valuable component of a diversified portfolio. While the current environment is not as target rich as it was a year ago from a spread perspective, the potential to generate high-single-digit returns with substantially less interest rate risk than investment grade bonds creates a powerful complement to a traditional asset allocation.

Those who have invested with us for longer time periods know that a core tenet of our philosophy is our emphasis on business quality—companies that exhibit attractive characteristics such as high recurring revenue, low capex needs, tangible barriers to entry and ultimately a reason to exist. In today's borrower-friendly environment where most issuers have been able to freely access capital markets, the importance of this tenet cannot be overstated. We remain discerning buyers of risk, with a high rejection rate on new issuance. It is our firm belief that those who practice disciplined and high-conviction credit investing are rewarded for their patience over the long term.

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Investment Risks: Fixed income securities carry interest rate risk and credit risk for both the issuer and counterparty and investors may lose principal value. In general, when interest rates rise, fixed income values fall. High income securities (junk bonds) are speculative, experience greater price volatility and have a higher degree of credit and liquidity risk than bonds with a higher credit rating. The portfolio typically invests a significant portion of its assets in lower-rated high income securities (e.g., CCC). Loans carry risks including insolvency of the borrower, lending bank or other intermediary. Loans may be secured, unsecured, or not fully collateralized, trade infrequently, experience delayed settlement, and be subject to resale restrictions. Private placement and restricted securities may not be easily sold due to resale restrictions and are more difficult to value. Use of derivatives may create investment leverage and increase the likelihood of volatility and risk of loss in excess of the amount invested. 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 and less developed markets, including frontier markets. These risks, among others, are further described in Artisan Partners Form ADV, which is available upon request.

Unless otherwise indicated, the Artisan Strategy characteristics relate to that of an investment composite or a representative account managed within a composite. It is intended to provide a general illustration of the investment strategy and considerations used by Artisan Partners in managing that strategy. Individual accounts may differ, at times significantly, from the reference data shown due to varying account restrictions, fees and expenses, and since-inception time periods, among others. Where applicable, this information is supplemental to, and not to be construed with, a current or prospective client's investment account information. References to individual security performance relate to a representative account in the composite. Individual holding periods may differ.

For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the Strategy. Securities named in the Commentary, but not listed here are not held in the portfolio as of the date of this report. Totals may not sum due to rounding.

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.

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.

ICE BofA US High Yield Index measures the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US market. Credit Suisse (CS) Leveraged Loan Index is an unmanaged market value-weighted index designed to mirror the investable universe of the US dollar-denominated leveraged loan market. New issues are added to the index on their effective date if they qualify according to the following criteria: loan facilities must be rated "BB" or lower; only fully funded term loan facilities are included; and issuers must be domiciled in developed countries. ICE BofA US Broad Market Index tracks the performance of US dollar-denominated investment grade debt publicly issued in the US domestic market, including US Treasury, quasi-government, corporate, securitized and collateralized securities. With the exception of local currency sovereign debt, qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch). The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

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Credit Quality ratings are determined by Artisan Partners based on ratings from S&P and/or Moody's, which typically range from AAA (highest) to D (lowest). For securities rated by both S&P and Moody's, the higher of the two ratings was used, and those not rated by either agency have been categorized as Unrated/Not Rated. Ratings are applicable to the underlying portfolio securities, but not the portfolio itself, and are subject to change. **Non-Investment Grade** refers to fixed income securities with lower credit quality. **Spread** is the difference in yield between two bonds of similar maturity but different credit quality. **Par-weighted Default Rate** represents the total dollar volume of defaulted securities compared to the total face amount of securities outstanding that could have defaulted. **Duration** estimates the sensitivity of underlying fixed income securities to changes in interest rates—the longer the duration, the greater the sensitivity to changes in interest rates. **Capital Expenditures (capex)** to either purchase fixed assets or to upgrade existing fixed assets having a useful life longer than the taxable year. **Par** represents the level a security trades at when its yield equals its coupon. **Magnificent Seven (M7)** is a term used to describe large US companies: Apple, Amazon, Alphabet, Tesla, NVIDIA, Microsoft and Meta. **Dispersion** is the difference in credit spreads between the highest and lowest spread securities in a given market segment.

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