CITYWIRE
SELECTOR

'I've never been better situated'

Long Read: Lewis Kaufman explains how he has repositioned to reduce traditional favourites and how he bulked up on China at the right time.

By **Chris Sloley** / 7 April, 2020

Lewis Kaufman has something to say. And the developing world equity manager is certainly making his voice heard. During a rapid fire half-an-hour conversation, Kaufman isn't even derailed when the line drops between San Francisco and London and powers on regardless.

'Where were we?' is his momentary lapse before continuing on a dissection of how the healthcare systems in China, the former BRICs and the Western world stack up. Anyone wanting to know where Kaufman is needs to only look at his numbers.

As he mentioned to Citywire last summer, Kaufman's emphasis is on finding areas of low penetration, which means looking closely at domestic demand. This is while working around three core principles – build, preserve and reinforce – which are designed to find strong businesses with growth potential.

'I think this framework that we've developed with a growth and compounding mind-set has proven incredibly valuable for staying out of some of the landmines in the asset class,' he told Citywire at the end of March.

'I think as we roll forward, the vast majority of people that have traditionally looked at emerging markets, or are looking at emerging markets, do so in the wrong way. I think there's an expectation that there's going to be some cyclical recovery. But there is pressure and, while I'm not saying that that markets can't bounce, I think some of these pressures that we're seeing are structural.'

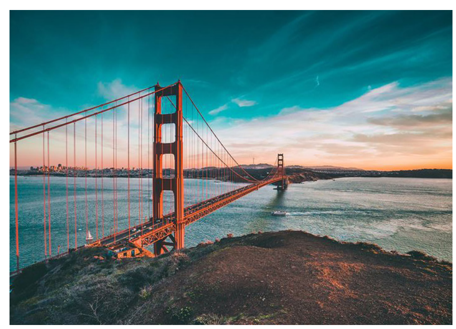
Making the move

The move that saw Kaufman swap Santa Fe-based Thornburg Investments for Wisconsin-headquartered Artisan was viewed as an intriguing mid-tier move, far from the prying eyes of the asset management giants hugging the seaboard. Five years on and Kaufman – who is now based in Artisan's Californian base – has seen his reputation grow.

'When I was at Thornburg back in 2009, I had been managing international equity portfolios and we decided to launch an emerging market strategy. I launched and managed that fund back in December 2009 and did so for the five years before moving and starting the strategy at Artisan in mid-2015.

'You know, the asset class today is in some ways similar and in some ways different. At our core, we are a domestic demand fund. We believe in low-penetration, domestic demand in emerging markets because we think that creates compounding outcomes.

'But I would say two or three years ago, I think we hit a little bit of a wall, where these low penetration stories in the emerging markets were no longer



progressing in the same way they used to,' he said.

For a man with 35.7% in China, Kaufman was not concerned about the challenges the region faced from being the epicentre of the Covid-19 outbreak. In fact, Kaufman said, he was adding to his China exposure at the expense of other countries, such as Brazil, India and South Africa, which were systematically sold down over the past year.

'China is different, and we've seen that during the crisis there and their quick response to the virus. But I think you've also seen it in their monetary and fiscal capacity, and I think the story goes beyond that.

'What you see in China is a country where, yes, demographics are challenged as it's an ageing society, but they have what I refer to as a 'skilled labour dividend'. In other words, in 1996, just 2% of the population had some form of higher education.

'Today 14% of the population has some form of higher education. To put that into numbers, it increased from about 20 million people to about 200 million people. And it doesn't really matter that you don't have a demographic dividend, because you have a lot of skilled workers.'

Looking at the immediate exposure, Kaufman said he seeks to be insulated from the wider implications of the Covid-19 downturn, which was undertaken by dropping exposure from 45% to Brazil, India, Mexico and South Africa, which is now around 22%.

'Some areas are going to be worse and more pronounced because of the damage imposed by the coronavirus. But, what is ironic for us is we believe that we have never been better situated to deliver the types of disproportionate equity outcomes, which is how I think about the asset class.

'I don't think you should invest in emerging markets because you want to play a trade or a cyclical recovery. I think you should consider investing in emerging markets because low penetration has the potential to engender better compounding outcomes and create disproportionate equity outcomes. That's what we're in the business of finding. We've never been better situated to do that.'

Backing the consumer story

At present, the largest positions in Kaufman's fund are Alibaba, the Chinese conglomerate, as well as Indian financials giant HDFC and Sea Ltd, a Singapore-based internet company. Despite these specific positions, Kaufman operates with a pronounced emphasis on consumer stocks.

His 37-strong portfolio has 25% in consumer cyclicals, nearly a 13 percentage point overweight to the index and 19.7% in consumer defensive, which is an 11 percentage point increase on the index. This is while the likes of MercadoLibre sit within his top 10 positions.

With the US unemployment rate rising and concerns about the knock-on effect for the consumer sector, is Kaufman also sharing these fears? 'I'm not valuation driven, I'm value driven,' he said. 'I look for companies that can create value in a disproportionate way and I'm looking for companies that can sustain that value creation. So we're not growth focused either.

'But, we're not looking for companies that can grow 30% for three years and then we sell and find the next one. We're looking for companies that can create value and sustain that value creation. I think the reason that is important in a consumer context is a lot of consumer-facing companies can do that.

'These are brands that have value that consumers can taste and touch, and we want to be aligned with that. We think there's a resilience to that story. We could certainly invest in the investment component of GDP.'

Kaufman said the market has been difficult – 'volatile and challenging in every way' – but he has sought to reinforce exposure to compounding stocks where possible. This is also achieved through managing currency risk and limiting exposure to countries dependent on foreign capital.

One way he has achieved that is through focusing on developed world stocks with developing world exposure, which is why he has 25% in US stocks. 'We invest in multinational companies that have different correlation and currency profiles are more robust, and we invest in financially sound, free cashflow generative companies that aren't leveraged and that will have to go to capital markets at hand during a period.'

This article represents the views of Chris Sloley of Citywire Selector and Lewis Kaufman as of the date of publication and those views and opinions presented are their own. Artisan Partners is not responsible for and cannot guarantee 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. This material is provided for informational purposes without regard to your particular investment needs. This material shall not be construed as investment or tax advice on which you may rely for your investment decisions. Investors should consult their financial and tax adviser before making investments in order to determine the appropriateness of any investment product discussed herein.

Clarifications: As of 31 March 2020 Consumer Discretionary and Consumer Staples sectors comprised 29.1% and 10.1% respectively, of the Artisan Developing World Fund. Source: Artisan Partners/GICS/MSCI.

Exposure as described by Lewis Kaufman in the article refers to companies that derive a significant portion of revenue from a stated country, which may differ from the companies' country classifications. As of 31 March 2020 country weights for China, United States, India, Brazil, Mexico and South Africa in the Artisan Developing World Fund were as follows: China 35.3%, United States 25.4%, India 5.4%, Brazil 4.2%, Mexico 0%, South Africa 0%. Source: Artisan Partners.

Investment Results as of 31 March 2020 (%) **Artisan Developing World Fund**	QTD	1YR	3YR	ITD	Expense Ratios Prospectus 30 Sep 2019
Investor Class: ARTYX	**-8.21**	**5.91**	**9.83**	**8.17**	**1.36%**
Advisor Class: APDYX	**-8.16**	**6.03**	**10.03**	**8.37**	**1.18%**
Institutional Class: APHYX	**-8.14**	**6.18**	**10.13**	**8.48**	**1.09%**
MSCI Emerging Markets Index	-23.60	-17.69	-1.62	-0.24	

Source: Artisan Partners/MSCI. Returns less than one year are not annualized. Fund inception: 29 Jun 2015.

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 800.399.1770 for current to most recent month-end performance.

Carefully consider the Fund's investment objective, risks and charges and expenses. This and other important information is contained in the Fund's prospectus and summary prospectus, which can be obtained by visiting www.artisanfunds.com. Read carefully before investing.

Investment Risks: 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. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations. 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.

MSCI Emerging Markets Index measures the performance of emerging markets. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI.

The Global Industry Classification Standard (GICS®) is the exclusive intellectual property of MSCI Inc. (MSCI) and Standard & Poor's Financial Services, LLC (S&P). Neither MSCI, S&P, their affiliates, nor any of their third party providers ("GICS Parties") makes any representations or warranties, express or implied, with respect to GICS or the results to be obtained by the use thereof, and expressly disclaim all warranties, including warranties of accuracy, completeness, merchantability and fitness for a particular purpose. The GICS Parties shall not have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of such damages.

Portfolio country classifications are defined by the investment team and may differ substantially from MSCI classifications. For the portfolio's country and region breakdown according to MSCI methodology, refer to the Fund's most recent portfolio holdings at www.sec.gov.

The discussion of portfolio holdings does not constitute a recommendation of any individual security. These holdings comprise the following percentages of the Artisan Developing World Fund's total net assets as of 31 March 2020: Alibaba Group Holding Ltd 6.8%, Visa Inc 6.7%, Sea Ltd 5.2%, MercadoLibre Inc 5.2%, TAL Education Group 4.7%, NVIDIA Corp 4.6%, HDFC Bank Ltd 4.6%, Adyen NV 4.5%, AIA Group Ltd 4.5%, Kweichow Moutai Co Ltd 4.3%. For the purpose of determining the Fund's holdings, securities of the same issuer are aggregated to determine the weight in the Fund. Securities named but not listed here are not held in the Fund as of the date noted. The portfolio holdings mentioned are subject to change and the Fund disclaims any obligation to advise investors of such changes.

Free cash flow is a measure of financial performance calculated as operating cash flow minus capital expenditures. **BRICS** in an association of emerging markets countries including, Brazil, Russia, India, China and South Africa.

Artisan Partners Funds offered through Artisan Partners Distributors LLC (APDLLC), member FINRA. APDLLC is a wholly owned broker/dealer subsidiary of Artisan Partners Holdings LP. Artisan Partners Limited Partnership, an investment advisory firm and adviser to Artisan Partners Funds, is wholly owned by Artisan Partners Holdings LP.