INVESTMENT **INSIGHTS**

George O. Sertl, CFA
Portfolio Manager
Artisan Partners U.S. Value Team

Value Investing for All Markets

George Sertl, Portfolio Manager of the Artisan Value Equity Strategy, shares his thoughts on value investing in today's environment.

P&I: *After several years of strong gains by U.S. stocks, are you still finding attractive value opportunities?*

George Sertl: Our job as we see it is to buy cash flows as cheaply and as safely as we can. Accomplishing the first part – buying cash flows cheaply – is more challenging today after stocks have roughly tripled since March 2009. Most stocks are trading in a range of fair to full value. Since we're looking for undervalued stocks, not fairly valued, our purchase activity continues to be on the low side.

We invest across the market-cap spectrum in the three portfolios we manage – Artisan Value Equity, U.S. Mid-Cap Value and U.S. Small-Cap Value. In our large-cap Value Equity portfolio, finding interesting opportunities is a bit easier. In a focused portfolio of about 30 to 40 holdings, we only have to find a few standouts relative to our process.

We also think large caps are one of the more appealing areas of the U.S. stock market currently, since they are higher quality and cheaper relative to the rest of the market. Their valuation advantage is not surprising, given that small-cap stocks have outperformed large caps during the current bull market. Large-cap companies also have stronger balance sheets and superior returns on capital, so we believe we're able to buy better businesses at relatively cheaper prices now.

P&I: *How do you think about risk and positioning relative to the benchmark?*

George Sertl: We view risk much differently than a lot of the industry. We don't build our portfolios based on what the index owns. Our sector and industry exposures will vary depending on stocks in those areas meeting our three margin-of-safety criteria – attractive valuation, sound financial condition and attractive business economics. Sometimes, large market sectors are absent in the portfolio or heavily underweight, and vice versa – and those differences will evolve over time.

The technology sector is a good example. For instance, in the 1990s and early 2000s, we owned very little technology. Now we have a large technology weight in all three portfolios. We like to say that what the index owns is its problem, and what we own is our problem. Our stock-by-stock decisions are focused on our three margin-of-safety criteria, not an attempt to hug an index. We want to be paid well for the risk we take. That process has allowed good results over long periods of time.

Because we are risk-aware investors, we also consider economic risk. As bottom-up stock pickers, macroeconomic events can create opportunities at the stock level. If one is not mindful, a portfolio can develop a build-up of risk from a single macroeconomic factor. We want to avoid that. Sector diversification gives some insight, but is imperfect–the same macro factors can be at work in two or three or more sectors.

And the reverse can be true. For example, the technology sector is nearly a third of our weighting in the portfolio. Based on that alone, one might think our portfolio lacks diversification. In our minds, however, our technology weighting is overstated based on that statistic. There are a number of companies categorized within the technology bucket that we would not consider technology companies. One example is Western Union, a money transfer company. Diversification by end market is another consideration. Apple and Samsung Electronics are largely consumer technology businesses, whereas Oracle, Microsoft and Cisco Systems are big on the enterprise side.

P&I: *Your top two holdings are Apple and Samsung – both smartphone companies. Can you discuss your interest in owning both at such a high weight?*

George Sertl: Apple and Samsung are the two dominant players in the smartphone and tablet businesses. People like to think that technology has to be a winner-take-all business, but we don't think that's the case. Both companies are doing well and are highly profitable in those businesses, while most of their competitors are losing money. They have big scale and brand advantages and are gaining market share, so we think their competitive edge is in fact widening.

Apple and Samsung have tremendous balance sheets with huge amounts of net cash that they can use as a competitive weapon. From a valuation standpoint, Samsung sells for around five times earnings, and if earnings were flat, it would take only four years to accrue cash equal to its market capitalization. Apple sells for somewhere around 12 times unlevered earnings. In summary, both companies stack up strongly against our investment criteria and, therefore, are big weights in the portfolio – about 12% combined. Yet only about 6% of that is tied to the smartphone market. Samsung also has semiconductor and consumer products businesses, and Apple has PC and services businesses. The smartphone exposure is something that we're aware of, but we're comfortable with it because it's a highly profitable business, and it's a business that's still growing.

P&I: *Sticking with technology, which is the portfolio's largest sector weighting at 32%, what are some of the other opportunities you're finding?*

George Sertl: When we look at the technology sector, it screens well against our three margin-of-safety criteria. Technology companies currently have the best balance sheets, generate strong free cash flow and are returning capital to shareholders through dividends and share buybacks. We think of technology as modern-day capital expenditures that are integral to the operations of most businesses. Much of this expense is not discretionary, and we believe companies will continue to spend on productivity enhancements.

From this standpoint, many technology businesses are not too different from industrial companies that produce capital equipment. Oracle, Microsoft and Cisco Systems are examples that fit this mold, and we own all three in the Value Equity portfolio. These mega-cap companies have dominant market positions, global reach and technological leadership. Despite superior business economics and balance sheets, they each trade at below-average P/E multiples in the low-to-mid teens. Some investors have written off these companies as future dinosaurs – and we can have that debate – but they are being priced as though they are closer to extinction than we believe they are.

P&I: *Banks are a large component of the Russell 1000® Value Index, but it's an area that you've tended to avoid. Can you explain why?*

George Sertl: In general, we have little banking exposure because we think of it as a mediocre business. Banks are in the business of buying and selling money – an activity that by design should not generate superior returns. Banks also continue to face a number of headwinds such as changing capital requirements and increased regulations.

Yet fear and uncertainty attract our attention, and banks have certainly been at the epicenter of uncertainty in recent years, so we aren't ignoring the area. We are earnings normalizers who take a long-term perspective, so on the surface, banking stocks would appear set up well from a normalized-earnings perspective. Yet when we examine the industry, we come away with a more modest viewpoint towards its earnings power, and we demand a cheaper price than other investors.

P&I: What is your outlook on U.S. stocks for the next three to five years?

George Sertl: This has been one of the strongest U.S. equity bull markets in history. It's now in its sixth year, also making it one of the longest. Most broad-based U.S. equity indexes have annualized returns of 15% to 20% over the past five years – an outsized return not reflective of the long-run economics of companies in the stock markets.

It is important to recognize the significance of start and end points – the current bull market started from an epic bottom following one of the biggest sell-offs in market history. Today, with market valuations closer to long-term averages, and given the recovery in profits, we think it's highly unlikely we experience a repeat of such returns over the next five years. Rather, we think returns over the next five years will be more similar to what we've experienced over the last seven years, with annualized returns in the mid-single digits. ❖

Read, print, and email this Q&A to a colleague at www.pionline.com/InvestmentInsights_ArtisanValue

ARTISAN PARTNERS

Artisan Value Equity Strategy

Artisan Partners U.S. Value Team

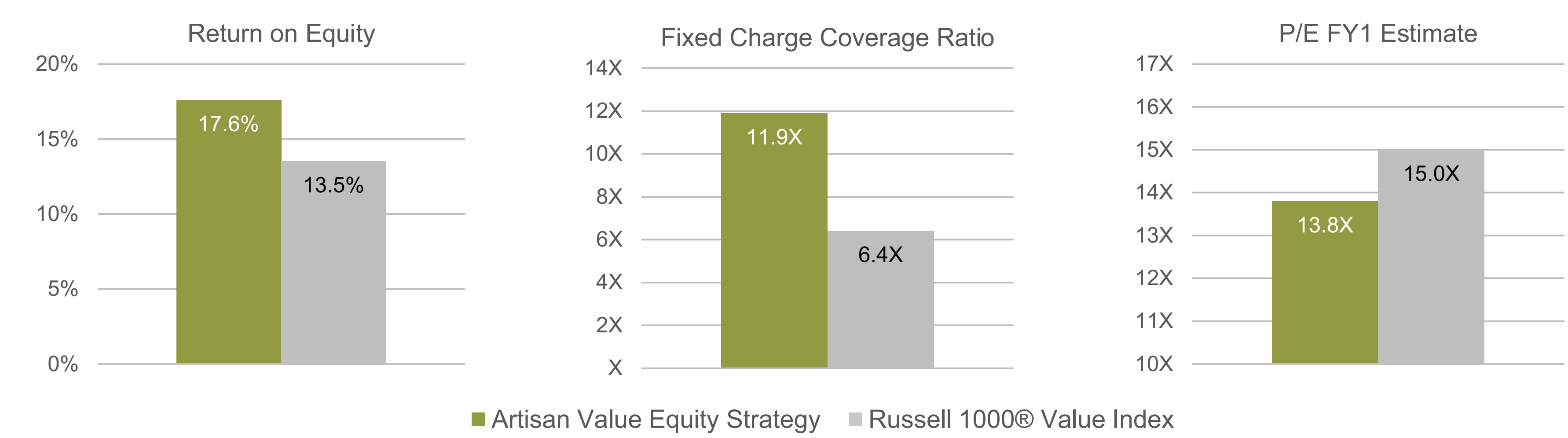
Name	Title	Years Investment Experience
George Sertl, CFA	Portfolio Manager	22
Scott Satterwhite, CFA	Portfolio Manager	33
Jim Kieffer, CFA	Portfolio Manager	25
Dane Kane, CFA	Portfolio Manager	16

$2,154
Total AUM ($Millions)

34
Number of Holdings

Investment Philosophy—Three Margin of Safety Criteria

Attractive Business Economics | Sound Financial Condition | Attractive Valuation



Top Holdings (% of total portfolio)

Apple Inc (Information Technology)	6.3
Samsung Electronics Co Ltd (Information Technology)	5.5
Apache Corp (Energy)	4.9
Oracle Corp (Information Technology)	4.3
Cigna Corp (Health Care)	3.5
Noble Corp plc (Energy)	3.3
Alleghany Corp (Financials)	3.2
National Oilwell Varco Inc (Energy)	3.1
Goldcorp Inc (Materials)	3.1
Berkshire Hathaway Inc (Financials)	3.0
TOTAL	**40.3%**

Vehicles Offered

MUTUAL FUNDS[1] Investor: ARTLX | Institutional: APHLX

SEPARATE ACCOUNTS[2]

COLLECTIVE TRUSTS[3]

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Carefully consider the Fund's investment objectives, 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 calling 800.468.1770. Read carefully before investing.

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All data as of 30 June 2014. Source of Characteristics and Top 10: Artisan Partners/FactSet(GICS)/Russell. [1]Offered through Artisan Partners Distributors LLC, member FINRA. [2]Advised by Artisan Partners Limited Partnership. [3]Offered through SEI Trust Company as advised by Artisan Partners Limited Partnership. This material (1) represents the views of the manager as of 31 Jul 2014, is based on current market conditions which will fluctuate, is subject to change without notice and does not necessarily represent those of Artisan Partners; (2) is believed to be reliable but there is no guarantee to the information's accuracy or completeness; (3) is for informational purposes only and should not be considered as investment advice or a recommendation. Strategy information provided relates to a representative account in the Artisan Value Equity Strategy. The holdings mentioned comprised the following percentages of that representative account as of 30 Jun 2014: Apple Inc 6.3%; Samsung Electronics Co Ltd 5.5%; Oracle Corp 4.3%; Microsoft Corp 2.0%; Cisco Systems Inc 2.0%. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property and a service mark of MSCI Inc. (MSCI) and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P) and is licensed for use by Artisan Partners. Neither MSCI, S&P nor any third party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages(including lost profits) even if notified of the possibility of such damages. For Institutional Investors Only—Not for Onward Distribution

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