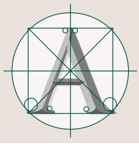

Artisan Floating Rate Strategy

QUARTERLY
Commentary

As of 30 June 2024

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 (Lead)

Seth B. Yeager, CFA
Portfolio Manager

Investment Results (% USD)

As of 30 June 2024	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception[1]
			Average Annual Total Returns				
Composite — Gross	**1.19**	**3.75**	**11.49**	—	—	—	**6.95**
Composite — Net	**1.02**	**3.40**	**10.74**	—	—	—	**6.23**
Credit Suisse Leveraged Loan Index	1.86	4.44	11.04	—	—	—	6.42

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

	2020	2021	2022	2023	2024
Composite — Net	—	—	—	**10.34**	**10.74**

Source: Artisan Partners/Credit Suisse. Returns for periods less than one year are not annualized. [1]Composite inception: 1 January 2022.

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 on the last page, which should be read in conjunction with this material.

Performance Discussion

Our portfolio underperformed the Credit Suisse Leveraged Loan Index during the quarter. Positive contributions from our secured bond allocation were offset by negative security selection effects within bank loans. By credit quality, our overweight to B-rated credit was the most notable positive contributor, while security selection within CCC-rated credits detracted from returns. Across sectors, security selection in services was the most significant positive contributor, while the primary detractor was our security selection in specialty retail.

Investing Environment

Interest rate volatility continued during Q2 as market participants digested recent economic data and Federal Reserve comments—resulting in a reassessment of rate cut expectations. In March, the Fed Funds futures market was pricing between two to three cuts by the end of the year; at the end of June, investors reduced their expectations to between one and two cuts. To place this change into context, the market had been pricing in upward of six cuts coming into the year. This movement helped place upward pressure on Treasury yields, with the 10-year Treasury yield ending the quarter up approximately 20bps at 4.4% (though off from its peak yield of 4.7% in April).

Against this backdrop, the leveraged loan market continued to perform, increasing its lead over the high yield market 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% (as measured by the ICE BofA US High Yield Index) and investment grade bonds at -3.0% (as measured by the ICE BofA US Broad Market Index). Importantly, the leveraged loan market has achieved these returns with significantly lower volatility than high yield and investment grade. The variance (volatility) of daily returns in leveraged loans since the end of 2020 through June 2024 is approximately 66% lower than high yield and 74% lower than investment grade corporate bonds (as measured by the ICE BofA US Corporate Index), providing valuable diversification to portfolios with both attractive return generation and risk reduction.

Like 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.

With net new credit creation low, from a technical perspective, robust demand from retail inflows and collateralized loan obligation (CLO) issuance has helped drive spreads tighter. Discount margins at the index level have tightened 20bps year-to-date to 507bps, aiding returns. Relative to history, discount margins for loans are at the 65th percentile or roughly 50bps above the long-term median; for comparison, this remains favorable relative to high yield bonds, which are at their bottom decile of tightness since inception. However, we continue to look past headline numbers and focus on bottom-up fundamental analysis to identify value. The leveraged loan index has migrated lower in credit quality since 2008, raising the importance of rigorous due diligence and active credit selection.

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 suggest a significant gap in trailing 12-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 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

For those that have invested with us for years, it should be of no surprise that we continue to position the portfolio in a high-conviction manner—particularly when compared to other managers

in the leveraged loan category. While our name count rose slightly during the quarter, our weight to the top 10 names increased relative to March, ending the quarter at approximately 30%. Our cash allocation has decreased relative to year-end, falling approximately 1% in Q2 and 5% since December as we continue to deploy capital in a select number of attractive opportunities.

There is a general market consensus that the Federal Reserve will reduce the federal funds rate in the coming years, though the exact timing and magnitude remain up for debate. Regardless, we have begun to position the portfolio—on the margin—with a barbell that we believe will likely benefit from rate reductions. As floating rate coupons reset frequently to reflect changes in base rates, rate reductions are generally a double-edged sword for leveraged loan investors. On one hand, declining rates benefit issuers by reducing debt service costs and improved cash flows and their credit profile. On the other hand, a reduction in coupon lowers total return potential—particularly for those names that are highly levered but have been able to lower their cost of capital (e.g., coupon spread) to levels we find inconsistent with their full-cycle risk profile. In practice, our barbell consists of higher credit quality, lower leverage companies with generally shorter maturities on one end (where pricing is likely very stable even in a lower base rate scenario), paired with a select number of more levered issuers, with solid underlying business models at attractive prices that could significantly benefit from reductions in interest expense, thereby improving the overall credit profile and tightening spreads.

From a sector perspective, our largest allocation and overweight continues to be insurance, specifically insurance brokerage. In a time period where there is significant uncertainty around monetary policy and the path of the economy, we continue to find the non-discretionary nature of insurance compelling, providing the portfolio with an attractive ballast of yield and stability. The second-largest sector exposure at quarter-end was technology, which continues to be a large segment of the leveraged loan universe and a key component of our overall portfolio. Importantly, we retain our selectivity in this space—while there are nearly 200 individual loans in the technology segment of the Credit Suisse Leveraged Loan Index, we only own 15, emphasizing businesses with strong margins and recurring revenue.

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 loans continue to perform well, buoyed by strong income returns and yields that are attractive relative to historical levels. Year-to-date total returns of 4.4% remain the third-highest in the past 10 years. We continue to view leveraged loans as a valuable component of an investor portfolio, providing long-term attractive total returns and a diversifying effect versus other asset classes. 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 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.

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 High Yield Index measures the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US market. 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). ICE BofA US Corporate Bond Index tracks performance of US dollar performance for investment corporate debt publicly issued in the US market. 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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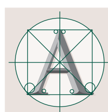
A R T I S A N  P A R T N E R S