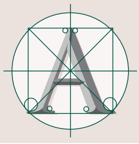


Artisan Select Equity Strategy

QUARTERLY Commentary

As of 31 December 2024

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

Daniel J. O'Keefe
Portfolio Manager (Lead)
Managing Director

Michael J. McKinnon, CFA
Portfolio Manager
Managing Director

Investment Results (% USD)

			Average Annual Total Returns				
As of 31 December 2024	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception[1]
Composite — Gross	**-1.11**	**16.96**	**16.96**	**7.91**	—	—	**12.92**
Composite — Net	**-1.30**	**16.09**	**16.09**	**7.11**	—	—	**12.09**
S&P 500® Index	2.41	25.02	25.02	8.93	—	—	17.11

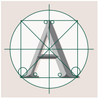
Calendar Year Returns (% USD)

	2020	2021	2022	2023	2024
Composite — Net	—	**16.00**	**-16.56**	**26.88**	**16.09**

Source: Artisan Partners/S&P. Returns for periods less than one year are not annualized. [1]Composite inception: 1 March 2020.

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.



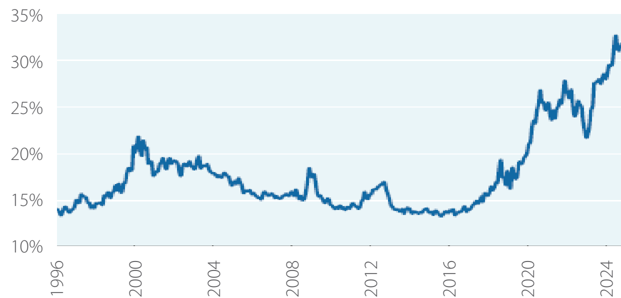
Market Overview

Another quarter, another smashing outperformance for US technology stocks. The only thing we can add to what we have said ad nauseam for the past several years is this: Yes, but even more so.

The growth stocks in the S&P 500® Index returned multiples of the overall market. There are a number of ways to look at this. Perhaps the easiest is to look at the broader S&P 500® Index performance of 25% compared to the Russell 1000® Value Index return of 14%. In the past 24 years, only four times before has the performance spread between the two indices reached double digits—and all four have occurred since 2020.

Driving all of this, of course, are US tech companies. All five of the index's best performing stocks for the year and the quarter were US tech companies—Tesla, NVIDIA, Amazon, Broadcom and Apple. Among the top 10 for both the quarter and the year, US tech accounted for 8 of them. The outperformance of US tech has led it to comprise a record share of the S&P 500® Index, and, of course, its returns. In 2022, 2023 and 2024, the Magnificent Seven accounted for 55% to 63% of the S&P 500® Index's total return. Stripping out the Magnificent Seven from the S&P 500® Index in 2024 leaves the return at about 10%. Notably, this is nearly 300bps lower than the return of the Russell 1000® Value Index and even lower than the performance of the stodgy Dow Jones Industrial Average.

Exhibit 1: Market Capitalization of Largest 7 Companies in S&P 500® Index



Source: FactSet/JPMAM. As of 30 Nov 2024.

So, we know that overall, the non-Magnificent Seven share prices have lagged terribly over the past several years. But how have these companies done from an earnings, rather than a stock market, perspective? Exhibit 2 shows earnings growth of the Magnificent Seven from 2019 through 2023. (2024 numbers are not yet available.)

Exhibit 2: S&P 500® Index Constituent Earnings

Company Earnings	2019	2020	2021	2022	2023	4-Year CAGR
Alphabet Inc. Class A	34,343	40,269	76,033	59,972	73,795	21%
Facebook	18,485	29,146	39,370	23,200	39,098	21%
Tesla	(870)	690	5,524	12,583	14,999	NA
Amazon	11,588	21,331	33,364	(2,722)	30,425	27%
Microsoft	39,240	44,281	61,271	72,738	72,361	17%
Apple	55,256	57,411	94,680	99,803	96,995	15%
NVIDIA	4,141	2,796	4,332	9,752	4,368	1%
Total Magnificent Seven	**162,183**	**195,924**	**314,574**	**275,326**	**332,041**	**20%**
All Other	1,125,610	694,726	1,556,909	1,414,037	1,458,377	7%
Total S&P 500® Index	**1,287,793**	**890,650**	**1,871,483**	**1,689,363**	**1,790,418**	**9%**

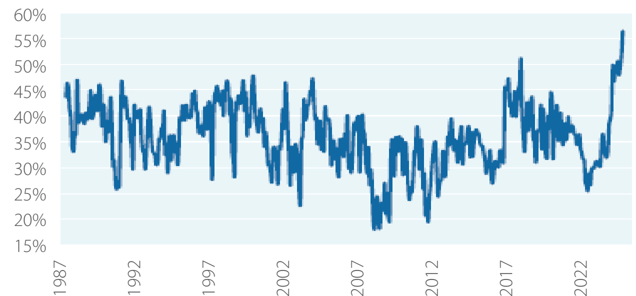
Source: FactSet. As of 31 Dec 2023.

Over this period, the Magnificent Seven have grown their earnings at an average of +20% per year. This is nearly 3X higher than the earnings growth for the other companies in the S&P 500® Index. From where we stand, it is pretty clear that the fundamentals have certainly justified outperformance.

The question is by how much, for how long and at what price. But investing is always a forward-looking exercise, and the Magnificent Seven companies currently trade at an average PE multiple of 39X—a significant premium to the 25X multiple for the broader index. For these stocks to continue to outperform, they will need to deliver this level of outsized growth into the future. Possible? Certainly. Probable? We shall see.

Clearly, a lot of investors believe that the US stock market is headed higher from here. Indeed, the number of true believers may be at an all-time high.

Exhibit 3: Share of US Households Expecting Higher Stock Prices in 12 Months (Percent of Respondents)



Source: Conference Board/Bloomberg/JPMAM. As of 30 Nov 2024.

Perhaps this reflects a rational expectation that the economy will strengthen considerably under the new Trump administration. Or that interest rates will fall considerably. Maybe. There are certainly valid arguments to be made as to why the economy, all else being equal, should do better under Trump than Biden. But there are also reasons why, regardless of who is president, the US and the global economy face real challenges. A few big issues come to mind: unprecedented debt levels, unsustainable deficit spending, risk of high rates from uncontrolled debt and deficits. We could go on.

Portfolio Discussion

Our best performers for the quarter were Charles Schwab, Heidelberg Materials and Alphabet.

Charles Schwab's share price recovered after a weak Q3 performance. Recall that Schwab's economics have been pressured by higher interest rates, which incented account holders to move their cash off Schwab's balance sheet and into higher yielding securities. This cash exodus has been a major headwind to Schwab's earnings power. The company's most recent disclosures show that the balance sheet cash trends have stabilized, signaling that this headwind might turn into a tailwind. We believe it will.

Heidelberg's share price rose 22% in local currency and 14% in US dollar terms. Results reported during the quarter were fine. Revenue was up a little; profit was up a little. The company has managed very

well through COVID-19, high energy prices in Europe and generally difficult construction markets on the continent. The company also announced an acquisition of a US cement company, which will bolster its position here in the States. The valuation looks reasonable. Heidelberg's share price has surged over the past couple of years. In our opinion, much of this is recovery from an absurd valuation. European investors seemed to believe CO2-intensive cement businesses would cease to exist as a result of a net-zero economy. It is becoming clear that net zero will not happen in our lifetimes, if ever. European investors seem to be willing to invest in cement again, judging by the revaluation of Heidelberg over the past couple of years. It also seems there is some expectation that Heidelberg might crystallize the value of its US cement and aggregates business. Were that asset trading in the US, it would probably command a multiple double that of Heidelberg's current 11X earnings multiple.

Alphabet's stock gained 14% during the quarter. Last quarter, we wrote about how the antitrust case against Alphabet weighed on its share price. It appears that investors are less concerned about this case because it is weak (in our view) and perhaps because they view the incoming Trump administration as less hostile to Alphabet's position. At any rate, the stock probably got too cheap last quarter; its business fundamentals are strong, and the share price this quarter reflected that.

Our three worst performers this quarter were Elevance, Samsung Electronics and Alibaba.

Elevance took a couple of blows this quarter. First, it warned that its Medicaid earnings would come in below expectations this year. The Medicaid business has been in the spotlight as a result of COVID-19. Medicaid rolls filled up during the pandemic, but then rolls started to come down as enrollees lost eligibility when the economy began to normalize. This has made estimating the severity and health trends of the remaining population difficult. So far this year, cost trends have been much worse than expected and are out of line with Elevance's approved rate structure. Margins in the Medicaid business, therefore, will be down this year, and overall profits are likely to be flat. We believe this is a temporary situation. State Medicaid programs are legally required to pay actuarially sound rates to the providers of Medicaid services, such as Elevance. Rates are expected, therefore, to move upward over the next 12 to 18 months, restoring Elevance's margins to a more normal level.

The second issue for Elevance is investor sentiment. A mentally deranged young man murdered a top executive of UnitedHealthcare, the largest health insurer in the country. This led to an Internet frenzy of vicious, inaccurate and, frankly, deplorable criticisms of health insurance companies and their executives. Negative and controversial headlines tend to hurt share prices. This was true of Elevance's stock in the aftermath of this heinous crime. The share price has fallen to extremely attractive levels, trading currently at about 11X earnings. We added to our position during this weakness.

Samsung continued to be a disappointment during the quarter. The shares declined 13% in local currency but were down 23% in US dollar terms. We wrote in some detail about Samsung's issues in our Q3 letter, and, unfortunately, those issues remain largely unresolved. To briefly sum it up, the company is still not fully participating in the lucrative high-end part of the memory market where artificial intelligence (AI) demand is booming.

Perhaps the most disappointing part of Samsung's performance this year is to consider what could have been. As the largest and best capitalized company in the memory semiconductor market, Samsung was perfectly positioned to be at the epicenter of the AI boom. Instead, it inexplicably failed to develop a competitive product and largely missed out on the massive demand created by AI investment.

This can only be described as a massive failure of management and governance. In November, we visited Korea to meet directly with senior management and assess the situation. We came away reassured that they are on a path to addressing the technology issues in their memory business. The company is implementing a redesign for its high bandwidth memory product that should allow it to have a similar (if not superior) product to serve the high-end AI market within the coming year. Importantly, Samsung's key customers are fully aligned to help resolve the issues, since accessing Samsung's massive manufacturing capacity will help unlock critical AI supply chain bottlenecks. In other words, Samsung's customers (including NVIDIA) want it to succeed. Recent comments from NVIDIA's CEO Jensen Huang at the Consumer Electronics Show conference support this conclusion. Like Jensen, we have confidence that Samsung will resolve these technology issues and fully participate in the AI memory market, meaningfully improving its financial performance and share price performance.

Unfortunately, simply addressing the technology issues is no longer enough. The past year's missteps revealed an unacceptable level of governance, which will still need to be addressed. We recently communicated our disappointment directly to management and the board of directors. Since these conversations, we have seen some positive developments—including changes in senior management and a buyback program. We are not alone in our prodding for the company to improve its corporate governance. The Korean government is also pushing for domestic companies to improve corporate governance practices through "Value-Up" programs. We have provided the Samsung board with ideas that should be included in their Value-Up program and look forward to them unveiling their plans in the coming months.

Alibaba's share price decline was primarily giving back the gains from the prior quarter. Recall that all Chinese stocks surged last quarter after the Chinese government unveiled an unanticipated stimulus that temporarily captivated investors. The reality of the undersized stimulus and the challenges facing the Chinese economy eventually prevailed, leading Chinese equities—including Alibaba—to come

back down to earth. Despite our concerns about China's economic outlook, which we outlined in detail in last quarter's letter, shares of Alibaba still represent significant value. The company is a leading player in several attractive market segments. We believe management is doing the right things, such as selling off businesses and returning capital to shareholders. It has made several changes to management and strategy that we expect will return the business to healthy growth over the coming year. In our opinion, the valuation is depressed and does not reflect a fair value for a company with these attributes.

We added no meaningful new names to the portfolio, nor did we exit any positions. However, we did put a hedge in place to protect our exposure to the Chinese RMB.

We believe there is clear risk in the dollar to RMB exchange rate. The rate is fixed by the Chinese government, and that rate is, to some degree, a political decision. At the end of 2019 (i.e., before COVID-19), the exchange rate was about 7 RMB per dollar. Today, it is 7.3 RMB per dollar. China's economic fundamentals have deteriorated significantly since 2019. Growth has stagnated. It's had no COVID recovery. Debt is a major issue after the housing bubble collapse, which wiped out an estimated 4.3% of household net worth. China is geopolitically isolated from the West, and the incoming Trump administration has promised massive tariffs on Chinese imports. None of these developments are good for China's economy and the RMB. Were the RMB freely floated, it would be worth significantly less than where it is fixed today, in our view. This is why we decided to hedge our direct exposure to the RMB during the quarter. We are now protected on our Alibaba investment against any depreciation of the RMB versus the dollar, and we are getting paid a positive spread on our currency position because of the interest rate differential between the dollar and the RMB.

Conclusion

Unsurprisingly, after the massive outperformance of the US market over the past few years, it is harder to find value in the US. That said, with the incoming Trump administration, we expect significant changes to tax, immigration, trade and regulatory policy will have an impact on the economic environment. Trump's extraordinary ascendence from the political ashes is a good reminder for those who believe they know the future. They do not. Humility, hard work and diversification are principles to stick by in any environment. We do not take for granted the trust that you, our clients, have placed in us, and we strive always to earn it.

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For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the Strategy. The holdings mentioned above comprised the following percentages of a representative account within the Strategy Composite's total net assets as of 31 Dec 2024: Alphabet Inc 5.8%, Heidelberg Materials AG 5.3%, The Charles Schwab Corp 5.3%, Elevance Health Inc 4.3%, Samsung Electronics Co Ltd 3.2%, Alibaba Group Holding Ltd 3.0%. Securities named in the Commentary, but not listed here are not held in the portfolio as of the date of this report.

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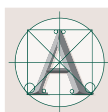
A R T I S A N  P A R T N E R S