# Artisan Value Income Strategy

QUARTERLY
Commentary

As of 31 March 2025

## Investment Process

We seek to invest in companies that are undervalued, in solid financial condition and have attractive business economics. We believe that companies with these characteristics are less likely to experience eroding values over the long term.

### Attractive Valuation

We value a business using what we believe are reasonable expectations for the long-term earnings power and capitalization rates of that business. This results in a range of values for the company that we believe would be reasonable. We generally will purchase a security if the stock price falls below or toward the lower end of that range.

### Sound Financial Condition

We prefer companies with an acceptable level of debt and positive cash flow. At a minimum, we seek to avoid companies that have so much debt that management may be unable to make decisions that would be in the best interest of the companies' shareholders.

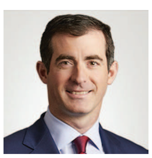
### Attractive Business Economics

We favor cash-producing businesses that we believe are capable of earning acceptable returns on capital over the company's business cycle.

## Team Overview

Everyone on the team functions as a generalist with respect to investment research and the entire team works together on considering potential investments.

### Portfolio Management



Thomas A. Reynolds IV
Portfolio Manager

Daniel L. Kane, CFA
Portfolio Manager

Craig Inman, CFA
Portfolio Manager

## Investment Results (% USD)

| | | | Average Annual Total Returns | | | | |
|---|---|---|---|---|---|---|---|
| As of 31 March 2025 | QTD | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Inception[1] |
| **Composite — Gross** | **2.81** | **2.81** | **8.44** | **5.50** | — | — | **5.52** |
| **Composite — Net** | **2.63** | **2.63** | **7.69** | **4.76** | — | — | **4.79** |
| S&P 500® Index | -4.27 | -4.27 | 8.25 | 9.06 | — | — | 10.09 |
| Dow Jones US Select Dividend Index | 3.25 | 3.25 | 13.49 | 5.91 | — | — | 7.13 |

## Calendar Year Returns (% USD)

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|
| **Composite — Net** | — | — | — | **11.42** | **10.14** |

Source: Artisan Partners/S&P/S&P DJI. Returns for periods less than one year are not annualized. [1]Composite inception: 1 March 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 near the back of this document, which should be read in conjunction with this material.

## Investing Environment

The growth stock trade that had propelled US stocks higher from late 2022 came undone in Q1. First was news of DeepSeek, the Chinese artificial intelligence (AI) model, which sparked a selloff in US tech stocks beginning on January 27. Then came broader weakness in US equities driven by a surge in policy uncertainty created by the new US administration's policies (tariffs, DOGE, immigration) that created concerns about earnings and economic growth. Stocks rallied after the November election on hopes of a business-friendly administration focused on reducing regulation and lowering taxes. However, the president's focus on using tariffs to reorder global trade, decrease the US trade deficit, promote US manufacturing and generate revenues has raised alarm bells among economists and investors. Tariffs are ultimately just taxes on consumers and businesses. They raise prices and reduce profit margins. We remember enough from our macroeconomics 101 classes to know that tariffs create deadweight loss—making the pie smaller. Regrettably, the odds of a US recession have increased considerably as business and consumer confidence are being negatively impacted by the uncertainty created by these policies and actions. Without clarity, companies are delaying long-term investments and hiring, which will weigh on near-term growth.

Dividend stocks were mostly insulated from the volatility. Prior to the DeepSeek news, stocks were broadly positive, with the S&P 500® Index up about 4%, and the Dow Jones US Select Dividend Index (DJUSDI) gaining ~3%. After DeepSeek, amid a sharp rotation from growth to value stocks, the S&P 500® Index declined nearly 8%, whereas the DJUSDI was modestly positive. Large-cap value was the only US style box to finish positive in Q1 as mid and small caps also succumbed to the risk-off market. In the S&P 500® Index, the worst performing sectors were information technology, consumer discretionary and communication services. The best performing sectors were energy, health care and consumer staples.

## Performance Discussion

Our portfolio generated a positive return in Q1 aided by strong gains by our Bond Proxy and Dividend Growth holdings. It was good to see our portfolio construction's flexibility come through in smoothing out return volatility as it was intended. As a reminder, one of the objectives of this equity income portfolio is to provide investors with the ability to participate in the power of long-term compounding. Everyone is a long-term investor in good times. But, when uncertainty rears its head and markets sell off, investors' time horizons can quickly shorten. Investing in lower duration investments (i.e., yield-producing securities) can mitigate volatility, which can thereby help investors remain disciplined and avoid selling at the worst times.

Our top contributors in Q1 were Philip Morris International (PM), Heineken and PPL. PM, a global tobacco company, is our largest position and our top contributor to returns over the one-year period. PM has sought to reduce its reliance on traditional cigarettes—a category in steady decline—by evolving its product portfolio to focus on potentially less harmful smoke-free products that offer superior growth. In the latest quarter, strong top- and bottom-line growth was driven by PM's smoke-free product platform led by IQOS, a heat-not-burn tobacco alternative, and Zyn nicotine pouches. Gross margins in its smoke-free business expanded a remarkable 330bps, and smoke-free is now 40% of PM's total gross profit. Since its 2022 acquisition of Zyn maker Swedish Match, a company we previously held in the portfolio, the popularity of Zyn pouches has surged, helped by free advertising from social media influencers and PM's ability to leverage its global scale and distribution. We believe PM still has significant runway for growth in the US—the world's most profitable nicotine market and one that makes up less than 10% of PM's revenues. On the horizon is the planned rollout in the US of its next-generation IQOS ILUMA heated tobacco device later this year. Looking at PM through our margin-of-safety criteria, the business trades for an undemanding valuation and has extraordinary business economics and a strong credit profile.

After a string of disappointing earnings reports, Heineken delivered stout Q4 2024 results, with improved financial metrics across the board. Strong volumes and organic sales growth were aided by rebounds in Asia and the Americas, offsetting declines in Europe. Operating margins also expanded despite increased marketing spend, supported by cost savings and diminishing inflation pressures. Notably, free cash flow in 2024 was $3.5 billion, the highest in the company's history. Much of that free cash flow is being returned to shareholders. In addition to quarterly dividends that will increase 7.5%, Heineken announced a new €1.5 billion share buyback program. Shares of Heineken and its peers lagged the broader market in 2024 as investors' greater appetite for faster growing businesses and concerns about weight loss drugs weighed on these steady growth stocks. Volume trends can ebb and flow, but on the whole, the alcoholic beverage category has a highly stable demand profile. Rather than sacrifice margins, Heineken has remained focused on maintaining its premium positioning—leveraging its strong brand portfolio and exposure to the premium beer segment—to pass through cost inflation. We believe Heineken's brands and scale provide it with competitive advantages on margins and cash flow and the capacity to invest for growth. Also, Heineken's geographical exposures provide growth tailwinds. It has a relatively small presence in the competitive and shrinking US beer market and an outsized presence in emerging markets.

PPL is an electric and gas utility, with subsidiaries servicing customers in Pennsylvania, Kentucky and Rhode Island. When markets are fearful, as they were in March, investors seek steadier defensive fare like PPL. We classify PPL in our Bond Proxy bucket, which we define as investments in businesses that are less economically sensitive and have steady dividend policies. PPL currently yields 2.9%. We have held PPL since the inception of the portfolio in February 2022. At that time, PPL was selling cheaply versus its history and peers. PPL had just sold its UK business for cash, using the proceeds to retire stock and purchase Narragansett Electric in Rhode Island. Post the UK asset sale, PPL also reduced its dividend more than expected, and its income-focused investor base reacted poorly. Fast forward to today, the company has successfully transitioned into a US-only, regulated utility operating in constructive regulatory areas, with a strong balance sheet to fund its growth initiatives.

Our biggest detractors included Polaris, Merck and nVent Electric. Polaris designs, engineers and manufactures powersports vehicles, operating in three segments: off-road, on-road and marine. Demand for recreational vehicles has remained weak, and now tariffs create additional growth challenges. Due to high dealer inventories, Polaris has had to pursue greater promotional activity through rebates as well as provide cheaper floorplan financing and advertising assistance to dealers—all of which are pressuring margins. Retail weakness is partly a hangover from robust sales during the pandemic that pulled forward demand. Additionally, as inflation has constrained consumer budgets, consumers are deferring big-ticket discretionary purchases and avoiding high financing costs at today's interest rates. We admit that the challenging sales environment may continue, but with the stock drifting back toward its lowest prices since the pandemic selloff of 2020, it now sells cheaply at a mere single-digit P/E based on our estimate of normalized earnings. The company is well run historically, and current management has demonstrated operating discipline by divesting bad businesses acquired under old management, focusing on the company's roots in powersports and continuing its history of returning capital to shareholders via dividends and buybacks. Returns over a business cycle are strong, with returns on tangible capital most years in the mid-to-high teens. Though cash generation has fallen—as expected in a tough retail backdrop—Polaris remains well financed.

Shares of Merck, a health care solutions company, were down 9%. Operating results have been solid, with Q4 earnings beating expectations, but investors were more focused on the continued weak demand in China for Gardasil, a vaccine for human papillomarivus (HPV), and the company's decision to pause vaccine shipments through at least mid-2025 to pare inventories. Though recent Gardasil setbacks have weighed on sentiment, the overarching issue for shareholders remains the success of Merck's late-stage pipeline to replace sales that will be lost when blockbuster oncology drug Keytruda (50% of Q4 sales) comes off patent in 2028. As shares sell cheaply at just 10X earnings, Merck seems to be getting little credit from investors for the 60+ programs it has in clinical development, despite having several solid and large new product opportunities. Additionally, the company's strong balance sheet and robust free cash flow provide it multiple options for future partnerships and acquisitions, besides return of capital to shareholders via dividends and share repurchases.

nVent Electric, a provider of electrical connections and protection solutions, was caught up in the selloff of AI beneficiaries. We added to our position on weakness as there hasn't been any significant change in the company's fundamental underpinnings. Strong growth in the business over the past few years has been supported by multiple secular tailwinds, including electrification, clean energy, energy efficiency, AI, digitalization and onshoring, to name a few. The company has also executed well, allocating capital wisely by deploying free cash flow into product development, accretive M&A and return of capital via dividends and share repurchases. The data solutions business (~14% of sales) has been and is expected to be a key source of growth over the next few years driven by the acceleration in AI infrastructure investment and the company's leading position in liquid cooling solutions. Liquid cooling has been growing 3X the rate of legacy cooling and is still only a small portion of how data centers are cooled today.

## Portfolio Activity

In Q1, we purchased Permian Resources, an independent oil and gas company, and Nestlé, the world's largest food and beverage company. Permian Resources (PR) is focused solely on the Delaware Basin of West Texas and southwestern New Mexico—the most prolific oil-producing region in the US. The founders and co-CEOs, who also have large ownership interests in the business, have sought to build a business that can produce substantial free cash flow, return capital to shareholders and generate attractive equity returns across varied commodities price environments. To achieve these goals, PR has pursued best-in-class operations and responsible capital stewardship by thoughtfully acquiring assets it believes are undervalued and divesting acreage it believes would be better in someone else's hands, while meaningfully returning capital to shareholders in the form of dividends. We always seek to align ourselves with shareholder-oriented management teams, but this is even more critical when investing in mid-sized energy companies given their dependence on the underlying commodity prices and minimal diversification by business and geography as well as the sector's general predilection for reinvesting capital for growth rather than returns. Shares were rangebound for much of 2024 as macro fears have weighed on oil prices and energy sector stocks, giving us an opportunity to purchase a strong operator at a favorable price.

Nestlé has a diverse portfolio, with over 30 "billionaire" brands—those generating CHF 1 billion—including Nescafé, Nespresso, Purina, Gerber and Kit Kat. The largest drivers are coffee, pet care and nutrition—accounting for ~64% of sales and ~65% of operating profit. Approximately 70% of sales are in No. 1 or No. 2 market positions. Nestlé is also highly diversified geographically, with a global footprint of 188 countries (60% developed markets, 40% emerging markets). The stock has been out of favor for a combination of reasons, some of which are company specific. During COVID, certain product categories saw rapid growth, and Nestlé raised prices to cover surging raw material costs. During that period, growth was entirely driven by price. Eventually, volumes decelerated, and consumers pushed back on pricing. The stock peaked in January 2022. The stock's valuation has fallen meaningfully in the ensuing three years, nearing trough valuation multiples. Other growth headwinds impacting the consumer-packaged goods (CPG) sector are slowing population growth, especially in developed markets, competition from private label and niche brands, and the advent of GLP-1 weight loss drugs, which curb appetites for sugary foods. In August, the board appointed

Laurent Freixe as the new CEO. His immediate focus is on organic growth through innovation and increased advertising and promotional spend to drive free cash flow generation. Innovation took a backseat during the pandemic, as was common among CPG businesses, and that likely hindered growth post the pandemic. Margins are expected to remain under pressure as the company invests to reignite growth over the next 12–18 months, as well as due to higher commodity prices ahead of lagged future price increases. We believe these challenges are already well recognized by the market and largely priced into the stock. As we wait for new management to turn around Nestlé's growth, the company continues to generate solid free cash flow and pay a solid dividend, yielding ~3.4%.

We sold one stock this quarter, exiting Airbus, an aerospace company, as shares reached our target selling range.

## Perspective

As we write this letter following April 2's rollout of tariffs by the US administration that shocked equity, fixed income and commodity markets across the world in its breadth and scope, Q1 seems like a distant memory.

How should we frame the range of outcomes? Before we go there, let's first revisit the last period of severe uncertainty, March 2020. In the early weeks and months of COVID, our framework was as follows:

- We don't know how long COVID will last. It could be a very bad 12–24 months. After that time, presumably life will return to normal.
- Therefore, we sold any companies that had diminished capability to make it to the other side.
- We purchased high-quality franchises we believed would make it and were cheap three years out, assuming a normalization of the business results.

With hindsight, we believe the COVID framework served us well, in what was a very difficult environment. Constructing an analog to current events is not as straightforward, however, because the intent of the administration is unclear. While some White House advisors say it is a negotiation, those who constructed the tariffs have said "this is not a negotiation." The distinction is important. If President Trump, who has talked up his 30 years of frustrations with being "mistreated" in global trade, truly wants to reorder global trade and return manufacturing to the US, tariffs will continue to be used and may be ratcheted up in 90 days. The tariffs would have to be viewed by CEOs as credibly intact for the duration of his presidency and beyond to build supply chains and manufacturing in the 50 states. To project this kind of certainty on tariffs for that long will create immediate and enduring inflation commensurate with the tariff rate. If the tariffs are high, it will likely create demand destruction. For affected companies, this translates to significant margin compression and a revenue recession. It appears with the 90-day reprieve of April 9 that the deep recession/depression risk is off the table for now, a giant relief. Now we begin the "deal" phase.

These are difficult times. Please know we are researching impacts with the seriousness they deserve. While the coming months may be extremely volatile, we'd note our portfolio performed well coming out of COVID. Our long-standing investment philosophy allows us to deploy capital in turbulent markets with both humility and confidence. We typically find more bargains in the market when the elements of fear and panic rise in magnitude. As always, we lean on our better-safer-cheaper foundation.

For more information: Visit www.artisanpartners.com

**Investment Risks: There is no guarantee that the companies in which the portfolio invests will declare dividends in the future or that dividends, if declared, will remain at current levels or increase over time. The equity, fixed income and derivative security types referenced each contain inherent risks, including the risk of loss like all investments, and capital appreciation and income is not guaranteed. 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. 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. Value securities may underperform other asset types during a given period. These risks, among others, are further described in Artisan Partners Form ADV, which is available upon request. This is a marketing communication.**

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. The holdings mentioned above comprised the following percentages of a representative account within the Artisan Value Income Strategy Composite's total net assets as of 31 Mar 2025: Philip Morris International Inc 4.1%, Heineken Holding NV 2.5%, PPL Corp 2.5%, Polaris Inc 1.5%, Merck & Co 0.6%, nVent Electric PLC 1.1%, Centennial Resource Development Inc 1.5%, Nestle SA 1.0%. Securities named in the Commentary, but not listed here are not held in the portfolio as of the date of this report.

Securities referenced may not be representative of all portfolio holdings. Securities of the same issuer are aggregated to determine a holding's portfolio weight. Portfolio statistics calculations exclude outlier data and certain securities which lack applicable attributes, such as private securities. Artisan Partners may substitute information from a related security if unavailable for a particular security. This material is as of the date indicated and is subject to change without notice. Totals may not sum due to rounding. Portfolio security yields are subject to market conditions and are not guaranteed.

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.

Portfolio holdings are classified into five income categories: Core Value, Dividend Recovery, Dividend Growth, Bond Proxy and Capital Structure. Core Value holdings are investments consistent with the team's value investing approach that also have an income component. Dividend Recovery holdings are investments where the current yield does not reflect the future payout. Dividend Growth holdings are investments where the dividend payout is expected to grow over a multiyear period. Bond Proxy holdings are investments in businesses which are less economically sensitive and have steady dividend polices. Capital Structure holdings are instruments that comprise non-equity parts of the capital structure (e.g., preferred securities, convertibles and bonds).

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.

S&P 500® Index measures the performance of 500 US companies focused on the large-cap sector of the market. The Dow Jones US Select Dividend Index measures the performance of the US's leading stocks by dividend yield. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.



This summary represents the views of the portfolio manager as of 31 Mar 2025. Those views and portfolio holdings are subject to change and Artisan Partners disclaims any obligation to advise investors of such changes. The discussion of portfolio holdings does not constitute a recommendation of any individual security.

**Price-to-Earnings (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings. **Free Cash Flow** is a measure of financial performance calculated as operating cash flow minus capital expenditures. **Dividend Yield** is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. **Normalized Earnings** are earnings that are adjusted for the cyclical ups and downs over a business cycle.

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