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INVESTING

Follow This Guy Across The High Seas In Quest Of Growth Stocks

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Rezo Kanovich likes companies that have zero analyst coverage. He explains why.

Small-stock aficionados: Are you limiting your attention to the U.S. market? Then you are missing out, says Rezo Kanovich, manager of an immensely successful portfolio of smaller foreign companies. “The universe of small stocks [abroad] is vast, bigger than the U.S. market by a factor of eight,” he says. “It creates a rich hunting ground for us.”

Kanovich has captured his share of game. After six years managing a small-foreign-stock fund at Oppenheimer, he was lured away to Artisan Partners Asset Management, a Milwaukee-based firm that oversees \$174 billion in pooled funds and separate accounts. In his three years in Artisan’s New York City office, the International Small-Mid Fund that he runs there has beaten its MSCI benchmark by approximately 6 percentage points a year on average, and that’s after a 1.3% expense ratio.

What does this fund buy? Shares of companies you have probably never heard of: Metso Outotec from Finland, Bâloise Holding from Switzerland, Fortnox from Sweden, Howden Joinery Group from England and 124 others.

A third of these companies aren’t even in the indexes, which means you don’t get them in an international index fund with approximately 4,000 small-company stocks. Many have zero analysts covering them, and there’s a reason for that. Explains Kanovich: “Companies that [are] covered tend to be the ones looking for capital. The better companies tend to be self-financed and not particularly interested in investment banking relationships.”

It takes work to assemble a portfolio of these gems. Unfortunately you cannot have Kanovich do the work for you at the moment. With \$6 billion in assets, the fund was getting muscle-bound and Artisan closed it to most new investors last summer.

Of course, you will hear about additions and deletions a few months after the event, but this lag does only so much damage when the manager in question is a buy-and-hold guy. Kanovich’s fund has a 26% turnover.

Most of the tens of thousands of stocks around the planet are of no interest to Kanovich, even if a surge in earnings makes one of them look cheap. “A small commodity company in Western Australia will have its moment under the sun, but it’s not sustainable,” he says. “You have to have technology, brands or know-how. Otherwise you end up being a slave in some else’s value chain.”

The place to look, says Kanovich, is “at the intersection of growth and change.”

Example: The supply lines of the fashion industry are changing, and that creates growth opportunities for innovators. His fund has stakes in Kornit Digital, an Israeli-American firm that makes machinery for quick-turnaround apparel, and Boohoo Group, a British company that sells fashion items online and doesn’t have stockpiles of inventory the way department stores used to. These companies, he says, “turn the economics of the textile industry upside-down. You don’t have to bet on green polka-dot shirts in XL size being in demand.”

Other sectors where he is finding small innovators: biotechnology, electric vehicles, building automation, business process automation.

Fortnox is a Swedish company that Kanovich describes as a blend of Intuit’s Quickbooks and Craigslist. Small businesses are addicted to its software. Altus Group, a Canadian firm, supplies data and software to the commercial real estate industry; Kanovich says that it has a customer retention rate higher than 100%, by which he means that customers not only stick around but also buy more products.

Metso Outotec, from Finland, looks a bit old-economy at first, but its metal-processing machinery, which includes recycling equipment, is suited to a world in which environmental demands are disrupting old processes.

And then there’s fintech. The fund owns Bâloise Holding, a property/casualty insurer in Basel that has been around since 1863

but has some novelty-seeking in its blood. Its online distribution is reminiscent of what upstart Lemonade is offering in the U.S., Kanovich says. Lemonade, something of a fad, trades at 30 times revenues, notwithstanding that it's losing money. You get Baloise at 0.8 times revenue and 12 times earnings.

That value-rich insurance company is something of an outlier in the growth-tilted Kanovich portfolio. His average price/earnings ratio (calculated as a harmonic mean, which is the right way to do it), is 26. The average for the stocks in my table is 36.

If you are bold enough to go where few investors go, how do you place your bets? Until recently, buying weird stocks traded in Helsinki and Zurich would have been quite a challenge. Now it's very doable. Big brokerage firms offer overseas-trading accounts that incorporate currency conversion with local trade execution. The negative is that fees are often stiff, a hit of 0.75% to 1% on just the currency.

Skip the big names and go to Interactive Brokers, a Wall Street upstart

and price-cutter that is just the sort of firm Kanovich would be interested in if it were located abroad rather than in Greenwich, Connecticut.

Interactive has had a very cosmopolitan bent from its early days as an option specialist. Customers can use Interactive's platform to access 135 markets in 33 countries while juggling 24 currencies. "International trading is huge for us," says Steve Sanders, executive VP for marketing. "Eighty percent of account applications are coming from outside the U.S. right now."

Interactive's currency conversion fee is a bargain 0.2% (less for large trades) and its foreign stock-trading commission, for all but the smallest trades, is usually between 0.05% and 0.1%. You can hold credit balances in a collection of different foreign currencies, a real convenience when the dividend payments arrive.

In the Interactive screening database: 5,698 U.S. stocks and 17,715 foreign ones.

Now, it's quite possible to buy foreign shares without delving into a foreign

exchange, but this is a bad idea for stocks, like the ones in the table, that are unfamiliar to American investors. One method is to buy an American Depositary Receipt (ADRs) with a five-letter ticker ending in Y. The other is to buy foreign shares traded in dollars in the U.S. over-the-counter market, via five-letter tickers ending in F.

ADRs for big companies like HSBC are traded on exchanges and very liquid. But the Y shares for small companies, which change hands over the counter, can be a trading disaster. On one recent day the total volume for BHOOPY, the ADR for Boohoo Group, was all of 100 shares. Boohoo's F shares had a \$284 grand total trading volume that day. A thin volume is an invitation to a market maker to pick your pocket. If you want Boohoo, buy it in London.

And if you buy it, buy and hold. In-and-out traders in small companies get hurt, Kanovich says, especially when they are venturing into the dimly lit corners of the universe.

Artisan International Small-Mid Fund is closed to most new investors. For new account eligibility criteria, please refer to the "Who is Eligible to Invest in a Closed Artisan Fund?" section of the prospectus.

This article represents the views of William Baldwin of Forbes and Rezo Kanovich, Portfolio Manager: Artisan International Small-Mid Fund, as of October 25, 2021 and those views and opinions are presented as their own. Artisan Partners is not responsible for and cannot guarantee the accuracy or completeness of any statement in the discussion. 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 advisor before making investments in order to determine the appropriateness of any investment product discussed herein.

Artisan International Small-Mid Fund Investment Results

Investment Results as of 30 September 2021 (%)	QTD	YTD	1YR	3YR	5YR	10 YR	Inception
Investor Class: ARTJX	-1.40	4.33	22.99	15.65	13.72	12.28	12.29
Advisor Class: APDJX	-1.35	4.48	23.20	15.80	13.80	12.33	12.32
Institutional Class: APHJX	-1.33	4.53	23.30	15.92	13.97	12.41	12.36
MSCI All Country World ex USA SMID Index	-0.94	9.48	28.94	8.88	9.40	8.69	9.32
MCSI All Country World ex USA Small Cap Index	0.00	12.23	33.06	10.33	10.28	9.44	10.25

Source: Artisan Partners Artisan Partners/MSCI. Returns for periods less than one year are not annualized. Class inception: Investor (21 December 2001); Advisor (4 December 2018); Institutional (12 April 2016). For the period prior to inception, each of Advisor Class and Institutional Class's performance is the Investor Class's return for that period ("Linked Performance"). Linked Performance has not been restated to reflect expenses of the Advisor or Institutional Class and each share's respective returns during that period would be different if such expenses were reflected.

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 800.344.1770 for current to most recent month-end performance.

Expense Ratios	ARTJX	APDJX	APHJX
Semi-Annual Report 31 Mar 2021 ¹	1.31	1.14	1.05
Prospectus 30 Sep 2020 ²	1.34	1.19	1.10

¹Unaudited, annualized for the six-month period. ² See prospectus for further details.

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 calling 800.344.1770. Read carefully before investing.

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. 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. Growth securities may underperform other asset types during a given period.

MSCI All Country World ex USA SMID Index measures the performance of small- and mid-cap companies in developed and emerging markets excluding the US. MSCI All Country World ex USA Small Cap Index measures the performance of small-cap companies in developed markets and emerging markets excluding the US. 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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Price-to-Earnings (P/E) is a valuation ratio of a company's current share price compared to its per-share earnings.

For the purpose of determining the Fund's holdings, securities of the same issuer are aggregated to determine the weight in the Fund. The holdings mentioned above comprised the following percentages of the Artisan International Small-Mid Fund's total net assets as of 30 September 2021: Kornit Digital Ltd 3.0%, Metso Outotec Oyj 1.8%, Howden Joinery Group PLC 1.2%, Fortnox AB 1.2%, Altus Group Ltd 1.1%, Boohoo Group PLC 1.0%, Baloise Holding AG 0.8%. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

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