Artemis European Growth *Fund*

Manager's Short Report

For the six months ended 30 September 2016

Investment objective and policy

The objective of the fund is to achieve long-term capital growth through investment principally in companies in Europe (excluding the United Kingdom).

The manager actively manages the portfolio in order to achieve the objective and will not be restricted in the choice of investments either by company size or industry, or in terms of the geographical split of the portfolio.

The fund may also invest in other transferable securities, units of collective investment schemes, money market instruments, warrants, cash and near cash, derivatives and forward transactions and other investments to the extent that each is permitted by the regulations.

Risk and reward profile

Typically lower rewards						Typically higher rewards
Lower risk						Higher risk
1	2	3	4	5	**6**	7

- This indicator is based on historical data and may not be a reliable indication of the future risk profile of the fund.
- The risk category shown is not guaranteed and may change over time.
- A risk indicator of "1" does not mean that the investment is "risk free".
- The indicator is not a measure of the possibility of losing your investment.

The risk indicator for the fund is as above because:

- The price of units, and the income from them, can fall and rise because of stock market and currency movements.
- Stock market prices, currencies and interest rates can move irrationally and can be affected unpredictably by diverse factors, including political and economic events.
- A portion of the fund's assets may be invested in a currency other than the fund's accounting currency (sterling). The value of these assets, and the income from them, may decrease if the currency falls in relation to sterling, in which the fund is valued and priced.

Fund information

Launch date	7 March 2001
Unit types	I accumulation R accumulation
IA sector	Europe (ex-UK)
Historic yield†	
I accumulation	1.7%
R accumulation	1.1%
Accounting dates	30 September & 31 March
Distribution date	31 May

† The historic yield reflects distributions declared over the past 12 months as a percentage of the mid-market unit price, as at the date of this report. It does not include any preliminary charge and unitholders may be subject to tax on their distributions.

ARTEMIS
The PROFIT Hunter

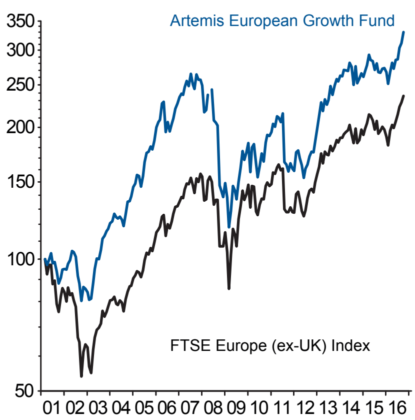
Investment review

- The fund returned 11.2%* versus the market's 13.5%*.
- The bias away from 'value' and towards expensive defensives remains extreme.
- Our stocks are cheaper than the market and are growing more quickly.

Performance – Reasonable returns …

The fund had a reasonable half-year, returning 11.2%. The European (ex-UK) market, meanwhile, was up 13.5% over the same period. A good deal of this was due to the weakness of sterling, which boosted the value of overseas assets. There has also been an underlying rise in stock prices. With sterling now looking a bit cheap and stock markets a bit expensive, future returns from European equities seem likely to be a bit below average. But they are likely to be positive – and better than those from cash or bonds.

Long-term performance

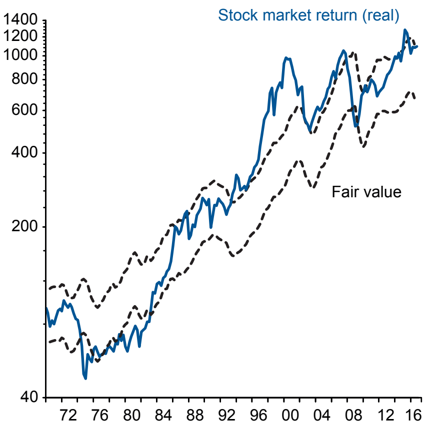


Source: Thomson Reuters Datastream.

Review – Focusing on the fundamentals …

It could be argued that the European market is now slightly expensive (see second chart) as share prices are a little ahead of fundamentals: dividends, cashflows and earnings per share. There is no rule to say that stock markets must follow corporate profits up and down. But there is a tendency for subsequent returns to be above average when markets are cheap relative to underlying earnings. Equally, returns tend to be below average when markets are expensive. With the dividend yield now below 3.5%, European equities may struggle to deliver 5% per annum over the next decade (although even this is likely to be much better than government bonds, yields on which are close to zero).

European equities are towards the top end of 'fair value'



Source: Thomson Reuters Datastream.

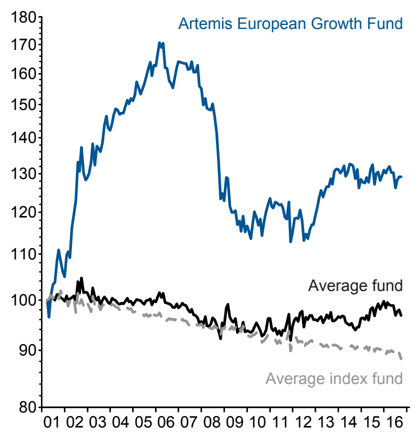
Many attribute sterling's weakness to the vote for Brexit. The reality, however, is that sterling was overvalued before the referendum. It may now be slightly undervalued – but not hugely so. Our expectation is that returns from European markets over the longer term are likely to be a function of growth in profits rather than swings in the currency.

In the US, investors have moved into index (or passive) funds in a big way. These charge a smaller fee than active funds and simply look to track the index. In the past decade, more than 90% of US mutual funds investing in the domestic market have underperformed the index. As a consequence, money has flowed out of active funds and into index funds, which now account for around half of US equity mutual funds.

In the UK, things are a little different. Active funds investing in the UK and European (ex-UK) markets have outperformed index funds over the past decade. As a result, while index funds are picking up market share, they are less dominant than in the US, accounting for about 23% of UK equity funds and 11% of Europe ex-UK funds.

The third chart shows the performance of three series: our fund versus the market; a group of index funds versus the market; and Europe (ex-UK) funds in general against the market. A number of things are clear. First, due to fees, index funds steadily underperform the index. Second, active funds tend to match the market even after fees. Third, our fund has outperformed the market handsomely over the years, but it has not been a smooth journey.

Fund performance versus FTSE Europe (ex-UK) Index



Source: Thomson Reuters Datastream.

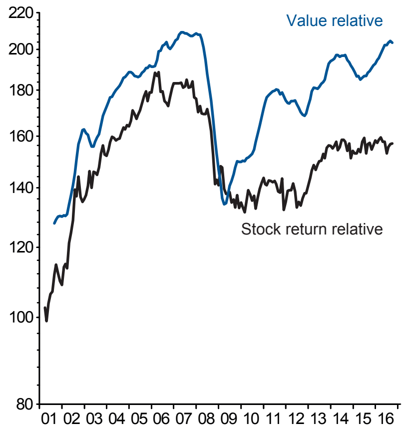
So why has our fund done well over the years, badly for a while and then been moribund (relative to the market) over the past few years? The answer lies in the relative growth of the stocks we have owned - together with some swings in fashion.

My belief is that while it is often difficult to understand year-to-year changes in the overall level of the stock market, the moves within it are easier to explain. They are dominated by relative growth in earnings, dividends, cashflows and book value (which we can collectively call the relative growth in fundamentals). To give an example, the fourth chart shows the relative performance of

* Source: Artemis/Lipper Limited, class I accumulation units, bid to bid basis in sterling with dividends reinvested to 30 September 2016. Benchmark is the FTSE World Europe (ex-UK) Index.

the stocks in our fund against the European market.

Relative fundamentals determine relative performance



Source: Thomson Reuters Datastream.

Basically the performance of our fund's relative performance is determined by changes in the relative fundamentals of the stocks we own. When the fundamentals improve, the fund does relatively well. When they deteriorate, it does poorly. Over the years, the fund has delivered superior growth and so has outperformed the market.

Outlook – Why we invest in 'value' (and growth) …

When we picked growth stocks that didn't deliver growth, as in 2007-08, we were punished. The past few years have been frustrating in that we have correctly identified companies with growth - but this has not been rewarded by performance.

While this is irritating, it is not entirely unprecedented. Our kind of stocks also tended to have a tough time in the late 1990s, when investors fell in love with technology stocks. When this bubble of optimism burst (as it happens, about the time of the launch of this fund) our stocks did very well. The market's appetite over the past six years has been for 'safety'. Investors have developed a huge aversion to losses which has revealed itself in a preference for government bonds. As a result, yields on government bonds are now close to zero – and investors are still pouring money into this asset class.

Similarly, within the equity market investors are favouring stocks that have not cut their dividends but whose dividend yields are now very low. Large-cap stocks such as Nestle, Unilever, AB InBev, SAP and Novo Nordisk all trade on high multiples of their earnings given their (modest) growth. It is not easy to predict when this will end. Commentators often argue that until economic growth picks up sustainably, expensive stocks will remain that way. This assumption seems dangerous. That is primarily because stock prices relative to the market are dominated by relative profits and dividends – not by whether economies are growing by 0.5% per annum compared to 2.5% per annum.

It is worth being aware that whilst many active equity managers like to think they have an insight to the future, their collective wisdom has tended to have poor predictive powers. Over the past 50-odd years, those stocks predicted to grow the fastest have actually delivered average growth; and because of their poorer valuations, they ended up delivering below average returns. (This is the reason we use our disciplined SmartGARP® process to identify winners based upon data, rather than predictions). By contrast, 'value' stocks have tended to do well (because their growth has been less bad than everyone predicted). Nevertheless, over the past decade this has not been the case: value stocks in general have gone on to deliver even worse profits than had been forecast, and so have performed poorly.

This has not been lost on professional investors. I observe that 79% of actively managed funds in the Europe (ex-UK) sector now have a bias towards expensive growth stocks. While this is understandable in the context of the past few years, it represents a fairly extreme bet - especially given the long history of these expensive stocks performing poorly. We suspect this could change suddenly if unloved companies start to deliver average, rather than poor, growth.

In summary, although our stocks are delivering the same excess growth as normal, they have become unusually cheap – probably because of a desire by markets to avoid things that seem "risky". While a handful of our competitors' funds have a disposition towards value, the vast majority of active funds are crowded into expensive defensive shares. Investors may come to regret that.

The stocks we own sit on low valuations and keep delivering growth that is superior to the market. Although these kinds of stocks have not been in favour over the past few years, it would be perfectly normal if they were to deliver improved returns in the future.

Philip Wolstencroft
Fund manager

Investment information

Portfolio split

	30 September 2016 % of net assets	31 March 2016 % of net assets
France	20.18	22.83
Germany	16.10	20.08
Italy	9.80	3.93
Sweden	6.50	5.72
Belgium	5.97	3.89
Netherlands	5.10	7.65
Denmark	4.43	3.62
Finland	4.01	-
United Kingdom	3.94	1.63
Switzerland	3.90	3.42
Russia	3.78	3.20
Greece	3.51	2.00
Spain	3.30	3.16
Norway	3.16	4.45
Austria	2.08	3.12
Turkey	1.67	2.99
Hungary	1.04	0.91
Portugal	0.61	0.88
Ukraine	0.45	0.93
Cyprus	0.17	-
Israel	-	2.17
Ireland	-	1.75
United States of America	-	1.51
Poland	-	0.37
Net other assets/ (liabilities)	0.30	(0.21)
Net assets	100.00	100.00

Ten largest investments

Investment	30 September 2016 % of net assets
Atos	3.87
Siemens	2.58
Renault	2.56
Deutsche Post	2.34
Lukoil, ADR	2.18
Thales	2.04
Rubis	1.99
Erste Group Bank	1.91
KBC Group	1.91
Enel	1.83

Investment	31 March 2016 % of net assets
Renault	3.14
Daimler	2.88
Swiss Life Holding	2.67
Atos	2.37
Axa	2.31
Thales	2.22
NN Group	2.18
Peugeot	2.11
GN Store Nord	2.10
Deutsche Lufthansa	2.02

Comparative tables

Fund sizes & net asset values

Date	Net asset value of fund (£)	Net asset value per unit (p)	Units in issue
31 March 2014	316,161,124		
I accumulation		260.73	34,279,790
R accumulation		249.24	90,989,337
31 March 2015	263,895,051		
I accumulation		272.38	37,534,302
R accumulation		258.44	62,551,132
31 March 2016	275,283,616		
I accumulation		267.12	74,632,780
R accumulation		251.52	30,187,065
30 September 2016	185,942,243		
I accumulation		297.08	37,485,021
R accumulation		278.69	26,761,370

Ongoing charges

Class	30 September 2016
I accumulation	0.89%
R accumulation	1.64%

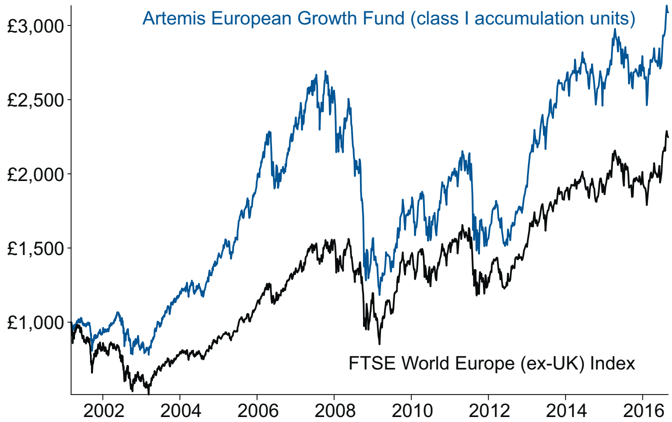
Ongoing charges shows the annual operating expenses of each unit class as a percentage of the average net assets of that class for the preceding 12 months.

Class I performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis European Growth Fund	212.5	100.6	29.2	20.0	11.2
FTSE World Europe (ex-UK) Index	127.4	83.6	27.1	21.1	13.5
Sector average	130.8	86.0	28.1	18.6	11.2
Position in sector	6/43	21/75	37/86	31/96	51/97
Quartile	1	2	2	2	3

* Data from 7 March 2001. Source: Artemis/Lipper Limited, data from 7 March 2001 to 7 March 2008 reflect class R accumulation units, and from 7 March 2008 to 30 September 2016 class I accumulation units, bid to bid in sterling. All performance figures show total return with dividends reinvested percentage growth. Sector is IA Europe (ex-UK), universe of funds is those reporting net of UK taxes.

Value of £1,000 invested at launch to 30 September 2016



Class R performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis European Growth Fund	193.2	93.3	26.3	19.1	10.8
FTSE World Europe (ex-UK) Index	127.4	83.6	27.1	21.1	13.5

* Data from 7 March 2001. Source: Artemis/Lipper Limited, class R accumulation units, bid to bid in sterling to 30 September 2016. All performance figures show total return with dividends reinvested percentage growth.

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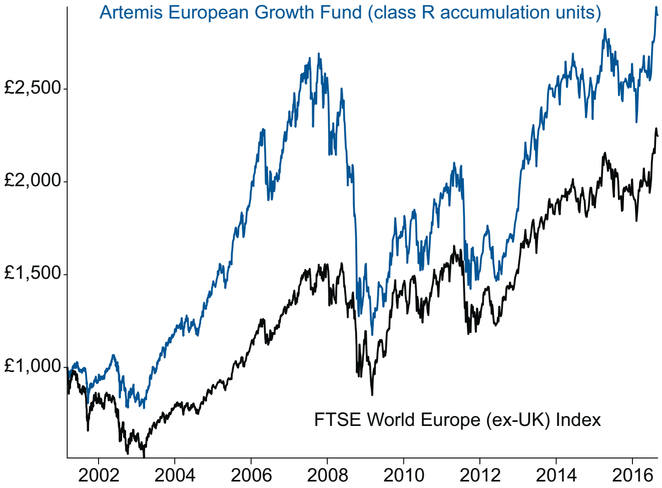

Changes to performance reporting

Following recent guidance from the Investment Association, changes have been made to fund performance disclosure. The majority of investors now buy 'clean class' fund units (typically those with the lowest charges), which for Artemis is the class I units. Sector performance information is therefore now shown for class I units, rather than for class R units.

General information

Tax information reporting

UK tax legislation requires fund managers to provide information to HM Revenue & Customs ('HMRC') on certain investors who purchase units in unit trusts. Accordingly, the fund may have to provide information annually to HMRC on the tax residencies of those unitholders that are tax resident outwith the UK, in those countries that have signed up to the OECD's ('Organisation for Economic Co-operation and Development') Common Reporting Standard for Automatic Exchange of Financial Account Information (the 'Common Reporting Standard'), or the United States (under the Foreign Account Tax Compliance Act, 'FATCA'). All new unitholders that invest in the fund must complete a certification form as part of the application form. Existing unitholders may also be contacted by the Registrar should any extra information be needed to correctly determine their tax residence. Failure to provide this information may result in the account being reported to HMRC. For further information, please see HMRC's Quick Guide: Automatic Exchange of Information – information for account holders: gov.uk/government/publications/exchange-of-information-account-holders.

Report & accounts

This document is the Short Report of the Artemis European Growth Fund for the six months ended 30 September 2016. The Half-Yearly Report can be obtained from the manager's website **artemis.co.uk**, by contacting the Client Services team on 0800 092 2051 or by writing to the manager's address above.

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