ARTEMIS Strategic Bond *Fund*

Manager's Short Report

For the six months ended 30 September 2016

Investment objective and policy

The fund seeks to achieve a combination of income and capital growth by investing predominantly in fixed income markets.

The fund aims to achieve its objective by investment predominantly in fixed income markets but may selectively invest in other markets. Equal emphasis is given to the security of capital and income although from time to time one may take prominence over the other in accordance with the strategy being pursued.

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.
- The fund may hold derivatives with the aim of profiting from falling prices. If the related assets rise in value the fund will lose money.
- Investments in fixed interest securities are subject to market and credit risk and will be impacted by movements in interest rates. Interest rate movements are determined by a number of economic factors, in particular market expectations of future inflation.
- The fund can invest in higher-yielding bonds, which may increase the risk to your capital due to a higher likelihood of the company issuing the bonds failing to pay returns on investments. Changes to market conditions and interest rates can have a larger effect on the values of higher-yielding bonds than other bonds.
- The fund holds bonds which could prove difficult to sell. As a result, the fund may have to lower the selling price, sell other investments or forego more appealing investment opportunities.

Fund information

Launch date	1 June 2005
Unit types	MI distribution
	MI accumulation
	QI distribution
	QI accumulation
	MR distribution
	MR accumulation
	QR distribution
	QR accumulation
IA sector	£ Strategic Bond
Distribution yield†	
MI distribution	4.2%
MI accumulation	4.2%
QI distribution	4.2%
QI accumulation	4.2%
MR distribution	3.7%
MR accumulation	3.7%
QR distribution	3.7%
QR accumulation	3.7%
Accounting dates	30 September & 31 March
Distribution dates	
MR & MI classes	Distribute on a monthly basis
QR & QI classes	30 April, 31 July, 31 October & 31 January

† The distribution yield reflects the amounts that may be expected to be distributed over the next 12 months as a percentage of the mid-market unit price of the fund as at the date of this report. It is based on a snapshot of the portfolio on that day. It does not include any preliminary charge and investors may be subject to tax on distributions.

ARTEMIS
The PROFIT Hunter

Investment review

- The fund returned 7.1%* vs 6.7%* for its peers.
- Markets dominated by politics (and central bankers.)
- We see opportunity in the further volatility ahead.

Performance – A case of returns …

In general, bonds have performed well over the last six months. The fund's performance, meanwhile, was slightly above the average of its peers. It returned 7.1% for the half year compared with 6.7% for its peer group. We are satisfied to have generated this return, despite having encountered a number of obstacles along the way. Our investment grade holdings (those rated 'BBB' and above) performed particularly well, having followed interest rates lower and outperformed government bonds.

The biggest detractor from returns was our reluctance to buy longer-dated government bonds. These rallied very sharply after further rounds of quantitative easing were announced. These bonds are volatile and don't yield much: an unhappy combination indeed. Our biggest worry is inflation. Weaker sterling and higher commodity prices could lead to some inflationary pressures in the UK, which would be bad for government bonds. So while we are irritated by missing out on returns in long-dated bonds, we are not inclined to chase the rally.

Review – Politics intrudes …

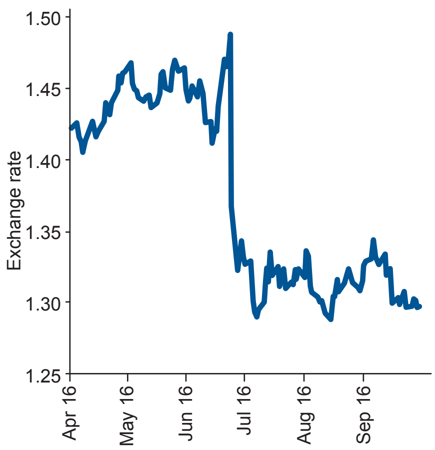
The six months under review were dominated by the UK referendum on its membership of the EU. The outcome was not what we had expected and we quickly moved the portfolio to reflect the changed economic outlook. In anticipation that sterling would be weaker if the UK voted to leave the EU we 'bought' US dollars on the day of the referendum (or, more technically, unhedged our exposure to the US dollar that arises from holding dollar-denominated bonds). We increased that position once it became clear that a vote to 'leave' was more likely. We also bought UK Gilts and US Treasuries. All of these moves proved profitable.

The Bank of England responded to the result by cutting interest rates and revived its quantitative easing programme by buying UK Gilts and corporate bonds. This has forced bond prices higher – which is good for the fund.

The implications of the vote to leave are generally positive for bonds in other ways too. Expectations for growth have been lowered and we expect private sector investment to be reduced. It is unlikely, for instance, that certain companies will make a big investment in manufacturing capacity when they are unsure of the terms of trade for their export markets. To make up the shortfall in demand, there will be pressure on the government to increase expenditure. Increased public investment is likely. That means greater government expenditure - and more borrowing.

Charts are a useful complement to the written word. For this reason we include a chart of sterling's performance against the US dollar over the last six months. The chart may be simple, but the story it tells is important.

Exchange rates: Sterling versus US Dollar



Source: Bloomberg.

Our biggest concern is that one consequence of weaker sterling will be higher inflation. It is inevitable that petrol prices will rise. Further, OPEC seems to be reaching some sort of accord to cut output which, at least for the short-term, has seen the price of oil rise. Inflation could be markedly higher over the next 12 months. The Bank of England will likely try to ride this out and resist raising interest rates. But if inflation becomes entrenched, it may have little choice.

The referendum has not been the only piece of excitement over the last six months. The European Central Bank ('ECB') is still buying corporate bonds through its programme of quantitative easing. Interest rates are negative and many European government bonds are offering negative yields. This is creating all sorts of distortions. It is particularly painful for European banks. With the exception of some big corporate clients, they cannot charge their clients for accepting their deposits yet find themselves obliged to pay when they deposit their reserves at the ECB. Meanwhile, the US Department of Justice is dreaming up reasons to impose ever-bigger fines for past sins. This smacks of protectionism: domestic US banks have been treated more leniently. Deutsche Bank has recently been in the headlines as its share price collapsed on rumours of record fines. Personally, we must admit to a degree of *schadenfreude*: it has treated its bondholders badly for years. All in all, European banks are causing repeated bouts of panic, nearly every quarter.

It is no surprise that the European economy remains in the doldrums given that the banks are so weak and unprofitable. Banks oil the wheels of commerce but that system is not operating smoothly at present. In our view, it will only be when banks are allowed to make profits that they will resume lending and the economy will recover. As part of that healing process, banks will need higher interest rates.

Quantitative easing is manna for corporate bonds. Forced buying by the ECB and now the Bank of England is pushing their prices higher. But it is also creating distortions. Some companies will borrow too much and, when the next economic downturn comes, will be under pressure. To be fair, they have generally refinanced for very long periods at extremely attractive rates,

* Source: Lipper Limited, class QI accumulation units, bid to bid basis in sterling with net income reinvested to 30 September 2016.

often replacing higher coupon bonds with significantly lower ones. But that doesn't mean that some companies are not overextending themselves. In practice, we are sceptical about the long-term benefits of corporate bond purchases (except in times of real distress.) And while we are enjoying the boost to performance that has come from central bank buying, we are not inclined to chase returns, so have focused the portfolio on other areas which are not included in the programme: bank and insurance company bonds, hybrid debt and high-yield bonds.

Some of our more interesting purchases have been old-style junior bank bonds. When these bonds were issued they were regarded as capital. Following the financial crisis, however, the regulator changed the rules and they won't count as capital after 2021. Banks are therefore retiring them when they can. We think the banks could either buy these back at par or tender for them over the next few years. They have already rallied strongly after Barclays tendered for some outstanding bonds in September, so the move has already been profitable. We anticipate further gains from these holdings in the future.

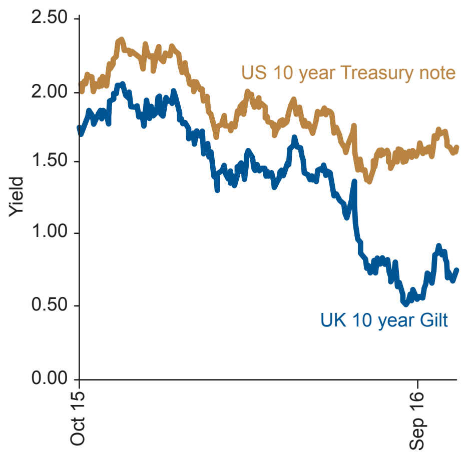
Insurance company bonds have been shunned by the market. We like the sector. By demanding that insurers hold more capital, new solvency rules are making them safer. The complexity of the rules is eye-watering, but the principles behind them seem sensible. The only downside is their volatility. They tend to behave poorly when markets weaken, but we consider these episodes as opportunities to buy more, as we have done over the period.

The fund's high-yield bonds (those rated below 'BBB') have been a big boost to its performance. The market was subdued in the run-up to the EU referendum, but rallied quite strongly as the spillover from quantitative easing helped the high-yield market. Our most profitable positions have been in oil company bonds, which have recovered from lows seen earlier this year, but there was also some good corporate news elsewhere. Bonds issued by cinema chain Odeon, for example, performed well after an American group bought it. Eden Springs, which supplies offices with water, was taken over and its bonds were called at a good premium.

Outlook – Reasons to remain wary (of government bonds) ...

Our biggest worries concern government bonds, particularly UK Gilts. We have reduced the fund's duration (which is to say lowered its sensitivity to an increase in interest rates) significantly, selling most of the UK Gilts we bought after the EU referendum. Weaker sterling, higher oil and commodity prices and tougher immigration rules could put upward pressure on inflation. UK Gilts have outperformed US Treasuries markedly since the EU referendum, as the below chart shows. We feel this will reverse.

Yields of UK Gilts and US Treasuries



Source: Bloomberg.

Furthermore, interest rates in the US seem set to rise. Growth continues, unemployment is falling and inflationary pressures are increasing. The US Federal Reserve sets the agenda for interest rates worldwide, suggesting we should be anticipating higher yields across all government bond markets. Although this will be negative for some of our investment grade positions, it should benefit the fund's holdings in bank and insurance company bonds, both of which can take advantage of higher yields. This is another reason for retaining these holdings.

Political upheaval seems likely to continue over the next year. With elections in France and Germany and a referendum in Italy, markets are bound to be volatile. Further, with the pollsters' credibility in tatters, investors will wait until the actual results before making decisions. The UK referendum was a clear example of a backlash against globalisation and although we are wary of making any electoral predictions, we expect similar populist results over the next year. With populism and anti-globalisation sentiment on the rise, markets will remain cautious. The consequence will be higher inflation, reinforcing our caution about government bonds.

Many investors were panicking about commodity prices – especially crude oil – in the early part of the year. We were a little more optimistic and bought bonds issued by commodity related companies such as Total and BHP Billiton. We have tended to buy their hybrid (junior) bonds, where yields are more attractive. Although these have already performed well for us, we feel that the more conservative management attitude towards dividends will continue to support them in the future. Hybrid bonds currently make up 18% of the portfolio.

The high-yield market is another core part of the fund, comprising around 48% of its portfolio. This area should continue to perform well while economic growth remains slow and steady. Although a recession would be unwelcome news for this asset class, we don't think one is imminent – although growth is likely to remain anaemic in the UK and Europe.

The coming year seems likely to present bond managers with more obstacles. Through what could potentially be a volatile year, we will depend on our nimble and pro-active approach. We feel confident we can take advantage of the opportunities that volatility always creates. The fund's performance over the last decade has been strong and we look forward to adding to those returns over the years to come.

James Foster and Alex Ralph
Fund managers

Investment information

Portfolio split

	30 September 2016 % of net assets	31 March 2016 % of net assets
Equities		
Norway	0.01	0.01
Government bonds		
United Kingdom	4.50	2.45
Germany	-	3.98
United Arab Emirates	-	1.00
Corporate bonds		
United Kingdom	42.82	41.97
United States of America	7.27	6.73
France	5.96	5.12
Germany	5.63	6.20
Netherlands	5.23	4.82
Italy	2.80	3.01
Ireland	2.75	2.31
United Arab Emirates	2.49	1.50
Switzerland	2.30	2.71
Spain	1.66	2.84
Australia	1.35	1.06
Luxembourg	1.19	0.92
Bermuda	1.09	1.14
Mexico	1.04	1.09
Sweden	0.99	1.11
Bulgaria	0.84	0.86
Jersey	0.74	0.75
Forward currency contracts	(0.86)	-
Net other assets	10.20	8.42
Net assets	100.00	100.00

Ten largest investments

Investment	30 September 2016 % of net assets
UK Treasury 2.00% 07/09/2025	2.36
UK Treasury 1.25% 22/07/2018	2.14
Alliance Data Systems 5.25% 15/11/2023	1.43
ING Bank, FRN 4.12% 21/11/2023	1.27
SSE, FRN 5.63% Perpetual	1.25
RWE, FRN 7.00% Perpetual	1.21
PGH Capital, FRN 5.75% 07/07/2021	1.19
NGG Finance, FRN 5.62% 18/06/2073	1.18
Electricite de France, FRN 6.00% Perpetual	1.16
Zurich Insurance, FRN 4.25% 01/10/2045	1.14
Investment	**31 March 2016 % of net assets**
Bundesrepublik Deutschland Bond 1.00% 15/08/2025	3.98
UK Treasury 2.00% 07/09/2025	2.45
Alliance Data Systems 5.25% 15/11/2023	1.38
BNP Paribas, FRN 5.95% Perpetual	1.28
RSA Insurance Group, FRN 5.13% 10/10/2045	1.26
PGH Capital, FRN 5.75% 07/07/2021	1.25
ING Bank, FRN 4.12% 21/11/2023	1.25
SSE, FRN 5.63% Perpetual	1.24
RWE, FRN 7.00% Perpetual	1.22
GE Capital Trust V, FRN 5.50% 15/09/2066	1.21

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	668,069,869		
MI distribution		54.93	262,450,025
QI accumulation		82.55	101,463,300
MR distribution		54.83	187,586,629
MR accumulation		80.78	105,299,419
QR distribution		54.79	112,167,692
QR accumulation		80.85	235,945,038
31 March 2015	830,856,442		
MI distribution		55.69	447,166,332
MI accumulation		57.79	14,058,069
QI distribution		83.69	16,335,311
QI accumulation		86.84	260,155,676
MR distribution		55.59	119,321,065
MR accumulation		84.61	75,930,549
QR distribution		55.55	80,322,650
QR accumulation		84.69	187,616,416
31 March 2016	860,709,932		
MI distribution		53.33	497,633,466
MI accumulation		57.44	49,609,273
QI distribution		80.13	55,514,499
QI accumulation		86.31	335,767,947
MR distribution		53.23	97,807,146
MR accumulation		83.72	51,196,498
QR distribution		53.18	25,200,990
QR accumulation		83.81	148,206,200
30 September 2016	953,168,951		
MI distribution		56.11	520,304,980
MI accumulation		61.51	66,259,733
QI distribution		84.31	60,311,397
QI accumulation		92.43	370,889,374
MR distribution		56.01	95,483,959
MR accumulation		89.47	48,595,589
QR distribution		55.96	21,312,742
QR accumulation		89.56	131,692,866

Distribution tables

Monthly distributions for the six months ended 30 September 2016

Payment date	MI distribution (p)	MI accumulation (p)	MR distribution (p)	MR accumulation (p)
31 May 2016	0.1500	0.1615	0.1315	0.2067
30 June 2016	0.1629	0.1759	0.1418	0.2236
29 July 2016	0.1835	0.1988	0.1642	0.2594
31 August 2016	0.1602	0.1741	0.1413	0.2239
30 September 2016	0.1626	0.1772	0.1402	0.2229
31 October 2016	0.1587	0.1735	0.1386	0.2208

Monthly distributions for the six months ended 30 September 2015

Payment date	MI distribution (p)	MI accumulation (p)	MR distribution (p)	MR accumulation (p)
29 May 2015	0.1636	0.1699	0.1433	0.2180
30 June 2015	0.1605	0.1672	0.1409	0.2150
31 July 2015	0.1702	0.1776	0.1489	0.2276
28 August 2015	0.1722	0.1804	0.1520	0.2331
30 September 2015	0.1666	0.1749	0.1482	0.2279
30 October 2015	0.1867	0.1967	0.1650	0.2544

Quarterly distributions for the six months ended 30 September 2016

Payment date	QI distribution (p)	QI accumulation (p)	QR distribution (p)	QR accumulation (p)
29 July 2016	0.7480	0.8056	0.4380	0.6904
31 October 2016	0.7257	0.7886	0.4207	0.6682

Quarterly distributions for the six months ended 30 September 2015

Payment date	QI distribution (p)	QI accumulation (p)	QR distribution (p)	QR accumulation (p)
31 July 2015	0.7453	0.7728	0.4338	0.6614
30 October 2015	0.7926	0.8293	0.4657	0.7161

Comparative tables (continued)

Ongoing charges

Class	30 September 2016
MI distribution	0.58%
MI accumulation	0.58%
QI distribution	0.58%
QI accumulation	0.58%
MR distribution	1.08%
MR accumulation	1.08%
QR distribution	1.08%
QR accumulation	1.08%

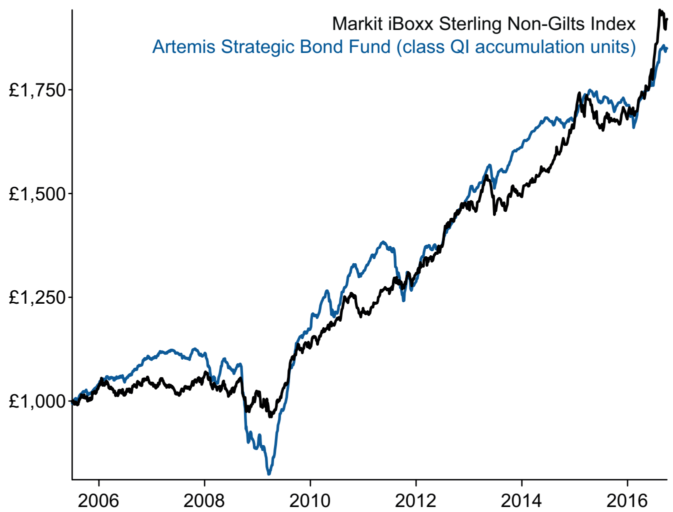
Ongoing charges shows the annual operating expenses of each unit class as a percentage of the average net assets of that class for the preceding 12 months.

Class I performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis Strategic Bond Fund	84.9	46.8	18.0	9.2	7.1
Markit iBoxx Sterling Non-Gilts Index	91.0	49.4	28.0	14.0	10.1
Sector average	64.5	37.4	16.0	8.2	6.7
Position in sector	7/28	18/48	26/64	22/69	25/70
Quartile	1	2	2	2	2

* Data from 30 June 2005. Source: Lipper Limited, data from 30 June 2005 to 7 March 2008 reflects class QR accumulation units and from 7 March 2008 to 30 September 2016 reflects class QI accumulation units, bid to bid in sterling. All figures show total returns with net interest reinvested, percentage growth. Sector is IA £ Strategic Bond, universe of funds is those reporting net of UK taxes.

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

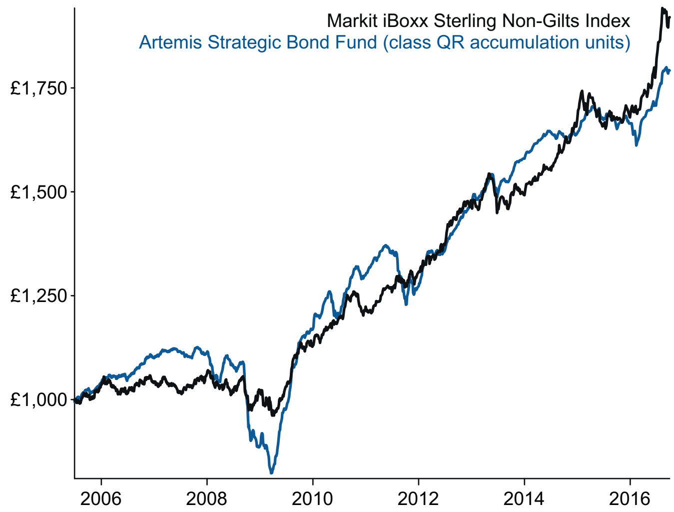


Class R performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis Strategic Bond Fund	79.2	43.8	16.5	8.7	6.9
Markit iBoxx Sterling Non-Gilts Index	91.0	49.4	28.0	14.0	10.1

* Data from 30 June 2005. Source: Lipper Limited, class QR accumulation units, bid to bid in sterling to 30 September 2016. All figures show total returns with net interest reinvested, percentage growth.

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



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.

Tax information reporting

UK tax legislation requires fund managers to provide information to HM Revenue and 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.

Changes to tax on interest distributions

With effect from 6 April 2017 interest distributions paid by the fund to all unitholders will be made without the deduction of any income tax.

Report & accounts

This document is the Short Report of the Artemis Strategic Bond 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 below.

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