Artemis UK Select *Fund*

Manager's Short Report

For the six months ended 30 June 2016

Investment objective and policy

The objective of the fund is to achieve long-term capital growth. The emphasis of the fund will be investment in companies listed, quoted and/or traded in the UK and in companies which are headquartered or have a significant part of their activities in the UK which are quoted on a regulated market outside the UK.

The manager actively manages the portfolio in order to achieve the objective and will not be restricted in respect of choice of investments either by company size or industry. The securities of companies listed, quoted and/or traded in the UK but domiciled elsewhere and the securities of companies traded on ISDX may be included in 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 / Lower risk						Typically higher rewards / 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 have a concentrated portfolio of investments, which can give rise to more risk than where investments are spread over a large number of companies. This may increase the potential gains, however, the concentration of exposure and lack of diversification may also substantially increase the risk of loss by this fund.
- 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.
- Investing in small and medium-sized companies can involve more risk than investing in larger, more established companies. Shares in smaller companies are often not as easy to sell as shares in larger companies are. This can cause difficulty in buying, valuing and selling those shares. Also, reliable information for deciding their value or the risks may not be available.
- 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.

Fund information

Launch date	3 April 1998
Unit types	I accumulation
	R accumulation
IA sector	UK All Companies
Historic yield *	
I accumulation	2.4%
R accumulation	1.5%
Accounting dates	30 June & 31 December
Distribution date	28 February

* 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

Performance – An apology ...

The first half of 2016 was a very disappointing period for the fund. It fell by 15.6%* versus a 4.3%* gain in the FTSE All-Share index. The majority of those losses came in the week after the UK voted to leave the EU. We had tilted the fund's sector positioning to benefit from a vote to remain. That proved mistaken. The performance of the fund has suffered significantly as a result, for which we apologise to unitholders.

Review – Stock-picking overshadowed by politics ...

Returns from the UK market over the last six months have been heavily influenced by big picture 'macro' events. These tended to overshadow our stock-specific insights. We started the year with a cautious outlook, reflecting our concerns over slowing growth in emerging markets and in the expectation that, because the labour market in the US was continuing to tighten and wages were starting to rise, the US Federal Reserve ('Fed') would move forward in raising interest rates. Indeed the Fed's own 'dot plot' guidance suggested we could expect three or even four rises of 0.25% over the course of 2016. Given this outlook, we were comfortable with the positioning of the portfolio inherited from the fund's previous manager, Tim Steer. As the year began, the fund was weighted towards UK domestic cyclical stocks and away from companies dependent on emerging markets and commodity prices.

Six months later, a lot has changed. Take the Fed, which, rather than focusing solely on data on the US economy, is now paying attention to the strains that higher rates in the US place on the wider global economy. China, meanwhile, reacted to a rapid slowdown in its economy through additional stimulus. Together, these actions have prompted a strong rally in commodity prices. And, of course, we had the UK referendum towards the end of June.

Amid this macro-inspired market turbulence we made a considerable shift to transition the portfolio away from the one we inherited and towards the one we wanted. With the benefit of hindsight we did not do this quickly enough. The top-down changes in the market complicated the task of selling some of the less liquid and less fashionable companies in the portfolio. For example, we inherited holdings in two peer-to-peer lending companies, Ranger Direct Lending and P2P Global Investments. Mounting evidence that similar lending platforms in the US were seeing higher-than-expected impairments on their loans caused shares in both companies to perform poorly. Furthermore, reward packages for these companies' managers incentivise them to issue new equity when their existing shares trade above NAV. Put together, we felt the balance between risk and reward in these investments was not in our favour. Other sales included satellite communications company Avanti Communications Group (which will likely need to raise more equity to get back to profitability) and Ibstock (given returns on capital are at all-time highs we are worried about the outlook for brick prices). Finally, we sold estate agent Purplebricks Group, whose performance had outstripped our expectations.

We did not anticipate the large stimulus program the Chinese government introduced in the first quarter. This provided a significant boost to the mining sector with the result that the fund rapidly lost the substantial relative gains it made by avoiding this area in 2015. We believe the slowdown in China was worse than many in the West had believed. So grave was the threat that it obliged the government to introduce a significant package of stimulus measures. To us, this only defers the inevitable rebalancing that needs to take place. So although we stand by our belief that China needs much less fixed asset investment and slower growth in housing, the correction has been postponed. We maintain our view that prices for bulk commodities remain above fair value levels and foresee further weakness in demand.

We are currently being told China is implementing its second stimulus of the year. We can't see much evidence of it in the data yet. Nonetheless, it would be remiss not to acknowledge that there has been welcome reform among the mining companies. Asset sales and cuts to dividend payments and capital expenditure have helped to improve balance sheets. Fundamentally, we maintain that a bear market in commodities only ends when growth in demand outstrips supply. And for the bulk commodities (iron ore and thermal coal) we believe a credible case can be made that global demand will fall from this point. Investment in infrastructure is slowing and environmental considerations mean coal-fired power stations are being retired. In January and February there were sudden concerns that China would devalue the renminbi. At that point, they opted for stimulus instead. More recently, while the eyes of the world were on the Brexit vote, the Chinese have made further strides in devaluing the renminbi. We see this as further reason to avoid producers of bulk commodities.

The situation in the oil sector is slightly different. We began the year with an underweight position. But as the price of crude fell, dipping below $30 per barrel, we believed that the pain felt by producers would trigger a response from OPEC. We therefore decided to increase our exposure by adding significantly to our holding in BP. Further down the market-cap scale, meanwhile, we took smaller positions in Tullow, Vedanta Resources and Genel. Shares in all of them had fallen very heavily due to their sensitivity to the oil price and worries about their balance sheets. The price of oil duly rallied and these holdings performed strongly. The only exception was Genel, where a large downgrade to estimated and proven reserves at a field in Kurdistan offset the benefits of the higher price of crude. We sold this holding.

Following oil's rally to $50 per barrel (and the rally the energy sector enjoyed in sterling terms after the referendum) the easy money appears to have been made. Falling production costs across

* Source: Lipper Limited, class I accumulation units, bid to bid basis, in sterling with income reinvested to 30 June 2016. Benchmark is the FTSE All-Share Index.

the industry are allowing producers to re-calibrate their business models for a world in which oil prices are lower. In the US, shale drillers are going to work again – efficiency improvements mean their wells are economic with oil prices at just $50 per barrel. We believe this will cap the rebound in oil prices and leads us to expect that energy companies will start to invest again. So we began looking at oil services and related businesses, initiating a holding in Fenner at the end of March. It will benefit as the mining industry resumes buying its conveyor belts and from renewed demand for its seals and flexible hoses from shale energy companies in the US.

It was, however, the EU referendum that had the biggest influence on the fund's performance over the period. We knew that our overweight position in stocks dependent on demand in the domestic economy left the fund positioned for a vote to 'remain'. And in February, when the date of the referendum was set, we were comfortable with that position. Over the second quarter, however, it became clear that the result would be closer than originally predicted. During May and June opinion polls began to exercise a dominant influence over the UK market and it became evident that there would be significant divergence in the performance between different sectors of the market depending on the outcome of the vote. So we took some precautionary measures, reducing holdings in the fund's most liquid, referendum-sensitive stocks: Lloyds Banking Group, Aviva, Legal and General and BT Group. We also reduced mid-cap holdings such as Grainger, Howden Joinery and sold Derwent London.

We reinvested some of the proceeds into a new holding in Shire following completion of its merger with Baxalta. The market's initial response to the deal was muted. We believe the modest earnings multiple on which the shares trade does not reflect the prospect of double-digit growth in earnings through to the end of the decade or the synergies from the deal. Yet while these trades have worked, with hindsight it is clear we should have done more.

On the day of the referendum result we further reduced the fund's holdings in Lloyds Banking Group, Redrow and Crest Nicholson Holdings. For a time, all were trading at prices above their lows for the year despite fears of a leave vote having become a reality. We used the proceeds to increase our holding in Shire and to initiate a new holding in Smith & Nephew. Despite the fact that their underlying prospects are unlikely to be materially affected by the referendum, shares in both companies de-rated heavily.

Outlook – Why 2016 is not 2008 ...

"There are decades where nothing happens; and there are weeks where decades happen."

We never thought we would quote Lenin, but it seems apposite. In the days following the referendum, investors moved rapidly to re-price individual stocks to reflect huge changes in exchange rates, altered expectations for interest rates worldwide and in anticipation of slower growth in the UK economy. To simplify, after the referendum, companies whose businesses are sensitive to asset prices (such as banks, insurers and property companies) underperformed materially as did stocks sensitive to the domestic UK economy.

In effect, the share prices of companies sensitive to asset prices began to anticipate imminent collapses in both the residential housing and commercial real estate markets. We certainly don't dispute that prices are likely to fall, but we differ as to the extent of the correction. The market has also rushed to price-in a collapse in consumer confidence and a freeze in industrial capital expenditure.

It seems the market is remembering what happened in 2008 and assuming the same thing will happen again. But there are good reasons to think 2016 is likely to be different: we do not expect there to be a freeze in financial markets and nor do we expect there to be a credit shock. Compared to 2008, banks have greater liquidity, their loan books are less risky, their capital ratios are higher and due to the Mortgage Market Review they have slowed loan growth. Furthermore, the Bank of England is aware of the risks and has already pre-emptively lowered capital requirements for banks, increased liquidity in the system and signalled that it is prepared to cut interest rates.

In the absence of a credit shock, a sharp increase in unemployment seems unlikely. So we would expect consumer confidence to stabilise over time. Although we aren't disputing that there will be a slowdown, we believe that lenders and consumers are in better shape than they were in 2008-09.

We believe that we are currently at the period of maximum uncertainty. With a new prime minister and cabinet in place, we expect confidence to improve. The government is already talking to companies and we expect to hear policy measures designed to support the economy. We look forward to an articulation of the UK's negotiating position in talks with the EU. The greater clarity on the UK's economic prospects that will emerge over the coming weeks will, we believe, allow investors to take a more informed view of the prospects for domestic stocks.

In these times of heightened uncertainty, we are sticking to our investment philosophy and, by applying it rigorously, using volatility to add to our preferred holdings at attractive prices. We also want to take advantage of relative-value opportunities – instances where companies with similar markets and currency exposures have seen their share prices reacting to Brexit in very different ways. This strategy has proved rewarding in previous periods of market dislocation. With the share prices of domestic earners and financial stocks continuing to fall, we believe that many have fallen too far. We have therefore been adding to (or buying back) some of our positions in these areas.

We enter the second half of the year with the restructuring of the portfolio complete. Looking ahead, we are optimistic about the stocks we hold, believing they currently offer attractive absolute and relative value with the prospect of a re-rating as the outlook for the UK economy becomes clearer.

Ed Legget
Fund manager

Investment information

Portfolio split

	30 June 2016 % of net assets	31 December 2015 % of net assets
Equities		
Consumer Goods	22.03	18.37
Industrials	21.29	18.66
Financials	17.59	20.97
Consumer Services	12.86	18.86
Oil & Gas	8.75	7.63
Telecommunications	5.09	6.00
Healthcare	5.00	1.54
Basic Materials	0.99	0.66
Derivatives		
Consumer Services	(0.04)	0.02
Industrials	(0.07)	0.04
Consumer Goods	-	0.01
Net other assets	6.51	7.24
Net assets	100.00	100.00

Ten largest investments

Investment	30 June 2016 % of net assets
SuperGroup Plc	4.99
Photo-Me International Plc	4.29
Imperial Brands Plc	4.27
Shire Plc	4.13
BT Group Plc	3.79
BBA Aviation Plc	3.28
Prudential Plc	3.26
BP Plc	3.07
British American Tobacco Plc	3.01
Barclays Plc	2.68
Investment	**31 December 2015 % of net assets**
SuperGroup Plc	5.49
Ashtead Group Plc	5.30
Howden Joinery Group Plc	5.07
Card Factory Plc	3.83
BT Group Plc	3.51
Imperial Tobacco Group Plc	3.46
Royal Dutch Shell Plc B shares	3.44
International Consolidated Airlines Group SA	3.03
Man Group Plc	2.79
Galliford Try Plc	2.72

Comparative tables

Fund sizes & net asset values

Date	Net asset value of fund (£)	Net asset value per unit (p)	Units in issue
31 December 2013	632,382,431		
I accumulation		427.16	38,478,418
R accumulation		417.22	112,175,766
31 December 2014	722,931,286		
I accumulation		429.38	72,499,880
R accumulation		415.81	98,993,814
31 December 2015	687,500,387		
I accumulation		481.75	77,478,183
R accumulation		463.02	67,869,117
30 June 2016	472,818,929		
I accumulation		406.29	58,973,567
R accumulation		389.04	59,947,363

Net revenue distribution & unit price range

Year	Net revenue per unit (p)	Highest offer price (p)	Lowest bid price (p)
I accumulation			
2011	4.8950	315.75	242.12
2012	5.3539	319.41	276.94
2013	5.8265	435.14	317.11
2014	5.5480	463.16	390.83
2015	9.6612	499.86	422.59
2016 *	-	482.46	391.73
R accumulation			
2011	2.8181	326.36	240.22
2012	3.1541	326.51	273.48
2013	3.0376	441.40	311.66
2014	2.2523	469.18	379.07
2015	5.9117	500.97	409.11
2016 *	-	482.02	375.12

Net revenue includes all amounts paid and payable in each calendar year.
* To 30 June 2016.

Ongoing charges

Class	30 June 2016
I accumulation	0.82%
R accumulation	1.57%

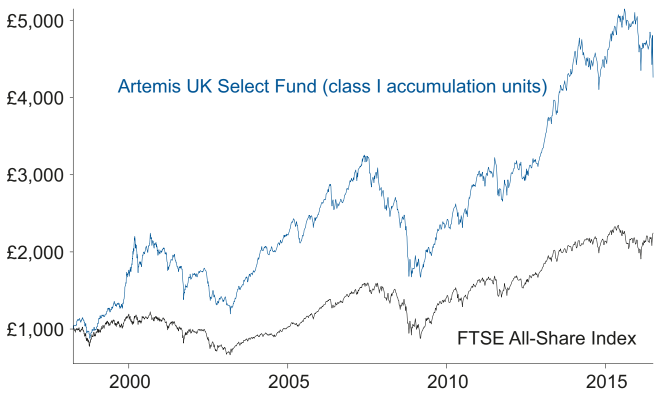
Ongoing charges shows the annual operating expenses of each unit class as a percentage of the average net assets of that class for the preceding 12 months.

Class I performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis UK Select Fund	326.2	37.5	10.5	(13.7)	(15.6)
FTSE All-Share Index	124.4	35.5	18.6	2.2	4.3
FTSE 100 Index	97.5	31.7	16.9	3.8	6.6
Sector average	136.5	36.9	16.8	(4.0)	(2.7)
Position in sector	8/85	107/216	204/244	249/258	259/262
Quartile	1	2	4	4	4

* Data from 3 April 1998. Source: Lipper Limited, data from 3 April 1998 to 1 September 2010 reflects class R accumulation units, and from 1 September 2010 reflects class I accumulation units, bid to bid in sterling to 30 June 2016. All performance figures show total returns with income reinvested, percentage growth. Sector is IA UK All Companies, universe of funds is those reporting net of UK taxes.

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



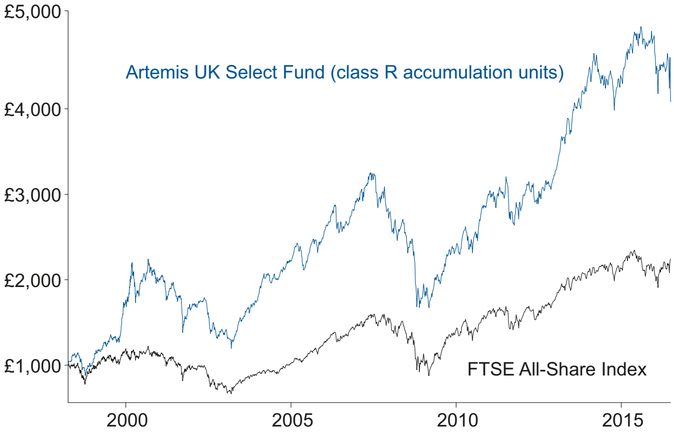
Comparative tables (continued)

Class R performance

	Since launch *	5 years	3 years	1 year	6 months
Artemis UK Select Fund	308.1	32.4	8.0	(14.3)	(15.9)
FTSE All-Share Index	124.4	35.5	18.6	2.2	4.3
FTSE 100 Index	97.5	31.7	16.9	3.8	6.6

* Data from 3 April 1998. Source: Lipper Limited, class R accumulation units, bid to bid, in sterling to 30 June 2016. All performance figures show total return with income reinvested, percentage growth.

Value of £1,000 invested at launch to 30 June 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.

Performance reporting periods for Artemis' fund class I unit classes are now shown from the launch of the fund, rather than from the launch of the unit class. Where class I units were launched at a later date than the fund, the earlier period reflects the performance of the class R units, and from the launch of the class I units, reflects the class I performance.

General information

Report & accounts

This document is the Short Report of the Artemis UK Select Fund for the six months ended 30 June 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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