Artemis High Income *Fund*

Manager's Short Report

For the year ended 7 August 2016

Investment objective and policy

The objective of the fund is to achieve a higher than average initial yield, combined with the prospect of rising income and some capital growth over the long term.

The emphasis of the fund will be investment in UK fixed-interest investments and preference shares, however, the manager has the flexibility to invest in all economic sectors worldwide and in equities.

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.

ARTHIF/09/16

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.
- 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.
- Whilst investing in units that pay income each month (class MI units) will produce a regular income, it may restrict the potential for those units to increase in value in comparison to the units that pay income every three months (classes QR and QI units).

Fund information

Launch date	9 September 2002+
Unit types	MI distribution QI distribution QR distribution
IA sector	£ Strategic Bond
Distribution yield *	
MI distribution	5.8%
QI distribution	5.8%
QR distribution	5.8%
Underlying yield †	
MI distribution	5.1%
QI distribution	5.1%
QR distribution	4.5%
Accounting dates	7 February & 7 August
Distribution dates	
MI class	Distributes on a monthly, basis two months after period end date.
QI & QR classes	Distribute on 7 January, 7 April, 7 July, 7 October

+ The date Artemis took over management of the fund.

* 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 31 July 2016. It is based on the portfolio on that date. It does not include any preliminary charge and unitholders may be subject to tax on their distributions.

† The underlying yield reflects the annualised income net of all the expenses of the fund (calculated in accordance with relevant accounting standards) as a percentage of the mid-market unit price of the fund. The distribution yield is higher than the underlying yield because a portion of the fund's expenses are charged to capital. This has the effect of increasing the amount available for the distribution and constraining the fund's capital performance by an equivalent amount for the year.

ARTEMIS
The Profit Hunter

Investment review

- The fund returned 2.6%*.
- Political risk and recession worries are offset by central banks.
- Our stock-picking strategy began to pay off in the second half of the year.

Performance – Our focus on income holds back total returns …

The fund returned 2.6%* over the year. This, however, lagged the sector average of 5.6%*. While our dividend-paying stocks performed well, they couldn't keep up with the gains enjoyed by long-duration assets such as government bonds, whose prices shot higher as their yields collapsed. Yields on benchmark 10-year government bonds fell from 2% at the beginning of the period to just 0.6% at the end, equating to a capital gain of 11%. Because our main objective is to create a high level of income for unitholders, we shy away from investing in long-duration assets simply because their yields are so low.

Review – Amid (misplaced) panic, we remain calm …

Markets have been on a roller coaster ride over last 12 months. The period began amid fears over a 'hard landing' in the Chinese economy. This initially sent commodity prices lower and then began to hurt other 'risk' assets, such as equities and high-yield bonds. The US Federal Reserve ('the Fed') added to the uncertainty when it declined to raise interest rates despite the strength of the US labour market. In addition to all this economic uncertainty, company-specific problems at Volkswagen and Glencore spread fear through the credit market. Glencore's problems were a largely foreseeable consequence of the rout in commodity prices. But Volkswagen's difficulties, a result of its emissions scandal, came as a shock. They caused aversion to risk to rise across the hybrid bond market (the most junior bond a company can issue) but particularly in the autos sector.

A measure of calm was restored to the market in October. By that stage, valuations had become compelling and Mario Draghi was hinting that the European Central Bank ('ECB') would extend its quantitative easing ('QE') programme. This would not be the last time that bond markets recovered thanks to the promise of further QE. Indeed, the reporting period was peppered with instances of recessionary fears being calmed by central bankers. The start of 2016, for example, was marked by (misplaced) panic over the threat of a global recession. The Bank of Japan's additional monetary stimulus in the form of negative yields was followed by the ECB's surprise announcement that it would extend its asset purchases to include investment-grade corporate bonds. The final piece of this puzzle was supplied by the Bank of England. After the shock result of the Brexit referendum, it cut interest rates and committed to a new phase of QE, through which it will buy another £60bn of gilts and £10bn of corporate bonds.

These periods of volatility created plenty of opportunities for us to pick up sources of income at discounted prices. For example, the bonds of commodity producers suffered during the first six months of the year as oil and mineral prices continued to collapse. Although we previously had very little exposure to the commodity sector, valuations in this part of the market became compelling and we began to increase our weighting to them. Our first addition was a position in BHP Billiton. A highly rated, investment-grade company with a strong balance sheet, its hybrid bond, which carried a coupon of 6.5% at issue, was an attractive proposition. It has returned 16% since purchase. As oil prices began to rally, we added to the fund's exposure to the energy sector by buying bonds issued by Continental Resources, a US shale energy producer. We also took a new position in Nyrstar, a zinc mining and smelting company. A rebalancing of supplies in the zinc market caused its results to beat expectations and it returned around 13% between the time we bought it and the end of the review period.

The market turbulence at the start of 2016 also gave us an opportunity to add to the fund's holdings in hybrid bonds. These are generally issued by investment-grade companies but are the most junior bonds in their capital structure. They were particularly badly hit during the New Year turbulence. This strategy paid off when the senior bonds of investment-grade companies became eligible for the ECB's expanded QE programme, encouraging investors to venture into more junior bonds to find yield.

One of the few new issues we bought during the period was Entertainment One. Its portfolio of assets includes the production and distribution of the Peppa Pig TV programme. Since we bought it, Entertainment One has spurned a takeover approach from ITV and our holding has returned 15%. The fund has benefited greatly from takeover activity this year. Cinema chain Odeon, which has long been one of our favoured holdings, finally accepted a takeover bid from an American buyer, AMC. Two other holdings, Eden Springs and EWOS, were taken over and their bonds repurchased by their new owners for healthy premiums.

The reporting period saw a spike in defaults in the US high-yield market. The sharp fall in the price of crude oil led to an increase in defaults in the energy sector, one of the biggest issuers of high-yield bonds. Default rates in Europe, in contrast, remained at historic lows, although we did see a debt restructuring by Abengoa, a European renewables company. While the default wasn't entirely unexpected, its timing took the market by surprise and its short-dated bonds fell by over 50%. While the fund didn't hold these bonds, it did have a small, residual holding in Isolux. Abengoa's restructuring had the effect of closing

* Source: Lipper Limited, class QI distribution units, bid to bid basis, in sterling with net income reinvested. Benchmark is Markit iBoxx sterling non-gilts Index. Sector is IA £ Strategic Bond.

financing channels for companies in its sector and related industries and engineering group Isolux struggled to find liquidity, compelling it to restructure its debts.

Also on the negative side, some of the fund's holdings in illiquid financial bonds hampered its performance. Although there was a sharp rebound in prices towards the end of the review period, some of our holdings are still trading at a discount. The woes of the European banking system continue to weigh on the market. Our exposure to these bonds has been very limited. Our biggest exposure within financials has been to insurance companies. While many of these have performed well, some of the more illiquid bonds have struggled as the market discriminated between liquid and illiquid bonds.

That returns from UK equities over the period were modest was hardly surprising given the lacklustre economic background and the surprise outcome of the Brexit vote. As a result, the fund's equity holdings made little contribution to the fund's overall return although their dividend yields are making an important contribution to the income it generates. They also offer the prospect of some income growth. Among our equity holdings, the best contribution came from the strong recovery in Ashmore, a fund manager that specialises in emerging-market debt. This time last year, few could find anything positive to say about emerging markets. But just 12 months later, they have rallied strongly, boosting Ashmore's revenues. We have begun to reduce our holding.

Elsewhere, BAE Systems performed well as spending on defence stabilised. We took a holding in Cobham with the intention of benefiting from the same underlying trend. Unfortunately, problems in Cobham's commercial business depressed its profits. This in turn led to its debts being too high for comfort. An unexpected rights issue meant that the fall in Cobham's share price more than erased the positive contribution from BAE Systems.

Meanwhile, our holdings in the shares of life insurance companies came under pressure following the unexpected result of the UK's referendum on EU membership. But they have subsequently reassured the market on their prospects, reconfirmed their commitments to pay dividends and so made up much of that lost ground.

In activity, we reduced our holding in Arvida Group, a retirement homes business in New Zealand. It had made a good contribution to returns. We also sold HK Electric. Although the capital gain on this holding has been modest, it has delivered an exceptionally high yield throughout the time we have owned it.

Outlook – Amid political and economic risks, the 'hunt for yield' continues ...

With valuations beginning to look stretched, we are cautious. Government bonds have rallied substantially over the last year. And with the global economy continuing to grow, we believe this rally could go into reverse. We don't, however, think any move higher in yields will prove too disruptive. In part, this is because we expect the 'hunt for yield' to continue as investors continue to look for sources of income, supporting capital values.

There are, of course, risks. With the employment market in the US continuing to tighten, interest rates in the US are likely to rise again towards the end of 2016. The global economy – particularly emerging markets – now seems to be on a stronger footing to cope with a rise in rates. But the uncertainty surrounding the precise timing of that increase could create volatility. We don't believe the Fed will have room to raise rates by much. If this assumption proves incorrect, however, there is a risk that yields on government bonds spike higher, which would weigh heavily on all asset classes.

Political risks in Europe are increasing. The 'Brexit' vote underscored the rise of populism and the threat it poses to political and economic stability in the EU. A referendum on Italian constitutional reform in October is the first potential flashpoint that Europe must face in the coming months, but French and German elections in 2017 also provide a source of doubt. The market turmoil that followed the UK's Brexit vote would pale into insignificance were there to be a populist outcome from elections in either country.

At home, the impact of Brexit on the UK economy remains largely unknown. We must wait to see whether the apparent slowdown in the economy that followed the vote was temporary or more deep-rooted. A quick recovery in consumer confidence would cushion the blow of any collapse in business investment. The next few months will show us where the UK economy is heading so we will monitor economic data with trepidation.

Despite the political uncertainty in Europe, we favour the region's bond markets. The approach to corporate financing tends to be quite conservative and the default rate looks certain to remain very low. There have been opportunities for us to pick up sources of yield in the US, however, and we have increased our exposure to US corporate bonds. We will continue to look for opportunities to pick up extra yield and find value.

With government bonds continuing to deliver negligible – or even negative – yields, we believe investors will continue to turn to credit markets. Some of the political and economic risks highlighted above will likely provoke periods of instability during which we will be able to buy bonds offering generous yields in areas that we believe can weather periods of uncertainty. In equities, the further fall in bond yields towards the end of the period suggests that equities with safe and above-average yields can also contribute meaningfully to the fund's overall return.

Alex Ralph & Adrian Frost
Fund managers

Investment information

Portfolio split

	7 August 2016 % of net assets	7 August 2015 % of net assets
Corporate bonds		
United Kingdom	35.89	41.51
United States of America	6.68	5.40
Luxembourg	6.13	5.14
Netherlands	5.48	4.16
France	4.48	3.89
Ireland	4.08	3.69
Jersey	2.63	2.33
Germany	2.56	2.34
Italy	1.96	0.74
Cayman Islands	1.54	0.79
Australia	1.34	-
Mexico	1.21	1.20
Canada	0.95	-
Bulgaria	0.83	0.68
Bermuda	0.82	0.88
Guernsey	0.77	1.12
Belgium	0.64	0.58
Portugal	0.43	0.40
Switzerland	0.32	0.58
Spain	0.25	0.52
Norway	-	0.39
Sweden	-	0.88
Government bonds		
United Kingdom	3.98	3.96
Israel	0.28	0.24
Equities		
United Kingdom	13.59	14.86
United States of America	0.57	0.70
Ireland	0.29	0.33
New Zealand	0.22	0.39
Hong Kong	-	0.96
Derivatives		
Forward currency contracts	(2.67)	0.44
Net other assets	4.75	0.90
Net Assets	100.00	100.00

Ten largest investments

Investment	7 August 2016 % of net assets
UK Treasury 1.00% 07/09/2017	3.98
Centrica Plc	2.21
BAE Systems Plc	2.01
PGH Capital Ltd. 6.63% 18/12/2025	1.45
RSA Insurance Group Plc, FRN 6.70% Perpetual	1.35
BHP Billiton Finance Ltd., FRN 6.50% 22/10/2077	1.34
RBS Capital Trust II, FRN 6.42% Perpetual	1.31
Legal & General Group Plc	1.30
F&C Finance Plc 9.00% 20/12/2016	1.27
International Game Technology Plc 4.75% 15/02/2023	1.26

Investment	7 August 2015 % of net assets
UK Treasury 2.00% 22/01/2016	3.96
Legal & General Group Plc	1.69
Centrica Plc	1.66
GlaxoSmithKline Plc	1.61
BAE Systems Plc	1.55
PGH Capital Ltd. 6.63% 18/12/2025	1.48
Scottish Widows Plc, FRN 5.13% Perpetual	1.45
F&C Finance Plc 9.00% 20/12/2016	1.38
RSA Insurance Group Plc, FRN 6.70% Perpetual	1.37
Investec Bank Plc 9.63% 17/02/2022	1.26

Comparative tables

	QI distribution			MI distribution			QR distribution		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Change in net assets per unit (p)									
Opening net asset value per unit	**84.05**	**84.07**	**80.10**	**84.07**	**84.08**	**85.39**	**79.77**	**80.29**	**76.97**
Return before operating charges *	3.61	5.92	9.09	3.58	5.37	0.49	3.40	4.63	8.72
Operating charges	(0.56)	(1.13)	(0.59)	(0.55)	(0.60)	(0.60)	(1.01)	(0.57)	(1.06)
Return after operating charges	3.05	4.79	8.50	3.03	4.77	(0.11)	2.39	4.06	7.66
Distributions on distribution units	(4.95)	(4.81)	(4.53)	(4.93)	(4.78)	(1.20)	(4.68)	(4.58)	(4.34)
Closing net asset value per unit	**82.15**	**84.05**	**84.07**	**82.17**	**84.07**	**84.08**	**77.48**	**79.77**	**80.29**
* after direct transaction costs of	(0.02)	(0.05)	(0.03)	(0.02)	(0.05)	(0.03)	(0.02)	(0.05)	(0.03)
Performance									
Return after charges	3.63%	5.70%	10.61%	3.60%	5.67%	(0.13)%	3.00%	5.06%	9.90%
Other information									
Closing net asset value (£'000)	779,315	636,095	337,192	64,125	23,172	764	298,949	484,923	653,317
Closing number of units	948,622,541	756,764,887	401,092,392	78,036,324	27,563,559	909,414	385,842,253	607,866,019	813,664,044
Operating charges	0.69%	0.70%	0.70%	0.68%	0.70%	0.70%	1.31%	1.32%	1.32%
Direct transaction costs	0.02%	0.06%	0.04%	0.02%	0.06%	0.04%	0.02%	0.06%	0.04%
Prices									
Highest offer unit price (p)	86.84	88.38	87.89	86.26	87.75	87.67	85.89	87.58	87.57
Lowest bid unit price (p)	76.09	82.84	79.67	76.13	82.30	80.04	71.98	78.94	76.56

* Direct transaction costs are stated after deducting the amounts collected in relation to expected dealing costs added to the issue of units and subtracted from the cancellation of units.

Ongoing charges

Class	7 August 2016
QI distribution	0.69%
MI distribution	0.69%
QR distribution	1.32%

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.

Distribution tables

Monthly distributions for the year ended 7 August 2016

Payment date	MI distribution (p)
6 November 2015	0.3231
7 December 2015	0.3061
7 January 2016	0.3306
5 February 2016	0.3177
7 March 2016	0.3075
7 April 2016	0.2852
6 May 2016	0.3734
7 June 2016	0.3069
7 July 2016	0.3792
5 August 2016	0.3502
7 September 2016	0.3048
7 October 2016	0.2917

Monthly distributions for the year ended 7 August 2015

Payment date	MI distribution (p)
7 November 2014	0.2797
5 December 2014	0.3476
7 January 2015	0.3425
6 February 2015	0.2955
6 March 2015	0.2954
7 April 2015	0.2782
7 May 2015	0.3167
5 June 2015	0.3026
7 July 2015	0.4288
7 August 2015	0.2756
7 September 2015	0.3048
7 October 2015	0.3593

Comparative tables (continued)

Distribution tables (continued)

Quarterly distributions for the year ended 7 August 2016

Payment date	QR distribution (p)	QI distribution (p)
7 January 2016	0.9139	0.9636
7 April 2016	0.8651	0.9137
7 July 2016	1.0057	1.0638
7 October 2016	0.9604	1.0176

Quarterly distributions for the year ended 7 August 2015

Payment date	QR distribution (p)	QI distribution (p)
7 January 2015	0.9360	0.9808
7 April 2015	0.8329	0.8741
7 July 2015	1.0025	1.0537
7 October 2015	0.8939	0.9411

5 year distribution record (QI distribution*) on an accounting period basis

Year ended	Net revenue per unit (p)	Movement
7 August 2012	3.8193	-
7 August 2013	4.0656	6.5%
7 August 2014	3.6269	(10.8)%
7 August 2015	3.8497	6.1%
7 August 2016	3.9587	2.8%

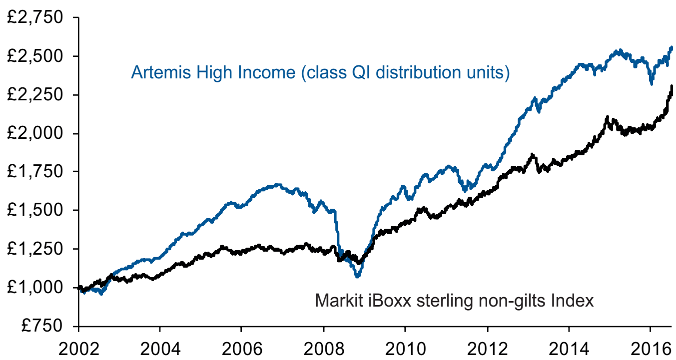
* QI distribution units have been used as it represents the largest unit class of the fund.

Class QI performance

	Since launch*	5 years	3 years	1 year	6 months
Artemis High Income Fund	170.0	52.8	17.8	2.6	8.3
Markit iBoxx sterling non-gilts Index	130.5	47.9	29.0	13.4	13.2
Sector average	104.9	31.1	15.3	5.6	7.9
Position in sector	2/20	1/49	27/65	56/70	30/70
Quartile	1	1	2	4	2

* Data from 9 September 2002 when Artemis took over mangement of the fund. Source: Lipper Limited, data from 9 September 2002 to 7 March 2008 reflects class QR distribution units and from 7 March 2008 to 7 August 2016 reflects class QI distribution units, bid to bid basis, in sterling with net interest reinvested to 7 August 2016. All performance figures show total return percentage growth. Sector is IA £ Strategic Bond.

Value of £1,000 invested at launch to 7 August 2016

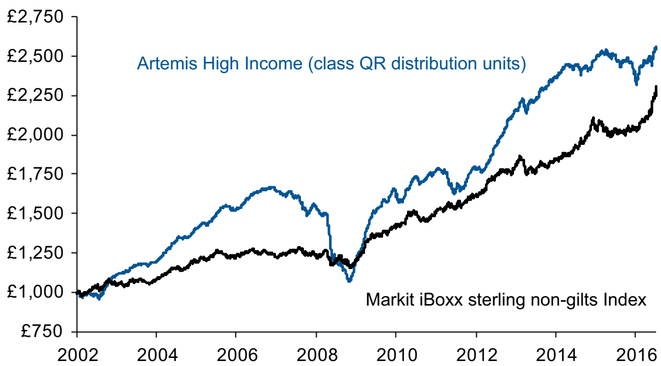


Class QR performance

	Since launch*	5 years	3 years	1 year	6 months
Artemis High Income Fund	156.2	48.1	15.6	2.0	8.0
Markit iBoxx sterling non-gilts Index	130.5	47.9	29.0	13.4	13.2

* Data from 9 September 2002 when Artemis took over mangement of the fund. Source: Lipper Limited, class QR distribution units, bid to bid basis, in sterling with net interest reinvested to 7 August 2016. All performance figures show total return percentage growth.

Value of £1,000 invested at launch to 7 August 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.

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 High Income Fund for the year ended 31 July 2016. The Manager's Report and Financial Statements 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.

Tax information reporting

UK tax legislation requires fund managers to provide information to 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.

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† Authorised by the Prudential Regulation Authority ('PRA') 20 Moorgate, London EC2R 6DA and regulated by the PRA and the FCA.

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