# Artemis High Income *Fund*

Manager's Report
and Financial Statements
for the year ended 7 August 2018

Artemis
The Profit Hunter

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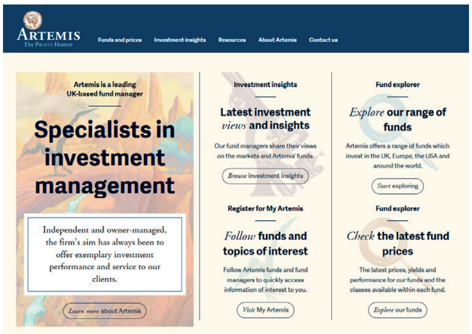


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**artemisfunds.com**

# General information

## Company profile

Artemis is a leading UK-based fund manager, offering a range of funds which invest in the UK, Europe, the US and around the world.

As a dedicated, active investment house, we specialise in investment management for both retail and institutional investors across Europe.

Independent and owner-managed, Artemis opened for business in 1997. Its aim was, and still is, exemplary investment performance and client service. All Artemis' staff share these two precepts – and the same flair and enthusiasm for fund management.

The firm now manages some £29.7 billion* across a range of funds, two investment trusts, a venture capital trust and both pooled and segregated institutional portfolios.

Our managers invest in their own and their colleagues' funds. This has been a basic tenet of the Artemis approach since the firm started. It means that interests of our fund managers are directly aligned with those of our investors.

* Source: Artemis as at 31 August 2018.

## Fund status

Artemis High Income Fund was constituted by a Trust Deed dated 26 May 1995 as amended by a supplemental Trust Deed dated 6 September 2002 and is an authorised unit trust scheme under the Financial Services and Markets Act 2000. The fund belongs to the category of UCITS schemes as defined in the Collective Investment Schemes Sourcebook ('COLL') of the Financial Conduct Authority ('FCA').

## Investment objective

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.

## Investment policy

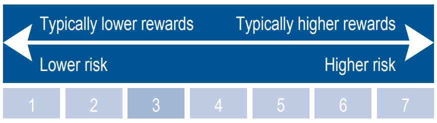
The emphasis of the fund will be investment in UK fixed-interest investments and preference shares, however, the manager has the flexibility to invest in all economic sectors worldwide and in equities.

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.

## Buying and selling

Units may be bought and sold by contacting the manager by telephone, at the address on page 3 or via the website **artemisfunds.com**. Valuation of the fund takes place each business day at 12 noon on a forward pricing basis. Investors are reminded that past performance is not a guarantee of performance in the future and that the price of units and the revenue from them can fall as well as rise.

## Risk and reward profile




- 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).
- 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.

## Prospectus

Copies of the most recent Prospectus are available free of charge from the manager at the address on page 3.

## Remuneration

Following an amendment to the UCITS Directive in the UK on 18 March 2016, all UCITS schemes are required to comply with the UCITS Remuneration Code. This includes a requirement to disclose, in the annual report of each scheme, details of the total amount of remuneration paid by the manager to its partners and staff for its financial year.

As the Artemis High Income Fund (the 'fund') is a UCITS scheme, Artemis Fund Managers Limited ('AFML') as manager is required to make these disclosures. Artemis operates its

## General information (continued)

remuneration policies and practices at a group level, which includes both Artemis Investment Management LLP and its subsidiary AFML. Details of the group remuneration policies are available on Artemis' website **artemisfunds.com**. Remuneration levels are set to attract, retain and motivate talented partners and staff and align long-term interests of partners and staff with those of our clients.

The remuneration policies which apply to all partners and staff across the group are overseen by the Remuneration Committee. The members of the Remuneration Committee are all non-executive officers. The Remuneration Committee is responsible for setting and overseeing the implementation of Artemis' remuneration policy, including approving the remuneration of partners and other senior staff. The Remuneration Committee will regularly review the remuneration policy to ensure it remains appropriate. The Remuneration Committee considers inputs from Artemis' Compliance and Risk functions when reviewing remuneration issues, including any risk adjustments or controls considered necessary. The Artemis remuneration period runs from 1 January to 31 December, therefore, the first full performance period subject to the UCITS Remuneration Code started on 1 January 2017 and ended on 31 December 2017. As a consequence, for certain partners and staff who are classified as 'Identified Staff' as their professional activities have a material impact on the risk profile of the firm, the payment of some of the variable remuneration (which may include profit share for partners) is deferred. Further, Artemis has the ability to reduce all or part of deferred variable remuneration that has been previously allocated to Identified Staff, before the end of the vesting period.

No staff are employed by AFML directly but are employed and paid by other entities of Artemis. Artemis has apportioned the total amount of remuneration paid to all 171 Artemis partners and staff in respect of AFML's duties performed for the UCITS schemes based on the number of funds. It has estimated that the total amount of remuneration paid in respect of duties for the fund for the year ended 31 December 2017 is £1,254,507, of which £327,834 is fixed remuneration and £926,673 is variable remuneration. No amount of remuneration, including any performance fees, was paid directly by the fund.

The aggregate amount of remuneration paid to UCITS Remuneration Code and Identified Staff that is attributable to duties for the fund for the year ended 31 December 2017 is £307,248. AFML Remuneration Code and Identified Staff are those senior individuals whose managerial responsibilities or professional activities could influence, and have a material impact on, the overall risk profile of each regulated entity and the funds it manages. For the purposes of UCITS Remuneration Code the AFML Remuneration Code staff are the members of Artemis' Management and Executive Committees, certain fund managers, the General Counsel, the Head of Compliance and the Head of Risk. This includes certain individuals who are partners in Artemis Investment Management LLP.

## 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.

## Removal of initial charge

The fund's prospectus includes the ability for Artemis to apply an initial charge on investments into the fund. The prospectus also sets out the maximum amount of this charge for different unit classes in the fund, although in almost all cases the initial charge has been waived in its entirety for a number of years. The prospectus was updated on 6 June 2018 to make it clear that no initial charge will be levied in respect of the existing unit classes. For further information please contact our client services team on 0800 092 2051.

## Manager

Artemis Fund Managers Limited *
Cassini House
57 St James's Street
London SW1A 1LD

Dealing information:
Artemis Fund Managers Limited
PO Box 9688
Chelmsford CM99 2AE
Telephone: 0800 092 2051
Website: artemisfunds.com

## Investment adviser

Artemis Investment Management LLP *
Cassini House
57 St James's Street
London SW1A 1LD

## Trustee and Depositary

(to 15 January 2018)
National Westminster Bank Plc †
Trustee & Depositary Services
Younger Building
1st Floor, 3 Redheughs Avenue
Edinburgh EH12 9RH

(from 15 January 2018)
J.P. Morgan Europe Limited †
25 Bank Street Canary Wharf
London E14 5JP

## Registrar

DST Financial Services International Limited (formerly International Financial Data Services (UK) Limited)*
DST House
St Nicholas Lane
Basildon
Essex SS15 5FS

## Auditor

Ernst & Young LLP
Atria One
144 Morrison Street
Edinburgh EH3 8EX

* Authorised and regulated by the FCA, 12 Endeavour Square, London E20 1JN.

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

## Statement of the trustee's responsibilities for the period from 8 August 2017 to 15 January 2018

The trustee must ensure that the scheme is managed in accordance with COLL, the Financial Services and Markets Act 2000, as amended, (together 'the Regulations'), the Trust Deed and Prospectus (together 'the scheme documents') as detailed below.

The trustee must in the context of its role act honestly, fairly, professionally, independently and in the interests of the scheme and its investors.

The trustee is responsible for the safekeeping of all custodial assets and maintaining a record of all other assets of the scheme in accordance with the Regulations.

The trustee must ensure that:

- the scheme's cash flows are properly monitored and that cash of the scheme is booked into the cash accounts in accordance with the Regulations;
- the sale, issue, redemption and cancellation of units are carried out in accordance with the Regulations;
- the value of units of the scheme are calculated in accordance with the Regulations;
- any consideration relating to transactions in the scheme's assets is remitted to the Scheme within the usual time limits;
- the scheme's income is applied in accordance with the Regulations; and
- the instructions of the manager are carried out (unless they conflict with the Regulations).

The trustee also has a duty to take reasonable care to ensure that the scheme is managed in accordance with the Regulations and the scheme documents in relation to the investment and borrowing powers applicable to the scheme.

## Report of the trustee to the unitholders of Artemis High Income Fund for the period from 8 August 2017 to 15 January 2018

Having carried out such procedures as we consider necessary to discharge our responsibilities as trustee of the scheme, it is our opinion, based on the information available to us and the explanations provided, that in all material respects the scheme, acting through the manager:

(i) has carried out the issue, sale, redemption and cancellation, and calculation of the price of the scheme's units and the application of the schemes income in accordance with the Regulations and the scheme documents; and

(ii) has observed the investment and borrowing powers and restrictions applicable to the scheme.

National Westminster Bank Plc
Trustee & Depositary Services
Edinburgh
15 January 2018

# General information (continued)

## Statement of the trustee's responsibilities in respect of the scheme and report of the trustee to the unitholders of Artemis High Income Fund ('the Trust') for the period from 15 January 2018 to 7 August 2018

The trustee of Artemis High Income Fund must ensure that the Trust is managed in accordance with the Financial Conduct Authority's Collective Investment Schemes Sourcebook, the Financial Services and Markets Act 2000, as amended, (together 'the Regulations'), the Trust Deed and Prospectus (together 'the scheme documents') as detailed below.

The trustee must in the context of its role act honestly, fairly, professionally, independently and in the interests of the Trust and its investors. The trustee is responsible for the safekeeping of all custodial assets and maintaining a record of all other assets of the Trust in accordance with the Regulations.

The trustee must ensure that:

- the Trust's cash flows are properly monitored and that cash of the Trust is booked into the cash accounts in accordance with the Regulations;
- the sale, issue, repurchase, redemption and cancellation of units is carried out in accordance with the Regulations;
- the value of units of the Trust are calculated in accordance with the Regulations;
- any consideration relating to transactions in the Trust's assets is remitted to the Trust within the usual time limits;
- the Trust's income is applied in accordance with the Regulations; and the instructions of the Authorised Fund Manager ('the AFM'), which is the UCITS Management Company, are carried out (unless they conflict with the Regulations).

The trustee also has a duty to take reasonable care to ensure that the Trust is managed in accordance with the Regulations and Scheme documents of the Trust in relation to the investment and borrowing powers applicable to the Trust.

Having carried out such procedures as we consider necessary to discharge our responsibilities as trustee of the Trust, it is our opinion, based on the information available to us and the explanations provided, that in all material respects the Trust, acting through the AFM:

(i) has carried out the issue, sale, redemption and cancellation, and calculation of the price of the Trust's units and the application of the Trust's income in accordance with the Regulations and the scheme documents of the Trust; and

(ii) has observed the investment and borrowing powers and restrictions applicable to the Trust in accordance with the Regulations and the Scheme documents of the Trust.

J.P. Morgan Europe Limited
London
2 October 2018

## Statement of the manager's responsibilities

COLL requires the manager to prepare financial statements for each annual accounting period which give a true and fair view of the financial affairs of the fund and of its revenue and expenditure for the year.

In preparing the financial statements the manager is required to:

(i) select suitable accounting policies and then apply them consistently;

(ii) comply with the disclosure requirements of the Statement of Recommended Practice for Authorised Funds issued by the Investment Management Association in May 2014 ('SORP');

(iii) follow applicable accounting standards;

(iv) keep proper accounting records which enable it to demonstrate that the financial statements as prepared comply with the above requirements;

(v) make judgements and estimates that are reasonable and prudent; and

(vi) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the fund will continue in operation.

The manager is responsible for the management of the fund in accordance with its Trust Deed, Prospectus and COLL.

The manager is also responsible for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## Report of the manager

We hereby approve the Manager's Report and Financial Statements of the Artemis High Income Fund for the year ended 7 August 2018 on behalf of Artemis Fund Managers Limited in accordance with the requirements of COLL as issued and amended by the FCA.

| | |
|---|---|
| M J Murray | R J Turpin |
| Director | Director |

Artemis Fund Managers Limited
London
2 October 2018

# Independent auditor's report to the unitholders of the Artemis High Income Fund

## Opinion

We have audited the financial statements of the Artemis High Income Fund ('the Fund') for the year ended 7 August 2018 which comprise the statement of total return, statement of change in net assets attributable to unitholders, balance sheet, distribution tables and the related notes 1 to 19, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) including FRS 102 'The Financial Reporting Standard applicable to the UK and Republic of Ireland'.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Fund as at 7 August 2018 and of the net revenue and the net losses on the scheme property of the Fund for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice FRS 102 'The Financial Reporting Standard applicable to the UK and Republic of Ireland'.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the manager's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the manager has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Fund's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

## Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The manager is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

## Opinions on other matters prescribed by the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority

In our opinion:

- the financial statements have been properly prepared in accordance with the Statement of Recommended Practice relating to Authorised Funds, the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority and the Trust Deed;
- the information given in the manager's report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- there is nothing to indicate that proper accounting records have not been kept or that the financial statements are not in agreement with those records.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matter in relation to which the Collective Investment Schemes Sourcebook of the Financial Conduct Authority rules requires us to report to you if, in our opinion:

- we have not received all the information and explanations which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

## Responsibilities of the manager

As explained more fully in the manager's responsibilities statement set out on page 4, the manager is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the manager determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

# General information (continued)

In preparing the financial statements, the manager is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the manager either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

### Use of our report

This report is made solely to the unitholders of the Fund, as a body, pursuant to Paragraph 4.5.12 of the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority. Our audit work has been undertaken so that we might state to the unitholders of the Fund those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Fund and the unitholders of the Fund as a body, for our audit work, for this report, or for the opinions we have formed.

Ernst & Young LLP
Statutory Auditor
Edinburgh
2 October 2018

Notes:

1. The maintenance and integrity of the artemisfunds.com web site is the responsibility of the manager; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

- The fund returned 1.7%* over the year.
- US high yield bonds boosted returns.
- Fundamentals remain sound, but reasons to be cautious.

## Performance – Helped by high yield and short duration …

The fund returned 1.7%* over the year, ahead of the sector's flat average. The period was marked by increasing volatility – which spiked mid-way through the reporting year – and by diverging regional performance in bond markets. The fund benefited from its exposure to US high-yield bonds and to the energy sector, the latter driven by a rallying oil price. US government bond yields rose over the year, along with interest rates. The fund's bias towards short duration (which means it is less affected by rising rates) helped protect returns. Our overweight in financials weighed on performance in the latter half of the period, along with certain stock-specific events in both equities and credit.

## Review – The US economy marches on …

Once again, the reporting period was characterised by increased geo-political risk against a strong economic backdrop. But this year, differing fortunes in growth came to the fore with the US outpacing the rest of the developed world. Movements in government bond yields reflected this divergence. US Treasury yields ended the year somewhat higher, while core European bond yields fell – albeit only marginally so.

The US economy began the period positively with jobless claims moving lower. Prospects for growth were further bolstered in December when the US Senate approved the Tax Cuts & Jobs Act, giving further impetus to an economy already firing strongly. As expected, the Federal Reserve began to raise interest rates in December, with three hikes so far.

The beginning of 2018 saw a sudden uptick in inflationary expectations, and most major government bond markets subsequently sold off. Thanks to its short-duration bias, the fund was able to hold onto positive returns during this time. This proved short-lived. If the last two years were characterised by their exceptionally low volatility, February was the month where that ended – and with a bang. The spike in volatility was initially a response to the change in inflationary expectations and a subsequent rise in yields on government bonds. That volatility became a self-sustaining process as it prompted a rush to the exit from some low-volatility funds.

High-yield bonds (and indeed the credit market more widely) saw spreads (the premium borrowers in the high-yield market must pay relative to government bonds) widening as volatility spiked. The fund's performance fell in line with the sector. Activity on the fund had been fairly muted up until this point, as the new issue market in high yield had been subdued. We took advantage of the volatility and the fall in the oil price to build a new position in Shelf Drilling, an operator of shallow-water rigs. Indeed at several points during the last 12 months we have used volatility within the energy market to our advantage and picked up assets during weakness. Furthermore, we used this opportunity to add to other US high-yield bonds, starting new positions in Weight Watchers International and Men's Warehouse. With default rates falling in the US and profitability improving, US high yield looked an attractive place to invest money. The sector also benefited from attractive supply and demand dynamics. This move paid off as US high yield outperformed all other credit markets over the year.

Politics featured heavily over the 12 months. The start of the period was marked by worries about North Korea and its testing of nuclear weapons. Emerging markets had a difficult time in the last six months. Political headlines caused some disquiet, particularly in Turkey, where there was increased rhetoric over economic warfare. Since the start of 2018 the emerging market debt index has fallen by 6%. While some of this has been country specific, the bulk of the move has come from the US dollar's strength. The threat of tariffs has added to concerns about slowing growth in emerging markets. Questions remain as to how long the dollar will carry on strengthening. We have steered clear of emerging market risk in the fund. This has helped relative performance over the past year, and we are retaining that stance.

Political risk wasn't just confined to emerging markets. Italian political developments, culminating in the president rejecting the proposed economic minister of the newly formed populist government, ended the spring's rally abruptly in May. Having been dangerously dismissive of Italian risk, the market immediately began to panic. Bank shares and bonds suffered the most, as concerns over Italian exposure led the sector sharply lower. Indeed, by falling over 8%, European bank equities had their worst month since the vote for Brexit in June 2016. The fund fell sharply in May. Its exposure to energy and a larger weighting in US high yield sheltered it from the very worst of the fall-out in European corporate high yield. Despite having minimal Italian exposure, however, the overweight in financials weighed on performance.

During the initial rebound, we cut our remaining Italian exposure. We sold Nexi (payment systems), Inter Milan and Generali. With the money raised, we took advantage of the discounted new issue market to invest in Provident Financial. The yield proved generous enough for a company we had previously been wary of and the bonds have subsequently performed well. We

* Source: Lipper Limited, class QI distribution units, bid to bid basis, in sterling with interest reinvested. Sector is IA £ Strategic Bond.

## Investment review (continued)

picked up euro-denominated new issues in TDC (Danish telecom) and BWAY (global packaging company) which came to the market at a decent discount to attract investors during this period of increased volatility. Indeed towards the end of the reporting year, the valuation gap between European and US high yield became rather stretched, so we returned to European investments.

Core European government bond yields traded lower from May onwards. Increased political risk and concerns over weakening growth had created demand for bonds despite the European Central Bank ('ECB') announcing the end of the bond buying programme. The fund continued to hold a short-duration bias within Europe however, as we believe the technical picture will once again dominate returns.

During the period we changed how the equity portion of the fund is managed, with the aim of providing a broader set of opportunities for investing. The allocation has been expanded to include European equities alongside the UK. This allows us to improve the liquidity of the equities held while also giving more scope to avoid concentration of risk by overlapping equity and fixed income positions. The core objective remains the same: to generate an above market and growing level of income from equities which also have the scope for capital appreciation. Currency exposure will be systematically hedged for non-sterling positions.

The healthiest contributors to returns in European equities had a distinctly defensive feel about them, in keeping with the signs of sector rotation within the market that we have seen recently. Deutsche Telekom did best as investors began to take a less hysterical view of its proposed merger of the US mobile business. This has been the most attractive asset in the group for some time and achieving further scale would release significant synergies, should regulators permit the deal to proceed. Enagas, the Spanish gas company, reported healthy results and proved resilient to the struggles that have yet again mired Spanish politics. We own two food and nutrition businesses, Danone and Marine Harvest. The former has spent the past few years addressing challenges in key product areas and is now beginning to see the benefit of this in renewed growth. Marine Harvest is a much more specialised business, primarily salmon farming. It should be a long-term winner in a fairly consolidated sector as demand for healthy sources of protein grows consistently. The most disappointing holding was Mediaset Espana Comunicacion. It has become rather popular among the more excitable parts of the market to assume free-to-air television is doomed. The fact that revenue and earnings are still growing belies this fear so we plan to hold on to this cheap stock through this period of unpopularity.

From a top-down view it was a similar story in the UK, although trade tariffs and resulting concerns over global growth were compounded by growing fears of a 'no deal' Brexit. The result was that our more defensive and/or international holdings performed well at the expense of domestic names. Imperial Brands rallied sharply, as a slower take up of their peers' next-generation tobacco products reduced fears that Imperial Brands' historic under-investment in new products would see them continue to cede market share. Among the more domestic names, Tesco performed strongly following full year results which confirmed that the operational turnaround in the business is still building momentum. Early responses from customers to the Booker deal have also been positive.

Among the more economically sensitive companies our holdings in 3i Group, DS Smith and International Airlines Group delivered good results that were accompanied by strong growth in their dividends, although the reaction of their share prices was muted. On the negative side, our small holding in Redrow fell sharply, in line with the rest of the housebuilding sector. Newsflow from its peers would suggest that the group continues to trade well. Our holding in Glencore was the biggest negative contributor in the period as trade fears led to fall in metal prices. The announcement that the US Department of Justice was launching an investigation into its activities in parts of Africa and Venezuela weighed further on sentiment. It is likely to be some time before this investigation reaches a conclusion. Results from Glencore showed that the business is still performing well with high coal prices providing an offset to base metal weakness, while volatility is aiding the marketing business. On a double-digit free cashflow yield and close to 8% all-in cash return this year, we believe the income is sufficiently attractive to wait out the near-term uncertainty.

## Outlook – Proceeding with caution …

A year ago, we wrote that at some point volatility would return - and it has. The world is grappling with different forces but most importantly they are all happening after peak quantitative easing. Geo-political risks have been increasing for some years now, but this time the biggest economy in the world is increasing interest rates. The strength of the US dollar – in part due to an outperforming economy, in part tariff risk – has exacerbated moves in emerging markets. Italian political change came the same month the ECB announced cuts to the bond buying programme, and its eventual end in December. In previous years, with a huge quantitative easing project supporting the markets, concerns about Italian politics might not have caused the same movement in asset prices as we witnessed this summer. The gradual removal of easy money was bound to create volatility.

While we remain cautious, fundamentals are still sound. Default rates, which tend to lead high-yield bond returns, are set to stay below historical levels. Corporate profitability, while under threat from rising wage inflation, will remain strong. Quantitative easing may have peaked, but is only being withdrawn at a very gradual pace and there is still demand for bonds. Volatility can be an opportunity. We have used setbacks over the last 12 months to add to our favoured positions and we will continue to do so. Oil is a late-cycle asset, and we don't think it's any different this time. Your fund will maintain a portion of assets in the oil market where we are still able to pick up decent yields for companies who will go on to generate good cashflows.

The fund's duration (the exposure to underlying government bond yields) will remain short. We do believe yields will continue to rise: not dramatically as inflation looks set to rise slowly, but enough to stop us increasing exposure. This outlook also prevents us from moving longer duration in credit, so we are sticking to short-dated corporate bonds.

Our preference for US high yield bonds has waned. European high yield is starting to offer a more generous spread. As predicted in the last annual report, we are now able to reinvest in higher-coupon issuers. Stock selection is key however, as the market punishes underperforming companies' results. Furthermore, we will have to navigate the ECB withdrawing stimulus.

Within equities we are aware that higher interest rates will have a dampening effect on the asset class. We believe this will be most pronounced in the more expensive 'long-duration' segments of the market where valuations rely heavily on profits generated in distant years. In many cases, these are stocks which have benefited greatly from the recent dominant trend in momentum investing. Indeed we are already seeing signs of a rotation back towards more defensive sectors. We expect this to continue, particularly as some 'market darlings' have begun to issue profit warnings in their outlook statements. This is not as simple as making a choice between 'growth' and 'value'. Rather we need to focus on stocks which combine realistic earnings prospects with reasonable current valuations. In addition, we must recognise that cost pressures are rising alongside inflation and so a degree of headroom must be built in to ensure expected dividends can still be paid under more challenging conditions.

To conclude, we believe markets will be harder to negotiate over the coming year so continue to focus on maintaining income and prioritising liquidity. There are, however, pockets of value out there for us to invest in; and we look forward to taking advantage of further volatility.

**Alex Ralph**
**Fund manager**

# Investment information

## Five largest purchases and sales for the year ended 7 August 2018

| Purchases | Cost £'000 | Sales | Proceeds £'000 |
|---|---|---|---|
| UK Treasury 0.75% 22/07/2023 | 59,319 | UK Treasury 1.75% 22/07/2019 | 111,665 |
| UK Treasury 1.75% 22/07/2019 | 40,758 | Direct Line Insurance Group | 29,735 |
| Bayerische Motoren Werke | 14,773 | Legal & General Group | 28,712 |
| BT Group | 14,510 | BT Group | 21,591 |
| Enagas | 13,700 | Nordea Bank | 17,812 |

## Portfolio statement as at 7 August 2018

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| **Equities 16.86% (18.73%)** | | | |
| **France 1.91% (0.00%)** | | | |
| Danone | 181,693 | 11,092 | 0.85 |
| Sanofi | 207,517 | 13,788 | 1.06 |
| | | **24,880** | **1.91** |
| **Germany 2.14% (0.54%)** | | | |
| Bayerische Motoren Werke | 189,337 | 14,299 | 1.10 |
| Deutsche Telekom | 1,060,668 | 13,614 | 1.04 |
| | | **27,913** | **2.14** |
| **Guernsey 0.00% (2.01%)** | | | |
| **Ireland 0.00% (0.31%)** | | | |
| **Jersey 0.00% (0.00%)** | | | |
| Acp Mezzanine ^ | 6,450,000 | - | - |
| | | **-** | **-** |
| **Netherlands 1.03% (0.00%)** | | | |
| Royal Dutch Shell A shares | 517,675 | 13,412 | 1.03 |
| | | **13,412** | **1.03** |
| **Norway 0.44% (0.00%)** | | | |
| Marine Harvest | 340,000 | 5,717 | 0.44 |
| | | **5,717** | **0.44** |
| **Spain 2.01% (0.00%)** | | | |
| Bolsas y Mercados Espanoles | 206,184 | 5,131 | 0.39 |
| Enagas | 636,554 | 13,813 | 1.06 |
| Grupo Isolux Corsan Warrant 22/12/2021 ^ | 4,798 | - | - |
| Mediaset Espana Comunicacion | 1,221,948 | 7,306 | 0.56 |
| | | **26,250** | **2.01** |
| **Sweden 0.00% (1.64%)** | | | |
| **Switzerland 1.25% (0.00%)** | | | |
| Adecco Group | 175,491 | 8,222 | 0.63 |
| Glencore | 2,500,000 | 8,092 | 0.62 |
| | | **16,314** | **1.25** |
| **United Kingdom 8.08% (14.23%)** | | | |
| 3i Group | 1,151,380 | 10,860 | 0.83 |
| Aberforth Split Level Income Trust | 13,381,626 | 13,168 | 1.01 |
| Balfour Beatty Preference shares 9.68% | 2,425,000 | 2,619 | 0.20 |
| BP | 1,605,100 | 9,261 | 0.71 |
| DS Smith | 1,923,345 | 9,709 | 0.75 |
| Ecclesiastical Insurance Group Preference shares 8.63% | 4,200,000 | 6,384 | 0.49 |
| Galliford Try | 391,000 | 3,711 | 0.28 |
| Hampton Trust Preference shares ^ | 200,000 | - | - |
| Imperial Brands | 327,990 | 9,677 | 0.74 |
| International Consolidated Airlines Group | 1,143,000 | 7,763 | 0.60 |
| Man Group | 2,887,000 | 5,158 | 0.40 |
| New Finsaga ^ | 135,817 | - | - |

| Investment | Holding or nominal value | Valuation £'000 | % of net assets |
|---|---|---|---|
| Redrow | 865,380 | 4,612 | 0.35 |
| Speymill Deutsche Immobilien ^ | 5,803,310 | - | - |
| St James's Place | 617,500 | 7,132 | 0.55 |
| Tesco | 2,481,360 | 6,558 | 0.50 |
| Vodafone Group | 4,285,700 | 8,013 | 0.61 |
| West Bromwich Building Society, STEP | 7,606 | 761 | 0.06 |
| | | **105,386** | **8.08** |
| **Equities total** | | **219,872** | **16.86** |
| **Government bonds 3.78% (5.99%)** | | | |
| **United Kingdom 3.78% (5.99%)** | | | |
| UK Treasury 0.75% 22/07/2023 | £50,000,000 | 49,313 | 3.78 |
| | | **49,313** | **3.78** |
| **Government bonds total** | | **49,313** | **3.78** |
| **Corporate bonds 77.43% (76.07%)** | | | |
| **Australia 2.12% (1.94%)** | | | |
| Australia & New Zealand Banking Group, FRN 2.67% Perpetual | $13,200,000 | 7,394 | 0.57 |
| BHP Billiton Finance, FRN 6.50% 22/10/2077 | £8,900,000 | 10,116 | 0.77 |
| Westpac Banking, FRN 2.60% Perpetual | $17,800,000 | 10,159 | 0.78 |
| | | **27,669** | **2.12** |
| **Belgium 2.32% (2.49%)** | | | |
| Ethias 5.00% 14/01/2026 | €10,500,000 | 10,350 | 0.79 |
| KBC Group, FRN 5.63% Perpetual | €10,000,000 | 9,111 | 0.70 |
| Nyrstar Netherlands Holdings 8.50% 15/09/2019 | €12,060,000 | 10,823 | 0.83 |
| | | **30,284** | **2.32** |
| **Bermuda 1.00% (1.05%)** | | | |
| Catlin Insurance, FRN 5.32% Perpetual | $10,000,000 | 7,636 | 0.59 |
| Catlin Insurance, FRN 5.32% Perpetual (Restricted) | $7,000,000 | 5,345 | 0.41 |
| | | **12,981** | **1.00** |
| **Bulgaria 0.00% (0.83%)** | | | |
| **Canada 0.60% (0.68%)** | | | |
| Entertainment One 6.88% 15/12/2022 | £7,500,000 | 7,859 | 0.60 |
| | | **7,859** | **0.60** |
| **Denmark 1.17% (0.63%)** | | | |
| Danske Bank, FRN 6.13% Perpetual | $10,300,000 | 7,604 | 0.58 |
| DKT Finance ApS 7.00% 17/06/2023 | €8,200,000 | 7,719 | 0.59 |
| | | **15,323** | **1.17** |
| **France 6.27% (6.26%)** | | | |
| Altice France 7.38% 01/05/2026 | $14,000,000 | 10,582 | 0.81 |
| CMA CGM 6.50% 15/07/2022 | €7,770,000 | 6,713 | 0.52 |
| Credit Agricole, FRN 6.63% Perpetual | $16,000,000 | 12,503 | 0.96 |
| Electricite de France, FRN 6.00% Perpetual | £13,000,000 | 13,432 | 1.03 |
| Horizon Parent Holdings Sarl 8.25% 15/02/2022 | €8,750,000 | 8,157 | 0.63 |
| Orange, FRN 5.88% Perpetual | £6,550,000 | 7,103 | 0.54 |
| Societe Generale, FRN 7.38% Perpetual | $15,900,000 | 12,832 | 0.98 |
| Vallourec 6.63% 15/10/2022 | €11,150,000 | 10,364 | 0.80 |
| | | **81,686** | **6.27** |
| **Germany 2.10% (1.76%)** | | | |
| Deutsche Pfandbriefbank, FRN 5.75% Perpetual | €5,800,000 | 5,000 | 0.38 |
| Raffinerie Heide 6.38% 01/12/2022 | €10,000,000 | 8,774 | 0.67 |
| RWE, FRN 7.00% Perpetual | £13,300,000 | 13,672 | 1.05 |
| | | **27,446** | **2.10** |
| **Ghana 0.98% (0.00%)** | | | |
| Tullow Oil 7.00% 01/03/2025 | $17,108,000 | 12,818 | 0.98 |
| | | **12,818** | **0.98** |
| **Ireland 2.78% (2.91%)** | | | |
| Allied Irish Banks 12.50% 25/06/2035 | £5,025,000 | 3,517 | 0.27 |

# Investment information (continued)

| Investment | Nominal value | Valuation £'000 | % of net assets |
|---|---|---|---|
| Allied Irish Banks, FRN 7.38% Perpetual | €3,797,000 | 3,767 | 0.29 |
| Bank of Ireland Group, FRN 4.12% 19/09/2027 | $15,500,000 | 11,266 | 0.86 |
| Eircom Finance DAC 4.50% 31/05/2022 | €6,000,000 | 5,481 | 0.42 |
| Lambay Capital Securities 6.25% Perpetual ^,§ | £14,000,000 | - | - |
| Mutual Securitasation 7.59% 30/09/2022 | £2,250,000 | 900 | 0.07 |
| National Asset Management 5.26% 01/03/2020 | €12,000,000 | 11,282 | 0.87 |
| Waterford Wedgwood 9.88% 01/12/2010 ^ | €2,000,000 | - | - |
| | | **36,213** | **2.78** |
| **Italy 1.70% (2.62%)** | | | |
| Assicurazioni Generali, FRN 6.42% Perpetual | £6,800,000 | 7,070 | 0.54 |
| Enel, FRN 6.62% 15/09/2076 | £8,900,000 | 9,731 | 0.75 |
| Intesa Sanpaolo, FRN 7.75% Perpetual | €5,600,000 | 5,367 | 0.41 |
| | | **22,168** | **1.70** |
| **Jersey 0.00% (0.16%)** | | | |
| **Luxembourg 3.45% (2.99%)** | | | |
| Altice Luxembourg 7.75% 15/05/2022 | $10,000,000 | 7,523 | 0.58 |
| ARD Finance 6.63% 15/09/2023 | €9,400,000 | 8,657 | 0.66 |
| DEA Finance 7.50% 15/10/2022 | €7,800,000 | 7,515 | 0.58 |
| Eurofins Scientific, FRN 7.00% Perpetual | €12,500,000 | 12,101 | 0.93 |
| Safari Verwaltungs 5.38% 30/11/2022 | €10,100,000 | 9,142 | 0.70 |
| | | **44,938** | **3.45** |
| **Mexico 1.05% (1.16%)** | | | |
| America Movil, FRN 6.37% 06/09/2073 | £12,800,000 | 13,680 | 1.05 |
| | | **13,680** | **1.05** |
| **Netherlands 3.63% (3.87%)** | | | |
| Chapel, FRN, Series 2007 'C' 0.37% 17/07/2066 | €3,700,000 | 3,054 | 0.23 |
| Highbury Finance 7.02% 20/03/2023 | £5,116,234 | 5,915 | 0.45 |
| ING Groep, FRN 6.87% Perpetual | $12,000,000 | 9,494 | 0.73 |
| Koninklijke KPN, FRN 7.00% 28/03/2073 | $13,000,000 | 10,503 | 0.81 |
| Lincoln Finance 6.88% 15/04/2021 | €6,700,000 | 6,201 | 0.48 |
| Vivat, FRN 6.25% Perpetual | $15,800,000 | 12,169 | 0.93 |
| | | **47,336** | **3.63** |
| **Norway 0.48% (0.00%)** | | | |
| Petroleum Geo-Services 7.38% 15/12/2020 | $8,000,000 | 6,202 | 0.48 |
| | | **6,202** | **0.48** |
| **Portugal 1.43% (1.03%)** | | | |
| EDP - Energias de Portugal, FRN 5.38% 16/09/2075 | €13,000,000 | 12,669 | 0.97 |
| GNB - Cia de Seguros de Vida, FRN 3.18% Perpetual | €9,500,000 | 5,948 | 0.46 |
| | | **18,617** | **1.43** |
| **South Africa 0.16% (0.00%)** | | | |
| Investec, FRN 6.75% Perpetual | £2,100,000 | 2,132 | 0.16 |
| | | **2,132** | **0.16** |
| **Spain 2.04% (3.35%)** | | | |
| Banco Santander, FRN 6.25% Perpetual | €8,000,000 | 7,587 | 0.58 |
| Codere Finance 2 Luxembourg 6.75% 01/11/2021 | €8,800,000 | 7,782 | 0.60 |
| Gas Natural Fenosa Finance, FRN 4.13% Perpetual | €3,900,000 | 3,679 | 0.28 |
| Lecta 6.50% 01/08/2023 | €8,504,000 | 7,566 | 0.58 |
| | | **26,614** | **2.04** |
| **Sweden 0.52% (0.00%)** | | | |
| Svenska Handelsbanken, FRN 5.25% Perpetual | $9,000,000 | 6,721 | 0.52 |
| | | **6,721** | **0.52** |
| **Switzerland 3.00% (2.30%)** | | | |
| Credit Suisse Group, FRN 6.25% Perpetual | $16,800,000 | 12,999 | 1.00 |
| Kongsberg Actuation Systems 5.00% 15/07/2025 | €5,700,000 | 5,088 | 0.39 |
| Swiss Re, FRN 5.75% 15/08/2050 | $17,000,000 | 13,281 | 1.02 |
| VistaJet Malta Finance 7.75% 01/06/2020 | $10,000,000 | 7,721 | 0.59 |
| | | **39,089** | **3.00** |

| Investment | Nominal value | Valuation £'000 | % of net assets |
|---|---|---|---|
| **United Arab Emirates 1.28% (0.64%)** | | | |
| Shelf Drilling Holdings 8.25% 15/02/2025 | $9,000,000 | 7,053 | 0.54 |
| Shelf Drilling Holdings 8.25% 15/02/2025 (Private Placement) | $2,286,000 | 1,752 | 0.14 |
| Topaz Marine 9.13% 26/07/2022 | $10,000,000 | 7,837 | 0.60 |
| | | **16,642** | **1.28** |
| **United Kingdom 30.75% (33.50%)** | | | |
| Afren 10.25% 08/04/2019 § | $4,801,113 | 1 | - |
| Anglian Water Osprey Financing 5.00% 30/04/2023 | £8,510,000 | 8,652 | 0.66 |
| Ardonagh Midco 3 8.38% 15/07/2023 | £6,750,000 | 6,807 | 0.52 |
| BUPA Finance 5.00% 08/12/2026 | £8,900,000 | 9,742 | 0.75 |
| Burford Capital 6.50% 19/08/2022 | £4,765,000 | 5,201 | 0.40 |
| Cabot Financial Luxembourg 7.50% 01/10/2023 | £9,500,000 | 9,178 | 0.70 |
| Cattles 7.13% 05/07/2017 ^,§ | £6,000,000 | - | - |
| Centrica, FRN 5.25% 10/04/2075 | £6,400,000 | 6,752 | 0.52 |
| EI Group 6.88% 09/05/2025 | £6,160,000 | 6,717 | 0.51 |
| EnQuest, FRN 7.00% 15/10/2023 | $15,607,494 | 11,033 | 0.85 |
| Galaxy Bidco, FRN 5.15% 15/11/2020 | £9,111,000 | 9,021 | 0.69 |
| HSBC Bank, FRN 2.81% Perpetual | $11,900,000 | 7,049 | 0.54 |
| HSBC Holdings, FRN 6.87% Perpetual | $7,000,000 | 5,678 | 0.44 |
| Iceland Bondco 6.75% 15/07/2024 | £8,228,000 | 8,529 | 0.65 |
| Intermediate Capital Group 5.00% 24/03/2023 | £5,850,000 | 6,060 | 0.46 |
| Investec Bank, FRN 4.25% 24/07/2028 | £8,300,000 | 8,223 | 0.63 |
| Ithaca Energy 8.13% 01/07/2019 | $12,000,000 | 9,209 | 0.71 |
| Just Group 9.00% 26/10/2026 | £8,300,000 | 10,231 | 0.78 |
| KCA Deutag UK Finance 9.88% 01/04/2022 | $13,900,000 | 11,095 | 0.85 |
| Legal & General Group, FRN 5.88% Perpetual | £10,000,000 | 10,188 | 0.78 |
| Lloyds Banking Group, FRN 7.50% Perpetual | $14,000,000 | 11,179 | 0.86 |
| Lloyds Banking Group, FRN 7.87% Perpetual | £3,898,000 | 4,535 | 0.35 |
| Matalan Finance 6.75% 31/01/2023 | £4,800,000 | 4,452 | 0.34 |
| Mclaren Finance 5.00% 01/08/2022 | £2,270,000 | 2,190 | 0.17 |
| Miller Homes Group Holdings, FRN 5.99% 15/10/2023 | £8,350,000 | 8,331 | 0.64 |
| Mizzen Bondco 7.00% 01/05/2021 | £9,292,911 | 9,454 | 0.72 |
| Nationwide Building Society, FRN 6.88% Perpetual | £10,500,000 | 10,804 | 0.83 |
| Neptune Energy Bondco 6.63% 15/05/2025 | $13,000,000 | 9,703 | 0.74 |
| NGG Finance, FRN 5.63% 18/06/2073 | £12,300,000 | 13,486 | 1.03 |
| Nottingham Building Society 7.88% Perpetual | £2,500,000 | 3,078 | 0.24 |
| Pension Insurance 6.50% 03/07/2024 | £7,000,000 | 7,802 | 0.60 |
| Phoenix Group Holdings 6.63% 18/12/2025 | £16,011,000 | 17,685 | 1.36 |
| Provident Financial 7.00% 04/06/2023 | £5,700,000 | 5,812 | 0.45 |
| Punch Taverns Finance B 7.75% 30/12/2025 | £5,750,000 | 5,729 | 0.44 |
| Quilter, FRN 4.48% 28/02/2028 | £8,000,000 | 8,030 | 0.62 |
| RAC Bond 5.00% 06/05/2046 | £9,000,000 | 8,415 | 0.65 |
| RBS Capital Trust II, FRN 6.42% Perpetual | $19,000,000 | 17,223 | 1.32 |
| Rothesay Life 8.00% 30/10/2025 | £10,400,000 | 12,871 | 0.99 |
| Rothschild Continuation Finance CI 9.00% Perpetual | £7,382,000 | 9,084 | 0.70 |
| Spirit Issuer 5.47% 28/12/2034 | £5,000,000 | 5,193 | 0.40 |
| Stonegate Pub Co. Financing 4.88% 15/03/2022 | £4,900,000 | 4,841 | 0.37 |
| TalkTalk Telecom Group 5.38% 15/01/2022 | £9,500,000 | 9,510 | 0.73 |
| Tesco 6.15% 15/11/2037 | $15,100,000 | 12,278 | 0.94 |
| Thames Water Kemble Finance 7.75% 01/04/2019 | £5,250,000 | 5,422 | 0.42 |
| Thomas Cook Group 6.25% 15/06/2022 | €11,750,000 | 11,133 | 0.85 |
| Virgin Media Secured Finance 5.13% 15/01/2025 | £9,965,000 | 10,136 | 0.78 |
| Viridian Group FinanceCo 4.75% 15/09/2024 | £9,000,000 | 8,547 | 0.66 |
| Voyage Care BondCo 5.88% 01/05/2023 | £9,300,000 | 9,311 | 0.71 |
| William Hill 4.88% 07/09/2023 | £5,000,000 | 5,252 | 0.40 |
| | | **400,852** | **30.75** |

# Investment information (continued)

| Investment | Holding or nominal value | Global exposure * | Valuation £'000 | % of net assets |
|---|---|---|---|---|
| **United States of America 8.60% (5.90%)** | | | | |
| AMC Entertainment Holdings 6.38% 15/11/2024 | £8,950,000 | | 9,165 | 0.70 |
| Burford Capital Finance 6.13% 12/08/2025 | $17,400,000 | | 13,646 | 1.05 |
| BWAY Holding 4.75% 15/04/2024 | €7,800,000 | | 7,099 | 0.54 |
| Continental Resources 4.50% 15/04/2023 | $14,350,000 | | 11,224 | 0.86 |
| Finial Holdings 7.13% 15/10/2023 | $8,250,000 | | 7,157 | 0.55 |
| Infor US 5.75% 15/05/2022 | €8,200,000 | | 7,429 | 0.57 |
| Ingles Markets 5.75% 15/06/2023 | $10,800,000 | | 8,345 | 0.64 |
| Men's Wearhouse 7.00% 01/07/2022 | $7,348,000 | | 5,809 | 0.45 |
| PSPC Escrow 6.00% 01/02/2023 | €10,300,000 | | 9,668 | 0.74 |
| Seagate HDD Cayman 4.75% 01/01/2025 | $7,500,000 | | 5,604 | 0.43 |
| State Street, FRN 2.90% 15/05/2028 | $7,486,000 | | 5,413 | 0.42 |
| USB Realty, FRN 3.49% Perpetual | $19,000,000 | | 13,050 | 1.00 |
| Weight Watchers International 8.63% 01/12/2025 | $10,000,000 | | 8,475 | 0.65 |
| | | | **112,084** | **8.60** |
| **Corporate bonds total** | | | **1,009,354** | **77.43** |
| **Forward currency contracts (1.54)% ((0.54)%)** | | | | |
| Buy Sterling 326,242,308 dated 10/09/2018 | | | 326,242 | 25.03 |
| Sell Euro 370,630,000 dated 10/09/2018 | | | (331,885) | (25.46) |
| Buy Sterling 5,657,918 dated 10/09/2018 | | | 5,658 | 0.43 |
| Sell Norwegian Krone 61,230,000 dated 10/09/2018 | | | (5,763) | (0.44) |
| Buy Sterling 8,000,811 dated 10/09/2018 | | | 8,001 | 0.61 |
| Sell Swiss Franc 10,551,000 dated 10/09/2018 | | | (8,192) | (0.62) |
| Buy Sterling 364,387,094 dated 10/09/2018 | | | 364,387 | 27.95 |
| Sell US Dollar 491,460,000 dated 10/09/2018 | | | (378,570) | (29.04) |
| **Forward currency contracts total** | | | **(20,122)** | **(1.54)** |
| **Futures (0.02)% (0.00%)** | | | | |
| Euro-Bund 06/09/2018 | (200) | (29,023) | (240) | (0.02) |
| **Futures total** | | **(29,023)** | **(240)** | **(0.02)** |
| Investment assets (including investment liabilities) | | | 1,258,177 | 96.51 |
| Net other assets | | | 45,454 | 3.49 |
| Net assets attributable to unitholders | | | 1,303,631 | 100.00 |

The comparative percentage figures in brackets are as at 7 August 2017.
^ Unlisted, suspended or delisted security.
§ Security is currently in default.
* Global exposure has been calculated in line with the guidelines issued by the European Securities and Markets Authority ('ESMA') and represents the market value of an equivalent position in the underlying investment of each derivative contract. For all other asset types the percentage of net assets has been calculated based on the valuation of each holding.

## Statement of total return for the year ended 7 August 2018

| | Note | 7 August 2018 £'000 | 7 August 2018 £'000 | 7 August 2017 £'000 | 7 August 2017 £'000 |
|---|---|---|---|---|---|
| **Income** | | | | | |
| Net capital (losses)/gains | 3 | | (45,735) | | 60,331 |
| Revenue | 5 | 73,782 | | 66,572 | |
| Expenses | 6 | (10,519) | | (9,887) | |
| Interest payable and similar charges | 7 | (317) | | (271) | |
| Net revenue before taxation | | 62,946 | | 56,414 | |
| Taxation | 8 | (229) | | (121) | |
| Net revenue after taxation | | | 62,717 | | 56,293 |
| **Total return before distributions** | | | **16,982** | | **116,624** |
| Distributions | 9 | | (72,499) | | (65,461) |
| Change in net assets attributable to unitholders from investment activities | | | (55,517) | | 51,163 |

## Statement of change in net assets attributable to unitholders for the year ended 7 August 2018

| | 7 August 2018 £'000 | 7 August 2018 £'000 | 7 August 2017 £'000 | 7 August 2017 £'000 |
|---|---|---|---|---|
| Opening net assets attributable to unitholders | | 1,203,039 | | 1,142,389 |
| Amounts receivable on issue of units | 200,986 | | 99,955 | |
| Amounts payable on cancellation of units | (44,877) | | (90,468) | |
| | | 156,109 | | 9,487 |
| Change in net assets attributable to unitholders from investment activities | | (55,517) | | 51,163 |
| Closing net assets attributable to unitholders | | 1,303,631 | | 1,203,039 |

## Balance sheet as at 7 August 2018

| | Note | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Fixed assets** | | | |
| Investments | 10 | 1,278,539 | 1,214,966 |
| **Current assets** | | | |
| Debtors | 11 | 19,618 | 18,836 |
| Cash and bank balances | 12 | 46,631 | 15,331 |
| **Total current assets** | | **66,249** | **34,167** |
| **Total assets** | | **1,344,788** | **1,249,133** |
| **Liabilities** | | | |
| Investment liabilities | 10 | 20,362 | 8,951 |
| **Creditors** | | | |
| Bank overdraft | | - | 141 |
| Distribution payable | | 19,017 | 15,955 |
| Other creditors | 13 | 1,778 | 21,047 |
| **Total creditors** | | **20,795** | **37,143** |
| **Total liabilities** | | **41,157** | **46,094** |
| Net assets attributable to unitholders | | 1,303,631 | 1,203,039 |

# Notes to the financial statements

## 1. Accounting policies

**(a) Basis of accounting.** The financial statements have been prepared under the historical cost basis, as modified by the revaluation of investments, in accordance with FRS 102 and SORP.

**(b) Valuation of investments.** All investments have been valued at 12 noon on the last working day of the accounting period. Listed investments are valued at fair value which is deemed to be the bid or SETS price. Unquoted investments are valued at fair value which is determined by the investment manager, with reference to the valuation guidelines issued by the International Private Equity and Venture Capital Valuation Guidelines Board.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

**(c) Foreign exchange rates.** Assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates prevailing at 12 noon on the last working day of the accounting period. Revenue and expenditure transactions are translated at the rates of exchange ruling on the dates of the transactions. Exchange differences on such transactions follow the same treatment as the principal amounts.

**(d) Derivatives.** Where appropriate, certain permitted transactions such as derivatives or forward currency contracts are used for efficient portfolio management and investment purposes. Derivatives are valued at 12 noon on the last working day of the accounting period. Exchange traded derivatives are priced at fair value, which is deemed to be the bid price. Over-the-counter derivatives are priced at fair values using valuation models or data sourced from market data providers. Returns on derivative instruments are recognised as either revenue or capital depending on the nature and circumstances of each particular case. Any positions on such transactions open at the year end are reflected in the balance sheet at their marked to market value.

**(e) Revenue.** Interest from debt securities is recognised on an effective interest rate basis inclusive of any expected changes to future cash flows. Dividends receivable from equity and non-equity shares are credited to revenue, net of attributable tax credits, when the security is quoted ex-dividend. Dividends received as shares (scrip/stock dividends), to the extent that the value of such dividends is equal to the cash dividends, are treated as revenue. Dividends on unquoted stocks are credited to revenue when the right to receive payment is established. Special dividends are reviewed on a case by case basis when determining if a dividend is to be treated as revenue or capital. It is likely that where a special dividend results in a significant reduction in the capital value of a holding, then the dividend will generally be treated as capital, otherwise this will be recognised as revenue. Bank interest is recognised on an accruals basis. Underwriting commission is recognised when the issue underwritten takes place.

**(f) Expenses.** All expenses (other than those relating to the purchase and sale of investments) are charged against revenue on an accruals basis.

**(g) Taxation.** Corporation tax is charged at a rate of 20% on the excess taxable revenue of the fund. In general, the tax accounting treatment follows that of the principal amount. Deferred tax is provided for all timing differences that have originated but not reversed at the balance sheet date other than those recorded as permanent differences. Deferred tax is provided for at the average rate of tax expected to apply. Deferred tax assets and liabilities are not discounted to reflect the time value of money.

## 2. Distribution policy

The fund shall distribute all available revenue, after deduction of expenses properly chargeable against revenue excluding the annual management charge. The investment objective of the fund concentrates on the generation of revenue as a higher priority than capital growth. The manager and the trustee have agreed that 100% of the annual management charge is to be transferred to capital for the purpose of calculating the distribution, as permitted by COLL. The distribution currently payable reflects this treatment. The manager may from time to time, smooth the distribution payments during the accounting period with the balance of revenue (if any) being paid in respect of the final distribution. Gains and losses on non-derivative investments and currencies, whether realised or unrealised, if taken to capital are not available for distribution. The fund holds instruments in order to comply with the qualifying instruments test of section 468L, Income and Corporation Taxes Act 1988. In satisfying these requirements, the fund pays interest distributions. With the exception of the manager's annual management charge, which is directly attributable to each unit class, all income and expenses are apportioned to each unit class pro-rata to the value of the net assets of the relevant unit class on the day that the income or expense is recognised. Distributions which have remained unclaimed by unitholders for six years are credited to the capital property of the fund.

## 3. Net capital (losses)/gains

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Derivative contracts | 1,476 | (2,188) |
| Capital transaction charges | (4) | (5) |
| Forward currency contracts | (2,399) | (13,878) |
| Currency losses | (6,003) | (2,129) |
| Non-derivative securities | (38,805) | 78,531 |
| Net capital (losses)/gains | (45,735) | 60,331 |

## 4. Direct transaction costs

For purchases and sales of equities, broker commissions, transfer taxes and stamp duty are paid by the fund on each transaction and are summarised below. Bonds have no separately identifiable transaction costs, these costs form part of the dealing price.

| | Year ended 7 August 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Principal £'000 | Commission £'000 | Taxes £'000 | Total after costs £'000 | Commission as a percentage of principal % | Taxes as a percentage of principal % |
| Purchases | | | | | | |
| Equities | 224,055 | 78 | 470 | 224,603 | 0.03 | 0.21 |
| Bonds | 488,205 | - | - | 488,205 | - | - |
| Sales | | | | | | |
| Equities | 212,833 | 87 | - | 212,746 | 0.04 | - |
| Bonds | 395,160 | - | - | 395,160 | - | - |
| Total | | 165 | 470 | | | |
| Percentage of fund average net assets | | 0.01% | 0.04% | | | |

| | Year ended 7 August 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Principal £'000 | Commission £'000 | Taxes £'000 | Total after costs £'000 | Commission as a percentage of principal % | Taxes as a percentage of principal % |
| Purchases | | | | | | |
| Equities | 121,590 | 154 | 460 | 122,204 | 0.13 | 0.38 |
| Bonds | 437,562 | - | - | 437,562 | - | - |
| Sales | | | | | | |
| Equities | 73,694 | 81 | - | 73,613 | 0.11 | - |
| Bonds | 470,528 | - | - | 470,528 | - | - |
| Total | | 235 | 460 | | | |
| Percentage of fund average net assets | | 0.02% | 0.04% | | | |

During the year the fund incurred £4,000 (2017: £5,000) in capital transaction charges.

### Dealing spread

As at the balance sheet date the average portfolio dealing spread was 0.82% (2017: 0.95%). This spread represents the difference between the bid and offer prices of each underlying investment expressed as a percentage of the value determined by reference to its offer price.

## 5. Revenue

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Interest on debt securities | 59,672 | 55,801 |
| UK dividends | 9,187 | 6,793 |
| Overseas dividends | 4,796 | 3,905 |
| Bank interest | 127 | 73 |
| Total revenue | 73,782 | 66,572 |

# Notes to the financial statements (continued)

## 6. Expenses

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| **Payable to the manager, associates of the manager and agents of either of them:** | | |
| Annual management charge | 9,772 | 9,153 |
| **Other expenses:** | | |
| Registration fees | 262 | 243 |
| Administration fees | 170 | 153 |
| Trustee fees | 126 | 140 |
| Operational fees | 120 | 126 |
| Safe custody fees | 60 | 63 |
| Auditor's remuneration: audit fees* | 9 | 9 |
| Total expenses | 10,519 | 9,887 |

All expenditure stated above is inclusive of irrecoverable VAT where applicable.
* The amount disclosed above includes VAT at the rate of 20%. The audit fee (excluding VAT) accrued during the year was £7,750 (2017: £7,500).

## 7. Interest payable and similar charges

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Interest payable on positions with brokers and counterparties | 303 | 258 |
| Interest payable | 14 | 13 |
| Total interest payable and similar charges | 317 | 271 |

## 8. Taxation

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| **a) Analysis of the tax charge for the year** | | |
| Irrecoverable overseas tax | 229 | 121 |
| Total taxation (note 8b) | 229 | 121 |
| **b) Factors affecting the tax charge for the year** | | |
| Net revenue before taxation | 62,946 | 56,414 |
| Corporation tax at 20% (2017: 20%) | 12,589 | 11,283 |
| **Effects of:** | | |
| Irrecoverable overseas tax | 229 | 121 |
| Non-taxable overseas dividends | (899) | (513) |
| Non-taxable UK dividends | (1,837) | (1,359) |
| Tax deductible interest distributions | (9,853) | (9,411) |
| Tax charge for the year (note 8a) | 229 | 121 |

**c) Provision for deferred tax**
No provision for deferred tax has been made in the current or prior accounting year.

**d) Factors that may affect future tax charges**
The fund has not recognised a deferred tax asset (2017: £nil)

## 9. Distributions

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Interim gross interest distribution - September 2017 | 628 | 312 |
| Interim gross interest distribution - October 2017 | 402 | 370 |
| Interim gross interest distribution - November 2017 | 15,715 | 16,596 |
| Interim gross interest distribution - December 2017 | 582 | 352 |
| Interim gross interest distribution - January 2018 | 475 | 400 |
| Interim gross interest distribution - February 2018 | 14,641 | 14,377 |
| Interim gross interest distribution - March 2018 | 646 | 426 |
| Interim gross interest distribution - April 2018 | 881 | 508 |
| Interim gross interest distribution - May 2018 | 19,585 | 15,649 |
| Interim gross interest distribution - June 2018 | 939 | 555 |
| Interim gross interest distribution - July 2018 | 673 | 451 |
| Final gross interest distribution - August 2018 | 18,345 | 15,504 |
| | **73,512** | **65,500** |
| Add: amounts deducted on cancellation of units | 382 | 562 |
| Deduct: amounts added on issue of units | (1,395) | (601) |
| Distributions | 72,499 | 65,461 |
| **Movement between net revenue and distributions** | | |
| Net revenue after taxation | 62,717 | 56,293 |
| Annual management charge paid from capital | 9,772 | 9,153 |
| Expenses paid from capital | 11 | 15 |
| Less: amounts deducted on conversion of units | (1) | - |
| | 72,499 | 65,461 |

The distributions take account of amounts added on the issue of units and amounts deducted on the cancellation of units. Details of the distributions per unit are set out in the distribution tables on pages 25 to 28.

## 10. Fair value hierarchy

All investments are designated at fair value through profit or loss on initial recognition. The following table provides an analysis of these investments based on the fair value hierarchy in accordance with FRS 102 which reflects the reliability and significance of the information used to measure their fair value.

The disclosure is split into the following categories:
Level 1 – Investments with unadjusted quoted prices in an active market;
Level 2 – Investments whose fair value is based on inputs other than quoted prices that are either directly or indirectly observable;
Level 3 – Investments whose fair value is based on inputs that are unobservable (i.e. for which market data is unavailable).

| | 7 August 2018 | | 7 August 2017 | |
|---|---|---|---|---|
| | Assets £'000 | Liabilities £'000 | Assets £'000 | Liabilities £'000 |
| Level 1 | 219,111 | 240 | 225,302 | 16 |
| Level 2 | 1,059,428 | 20,122 | 989,664 | 8,935 |
| Total | 1,278,539 | 20,362 | 1,214,966 | 8,951 |

# Notes to the financial statements (continued)

## 11. Debtors

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Accrued revenue | 18,048 | 16,668 |
| Amounts receivable for issue of units | 1,381 | 1,722 |
| Overseas withholding tax recoverable | 188 | 55 |
| Prepaid expenses | 1 | 1 |
| Sales awaiting settlement | - | 390 |
| Total debtors | 19,618 | 18,836 |

## 12. Cash and bank balances

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Amounts held in JPMorgan Liquidity Funds – Sterling Liquidity Fund (Institutional dist.) | 23,290 | 10,175 |
| Amounts held at futures clearing houses and brokers | 17,477 | 442 |
| Cash and bank balances | 5,864 | 4,714 |
| Total cash and bank balances | 46,631 | 15,331 |

## 13. Other creditors

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Accrued annual management charge | 1,008 | 947 |
| Amounts payable for cancellation of units | 509 | 674 |
| Accrued other expenses | 261 | 181 |
| Purchases awaiting settlement | - | 19,245 |
| Total other creditors | 1,778 | 21,047 |

## 14. Contingent liabilities and commitments

There were no contingent liabilities or outstanding commitments at the current or prior year end.

## 15. Reconciliation of unit movements

| Class | Units in issue at 7 August 2017 | Units issued | Units cancelled | Units converted | Units in issue at 7 August 2018 |
|---|---|---|---|---|---|
| MI distribution | 124,485,546 | 55,822,267 | (3,575,133) | 1,125,076 | 177,857,756 |
| QI distribution | 940,153,994 | 162,064,954 | (28,124,593) | 1,982,160 | 1,076,076,515 |
| QR distribution | 355,775,513 | 17,965,014 | (22,968,694) | (3,321,702) | 347,450,131 |

## 16. Risk disclosures

The fund's financial instruments comprise equities, fixed interest investments, floating rate investments, derivatives, cash balances and liquid resources which include debtors and creditors. The fund holds such financial assets in accordance with its investment objective and policy as set out on page 1. The fund is exposed to a number of risks that are associated with the financial instruments and markets in which it invests. The most significant risks to which the fund is exposed to are market risk, credit and counterparty risk and liquidity risk.

### (a) Market risk

Market risk, which includes interest rate risk, currency risk, other price risk and leverage risk, arises mainly from uncertainty about future values of financial instruments in the fund's investment portfolio. The fund, in order to meet its investment objective and policy, invests predominantly in bonds and equities and maintains an appropriate spread of investments in accordance with COLL, the Trust Deed and the Prospectus to seek to reduce the risks arising from factors specific to a particular company or sector. The manager's investment strategy is to select investments for their fundamental value. Stock selection is therefore based on disciplined accounting, market and sector analysis, with the emphasis on long-term investments. There is no material difference between the carrying values and the fair values of the financial assets and liabilities of the fund disclosed in the balance sheet.

### (i) Interest rate risk

Changes in interest rates or changes in expectations of future interest rates may result in an increase or decrease in the market value of the investments held. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background. Key determinants include economic growth prospects, inflation, governments' fiscal positions, short-term interest rates and international market comparisons.

As part of the continuing review of the portfolio, the manager monitors and reviews these factors.

| Currency | Floating rate financial assets † £'000 | Fixed rate financial assets £'000 | Financial assets not carrying interest £'000 | Total £'000 |
|---|---|---|---|---|
| 7 August 2018 | | | | |
| Sterling | 97,010 | 396,857 | 101,988 | 595,855 |
| US Dollar | 54,621 | 320,537 | 6,262 | 381,420 |
| Euro | 35,714 | 200,298 | 96,257 | 332,269 |
| Swiss Franc | 260 | - | 8,222 | 8,482 |
| Norwegian Krone | - | - | 5,727 | 5,727 |
| 7 August 2017 | | | | |
| Sterling | 34,113 | 484,162 | 169,804 | 688,079 |
| US Dollar | 46,876 | 213,309 | 7,446 | 267,631 |
| Euro | 25,278 | 198,630 | 10,123 | 234,031 |
| Swedish Krona | - | - | 19,692 | 19,692 |
| Norwegian Krone | - | - | 55 | 55 |

† Includes cash and bank balances.

Forward currency contracts for Euro, Swiss Franc, Norwegian Krone, Sterling and US Dollar are not included within this table. These can be found in the portfolio statement on page 14.

As at 7 August 2018 if there is a parallel shift in government bond yields with an increase of 1%, the fund could expect to see a 3.3% fall in the prices of the underlying bonds it holds (2017: 3.2%). A 1% fall in government bond yields would have an equal and opposite impact. This calculation has been prepared on a modified duration basis. Modified duration follows the concept that interest rates and bond prices move in opposite directions. The calculation has been used to serve as an indication of the possible impact to the fund from changes to government bond yields. This concept relies on a large number of assumptions, in particular, that all bonds are equally sensitive to government bond yields. In practice, this is not the case as many bonds with higher credit risk have lower correlation with government bond yields and in some cases even negative correlation. The fund contains a high and varying proportion of bonds with sometimes a high degree of credit risk. Furthermore, this makes the assumption of a parallel shift in yields. In practice, when interest rates change, longer dated government bond yields do not usually move in parallel with short-term interest rates. It is not unusual to see a negative correlation to short-term interest rate movements. The calculation also includes the impact of any futures positions, which are priced according to the yield of 10 year government bonds.

### (ii) Currency risk

A portion of the net assets of the fund are denominated in currencies other than sterling, and therefore the balance sheet and total return can be affected by currency movements. The manager may decide that a proportion of the investments that are not priced in sterling, may be covered by forward currency contracts, so that the fund's exposure to currency risk is reduced. The loss on forward currency contracts for the year was £2,399,000 (2017: £13,878,000).

Revenue received in foreign currencies is converted into sterling on or near the date of receipt.

The exposure to each currency is shown in the following tables and includes the effect of any forward currency contracts.

# Notes to the financial statements (continued)

| Currency | Investments £'000 | Net other assets £'000 | Forward currency contracts £'000 | Total £'000 |
|---|---|---|---|---|
| 7 August 2018 | | | | |
| Sterling | 562,354 | 33,501 | 704,288 | 1,300,143 |
| US Dollar | 374,565 | 6,855 | (378,570) | 2,850 |
| Euro | 327,441 | 4,828 | (331,885) | 384 |
| Swiss Franc | 8,222 | 260 | (8,192) | 290 |
| Norwegian Krone | 5,717 | 10 | (5,763) | (36) |
| 7 August 2017 | | | | |
| Sterling | 698,480 | (10,401) | 509,359 | 1,197,438 |
| Euro | 230,358 | 3,673 | (229,933) | 4,098 |
| Swedish Krona | 19,692 | - | (18,092) | 1,600 |
| Norwegian Krone | - | 55 | - | 55 |
| US Dollar | 263,934 | 3,697 | (267,783) | (152) |

A five per cent increase in the value of the fund's foreign currency exposure would have the effect of increasing the return and net assets by £174,000 (2017: £280,000). A five per cent decrease would have an equal and opposite effect.

### (iii) Other price risk

Other price risk is the risk that the value of an instrument will fluctuate as a result of changes in market prices (other than those relating to interest rate risk, currency risk and credit and counterparty risk), whether caused by factors specific to an investment or wider issues affecting the market generally. The value of equities is dependent on a number of factors, arising from the performance of the company itself and matters arising in the wider market (for example the state of the underlying economy and current government policy). The portfolio is invested in securities domiciled in a number of countries as detailed in the portfolio statement and will be exposed to market movements in the relevant country arising from changes in the local economy and government decisions. As part of the continuing review of the portfolio, the manager monitors and reviews these factors. A five per cent increase in the value of the fund's portfolio would have the effect of increasing the return and net assets by £62,909,000 (2017: £60,301,000). A five per cent decrease would have an equal and opposite effect.

Returns from bonds are fixed at the time of purchase, the fixed coupon payments are known, as are the final redemption proceeds. This means that if a bond is held until its redemption date, the total return achieved is unaltered from its purchase date. However, over the life of a bond, the yield (and hence market price) at any given time will depend on the market environment at that time. Therefore, a bond sold before its redemption date may have a different price to its purchase level and a gain or loss may be realised.

Bond investments are exposed to credit rating risk which reflects the ability of a bond issuer to meet its obligations (i.e. pay interest on a bond and return the capital on the redemption date). Generally, the higher the credit rating of the bond issuer, the rate at which they can borrow money may be lower than a bond issuer with a lower credit rating reflecting the potentially higher risk. Additionally, the credit rating of a bond is likely to impact upon the market price of a bond with a higher credit rating reflecting the greater expectation that the bond will be redeemed by the issuer on the maturity date at the nominal amount. An element of the market price of a bond will reflect this.

### (iv) Leverage risk

Leverage is defined as any method by which the fund can increase its exposure by borrowing cash or securities or from leverage that is embedded in derivative positions. The manager is required to calculate and monitor the level of leverage of a fund, expressed as a percentage of the exposure of the fund and its net asset value under the commitment method. The fund can use cash borrowing (subject to restrictions as set out in its Prospectus) and financial derivatives as sources of leverage. A result of 100% indicates that no leverage has been used.

As at 7 August 2018 and 7 August 2017 the leverage ratios of the fund were:

| | 2018 % | 2017 % |
|---|---|---|
| Sum of the notionals | 161.0 | 150.5 |
| Commitment | 104.2 | 106.4 |

### Debt security credit analysis

At the reporting date, the credit analysis of the fund's debt securities was as follows.

| | 7 August 2018 £'000 | 7 August 2017 £'000 |
|---|---|---|
| Investment grade securities | 300,403 | 238,760 |
| Below investment grade securities | 668,192 | 651,047 |
| Unrated securities | 90,072 | 97,371 |
| Total of debt securities | 1,058,667 | 987,178 |

* Source of credit ratings: Artemis Investment Management LLP.

### (b) Credit and counterparty risk

Credit and counterparty risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment it has entered into with the fund, resulting in a financial loss. From time to time, the fund may be subject to short-term credit risk with counterparties pending settlement of investment transactions. The manager has a pre-approved list of counterparties it uses for investment transactions, which is reviewed on a regular basis. The largest counterparty risk is with JP Morgan Chase N.A. ('JP Morgan'), the fund's custodian and banker, who holds the fund's investments and maintains the bank accounts. Bankruptcy or insolvency of JP Morgan may cause the fund's rights with respect to securities and cash held by the custodian to be delayed or limited. The trustee receives and reviews a semi-annual report on the internal controls in place at JP Morgan. The fund is also exposed to counterparty risk through holding specific financial instruments.

The manager is permitted to use one or more separate counterparties for derivative transactions. The fund may enter into transactions in over-the-counter ('OTC') markets that expose it to the creditworthiness of its counterparties and their ability to satisfy the terms of such contracts. Where the fund enters into derivative contracts, it will be exposed to the risk that the counterparty may default on its obligations to perform under the relevant contract. In the event of bankruptcy or insolvency of a counterparty, the fund could experience delays in liquidating the position and may incur significant losses.

There may be a risk that a counterparty will be unable to meet its obligations with regard to the return of the collateral and may not meet other payments due to the fund. To minimise such risk the manager will assess the creditworthiness of any counterparty that it engages. On a daily basis the manager assesses the level of assets with each counterparty to ensure that the exposure is within the defined limits in accordance with the requirements stipulated in COLL and the Prospectus.

The derivatives are disclosed in the portfolio statement and UBS AG ('UBS') is the counterparty for the forward currency contracts and J.P. Morgan Securities plc ('J.P. Morgan') is the counterparty for the futures. Aside from the custodian, the derivative counterparties and brokers where trades are pending settlement, there were no significant concentrations of credit and counterparty risk as at 7 August 2018 or 7 August 2017.

At the reporting date, the fund's financial assets exposed to credit and counterparty risk amounted to the following:

### Counterparty and collateral exposure

| Currency | Forward currency contracts £'000 | Futures £'000 | Total gross exposure £'000 | Net collateral pledged/(held) £'000 |
|---|---|---|---|---|
| 7 August 2018 | | | | |
| J.P. Morgan | - | (29,023) | (29,023) | 695 |
| UBS | (20,122) | - | (20,122) | 16,782 |
| 7 August 2017 | | | | |
| J.P. Morgan | - | (28,955) | (28,955) | - |
| UBS | (6,449) | - | (6,449) | 4,640 |

Only cash collateral is pledged or held by the fund.

### c) Liquidity risk

Some of the fund's financial instruments can include securities that are not listed on a recognised stock exchange and

# Notes to the financial statements (continued)

which may not always be readily realisable. However, from time to time, liquidity in any market or in a specific security can be affected by economic events. As a result, the fund may not be able to realise these investments quickly at their fair value to respond to any further liquidity requirements, or to respond to specific events such as deterioration in the creditworthiness of any particular issuer. In order to manage liquidity requirements, the fund seeks to maintain sufficient cash to pay creditors. Liquidity risk limits are set by reference to two key metrics: market liquidity and investor concentration. These measures will, in combination, identify instances where the fund may be unable to meet investor redemptions. Market liquidity considers a fund's liquidity compared against the daily average liquidity over the previous twelve months. Investor concentration considers the proportion of the fund that is realisable within a redemption cycle measured against the largest unitholder.

## 17. Related party transactions

The manager is deemed to be a related party. All transactions and balances associated with the manager are disclosed within the statement of total return, statement of change in net assets attributable to unitholders and the balance sheet on page 15 and notes 6, 9, 11 and 13 on pages 18 to 20 including all issues and cancellations where the manager acted as principal.

The balance due to the manager as at 7 August 2018 in respect of these transactions was £136,000 (2017: due from the manager £101,000).

## 18. Unit classes

The annual management charge on each unit class is as follows:

| | |
|---|---|
| MI distribution | 0.625% |
| QI distribution | 0.625% |
| QR distribution | 1.250% |

The net asset value per unit and the number of units in each class are given in the comparative tables on page 29. The distributions per unit class are given in the distribution tables on page 25 to 28. All classes have the same rights.

## 19. Post balance sheet event

Since 7 August 2018, the net asset values per unit, on a bid basis, have changed as follows:

| | Net asset value per unit (p) | | |
|---|---|---|---|
| | 1 October 2018 | 7 August 2018 | Movement |
| MI distribution* | 82.14 | 82.65 | (0.6)% |
| QI distribution | 82.55 | 82.64 | (0.1)% |
| QR distribution | 76.81 | 76.96 | (0.2)% |

* The monthly interim distribution declared on 7 September 2018 of 0.4242p (class MI distribution) has been included in the calculation of the movement in the net asset value per unit.

# Distribution tables

**Interim interest distribution for the month ended 7 September 2017 (paid on 7 November 2017) in pence per unit.**
Group 1 - Units purchased prior to 8 August 2017.
Group 2 - Units purchased from 8 August 2017 to 7 September 2017.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 November 2017 | Distribution per unit (p) 7 November 2016 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.4881 | - | 0.4881 | 0.3062 |
| Group 2 | 0.1969 | 0.2912 | 0.4881 | 0.3062 |

**Interim interest distribution for the month ended 7 October 2017 (paid on 7 December 2017) in pence per unit.**
Group 1 - Units purchased prior to 8 September 2017.
Group 2 - Units purchased from 8 September 2017 to 7 October 2017.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 December 2017 | Distribution per unit (p) 7 December 2016 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.2984 | - | 0.2984 | 0.3459 |
| Group 2 | 0.1553 | 0.1431 | 0.2984 | 0.3459 |

**Interim interest distribution for the month ended 7 November 2017 (paid on 5 January 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 October 2017.
Group 2 - Units purchased from 8 October 2017 to 7 November 2017.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 5 January 2018 | Distribution per unit (p) 6 January 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3593 | - | 0.3593 | 0.3557 |
| Group 2 | 0.1645 | 0.1948 | 0.3593 | 0.3557 |

**Interim interest distribution for the quarter ended 7 November 2017 (paid on 5 January 2018) in pence per unit.**
Group 1 – Units purchased prior to 8 August 2017.
Group 2 – Units purchased from 8 August 2017 to 7 November 2017.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 5 January 2018 | Distribution per unit (p) 6 January 2017 |
|---|---|---|---|---|
| QI distribution | | | | |
| Group 1 | 1.1507 | - | 1.1507 | 1.0117 |
| Group 2 | 0.4016 | 0.7491 | 1.1507 | 1.0117 |
| QR distribution | | | | |
| Group 1 | 1.0777 | - | 1.0777 | 0.9534 |
| Group 2 | 0.3796 | 0.6981 | 1.0777 | 0.9534 |

**Interim interest distribution for the month ended 7 December 2017 (paid on 7 February 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 November 2017.
Group 2 - Units purchased from 8 November 2017 to 7 December 2017.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 February 2018 | Distribution per unit (p) 7 February 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3919 | - | 0.3919 | 0.2982 |
| Group 2 | 0.1938 | 0.1981 | 0.3919 | 0.2982 |

# Distribution tables (continued)

**Interim interest distribution for the month ended 7 January 2018 (paid on 7 March 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 December 2017.
Group 2 - Units purchased from 8 December 2017 to 7 January 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 March 2018 | Distribution per unit (p) 7 March 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3116 | - | 0.3116 | 0.3295 |
| Group 2 | 0.1453 | 0.1663 | 0.3116 | 0.3295 |

**Interim interest distribution for the month ended 7 February 2018 (paid on 6 April 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 January 2018.
Group 2 - Units purchased from 8 January 2018 to 7 February 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 6 April 2018 | Distribution per unit (p) 7 April 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3387 | - | 0.3387 | 0.3715 |
| Group 2 | 0.1766 | 0.1621 | 0.3387 | 0.3715 |

**Interim interest distribution for the quarter ended 7 February 2018 (paid on 6 April 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 November 2017.
Group 2 - Units purchased from 8 November 2017 to 7 February 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 6 April 2018 | Distribution per unit (p) 7 April 2017 |
|---|---|---|---|---|
| QI distribution | | | | |
| Group 1 | 1.0465 | - | 1.0465 | 1.1046 |
| Group 2 | 0.4716 | 0.5749 | 1.0465 | 1.1046 |
| QR distribution | | | | |
| Group 1 | 0.9784 | - | 0.9784 | 1.0389 |
| Group 2 | 0.3738 | 0.6046 | 0.9784 | 1.0389 |

**Interim interest distribution for the month ended 7 March 2018 (paid on 4 May 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 February 2018.
Group 2 - Units purchased from 8 February 2018 to 7 March 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 4 May 2018 | Distribution per unit (p) 5 May 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.4008 | - | 0.4008 | 0.4042 |
| Group 2 | 0.2046 | 0.1962 | 0.4008 | 0.4042 |

**Interim interest distribution for the month ended 7 April 2018 (paid on 7 June 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 March 2018.
Group 2 - Units purchased from 8 March 2018 to 7 April 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 June 2018 | Distribution per unit (p) 7 June 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.5338 | - | 0.5338 | 0.4590 |
| Group 2 | 0.2928 | 0.2410 | 0.5338 | 0.4590 |

**Interim interest distribution for the month ended 7 May 2018 (paid on 6 July 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 April 2018.
Group 2 - Units purchased from 8 April 2018 to 7 May 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 6 July 2018 | Distribution per unit (p) 7 July 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.4206 | - | 0.4206 | 0.3417 |
| Group 2 | 0.2407 | 0.1799 | 0.4206 | 0.3417 |

**Interim interest distribution for the quarter ended 7 May 2018 (paid on 6 July 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 February 2018.
Group 2 - Units purchased from 8 February 2018 to 7 May 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 6 July 2018 | Distribution per unit (p) 7 July 2017 |
|---|---|---|---|---|
| QI distribution | | | | |
| Group 1 | 1.3622 | - | 1.3622 | 1.2102 |
| Group 2 | 0.6867 | 0.6755 | 1.3622 | 1.2102 |
| QR distribution | | | | |
| Group 1 | 1.2717 | - | 1.2717 | 1.1365 |
| Group 2 | 0.5104 | 0.7613 | 1.2717 | 1.1365 |

**Interim interest distribution for the month ended 7 June 2018 (paid on 7 August 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 May 2018.
Group 2 - Units purchased from 8 May 2018 to 7 June 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 August 2018 | Distribution per unit (p) 7 August 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.5342 | - | 0.5342 | 0.4710 |
| Group 2 | 0.2221 | 0.3121 | 0.5342 | 0.4710 |

**Interim interest distribution for the month ended 7 July 2018 (paid on 7 September 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 June 2018.
Group 2 - Units purchased from 8 June 2018 to 7 July 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 7 September 2018 | Distribution per unit (p) 7 September 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3783 | - | 0.3783 | 0.3724 |
| Group 2 | 0.1942 | 0.1841 | 0.3783 | 0.3724 |

**Final interest distribution for the month ended 7 August 2018 (payable on 5 October 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 July 2018.
Group 2 - Units purchased from 8 July 2018 to 7 August 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 5 October 2018 | Distribution per unit (p) 6 October 2017 |
|---|---|---|---|---|
| MI distribution | | | | |
| Group 1 | 0.3472 | - | 0.3472 | 0.3357 |
| Group 2 | 0.1622 | 0.1850 | 0.3472 | 0.3357 |

# Distribution tables (continued)

**Final interest distribution for the quarter ended 7 August 2018 (payable on 5 October 2018) in pence per unit.**
Group 1 - Units purchased prior to 8 May 2018.
Group 2 - Units purchased from 8 May 2018 to 7 August 2018.

| | Gross revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 5 October 2018 | Distribution per unit (p) 6 October 2017 |
|---|---|---|---|---|
| QI distribution | | | | |
| Group 1 | 1.2663 | - | 1.2663 | 1.1843 |
| Group 2 | 0.5559 | 0.7104 | 1.2663 | 1.1843 |
| QR distribution | | | | |
| Group 1 | 1.1803 | - | 1.1803 | 1.1108 |
| Group 2 | 0.4417 | 0.7386 | 1.1803 | 1.1108 |

Equalisation applies only to units purchased during the distribution period (group 2 units). It is the average amount of revenue included in the purchase price of all group 2 units and is refunded to holders of these units as a return of capital. Being capital it is not liable to income tax but must be deducted from the cost of units for capital gains tax purposes.

# Comparative tables

| | MI distribution | | | QI distribution | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| **Change in net assets per unit (p)** | | | | | | |
| **Opening net asset value per unit** | **86.05** | **82.17** | **84.07** | **86.05** | **82.15** | **84.05** |
| Return before operating charges * | 1.98 | 9.26 | 3.58 | 2.01 | 9.25 | 3.61 |
| Operating charges | (0.58) | (0.58) | (0.55) | (0.59) | (0.59) | (0.56) |
| Return after operating charges | 1.40 | 8.68 | 3.03 | 1.42 | 8.66 | 3.05 |
| Distributions | (4.80) | (4.80) | (4.93) | (4.83) | (4.76) | (4.95) |
| Retained distributions on accumulation units | - | - | - | - | - | - |
| **Closing net asset value per unit** | **82.65** | **86.05** | **82.17** | **82.64** | **86.05** | **82.15** |
| * after direct transaction costs of | (0.03) | (0.04) | (0.02) | (0.03) | (0.04) | (0.02) |
| **Performance** | | | | | | |
| Return after charges | 1.63% | 10.56% | 3.60% | 1.65% | 10.54% | 3.63% |
| **Other information** | | | | | | |
| Closing net asset value (£'000) | 146,995 | 107,125 | 64,125 | 889,241 | 809,002 | 779,315 |
| Closing number of units | 177,857,756 | 124,485,546 | 78,036,324 | 1,076,076,515 | 940,153,994 | 948,622,541 |
| Operating charges | 0.69% | 0.69% | 0.68% | 0.69% | 0.69% | 0.69% |
| Direct transaction costs | 0.04% | 0.05% | 0.02% | 0.04% | 0.05% | 0.02% |
| **Prices** | | | | | | |
| Highest offer unit price (p) | 88.39 | 88.14 | 86.26 | 89.20 | 89.01 | 86.84 |
| Lowest bid unit price (p) | 82.28 | 81.83 | 76.13 | 82.84 | 81.83 | 76.09 |

| | QR distribution | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| **Change in net assets per unit (p)** | | | |
| **Opening net asset value per unit** | **80.64** | **77.48** | **79.77** |
| Return before operating charges * | 1.88 | 8.69 | 3.40 |
| Operating charges | (1.05) | (1.05) | (1.01) |
| Return after operating charges | 0.83 | 7.64 | 2.39 |
| Distributions | (4.51) | (4.48) | (4.68) |
| Retained distributions on accumulation units | - | - | - |
| **Closing net asset value per unit** | **76.96** | **80.64** | **77.48** |
| * after direct transaction costs of | (0.03) | (0.04) | (0.02) |
| **Performance** | | | |
| Return after charges | 1.03% | 9.86% | 3.00% |
| **Other information** | | | |
| Closing net asset value (£'000) | 267,395 | 286,912 | 298,949 |
| Closing number of units | 347,450,131 | 355,775,513 | 385,842,253 |
| Operating charges | 1.31% | 1.32% | 1.31% |
| Direct transaction costs | 0.04% | 0.05% | 0.02% |
| **Prices** | | | |
| Highest offer unit price (p) | 86.98 | 86.92 | 85.89 |
| Lowest bid unit price (p) | 77.20 | 77.03 | 71.98 |

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

## Class I performance

| | Since launch* | 5 years | 3 years | 1 year | 6 months |
|---|---|---|---|---|---|
| Artemis High Income Fund | 203.3 | 32.3 | 15.3 | 1.7 | 0.6 |
| Sector average | 113.5 | 20.0 | 10.0 | 0.0 | (0.3) |
| Position in sector | 2/18 | 6/63 | 7/66 | 6/73 | 20/73 |
| Quartile | 1 | 1 | 1 | 1 | 2 |

* Data from 9 September 2002 when Artemis took over management 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 2018 reflects class QI distribution units, bid to bid basis, in sterling with interest reinvested to 7 August 2018. All performance figures show total returns with interest reinvested, percentage growth. Sector is IA £ Strategic Bond.

## Ongoing charges

| Class | 7 August 2018 |
|---|---|
| MI distribution | 0.69% |
| QI distribution | 0.69% |
| QR distribution | 1.31% |

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 R performance

| | Since launch* | 5 years | 3 years | 1 year | 6 months |
|---|---|---|---|---|---|
| Artemis High Income Fund | 184.2 | 28.2 | 13.1 | 1.0 | 0.2 |
| Sector average | 113.5 | 20.0 | 10.0 | 0.0 | (0.3) |

* Data from 9 September 2002 when Artemis took over management of the fund. Source: Lipper Limited, class QR distribution units, bid to bid basis, in sterling with net interest reinvested to 7 August 2018. All performance figures show total returns with interest reinvested, percentage growth.

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