Profit *hunters*

# Artemis UK Special Situations *Fund*

## Manager's Report and Financial Statements

for the year ended 31 December 2018

Artemis
The Profit Hunter

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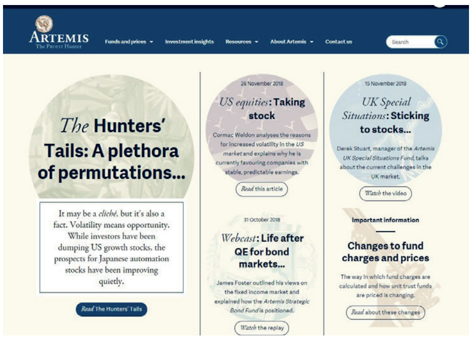


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- Artemis *Filmclub* videos by our fund managers
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- Daily fund prices
- Fund literature

**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 £27.5 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 January 2019.

## Fund status

Artemis UK Special Situations Fund was constituted by a Trust Deed dated 25 & 28 February 2000 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 long-term capital growth by exploiting special situations. The fund invests principally in UK equities and in companies which are headquartered or have a significant part of their activities in the UK which are quoted on a regulated market outside the UK.

## Investment policy

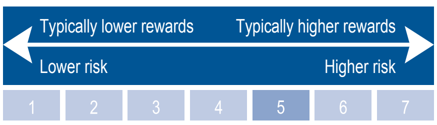
The manager actively manages the portfolio in order to achieve the objective and will not be restricted in respect of investment either by company size or industry. The securities of companies listed, quoted and/or traded in the UK but domiciled elsewhere and the securities of companies traded on ISDX may be included in the portfolio.

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

## 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 may not fully take into account the following risks and the following may affect fund performance:

- The value of the fund and any income from it can fall or rise because of movements in stockmarkets, currencies and interest rates, each of which can move irrationally and be affected unpredictably by diverse factors, including political and economic events.
- Some or all of the fund's assets may be invested in a currency other than the fund's accounting currency. The value of the assets, and the income from them, may decrease if the currency falls in relation to the accounting currency.
- Investing in small and medium-sized companies can involve more risk than investing in larger, more established companies. Shares in smaller companies may not be as easy to sell, which can cause difficulty in valuing those shares.
- There was no change to the indicator in the period.

## Prospectus

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

## Change of Trustee and Depositary

With effect from 15 January 2018 J.P. Morgan Europe Limited was appointed as Trustee & Depositary of the fund.

## 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.

# General information (continued)

## Changes to Artemis' funds from February 2019

With effect from 1 February 2019, Artemis made changes to how its funds operate:

- the way in which fund charges are calculated, moving from variable expenses to an administration fee with a discount applied based on fund size.
- how our unit trust funds are priced, changing from 'bid price' and 'offer price' to a 'single price'.

The prospectus was updated on 4 February 2019 as a result of the changes.

## 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 UK Special Situations Fund (the 'fund') is a UCITS scheme, Artemis Fund Managers Limited ('AFML') as manager is required to make these disclosures. Artemis operates its 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-ofinformation-account-holders.

## 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 *
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 1 January 2018 to 15 January 2018

The trustee must ensure that the Artemis UK Special Situations Fund ('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 in 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 in the scheme is 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 Authorised Fund Manager ('the AFM') 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 UK Special Situations Fund for the period from 1 January 2018 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 scheme's 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

## Statement of the trustee's responsibilities in respect of the scheme and report of the trustee to the unitholders of Artemis UK Special Situations Fund ('the Trust') for the period from 15 January 2018 to 31 December 2018

The trustee of Artemis UK Special Situations 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.

# General information (continued)

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 in cash accounts in accordance with the Regulations;
- the sale, issue, repurchase, redemption and cancellation of units are 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
25 February 2019

## 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 UK Special Situations Fund for the year ended 31 December 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 — Director
J L Berens — Director
Artemis Fund Managers Limited
London
25 February 2019

# Independent auditor's report to the unitholders of the Artemis UK Special Situations Fund

## Opinion

We have audited the financial statements of the Artemis UK Special Situations Fund ('the Fund') for the year ended 31 December 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 18, 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 31 December 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.

In preparing the financial statements, the manager is responsible for assessing the Fund's ability to

# General information (continued)

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 them 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, or this report, or for the opinions we have formed.

Ernst & Young LLP
Statutory Auditor
Edinburgh
25 February 2019

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.

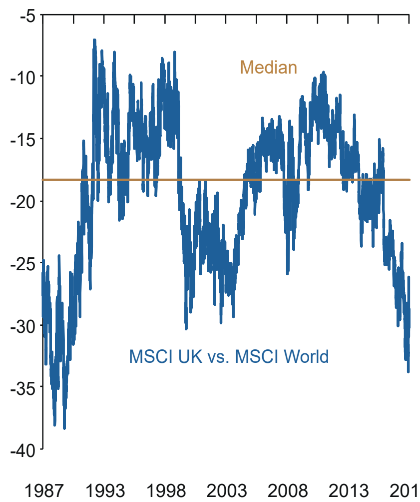
- The fund fell by 14.3%* versus a 9.5%* decline in the FTSE All-Share Index.
- The uncertainty of Brexit puts pressure on our domestic earners.
- Our portfolio trades at a material discount to the wider UK market.

## Performance – A poor year for cyclicals and domestic earners …

It is always interesting reflecting on the year just passed – and to look back on what we anticipated it would bring. This time a year ago, we commented that we were cautious about equity markets given valuations, rising interest rates and trade wars. We wrote that we did not know what the ultimate outcome of Brexit would be. And we noted that the UK market – and particularly its domestically focused companies – offered value.

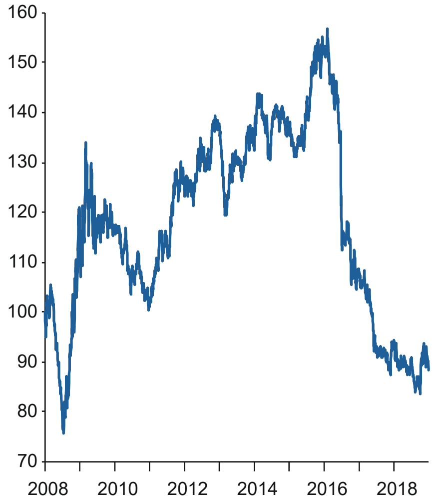
Let's reflect on those comments. Sadly, despite having done much research on Brexit we are still none the wiser as to what the eventual outcome will be. But we can confirm that the UK market now offers even more value than it did a year ago. And, within that, its domestic earners are still out of favour. And while expectations for the UK economy coming into 2018 were low, it has delivered modest economic growth, helped by good weather, a World Cup and – at long last – a pickup in wage inflation.

**UK equities look cheap vs. the rest of the world - average % premium on P/E, DY & PBV**




Source: MSCI, IBES, Morgan Stanley Research as at 4 January 2019.

**UK domestic stocks continue to under perform exporters - domestic UK exposure vs. UK exporters (rebased to 100)**




Source: MSCI, Morgan Stanley research as at 31 December 2018.

Globally, higher interest rates in the US did indeed provoke concerns over growth, with the gloom intensifying towards the year end. In terms of economic news, the data certainly got worse. China is showing clear evidence of a slowdown (a policy response is already being introduced). The outlook for Europe also deteriorated, with France under the grip of the yellow vests, Italy dealing with budget issues again and Germany being affected by a slowdown in sales in the auto sector. Amid that, the US economy remained strong. But with interest rates rising we should expect the rate of growth to slow. Meanwhile, China remains Trump's enemy number one – so the trade war continued.

In general, with monetary conditions tightening and tensions around trade mounting, it is unsurprising that global growth should have slowed. How much further it will slow is difficult to predict but investors took a clear view: equity markets in general had a poor second half of 2018 and any company that offered a whiff of cyclicality saw its shares decline, especially in the final quarter. The fund's holdings were not immune to this, and it fell by 14.3%, which compares to our benchmark declining by 9.5%.

## Review – The year on a stock level …

Over the year, the fund suffered from both actual as well as perceived deterioration in results from some of its holdings. Let us first deal with the ones where we believe the market got it wrong.

Tesco, our largest holding, spent the second half of the year giving back its impressive performance from the first half. It faced three main issues. First, the UK high street suffered. Everything from unseasonal weather, flawed business models and the move to online shopping put pressure on retailers in general. Second, the discounters (Aldi, Lidl) showed a bit more vigour during the second half. Third, its interim results brought a modest downgrade to earnings due to some trading issues at its operation in Thailand.

Why do we keep faith with Tesco? To us, the recent trading update demonstrated a number of things. The original plan for the business to reach operating margins of 3.5% to 4% is on track. And we have the contribution of Booker on top of that. The management seems to have got to grips with its problems in Thailand. And it has delivered on its new product ranges, outperforming the sector over Christmas. The majority of the plan for improving profits is within the gift of management. On its forecasts, Tesco offers a 9% free cashflow yield. Its next problem will be what to do with its excess cash. It remains our largest holding.

Capita is a stock we have discussed a lot in our updates over the past 12 months. We noted at the interim stage that the shares had bounced nicely after its rights issue. They spent the balance of the year giving that performance back. Rather frustratingly, this was despite there being no material change to earnings forecasts. In fact, the more we see from this company, the more we like it. High-priced disposals have improved the balance sheet. Its contract wins are quite remarkable, given the negative news that has surrounded the company. Appointments at the company

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

## Investment review (continued)

are allowing it to focus on the growth of its software business. Indeed, in our view most of the current market capitalisation can be supported by the software business alone – and that represents just 25% of the overall business. If management do hit their targets for 2020, the shares are trading on a multiple of 7x earnings and double-digit free cashflow yield. So why did they drift lower over the second half of the year? In many ways they represent the perfect Brexit short: this is a 100% UK-focused business which offers a negative outcome if the Labour Party gets into power. We have continued to add to our position and the holding now represents 4% of the fund.

Our more cyclically oriented companies also had a tough second half of the year despite generally delivering decent trading updates. Bodycote, Essentra and Synthomer all belong to this category. We remain holders of all three. Indeed, in the case of the majority of our underperformers we have seen nothing but evidence to support their continued position in the fund; and in many cases we have added to them.

We did, however, have a couple of company-specific issues: Superdry and Restaurant Group. Superdry has struggled for much of the year as it updated its product range. The recent warning, however, was more to do with poor demand for cold-weather clothing during a mild winter and the general malaise on the high street. So what is the value now? The brand has an enterprise value of around £330m (the company still has £50m of cash), nearly £900m of sales (which are still growing) and around £100m of cash earnings. So with a multiple of just over 3x those earnings and with a dividend yield of over 6%, we see value in the shares. Superdry does need to prove the growth in new product areas. But with growing overseas sales and a good online position, the upside could be significant.

Our other large negative didn't actually warn on profits. In October, Restaurant Group announced it would acquire Wagamama. This is a good asset. We like it and we like eating there. What we didn't like was the price Restaurant Group was willing to pay – and the equity it was issuing to buy it. We were not alone. To our frustration, and after several meetings with the management, they pushed ahead with the deal, issuing equity as the share price slid. We voted against the deal – as did 40% of shareholders. But the deal still went through. It is an interesting dilemma in investment management of what to do when faced with a share price that has declined a lot and where we face the prospect of dilution where we are not feeling particularly happy about management's strategic decision. Given the move in the share price, we decided to take up our rights. But we will be monitoring progress carefully.

On the positive side, the fund benefited from BT's modest renaissance. The shares rallied strongly after its earnings beat predictions modestly. This reflected the level of pessimism that had come to surround the stock: actually delivering on a set of figures came as a very pleasant surprise to the market. BT's shares performed reasonably well this year. But its ability to grow is minimal and pressures from both regulator and technology hang over the company. So we reduced the position significantly.

Elsewhere, Northgate is slowly starting to deliver. Who would have thought that van hire could be such a complicated business? The shares are trading at their net asset value so there is hardly unbridled optimism being priced in. Improving returns from their historically dismal level should spark a decent re-rating. Let's hope we can deliver news of this happy event in our next report. The fund also benefitted from positive trading updates from Britvic, SDL and Spirent. We have been patient with Spirent, but the operational leverage is finally coming through. Roll on 5G!

As noted above, we took profits in BT and also reduced our position in GlaxoSmithKline. Partly this reflected the fact that the shares had performed well and partly it was due to concern over its recent acquisition of a US biotech company. Paying a large premium for a company that might deliver a product at some point in the future doesn't seem like a particularly low-risk allocation of capital. It did, however, partly redeem itself shortly afterwards through a potentially value-enhancing joint venture with Pfizer.

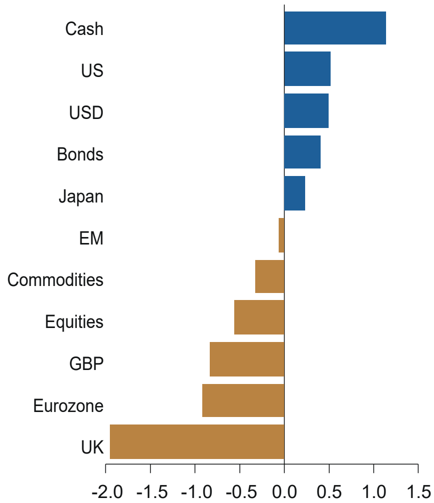
We bought new positions in Paddy Power Betfair and RBS. Paddy Power Betfair has struggled since its creation through the merger of the two businesses. The necessary internal changes have now been made, the company has a very strong platform and it has established a good foothold in the US, where gambling is being de-regulated. Coupled with the cash on its balance sheet, the company is now in a very strong competitive position. Like other banks, RBS has performed poorly in the face of ongoing concerns over Brexit. Yet financially the business is in much better shape and is now in the enviable position of being well capitalised. It is also trading at a 20% discount to book value. We feel this is more than pricing in the uncertainty of what the post-Brexit era will bring.

We have increased marginally our weighting to more domestically focused companies. They offer the most value and in many cases are pricing in a very difficult world post-Brexit. While we acknowledge this could materialise, we feel the balance of probability is for an outcome which is not quite as apocalyptic as some forecasters would have us believe.

### Outlook – Owning cheap stocks in a cheap market…

Given tightening monetary conditions and generally slower growth, we are not particularly bullish about global equities at present. When it comes to the UK, however, we are more optimistic. Ours is a cheap market. And within that market, domestically focussed stocks are cheaper still. The UK market trades on 11.5x earnings and 8% free cashflow yield. This is in itself great value. Our portfolio, meanwhile trades on 9.8x earnings with a 9% free cashflow yield. With investors' sentiment at multi-year lows, we feel this is a good position starting from which to make some positive returns.

### Investor positioning vs. history




Source: BoAML Global Fund Manager Survey as at 18 December 2018. Data since 2006 for commodities, since 2001 for all others.

We feel the outcome of Brexit will have a bigger impact on sentiment than on the fundamentals of business. As we write, there are feverish discussions about a way forward. With the country split, the Cabinet divided and with the majority of MPs supporting Remain (or at least opposing 'no deal'), the risks of not actually delivering on what the country voted for are high. Among all this uncertainty the bellwether of the outcome, sterling, has remained remarkably stable. One feels it is now starting to reflect a softer outcome, with the UK remaining within some form of single market or customs union. That would be good for business if, perhaps, bad for democracy. When there has been a whiff of resolution in the air, the pound has demonstrated short bouts of performance. Imagine what might happen when a resolution is finally found. Although a stronger pound would not help all UK companies - overseas earners would suffer - it would be beneficial for our domestic stocks.

At the same time, we acknowledge the recent tightening in lending markets and have been keen to focus our interest on companies that are well-financed. We are 10 years into a bull market. And, as we know from history, complacency tends to breed shoddy lending and risky accounting practices. Around 25% of our holdings have net cash. Around 33% have debts equivalent to less than 1x cash 25% of the fund have debts equivalent to less than 2x cash earnings. Of the remaining holdings that have higher levels of debt, all are FTSE 100 stocks with more stable earnings. That doesn't mean they can't go wrong or won't suffer from debt. But it does mean that we can sell them if we become more concerned on the economic outlook.

We have yet to see a turnaround in the fund's performance. That is what preoccupies us at the moment. By and large we are happy with our holdings and believe that their value will be recognised over time. The lowly valuation of the fund puts us in a decent position to achieve returns ahead of the market average. There will be volatility as investors react to political noise and adjust to a world in which liquidity is less abundant. But we look forward to reporting on our companies' results in the fund's interim report this summer.

**Derek Stuart & Andy Gray**
**Fund managers**

# Investment information

## Five largest purchases and sales for the year ended 31 December 2018

| Purchases | Cost £'000 | Sales | Proceeds £'000 |
|---|---|---|---|
| Capita | 28,001 | Computacenter | 39,880 |
| Royal Dutch Shell B shares | 23,985 | Johnson Matthey | 28,995 |
| British American Tobacco | 23,531 | BT Group | 28,692 |
| Britvic | 20,505 | GlaxoSmithKline | 27,871 |
| Superdry | 19,571 | Royal Dutch Shell B shares | 25,414 |

## Portfolio statement as at 31 December 2018

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| **Equities 97.76% (97.86%)** | | | |
| **Basic Materials 2.31% (4.31%)** | | | |
| Synthomer | 4,023,156 | 14,379 | 2.31 |
| | | **14,379** | **2.31** |
| **Consumer Goods 6.79% (0.66%)** | | | |
| British American Tobacco | 630,378 | 15,807 | 2.54 |
| Britvic | 2,430,960 | 19,472 | 3.13 |
| Superdry | 1,508,612 | 6,948 | 1.12 |
| | | **42,227** | **6.79** |
| **Consumer Services 15.42% (21.12%)** | | | |
| 888 Holdings | 2,253,773 | 3,899 | 0.63 |
| easyJet | 618,059 | 6,876 | 1.11 |
| Footasylum # | 3,295,712 | 824 | 0.13 |
| International Consolidated Airlines Group | 1,279,840 | 7,897 | 1.27 |
| ITV | 5,191,293 | 6,474 | 1.04 |
| Paddy Power Betfair | 130,206 | 8,281 | 1.33 |
| Pearson | 619,863 | 5,773 | 0.93 |
| Rank Group | 5,617,456 | 7,808 | 1.26 |
| Restaurant Group | 11,093,634 | 15,642 | 2.52 |
| Tesco | 15,643,138 | 29,800 | 4.79 |
| William Hill | 1,641,232 | 2,545 | 0.41 |
| | | **95,819** | **15.42** |
| **Financials 18.11% (17.60%)** | | | |
| Aviva | 2,545,340 | 9,548 | 1.54 |
| Barclays | 9,994,119 | 14,943 | 2.40 |
| IG Group Holdings | 1,759,856 | 10,181 | 1.64 |
| Lloyds Banking Group | 24,037,771 | 12,399 | 1.99 |
| London Stock Exchange Group | 156,781 | 6,335 | 1.02 |
| Prudential | 2,033,882 | 28,525 | 4.59 |
| Quilter | 4,912,518 | 5,812 | 0.94 |
| Rok Entertainment Group ^ | 410,914 | – | – |
| ROK Global ^ | 66,096 | – | – |
| Royal Bank of Scotland Group | 3,591,988 | 7,723 | 1.24 |
| RSA Insurance Group | 2,000,434 | 10,230 | 1.65 |
| Sherborne Investors Guernsey C shares | 9,750,069 | 6,825 | 1.10 |
| | | **112,521** | **18.11** |
| **Healthcare 5.04% (5.23%)** | | | |
| GlaxoSmithKline | 1,326,483 | 19,757 | 3.18 |
| Smith & Nephew | 790,212 | 11,584 | 1.86 |
| | | **31,341** | **5.04** |

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| **Industrials 27.66% (25.86%)** | | | |
| Balfour Beatty | 9,290,694 | 23,115 | 3.72 |
| Bodycote | 1,385,458 | 10,024 | 1.61 |
| Capita | 23,109,474 | 25,709 | 4.14 |
| Essentra | 4,628,995 | 15,822 | 2.55 |
| Howden Joinery Group | 3,716,679 | 16,316 | 2.62 |
| IWG | 3,048,244 | 6,307 | 1.01 |
| Johnson Service Group # | 272,949 | 320 | 0.05 |
| Keller Group | 604,646 | 2,984 | 0.48 |
| MBA POLYMERS ^ | 2,105,625 | – | – |
| Melrose Industries | 5,013,975 | 8,128 | 1.31 |
| Northgate | 4,130,719 | 15,697 | 2.53 |
| Oxford Instruments | 1,101,370 | 9,560 | 1.54 |
| SIG | 13,366,677 | 14,703 | 2.37 |
| Spectris | 448,437 | 10,305 | 1.66 |
| Speedy Hire | 17,799,889 | 10,502 | 1.69 |
| SRG Realisations 2017 ^ | 1,770,432 | 35 | – |
| Xaar | 1,675,864 | 2,363 | 0.38 |
| | | **171,890** | **27.66** |
| **Oil & Gas 8.11% (8.29%)** | | | |
| BP | 5,991,668 | 29,854 | 4.80 |
| Mycelx Technologies # | 1,407,715 | 2,393 | 0.39 |
| Royal Dutch Shell B shares | 778,829 | 18,170 | 2.92 |
| | | **50,417** | **8.11** |
| **Technology 9.10% (10.08%)** | | | |
| Computacenter | 1,049,999 | 10,521 | 1.70 |
| Intechnology ^ | 21,937,940 | – | – |
| NCC Group | 5,859,548 | 10,389 | 1.67 |
| SDL | 4,035,777 | 18,847 | 3.03 |
| Spirent Communications | 14,097,496 | 16,776 | 2.70 |
| | | **56,533** | **9.10** |
| **Telecommunications 5.22% (4.71%)** | | | |
| BT Group | 3,899,595 | 9,252 | 1.49 |
| Vodafone Group | 15,172,536 | 23,159 | 3.73 |
| | | **32,411** | **5.22** |
| Investment assets | | 607,538 | 97.76 |
| Net other assets | | 13,929 | 2.24 |
| Net assets attributable to unitholders | | 621,467 | 100.00 |

The comparative percentage figures in brackets are as at 31 December 2017.
# Security listed on the Alternative Investment Market ('AIM').
^ Unlisted, suspended or delisted security.

# Financial statements

## Statement of total return for the year ended 31 December 2018

| | Note | 31 December 2018 £'000 | 31 December 2018 £'000 | 31 December 2017 £'000 | 31 December 2017 £'000 |
|---|---|---|---|---|---|
| **Income** | | | | | |
| Net capital (losses)/gains | 3 | | (139,316) | | 43,098 |
| Revenue | 5 | 30,377 | | 31,682 | |
| Expenses | 6 | (10,071) | | (11,996) | |
| Net revenue before taxation | | 20,306 | | 19,686 | |
| Taxation | 7 | (98) | | (147) | |
| Net revenue after taxation | | | 20,208 | | 19,539 |
| **Total return before distributions** | | | **(119,108)** | | **62,637** |
| Distributions | 8 | | (20,245) | | (19,712) |
| Change in net assets attributable to unitholders from investment activities | | | (139,353) | | 42,925 |

## Statement of change in net assets attributable to unitholders for the year ended 31 December 2018

| | 31 December 2018 £'000 | 31 December 2018 £'000 | 31 December 2017 £'000 | 31 December 2017 £'000 |
|---|---|---|---|---|
| Opening net assets attributable to unitholders | | 930,676 | | 1,106,152 |
| Amounts receivable on issue of units | 15,335 | | 15,539 | |
| Amounts payable on cancellation of units | (201,305) | | (249,101) | |
| | | (185,970) | | (233,562) |
| Change in net assets attributable to unitholders from investment activities | | (139,353) | | 42,925 |
| Retained distribution on accumulation units | | 16,114 | | 15,161 |
| Closing net assets attributable to unitholders | | 621,467 | | 930,676 |

## Balance sheet as at 31 December 2018

| | Note | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Fixed assets** | | | |
| Investments | 9 | 607,538 | 910,737 |
| **Current assets** | | | |
| Debtors | 10 | 2,974 | 2,457 |
| Cash and bank balances | 11 | 14,044 | 22,117 |
| **Total current assets** | | **17,018** | **24,574** |
| **Total assets** | | **624,556** | **935,311** |
| **Liabilities** | | | |
| **Creditors** | | | |
| Distribution payable | | 884 | 2,395 |
| Other creditors | 12 | 2,205 | 2,240 |
| **Total creditors** | | **3,089** | **4,635** |
| **Total liabilities** | | **3,089** | **4,635** |
| Net assets attributable to unitholders | | 621,467 | 930,676 |

# 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, and in accordance with FRS 102, the SORP and the Financial Conduct Authority's Collective Investment Schemes Sourcebook ('COLL'). The financial statements have been prepared on a going concern basis.

**(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.

**(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 investment purposes and efficient portfolio management. 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.

**(e) Revenue.** Dividends receivable from equity and non-equity shares, including Real Estate Investment Trusts, 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 the 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 distribution policy of the fund is to distribute all available revenue, after deduction of expenses properly chargeable against revenue and taxation. Gains and losses on non-derivative investments and currencies, whether realised or unrealised, are taken to capital and are not available for distribution. 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.

For accumulation units this revenue is not distributed but automatically reinvested in the fund and is reflected in the value of these units.

Distributions which have remained unclaimed by unitholders for six years are credited to the capital property of the fund.

## Notes to the financial statements (continued)

## 3. Net capital (losses)/gains

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| Currency (losses)/gains | (3) | 53 |
| Capital transaction charges | (6) | (6) |
| Non-derivative securities | (139,307) | 43,051 |
| Net capital (losses)/gains | (139,316) | 43,098 |

## 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.

| | Year ended 31 December 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 | 341,232 | 116 | 1,579 | 342,927 | 0.03 | 0.46 |
| Sales | | | | | | |
| Equities | 506,995 | 177 | 1 | 506,817 | 0.03 | - |
| Total | | 293 | 1,580 | | | |
| Percentage of fund average net assets | | 0.03% | 0.19% | | | |

| | Year ended 31 December 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 | 576,095 | 401 | 2,563 | 579,059 | 0.07 | 0.44 |
| Sales | | | | | | |
| Equities | 787,539 | 545 | 1 | 786,993 | 0.07 | - |
| Total | | 946 | 2,564 | | | |
| Percentage of fund average net assets | | 0.10% | 0.25% | | | |

During the year the fund incurred £6,000 (2017: £6,000) in capital transaction charges.

### Dealing spread

As at the balance sheet date the average portfolio dealing spread was 0.41% (2017: 0.21%). 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

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| UK dividends | 28,878 | 29,601 |
| Overseas dividends | 1,391 | 2,005 |
| Bank interest | 108 | 76 |
| Total revenue | 30,377 | 31,682 |

## 6. Expenses

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| **Payable to the manager, associates of the manager and agents of either of them:** | | |
| Annual management charge | 9,619 | 11,449 |
| **Other expenses:** | | |
| Registration fees | 175 | 197 |
| Administration fees | 131 | 140 |
| Trustee fees | 70 | 122 |
| Operational fees | 45 | 54 |
| Safe custody fees | 21 | 24 |
| Auditor's remuneration: audit fee* | 9 | 8 |
| Price publication | 1 | 1 |
| Printing and postage fees | - | 1 |
| Total expenses | 10,071 | 11,996 |

All expenditure stated above is inclusive of irrecoverable VAT where applicable.
* The amounts disclosed above includes VAT at the rate of 20%. The audit fee (excluding VAT) accrued during the period was £7,500 (2017: £7,000).

## 7. Taxation

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| **a) Analysis of the tax charge for the year** | | |
| Irrecoverable overseas tax | 98 | 147 |
| Total taxation (note 7b) | 98 | 147 |
| **b) Factors affecting the tax charge for the year** | | |
| Net revenue before taxation | 20,306 | 19,686 |
| Corporation tax at 20% (2017: 20%) | 4,061 | 3,937 |
| **Effects of:** | | |
| Unutilised management expenses | 1,992 | 2,384 |
| Irrecoverable overseas tax | 98 | 147 |
| Non-taxable overseas dividends | (278) | (401) |
| Non-taxable UK dividends | (5,775) | (5,920) |
| Tax charge for the year (note 7a) | 98 | 147 |

**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 of £38,549,000 (2017: £36,557,000) arising as a result of having unutilised management expenses of £192,746,000 (2017: £182,783,000). It is unlikely that the fund will obtain relief for these in the future so no deferred tax asset has been recognised.

## Notes to the financial statements (continued)

## 8. Distributions

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| Final dividend distribution | 16,998 | 17,556 |
| Add: amounts deducted on cancellation of units | 3,401 | 2,346 |
| Deduct: amounts added on issue of units | (154) | (190) |
| Distributions | 20,245 | 19,712 |
| **Movement between net revenue and distributions** | | |
| Net revenue after taxation | 20,208 | 19,539 |
| Add: revenue received on conversion of units | 37 | 173 |
| | 20,245 | 19,712 |

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 table on page 20.

## 9. 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).

| | 31 December 2018 Assets £'000 | 31 December 2017 Assets £'000 |
|---|---|---|
| Level 1 | 607,503 | 910,631 |
| Level 3 | 35 | 106 |
| Total | 607,538 | 910,737 |

## 10. Debtors

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| Accrued revenue | 2,627 | 1,675 |
| Overseas withholding tax recoverable | 228 | 172 |
| Sales awaiting settlement | 119 | 610 |
| Total debtors | 2,974 | 2,457 |

## 11. Cash and bank balances

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| Amounts held in JPMorgan Liquidity Funds – Sterling Liquidity Fund (Institutional dist.) | 14,034 | 22,107 |
| Cash and bank balances | 10 | 10 |
| Total cash and bank balances | 14,044 | 22,117 |

## 12. Other creditors

| | 31 December 2018 £'000 | 31 December 2017 £'000 |
|---|---|---|
| Amounts payable for cancellation of units | 1,353 | 1,308 |
| Accrued annual management charge | 614 | 803 |
| Accrued other expenses | 132 | 129 |
| Purchases awaiting settlement | 106 | - |
| Total other creditors | 2,205 | 2,240 |

## 13. Contingent liabilities and commitments

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

## 14. Reconciliation of unit movements

| | Units in issue at 31 December 2017 | Units issued | Units cancelled | Units converted | Units in issue at 31 December 2018 |
|---|---|---|---|---|---|
| I distribution | 18,076,893 | 1,441,628 | (14,213,521) | 262,291 | 5,567,291 |
| I accumulation | 55,929,188 | 30,246 | (12,060,361) | 757,452 | 44,656,525 |
| R accumulation | 77,965,291 | 1,185,134 | (9,425,433) | (1,074,793) | 68,650,199 |

## 15. Risk disclosures

In pursuing it's investment objective, the fund may hold a number of financial instruments. These financial instruments comprise equities, cash balances and liquid resources, which include debtors and creditors that arise directly from the fund's operations.

The manager has a risk management policy. The processes detailed within are designed to monitor and measure at any time the risk of the funds' positions and their contribution to the overall risk profile of the fund. In addition, our Investment Committee and Risk and Compliance Committee meet monthly and quarterly respectively, and as required to evaluate risk across each of our funds. These policies have been consistent for both the current and prior period to which these financial statements relate.

In the normal course of business, the fund's activities expose it to various types of risk which are associated with the financial instruments and markets in which it invests. These financial risks: market risk (comprising currency risk, interest rate risk, other market price risk and leverage risk), credit and counterparty risk and liquidity risk and the approach to the management of these risks, are set out below and remain unchanged from the previous accounting year. For a detailed explanation of these and further risks involved in investing in the fund, reference should be made to the Prospectus.

### (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 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. As the majority of the fund's financial assets are non-interest bearing, the fund is only subject to limited exposure to fair value interest rate risk due to fluctuations in levels of market interest rates and therefore no sensitivity disclosed.

# Notes to the financial statements (continued)

### (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. Therefore, 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. There were no forward currency contracts held as at 31 December 2018 or 31 December 2017.

Revenue received in foreign currencies is converted into sterling on or near the date of receipt. No hedging is undertaken with regard to managing the currency movement risk on accrued revenue.

The exposure to each currency is shown in the table below:

| Currency | Investments £'000 | Net other assets/ (liabilities) £'000 | Total £'000 |
|---|---|---|---|
| 31 December 2018 | | | |
| Sterling | 607,538 | 13,701 | 621,239 |
| Euro | - | 228 | 228 |
| 31 December 2017 | | | |
| Sterling | 910,737 | 19,767 | 930,504 |
| Euro | - | 172 | 172 |

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 £11,000 (2017: £9,000). 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). 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 £30,377,000 (2017: £45,537,000). A five per cent decrease would have an equal and opposite effect.

### (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 'sum of the notionals' and 'commitment' methods.

The fund can use cash borrowing and financial derivatives (subject to restrictions as set out in its Prospectus and COLL) as sources of leverage. A result of 100% indicates that no leverage has been used.

As at 31 December 2018 and 31 December 2017 the leverage ratios of the fund were:

| | 2018 | 2017 |
|---|---|---|
| Sum of notionals | 102.71% | 102.37% |
| Commitment | 100.00% | 100.00% |

### (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 J.P. 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.

There were no significant concentrations of credit risk to counterparties other than to the custodian, or brokers where trades are pending settlement, at 31 December 2018 or 31 December 2017.

### (c) Liquidity risk

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

## 16. 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 12 and notes 6, 8,10 and 12 on pages 15 to 17 including all issues and cancellations where the manager acted as principal. The balance due to the manager as at 31 December 2018 in respect of these transactions was £1,967,000 (2017: £2,111,000).

## 17. Unit classes

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

I distribution: 0.75%
I accumulation: 0.75%
R accumulation: 1.50%

The net asset value per unit and the number of units in each class are given in the comparative tables on page 21.
The distributions per unit class are given in the distribution table on page 20. All classes have the same rights on winding up.

## 18. Post balance sheet event

There were no significant post balance sheet events subsequent to the year-end.

# Distribution table

**Final dividend distribution for the year ended 31 December 2018 (payable on 28 February 2019) in pence per unit.**
Group 1 - Units purchased prior to 1 January 2018.
Group 2 - Units purchased from 1 January 2018 to 31 December 2018.

| | Net revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 28 February 2019 | Distribution per unit (p) 28 February 2018 |
|---|---|---|---|---|
| I distribution | | | | |
| Group 1 | 15.8786 | - | 15.8786 | 13.2481 |
| Group 2 | 10.3692 | 5.5094 | 15.8786 | 13.2481 |
| I accumulation | | | | |
| Group 1 | 17.6901 | - | 17.6901 | 14.4251 |
| Group 2 | 9.8779 | 7.8122 | 17.6901 | 14.4251 |
| R accumulation | | | | |
| Group 1 | 11.9652 | - | 11.9652 | 9.0981 |
| Group 2 | 5.5999 | 6.3653 | 11.9652 | 9.0981 |

Corporate unitholders should note that:
1. 100.00% of the revenue distribution together with the tax credit is received as franked investment income.
2. 0.00% of the revenue distribution is received as an annual payment received after deduction of income tax at the lower rate and may be liable to corporation tax. It is not franked investment income.

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

| | I distribution | | | I accumulation | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| **Change in net assets per unit (p)** | | | | | | |
| **Opening net asset value per unit** | **577.78** | **554.14** | **524.76** | **643.59** | **603.54** | **558.58** |
| Return before operating charges * | (78.56) | 41.49 | 46.31 | (87.56) | 45.05 | 49.47 |
| Operating charges | (4.62) | (4.60) | (4.24) | (5.12) | (5.00) | (4.51) |
| Return after operating charges | (83.18) | 36.89 | 42.07 | (92.68) | 40.05 | 44.96 |
| Distributions | (15.88) | (13.25) | (12.69) | (17.69) | (14.43) | (13.52) |
| Retained distributions on accumulation units | - | - | - | 17.69 | 14.43 | 13.52 |
| **Closing net asset value per unit** | **478.72** | **577.78** | **554.14** | **550.91** | **643.59** | **603.54** |
| * after direct transaction costs of | (1.20) | (1.89) | (1.37) | (1.33) | (2.05) | (1.45) |
| **Performance** | | | | | | |
| Return after charges | (14.40)% | 6.66% | 8.02% | (14.40)% | 6.64% | 8.05% |
| **Other information** | | | | | | |
| Closing net asset value (£'000) | 26,651 | 104,444 | 103,731 | 246,018 | 359,957 | 459,716 |
| Closing number of units | 5,567,291 | 18,076,893 | 18,719,401 | 44,656,525 | 55,929,188 | 76,169,405 |
| Operating charges | 0.80% | 0.81% | 0.81% | 0.80% | 0.81% | 0.81% |
| Direct transaction costs | 0.21% | 0.33% | 0.26% | 0.21% | 0.33% | 0.26% |
| **Prices** | | | | | | |
| Highest offer unit price (p) | 619.90 | 602.84 | 582.37 | 690.46 | 656.45 | 620.09 |
| Lowest bid unit price (p) | 485.33 | 544.59 | 465.86 | 540.59 | 593.03 | 496.04 |

| | R accumulation | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| **Change in net assets per unit (p)** | | | |
| **Opening net asset value per unit** | **598.05** | **565.05** | **526.88** |
| Return before operating charges * | (80.82) | 42.02 | 46.41 |
| Operating charges | (9.15) | (9.02) | (8.24) |
| Return after operating charges | (89.97) | 33.00 | 38.17 |
| Distributions | (11.97) | (9.10) | (8.74) |
| Retained distributions on accumulation units | 11.97 | 9.10 | 8.74 |
| **Closing net asset value per unit** | **508.08** | **598.05** | **565.05** |
| * after direct transaction costs of | (1.23) | (1.92) | (1.37) |
| **Performance** | | | |
| Return after charges | (15.04)% | 5.84% | 7.24% |
| **Other information** | | | |
| Closing net asset value (£'000) | 348,798 | 466,275 | 542,705 |
| Closing number of units | 68,650,199 | 77,965,291 | 96,044,972 |
| Operating charges | 1.55% | 1.56% | 1.56% |
| Direct transaction costs | 0.21% | 0.33% | 0.26% |
| **Prices** | | | |
| Highest offer unit price (p) | 666.63 | 638.43 | 606.06 |
| Lowest bid unit price (p) | 498.60 | 554.93 | 467.48 |

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

## Ongoing charges

| Class | 31 December 2018 |
|---|---|
| I distribution | 0.80% |
| I accumulation | 0.80% |
| R accumulation | 1.55% |

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

## Class I performance

| Performance | Since launch * | 5 years | 3 years | 1 year | 6 months |
|---|---|---|---|---|---|
| Artemis UK Special Situations Fund | 480.0 | 4.8 | (1.2) | (14.3) | (17.3) |
| FTSE All-Share Index | 121.9 | 22.1 | 19.5 | (9.5) | (11.0) |
| Sector average | 129.3 | 18.5 | 12.7 | (11.1) | (13.5) |
| Position in sector | 2/90 | 202/220 | 214/234 | 188/245 | 216/249 |
| Quartile | 1 | 4 | 4 | 4 | 4 |

* Since launch' data from 9 March 2000 to 7 March 2008 reflects class R accumulation units, and from 7 March 2008 to 31 December 2018 reflects class I accumulation units, bid to bid in sterling. All figures show total returns with dividends reinvested. Sector is IA UK All Companies.

## Class R performance

| Performance | Since launch * | 5 years | 3 years | 1 year | 6 months |
|---|---|---|---|---|---|
| Artemis UK Special Situations Fund | 434.9 | 1.0 | (3.4) | (15.0) | (17.7) |
| FTSE All-Share Index | 121.9 | 22.1 | 19.5 | (9.5) | (11.0) |

* Data from 9 March 2000. Source: Lipper Limited, class R accumulation units, bid to bid in sterling to 31 December 2018. All performance figures show total returns with dividends reinvested.