Incentive culture seeds new growth

Artemis continues to deliver strong results, despite a dip in performance last year. The firm's assets have risen eight-fold since 2002 and its prospects are good, as Simon Hildrey reports.

ARTEMIS was established in 1997 and merged with ABN Amro Fund Managers in September 2002. It has £16.3 billion in assets under management, of which about £9.5 billion is in retail funds.

When Nigel Thomas and George Luckraft left ABN Amro Fund Managers for Framlington in 2002, it had to do something impressive to retain the support of advisers and investors' assets. It did just that by merging with Artemis.

In September 2002, the combined asset manager had about £2 billion in assets under management. Now it has £16.3 billion in assets. Before the merger, the two asset managers were focused on retail funds.

Today, it has £6 billion in institutional funds and mandates, one investment trust, hedge funds and three offshore funds in addition to about £9.5 billion in retail funds.

At the same time, the number of employees has only risen from 85 to just under 100 over the past five years. This is part of what Nick Wells, the product development and communications director at Artemis, argues is its focus on fund management and ensuring that it writes profitable business.

Part of this strategy has been to outsource functions that do not relate to Artemis' core business, says Wells. This includes administration, fund pricing and dealing. "This means Artemis does not have internal staff for these functions and is not distracted by these activities. Outsourcing keeps the business leaner," he says.

Artemis was founded in 1997 by Mark Tyndall, John Dodd, Derek Stuart and Lindsay Whitelaw. The recruitment of Mark Niznik takes the number of fund managers at Artemis to 16.

Wells says that as assets under management have grown, Artemis has had to work harder to be successful. For example, says Wells, Niznik has been hired from Standard Life Investments, where he managed the £400m UK Opportunities fund, to assist Stuart and, in particular, Dodd.

"After Mark joins in a few months, he will be a member of the team helping the smaller companies' exposure," says Wells. "We will announce his responsibilities when he arrives. He will work alongside Dodd in Edinburgh.

"Mark's appointment is not a reflection of the performance of the UK Smaller Companies fund. It is just that the fund is £721m in assets under management and it needs more than one person to manage it."

Financial advisers say fund performance at Artemis was not as strong in 2006 as in previous years. Over three years to June 18, 2007, according to Morningstar, Artemis had seven funds in the first quartile out of nine funds. The other two funds were in the third quartile.

Over one year, Artemis had five out of 10 funds in the first quartile. Four funds were in the second quartile and one was in the third quartile.

Wells admits that performance in 2006 dipped slightly. He points to the spring correction last year as affecting performance. "When you are looking for companies growing faster than the market or those that are priced below the average of the market, you are sensitive to sharp moves in share prices.

"But fund performance recovered well. When the news flows started re-pricing share prices again, the fund performance recovered quickly. In effect, it is saying that when there is a set-back in the market, it is worth investing in the funds.

"It is also true that the types of companies we held were not rewarded as much as they should have been in 2006. The market had decided to overlook positive news flows," says Wells.

SmartGarp is central to the management of the Capital, European Growth and Global Growth funds. "SmartGarp drives the central process," says Wells. "It throws up ideas for all the fund managers if they want them.

"In running the Income and High Income funds, for example, Adrian Frost and Adrian Gosling use SmartGarp to double-check stock ideas or look at stocks in a different way.

"But we are style-agnostic: all the managers and teams can adopt their own investment style."

When there are inflexion points in the market, the performance of funds using SmartGarp can be hit, even if it is for a short period of time. "Any system like SmartGarp is backwards looking, so it will always struggle at inflexion points," says Wells. "But it should right itself fairly quickly.

"We hit such volatility in the European Growth fund last year but it came good. SmartGarp is as up-to-date as we can get it. News flows get updated in the system within 24 hours. It is important to remember that SmartGarp is a guide and a ranking system.

It is a way of directing managers to companies they should be looking at rather than wasting their time with companies they should not be looking at.

ARTEMIS INVESTMENT MANAGEMENT'S FUND RETURNS OVER ONE AND THREE YEARS

UK unit trusts/Oeics	19/6/06 18/6/07 % Chg	Rank	Qrtl	Mean	21/6/04 18/6/07 % Chg	Rank	Qrtl	Mean	IMA Sector
Artemis Capital	24.24	113/298	2	24.10	82.03	39/255	1	68.65	UK All Companies
Artemis European Growth	33.36	24/94	2	31.15	111.55	9/87	1	90.55	Europe excluding UK
Artemis Global Growth	32.95	7/157	1	22.12	118.29	4/140	1	61.03	Global Growth
Artemis High Income	8.02	8/47	1	4.57	38.39	1/41	1	22.25	UK Other Bond
Artemis Income	25.93	11/83	1	22.11	76.89	9/73	1	68.18	UK Equity Income
Artemis New Enterprises	41.27	1/15	1	17.10	42.92	2/15	1	26.90	Technology & Telecoms
Artemis Strategic Bond Q Inc	5.42	20/47	2	4.57	N/A	----	----	22.25	UK Other Bond
Artemis UK Growth	25.80	88/298	2	24.10	61.17	178/255	3	68.65	UK All Companies
Artemis UK Smaller Cos	28.22	35/52	3	30.62	88.38	25/48	3	89.51	UK Smaller Companies
Artemis UK Special Situations	28.10	52/298	1	24.10	74.60	60/255	1	68.65	UK All Companies

Shows percentage returns, position in sector, quartile ranking and sector average, bid-bid, net income reinvested, over one and three years to June 18. Source: Morningstar

"Then it is down to the managers to decide which stocks they want to hold. In Europe, about 80% of the process is done by SmartGarp. But most of Philip Wolstencroft and Peter Saacke's time is spent on the other 20%."

Despite the events of 2006, Artemis has had consistently good performance across most of its funds. Wells says this is the result of several factors. "With the exception of Mark [Tyndall], all the managers have no other responsibilities apart from managing their funds.

"Managers are paid similar salaries and are incentivised by having a shareholding or options. Therefore, they want everyone to do well as they benefit financially. It is in their own interests to share investment ideas.

"They all invest in their own funds. This means investors' expectations and those of managers are aligned."

Darius McDermott, managing director of Chelsea Financial Services, says he likes the fund managers and the culture at Artemis. "You get the impression that Artemis is a happy ship and they all get on with each other. We like the way in which the managers have stakes in the business. Managers have an incentive to stay and to perform."

Out of the 40 funds on the Chelsea Leaders list, three are Artemis funds. They are the UK Special Situations, Income and European Growth funds. The larger Chelsea Financial Services list includes the Artemis Capital, UK Growth, UK Smaller Companies, Strategic Bond, Global Growth and New Enterprises funds. "Artemis has shown that it can deliver performance over the long term.

"The UK Growth fund was hit for a period in 2005 and 2006 because the manager made a couple of wrong calls," says McDermott. "We stuck with the fund because we believe Adrian Patterson is a good manager and he has been second quartile over the past year and first quartile over the past three months."

While the UK Smaller Companies fund has not performed as strongly as other funds in the range, McDermott argues it has still generated a positive return, is second quartile over three years and just below second quartile over one year.

Mark Dampier, head of research at Hargreaves Lansdown, says: "We have invested with Tyndall and other managers since their Ivory & Sime days.

"Artemis has one of the best UK desks in the industry. It has a real depth that is lacking in other asset managers. It had a difficult time last year but performance has been improving. It is an owner-managed business with fund managers having a key say in the day-to-day management."

He adds: "It has talented managers who spark ideas off each other. We like the SmartGarp system. You would imagine it could work in the US market, which would present an interesting choice for investors."

The Global Growth fund, which is in the first quartile over one and three years, was an ABN Amro fund. "It was very small in assets," says Wells. "The choice was, do we shut it or do we make it work?

When Saacke joined Artemis, he spent six months building a global version of SmartGarp, which was a pan-European model. He spent six months testing it and then took over the Global Growth fund at the beginning of 2004," he explains.

"SmartGarp could be extended beyond these funds. But it is about the business and whether it is profitable to launch funds."

Wells argues that whether the business is profitable is more important than trying to attract assets at any price. For this reason, Artemis has a level of fees for which it is not prepared to compromise.

He adds that Artemis has no plans to expand beyond the range of funds. "This does not mean we are ruling out expansion, however.

"We did not have a bond fund until there was an opportunity to recruit James Foster and Alexandra Ralph [from F&C]. The Strategic Bond fund has grown to £125m. There is no intention at this stage to add to the range but if we got the right people, we would launch funds."

Despite not having any plans to broaden its fund range, Wells says Artemis has been diversifying its business. He points to the fact it has developed an institutional business, which has more than £6 billion in funds and mandates.

"Rather than having a business wholly dependent on retail funds, Artemis is a much wider business," says Wells. "If retail investors decide not to invest any more, we will not attract money however well our funds are performing. Institutional money is more sticky because they have to invest somewhere."

At the end of last year, Artemis launched a Luxembourg-based Sicav range of three funds. The Pan-European Equity, Global Equity and UK Equity funds have accumulated £140m in assets.

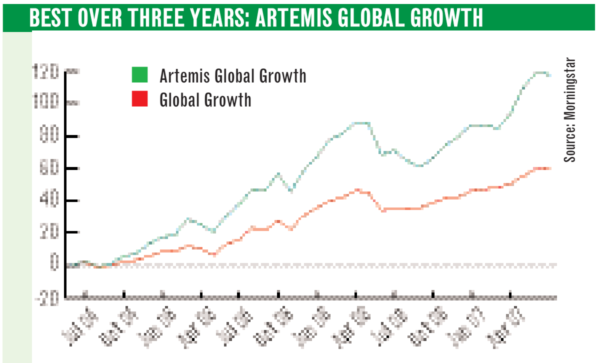
The need for diversification is illustrated by the fact that Wells says so far this year, 43% or 44% of net retail sales have gone into property funds. "Our sales have held up and gross sales are fine. But we have seen a pick-up in redemptions. Nevertheless, we have still been net positive every month for two years," he says.

ABN Amro, which is the focus of two takeover bids, owns nearly 70% of Artemis, with the other 30% owned by employees. But Wells plays down the potential impact of a takeover on Artemis.

"If there is a change, the new owner will be in the same position as ABN Amro," says Wells. "Executive control remains with the founding partners. It is an economic interest for ABN Amro and we run the company on a day-to-day basis."

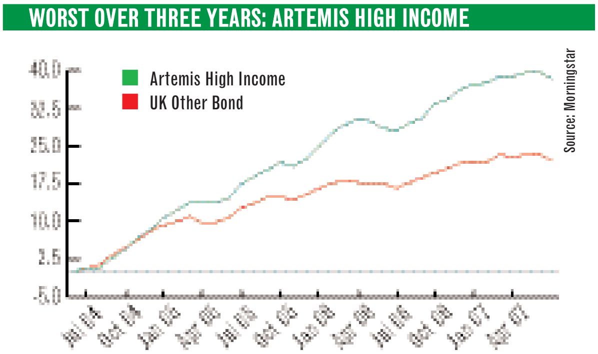
Part of Artemis' day-to-day challenge is to maintain the impressive level of fund performance it has achieved over the past few years.

BEST OVER THREE YEARS: ARTEMIS GLOBAL GROWTH



Percentage returns from Artemis Global Growth and the IMA Global Growth sector average, bid-bid, net income reinvested, over three years to June 18.

WORST OVER THREE YEARS: ARTEMIS HIGH INCOME



Percentage returns from Artemis High Income and the IMA UK Other Bond sector average, bid-bid, net income reinvested, over three years to June 18.

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