INVESTOR FOCUS

OCTOBER 2004

The last six months have been rather a mixed time. Markets have continued to be generally flat, although there have been a few ups and downs along the way, and oil prices have been a major factor. Interest rate rises both here and in the US have also had an impact, and there are further signs that the consumer spending boom is coming to an end. The housing market, for instance, has continued to rise over the past 12 months, but the percentage increase is considerably lower than for the previous 12 months. In these kinds of conditions, the skill of the fund manager in selecting the right shares continues to be crucial in delivering growth for investors.

What has been happening over the last six months?

Although 2004 began with widespread anticipation of six good months ahead, followed by a more difficult second half as interest rate rises began to bite, things didn't really work out like this. Interest rates have indeed risen, but at the same time investors became more cautious as early as March and April. This was partly due to rising oil prices; high prices can act as a drag on economic growth, with consumers (especially in the US where they are used to low petrol prices, i.e. 51 cent a litre, the equivalent to 29 pence!*) feeling they have less money.

There are several reasons why oil has become such an issue. The global slowdown of the early 2000s in the US and Europe masked higher demand for oil and natural resources from large developing economies such as India and China. With the recovery of industrial demand in the US, industries are now finding they have to compete with these developing giants for the resources. This surge of demand has coincided with worries over supply, not just because of the ongoing problems in Iraq, but also the recent hurricanes in the Gulf of Mexico and the

* Exchange rate on the 12/10/2004, £0.5597 = $1. Petrol prices are based on the average price in June 2004.

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situation with Yukos (this large Russian oil company has had its assets frozen this summer as a result of an ongoing investigation for tax evasion). Of course, this has driven up prices and resulted in shares in oil companies rising by 7%* in this last quarter alone. This took some people by surprise, although Artemis funds did rather well out of it; we positioned ourselves to take advantage of the situation some time ago.

China also worried investors by announcing that it wanted to slow the massive growth the country was enjoying to prevent problems with inflation. As China is now a huge market for many companies worldwide, this was expected to have quite an impact. Meanwhile the Madrid bombing in March reminded everyone that the problem of terrorism is still very much with us.

Against this backdrop, markets seemed to take a backwards step during the summer. Oil prices rose yet again, and a number of companies announced that their profits would be lower than anticipated. But by mid-August investors began to look forward once more. Oil prices stabilised, while interest rates seemed to be almost at their peak. Most companies were still showing good earnings, and demand from China was growing again. However, more recently oil prices have risen to almost historic highs, reaching beyond $50 a barrel, and the focus of investors is now firmly on this issue.

The UK housing market has also been an area of concern, with much media speculation about whether or not a housing crash is imminent. House price rises seem to have stabilised, and there are some anecdotal reports of falling values. It is important to remember though that even if the market lost 20% of its value, which is by no means assured, this would wipe out only one year of gains.

Shares in UK companies look good value at the moment, and the outlook for key industries such as telecoms and banking is positive. There is scope for problems in the consumer sector however; interest rate rises have made borrowing more expensive, leaving people with less money to spend. The dismal weather over the summer only made matters worse, with disappointing retail sales figures for August.

* Source: Lipper Limited, 3 months to 30th September 2004, total returns for the FTSE UK Oil & Gas sector.

Despite these concerns, at Artemis we remain positive about the future, and our principal theme over the last few years – modest, sensible expectations – still holds true.

So which types of companies have fared well in this environment?

Over the summer, as people became more cautious they looked to companies that traditionally tend to do well even when economic conditions are uncertain - those producing essentials like toiletries, household products or food, for example. These types of companies have had a strong run over the last ten to 15 years, and many investors expected this to continue. Businesses such as Unilever or Cadburys were seen as safe places. Unfortunately this has turned out not to be the case, and many are suffering from intensive competitive pressure. Indeed, last month Unilever, which has seen huge increases in profits over the years, said that sales and profits would not be as great as had previously been predicted. Companies like this are vulnerable to rivals undercutting them, and if this happens on a large scale we could see widespread price cuts. At Artemis we recognised the weakening of this sector early on, and so have avoided these shares. It is interesting to note though that if you were invested in an index tracker or a fund with a less active manager, your money would automatically be invested in these companies simply because they make up a large part of the index (the yardstick against which the performance of shares are measured, such as the FTSE All-Share). By choosing a manager that actively seeks out profits, you could be protecting yourself from being invested in businesses that might not have the best potential for growth.

More recently we have begun to see signs that investors are moving away from companies that serve consumers and towards those that serve businesses. As a result, organisations producing such items as materials or oil are more in favour. Many have announced that they expect to earn more this year than they had at first thought.

There has also been a move away from small and mid-sized companies after excellent performances over the last few years. This has a lot to do with the technology boom at the end of the 1990s, and the focus on 'new' and 'old' economies. At the time, everyone wanted to be invested in the 'new' economy, which typically consisted of small companies, many of which had yet to show a profit. After the bubble inevitably burst, solid 'old' economy companies, which tended to be larger, began to do well, attracting investors looking for a new home for their money. However, we think this process is now finished and that we are reverting to a more normal situation.

How can I make sure I am invested in the right places?

With low interest rates and low returns from bonds, shares still provide the best way to achieve long-term growth. And in a world of low market returns, where yesterday's favourites cannot be counted on to deliver growth, careful stock picking will become even more important. When you consider that an income fund could realistically deliver more growth than the average smaller companies fund, you can see how important it is to have someone working for you with the expertise to hunt out profits.

At Artemis, fund managers are focused on companies rather than particular industry sectors or geographical regions, looking for businesses with real potential at attractive prices wherever they can be found. This means we can make money whatever the situation. For example, since launch our Smaller Companies Fund has managed to deliver 395.3% - and this covers the worst period of the bear market, the last six to 12 months of flat markets, as well as the recent move away from small and medium-sized companies - while the Hoare Govett Smaller Companies Index (ex Investment Trusts) delivered 36.9% over the same period*.

* Source: Internal as at 30th September 2004.

Discrete Years Performance† - Percentage Growth of the Artemis UK Smaller Companies Fund
12 Months to 30th September

2000	2001	2002	2003	2004
174.0	-28.6	1.8	34.7	24.5

† Source: Lipper Limited, bid to bid, net income reinvested, all figures show total returns.
Please remember that past performance is not necessarily a guide to future performance.

We're invested alongside you

What allows us to succeed in this manner is the way in which our fund managers work. Artemis is owned in part by the people who run the funds. Our managers have all invested in the funds themselves, so you can be sure they are doing everything they can to manage them to the best of their ability. What's more, none of the managers are allowed to invest elsewhere, so if they know of a stock worth considering they certainly won't be keeping it to themselves. By placing our investment future right beside yours, we aim to achieve the best possible return for all our investors.

To complement our fund managers' expertise, we have developed a unique tool called SmartGARP which helps us identify the best companies. Based on the latest technology, it is used as a screening process to unearth good and bad stocks, and we believe it gives us a distinct advantage over our competitors. The process is based on common sense; shares within a particular market are assessed and the ones which score highly are examined further and may be included in the funds.

An example of a company we hold across many of our funds at the moment is Centrica. This energy company was created when it split from British Gas in 1997. An initial quick return followed the split, and earnings have been good ever since. However, analysts considered this company to be less attractive than its peers. Even in the face of good profits, they insisted that its impressive performance was due to pricing, and not good management. We disagreed and have owned the shares throughout this period, ever since the company was identified by SmartGARP as having great potential. Now it is growing fast with profits being revised upwards, and our funds are reaping the rewards.

What has been happening in 'Fund of Funds'?

At Artemis we also offer a range called Premier Funds. This consists of eight different funds, each one with a separate investment objective. What is different about these products is that instead of investing in individual shares, the funds invest in a carefully selected and monitored range of mutual funds from any provider, thus offering exposure to literally hundreds of companies through one single point of entry. The managers specialise in the twin skills of asset allocation and portfolio construction. We are therefore affectively contrasting and managing 'packaged' portfolios. These types of funds have been attracting investors over the past few years, either as a total investment solution or as the basis for a core portfolio.

When selecting funds, we look for managers who construct their portfolios in the same way that we do - from companies they believe have the potential to do well. As with our own funds, we don't want to invest in areas simply because they form a large part of the benchmark index. But our work doesn't stop here. Monitoring an investment to make sure it stays on track is just as important as the initial choice itself.

At present, although our Fund of Funds portfolio always has a solid footing in the UK, we favour Asia over Western markets, a region that has become increasingly important in recent years. We like to select those investments that are most likely to benefit from the phenomenal growth in China. Those with exposure to Korea, Taiwan, and Singapore are good examples of this, as is Indonesia, where great businesses exist whose share prices are well below those of their international counterparts. Again we prefer to look to the future, rather than clinging to the good performers of the past. We think the Asian consumer will become far more important from an investment perspective over the next ten years, especially when compared to the US consumer. When you consider that the US has budget and trade deficits, while Asia has surpluses, it isn't hard to see why.

As with the rest of Artemis' funds, flat markets really do provide an opportunity to find the best investments. While we can continue to do well whatever the market environment, we are especially well placed to benefit if economic recovery gains pace.

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So what of the future?

We have just discussed the continuing flat markets, and the facts that trends which have performed well in the past may not do so in the future. As profit hunters, we believe that actively searching for promising businesses and investing for the long-term is the only way to achieve decent returns in all conditions.

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The Lesser Spotted PROFIT
& how to CATCH it.

ELUSIVE and unpredictable, the Lesser Spotted Profit is highly prized within the fund management community.

Unlike miniature Profits, which are easily tracked and therefore tempt most fund managers, the Lesser Spotted Profit requires a more astute, agile hunter. This is the domain of the Artemis Fund Manager.

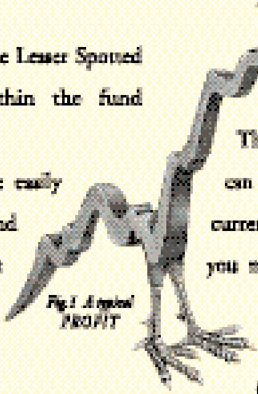

Fig.1 A typical PROFIT

These experienced Artemis Profit Hunters lure large Profits into the open using a range of skills. Once flushed out, the unencumbered Artemis Hunter is nimble and accomplished, able to take the wily Profit before it disappears. Indeed, over the past six years, the Artemis record is truly impressive.

Please remember that past performance is not necessarily a guide to future performance. The value of an investment and any income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. If you fancy a spot of Profit hunting, contact your Independent Financial Adviser, call *0800 092 2051*, visit *www.artemisonline.co.uk* or email *investorsupport@artemisfunds.com*.

WARNING:
Do not confuse a PROFIT with a LOSS

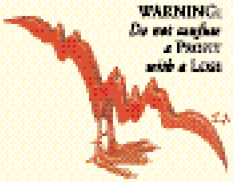

Fig.2 A typical Loss

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