

Dog bites Man

Artemis still doing the same old job

Just as dog bites man is not a big newspaper story, so stock markets being volatile is not fresh news either. Of course the newspapers and TV reports are full of stories of banking collapse and financial turmoil, but reality is a lot duller than this. Year to date the UK stock market has returned about 7%* - a bit less than the 9.7%* per annum the market has seen on average since 1900, but not bad in a low inflation environment when we are only part way through the year. In fact, stock markets are typically quite volatile – a rise or fall of 17%* in a year is the average move of the past century. So this year's headline ought to be “markets remarkably stable in 2007.”*

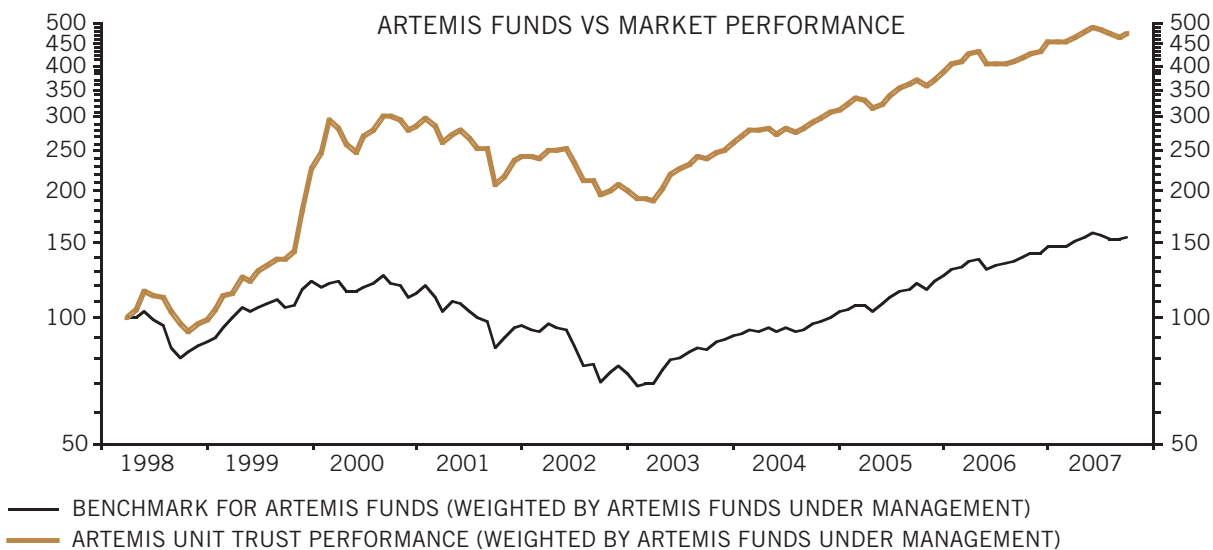
The objective of this newsletter is to give an overview of what has been happening in markets, what we think might happen in the future and what we are doing about it. The quick summary is that we are broadly comfortable with the environment we are operating in and that the same team that was managing your money is still managing your money.

Artemis, as a group, has delivered some spectacular performance over the past decade and whilst this year has been comparatively uninteresting, we still believe that we can beat the markets in future. We feel confident enough to invest our own money in our funds and hope you do too.

Summary

- Good outlook
- Same Artemis team in place
- Beating the markets

*Source: ABN AMRO/London Business School, 2007.



Source: DATASTREAM

(The chart above shows how £100 invested in our funds has performed compared to £100 invested in the indices we are trying to beat over a ten year period. The index funds would have risen to £157 whilst the Artemis funds would have risen to £475). Source: Datastream and internal. Please remember that past performance is not necessarily a guide to future performance.

What has happened over the past six months?

With something like 18% of Britain's mortgages given out in the first half of the year coming from Northern Rock, the company certainly ranks as a significant player in our lives. With only a 4% share of deposits, the company had to rely on borrowing from other banks to fund their business. This proved difficult to achieve in September and the result was only too evident to anyone who has switched on the TV or read a newspaper in the past few months. The bank's customers have not lost any money, but shareholders certainly have with the share price down by more than 80% from the start of the year*. All banks are subject to this kind of risk – they make loans that are paid back over many years, but depositors can take their money out pretty much instantaneously. In general, not all customers want to take their

money out at the same time, so banks are able to run with this potential mis-match between assets and liabilities. However, there are always exceptions to the rules and Northern Rock seems to have been one of them. The Bank of England appears to have isolated the problems and there is little reason to suppose that there are endemic problems in the financial system.

Of course this does not stop markets getting excited about the possibility of contagion. Fund managers in Britain and Europe have had less money invested in the bank sector than that which is in the index and this has been good (for them). However, with newspapers full of bad news, they have decreased their positions even further and it is now their most unloved sector. Typically when sentiment has been so negative the stock prices tend to go back up again. As a result the Artemis SmartGarp™ funds (Europe, Global Growth and Capital) are optimistic on this sector and have a large portion of their assets in this part of the market.

*Source: Datastream & internal.

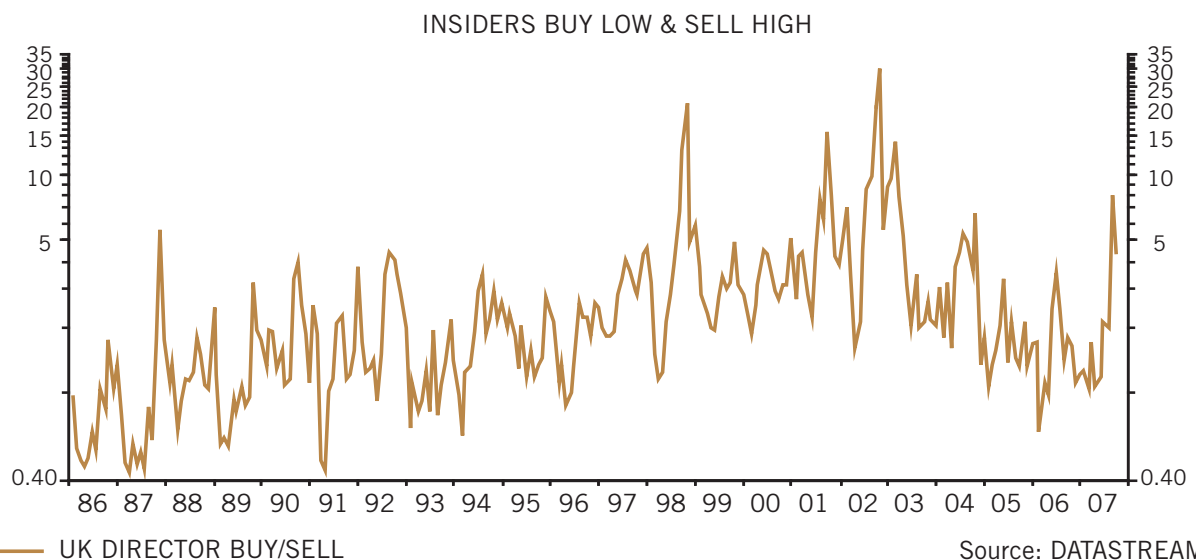
In the meantime, one should not lose sight of the fact that the world economy is in good shape. Global growth in the past couple of years has been the fastest in thirty years – a factor that has not gone unnoticed by stock markets. Some of the best performing shares over the past few years have been cyclical type stocks such as metal miners, steel producers and capital goods companies. Human nature is such that just as fund managers' love affair with banks is on the rocks, so their lust for industrials appears to know no bounds. Again, in response to this, some of the Artemis funds have been scaling back some of their positions in these kind of stocks.

What about the future?

If only we knew! Whilst we would love to have a crystal ball to tell us about the winners of tomorrow, none of us knows for sure what will happen. As a result, our fund managers use various techniques that we believe will skew the odds in our favour. The income team spend their time pouring over the free cash flow yields of

companies, the small companies and special situations teams try to glean insights from talking to the managers of companies, whilst the SmartGarp team spend their time poring over the data. No one method could be said to be fool proof and each year we strive to have our (hopefully small) portion of losers not outweigh the winners.

One of the more useful rules in financial markets is to buy low and sell high! Often the market does not follow this simple rule; preferring to buy when sentiment is overly positive and sell when negative news abounds. Oddly enough if one monitors the actions of directors of quoted companies in aggregate, then they do seem to do just that. The ratio of director buying to selling in their own companies in August and September 2007 was 6 – up from 1.5 in the previous two years.* The ratio has been at high levels in the past – November 1987, September 1992, October 1998, October 2002 and January 2003 to name a few. So maybe with directors of UK companies



*Source : Director Deals Ltd. January 1986 - October 2007. Ratio is number of directors buying vs selling.

voting with their wallets we should not be too pessimistic after all.

The danger we are taking here is that we are starting to talk about market direction in the next year or so. The reality is that the Artemis funds are not being swung around as we get more or less optimistic – we each tend to have a strategy for picking winners. We tend to stick to that strategy and resist the temptation to try and be too clever.

Stating the obvious

Indeed, sometimes it is easy to forget the obvious. And the obvious is that Artemis have more than our fair share of successful funds. We sometimes find it difficult to articulate why we have attracted so many good fund managers and why none of them seem to leave. Maybe it

is the independent culture, the freedom to manage money in the way they see best or the collegiate approach to the business of investing. Regardless, the table below shows returns since launch of the Artemis funds, and is a reminder of the unit trusts we manage.

Clearly all the funds have done well – better than the indices that they are measured against and better than their sector average. Maybe one of the more important points from the table is the power of compounding returns over the years. Big investment returns have come from buying and holding good funds over many years.

We cannot be certain what will happen in the future, but you can be sure we will be endeavouring to strive and continue beating the markets.

Fund	Artemis Launch	Return (%)	Sector Average (%)	Fund Size (£m)	Fund Manager
Artemis UK Smaller Companies	April 1998	735.0	126.3	666.8	John Dodd
Artemis High Income	May 1995	256.5	146.5	849.2	Adrian Frost Adrian Gosden
Artemis UK Special Situations	March 2000	259.9	28.3	1,140.7	Derek Stuart
Artemis UK Growth	April 1998	194.9	57.5	622.2	Adrian Paterson
Artemis Income	June 2000	150.0	54.3	2,436.9	Adrian Frost Adrian Gosden
Artemis European Growth	March 2001	157.5	45.3	1,984.8	Philip Wolstencroft Peter Saacke
Artemis Capital*	September 2002	115.6	95.1	1,027.1	Jacob de Tusch-Lec Mark Tyndall
Artemis Global Growth†	January 2004	124.5	56.0	294.2	Peter Saacke
Artemis Strategic Bond	June 2005	11.3	6.5	157.0	James Foster Alex Ralph
Artemis New Enterprises	June 2000	10.4	-60.9	42.7	Lindsay Whitelaw

Source: Lipper Limited, bid to bid in sterling with net income reinvested to 28th September 2007. All figures show total returns. Sector Average is IMA Sector. †Figures are since Peter Saacke became fund manager of the Artemis Global Growth Fund on 1st January 2004. *Figures are since Mark Tyndall took over the management of the fund on 9th September 2002. Please remember that past performance is not necessarily a guide to future performance.

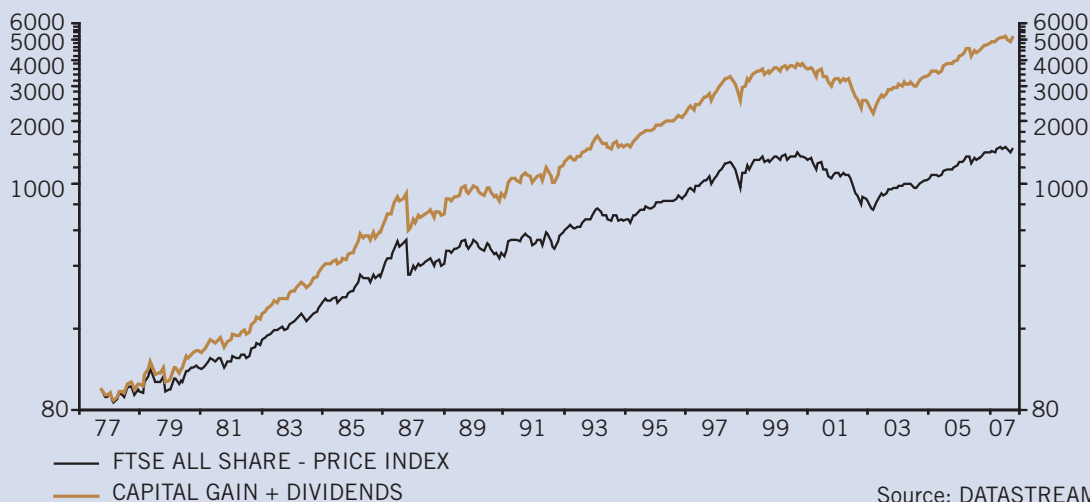
Investing in volatile times

Recent events have provided a reminder that stock markets can be sensitive to volatility and that two important aspects of investing can make a vital difference to the returns from equity investing, and play a big role in times of market volatility: reinvesting dividends and investing on a regular basis.

Reinvesting dividends can drive growth of equity investment and efficiently increase the size of your holding. More units are purchased by dividend reinvestment at the time of falling or lower unit prices. When prices rise, these extra units act as a return accelerator and help increase total returns through compounded growth. The chart below illustrates the capital growth of the FTSE All Share Index over the past 30 years (£100 has grown to just below £1,500) compared to the total return (capital gains + reinvested dividends where £100 grew to over £5,000).

We noted earlier that stock markets are typically quite volatile. Moreover, human nature being as it is, investors tend to put more money into unit trusts after they have risen and take money out after they have fallen. The result is often disappointed investors – but ones who can never break the habit of a lifetime. It is almost as if we need an investment rule that we cannot tinker with month to month!

One such rule is to invest each month or quarter. Regular investing helps you take advantage of stock-market volatility when buying units by smoothing out share-price peaks and troughs. It removes some of the risk of market timing that can occur when buying shares with a lump sum. By investing a fixed amount each month, you will buy more units in weak markets and less units in strong markets, resulting in the average unit price paid over a given period being lower than the average costs. Due to the pound-cost-averaging effect and market-timing advantages, regular investing is an excellent way of helping to smooth stock-market volatility.



Risk Warning

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. In particular, there can be no assurance that capital appreciation will occur in the early years as initial charges are levied on your investment and charges are not made uniformly throughout the life of your investment. Artemis Fund Managers Limited does not offer investment advice. We recommend you seek investment advice from a Financial Adviser before making any financial commitments or investments. For your protection, telephone calls are usually recorded.

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ARTEMIS & *The Profit* HUNTER

SHY by nature and remarkably fast, the Profit is a notoriously elusive creature. Indeed to flush and bag one of these magnificent beasts takes a hunter of particularly rare ability. Like the Artemis Profit Hunter.

BLESSED with instinct and agility, these experienced hunters like to go after large Profits wherever they may be, unlike their bigger peers who are consigned to tracking scruffy Profits along well-worn paths. This independent style of hunting has certainly paid dividends with the Artemis Hunter able to return some of the best Profits around.

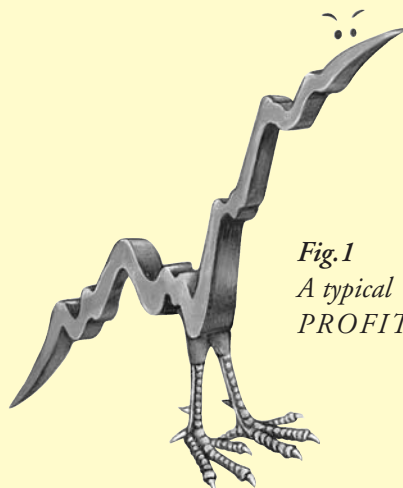


Fig.1
A typical
PROFIT

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