

# INVESTOR *FOCUS*

October 2005

The last six months have seen quite a strong market. Although there has been little good news on the economy, share prices have continued to rise. The FTSE 100 recently hit a four-year high, while further afield Asian markets were at five-year highs. Only US markets

remained subdued. It is still a good time to be invested, and of all the different types of investments, we think that shares now offer the best value. However, even though markets are rising, the economic backdrop means the skills of the fund manager in selecting the right shares will continue to be crucial.

## What has been happening in the last six months?

Something which has been in the news over the period has been the level of debt which US and UK consumers are carrying. As recent economic growth has been fuelled by borrowing, this is beginning to cause a problem.

If someone is highly indebted, any rise in the expenditure each month is going to have a significant effect. The recent interest rate cut in the UK was welcome news, but this may not have too much of an impact because of the growing cost of fuel - many of us will have noticed our gas and electricity bills getting higher, not to mention the price of petrol. So even if mortgage and loan payments come down, we may actually feel worse off. In fact, in the US consumer confidence fell by its biggest monthly amount in 15 years in August due to the rise in petrol prices after Hurricane Katrina. In the UK growing inflation is also a factor, with a whole raft of items becoming more expensive. The only thing that could ease the situation and help restore consumer confidence is a fall in long-term oil prices. At Artemis we think oil prices will remain high for some time. One reason for this is the demand generated by

regions such as China and India. Unless these economies stop growing, and there is nothing to suggest this will happen, demand will remain strong.

Another factor which has generated a lot of coverage is the gloom on the high street, with many retailers reporting falling sales, and some even going out of business. However, things are not as bleak as they may seem. Although we have seen a drop in consumer expenditure, this is the first sign of a slowdown in ten years. Rather than being a collapse in demand, it appears to be more of a shift downwards. In addition the gloom of the retailers is partly to do with higher costs borne by their businesses. It increases the likelihood of lower interest rates, which can only be a good thing.

The last six months have also seen their fair share of shocks. The terrible events in London in July once again raised the issue of terrorism, while Hurricane Katrina in the US caused billions of pounds worth of damage and displaced a whole region. Although markets have recovered from both events, Katrina could have far-reaching implications for the US economy. In the short term it may have a positive effect; the damage has to be put right, which means work for building firms and other contractors. However, someone has to foot the bill, so over the long term government borrowing could be higher. As the US is already highly indebted, this could store up problems for the future.

## What types of companies have done well in this environment?

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Shares in consumer companies have obviously not been among the winners, but they only account for a small part of the market. UK consumer concerns also blighted banks, which showed a rather lacklustre performance.

Unsurprisingly resources have continued to prosper.

The types of shares which have been most popular for the last few years are those in medium-sized companies – known as mid-caps. Recently these have done very well out of the upturn in mergers and take-overs, with many companies receiving bids. Artemis has benefited from having above average

holdings in mid-caps, but in the last six months we have moved some of our capital towards larger companies. This is partly because of the current state of the UK economy; larger companies are more international and more diversified – many have global operations which can profit from growth in India and China - while mid-cap shares tend to cover domestic areas such as building firms or retailers, which are understandably less attractive right now.

We have also noticed a shift in where the best value lies, something we are taking full advantage of. The last few years have been a good time for stocks with strong yields, and they became increasingly attractive as bond yields fell sharply. But as bonds have improved, we have moved our focus to lower yield stocks with faster dividend growth. This means that instead of focusing on generating income right now, we are looking for those shares that have the most potential for growth over the long term.

We feel that dividend payments have been strong in recent years not only because of the economy but because many companies have reorganised their finances, the latter is a one off; as this is something they don't tend to do too often, it seems unlikely that this strength will continue. And although shares that can generate an income are still an excellent choice for the long term, at the moment there are more opportunities to be found in companies which can invest for future capital growth. The Artemis Capital Fund, which searches for these types of companies, is a good example of this thinking in action. Over the last six months it has seen growth of 10% compared to 8.9% for the FTSE All-Share Index.\*

	Since Launch*	5 years	3 years	1 year	6 months
Artemis Capital Fund (TR)	1398.8	-7.9	53.5	27.3	10.0
FTSE All Share (TR)	549.1	-3.2	43.9	24.1	8.9

Percentage Growth Artemis Capital Fund 12 months to 31st August*				
2001	2002	2003	2004	2005
-19.6	-25.3	3.5	16.5	27.3

\*Source: Lipper limited, bid to bid with net income reinvested as at 31st August 2005, all figures show total returns. Launch date 23/12/86.

Something that underlines the importance of being able to pick the most promising stocks rather than using the benchmark index (the yardstick against which the performance of a fund is measured) as a guide, is the ongoing issue of pensions deficits. Many take-over bids are faltering because companies which look sound on the surface have been revealed to have large deficits, and the recent appointment of a government pensions regulator means that organisations with healthy pension funds are becoming even more attractive. The regulator is tasked with ensuring that companies cannot ignore the needs of their retirees, and it can force employers to make adequate provision for their pension funds. While this is welcome news for everyone with a company pension, it may cause some shares to become less attractive. Stock pickers have been aware of this fact for some time, and this is one of the areas we examine when looking at a company. The whole situation also reinforces the importance of looking after your own financial future and ensuring you have enough invested to fund a comfortable retirement.

In bond markets, higher risk high-yield bonds have been a success story over the period, amid quite a lot of volatility. The Artemis Strategic Bond Fund, launched in June, has been able to take full advantage of this as, rather than concentrating on just one area, it can select opportunities wherever they lie. This makes it rather fleet of foot than some of its competitors, and means it can make money in any conditions. The fund has performed very well since launch, with at least half of its performance coming from stock selection. Going forward, something the managers are very keen to avoid is generating income at the expense of capital. Unlike many other bond funds, there is an equal focus on both preserving your initial investment and providing a good level of income.

## **Stockpicking can increase your chances of making good returns**

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Although the outlook on the economy seems less than positive at the moment, it is definitely not as bleak a picture as some commentators are

painting. Having said that, we expect it to remain rather weak for the time being. As stockpickers, this doesn't really worry us as we can always find promising investments.

For example, although they are starting to recover now, the last couple of years can hardly be said to have been a good time for Europe, with both Germany and France suffering from a difficult environment. However, returns from the Artemis European Growth Fund have been encouraging. Over the last year the fund has risen 39.8% compared to 29.2% for the FTSE Europe ex UK Index\*. This is because the fund managers selected companies they knew could do well, such as international companies that are not solely reliant on their home economies, or those that have a strong competitive edge. The same approach, in fact, that we are now taking with the UK.

	Since Launch*	3 years	1 year	6 months
Artemis European Growth Fund (TR)	73.1	87.7	39.8	12.9
FTSE Europe ex UK (TR)	0.8	51.4	29.2	9.7

Percentage Growth Artemis European Growth Fund 12 months to 31st August*				
2001	2002	2003	2004	2005
n/a	-5.6	16.0	15.8	39.8

All of our funds have this potential for outperformance because although we take note of what is happening in the wider economy, we don't use it as a guide to what to buy. Rather it gives us the impetus to really search out the best ideas in different places.

This modus operandi is the trademark of the Artemis Special Situations Fund which has long appealed to the slightly more adventurous investor. As you may be aware there has been a lot of coverage in the press recently on Special Situations for different reasons. We are pleased to report that the Artemis Special Situations Fund continues to flourish, as at the end of August 2005

\*Source: Lipper limited, bid to bid with net income reinvested as at 31st August 2005, all figures show total returns. Launch date 7/3/01.

it has returned 171.7% since its launch in March 2000, making it number one in its sector out of 221 funds and consistently in the first quartile\*. The manager, Derek continues to enthusiastically spot profits.

## We're invested alongside you

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An important factor in our success is the way we are run. 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 stock analysis system called SmartGARP, which is used as a screening process to unearth good and bad stocks. SmartGARP generates investment ideas, as well as helping fund managers to judge whether a holding has reached its full potential. In short, it gives us the kind of information we would only otherwise have access to if we had a vast army of analysts, economists, strategists and fund managers working for us.

## But what of the future?

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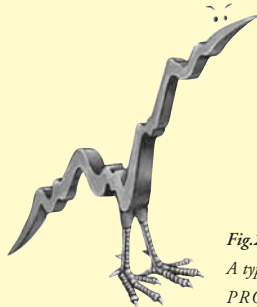
With stock markets rising, those who stayed invested through the bad times will be seeing their persistence pay off. And if you are just starting to invest, now is a very good time to take advantage of the great long-term value and potential we see. Although the UK economy may be entering an uncertain period, global investment conditions are still very positive, and you can be confident that we will be hunting out the very best opportunities on your behalf.

\*Source: Lipper limited, bid to bid with net income reinvested as at 31st August 2005, launch date is 7/3/2000 and part of the IMA UK All Companies sector.

# ARTEMIS & *The Profit* HUNTER

**S**HY 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.

**B**LESSED 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 mangy 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.2*  
*A typical*  
*PROFIT*

### Risk Warning

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