Investment Objective and Policy

The objective of the Sub-Fund is to achive long term capital appreciation.

The Sub-Fund seeks capital appreciation by investing in an actively managed portfolio composed principally of quoted equity securities, issued by companies established or operating in emerging market countries, principally in Asia, Eastern Europe, the Middle East, Africa and Latin America and whose market capitalisation does not exceed US$2.5 billion at the time of the investment. The Sub-Fund may also invest in other investment funds in order to gain exposure to specific markets or the expertise of specific managers.

The Sub-Fund generaly seeks to maintain a diversified portfolio in order to reduce its dependence on specific companies or industry sectors. The Sub-Fund may invest in cash and near cash, and in shares in other collective investment schemes, however investments by the Sub-Fund in other schemes will be limited to a maximum of 10% of the share property of the Sub-Fund.

The Company permits the use of derivatives for investment purposes by the Sub-Fund, however, this policy is not currently applied and may not be applied without giving the required 60 day notice to Shareholders. If derivatives are used for the purpose of meeting the investment objective of the Sub-Fund it is not intended that the use of derivatives would significantly raise the risk profile but this cannot be guaranteed and the risk profile may increase as a result of a change in the investment policy for derivatives.

The Sub-Fund is permitted to invest 5% or more of its scheme property warrants. Such investments may increase the volatility of the Sub-Fund and therefore may adversely affect its risk profile.

Investment Manager's Report

for the period ended 30 September 2011

The Somerset Emerging Markets Small Cap Fund, which launched on 1st November 2010, performed in line with the index over the eleven months to its Year End, 30th September 2011. In GBP terms, the net return since Fund inception was -18.56% versus -17.60% for the MSCI Emerging Markets Index. Activity during this period was limited to around 2-3 buys and sells per quarter – in line with the strategy's long term average. It is helpful at this stage to consider some of the long term themes and some of the stocks both bought and disposed of from the Fund.

Inflationary concerns intensified during late 2010 and Q1 2011 leading to underperformance in emerging markets compared to the developed regions. Oil reached $125 which raised the spectre of a 2008 style collapse. However, we do not think this the most likely scenario as earnings and credit conditions are fundamentally different from three years ago. The relative outperformance of developed versus GEM is probably entering its latter stages, but absolute performance could remain weak. Although fund valuations at 11.5x 2011 price earnings (P/E) are reasonably attractive, both price and earnings momentum have been strong in recent years. For that reason we have continued to cut some of the more aggressive positions and added some cheap defensive stocks throughout the period in question. This is likely to be the end of our defensive and value adjustments and we are now looking to buy the best companies on our watchlist when they come in range.

Saraiva, the Brazilian publisher and bookseller, is an example of a stock we have held since the inception of the Fund on the expectation of higher margins post the renovation of its acquired Siciliano stores. The stock has done well in anticipation of this but we were concerned that the margin gain has been diluted by diversification into online retailing which involves selling electronics and other lower margin goods. The contrast with Navneet, the other education publisher we hold, was instructive. Top companies can clearly and repeatedly state and capitalise on their core competitive advantage (in Navneet's case its content and contacts); this advantage should not require high capital or additional funding. Saraiva seems to have forgotten about creating content and has become a distributor/retailer and finally an internet trading organisation, selling other people's goods. One of the other things we had liked about Saraiva was the fact that management were incentivised on 'cash value added' whereby the management were rewarded on the cash they generated over the cost of capital. What seems to have happened however, perhaps coincidentally, is that their cost of capital has been lowered through increased debt funding including lowest cost BNDES funds. The latter is a hidden risk of too much Brazilian corporate funding in our view. Since the

Investment Manager's Report

continued

stock had reached 22x p/e and we considered these negatives not fully priced in, we sold the stock. This is just one example of acting where valuations has become excessive, and we identified value elsewhere.

Another stock sold in Q1 2011 was Otokar. This Turkish commercial vehicles and defence manufacturer was a company the analysts were very keen should be in the Fund although I remember being less enthusiastic at the time of purchase, largely because the lumpiness and volatility of orders made the company's cashflow very hard to predict. Profitability in some years could be quite high for its industry but it was always hard to know when. The most compelling reason to own it was its historically low asset turnover and indeed it turned out to have been well timed as profits look likely to double to the end of 2011. If they do this however, the stock will still be trading on 15x earnings which, given its industry, is expensive in our view. After a tremendous run we decided to take profits.

Adel Kalemcilik, a Turkish stationary manufacturer that has Faber Castell and the Anadolu group as strategic investors was purchased for different reasons. Very cheap and completely uncovered it came up on a screening with very attractive metrics including a 26% return on assets for only 9x p/e and a 40% dividend payout policy. Selling pencils, pens, watercolours and paints into the office and education sectors of a fast growing economy like Turkey is an attractive business model. What has become apparent to us, to our surprise, is the level of skilled labour required to manufacture a traditional pencil. This poses a significant barrier to entry in the form of labour cost and supply.

Another interesting purchase made for the Fund was V.I.P. Industries, a leading Indian luggage brand, established in 1968. They sell all types of luggage including briefcases, backpacks and uprights. They did quite well for 20 years then diversified into other businesses but these mostly failed so were closed down. Now they're just focused on luggage. The company used to make 8-9% operating margins and this has now moved to 15% owing to cost control and operating leverage as well as an increase in the mix of soft luggage. They expect 200bp expansion in margins over the next two years even with commodity pressure. They expect 20% growth for the next 3-4 years (18% this year) owing to their distribution and branding efforts. They launched three new brands during 2011.

As we look forward into 2012, the main concern with Global Emerging Markets remains China. Chinese valuations reached 2008 trough levels in September of this year, which we felt was unjustified and led us to add to positions on weakness. The understandable concerns centre on corporate governance, corruption, a housing bubble and social / political unrest. China needs the rule of law. The key difference between China and The West, is that China has an Income Statement problem, whilst The West has a Balance Sheet problem. The latter is much worse. In addition, China is allowing wage inflation at the expense of export margins. This is the much called for re-gearing of the Chinese economy towards consumption. Few people are pointing to this as a positive.

In conclusion, the Small Cap universe remains inefficient, uncovered and under-owned, qualities a stock picker rates highly. Opportunities continue to emerge.

By Mark Asquith
Lead Investment Manager

Fund Facts

Accounting and distribution dates

	Accounting	Distribution
Interim	31 March	31 May
Final	30 September	30 November

Net asset values

Year as at 30 September	GBP B Accumulation shares			EUR B Accumulation shares			USD B Accumulation shares		
	Net asset value (£)	Number of shares in issue	Net asset value (pence per share)	Net asset value (€)	Number of shares in issue	Net asset value (€ cents per share)	Net asset value ($)	Number of shares in issue	Net asset value ($ cents per share)
2011	6,675,219	8,225,952	81.15	13,541,383	16,602,827	81.56	40,505,087	51,709,937	78.33

Fund Facts

continued

Price history & distribution record

The tables below show the highest and lowest prices per share on a calendar year basis in pence per share since launch.
Past performance is not necessarily a guide to the future performance.

Year	GBP B Accumulation shares			EUR B Accumulation shares			USD B Accumulation shares		
	Highest (pence)	Lowest (pence)	Net revenue (pence per share)	Highest (€cents)	Lowest (€cents)	Net revenue (€ cents per share)	Highest ($ cents)	Lowest ($ cents)	Net revenue ($ cents per share)
2010^	101.40	96.01	–	103.02	98.90	–	101.84	94.19	–
2011^^	102.31	80.51	1.6842	104.83	80.16	1.4170	99.11	77.42	1.3569

^ From launch 1 November 2010 to 31 December 2010
^^ to 30 September 2011

Total expense ratios

30 September 2011^	Expense type	%
GBP Accumulation	Manager's periodic charge Other expenses	1.25 0.47
	Total expense ratio	1.72
EUR Accumulation	Manager's periodic charge Other expenses	1.25 0.36
	Total expense ratio	1.61
USD Accumulation	Manager's periodic charge Other expenses	1.25 0.34
	Total expense ratio	1.59

^ The total expense ratio is annualised based on the fees incurred during the accounting period.

Risk Warning

An investment in an Investment Company with Open Ended Investment Company should be regarded as a medium to long term investment. Investors should be aware that the price of shares and the revenue from them can fall as well as rise and investors may not receive back the full amount invested. Past performance is not a guide to future performance. Investments denominated in currencies other than the base currency are subject to fluctuation in exchange rates, which can be favourable or unfavourable.

Sector spread of investments

All sectors in percentage order are shown below.

Sector	% of Fund as at 30.09.11
Consumer Discretionary	26.07
Financials	23.72
Healthcare	11.35
Industrials	9.86
Information Technology	8.85
Consumer Staples	7.84
Materials	1.30
Net other assets	11.01

Fund Facts
continued

Major holdings
The top ten holdings at the end of the year are shown below.

Holding	% of Fund as at 30.09.11
E Ink	4.38
Security Bank	3.73
BEC World	3.57
JSE	3.42
Ports Design	3.38
V.I.P. Industries	3.37
Grupo Herdez SAB-Series	3.31
Navneet Publications India	3.25
Sino Biopharmaceutical	3.20
Giant Manufacturing	3.16

General Information

Authorised Status
PFS Somerset Capital Management Investment Funds ICVC (the "Company") is incorporated in England and Wales as an ICVC under registration number IC000713. The Shareholders are not liable for the debts of the Company.

The Company is authorised by the FSA as a UCITS Scheme under the COLL Sourcebook and is an umbrella company for the purposes of the OEIC Regulations with each Fund being a UCITS Scheme. The effective date of the authorisation order made by the FSA was 17 October 2008.

Buying and selling units
The ACD will accept orders for the purchase and sale of shares on normal business days between 8.30am and 4.30pm. Instructions to buy or sell shares may either be in writing to: PO Box 10282, Chelmsford, Essex CM1 9LJ or by telephone on 0845 026 4282.

A contract note will be issued by close of business on the next business day after the dealing date to confirm the transaction.

Report and accounts
This document is a short report of PFS Somerset Emerging Markets Small Cap Fund for the period ended 30 September 2011. The full Report and Accounts for the Fund is available upon written request to Phoenix Fund Services (UK) Ltd, PO Box 10282, Chelmsford, Essex CM21 9LJ.

Other information
The information in this report is designed to enable you to make an informed judgement on the activities of the Fund during the period it covers and the results of those activities at the end of the period.

Risk Profile
The Fund has little exposure to credit or cash flow risk. There are no borrowings or unlisted securities of a material nature and so there is little exposure to liquidity risk. The main risks it faces from its financial instruments are market price foreign currency and interest rate risk. The ACD reviews the policies for managing these risks in order to follow and achieve the Investment Objectives.

PHOENIX
Fund Services

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Directors of the ACD
J. Rice (appointed 22 February 2011)
R. Elliott (appointed 11 April 2011)
S.A. King
S.D. Mathieson (retired 31 October 2011)
A. C. Reed (appointed 1 November 2011)

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