Quarterly Newsletter & Investment Review

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Heritage Capital Management Limited

Heritage Capital Management Limited is an independent, specialist investment management company based in London and regulated by the Financial Services Authority, providing a wide range of investment services to individuals, trusts, companies and pension funds.

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A good start to the year

The good run for global equity markets has continued into 2006 with all the major indices rising in the first quarter, although bond investors have had a tougher time recently as yields have turned upwards.

We are pleased to report that all of the Heritage Funds have had a positive start to the year with the Managed Portfolio Fund leading the way this quarter with a gain of 5.6%. Further details of all our funds can be found as usual on page 3.

Heritage Funds obtain stock exchange listing

Longstanding clients may recall that the Heritage Investment Funds were originally established with a British Virgin Islands domicile with the custody, banking and administration all done in the Channel Islands. In 2003 we took the decision to migrate the Funds themselves to Guernsey and we are now pleased to announce the latest development in their evolution, a listing on the Channel Islands Stock Exchange (CISX).

The CISX is a well established and internationally recognised stock exchange operating in one of the offshore world's premier financial services locations, making it the exchange of choice for a growing number of international issuers.

Although the liquidity of shares listed on the CISX is not comparable with a major exchange such as the London Stock Exchange, the listing could help to facilitate the sale and purchase of shares in the Heritage Funds beyond the normal system of monthly subscriptions and redemptions.

Furthermore, the official designations obtained by the CISX from the likes of the US Securities and Exchange Commission, the UK Financial Services Authority and the UK Inland Revenue provide additional benefits and opportunities. For example, UK based individuals will now be able to use the Heritage Funds as the basis for their personal pension planning which should become an increasingly attractive proposition under the new pensions rules which take effect from 6th April this year (further details of the new pensions regime are outlined on page 4 of this newsletter).

We believe that with their conservative style, absolute return focus and long-term approach to investment, the Heritage Funds are especially well suited to the needs of the retirement savings market and that the CISX listing will help to make pension fund management an increasingly important part of our business.

Market Commentary

Equity investors have continued to enjoy the combination of good economic and profit growth, together with low interest rates that have pushed markets higher in recent years, with all the major indices rising in the first quarter of 2006.

The problem for investors seeking value is that virtually all asset classes have had a good run with the price rises in equities, bonds, property, oil, gold and other commodities making it difficult to point to an asset class that currently offers attractive valuations. This problem is compounded by the fact that within asset classes the valuation gaps have been narrowing, with for example the differences between small cap and large cap stocks and investment grade and high yield bonds converging.

This widespread asset price inflation has largely been caused by a period of loose monetary policy and increasing investor confidence, but the risk is that with bond yields now rising the current elevated prices could be vulnerable to a sharp correction. Looking forwards the best that we can probably hope for is that these assets offer fair value, and so whilst the recent exceptional gains cannot continue indefinitely, they will at least provide reasonable returns in line with their long-run historical averages.

United Kingdom

The UK market's good run has continued into 2006 with a 1st quarter gain of 6.15% for the FTSE 100 index, although it just failed to close above the 6,000 mark. The last time the FTSE was at 6,000 was 5 years ago and the first time it reached this level was back in 1998, so despite the recent rise longer term returns have still been disappointing.

For now the market continues to be supported by a combination of good earnings and dividend growth, continued bids for UK companies from foreign buyers and private equity funds, and reasonable valuations and the fact that unlike the other major markets where interest rates are rising, UK monetary policy is more finely balanced.

United States

Following a relatively poor year in 2005, the US market was again the weakest of the major markets for the first quarter of 2006 although the 3.73% rise in the S&P 500 index is still a reasonable performance.

The new Federal Reserve Chairman, Ben Bernanke, has continued to raise interest rates much as expected. US Dollar rates are now the highest of all the major currencies and have risen steadily from just 1% a couple of years ago to their current level of 4.75%. The likelihood is that they will move above 5% later this year which might help to support the dollar but could hinder equity market prospects.

Europe

European markets have continued to perform well with the FTSE Eurotop 100 index gaining 5.48% this quarter.

Economic growth in Europe has been trending higher recently and the EC's consumer confidence index is at its highest level since 2002. Against this background, the European Central Bank has followed up last quarter's rise in interest rates with a further 0.25% increase taking the rate to 2.5%.

Japan

The strong performance by the Japanese market last year has continued into 2006 with a 5.9% gain for the Nikkei in the first quarter.

The Bank of Japan has signalled its intention to end its zero percent interest rate policy as signs are emerging that the deflation which has dogged the economy since the bursting of the late 1980's bubble is finally coming to an end.

Emerging markets

Emerging equity markets have suffered some localised set backs although overall they generally still have better growth prospects and valuations than the larger, mature markets.

The current concern is that the so called "carry trade", whereby investors borrow low yielding currencies such as Japanese Yen and invest in higher yielding emerging market currencies finally appears to be showing signs of topping out, with the first casualties being the Icelandic Krona and New Zealand Dollar.

Investment Statistics - 31/03/2006

Equity Markets	Q1 2006	2005	2004	2003	2002	2001
Global - MSCI World ($)	6.16%	7.55%	13.01%	30.61%	-21.47%	-17.29%
UK - FTSE 100	6.15%	16.71%	7.54%	13.62%	-24.48%	-16.15%
US - S&P 500	3.73%	3.00%	8.99%	26.38%	-23.37%	-13.04%
Europe - FTSE Eurotop 100	5.48%	21.66%	6.59%	11.38%	-33.51%	-18.64%
Japan - Nikkei 225	5.89%	40.24%	7.61%	24.45%	-18.63%	-23.52%

Other	UK	US	Europe	Japan
PE Ratio	14	19	15	36
Dividend Yield	3.0%	1.7%	2.0%	0.9%
Interest rates - base	4.50%	4.75%	2.50%	0.00%
Bond Yields - govt. 10 year	4.40%	4.86%	3.79%	1.78%
Exchange rates (vs GBP)	-	1.7346	1.4333	204.66
Exchange rates (vs USD)	1.7346	-	1.2102	117.99
Gold ($ per ozs)		$584		

Source : Financial Times

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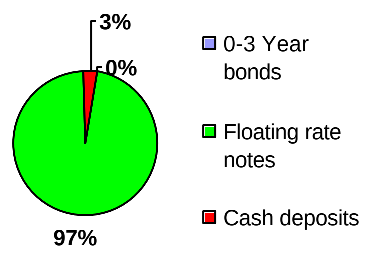
Heritage Investment Fund Limited

Review for the quarter ended 31st March 2006

Performance

	Enhanced Bond Fund	Absolute Return Funds		Managed Portfolio Fund	Cash Deposits	MSCI World Index
Risk profile	Low	Moderate		High / Moderate	(£)	(£)
Minimum investment horizon	1 year +	3 years +		5 years +		
Typical range of returns	2% to 5%	0% to 8%		-9% to +12%		
Price at 31 March 2006	£152.97	£137.72	US$128.37	£142.74		
Return for qtr & year to date (net)	0.80%	1.50%	1.49%	5.61%	0.75%	5.07%
Year 2005 return (net)	4.29%	6.24%	3.72%	14.28%	3.17%	20.27%
Year 2004 return (net)	3.49%	7.15%	4.46%	10.92%	3.06%	5.21%
Year 2003 return (net)	2.49%	5.71%	3.65%	16.10%	2.69%	17.64%
Year 2002 return (net)	5.19%	7.95%	5.82%	-0.41%	3.04%	-29.01%
Year 2001 return (net)	5.51%	6.83%	5.38%	-7.19%	3.78%	-15.11%
Year 2000 return (net)	9.59%	6.53%	6.89%	-0.64% (1 mth)	4.72%	-7.11%
Compound annual rtn (from 1/01)	4.14%	6.74%	4.67%	7.14%	3.14%	-1.12%
Annual volatility	0.4%	0.6%	0.7%	3.7%	0.0%	12.2%
Size of Fund (millions)	£3.7	£39.9	US$21.8	£26.0		

Enhanced Bond Fund

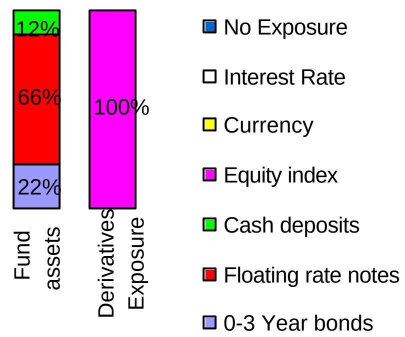


The Sterling Enhanced Bond Fund is invested in a diverse spread of high-quality investment grade bonds designated in the major international currencies. The bond portfolio currently yields 4.7% per annum gross to maturity and has an average duration of 0.25 years.

UK bond yields rose for the short and medium term, flattening the yield curve over the quarter, as investors now regard a further reduction in rates in the short term as unlikely. European bond yields rose by around 40 basis points across the curve during the quarter as investors anticipate further interest rate rises. The stepped increases in US interest rates continued as rates were raised again by 0.50% to 4.75% during the quarter.

The Sterling Enhanced Bond Fund produced a steady return for the quarter, a little below our target but the year-to-date return is above that obtainable on cash deposits.

Absolute Return Funds

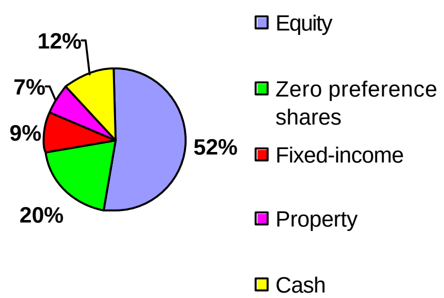


The Absolute Return Funds seek to generate consistent positive returns irrespective of market direction by exposure to interest rates, currencies and equity indices by employing futures and options. As these positions require limited margin outlay, the balance of funds is invested in short-dated investment grade bonds to provide underlying income for the Funds.

The derivatives overlay contributed 85 basis points for the quarter, which was earned from taking positions in the US equity index to benefit from a neutral or rising market. This was slightly behind our quarterly target of 1%, due to a loss incurred on a bullish position in US Treasury Notes, which was closed. We did not take any currency positions in view of the current difficulty in forecasting future moves.

Both Absolute Return Funds produced satisfactory returns for the quarter, slightly below our targets but both Funds have made a solid start to the year.

Managed Portfolio Fund



The Managed Portfolio Fund seeks to generate long-term capital growth at a lower risk than that associated with pure equity market investment. The Fund has started 2006 well, gaining 5.61% in the first quarter compared to a rise of 5.07% for the MSCI £ World Index.

Returns were fairly strong across the board from our equity holdings this quarter with the best returns coming from our holdings in construction, insurance, retailers and emerging markets. Our property investments have also continued to perform well.

The zero-dividend preference shares have continued to benefit from the improving cover on their equity-based portfolios which reduces their risk, although going forward the yields, whilst still acceptable, are no longer as attractive as when we first purchased them.

Overall our main focus continues to be on building a diversified portfolio of good investments that offer potentially attractive returns in relation to the risks involved.

This report is not an invitation to subscribe for shares in the Heritage Investment Funds and is for the information of investors only. Investors should be aware that past investment performance is not a guide to future performance, and that the value of investments may fall as well as rise. An investor may get back less than the original amount invested.

Pension reform

Following years of consultation and planning, the UK's new pension regime will start from the 6th April this year, with this watershed date becoming known as "A Day".

The pension rules have been radically reformed with the idea being that the multitude of hugely complicated existing regulations will be simplified into a single new regime.

Although there are some doubts as to just how simple this new regime will be, it is now clear that the establishment of a Self Invested Personal Pension (SIPP) will be a very attractive option for those having or planning to accumulate sizeable pension savings to supplement the inadequate state pension.

In summary, rather than holding pension savings within numerous plans governed by different rules and administered and managed by large life insurance companies, each individual will now be able to build up their own personal pension fund.

Also, the income tax relief available on pension contributions will be more generous and straightforward with an annual limit of £215,000 up to an overall lifetime total of £1.5 million (which will rise to £1.8million by 2010) as opposed to the previous complex rules based around earnings, ages and length of service.

With our well-established background of managing trust and pension monies and commitment to personal service, we believe that Heritage is ideally placed to assist clients with the management of their SIPPs under the new pension regime.

Enhancing our Bond Fund

Our Enhanced Bond Fund is a low risk Fund that gives our investors the opportunity to diversify their investments or adopt a cautious approach when the equity markets are volatile.

We target a return of approximately 1% above 3-month interest rates for the Fund, whilst preserving capital. This target was achieved last year, but it has become difficult to achieve this level of return without taking greater risk and, at present, we feel that there is insufficient reward to justify this.

Buying bonds with longer dated maturities can typically earn higher returns but, as the UK yield curve is currently inverted, investors currently receive less for going longer. Investing in bonds that have a lower credit rating will also give a higher return. However, as our Fund aims to preserve the capital of our investors, we only invest in safer investment grade bonds, as the risk of default for high yield bonds is too great.

The Fund has held Euro and US Dollar denominated bonds in the past, fully hedging any foreign currency exposure. This was successful when investors could earn a premium on hedging lower yielding currencies into higher yielding Sterling, but the recent convergence of Western interest rates has made this strategy no longer attractive.

The Fund currently holds floating rate notes to guard against price volatility caused by interest rate movements. By opting for stability we do, however, lose the opportunity to make gains by trading bonds before maturity.

Despite the current obstacles, we continue to look for low risk strategies to enhance our current return.

Model risk-adjusted asset allocations for Heritage's mutual funds:

	Suggested asset allocation				Last 12 months	
	Enhanced Bond Fund	Absolute Return Fund	Managed Portfolio Fund	Target returns £	Actual return £	Average volatility
Model portfolios:						
Cautious	57%	43%		5.0%	5.1%	0.4%
Balanced	23%	50%	27%	7.0%	9.2%	1.2%
Growth		33%	67%	9.0%	14.6%	2.6%
Benchmarks:						
3 month interest rate					4.5%	0.2%
5 year government bonds (total return)					5.2%	2.4%
MSCI World Equity Index					26.3%	12.2%

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