Heritage

Quarterly Newsletter & Investment Review

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In this issue

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.

Contacts - directors

Roy Glew
Roy is responsible for advising the Heritage Absolute Return Funds.
roy@heritage-capital.co.uk

Graeme Olsen
Graeme is responsible for client portfolios and advising the Heritage Managed Portfolio Fund.
graeme@heritage-capital.co.uk

www. heritage-capital.co.uk
Tel +44 (0) 20 7799 2110
Fax +44 (0) 20 7222 1599
Broadway House, Tothill Street,
London SW1H 9NQ

A good start to 2010

The new decade has got off to a good start for investors with markets overcoming an initial pullback in January to produce a good overall result for the first quarter of 2010.

The Heritage Funds have also made a decent start, with the Managed Portfolio Fund leading the way this quarter with a gain of 4.77%. Further details on the performance and strategies for our funds can be found as usual on page 3.

Exceptional returns over the past year

What a difference a year makes! This time last year we were reporting a bad start to 2009 following on from 2008 which was one of the worst ever years for investors. The pervading sentiment was extremely negative and most people were more interested in checking that any cash that they were holding was in a bank that would survive, rather than considering investing in shares or corporate bonds.

However, that turned out to be a low point for markets and although the economy remained in recession throughout most of last year, the stockmarket was already anticipating a recovery and has bounced strongly from its depressed level.

With this helping wind the Heritage Funds have posted their best ever 12 month returns. The Absolute Return Fund which has produced consistently positive returns a few percent above cash rates in all but one of the last 10 years recorded its first double digit gain over a 12 month period with the Sterling, US Dollar and Euro Funds returning an average of 10.8% in the year to 31st March 2010 compared to current cash interest rates of below 1%. The Heritage Managed Portfolio Fund also had a record 12 months with a return of 24.8%, beating the previous record of 20.3% in the year following the end of the 2000-2002 bear market and the invasion of Iraq.

These returns were achieved despite our continued conservative approach. The Absolute Return Funds are not geared and the capital is invested in a combination of government and other highly rated bonds whilst equity market exposure in the Managed Portfolio Fund is well below average. With hindsight a more bullish stance would have resulted in even higher returns but we favour a consistent and cautious approach rather than trying to call the twists and turns in the markets and the past year has shown that good returns are achievable without the need to take excessive risk. Furthermore, there are still reasons to be cautious as the economy struggles to make a robust recovery and government debt soars.

Overall, whilst it must be recognised that the past 12 months have been exceptional, we believe that our Funds are well positioned to continue to produce decent returns going forward and that our cautious approach means that we are also relatively well placed to withstand any market setbacks.

Heritage Capital Management Limited

Review for the quarter ended 31st March 2010

Market Commentary

Following a worrying initial plunge in January, global stock markets subsequently rallied strongly over the remainder of the first quarter with all of the major markets producing positive returns.

Much of this recovery can be explained by the boost received by the stronger than anticipated recovery in corporate profitability during the recent earnings results season. With analysts now also revising upwards their 2010 earnings forecasts, valuation measures such as the PE ratio, which were in danger of becoming stretched, now still at least look reasonable compared to their run-long averages.

However a note of caution is required, as the boost to profits has been mainly due to the implementation of successful cost cutting programmes, and once the gains from these efficiencies have been made it is harder to see what will continue to drive profits higher. In particular sales growth will be hard to come by in a world where credit is constrained and overall demand remains weak.

United Kingdom

The UK was the best performing major market in the first quarter with the FTSE 100 index gaining 6.1%, helped by the news that the economy has finally come out of recession, albeit only just.

With the date of the general election now confirmed as 6th May, attention will now be firmly focussed on politics and investors will be particularly interested to see what action will be taken to tackle the huge deficit and ballooning government debt which the current Chancellor has so far largely avoided.

The current uncertainty over the result and the spectre of a hung parliament has already weighed heavily on Sterling and although there is a danger that it could weaken further, with much of the risk already factored in at current rates it would not take much positive news for the pound to stabilise or even strengthen when you consider some of the severe challenges faced by the other major currencies.

United States

In the US, the S&P 500 index also made a good start to the year with a return of 5.4%.

Although recent economic indicators have been encouraging there are still a number of challenges to be faced, including continuing weakness in the labour and housing markets and problems obtaining access to credit for businesses and consumers. It is therefore likely that any further economic recovery this year will be subdued and that interest rates are unlikely to be raised from just above zero in the near future.

On the political front the major news was the passing of Barack Obama's controversial ten-year, $940bn healthcare reform bill which has provided a much needed boost to his presidency.

Europe

Europe was the weakest of the major equity markets this quarter, although a 3.2% return still represents a decent start to the year.

The major factor weighing on the Eurozone continues to be the uncertainty surrounding the potential need of a bailout for Greece. The announcement of a joint EU and International Monetary Fund financing package should it be needed has at least provided some cause for optimism on this front, although with even the stronger members such as Germany and France facing major headwinds the overall outlook for Europe remains challenging.

Japan

The Japanese market has also had a good start to 2010 with 5.9% gain for the Nikkei index and although recent indicators show a cyclical upturn from the recent severe downturn, Japan still faces a number of longer term structural problems including an ageing population and a vast accumulation of government debt.

Emerging markets

After an exceptionally strong recovery in 2009, emerging markets have so far lagged behind in 2010 with China and Brazil actually falling back slightly. However, economic data continues to confirm that the emerging markets are making a much more robust recovery than their more developed counterparts.

Investment Statistics - 31/03/2010

Equity Markets	Q1 2010	2009	2008	2007	2006	2005
Global - MSCI World ($)	3.37%	30.57%	-40.30%	7.09%	17.95%	7.56%
UK - FTSE 100	6.07%	27.89%	-27.93%	3.80%	10.71%	16.71%
US - S&P 500	5.39%	26.47%	-36.91%	3.53%	13.62%	3.00%
Europe - FTSE Eurotop 100	3.19%	29.97%	-40.57%	2.41%	12.41%	21.56%
Japan - Nikkei 225	5.87%	21.05%	-41.03%	-11.13%	6.92%	40.24%

Other	UK	US	Europe	Japan
PE Ratio	18	19	16	40
Dividend Yield	3.3%	1.8%	3.5%	1.4%
Interest rates - base	0.50%	0.00%	1.00%	0.10%
Bond Yields - govt. 10 year	3.94%	3.83%	3.09%	1.58%
Exchange rates (vs GBP)	-	1.5184	1.1239	141.91
Exchange rates (vs USD)	1.5184	-	1.3510	93.47
Gold ($ per ozs)		1113		

Source: Bloomberg/FT

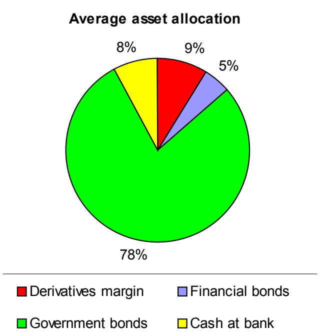
Heritage Capital Management Limited is authorised and regulated by the Financial Services Authority. Investors should be aware that past investment performance is not a guide to future performance, and that the value of investments may fall as well as rise. An investor may get back less than the original amount invested.

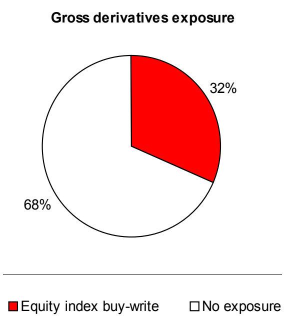
Heritage Investment Fund Limited

Review for the quarter ended 31st March 2010

Performance	**Absolute Return Funds**			**Managed Portfolio Fund**	**Cash Deposits (£)**	**MSCI World Index (£)**
Risk profile	Moderate			High /Moderate		
Minimum investment horizon	3 years +			5 years +		
Target return over bank deposit rate	+2.5%			+5%		
Price at 31 March 2010	£152.89	US$126.56	€97.62	£158.11		
Return for quarter (net)	0.29%	-0.37%	0.59%	4.77%	0.06%	9.88%
Year 2009 return (net)	4.25%	1.26%	6.50%	10.32%	0.13%	17.86%
Year 2008 return (net)	-5.81%	-12.95%	-8.87%	-15.66%	4.20%	-18.86%
Year 2007 return (net)	7.14%	6.09%		2.74%	4.62%	8.24%
Year 2006 return (net)	6.79%	7.41%		16.79%	3.23%	6.01%
Year 2005 return (net)	6.24%	3.72%		14.28%	3.17%	22.69%
Year 2004 return (net)	7.15%	4.46%		10.92%	3.06%	7.30%
Compound annual return (from 1/01)	4.95%	2.47%	-1.11%	5.15%	3.52%	-0.37%
Annual volatility	3.0%	4.0%	3.4%	5.2%	0.0%	15.3%
Size of Fund (millions)	£39.3	U$21.3	€6.1	£35.2		

Absolute Return Funds





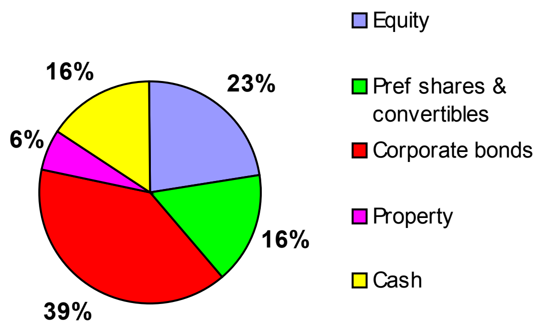
The Absolute Return Funds aim to generate positive returns significantly in excess of cash deposits over time by limited exposure to derivative products, mainly based on underlying equity market indices. As these positions require limited margin outlay, most of the funds are invested in short-dated government and investment grade bonds to provide income.

The core bond portfolios currently yield 0.75% (GBP), 0.42% (USD) and 0.65% (EUR) per annum gross to maturity and have average durations of 0.7, 0.9 and 1.0 years respectively. We sold most of our financial bonds during the quarter as prices firmed and added to our short-dated government bond positions for security and liquidity.

Our long futures, short call options derivatives positions in UK, US and European equity market indices only broke even during the quarter as losses in January were reversed in the following months, with losses on our futures exposure being reduced by income generated from the sale of options against these positions.

The Absolute Return Funds produced modest, mixed returns for the quarter. However, the Funds are relatively defensively positioned going forward and well placed to generate steady positive returns in excess of cash deposits.

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 through active management of a well diversified portfolio.

The Fund has made a good start to the year with a return of 4.77% in the first quarter, helped by favourable market conditions with the MSCI £ World Index returning 9.88%.

The performance of our equities was quite mixed but overall produced a positive contribution which was boosted by a take-over approach for a transport company holding. Our property holdings also received a boost from a Chinese real estate company, where we added to our position in a placing which was rewarded with a substantial subsequent share price increase.

Our bond portfolio has continued to perform well and with a running yield of just over 7% and a yield to maturity of over 9%, there is still scope for further decent returns.

Overall, our strategy of maintaining a defensive portfolio of well diversified and attractively valued investments should enable us to produce a reasonable return over the long-term.

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.

The equity index buy-write strategy explained

Investors in our Absolute Return Funds will be aware that the Funds currently seek to generate their incremental return from exposure to equity index buy-write strategies (also known as covered call writing). This strategy involves buying futures on stock market indices and, simultaneously, selling call options on those indices in exchange for a premium. Our Absolute Return Funds typically have approximately 30% gross exposure to these strategies on US, UK and European equity indices.

Buy-write strategies generate a premium from selling call options, which limits the upside gains from holding equity index positions in a rising market, but provides a guaranteed return. However, the receipt of this premium income helps to cushion the effects of any fall in equity markets. The volatility of a buy-write strategy is, therefore, significantly lower than long-only equity market investment. The major determinants of premium levels are volatility and time to expiry. Premiums rise when equity markets are volatile, as when equity markets fell sharply in late 2008, but fall when equity markets are stable.

Equity index buy-write is a neutral to bullish strategy which relies on equity markets moving sideways or rising for its success. Historically, monthly equity market returns have been positive approximately 60% of the time, providing a positive bias for this strategy. In strong bull markets, the returns generated by a buy-write strategy will be lower than on long-only equity exposure, as they are limited to the premium income received. However, in neutral to mildly bearish equity markets, the returns on a buy-write strategy will generally be better than on long-only equity exposure, as the premium income can be offset against the equity losses incurred.

There is strong empirical evidence that a passive buy-write strategy outperforms an unhedged equity market index on a risk-adjusted basis by a few percent per annum. Historical equity index buy-write returns also outperform the returns obtained on bonds and cash, but have been more volatile.

We adopt a more active approach to the buy-write strategy by taking a view on the likely direction of equity markets and writing options at differing levels to maximise the risk-adjusted return. In particular, we strive to limit losses when equity markets fall. Investors must appreciate that, as with any equity market investment, the equity index buy-write strategy is a long-term strategy designed to generate superior risk-adjusted returns and that there may be periods when limited losses will be incurred on these positions.

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

	Suggested Asset Allocation		Target returns	Last 12 months Actual return	Compound annual return since 1/1/01	Average volatility
	Absolute Return Fund	Managed Portfolio Fund				
Model Portfolios:			£	£	£	
Cautious	63%	37%	5.0%	15.1%	5.0%	3.2%
Balanced	40%	60%	6.0%	18.6%	5.1%	3.8%
Growth	16%	84%	7.0%	22.3%	5.1%	4.6%
Benchmarks:						
3 month interest rate				0.9%	4.1%	0.0%
5 yr Government bonds (total return)				1.2%	5.5%	3.7%
MSCI World Equity Index (total return)				44.1%	-0.4%	15.3%

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Heritage Capital Management Limited
Broadway House, Tothill Street, London SW1H 9NQ
Tel: +44 (0) 20 7799 2110 Fax: +44 (0) 20 7222 1599
General Email: info@heritage-capital.co.uk
Website www.heritage-capital.co.uk

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