Quarterly
Newsletter & Investment Review

Issue 13 | Combined news & investment review from the Heritage Group | Spring 2001

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Conservative approach pays dividends

Whilst the current turmoil in global equity markets has been a major cause for concern for many investors and fund managers, we at Heritage are pleased to report that our conservative approach to investment has continued to produce good results.

Following a fall of 14.1% in 2000 the MSCI World Index fell a further 13.1% in the first quarter of 2001. This is in stark contrast to the performance of our largest fund, the Sterling **Enhanced Bond Fund** , which returned 9.6% (9.7% for the US Dollar version) last year and is up a further 1.7% (2.0% for the US Dollar version) this year representing an outperformance since the beginning of last year of just under 40%. The Enhanced Bond Fund is therefore suitable for risk averse investors seeking consistent positive performance.

The **Diversified Hedge Fund** has also demonstrated its ability to produce positive returns in a falling market. Last year this fund returned 6.5% (Sterling version) and 6.9% (US Dollar version) and it has continued to hold up well so far this year resulting in an outperformance of the world index of approximately 35% since the start of 2000.

The **Sterling Managed Portfolio Fund** is our newest fund and it is based upon the traditional equity and bond portfolios which we have been successfully managing for clients for a number of years. Although this fund will inevitably suffer when equity markets are weak, the ability to actively manage the bond and equity content (asset allocation) and select individual shares which represent good long term value, allows the fund to manage the risk and restrict losses. The fund is down 2.6% so far this year compared to losses of at least 10% or more for most major equity markets indices and funds. The Managed portfolio Fund is therefore suitable for long term investors seeking capital growth with a lower risk than pure equity alternatives.

Company establishment and administration

Heritage Trust in Guernsey has for many years been establishing and administering offshore companies for Heritage clients. The company structure allows a fully independent means of conducting a client's international business affairs in a tax efficient manner as well as the protection, preservation and enhancement of property and investments. Typical uses of such companies include holding investment portfolios or other assets such as property or intellectual property rights, international trading and financing activities and providing employment and consulting services.

Recently there have been a number of favourable changes to the business environment for companies in the UK and in particular the reduction of the small companies tax rate from 25% a few years ago to a starting rate of just 10% today. This has resulted in an increased interest in establishing UK companies and this is now something which we are able to offer from Heritage Capital Management in London.

Heritage Capital Management Limited

Review for the quarter ended 31 March 2001

Market Commentary

After last year's poor performance from all the major equity markets many investors were hoping that this was just a minor correction and hopes were for a quick recovery and a continuance of the long running bull market. However, 2001 has got off to a terrible start with most markets now down at least 20% from their previous highs and a general acceptance that we are now in a genuine bear market.

With the outlook for earnings deteriorating in the face of an impending US led recession, PE ratios still remain quite high by historic standards and in the current negative climate there is certainly a risk of further falls. However, there is also a risk that investors could miss out on good returns as the markets begin to anticipate the inevitable recovery. Trying to pick the bottom of the market is extremely difficult and studies show that on average the first six months of equity recovery from a recession bear market typically achieves 50% of total returns for three years.

In the **UK,** the FTSE 100 continued its decline, falling by by a further 9.5% in the first quarter of 2001 and is now down approximately 20% since its peak at the end of 1999. Whilst last year's falls were mainly due to the bursting of the overvaluation bubble within the technology and telecoms sectors, the recent falls have spread to all areas of the market including defensive sectors and small and mid cap companies which had previously been holding up quite well.

The much anticipated interest rate cuts have finally started to take place with a 0.25% decrease in February and a further 0.25% just after the quarter end taking base rates to 5.5%. Although domestic demand within the UK economy continues to be reasonably robust the external environment is certainly deteriorating rapidly and further rate reductions may still be required.

The **US** market was down by 11.90% in the first quarter of 2001 with losses worst in the technology sector with the Nasdaq now down approximately 60% since its high just over a year ago. Sentiment has changed dramatically since then with attention now focussed on the seemingly endless stream of corporate profit warnings and talk of how long and how deep the recession will be.

Despite all these problems the US Dollar continues to be surprisingly strong, but it may come under pressure at some point this year as the trade deficit remains extremely high and US interest rates, which have already come down from 6.5% at the start of the year to 5% today, continue to fall.

Europe, fell along with the other major markets ending the first quarter down nearly 12%. The European Central Bank is the only major central bank not to cut interest rates so far this year but hopes that Europe will be able to avoid a US led world-wide economic slowdown seem over-optimistic. However, without the trade deficit of the US or the government deficit of Japan, Europe is potentially best placed of the major economies to capitalise on its positive aspects. These include its new found economies of scale arising from the implementation of the Euro and the introduction of a more business friendly environment including for example tax cuts and privatisations.

Japan started the year by falling even more sharply than the major Western markets with the Nikkei falling below 12,000 to a fifteen year low, with a weakening Yen and seemingly no end in sight to its long running economic and political woes. However, a sharp recovery late in the quarter following a return to the zero interest rate policy actually made Japan the best performer of a bad bunch so far this year.

Many **emerging markets** have also held up surprising well considering the turmoil in the major markets, although the riskiness of investing in a single emerging market country was again highlighted by the recent Turkish crisis.

Investment Statistics - 31/3/01

Equity Markets	Q1 2001	2000	1999
Global - MSCI World ($)	-13.10%	-14.05%	23.56%
UK - FTSE 100	-9.46%	-10.21%	17.81%
US - S&P 500	-11.90%	-9.31%	20.74%
Europe - FTSE Eurotop 100	-11.59%	-3.82%	33.46%
Japan - Nikkei 225	-5.70%	-27.19%	36.79%
Emerging Mkts - MSCI EM ($)	-5.62%	-30.00%	66.18%

Source : Micropal

Other	UK	US	Europe	Japan
Interest rates - base	5.75%	5.00%	4.75%	0.00%
Interest rates - 10 year	4.85%	5.02%	4.70%	1.35%
Exchange rates (vs GBP)	-	1.4217	1.6082	178.16
Exchange rates (vs USD)	1.4217	-	0.8840	125.32
Gold ($ per ozs)		272.85		

Source : FT

Managed Portfolio Fund

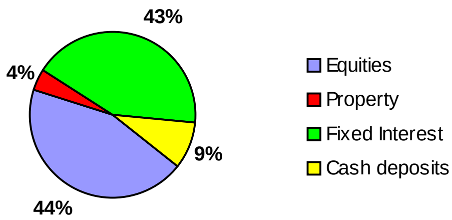
The fund's **objective** is to generate long term capital growth through actively managing a well balanced and diversified portfolio including equities and fixed interest securities.

Price at 31/3/01	£ 96.78
Return for Q1 2001	-2.61%
Fund currency	£ Sterling
Size of fund (millions)	£ 3.1m

The fund was launched on 1/12/00 and is based on the private client portfolios which Heritage has been successfully managing for a number of years.

Performance – The fund fell by 2.61% during the quarter as a result of the severe weakness in equity markets. However, the fund's defensive positioning and the relative outperformance of the equity holdings meant that it has held up relatively well compared to falls of 10% or more in both the UK and other major equity markets.

Managed Portfolio Fund Asset Allocation



Commentary - The fund is currently reasonably defensively positioned with less than 50% in equities.

UK equities account for 29% with the majority of this invested directly in a fairly concentrated portfolio of UK companies selected on a "bottom-up" stock picking approach based on fundamental analysis and research.

International and specialist equity funds account for 18% of the fund. This is spread fairly evenly between the major equity markets of the US, Europe and Japan with a small amount also allocated to other minor markets and sector specialist equity funds.

Although most of the equity based holdings did fall along with the markets generally, there were a few positive contributions from both companies, such as BAA and Lex Service, and funds such as North American Smaller Companies IT, Gartmore Irish Growth Trust and Invesco Asia IT.

The property investments added a positive contribution during the quarter. Exposure is through a listed UK property company and a specialist property investment trust both of which currently are trading at a discount to their underlying net asset value.

The fixed interest part of the fund's primary aim is to provide stability of capital with a fixed yield and also to assist in the reduction and management of risk. Exposure is mainly spread between highly rated Sterling eurobonds with an average yield to maturity of approximately 5.5% and zero dividend preference shares with an average yield of over 7%.

Heritage Investment Fund Limited
Absolute Return Funds

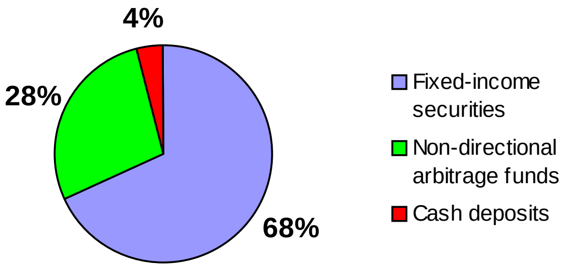
Performance for the quarter ended 31 March 2001

Performance

	Sterling Enhanced Bond Fund	**US Dollar Enhanced Bond Fund**	**Sterling Diversified Hedge Fund**	**US Dollar Diversified Hedge Fund**
Risk profile	Low	Low	Moderate	Moderate
Minimum investment horizon	1 year	1 year	3 years	3 years
Target annual return	Bank deposits + 3%	Bank deposits + 3%	Bank deposits + 6%	Bank deposits + 6%
Typical range of returns	5% - 8%	5% - 8%	7% - 11%	7% - 11%
Price at 31 March 2001	£125.67	US$116.47	£98.90	US$101.99
Quarterly return (net)	1.7%	2.0%	1.2%	1.0%
2000 return (net)	9.6%	9.7%	6.5%	6.9%
Annual volatility	0.9%	0.8%	3.5%	3.4%
Size of Fund (millions)	£19.9	US$10.0	£3.8	US$2.5

Asset Allocation

Enhanced Bond Funds

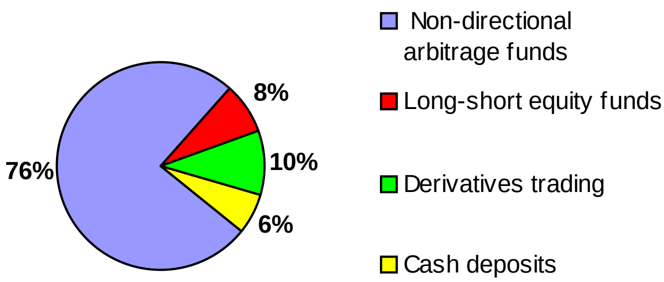


The core of our Enhanced Bond Funds is invested in a diverse spread of high-quality, short-dated AAA/AA bonds, with not more than 5% allocated to any one issuer. The Sterling and US Dollar bond portfolios currently yield 5.4% and 4.8% per annum to maturity, and have net average durations of 1.2 and 1.1 years respectively. This return is augmented, where considered appropriate, by limited exposure to interest rates and currencies using derivative instruments.

We seek to further enhance the return of the Funds by modest exposure to a portfolio of 9 investment funds following non-directional arbitrage strategies, which have a low correlation to equity and bond market movements. Each holding is restricted to approximately 3% to limit specific risk. These funds gained 2.7% for the quarter in line with expectations.

Both Enhanced Bond Funds have continued to produce positive monthly returns for the quarter, despite the volatile market conditions.

Diversified Hedge Funds



The allocation between non-directional arbitrage strategies/cash and directional strategies is currently 82:18. The core non-directional arbitrage strategies are intended to underpin the portfolio returns and limit losses in the event of equity markets falling. The directional strategies have the potential to generate higher returns when equity markets are performing. Individual fund holdings are limited to approximately 7%.

The overall quarterly performance of the 12 core non-directional arbitrage funds of 2.3% was much in line with expectations. The directional long-short equity funds (which have been reduced from 20% exposure at the end of the previous quarter) lost a disappointing 11.5% during a difficult quarter for equities, but derivatives trading continued its impressive gains with a 5.5% average return.

After a good start to the year in January, the Diversified Hedge Funds struggled to make significant progress in February and March, during a volatile quarter when global equity markets fell by approximately 13%.

The detailed composition of the Enhanced Bond and Diversified Hedge Fund portfolios is available to investors upon request.

The Future of the Euro

From its inception on 1 January 1999 amidst great euphoria, the Euro has fallen by 25% against the US Dollar and by 12% against Sterling. At its launch, it was hailed as an alternative global reserve currency to match the US Dollar. The original 11 participating countries were joined by Greece at the beginning of this year. However, almost from the first day of its launch, the Euro fell against the major international currencies, reaching its low of .82 against the US Dollar in October 2000. From this low, the Euro appreciated to .95 in mid-January 2001, prompting speculation that 2001 was to be the year of the Euro and that the worst was behind it.

However, by the end of March 2001, the Euro had fallen back to .88 against the US Dollar and looked like it might test its all-time low. In contrast with the international concern over the weakness of the Euro last year, culminating in G7 central bank intervention, Euro-zone policymakers appear unconcerned this time around. One of the reasons for this is that it is more US Dollar strength rather than Euro weakness that has depressed the exchange rate. In fact, viewed on a trade-weighted basis, the Euro is only down slightly from the beginning of the year.

Like any commodity, currencies are largely affected by supply and demand. Investment capital has continued to flow out of the Euro-zone at an alarming rate, principally into the US. This US investment has continued, despite the slowdown in the US economy, as there is a perception that the aggressive interest rates cuts by the US Federal Reserve this year could mean that the US will recover more quickly than the other world economies. Indeed, the failure of the European Central Bank up to now to cut interest rates has caused concern about projected Euro-zone economic growth and cast a shadow over the Euro. There is also evidence that US investors, who became involuntary holders of European equities when US companies were taken over by European ones, have been selling such shares, putting more pressure on the Euro. European pension funds, freed from their previous restrictions on where they could invest, are also diversifying their portfolios internationally.

All this adds up to significant selling pressure on the Euro, making it difficult for the Euro to appreciate significantly against the US Dollar. This may possibly change if the European Central Bank reduces interest rates, thereby protecting Euro-zone growth rates and European growth manages to exceed that of the US.

A word of warning about hedge funds

We are becoming increasingly concerned about the significant number of hedge funds which have recently been launched. This has largely occurred in response to the steep falls in equity markets, as investment houses seek alternative products insulated from the vagaries of the stockmarket into which to switch investors. Hedge funds have the ability to limit their downside, and even generate gains in falling markets, by their ability to sell securities short. A number of new hedge fund managers only have previous experience in investing on the long side, with little experience of selling securities short, whilst others are completely unknown with no previous track records.

There are a limited number of hedge fund strategies (eg. merger arbitrage, convertible bond arbitrage, long-short equity, etc) and many of these strategies cannot accommodate an unlimited quantum of funds. In the case of arbitrage strategies, in particular, the spreads from which the returns are generated have narrowed considerably and this is making it more difficult for managers to maintain the level of the returns they have earned in previous years. This may even prompt some managers to take on more leverage and other forms of risk in the hope of maintaining past returns.

Many of the new hedge funds being launched are funds of funds, which invest in other hedge funds. This has resulted in a scramble to invest with the best managers and an increasing number of those managers with sound long-term track records have closed their funds to new, and sometimes even existing, investors. Some are locking investors in for longer periods and restricting redemptions from their funds, thereby severely restricting liquidity.

We have tried to steer clear of these problems in our Diversified Hedge Funds, by focusing on investing in a well-diversified spread of the lower-risk arbitrage strategies, with managers who are well-known in the industry and have exceptional long-term track records. However, we feel it prudent to appraise investors of the potential problems currently inherent in hedge fund investment, despite the benefits of generating positive absolute returns when equity markets are falling. For those investors who are concerned about these potential risks, we do offer as an alternative our Enhanced Bond Funds, which largely comprise fixed-income securities enhanced by much more modest exposure to non-directional hedge funds, or our Managed Portfolio Fund, which follows a more traditional long-only approach to equity and fixed-income investment.

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