Quarterly
Newsletter & Investment Review

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Heritage

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2001 - another good year for Heritage

The past year has seen a continuation in the sharply contrasting fortunes of the Heritage Investment Fund compared to global equity markets generally. Whilst the World Index fell another 16% in 2001 and is therefore down by approximately 30% since the beginning of 2000, the Heritage Investment Fund has achieved total investment growth of just under 15% over this same period. The Fund is made up of 5 sub-funds which allows investors to achieve a broad diversification in terms of both asset classes and individual investments. Our conservative style has led us to concentrate on achieving consistent absolute returns, predominantly through the use of bonds and hedging techniques, compared to many investment companies who place a much greater emphasis on equities. Further details of the Fund's performances and asset allocations can be found on page 3.

Target returns for 2002

The past decade of abnormally high investment returns and excessive market volatility, has led to inflated expectations amongst investors about what return is achievable in the long-term. Too much money has been chasing insufficient attractive investment opportunities, which has led to more frequent market booms and bubbles, with almost everyone buying the dips.

With the substantial reduction in short-term interest rates over the past year in the UK, US and Europe, supported by some of the lowest inflation statistics in decades, it is appropriate to temper investors' return expectations for the year ahead. After 11 interest rate reductions during 2001, the US Federal Funds rate currently stands at 1.75% per annum. With less drastic rate reductions, the present UK base rate has been lowered to 4% per annum, whilst the European Central Bank rate is now 3.25% per annum.

Our Enhanced Bond and Diversified Hedge Funds target absolute returns, irrespective of the performance of equity markets. We seek to achieve a net margin over short-term bank deposit returns for these Funds, after management fees and costs. For our Enhanced Bond Fund, this margin is 2% over short-term bank deposit rates, which translates to a target net return of 5.75% per annum for Sterling and 3.5% per annum for US Dollars. These returns may appear modest in the light of bank deposit rates in past years, but they represent a substantial percentage increase over the rates that are currently available for secure investments. Our Diversified Hedge Funds target a margin of 5% over short-term bank deposit rates, giving net targets of 8.75% and 6.5% per annum for Sterling and US Dollars respectively.

Investors will appreciate that the above target returns are indicative only and that there is no guarantee that they will be achieved over the coming year. As you will be aware, past performance is no guarantee of future performance and the value of investments can fall as well as rise.

Heritage Capital Management Limited

Review for the quarter ended 31 December 2001

Market Commentary

Global equity markets rallied strongly towards the end of 2001 with gains of around 10% for the final quarter. However, overall 2001 has been another bad year for equity investors with the World Index down by 16%, coming on top of a similar loss in 2000. This is the first time since 1974/75 that equity markets have fallen for two consecutive years and investors will no doubt be hoping for a better year in 2002 so that we can avoid the possibility of three consecutive down years – an event not seen since the early 1930s depression.

The problem is that despite the market weakness, valuations have not really improved, as falling share prices have been matched by falling company profits. In fact, current PE ratios for the major markets of 20 or more are still much higher than the valuations seen at previous bear market bottoms when PE ratios have often fallen to single figures.

Furthermore, the sharp 4th quarter rally means that investors have to a large extent already priced in a healthy economic recovery which may in reality be weaker and may take longer in coming than many are expecting.

All this means that although markets may indeed fare better in 2002 than they have done over the last two years, there is little reason to believe that we are in for a return to the heady days of the late 1990's bull market.

United Kingdom

In the UK the FTSE 100 index ended the year down 16.2% - its worst ever annual performance. However, during the 4th quarter, UK fund managers have appeared to shrug off the bad news, including a number of profit warnings, corporate failures such as Railtrack and the high profile news of the wholesale switch out of equities into bonds by the Boots pension fund.

The main reasons for retaining confidence in the UK is that consumer spending continues to be holding up robustly for now with retailers in particular having appeared to have enjoyed a good Christmas, and that the UK economy is currently probably the best performing of the major G7 countries.

United States

Now that the US is officially in recession the big questions for all investors are how long will it last and how strong will the recovery be when it arrives. The Federal Reserve has certainly taken very aggressive action in order to try and stimulate a recovery with interest rates now reduced to just 1.75% which has resulted in a strong liquidity driven market rally since the September lows.

Conversely, these cuts in short rates and the resultant optimistic outlook for economic recovery implied by the equity markets have made longer bonds better value and the yield on the 10 year US Treasury bond has recently risen sharply, to over 5%.

Europe

Although Europe was the best performing major market in the final quarter of 2001 it finished the year behind the US and UK with a fall of over 18%.

January 1st 2002 marked the historic introduction of Euro notes and coins for the twelve participating European Union countries, although it remains to be seen whether becoming a physical reality will stimulate a recovery in the Euro's ailing fortunes.

Japan

Although Japan also enjoyed a modest bounce in the 4th quarter it was actually the worst performing major market in 2001 as its economic woes continue to worsen and the weakening Yen has further increased the losses suffered by international investors.

Emerging Markets

Emerging markets continue to demonstrate that there are considerable economic and political risks associated with investment. Argentina has recently managed to have 5 different presidents in the space of just two weeks to go with a currency devaluation and Southern Africa has been afflicted by the problems in Zimbabwe and a tumbling South African Rand.

Investment Statistics - 31/12/01

Equity Markets	Q4 2001	2001	2000	1999
Global - FTSE World ($)	9.19%	-16.20%	-14.05%	23.56%
UK - FTSE 100	6.40%	-16.15%	-10.21%	17.81%
US - S&P 500	10.29%	-13.04%	-9.31%	20.74%
Europe - FTSE Eurotop 100	10.83%	-18.64%	-3.82%	33.46%
Japan - Nikkei 225	7.86%	-23.52%	-27.19%	36.79%

Source : Financial Times

Other	UK	US	Europe	Japan
Interest rates - base	4.00%	1.75%	3.25%	0.00%
Interest rates - 10 year	5.07%	5.03%	5.01%	1.35%
Exchange rates (vs GBP)	-	1.4554	1.6346	190.75
Exchange rates (vs USD)	1.4554	-	0.8904	131.06
Gold ($ per ozs)		276.80		

Source : Financial Times

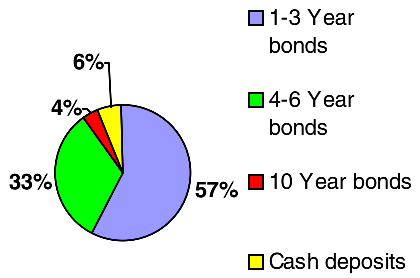
Heritage Investment Fund Limited

Performance for the year ended 31 December 2001

Performance

	Enhanced Bond Funds		Diversified Hedge Funds		Managed Portfolio Fund
Risk profile	Low		Moderate		High / Moderate
Minimum investment horizon	1 year		3 years+		3 - 5 years+
Target annual return	Bank deposits + 2%		Bank deposits + 5%		10%+
Typical range of returns	4% - 7%		3% - 9%		-5% - +15%
Price at 31 December 2001	£130.49	US$120.08	£104.66	US$106.70	£92.23
Return for Quarter (net)	0.64%	0.06%	2.49%	2.09%	5.23%
Year 2001 return (net)	5.56%	5.16%	7.03%	5.64%	-7.19%
Year 2000 return (net)	9.59%	9.66%	6.53%	6.89%	-0.6% (1 month)
Annual volatility	1.1%	1.5%	2.5%	1.8%	15.3%
Size of Fund (millions)	£25.3	US$12.8	£3.5	US$2.3	£4.2

Enhanced Bond Funds

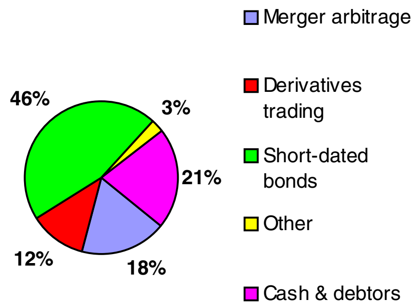


Our Enhanced Bond Funds are invested in a diverse spread of high-quality AAA/AA bonds, with not more than 5% allocated to any one issuer. The Sterling and US Dollar bond portfolios currently yield 4.8% and 3.9% per annum gross to maturity, and have average durations of 2.3 and 2.7 years respectively.

This quarter proved to be one of the worst periods for fixed-income securities in recent decades, with 5 and 10 year UK and US government bond yields rising in the last 2 months of the year to the levels of 12 months ago. The US bond market was particularly depressed in the light of market expectations of an economic recovery and a consequent bouyant equity market. Fortunately, our interest rate and currency hedges ensured that we were protected against most of these losses.

As a result, both Enhanced Bond Funds underperformed cash deposits for the quarter, but have still generated net returns for the year a few percent ahead of cash deposit rates.

Diversified Hedge Funds

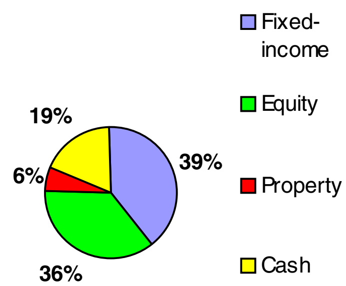


The Diversified Hedge Funds focus on non-directional investment strategies, which have the potential to perform irrespective of the direction of equity and bond markets. This is achieved by investing partly with third party managers and/or employing our own in-house proprietary investment strategies.

The percentage invested with outside managers has been reduced to 33% on concerns about transparency and liquidity. We are, accordingly, increasing the Funds' exposure to in-house derivatives strategies. These strategies employ futures and/or options on equity indices, government bonds and currencies, which are an efficient, transparent and highly liquid method of gaining controlled exposure to markets. As these positions require limited cash and margin outlay, the balance of funds is being invested in high quality, short-dated bonds to provide underlying income for the Funds.

Both Diversified Hedge Funds generated pleasing returns for the quarter, with the performance for the year being well ahead of cash and equity market returns.

Managed Portfolio Fund



The Managed Portfolio Fund had a good final quarter, appreciating by 5.2%. The overall loss for the year of 7.2% is disappointing, but against a background of the weakest equity markets for over 25 years (with the World Index down by over 16%) the Fund has actually held up reasonably well.

The good performance for the current quarter can be attributed to:
- The continued recovery in global equity markets generally.
- A strong performance by the fund's individual equity holdings, particularly small caps in which we remain overweight.
- A good performance by the Zero Dividend Preference shares.

The corporate bonds on the other hand, had a relatively poor quarter as yields rose sharply.

In terms of portfolio strategy, we have been sceptical about the sustainability of the recent sharp rally in equity markets and have taken the opportunity to lighten up on some positions to protect against, and take advantage, of any future weakness.

The detailed composition of the Fund portfolios is available to investors upon request.

Individual investment accounts

We have recently had a few clients who were unaware that they were are able to open individual investment accounts with Heritage in their own name, in addition to existing offshore trust or company portfolios.

It is therefore worth pointing out that a large proportion of the funds that we manage are held in personal accounts as there are often considerable benefits. For example:

1) South African residents can now invest up to R750,000 each in an offshore account – an allowance that has been well worth utilising considering the recent plight of the Rand. For most other countries (e.g. the UK) there are no limits as to how much can be invested offshore.

2) Investment in our offshore "roll-up" fund has considerable tax benefits for individual investors, as all income and gains are rolled up within the fund so that there is no tax to pay or account for on an annual basis. Further tax planning opportunities may also arise when the holding is finally sold.

3) Unlike many other financial advisors and fund managers offering investment services, we at Heritage do not impose, what we consider, unjustifiable initial and redemption charges (usually in the range of 3-5%) on funds received for investment.

Please contact us if you would like any further information or an application form to open an individual account.

A word of warning about Capital Guaranteed Products

Capital guaranteed products ("CGP") are packaged products that provide an exposure to stock market gains, whilst guaranteeing no loss of original capital. They are created by sacrificing some of the potential equity market gain in order to provide downside protection. There is a wide range of available CGP which provide varying market exposure and guaranteed returns. Many investors have become risk averse as a result of the fall in equity markets over the past two years and, with interest rates at low levels, the combination of equity participation and capital protection appears attractive.

In its simplest form, the CGP is constructed by combining a zero coupon bond and a call option with the same term. The bond provides the capital guarantee and the call option provides the stock market exposure. The greater the level of principal protection required, the lower the level of equity participation. In a rising equity market, the returns you receive will be less than those you would have received if you had invested directly in the market. However, the age-old rule applies to CGP - you do not get anything for nothing!

Low bond yields reduce the amount available to buy options and higher market volatility makes options more expensive. There have been cases of CGP being terminated early and returning the funds to investors as they have been unable to provide the level of equity market exposure originally promised. The fine print in the prospectus of a typical CGP permits the directors to redeem investors' shares early, in which case the guarantee does not apply. A significant drawback is that you have to hold the investment until maturity, which is typically 5 to 10 years, to qualify for the guarantee protection.

One of the main problems with CGP is that at the time when the guarantee is needed most (ie when markets are falling), the cost of the guarantee is so high that it reduces any potential gains if equity markets appreciate. Furthermore, over the typical lock-in period of 5 to 10 years for a CGP, the equity market has a tendency to correct itself - in which case the guarantee is less necessary.

In practice, you could create the same effect as a CGP yourself by investing in our low-risk Enhanced Bond Fund to protect your capital and utilising the annual return generated by this Fund to purchase call options on the equity market of your choice, which we can easily arrange. The call options will provide you with equity market exposure and will increase in value should equities appreciate. However, should equities fall in value over the option period, the maximum you stand to lose is the option premium paid. The major benefit would be that you would not be locked into a CGP for 5 to 10 years and would have monthly liquidity on your investment without early redemption penalties.

Heritage

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