Quarterly
Newsletter & Investment Review

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In this issue

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Difficult start to the year for Investors

It has been a difficult start to the year for investors as equity markets have failed to make any real progress and bond prices have fallen as interest rates have started to turn upwards. However, we are pleased to report that despite this, overall the Heritage Investment Fund has had another steady quarter with the Enhanced Bond Funds and Diversified Hedge Funds in particular doing well to produce positive returns in excess of cash deposit rates.

Funding your retirement - an alternative view

Pension problems have been in the news again recently. For some time now most people have realised that they cannot rely on the state to adequately fund their retirement. To a large extent this role was taken over by employers who would typically establish and contribute to a general pension fund which would allow a pension income to be paid to retired employees based on a percentage of their final salary. However, falling equity market returns, the imposition of tax on dividends in pension funds and a new accounting standard which highlights the potential liabilities arising from offering final salary schemes have led many companies to close such schemes and switch to offering a “defined contribution” pension.

The current situation means that the investment risks and the responsibility for ensuring that a sufficient amount of earnings are saved and invested to produce a capital sum which can adequately fund retirement has been forced from the state and employers onto the individuals themselves. Although there are still good reasons to persevere with a pension as the primary source of funding retirement (such as tax breaks on contributions and contributions from employers), there are a number of drawbacks. For example, pensions are very heavily regulated by the government, which makes them highly inflexible. Although the fund may legally belong to you the state will not let you access it until you have reached the state imposed retirement age. Furthermore, once retired, a pension income must be drawn and this income is taxed at the normal income tax rates. Perhaps worst of all, however, is the requirement to use the capital sum accumulated in a pension fund to purchase an annuity from an insurance company, thereby taking away control of the investments and the ability to pass on the fund to the next generation in a way that might otherwise be possible. Traditional pensions managed by large life assurance companies are also notoriously opaque and most individuals have very little idea of how their pension is being invested or what charges are being levied.

It is for the above reasons that many of our clients have decided that building up an alternative retirement fund or “nest egg” is a sensible strategy. For example, our own funds offer a good vehicle for such savings, as all income and gains can be “rolled-up” gross within the fund indefinitely, which makes it very simple and tax efficient. On retirement an “income” can be drawn which will be partly treated as a return of capital - which results in a much lower effective tax rate on the “income”. Furthermore, the investment is totally flexible with full or partial access to your capital available at any time during or even before retirement. The investment strategy is also easily understandable and can be discussed on a regular basis with an individual whom you know and trust, to ensure that it remains suitable for your changing circumstances, and finally the charges are both reasonable and transparent. Although we are not pensions advisors, we would of course be most happy to discuss implementing such a supplemental retirement plan in more detail if required.

Heritage Capital Management Limited

Review for the quarter ended 31 March 2002

Market Commentary

Global equity markets ended the first quarter of 2002 broadly flat. The lack of any clear directional trend in the market is due to the balance of opposing factors which investors are currently weighing up.

On the one hand, there do now appear to be signs of economic recovery in the world's major economies. Also, with interest rates still at historically low levels the resultant liquidity is providing an additional boost to the markets.

However, despite the bullish points above there are a number of bearish factors holding the major indices back. Although there are signs of economic recovery it is still too early to conclude that we can now look forward to a strong and sustainable recovery and the risk of further setbacks remain. Also, any economic recovery would be accompanied by higher interest rates which would make it difficult for equity markets to progress strongly. Perhaps most importantly though, is the fact that equity market valuations remain very high. The strong equity rally in the final quarter of last year, which has not as yet been followed by higher corporate earnings has pushed PE ratios back to the level that they were at their "bubble" peak of a couple of years ago.

Overall then, although equities may rally further based on favourable short term cyclical factors, there are still many reasons to be cautious. These concerns are likely to prevent a return of the double digit annual capital gains which were a regular feature of the late 1990's bull market.

United Kingdom

In the UK the FTSE 100 index ended the quarter marginally up (1.0%). Compared to other major equity markets, the relatively defensive nature and higher-yield characteristic of the UK market, have together with a reasonably resilient economy, made the UK a safer haven in the recent downturn. Of course, these factors could leave the UK lagging behind other less defensive markets in the event of a general world-wide recovery.

With domestic consumer spending remaining strong, the likelihood is that interest (base) rates, which are currently 4%, have reached their low point for the current cycle and that we can expect rates to be higher by the end of the year. However, with inflation remaining well under control it is unlikely that rates will have to rise dramatically and the economy should be able to avoid the damaging "boom-bust" nature of previous cycles.

United States

The US market was flat in the first quarter, with the S&P 500 index down just -0.1%.

The major event of the quarter was the Enron scandal, where the once highly regarded energy company collapsed amid a variety of accounting and other irregularities. In addition to the obvious losers such as the shareholders, employees and the auditors (Arthur Andersen), the knock-on effects have been widespread. In particular, from the investor's point of view, question marks are now being raised about the quality and reliability of the reported earnings figures and corporate governance standards in general.

On the interest rate front, with short US Dollar rates at just 1.75%, the Federal Reserve Bank has finally signalled that further cuts are unlikely and it is now more a question of how far and how fast rates will rise later this year.

Europe

The European market too was broadly flat this quarter, with the Eurotop 100 index up just 0.1%.

The introduction of physical Euro notes and coins for the citizens of the twelve participating European Union countries appears to have been implemented relatively smoothly and there have recently been some encouraging signs of economic recovery.

Japan

Japan was the only major market to make any progress during the quarter with the Nikkei index finally registering a 4.6% gain, after being down by over 10% at one point. This was due to some evidence that the current downturn has now bottomed, but with the longer term structural problems remaining largely unsolved, there remains little scope for further optimism.

Emerging Markets

Emerging markets also generally had a good start to the year with Asian markets in particular enjoying a strong rally. The combination of reasonable valuations and the prospect of good earnings growth make this region currently one of the most attractive, for less risk averse global investors.

Investment Statistics - 31/03/02

Equity Markets	**Q1 2002**	**2001**	**2000**	**1999**
Global - FTSE World ($)	0.13%	-16.20%	-14.05%	23.56%
UK - FTSE 100	1.04%	-16.15%	-10.21%	17.81%
US - S&P 500	-0.06%	-13.04%	-9.31%	20.74%
Europe - FTSE Eurotop 100	0.10%	-18.64%	-3.82%	33.46%
Japan - Nikkei 225	4.57%	-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	5.30%	5.46%	5.32%	1.34%
Exchange rates (vs GBP)	-	1.4240	1.6323	188.73
Exchange rates (vs USD)	1.4240	-	0.8724	132.53
Gold ($ per ozs)		302.5		

Source : Financial Times

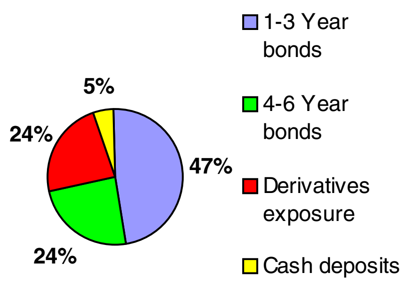
Heritage Investment Fund Limited

Performance for the year ended 31 March 2002

Performance

	Enhanced Bond Funds		Diversified Hedge Funds		Managed Portfolio Fund	
Risk profile	Low		Moderate		High / Moderate	
Minimum investment horizon	1 year +		3 years+		5 years+	
Target annual return	Bank deposits + 2%		Bank deposits + 5%		10%+	
Typical range of returns	4% - 6%		3% - 9%		-5% - +15%	
Price at 31 March 2002	£131.79	US$121.04	£106.70	US$107.98	£91.87	MSCI Index
Return for Quarter (net)	1.05%	0.85%	2.14%	1.46%	-0.38%	1.87%
Year to date return (net)	1.05%	0.85%	2.14%	1.46%	-0.38%	1.87%
Year 2001 return (net)	5.56%	5.16%	7.03%	5.64%	-7.19%	-15.11%
Year 2000 return (net)	9.59%	9.66%	6.53%	6.89%	-0.6% (1 mth)	-7.11%
Annual volatility	1.1%	1.5%	2.5%	1.7%	13.7%	17.9%
Size of Fund (millions)	£25.6	US$12.9	£3.9	US$2.8	£4.7	

Enhanced Bond Funds

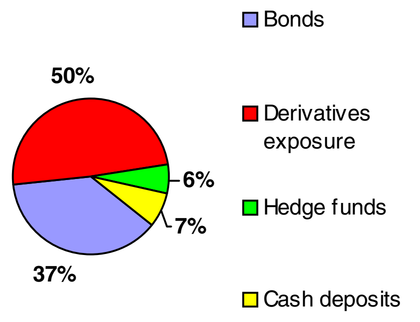


The Enhanced Bond Funds are invested in a diverse spread of high-quality AAA/AA bonds, with not more than 5% allocated to any one issuer. The Sterling and US Dollar bond portfolios currently yield 5.1% and 4.1% per annum gross to maturity, and both have average net durations of 0.1 years.

It was a difficult quarter for fixed-income securities, with Sterling and US Dollar bonds yields rising by between 0.25% and 0.50%, resulting in a fall in capital values ranging from -1% to -3%. We were able to mitigate the effect of most of these losses by prudent hedging of the interest rate exposure of our bond portfolios. The fixed-income returns were further enhanced by limited exposure to interest rate derivatives.

Both Enhanced Bond Funds produced satisfactory returns for the quarter slightly ahead of cash deposits.

Diversified Hedge Funds

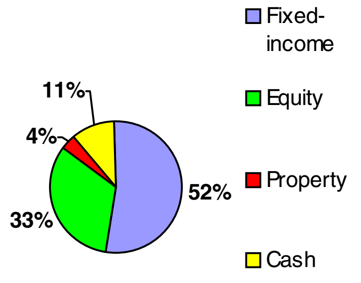


The Diversified Hedge Funds focus on non-directional investment strategies, which have the potential to perform irrespective of the direction of equity and bond markets. This is principally achieved by employing our own in-house proprietary investment strategies using derivatives and by limited investment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

Our in-house derivatives exposure is predominantly centred around equity index positions, based on our views on likely future market volatility and direction. As these positions require limited cash margin outlay, the balance of funds is invested in high quality AAA/AA bonds to provide underlying income for the Funds. The modest percentage invested with outside hedge fund managers is limited to a number of experienced derivatives trading funds.

The Diversified Hedge Funds generated pleasing returns for the quarter much in line with our targets, being well ahead of cash deposits.

Managed Portfolio Fund



The Managed Portfolio Fund has struggled to make any progress so far this year, ending the first quarter marginally down (by 0.38%) against a background of broadly flat global equity markets and a weak bond market.

The performance of the fund's equity holdings was mixed, although on the positive side, the number of individual company holdings rising outnumbered the fallers by a ratio of two to one and our overweight position in the Asia/Pacific region performed well.
The fixed interest part of the portfolio was held back due to the combination of rising interest rates and a widening of spreads on zero dividend preference shares. Fortunately, our analysis has enabled us to avoid the numerous poorer quality issues and we have used the opportunity to build a well covered portfolio of zeros on attractive yields.

In terms of portfolio strategy, we continue to maintain a fairly defensive asset allocation and seek to invest in simple, profitable companies with solid finances and good prospects on reasonable valuations.

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

Benefits of Regulation

There is no doubt that over the last few years there has been a world-wide trend towards increased regulation of financial services and investments. Complying with the UK's regulatory environment is an onerous requirement for firms such as ourselves, but we believe that it does provide a comforting level of assurance and protection to our clients.

Heritage Capital Management now falls under the supervision of the UK's new all encompassing financial services regulator, the FSA (Financial Services Authority). The following are important examples of how regulation provides protection to investors;

Qualified individuals – in addition to the company itself being regulated, those individuals with responsibility for the management and administration of client investments are personally registered with the FSA and must obtain benchmark investment qualifications and then maintain a programme of continuing professional development. At Heritage our investment managers have gone beyond the basic requirements to obtain the top qualifications attainable.

Compliance procedures – in order to become authorised to conduct investment business we need to comply with a number of rules and regulations laid down by the FSA. Important aspects are ; client cash and investments must be segregated from company funds in specially designated client accounts; regular reconciliations of client cash and investments to banking and custodian accounts must be performed, and the appointment of a Compliance Officer who has responsibity for ensuring that all the correct systems and procedures are properly followed is required.

Financial strength – for those investment managers, such as ourselves, who are authorised to manage investments and hold client cash there are also strict capital adequacy rules. This requirement to have a strong balance sheet is designed to ensure that the company has stability and can continue to operate and manage investments without running into financial difficulty.

Audit – as well as regular quarterly returns to the FSA, our business is also subject to an annual independent regulatory audit of both our accounts and our compliance systems and procedures.

Professional Indemnity Insurance – this is a mandatory requirement for all regulated firms and provides an additional level of assurance to investors in the unlikely event of problems arising due to negligent errors, omissions or fraud.

Overall, the UK regulatory environment is widely acknowledged as being one of the most rigorous and effective in the world. Our clients can take comfort from the fact their investments are being handled by an organisation and individuals operating within this environment, whilst still maintaining the option of taking advantage of the flexibility, taxation benefits and confidentiality afforded by "offshore" investing.

Potential changes to domicile laws in the UK

In order to attract foreign talent to work in the UK, the government has long had a policy of only taxing foreigners, who are resident but not domiciled in the UK, on their income and capital gains arising in or brought into the UK. This concession allows foreigners to legitimately accumulate assets offshore free of tax. This long-standing arrangement is now under threat.

The concept of domicile is unusual as a basis for worldwide taxation, as most countries purely use residence as a basis for taxation, sometimes with some exemptions. Your country of domicile may be different to your country of residence. Everyone has a domicile of origin at birth, which is usually determined by their father's domicile. This domicile only changes if you subsequently decide to make your permanent home in another country. You can only have one domicile at any one time. Your domicile is not necessarily changed by virtue of you residing in another country or even holding the passport of that other country.

In response to Inland Revenue findings, the Treasury is considering changing the rules on domicile. A consultation paper is to be issued later this year, which is likely to recommend maintaining the tax exemption for non-domiciled foreigners staying in the UK for up to 4 years, but abolishing it for longer-term residents. At present, inheritance tax is treated differently and non-domiciled individuals are deemed to have become domiciled when they have lived in the UK for 17 out of 20 years. This brings their worldwide estate into the UK inheritance tax net, but does not presently affect their offshore income and capital gains.

Reforms to the non-domiciled status of foreigners living in the UK have been proposed before, but they never came to anything because of the complexity of the system and the lobbying of powerful groups (eg Greek shipowners). This time, however, the change appears politically motivated and may be more likely to succeed. However, any change is unlikely to result in additional revenue for the fiscus as internationally mobile foreigners may simply move elsewhere if these privileges are removed, taking their talents and high spending somewhere else.

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