Heritage

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 Conduct 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

Equity markets have made a positive start to the year, led by a surge in European markets in response to stimulus measures introduced by the European Central Bank.

We are pleased to report that our largest fund, the Heritage Managed Portfolio Fund has had a strong start to the year with a return of 4.25% in the first quarter and full details on our funds can be found as usual on page 3.

Advantages of owner managed, family businesses

Many Heritage clients are already familiar with the virtues of owner managed businesses, having created their own wealth through successfully establishing and running a family business. Furthermore, Heritage itself is an owner managed business, and over the years we have often highlighted how we believe this structure can be beneficial to our clients too.

A key advantage is the stability provided by the commitment and loyalty found within a successful family business. This is good for the business as it means that key personnel are not susceptible to poaching from competitors and this stability is good for clients too, particularly in an industry such as investment, where planning, management and relationships should all ideally be done with a very long-term time frame in mind.

Interestingly, family owned businesses have recently been the subject of an academic study that has not only provided empirical evidence to back up our intuitive belief, but also has implications for the investments that we manage.

Researchers at the IE Business School in Madrid analysed over 800 listed European companies and the roughly one third of these that they classified as family businesses (through a combination of shareholding and directorships) outperformed the rest by a significant margin between 2001 and 2010. Furthermore, the family businesses were also less likely to fail and posted less volatile results, with the structural stability and long-term strategic thinking provided by a family doing its best to protect its wealth for future generations undoubtedly part of the reason for this.

This was clearly demonstrated during the credit crisis, particularly in the listed property sector, where professional managers with more of an eye on their salaries and job security were happy to raise additional capital using discounted rights issues, whilst owner managers generally entered the crisis with stronger balance sheets and were better able and more inclined to safeguard the value of their existing equity.

Despite the evidence of superior performance, it is interesting that most family businesses still trade at a discount rather than a premium to their listed peers as most institutional investors seem to be more attuned to slick professional managers and modern corporate governance methods rather than traditional family values.

At Heritage we are pleased to say that we both recognise and embrace the advantages provided by owner managed family businesses and that this can also provide a clear benefit to our clients.

Market Commentary and Outlook

It has been a good start to 2015 for investors with the World Index gaining 2.7% and Europe for once leading the way thanks to the stimulus provided by the European Central Bank.

Something that investors are currently having to grapple with, which is new to everyone, is the reality of negative yields. It started with the Swiss National Bank imposing negative interest rates on cash deposits in an attempt to prevent its currency from becoming too overvalued but has now also extended to bond markets which have driven the government bond yields for several countries including Germany, France and Denmark and even some corporates such as Nestle, into negative territory.

Although it seems very odd that investors would accept a negative yield – after all why would you allow a bank, government or corporate borrower to take your funds for free and even pay them for this - some justification can be found. Firstly, if deflation takes hold it is possible for investors to achieve a positive real return even with negative nominal yields. Secondly, if yields can cross the threshold below zero then they could continue to fall further into negative territory and so traders can still make a gain from the corresponding increasing price of the bond. Further possible reasons include holding the bonds as a currency play where the yield is less important or accepting a small negative yield as the cost of a level of capital security unavailable through other riskier investments.

However, it has to be said that for most long term investors negative bond yields appear very unappealing and make the alternatives of income producing assets such as dividend paying shares and property look relatively attractive.

United Kingdom

After an initial new year plunge the UK stock market recovered strongly and the FTSE 100 index even managed to climb above 7,000 to finally surpass its all time high level reached in December 1999, before settling back to provide a total return of 3.15% for the first quarter.

Although the price level of the FTSE is now back at around the highs reached in the dotcom bubble at the turn of the millennium the valuation today is far more reasonable. Back then the overall market PE ratio was about 30 but as profits have substantially increased, the PE ratio today is a much more reasonable level of around 15.

However, whilst valuations may not be of too much concern and the UK economy appears to be improving and currently outperforming its European neighbours, investors do still have the outcome of the general election on May 7th to worry about.

United States

In contrast to last year the US has so far lagged behind the other major markets this year with the S&P 500 index gaining just 0.44% in the first quarter.

The recent strength of the Dollar is proving to be a headwind for many US based multinationals although it did not stop Apple from reporting an all time record quarterly profit of $18bn thanks to sales of over 74 million iPhones.

Europe

European stock markets have shaken off their poor year in 2014 to become the star performer in early 2015, with the market up over 17% in the first quarter. Although this surge may seem surprising given that the European economy continues to struggle and the Greek debt crisis remains unresolved, the catalyst was undoubtedly the massive boost that the European Central Bank provided by finally releasing a €60bn per month quantitative easing program in order to counter deflationary pressures.

Japan

Japan also had a good start to the year with a 10% gain as investors remain hopeful that Shinzo Abe's package of pro growth and inflation reforms will eventually have the desired effect.

Emerging Markets

After a volatile year in 2014 with the Russian and Ukraine crisis, Argentinean debt default and Hong Kong protests, this year has so far been much calmer for emerging markets which ended the first quarter with a small gain overall.

Investment Statistics - 31/3/2015

Equity Markets	Q1 2015	2014	2013	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	2.72%	4.42%	22.10%						
US (S&P 500)	0.44%	11.48%	29.60%	19	2.4%	0.25%	1.93%	1.4816	1.0000
UK (FTSE 100)	3.15%	-2.71%	14.43%	15	3.5%	0.50%	1.58%	1.0000	1.4816
Europe (STOXX 50)	17.51%	1.20%	17.95%	19	3.2%	0.05%	0.18%	1.3802	1.0730
Japan (Nikkei 225)	10.06%	7.11%	56.72%	21	1.4%	0.10%	0.39%	177.98	120.12

Total returns- including dividends

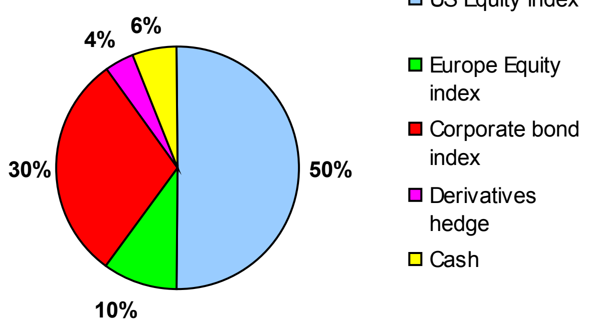
Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 31st March 2015

Performance	**Absolute Return Funds**		**Managed Portfolio Fund**	**Inflation (UK)**	**TR Global World Index (£ total return)**
Risk profile	Low		Medium		
Minimum investment horizon	3 years +		5 years +		
Target net annual return	Inflation plus 2-3% (ie 4-5%)		6-7%		
Price at 31 March 2015	£173.26	US$141.59	£242.30		
Return for quarter & 2015 ytd (net)	0.43%	-0.01%	4.25%	0.10%	7.96%
Year 2014 return (net)	6.20%	5.42%	7.74%	1.67%	10.99%
Year 2013 return (net)	4.67%	3.98%	13.85%	2.61%	19.85%
Year 2012 return (net)	1.28%	1.95%	13.27%	2.87%	7.93%
Year 2011 return (net)	-2.22%	-2.28%	0.06%	4.55%	-4.50%
Year 2010 return (net)	2.80%	2.06%	10.78%	3.35%	16.49%
Year 2009 return (net)	4.25%	1.26%	10.32%	2.19%	17.86%
Compound annual return (from 1/01)	4.12%	2.46%	6.46%	2.31%	5.43%
Annual volatility	3.06%	3.01%	3.01%	0.18%	6.49%
Size of Fund (millions)	£14.0	U$7.9	£122.7		

Absolute Return Funds



The Absolute Return Funds aim to protect investors capital and generate annual returns significantly in excess of inflation by following a top-down asset allocation strategy investing in a balanced portfolio of liquid exchange traded funds which track developed equity market and investment grade bond indices, with the risk of significant losses being hedged using derivatives.

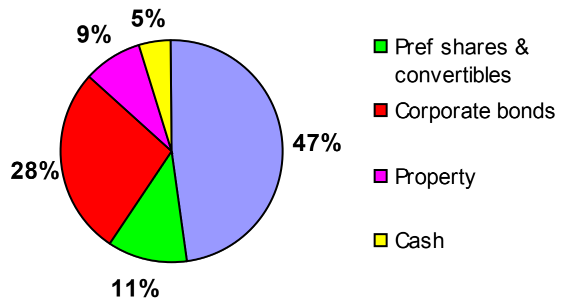
The core equity index funds, which track the S&P 500 largest US companies, broke even for the quarter on the back of a flat, but volatile quarter for the US equity market, as a result of the strength of the US Dollar. Towards the end of the quarter, we introduced some European equity index exposure.

The core UK and US investment-grade corporate bond index funds gained 1.00% and 0.53% respectively for the quarter. The bond funds currently yield an average of 3.30% (GBP) and 3.09% (USD) per annum gross to maturity and have average durations of 9.2 and 8.2 years respectively.

The derivatives positions, hedging against significant losses, lost a net 0.45% for the quarter. Losses are limited to approximately 5% from current levels.

The Funds have had a disappointing start to the year, but are well positioned to generate returns substantially in excess of inflation in the medium term, with limited downside risk.

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 had a good start to the year with a gain of 4.25% in the first quarter with all areas of the portfolio generating positive contributions.

The majority of our equity holdings were positive this quarter with a take-over approach for one of our insurance holdings, Brit plc, providing a further boost.

Our corporate bond portfolio has continued to perform well, and the overall yield on our bonds has come down to around 5%.

It was also another good quarter for our commercial property investments, which continue to provide an attractive combination of rising capital values and a decent income yield.

Overall, we believe that our portfolio of investments remains well positioned to generate decent returns for long-term investors, whilst our relatively defensive positioning and diversification should provide some protection against any market setbacks.

Pension Freedom

The start of the new tax year on the 6th of April heralds a new dawn for UK pension investors who will receive wide ranging new powers over their retirement savings.

Whilst in the past the majority of pensioners with a defined contribution arrangement purchased an annuity with their accumulated pension pot, the new rules allow either partial or even full access to withdraw your funds at any point after the age of 55.

Apart from freedom to access the funds there are also a range of related rule changes on "flexi access drawdown" and "Life Time Allowances" as well as a complete change to the rules for Inheritance Tax in relation to pensions.

The overall result of these changes are overwhelmingly positive for most responsible pension savers. However, the added complexity and choice means that the need for professional advice has never been greater and whilst Heritage itself is not regulated to give pension advice, we are able to offer existing clients a free initial consultation with a pensions expert whom we work closely with. If this is of interest please do contact us.

FATCA

FATCA is US legislation which was developed with the aim of detecting and deterring US tax evasion by US persons who hide financial assets offshore. The concept of FATCA originated in the US but it is evolving into a global standard with more and more territories signing up to reduce global tax evasion. FATCA provides greater transparency through tax authorities agreeing to collect and exchange information on each other's tax residents to prevent financial assets being concealed.

FATCA came into force in the UK on the 1st July 2014. The UK government has signed Intergovernmental Agreements (IGAs) agreeing to the collection and exchange of information on tax residents of the United Kingdom and each of its Crown Dependencies.

Heritage is classified as a UK Financial Institution (FI) under FATCA and we have registered as a FI with the Internal Revenue Service (IRS). Under FATCA UK legislation, we are required to identify and report to Her Majesty's Revenue and Customs (HMRC) regarding any of our accounts held by clients who are tax resident in the US, Jersey, Guernsey, the Isle of Man, The British Virgin Islands or other Crown Dependencies (Reportable Clients).

In relation to trusts, HMRC under FATCA will be looking at the tax residencies of the settlor, beneficiaries of mandatory and discretionary distributions and any person that exercises ultimate effective control over the trust and for companies, HMRC will be looking into the tax residencies of those who hold equity interests.

Under FATCA, the following information in relation to each identified Reportable Client will be reported annually to HMRC: Name and Address; Taxpayer Identification Number (TIN); Heritage account balance or value as of the end of the calendar year; and Total gross amount paid or credited to the Specified Person during the calendar year.

The first exchange of information to the US will be for the 2014 calendar year and this information is required to be reported to HMRC by 31st May 2015. The second exchange of information to the US, Jersey, Guernsey, the Isle of Man, The British Virgin Islands and other Crown Dependencies will be for the 2015 calendar year and this information is required to be reported to HMRC by 31st May 2016 and thereafter annually.

In order for Heritage to be compliant we will be contacting some of our clients to reconfirm to us their personal tax residency and status via our 'FATCA Self-Certification Form'. If required, we may request further documentation from our clients to confirm their tax status. Co-operation from our clients would be greatly appreciated.

Under UK law, Heritage must report information to HMRC. If a client fails to kindly co-operate with Heritage regarding their tax residency, then we will still be obliged to disclose details to HMRC if we believe a client may be a Reportable Client based on the information we currently hold.

Please note that at Heritage we do not provide tax or legal advice. If you believe you will be affected by FATCA, please contact your tax adviser.

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	75%	25%	5.0%	7.2%	4.7%	2.7%
Balanced	50%	50%	6.0%	8.2%	5.3%	2.6%
Growth	0%	100%	7.0%	10.3%	6.5%	3.1%
Benchmarks:						
UK Inflation				1.2%	2.3%	0.2%
TR Global Equity Index (total return)				19.0%	5.4%	6.5%

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