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 Conduct Authority, providing a wide range of investment services to individuals, trusts, companies

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A decent year for investors despite the shocks

For a year that started with a very weak first quarter and then had to face the twin shocks of the unexpected Brexit vote and the US presidential election, 2016 has actually turned out to be a surprisingly good year for investors.

We are pleased to report that the Heritage Managed Portfolio Fund had a positive final quarter which helped to produce a decent return of 7.5% for the full year. Further details of our Funds including the current asset allocation and a commentary on performance can be found as usual on page 3.

Finally, on page 4 there is news of the launch of our first UK regulated fund. The SVS Heritage Balanced Portfolio Fund will compliment our existing Guernsey funds and will also enable us to manage ISA funds for clients.

25 years and counting for Heritage

Whilst our year end newsletter usually addresses a review of the past year and the prospects for the year ahead, this time we thought it would be more appropriate to take a much longer term perspective to commemorate reaching our 25th anniversary.

Heritage was formed in 1992 as a partnership between the Olsen and Glew families with a view to providing a personal service to private clients who are primarily concerned with preserving and enhancing their accumulated wealth. Our investment approach has therefore always been fairly conservative and fortunately this has helped us to navigate some fairly turbulent times over the years, including the bursting of the technology bubble which followed the internet mania of 2000 as well as the great financial crisis of 2008.

One of our early major developments was the establishment in 1996 of the Heritage Investment Funds, as this allowed us to genuinely pool our own family money with our clients and enabled us to more efficiently and effectively manage larger amounts for a growing number of clients. From under £20 million at inception, these funds have increased significantly in size and the Heritage Managed Portfolio Fund, which has been a particularly strong performer and has itself grown to over £150m, now accounts for over half of our firm's total assets under management. We are proud to say that the increasing amounts entrusted to us to manage over the years has arisen entirely from doing a good job for our existing clients and relying on them and our network of contacts for referrals.

Another important factor has been the stability of our team. Whilst nearly all of our peers and competitors have succumbed to endless changes in corporate ownership and personnel, our core team at Heritage has now been together for the last 20 years. This longevity has allowed us to build genuinely long-term investment strategies as well as long-standing relationships with our clients and in many cases we are now looking after second or even third generations of families.

Overall we believe that the foundations and principles that we have established together with the experience that we have gained over the past 25 years leave us very well placed to meet the inevitable challenges that we will face in the years ahead and we can look forward with confidence to the next 25 years for Heritage.

Market Commentary and Outlook

Helped by a positive final quarter, 2016 has turned out to be a surprisingly decent year for investors with all of the major markets ending in positive territory and the overall Global index gaining 8.5%.

One factor that investors have become fairly complacent about in recent years is inflation. For a while now this has been so low that investors have no longer needed to make much of a distinction between "nominal" returns and "real" returns (i.e. after adjusting for inflation). However, there are currently some potentially inflationary pressures building.

In the UK the weaker pound that followed the Brexit vote means that imported goods will become more expensive, although it is not yet entirely clear how that pain will be shared between suppliers, retailers and customers, as the high profile battle between Marmite maker Unilever and Tesco showed. Furthermore the change in the minimum wage legislation also has the potential to create additional inflationary pressure.

In the US it could be argued that the last thing that an economy operating at near to full capacity needs is a major fiscal stimulus but this is potentially exactly what it will receive in 2017 if the new Trump administration goes ahead with promised tax cuts and increased spending.

Overall these inflationary threats and how central banks react to them have the potential to cause far reaching effects for investors. As always bonds will be the most obvious casualties from any pick up in inflation but the implications for all securities including equities and property cannot be ignored.

United Kingdom

The FTSE 100 index finished the year at a new all time closing high of 7,143 and was the best performing major market in 2016 with a gain of over 14%.

Two of the major drivers for this performance were the boost that UK listed global multinationals received from the weaker pound that followed the Brexit vote and a sharp recovery in the prices of London listed resources groups. In fact the top 5 performers in the FTSE 100 were all mining stocks with gains ranging from 58% for Rio Tinto to 288% for Anglo American, whilst the 2016 gain for the more domestically focused FTSE 250 index was much more muted at under 4%.

United States

The US had a decent year with the S&P 500 index hitting record highs in December and registering an overall gain of 9.5% for the year.

Two big issues hanging over US markets in 2016 were finally resolved in the final quarter. Firstly, the Presidential election in November which has so far been taken fairly positively by markets as evidenced by the so called "Trump bump" in expectation of more pro-business policies and a likely fiscal stimulus. Secondly, the much anticipated rise in US interest rates finally happened in December, although this story will continue to run in 2017 as attentions now turn to how far the Federal Reserve may go.

Europe

After what seemed like a rolling crisis over the previous few years Europe had a relatively quieter 2016 and a decent final quarter helped to leave European equity markets marginally positive for the year.

However, with upcoming elections in France and Germany, Brexit negotiations, major issues for Italian banks and no end in sight for the problems in Greece, 2017 has the potential to be a more volatile one for the Eurozone – all of which is why the European Central Bank are unlikely to be in any hurry to remove the zero interest rates policy that they have adopted this year.

Japan

Having been down by over 18% halfway through the year the Nikkei staged a remarkable recovery to claw its way into positive territory for the full year. The overall 0.4% rise resulted in the first run of five consecutive positive years for the Japanese market since the 1980's bull market, although remarkably the current level of 19,114 is still less than half the all time high of 38,916 reached way back in 1989!

Emerging Markets

Emerging markets have enjoyed their best year for quite a while, outperforming developed markets up until November when some of the shine was taken off as investors fretted over the possible negative implications for global trade if the US becomes more protectionist under its new president.

Investment Statistics - 31/12/2016

Equity Markets	Q4 2016	2016	2015	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	1.25%	8.49%	-2.07%						
US (S&P 500)	3.25%	9.54%	-0.73%	20	2.5%	0.75%	2.43%	1.2339	1.0000
UK (FTSE 100)	3.53%	14.43%	-4.93%	25	3.8%	0.25%	1.24%	1.0000	1.2339
Europe (STOXX 50)	9.60%	0.70%	3.85%	17	3.6%	0.00%	0.21%	1.1706	1.0513
Japan (Nikkei 225)	16.20%	0.42%	9.07%	20	1.7%	-0.10%	0.05%	144.02	116.87

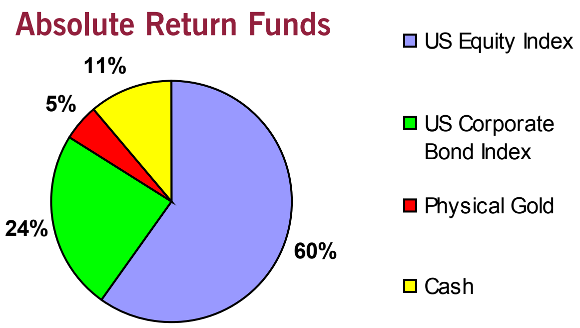
Total returns- including dividends

Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 31st December 2016

Performance	US Dollar Absolute Return Fund	Managed Portfolio Fund	Inflation (US)	TR Global World Index (£ total return)
Risk profile	Low	Medium		
Minimum investment horizon	3 years +	5 years +		
Target net annual return	3-4%	6-7%		
Price at 31 December 2016	US$143.86	£266.78		
Return for quarter (net)	0.73%	1.83%	0.40%	6.49%
Year 2016 return (net)	2.08%	7.48%	1.16%	29.59%
Year 2015 return (net)	-0.47%	6.80%	0.08%	3.49%
Year 2014 return (net)	5.42%	7.74%	1.65%	10.99%
Year 2013 return (net)	3.98%	13.85%	1.49%	19.85%
Year 2012 return (net)	1.95%	13.27%	2.10%	7.93%
Year 2011 return (net)	-2.28%	0.06%	3.21%	-4.50%
Compound annual return (from 1/01)	2.24%	6.37%	2.12%	6.26%
Annual volatility	5.89%	5.34%	0.09%	10.49%
Size of Fund (millions)	U$14.1	£159.0		

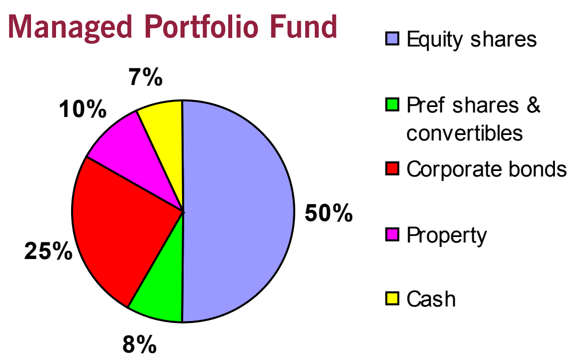


The US Dollar Absolute Return Fund aims to protect investors' capital and generate annual returns in excess of inflation by investing in a diversified range of liquid exchange traded funds, with the risk of significant losses being hedged using derivatives.

The Fund has 60% invested in an equity index ETF, which tracks the S&P 500 largest US companies. This ETF is hedged against significant losses using protective put options. The US equity market experienced a volatile year, but recovered strongly after the election result on the expectation that Trump's proposed infrastructure spending and tax cuts will increase economic growth.

The Fund also has 24% invested in a US investment grade corporate bond ETF yielding 3.4% per annum to provide some income. The interest rate exposure of this ETF is currently hedged using derivatives. Bond yields rose significantly during the second half of the year on the expectation that interest rates and inflation will rise.

Although the Fund gained a modest 2% in US Dollar terms over the past year because of the strong US dollar, rising interest rates and hedging costs to limit losses, for a Sterling-based investor this translated into a return of 22%. The Fund is well positioned to generate returns in excess of inflation in the medium term, with limited downside risk.



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 multi-asset portfolio.

After a weak start to the year markets made a good recovery and the Fund had a strong second half to finish the year with a decent overall return of 7.49% for 2016.

Rising stock markets and take-over approaches for a couple of our holdings (UK Mail and Sky) helped drive a positive contribution from our equity portfolio in the final quarter. This year's overall winners were a mixture of large caps such as Shell, HSBC, Compass and Glaxo that benefitted from a weaker sterling and strong individual small cap performers including Brainjuicer, Animalcare and Air Partner.

Although government bond markets have recently suffered a bit of a setback, our higher yielding corporate bonds (including some floating rate notes) are not as sensitive to rising interest rates and their prices have held up relatively well.

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

New fund launch - the SVS Heritage Balanced Portfolio Fund

We are pleased to report that following a rigorous and lengthy application process, our financial regulator, the FCA, gave their approval for us to launch a new fund on December 1st 2016. One of the main reasons for establishing the SVS Heritage Balanced Portfolio Fund is to allow access to our funds service for investors that are restricted from investing in the Guernsey regulated Heritage Managed Portfolio Fund.

In particular the new fund can be held within an ISA, a tax advantaged account that is becoming an increasingly important financial planning tool now that the annual limit is set to increase to £20,000 per annum in 2017/18. The fund will also be eligible as Funds at Lloyd's to support the insurance underwriting activities for a number of our clients who participate in this market.

The new fund will adopt the same approach as the HMPF, our largest existing fund which has built an excellent track record since it was launched sixteen years ago. The main elements of this approach are set out below;

We recognise that good investment returns are only possible if a certain amount of risk is undertaken but that it is important not to underestimate the considerable risks involved with equity investment and we therefore seek to manage and control this risk through diversification of equity risk, as well as investing in less risky alternatives such as fixed interest securities and property based investments.

Our approach can also be described as long term as we believe that good investment ideas often take time to reach fruition and that a short term approach based on significant trading merely serves to add to the costs and reduce the expected returns. We do not profess to know which way the markets are going in the short term and are very sceptical of those who claim that they can. However, we do believe that a well researched investment purchased at a discount to its intrinsic value will more often than not result in a satisfactory return if held for the longer term.

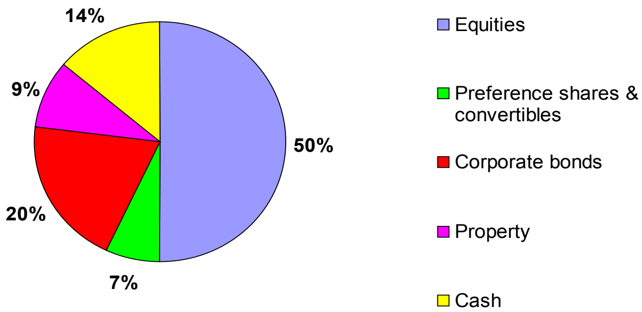
Flexibility and common sense are also important to our approach. We are distrustful of following particular investment styles or fashions and prefer to maintain a more flexible and pragmatic approach based on our own criteria of value.

As with our existing funds, clients can also be assured that our interests will be aligned with theirs and that we will be "eating our own cooking", as our own family ISA savings and Funds at Lloyd's will be invested in the new fund.

SVS Heritage Balanced Portfolio Fund summary of key features

Price at 31/12/16	102.4p (launched at 100p 1/12/16)
Fund size	£10.8m
Fund type	OEIC, UCITS (UK domiciled)
Eligible for	ISAs, SIPPs, Funds at Lloyd's
Sedol code	BDQPPL5
Pricing and dealing	Daily
Minimum Investment	£10,000
Management fee	1% per annum
Administrator/ACD	Smith & Williamson

Asset allocation



Commentary and performance

The Fund launched on 1st December 2016 and has made a positive start. The initial funds have been invested broadly in line with the existing larger offshore version of the fund (the Guernsey regulated Heritage Managed Portfolio Fund) and the share price has increased by 2.4% from its starting level of 100p to 102.4p.

Notable contributors to this positive start include Sky, where 21st Century Fox has launched a take-over bid and media agency Brainjuicer which released a very positive trading statement.

Further information

Further details and the full factsheet for our new fund can be found on our website at www.heritage-capital.co.uk and we would of course be very happy to answer any particular queries that you may have.

The information set out above does not constitute an offer to subscribe to shares, which may only be purchased after reading the full Prospectus/Key Investor Information Document (KIID). The Prospectus and KIID can be found at www.heritage-capital.co.uk.

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