Heritage

Quarterly Newsletter & Investment Review

Issue 79 Quarterly news & investment review from Heritage Quarter 3 2017

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Heritage Capital Management Limited

Heritage Capital Management Ltd 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 positive quarter for investors

It has been a good quarter for investors with all of the major markets making positive progress. We are pleased to report that this has translated into another solid quarter for the Heritage funds with the Managed Portfolio Fund now up by 8.7% for the year-to-date, which is ahead of both the £ World Index and the FTSE 100 index.

Further details of our Funds including the current asset allocation and a commentary on performance can be found as usual on page 3 and we now also include information on our new UK regulated fund, the SVS Heritage Balanced Portfolio Fund on page 4.

Holding property in a diversified portfolio

Most managers of multi-asset or balanced funds tend to simply hold a combination of equities, bonds and cash but at Heritage we think it is important not to overlook other asset classes such as property. The fundamental attractions of property are that it is a tangible asset which is easy to see and understand, it produces an income in the form of rent and as a real asset it provides a natural hedge against inflation, as in the long run both rental income and capital values tend to rise. However, there are a number of considerations to take into account when it comes to investing in property.

Firstly, performance tends to be quite cyclical as investors, drawn in by these fundamental attractions, bid up prices to ever higher levels. Furthermore, banks have traditionally been keen to lend against this type of asset and the gearing this creates further accentuates price moves. Property last reached such a cyclical peak back in 2007 and the subsequent financial crisis and bursting of the credit bubble had a devastating effect on property markets with investors who were highly geared or focused on risky areas such as development suffering particularly badly.

Secondly, it is important to distinguish between the various types of property. For example as home owners most people have a reasonable understanding of the residential housing market but this often behaves quite differently from commercial property. Whilst residential property values generally held up relatively well in the financial crisis and recovered to new highs afterwards this leaves them looking expensively valued and net yields for investors are currently not at all attractive. By contrast, commercial property values fell by around 40% from their peaks and although the market has since stabilised, the recovery has been fairly weak and they still trade well below their 2007 values and with a bit of effort net yields of 7% or more can still be found.

Also, commercial property can itself be broken down into the major sub sectors of offices, retail, industrial and leisure/other and course there are good reasons why some sectors look more attractive than others. For example, the high street retail property market is structurally challenged due to the rise of online competition from the likes of Amazon, whilst others including industrial warehouses offer much better prospects. There are also niche property vehicles such as those that specialise in the very long and safe leases that exist within the primary healthcare sector.

Taking all of the above into account it should not be a surprise that whilst we avoid expensive looking residential markets and central London trophy assets, we do think that there is a significant place in a well-diversified multi-asset portfolio for solid income producing commercial properties.

Heritage Capital Management Limited

Review for the quarter ended 30th September 2017

Market Commentary and Outlook

It has been a good quarter for global markets with all of the major indices making positive progress and many registering record new highs.

Although it's not an anniversary to be celebrated by investors, it is now 10 years since the start of the Global Financial Crisis or GFC as it has become known. As markets around the world succumbed to the huge debts and risk that had been built up within the financial system and economies were pulled into recession things looked incredibly bleak. Fortunately a massive concerted effort by central banks to stimulate the system with ultra-low interest not only stabilised things but went on to give rise to a huge increase in the value of all financial assets.

The S&P index in the US is up over 250% since its GFC low point making this the second strongest bull market since World War II and with interest rates having been pinned to the floor for almost a decade, most other markets have also enjoyed a huge rally.

Following such a strong run it is only natural that cautious investors should be asking how long this run can continue as history shows that bull markets don't last forever. There are some signs that risks are again building within the financial system that could lead to another crisis or that we may simply be due for a normal cyclical recession - and the danger is that this time central banks will not have the ability to revive the patient by slashing interest rates.

Having said all of that there is also the possibility that the positive momentum in markets could continue to help drive the bull market upwards to new heights and so rather than indulging in bold predictions about future market movements, our preferred approach continues to be to invest in a well-diversified, multi-asset portfolio that should continue to generate long-term returns in a wide range of scenarios.

United Kingdom

The FTSE 100 index has had a fairly uneventful summer with some steady progress in July and August being partially reversed by a weaker September producing an overall gain of just under 1% for the quarter. Although the UK appears to be the weakest of the major markets this year, this is partly explained and offset by the fact that sterling has made a decent recovery, gaining over 10% from its low point against the US Dollar.

Part of the reason for the stronger pound recently is down to expectations that interest rates might start to rise, as the Bank of England's Monetary Policy Committee (MPC) hinted in September that a hike in rates may happen sooner than households and markets expect. If rates do now rise from their current level of just 0.25% at the next meeting in November it would be the first time that they have risen in over a decade.

United States

The US has continued its good run this year with the S&P 500 appreciating by a just under 4% this quarter and hitting new all-time highs above 2,500.
Investors in US companies are currently focusing on the potential positive impact of president Trump's proposal to cut corporation tax rates from 35% to 20% and tax reform legislation to encourage US companies with large cash balances held abroad to repatriate it. The amounts at stake are enormous as it is estimated that US companies are currently hoarding over $2.5 trillion abroad, which could be used to pay increased dividends, reduce debt and do deals if Trump is able to push his tax reforms through Congress.

Europe

In a quarter where all the major markets posted positive returns, Europe was the top performer with a gain of 4.44%.

Following surprise election results in the US, France and UK within the last year, the recent re-election of Angela Merkel in Germany may appear to provide some welcome continuity and stability. However, the rise of the German anti-immigrant AfD party and flare ups over Catalonian independence in Spain means that it would be wrong to become too complacent about stability in Europe.

Japan

Whilst the Japanese Nikkei index often tends to exhibit greater volatility than the other major markets, so far this year it has registered a solid but unspectacular gain of 6.5%. However, there still scope for an increase in volatility in the final quarter as prime minister Shinzo Abe has just called a surprise snap election to be held on October 22nd with his handling of the Korean crisis sure to be a major focus.

Emerging Markets

Emerging markets have continued their good run in 2017 with the FTSE BRIC 50 index of the largest listed companies in Brazil, Russia, India and China leading the way with a gain of over 10% this quarter.

Investment Statistics - 30/09/2017

Equity Markets	Q3 2017	2017 ytd	2016	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	5.25%	17.70%	8.49%						
US (S&P 500)	3.96%	12.53%	9.54%	22	2.4%	1.25%	2.33%	1.3397	1.0000
UK (FTSE 100)	0.82%	3.22%	14.43%	22	4.0%	0.25%	1.37%	1.0000	1.3397
Europe (STOXX 50)	4.44%	9.25%	0.70%	16	3.3%	0.00%	0.46%	1.1338	1.1812
Japan (Nikkei 225)	1.61%	6.50%	0.42%	17	1.7%	-0.10%	0.06%	150.70	112.47

Total returns- including dividends

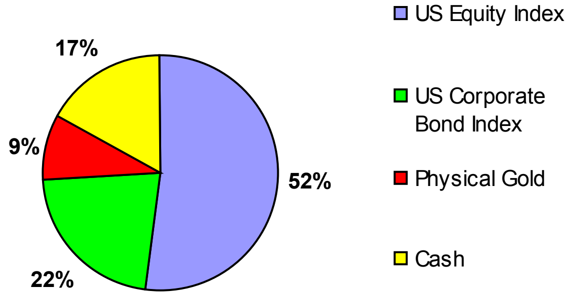
Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 30th September 2017

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	4-5%	6-7%		
Price at 30 September 2017	US$153.62	£290.02		
Return for quarter (net)	2.16%	1.84%	0.43%	2.20%
Year 2017 return (net)	6.78%	8.71%	1.59%	8.25%
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%
Compound annual return (from 1/01)	2.54%	6.60%	2.12%	6.47%
Annual volatility	3.89%	3.55%	0.11%	8.42%
Size of Fund (millions)	U$13.1	£177.7		

US Dollar Absolute Return Fund



The US Dollar Absolute Return Fund aims to protect investors' capital and generate annual returns in excess of inflation by investing in liquid, well-diversified exchange traded funds which track US equity, corporate bond and gold indices, whose returns are uncorrelated in order to reduce losses and volatility. Downside risk is managed using derivatives, when considered appropriate.

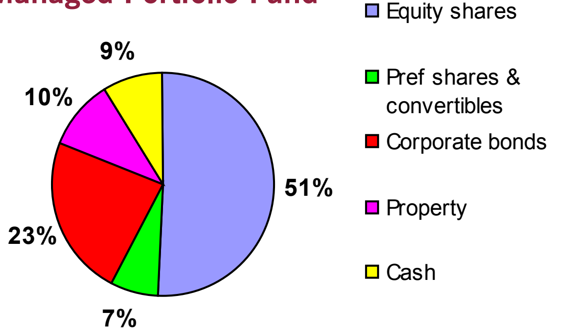
The Fund has 52% invested in an equity index ETF for growth, which tracks the S&P 500 largest US companies and yields 1.45% per annum, which gained 2.08% for the quarter after hedging.

The Fund also has 22% invested in a US investment-grade corporate bond ETF, yielding 3.28% per annum, both for income and as a hedge against equity market weakness, which gained 0.10% for the quarter after hedging.

The Fund has a further 9% invested in a physical gold ETF, as a hedge against inflation and US Dollar weakness, which gained 0.38% for the quarter.

The Fund produced a positive return of 2.16% for the quarter and is up 6.78% for the year to date. It is well positioned to generate future returns well in excess of inflation over the medium term.

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 multi-asset portfolio.

It has been another positive quarter for the Fund which gained 1.84%, and for the year to date the Fund is now up by 8.71%, ahead of both the 8.25% for the £ World Index and the 3.22% gain of the UK market.

Our share portfolio performance was positive overall benefitting from a take-over of Lloyd's insurer Novae Group and strong trading updates from specialist chemicals group Victrex and IT services company, Computacenter, which is now our largest single shareholding. On the other hand we did however suffer from a profit warning by our holding in media company, System 1 Group.

Both our bonds and property holdings also had another decent quarter with our bond portfolio boosted by a ratings agencies upgrade to the credit rating of JRP Group and our property holdings benefitting from confirmation that Hansteen has successfully sold its European portfolio and will be making a substantial capital return.

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.

Tax self-certification

In our last quarterly newsletter, we updated you on the Automatic Exchange of Information that is happening around the world. Governments globally have introduced or will be introducing legislation which requires financial institutions to gather client information and report on such information to tax authorities. This legislation includes the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS). The legislation has been developed with the aim of fighting tax evasion and protecting the integrity of tax systems. It provides greater transparency through tax authorities agreeing to collect and exchange information on each other's tax residents to prevent financial assets being concealed.

In order for Heritage and our clients to be complaint under the above legislation, Heritage will be shortly sending out Tax Self-Certification Forms to complete to state the residency for tax purposes of the person or persons identified as the holder(s) or controlling person(s) of a Heritage Investment Account. In relation to trusts, controlling persons of a trust are the settlor(s), the trustee(s), the protector(s), the beneficiary(ies) or class(es) of beneficiaries, or any other natural person(s) exercising ultimate effective control over the trust. These need to be completed and either emailed or posted back to us before the deadline of 31st December 2017.

Please note that we will only be asking our clients to complete a Tax Self-Certification form once and you will only be asked to complete another when we believe that your reportable status may have changed. Also, as with all our client information, we will respect the privacy of the information reported to us and we will only disclose information to Her Majesty's Revenue and Customs (HMRC) if we are legally required to do so.

Under UK law, Heritage must report information regarding account holder tax residency to HMRC and if a client fails to provide the requested information then we will still be obliged to disclose details to HMRC if we believe a client may be a Reportable Client under FATCA and CRS based on the information we currently hold.
We appreciate that completing forms can be a chore but we will endeavour to make the process as simple as possible and co-operation from our clients would be greatly appreciated.

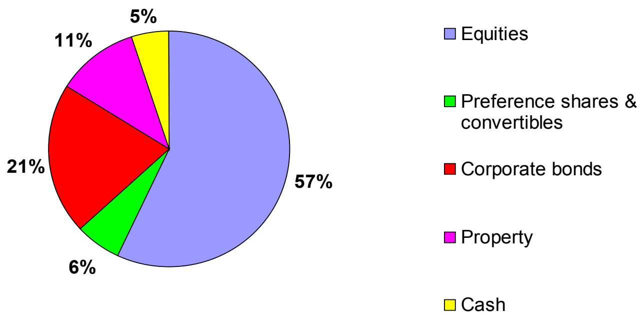
UK dividend tax information

Many of our UK clients will have completed or will be in the process of gathering 2016/2017 tax information for their HMRC Self-Assessment Tax Returns. You may have noted that from April 2016 dividends are taxed differently, with the Dividend Tax Credit now replaced by a new £5,000 tax-free Dividend Allowance. We apologise for any inconvenience caused by the delay in sending out the usual consolidated tax certificates, which is due to our custodians having issues with the new system. It is however, worth noting that as dividends paid by companies on or after 6th April 2016 no longer carry a UK tax credit, dividend information can now be extracted directly from the Heritage cash statements and that we can assist with this if tax information is required before formal certificates can be issued.

SVS Heritage Balanced Portfolio Fund - summary of key features

Price at 30/09/17	112.1p (launched at 100p 1/12/16)
Fund size	£13.97m
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 approach adopted by the Fund is in line with the existing larger offshore version of the fund (the Guernsey regulated Heritage Managed Portfolio Fund).

The Fund has continued its positive start with a gain of 1.72% this quarter and is now up by 9.47% for the year to date and by 12.1% since launch on 1/12/16.

Further details and the full fact sheet for the fund can be found on our web site at www.heritage-capital.co.uk.
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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