Heritage

Quarterly Newsletter & Investment Review

Issue 81 Quarterly news & investment review from Heritage Quarter 1 2018

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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 sharp reminder that markets also go down

The first quarter of 2018 has provided a nasty shock for any investors who had grown complacent in recent times, as the long uninterrupted spell of smooth upward progress by global markets came to an abrupt end. Overall this was the weakest first quarter since 2009 with the UK market suffering a fall of around 8%.

Whilst the general market weakness has meant that the Heritage Funds have also had a negative start to the year, our conservative approach and risk management tools limited the falls to under 2% for our Managed Portfolio and Absolute Return Funds. Further details 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 newer UK regulated fund on page 4).

Private equity - adding some spice to the mix

Regular readers of our quarterly newsletter will be familiar with our generally conservative investment style. However, without taking any risk it is impossible to generate decent returns and therefore, where appropriate, we are not averse to taking on risk if we think that we will be adequately rewarded. An example of this is our limited exposure to investments in unquoted companies or private equity as it is otherwise known.

The private equity market itself can be sub-divided into various sectors such as early stage venture capital, expansion or growth capital and management buy-outs or buy-ins of more mature businesses. A common feature is strong management teams whose interests are closely aligned with the capital providers through having a meaningful equity stake. In addition, with ever increasing regulation and scrutiny of publicly listed companies many of the best management teams prefer to build a business away from the public arena. The value of such companies can grow in a number of ways. New opportunities and markets can be developed, other complimentary businesses can be acquired or a simple established business can be bought at a favourable price with cash flows then used to pay dividends and increase equity value.

One way for us to access private equity is through listed private equity investment trusts which are themselves quoted on the stock exchange, providing exposure and diversification whilst also maintaining our liquidity and flexibility. The historical returns from private equity are excellent when compared to other asset classes as evidenced by the returns of the listed investment trusts specialising in this sector – over the years Electra Private Equity has been one of our best investments and last year we enjoyed excellent returns from Dunedin Enterprise, HgCapital and ICG Enterprise.

In addition to specialist investment trusts our Heritage Managed Portfolio Fund also has some direct holdings in private companies. This allows us to take advantage of specific opportunities that we come across through our clients and wider network of contacts, and to take a more active approach to realising value through supporting the development of the company. Recent examples include an investment in 12 properties in Wokingham opportunistically acquired from a major housebuilder that were subsequently sold for a decent profit and we are currently negotiating an exit from a very successful long-term holding in an equine MRI scanning business. Finally, we are always on the lookout for interesting new investments so please do get in touch if you come across an opportunity for us to take a look at.

Heritage Capital Management Limited

Review for the quarter ended 31st March 2018

Market Commentary and Outlook

Following a long run of gently rising markets, the first quarter of 2018 has seen volatility return with a vengeance and it has been the worst start to the year for investors since the financial crisis nearly ten years ago. The initial plunge in early February was sparked by inflationary fears and the higher interest rates that would be required to combat this and for most markets this drop was large enough to qualify as a 10% "correction" from the peak.

Markets then staged a recovery through February and early March before suffering a further sell off at the end of the quarter. This time the weakness was put down to fears of the negative implications for the global economy from a looming trade war between the US and China as well as sudden weakness from the US technology giants that had led the market upwards in recent years.

Whether the current weakness turns out to be just a "healthy correction" in an ongoing bull market or the start of a more serious major bear market is as always difficult to predict. However, the risks associated with high valuations and deteriorating sentiment towards the tech giants may mean that there are currently better opportunities to be found in other areas of the market.

United Kingdom

Having started the year at a new all-time high of 7,688 the FTSE 100 index has seen a sharp reversal, briefly dropping below 6,900 at its low point and ending down over 8% for the first quarter.

Although many companies with December year ends have actually been reporting pretty decent results it appears that most of the good news had already been priced into the shares, whilst on the other hand any companies that have come up short of expectations have seen their share prices severely punished.

An interesting feature of the UK market is that many international investors are currently underweight as they remain wary of the uncertainty surrounding the outcome of the Brexit negotiations. The result of this is that the UK is now the cheapest of all the major international markets with a PE of 13 and a dividend yield of over 4%, which could offer a good opportunity to long-term value and contrarian investors.

United States

The US market started the year by continuing its impressive run with the S&P 500 hitting a new high of 2,873 in late January before a severe plunge to below 2,600 resulted in the first "correction" of over 10% for a few years.

Whilst the initial plunge was due to the whole equity market being spooked by the prospect of higher inflation and interest rates the more recent weakness has been largely down to a turn in sentiment towards the tech giants. Their seemingly unstoppable rise had been driving the market upwards to the point where tech now dominates the US index with a 24% weighting.

However the clouds are now building – Google has been slapped with a record $2.7bn fine by the European Commission, president Trump appears to have Amazon in his sights and Facebook is suffering a massive fallout from its inability to safely manage and protect user data. Overall it appears that the tech giants are now facing a potentially toxic combination of hostility from politicians, regulators and the general public.

Europe

European markets have also been volatile this quarter and ended down by just over 4%.

Although president Macron has generally been considered to be making good progress with necessary reforms in France he is currently facing his biggest test by taking on the powerful rail unions and it will be interesting to see if he can pass the test as he faces his "Maggie Thatcher" moment. Elsewhere investors have been reassured by Angela Merkel's ability to finally form a government in Germany but worried by the uncertainty created by the recent Italian election.

Japan

The Japanese market was down nearly 6% in the first quarter and whilst much of the weakness can be put down to the overall malaise infecting global markets Japan has also been rocked by a cronyism scandal linking Prime Minister Abe and his wife to a suspicious looking land deal.

Emerging Markets

Compared to the falls suffered this quarter by the major developed market indices, emerging markets have generally held up relatively well and the FTSE BRIC index (consisting of Brazil, China, Russia and India) has actually managed a positive return for the year-to-date.

Investment Statistics - 31/03/2018

Equity Markets	Q1 2018	2017	2016	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	-0.72%	24.62%	8.49%						
US (S&P 500)	-1.22%	19.42%	9.54%	22	2.4%	1.75%	2.74%	1.4018	1.0000
UK (FTSE 100)	-8.21%	7.63%	14.43%	13	4.2%	0.50%	1.35%	1.0000	1.4018
Europe (STOXX 50)	-4.07%	6.49%	0.70%	14	3.7%	0.00%	0.50%	1.1376	1.2323
Japan (Nikkei 225)	-5.76%	19.10%	0.42%	15	1.7%	-0.10%	0.05%	148.96	106.28

Total returns- including dividends

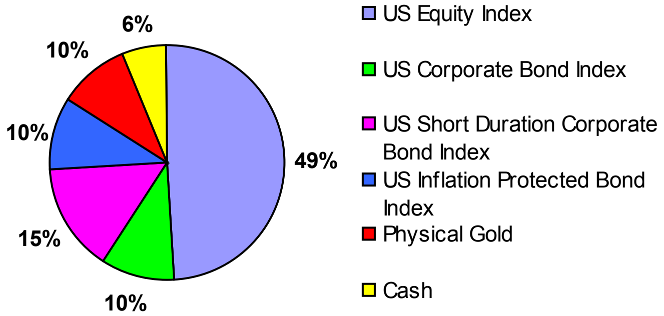
Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 31st March 2018

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	5%	6-7%		
Price at 31 March 2018	US$156.95	£291.74		
Return for quarter & 2018 ytd (net)	-1.56%	-1.92%	0.53%	-4.36%
Year 2017 return (net)	10.83%	11.50%	2.14%	13.78%
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)	2.59%	6.44%	2.12%	6.31%
Annual volatility	4.56%	3.57%	0.07%	7.10%
Size of Fund (millions)	U$13.6	£183.5		

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 (ETFs) which track US equity, bond and gold indices, whose returns are uncorrelated in order to reduce losses and volatility. Downside risk is managed using derivatives and the maximum loss for the calendar year is limited to approximately 7%.

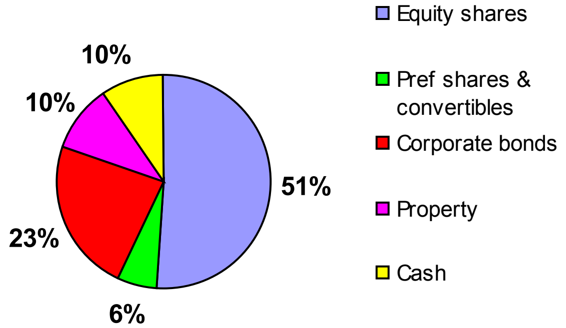
The growth investment in the US equity index ETF tracks the S&P 500 largest US companies and yields 1.73% per annum. The risk of significant loss is hedged using derivatives.

The investments in US long and short duration corporate bond ETFs are investment grade, yield 3.39% and 1.91% per annum respectively, and are held for income and as a hedge against equity market weakness. The interest rate exposure of the long duration bonds is hedged with derivatives. The US Treasury inflation protected bond ETF is held as a hedge against an increase in inflation and has a real yield of 0.64% per annum.

The investment in the physical gold ETF is held as a hedge against inflation and US Dollar weakness.

The Fund incurred a disappointing loss of 1.56% for the quarter. It is, nevertheless, well positioned to generate future returns significantly in excess of inflation over the medium term, with limited downside losses.

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.

Following a long period of steadily rising markets, the Fund has suffered its first negative quarter since the beginning of 2016 with a loss of 1.9%.

The majority of our shareholdings were impacted by the 8% fall in the UK market this quarter, although one notable exception was our holding in Sky which benefitted from US media giant Comcast entering a bidding war for the satellite TV broadcaster. Also on the positive side a number of our holdings with December year ends have been reporting good 2017 results.

Our property and fixed interest holdings have held up reasonably well during the recent general market turbulence and our conservative strategy of maintaining a healthy cash position in the fund allows to take advantage of buying opportunities that present themselves.

Looking ahead, we 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 the risks of any ongoing market weakness.

The EU General Data Protection Regulation (GDPR)

The EU General Data Protection Regulation (GDPR) comes into force on 25th May 2018 and will replace and extend the current UK Data Protection Act in order to strengthen and unify data protection for individuals within the European Union. The primary objectives of GDPR are to give citizens control over their personal data and to simplify the regulatory environment for international companies.

GDPR covers the use, storage and processing of personal data held on individuals. As a controller of personal data, Heritage is required to have a data protection policy, restrictions on the processing of personal data, obligations to provide clients with certain information if requested, obligations relating to the security of personal data, and requirements to keep records of data processing.

GDPR is a positive step towards our clients having more control over how their personal data is used and how we communicate with you. The changes will help to better protect your personal data. Personal data constitutes any information relating to a natural person or data subject which can be used to directly or indirectly identify that person, for example, email addresses, bank details, telephone numbers, tax identification numbers, copies of passports, etc.

At Heritage, we undertake to keep your personal data secure and private, and not to share your personal data with any third party. We will only use your personal data to manage our relationship with you and to meet your investment requirements.

Heritage has a necessary and legal obligation to obtain certain personal information on all our investment clients to meet our obligations as investment managers and to comply with anti-money laundering regulations and the automatic exchange of tax information. Every investment client is, accordingly, required to complete and sign our Investment Agreement, which provides us with your personal details and sets out our obligations with regard to the personal data we hold on you.

Prior to 25th May 2018, we will be updating our Data Protection Policy document and will be publishing it on our website. We would encourage clients to read this document on our website to familiarise themselves with the enhanced data protection regulations, and their individual rights and how to exercise them.

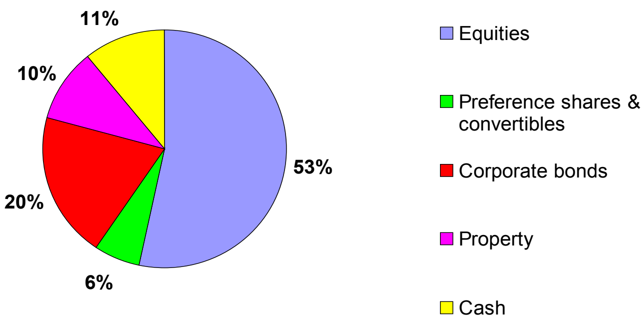
SVS Heritage Balanced Portfolio Fund

Price at 31/03/18	111.9p (launched at 100p 1/12/16)
Fund size	£15.23m
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

Performance

Total Return to 31/03/18	2018 ytd	2017
Heritage Balanced Portfolio Fund A Accumulation	-2.70%	12.30%
Thomson Reuters UK Index	-7.95%	8.53%

Asset allocation



Commentary

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) – i.e. 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.

The Fund had its first negative quarter as markets suffered a weak start to the year. Overall the UK market fell by 8% whilst the Fund's loss was limited to 2.7% helped by the relatively cautious approach that we adopt.

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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