Heritage

Quarterly Newsletter & Investment Review

Issue 82 Quarterly news & investment review from Heritage Quarter 2 2018

In this issue

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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Markets flat after a second quarter recovery

Following the sharp falls suffered in the first quarter of 2018, markets have staged a decent recovery in quarter two and are now broadly flat for the first half of the year.

The Heritage Funds have had a good quarter and we are particularly pleased to note that the 3.87% gain for our largest fund, The Heritage Managed Portfolio Fund has taken its share price above £300, meaning that anyone invested from when it started in 2000 has now trebled their original investment. 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).

Value investing and the UK stock market

Our investment approach is based upon actively seeking out sound long term investments opportunities but of course the best looking companies are often highly priced and so the key is to avoid overpaying and instead find the attractive investments that are undervalued by the market. In the past this discipline has served us well, for example during the technology bubble when we avoided the overpriced internet stocks and were able to invest in unloved and underpriced solid dividend paying shares.

There are a range of valuation tools that we use with the most well-known ones being the Price to Earnings Ratio and Dividend Yield and for companies that have significant assets such as property and financials, the Price to Net Asset Value. Typically we undergo this valuation exercise for the individual companies that we analyse but it is also possible to calculate average valuations for the entire market and to compare these across different sectors and regions. The regular table at the bottom of page 2 of our newsletter includes a selection of such valuation data for the major markets and what is currently interesting to note is how cheap the UK looks relative to the other markets with a PE ratio of just 13 and a dividend yield of 4%.

The main reason for this is that the UK market is currently out of favour with the majority of global fund managers who have been avoiding the UK, primarily due to fears over Brexit. Whilst the current uncertainty surrounding Brexit is undoubtedly a cause for concern, London remains a major global financial hub and the reasons for this are deep rooted and likely to endure as Britain is an open, developed market with a multitude of global relationships, good corporate governance and a strong legal and regulatory framework. It also helps that English is the main international business language and that the UK now has one of the lowest corporation tax rates in the developed world. London is therefore not just a home for domestic UK companies, but is seen as a good base for a wide range of global multinational groups and an analysis of all UK listed companies reveals that around two thirds of the total turnover and profits come from overseas - a dynamic which is sometimes overlooked and actually acts as a very good hedge against weakness at home and in the pound.

Overall, we think that markets are likely to ultimately move on from their current fears concerning the UK and patient value investors will be rewarded – whilst being paid an attractive and growing dividend yield in the meantime.

Heritage Capital Management Limited

Review for the quarter ended 30th June 2018

Market Commentary and Outlook

Following a very weak first quarter all of the major markets had a positive second quarter, although the US is the only one to make it back into positive territory at the half year stage.

Whilst corporate profits and the global economy are currently in fairly decent shape a lot of the good news had already been anticipated and priced in to markets following their good run last year and further progress this year appears to be being held back by concerns over rising US interest rates and the possibility of a global trade war.

Whilst on the one hand rising US interest rates are a sign of a strengthening economy, higher rates also exert a downward pressure on both equity and bond markets, as the present values of future cash flows are less valuable when discounted at higher rates.

Markets are also having to deal with the possibility of the first major trade war in recent times and the uncertainty surrounding such an outcome. Having already threatened major changes to tariffs on China, US president Trump appears to have now also set his sights on Europe.

At present it is not clear to what extent this is just political posturing, but if carried out it could lead to retaliation and a full scale battle that would certainly have major negative consequences for trade in a range of key sectors such as aluminium, steel, agriculture and automobiles.

United Kingdom

The UK was the best performing major market this quarter with an 8.2% gain but after a very weak first quarter it is still down by just over 0.6% for the year-to-date.

Leading the UK market in recent months have been the London listed major global oil and resources companies such as BP, Royal Dutch Shell and BHP Billiton which were all up around 20% but perhaps surprisingly the top spot this quarter was taken by food retailer, Sainsbury's which was up over 30% after announcing its intention to merge with its Walmart owned rival, Asda.

As noted in our article on page 1, Brexit continues to be a major headwind for the UK and in particular the lack of progress by politicians towards finalising a mutually acceptable deal, as the 29th March 2019 exit deadline draws ever nearer.

United States

The US market also had a decent quarter and its rise of 2.9% has helped produce an overall gain of 1.7% for the year-to-date.

Despite the wobble earlier in the year the global technology giants have continued to lead the market higher by resuming their upwards march, with Apple currently leading the race against Amazon and Microsoft to become the world's first company to achieve a $1 trillion valuation.

For now the US remains also the only major economy to be considered strong enough to justify interest rate rises and the most recent increase to 2% means that the differential between the US Dollar and other major currencies is becoming quite significant and has been driving the Dollar higher.

Europe

European markets were weakest this quarter with a comparatively lacklustre gain of just 1% leaving the region down by just over 3% for the first half of the year.

The economy is not showing sufficient strength to justify a rise in the Euro interest rate which remains at zero and political risk in Europe continues to heighten with the formation of a new populist government in Italy and the recent dispute between German chancellor, Angela Merkel, and her coalition partners over immigration has exposed the further weakening of her position after 12 years of solid rule.

Japan

Whilst a near 4% gain made it a decent quarter for the Japanese market it has still not been able to lift the so called "iron coffin lid" after nearly 30 years of trying and failing to break through to new highs that were originally set before the crash in the late 1990s.

Emerging Markets

Whilst the major developed markets have all recovered their first quarter losses to varying degrees, by contrast emerging markets have generally suffered a much poorer second quarter with China's A share index and Brazil's Bovespa amongst the worst performers with falls of well over 10%.

Investment Statistics - 30/06/2018

Equity Markets	Q2 2018	2018	2017	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	0.34%	-0.38%	24.62%						
US (S&P 500)	2.93%	1.67%	19.42%	22	2.4%	2.00%	2.85%	1.3209	1.0000
UK (FTSE 100)	8.22%	-0.66%	7.63%	13	4.0%	0.50%	1.28%	1.0000	1.3209
Europe (STOXX 50)	1.01%	-3.09%	6.49%	15	3.6%	0.00%	0.31%	1.1303	1.1685
Japan (Nikkei 225)	3.96%	-2.02%	19.10%	17	1.8%	-0.10%	0.03%	146.23	110.68

Total returns- including dividends

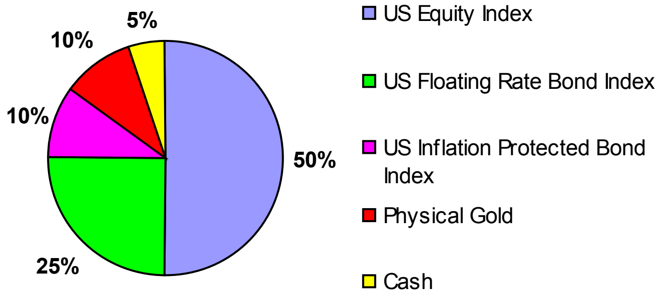
Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 30th June 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 June 2018	US$158.44	£303.04		
Return for quarter (net)	0.95%	3.87%	0.64%	6.57%
Year 2018 return (net)	-0.63%	1.88%	1.18%	1.92%
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%
Compound annual return (from 1/01)	2.61%	6.58%	2.13%	6.60%
Annual volatility	4.55%	3.57%	0.10%	7.59%
Size of Fund (millions)	U$13.8	£190.1		

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 to limit calendar year losses to single digits.

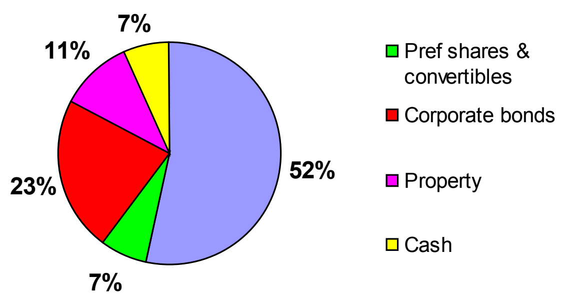
The investment in the US equity index ETF for growth tracks the S&P 500 largest US companies and yields 1.59% per annum. The risk of significant loss is hedged using derivatives.

During the quarter we switched the corporate bond ETFs into a floating rate bond ETF to protect the capital and for income. This ETF yields 1.79% per annum and its yield will increase as US interest rates are raised. The US Treasury inflation protected bond ETF is held as a hedge against an increase in inflation and has a yield of 2.36% per annum.

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

The Fund gained 0.95% for the quarter, but is unfortunately still down 0.63% year-to-date due to the strong US Dollar and unsettling geopolitical climate. It is, nevertheless, well positioned to generate future returns 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.

The Fund had a good quarter with a positive return of 3.87% and is now up by 1.88% for the year-to-date.

The majority of our shareholdings made good gains as stock markets enjoyed a strong recovery. Among the Fund's top contributors were Bloomsbury Publishing (up 33% due to results ahead of expectations), BP & RD Shell (up 20% on the back of higher oil prices) and our largest holding, Computacenter (up 26% following a positive trading statement). With markets having been a bit more volatile so far this year we have been looking for opportunities to top up our favoured holdings and have also added a new holding, RELX, the global business information provider.

Our property holdings also had a good quarter with the best performances coming from smaller niche companies including Circle Property (up 33%) and Conygar (up 16%).

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 general market weakness.

Exchange of tax information under FATCA and CRS

In previous quarterly newsletters, we have 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 such information to tax authorities.

This legislation includes the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS), and covers over 100 jurisdictions worldwide. This 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.

Under UK law, Heritage must report information regarding account holder tax residency to the UK tax authority (HMRC) based on information we currently hold. In May 2018, we had to report on all clients for the year ended 31st December 2017 who are tax resident in the following countries; France, Germany, Guernsey, Italy, Netherlands, Portugal, Seychelles, South Africa, Turks and Caicos Islands and the United States of America.

In relation to trusts, HMRC are 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. For companies, HMRC are looking into the tax residencies of those who hold equity interests.

Under FATCA and CRS, the following information in relation to each identified Reportable Client will be reported annually to HMRC: Name; Date of Birth; Country and City of Birth; 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.

Please be aware that more governments globally will be introducing tax exchanging legislation and so our reportable client jurisdictions will continue to expand. Australia, Bahamas, Canada, Mauritius, Monaco, New Zealand, Russia and many others will become reportable tax jurisdictions. For more information on which countries will be reportable next year, please have a look on the OECD's website.

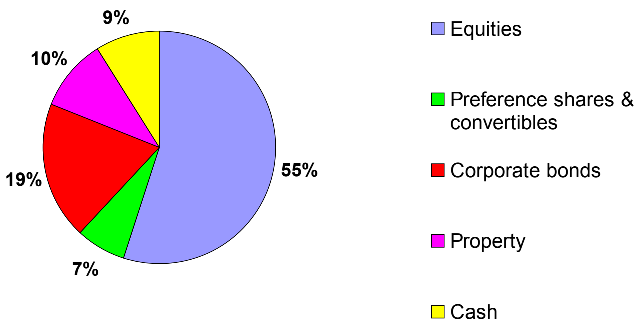
SVS Heritage Balanced Portfolio Fund

Price at 30/06/18	116.7p (launched at 100p 1/12/16)
Fund size	£16.4m
Fund type	OEIC, UCITS (UK domiciled)
Eligible for	ISAs, SIPPs, Funds at Lloyd's
Pricing and dealing	Daily
Minimum Investment	£10,000
Management fee	1% per annum
Administrator/ACD	Smith & Williamson

Performance

Total Return to 30/06/18	2018 ytd	2017
Heritage Balanced Portfolio Fund A Accumulation	1.48%	12.30%
Thomson Reuters UK Index	-0.61%	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 a good quarter with a positive return of 4.3% and is now up by 1.48% for the year-to-date. The more detailed comments on the HMPF performance on page 3 of this newsletter also apply to the SVS Heritage Balanced Portfolio Fund.

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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