Heritage

Quarterly Newsletter & Investment Review

Issue 83 Quarterly news & investment review from Heritage Quarter 3 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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Local markets struggling to progress this year

The UK market was down over the third quarter and together with the rest of Europe remains in negative territory so far this year, in contrast to the US market which continues to power ahead.

Against this background the Heritage Managed Portfolio Fund did at least manage to eke out a small positive return this quarter and together with the USD Absolute Return Fund is now up by just over 2% for the year-to-date. 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).

The importance of investment income

It is a common misconception that the income from investments is of primary importance to retired individuals who need to produce a regular income stream from their investment portfolio and that longer term investors should be more concerned with capital growth. However, the truth is that income is a vital part of the total return for all investors due to the powerful effect of compounding of reinvested dividends. In fact £1,000 invested in the FTSE 100 index at the turn of the century would be worth just £1,080 today but with dividends re-invested the original sum would have more than doubled to £2,075. This startling difference proves just how vital it is for long-term investors to reinvest the income from their portfolio in order to maximize returns and there are some practical issues that can help ensure that investors fully benefit from this effect.

Unlike most portfolios and other funds, the Heritage Funds are set up in a way that derives maximum benefit as all income in our offshore "roll-up" fund is retained within the Fund for reinvestment and because income received in the Fund is not taxed, it is the gross rather than net amount that is reinvested. Our newer UK Balanced Portfolio Fund has also been established with an "Accumulation" share class which automatically reinvests all income rather than distributing it. These fund structures are not only helpful for those seeking to maximize long-term returns, but are also tax efficient for those who do require an income, as the exact amount and specific timing of the required "income" can be generated through regular or ad-hoc small redemptions (as described in more detail on page 4).

Furthermore, our funds have a bias towards profitable companies that have established and sustainable business models that enables them to pay attractive levels of dividends and we also receive a decent level of income from the interest on our higher yielding corporate bonds and the rental income from our property based investments, all of which has been reinvested over the years and has helped £1,000 invested in our Managed Portfolio Fund at inception in 2000 to grow to be worth over £3,000 today.

Overall we therefore believe that these advantages make the Heritage Funds a useful tool in helping investors to reap the maximum benefit from the powerful effects of compounding and reinvested investment income.

Heritage Capital Management Limited

Review for the quarter ended 30th September 2018

Market Commentary and Outlook

Most investors are familiar with the concept of correlation whereby the major global markets generally tend to move both up and down broadly in line with each other. However, this year is proving to be less typical with the negative returns for the year-to-date from UK and European markets contrasting with the positive performances of the US and Japan.

The strength of America and Japan has also been at odds with emerging markets where it has been a poor year with political and economic trouble on a number of fronts leading to weakness in both currencies and stock markets. Turkey has been suffering a perfect storm of twin deficits, high inflation and a president who has made things worse, leading to a currency crisis.

Argentina is in the midst of a debt crisis and its Peso has fallen by over 40% this year, and in South Africa any optimism over its prospects under new president, Cyril Ramaphosa, has evaporated on news that the economy has entered recession. Although China's economy may just be losing a bit of steam at present, its stock market has already entered a bear market this year with a potential trade war with the US not helping things.

Whilst it is difficult to predict how long the current divergence in the international markets will continue and who the next relative winners and losers will be, the lesson once again for investors appears to be the importance of diversification.

United Kingdom

The UK was the weakest of the major markets this quarter with a fall of 1.66% taking the year-to-date loss to 2.31%.

Whilst Brexit continues to be a headwind for the UK market at the moment, it appears that foreign companies are looking through the short term disruption to see the long-term value and strength in the underlying businesses, as the best performances from FTSE 100 stocks this quarter were due to takeovers from American companies. Firstly, Coca-Cola bid just under £4bn for Whitbread's Costa Coffee division and then Comcast prevailed in a long running battle with 21st Century Fox (backed by Disney) with a £30bn winning bid for Sky TV.

The challenge and opportunity for active investors is therefore to see what other hidden value they can find within UK listed companies before they get snapped up by foreign competitors.

United States

The US market had a good quarter with a gain of 7.20% resulting in the strongest year-to-date return of all the major markets at 8.99%.

During the quarter the race to become the first company worth $1 trillion was won by Apple, followed shortly afterwards by Amazon, helping the company's CEO, Jeff Bezos, become the wealthiest person in the world.

The US economy has also continued to strengthen, leading the Federal Reserve bank to increase interest rates by another 0.25% to 2.25%. Although this is still well below what was considered normal before the financial crisis ten years ago, it is now well above the rates for other major currencies.

Europe

European markets were broadly flat this quarter leaving them down by 3% for the year-to-date.

The Euro interest rate remains at zero with most banks actually charging negative interest on balances held. Clearly this is not the sign of a normal healthy economy and political risk remains heightened in the Eurozone with Italy being the latest cause for concern as the new populist coalition government has prepared a budget showing a 2.4% deficit for the next few years, which has not surprisingly impacted the government bond market.

Japan

The Japanese market has continued its recent strong run with a gain of just over 8% this quarter taking the year-to-date return for the Nikkei index to 5.95%. The market is currently being led by the major exporters, such as Toyota, that are benefitting from decent global growth coupled with a weaker Yen which is helping their international competitiveness.

Emerging Markets

As noted above it has been a very difficult year so far for emerging markets and the overall fall in the emerging markets index of around 10% would have been even worse if it had not been for some positive contributions from India and Russia.

Investment Statistics - 30/09/2018

Equity Markets	Q3 2018	2018	2017	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	3.90%	3.50%	24.62%						
US (S&P 500)	7.20%	8.99%	19.42%	22	2.3%	2.25%	3.06%	1.3031	1.0000
UK (FTSE 100)	-1.66%	-2.31%	7.63%	12	4.2%	0.75%	1.57%	1.0000	1.3031
Europe (STOXX 50)	0.11%	-2.99%	6.49%	16	3.6%	0.00%	0.47%	1.1227	1.1609
Japan (Nikkei 225)	8.14%	5.95%	19.10%	17	1.7%	-0.10%	0.13%	148.12	113.70

Total returns- including dividends

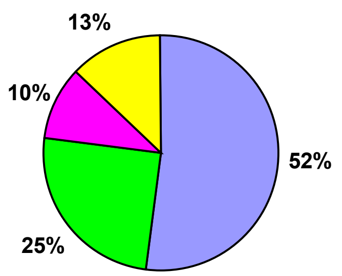
Source: Thomson Reuters and the Financial Times

Heritage Investment Fund Limited

Review for the quarter ended 30th September 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 30 September 2018	US$162.87	£303.49		
Return for quarter (net)	2.80%	0.15%	0.71%	5.32%
Year 2018 return (net)	2.15%	2.03%	1.90%	7.35%
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)	2.73%	6.49%	2.14%	6.82%
Annual volatility	4.64%	3.52%	0.10%	7.62%
Size of Fund (millions)	U$14.2	£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 currently track US equity and bond 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.

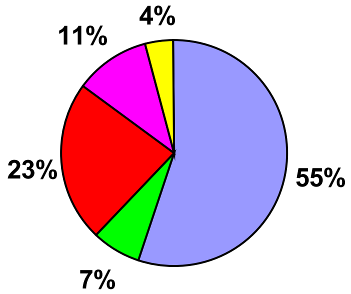
The investment in the US equity index ETF for growth tracks the S&P 500 largest US companies and yields 1.47% per annum. The risk of significant loss is hedged using derivatives.

The US floating rate bond ETF, which is held to protect the capital and to generate income, yields 2.57% 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 nominal yield of 2.57% per annum.

The investment in the physical gold ETF was sold during the quarter as it produces no yield in a climate of rising US interest rates.

The Fund gained 2.80% for the quarter and is up 2.15% for the year-to-date. It is 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 was marginally up by 0.15% in the third quarter and overall is now up by 2.03% for the year-to-date.

With the UK market falling this quarter it has been hard for our equity portfolio to make much progress and the notable exceptions were due to individual stock specific news, including the culmination of the bidding war for Sky, a new CEO and strategy for retirement house builder McCarthy & Stone and positive news on product development from Victrex and AstraZeneca.

Our bond portfolio, which consists of mostly higher yielding corporate bonds, had a solid quarter and the running yield of just over 6.5% continues to provide a useful boost to the fund's income.

Our property holdings also had a reasonable quarter, helping to demonstrate that our strategy of blending shares with bonds and property gives us good diversification and a smoother ride than fund strategies that focus solely on equities.

The Fund's portfolio of investments remains well positioned to generate attractive returns for long-term investors, whilst our relatively defensive positioning should continue to provide some protection against the risks of any general market weakness.

A guide to the UK tax implications of investing in the Heritage Funds

Heritage manages investment funds in two jurisdictions, the Heritage Investment Fund Limited (HIFL), which is domiciled in Guernsey and comprises two sub-funds, namely the Heritage Sterling Managed Portfolio Fund and the Heritage US Dollar Absolute Return Fund, and the SVS Heritage Balanced Portfolio Fund (HBPF) domiciled in the UK.

HIFL is a roll-up fund which automatically retains income and capital gains within the sub-funds without the deduction of tax. On an ongoing annual basis there is no need for the individual investor to account for or pay any tax as long as the they remain fully invested.

When an investor sells some or all of their shares in HIFL, only that portion of the proceeds that represents a gain will be taxable as income and the balance will be treated as a return of capital. For example, if your original investment was £100,000 and three years later it is worth £120,000 you may decide to drawdown the £20,000 return. However, you do not pay tax on the full £20,000 but just on the 20% of it that represents growth, i.e. just £4,000 is taxable.

HBPF, on the other hand, has two classes of shares:

Accumulation shares which retain income within the fund and the value of this income is reflected in an increase in the share price. In relation to tax, an individual investor will need to report this income as dividend income on their tax return, even though it has not been received in cash. For capital gains tax purposes, when calculating gains or losses, this notional dividend income should be added to the cost of the shares as it is effectively reinvested.

Income shares which pay out the income arising on the underlying investments as a cash dividend and an individual investor will need to report this income as dividend income on their tax return.

Notional and cash dividend income received from HBPF is paid gross, i.e. without deducting any income tax. The Fund makes notional or cash dividend distributions twice a year to shareholders registered at the ends of June and December.

Finally it should be noted that the exact tax position will differ depending on personal circumstances and many of our clients will hold the funds within a pension, ISA or trust that may further mitigate or eliminate any tax payable.

Please note that the guidance above is based on our current interpretation of tax law and HM Revenue & Customs practice. At Heritage, we do not provide tax or legal advice. We recommend that you use our interpretation above as a general guide only and that you seek advice from your tax adviser.

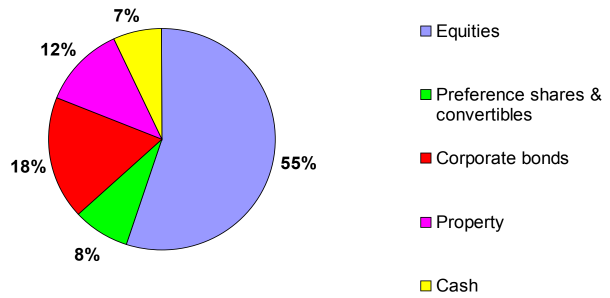
SVS Heritage Balanced Portfolio Fund

Price at 30/09/18	116.7p (launched at 100p 1/12/16)
Fund size	£16.9m
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 30/09/18	2018 ytd	2017
Heritage Balanced Portfolio Fund A Accumulation	1.48%	12.30%
Thomson Reuters UK Index	-2.26%	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 flat quarter and remains 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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