Heritage

Quarterly Newsletter & Investment Review

Issue 89 Quarterly news & investment review from Heritage Quarter 1 2020

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.

Contacts - directors

Graeme Olsen
graeme@heritage-capital.co.uk
Graeme is responsible for client portfolios and advising the Heritage Managed Portfolio and SVS Heritage Balanced Portfolio Funds.

Roy Glew
roy@heritage-capital.co.uk
Roy is responsible for advising the Heritage Absolute Return Fund.

Jemma Spencer
jemma@heritage-capital.co.uk
Jemma is responsible for compliance oversight and assisting with the management of the Heritage funds.

www.heritage-capital.co.uk
Tel +44 (0) 20 7799 2110
Fax +44 (0) 20 7222 1599
Broadway House, Tothill Street,
London SW1H 9NQ

Coronavirus deals a severe blow

Whilst the current coronavirus pandemic is primarily a global healthcare crisis and naturally all of our main concerns at this time are for our friends, family, work colleagues and frontline medical staff, investment markets have also been severely impacted, making the current quarter the worst since the stock market crash of 1987.

The rate at which the virus is spreading and the severity and implications for the economy of the measures required to try and contain it have come as a huge shock and by mid March most major markets, including the FTSE index, had experienced at least one daily loss of over 10% and an overall plunge of around 30% from their recent highs. The Heritage funds have not been immune and our Managed Portfolio Fund has suffered its worst quarter in its 19 year history with a loss of 17.95%. Further details and commentaries on our funds can be found on pages 3 and 4, where we also explain how our US Dollar Absolute Return Fund has managed to hold up so well during such a tumultuous quarter.

Long term investors should keep faith with their strategy

The Coronavirus crisis has caused extreme turbulence and volatility on a scale not seen since the global financial crisis over 10 years ago and at times such as these there is quite naturally a tendency for investors to become fearful, or even panic and sell their investments. However, amid all this doom and gloom it is important that investors keep faith in their long-term investment strategies as there remain very good reasons for doing so.

Firstly, valuations are now looking very attractive for those prepared to look beyond the current overwhelmingly negative news on the economy and corporate profitability. This applies not only to shares but also investment trusts and listed property companies that are now trading at steep discounts to their underlying net asset value and corporate bonds where prices have fallen and yields have risen to extremely attractive levels. It is exactly times such as these when markets are gripped by fear and uncertainty that some of the best long-term buying opportunities appear. The only caveat that we would add for the current situation is that it is important to look at balance sheet strength to see which companies are financially robust enough to survive a temporary drop in activity and profits and to also consider if the current crisis will lead to any longer term structural changes – for example will large amounts of business travel and meetings end up being permanently replaced by remote communications and will “just-in-time” supply chains need to be completely restructured?

Also, a look back at history helps to put some perspective on things as there have been a number of severe shocks to markets in the past including the above mentioned 1987 crash, the 9/11 terrorist attacks in 2001 and the global financial crisis in 2008/9, but these have always been followed by a recovery. In fact Heritage clients with a good memory will note the similarity between our message now and the one in our newsletter in early 2009, towards the end of the financial crisis and those who did not panic and remained invested in our Heritage Managed Portfolio Fund have subsequently been rewarded with a more than doubling of their investments - even after the recent sharp setback.

Overall, although markets may remain volatile and could yet fall further in the short-term, we have always taken the view that investment is a long term activity and whilst setbacks such as these do feel uncomfortable at the time, the right thing to do is not to panic and rather to wait for the crisis to pass and things to recover – as they always have done in the past.

Heritage Capital Management Limited

Review for the quarter ended 31st March 2020

Market Commentary and Outlook

The longest bull market on record, which was principally driven by abnormally low interest rates since the financial crisis of 2008, has finally come to a dramatic end with the unexpected onset of the global coronavirus pandemic. All of the major equity markets have entered bear market territory with falls of at least 20% and corporate bonds and property investments have also seen significant falls.

The global economy, which until recently was forecast to continue to grow at a reasonable rate, is now almost certainly heading for a severe recession and in response to this governments and central banks around the world have launched a range of measures that are unprecedented in both their size and range, including interest rate cuts, further quantitative easing, fiscal stimulus as well as a wide variety of innovative new relief packages for businesses and individuals.

Whilst this is undoubtedly much needed, it is nevertheless also the case that the massive cost and associated increase in government debt will continue to be a burden for a long time to come, whilst in the short term it will still not be enough to prevent a serious economic slowdown.

From an investment point of view, it is worth noting that stock markets tend to bottom out well before the economy itself starts to recover, so keeping an eye out for early signs that the worst is over will be important. In this case that might be signs that new infections or death rates are starting to fall, announcements that draconian lockdown measures are being lifted or positive news on vaccines and other medical progress.

United Kingdom

In the UK the FTSE 100 index ended the quarter down by 24.8%, whilst mid and small caps have been hit even harder with falls of over 30%, making this the worst quarter for UK equity markets since the 1987 crash.

Having been thrown in at the deep end, the new Chancellor, Rishi Sunak, announced in his first budget a wide range of government grants and schemes to combat the threat from the virus at a cost of around £12bn, but as the scale of the crisis became apparent he has had to massively increase the response to a £350bn relief package and an undertaking to do "whatever it takes" to help get the UK through the crisis and help soften the blow to the economy.

We also have a new Governor of the Bank of England with former FCA head, Andrew Bailey, having to oversee two base rate cuts in just over a week from 0.75% to a new record low of just 0.1%.

United States

The S&P 500 index ended the quarter down by 20% and the volatility experienced by investors has been quite extreme, with a total fall between the high in February and the low in March of 34%.

In response to the crisis the US Federal Reserve announced a liquidity programme that included buying corporate debt, something that they did not go as far as doing in the 2008 financial crisis and this was shortly followed by an unprecedented $2 trillion package of spending and tax breaks agreed between Republicans and Democrats.

Europe

Much in line with other major indices, the European market was down by 24.8% in the first quarter.

After initially being criticised for its weak and slow response to the current crisis, the new ECB head, Christine Lagarde, has now announced a €750bn package including further quantitative easing. One of the issues relating to the current crisis is the potential for it to cause a rift similar to that seen during the European debt crisis in 2010-12, as the stimulus packages announced by the richer countries in the north led by Germany and the Netherlands are far greater than those for their poorer more indebted neighbours in the south such as Italy and Spain, who so far appear to have been more severely impacted by the COVID-19 pandemic.

Japan

With a fall of over 25% Japan was actually the weakest of the major markets this quarter, despite the fact that it has had far fewer cases of infection and deaths than many other countries so far. The news that the Olympic Games will not be going ahead in Tokyo this year is undoubtedly a blow but should at least now provide a boost in 2021when they have been rescheduled for.

Emerging Markets

Whilst the COVID-19 pandemic originated in China, it appears that the experience of the SARS virus in 2003 has left the Far Eastern countries much better equipped to deal with such outbreaks, although the worry is that many other emerging markets appear to be far less well placed to deal with the virus and that any badly handled lockdown response has the potential to cause major economic and societal problems.

Investment Statistics - 31/03/2020

Equity Markets	Q1 2020	2019	2018	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	-22.47%	26.29%	-9.61%						
US (S&P 500)	-20.00%	28.88%	-6.24%	18	2.9%	0.25%	0.70%	1.2420	1.0000
UK (FTSE 100)	-24.80%	12.10%	-12.48%	13	5.7%	0.10%	0.36%	1.0000	1.2420
Europe (STOXX 50)	-25.59%	24.78%	-14.34%	15	4.3%	0.00%	-0.46%	1.1261	1.1031
Japan (Nikkei 225)	-20.04%	18.20%	-12.08%	15	2.5%	-0.10%	0.02%	133.57	107.55

Total returns- including dividends

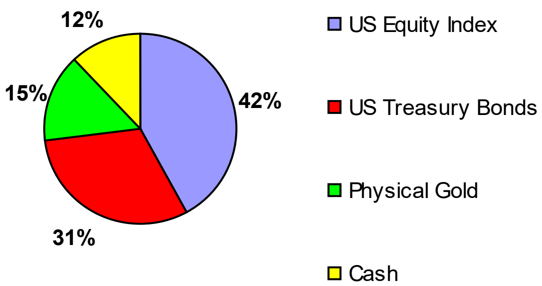
Source: Thomson Reuters

Heritage Investment Fund Limited

Review for the quarter ended 31st March 2020

Performance	US Dollar Absolute Return Fund	Managed Portfolio Fund	Inflation (US)	Inflation (UK)
Risk profile	Low	Medium		
Minimum investment horizon	3 years +	5 years +		
Target net annual return	5%	6-7%		
Price at 31 March 2020	US$166.82	£276.06		
Return for quarter & ytd 2020 (net)	-0.67%	-17.95%	0.19%	0.40%
Year 2019 return (net)	11.37%	16.31%	1.79%	1.82%
Year 2018 return (net)	-5.42%	-2.76%	2.49%	2.51%
Year 2017 return (net)	10.83%	11.50%	2.14%	2.72%
Year 2016 return (net)	2.08%	7.48%	1.16%	0.68%
Year 2015 return (net)	-0.47%	6.80%	0.08%	0.04%
Year 2014 return (net)	5.42%	7.74%	1.65%	1.47%
Compound annual return (from 1/01)	2.64%	5.45%	2.13%	2.12%
Annual volatility	4.16%	15.29%	0.08%	0.08%
Size of Fund (millions)	US$18.0	£161.7		

US Dollar Absolute Return



The US Dollar Absolute Return Fund aims to generate annual returns in excess of inflation and to protect investors' capital against significant double-digit annual losses by hedging using derivatives. The Fund invests in liquid, well-diversified exchange traded funds which track US equity, bond and gold indices, whose returns are normally uncorrelated in order to reduce losses and volatility.

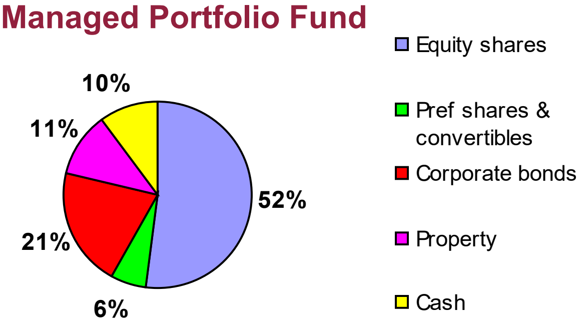
The US equity market position, which is held for growth, fell significantly in value during the quarter as the coronavirus spread globally and concern escalated over the impact on global economic growth. This loss was partially offset by strong gains on our managed derivatives positions.

The position in US Treasury Bonds, which is held for capital protection and as a hedge against equity market weakness, rose in value during the quarter as yields fell to historical lows as investors sought safety from falling equity markets in government bonds.

The physical gold position, which is held as a hedge against inflation and US Dollar weakness, also gained in value during the quarter, but did not prove to be as an effective hedge as we had hoped as investors took profits and sold gold to raise cash.

During a quarter of steep equity and corporate bond market falls, the Fund only lost 0.67% and its hedging strategies proved to be largely effective. The uncorrelated, diversified asset class exposure and the protective derivatives positions should help insulate the Fund against double digit losses during the current year in the event of markets falling further.

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 recent severe downturn in markets due to the disruption and uncertainty caused by the Coronavirus pandemic has resulted in the Fund recording its worst ever quarter with a fall of 17.95%.

Within our share portfolio all of our holdings were down this quarter, as the market sell-off has been widespread and largely indiscriminate. Holdings in a number of our favoured investment trust funds and listed property companies have also been hit hard and have suffered from a widening of their discounts to net asset value, with the only bright spot being the positive returns from our two healthcare property companies.

Also, whilst our bonds initially held up quite well, the recent increased risk aversion in markets has seen credit spreads widen significantly and prices have fallen to levels where our overall bond portfolio now offers an attractive average yield of 7.5%.

Although the outlook is currently very uncertain, we believe that our portfolio of investments remains well positioned to generate attractive returns for long-term investors, whilst our decent cash weighting should provide some protection against the risks of further market weakness and enable us to add to favoured investments at attractive prices.

Heritage coronavirus update

As the COVID-19 pandemic continues to wreak havoc with the economy and force the shutdown of entire industries, it is important to reassure all our clients that Heritage remains robust and able to continue to do business. Despite the enforced closure of our London office due to the lockdown imposed to contain the virus, we are fortunate given the nature of our business that all of our team are able to work remotely and we have now successfully implemented this. As we are sure clients will understand, we are currently unable to conduct face to face meetings but remain available to deal with any investment trades, payments and queries etc. as usual via email and phone.

Performance of Heritage US Dollar Absolute Return Fund

After periods of underperformance during the bull market, due to the cost of hedging the downside risk which acts as a drag on returns, our Absolute Return Fund has proved to be a fairly stable investment during these uncertain and volatile times. The Absolute Return Fund typically has about half of its funds under management invested in the US equity market giving it exposure to the largest multinational and technology companies based there. It uses derivatives to hedge this exposure against the risk of significant losses, and gains on these option positions this quarter have partially offset the fall in value of US equities.

To further protect the investment portfolio and reduce volatility, the Absolute Return Fund also holds investments in US government bonds and physical gold, which typically have a negative or low correlation with equity market returns. Although our holding of US Treasury bonds has risen in value as investors have sought safety in government bonds, government bond prices have fluctuated significantly as fund managers have come under pressure to sell their most liquid holdings in order to return cash to investors.

Our gold holding has not proved as effective a hedge against equity market weakness as we had hoped, as equity market falls have become so severe and volatile that nervous investors have been realising all their assets (including gold) and converting them to cash. The exceptionally strong US Dollar, as investors have sought safety in the world's largest reserve currency, and lower inflation expectations have also restrained the rise in the price of gold, which is priced in US Dollars.

For those of our Sterling based investors who have diversified part of their portfolio into our US Dollar denominated Absolute Return Fund, they have had the added benefit of a currency uplift as Sterling has fallen in value against the US Dollar during the quarter and the small loss in US Dollars for the quarter has resulted in a gain when expressed in Sterling terms.

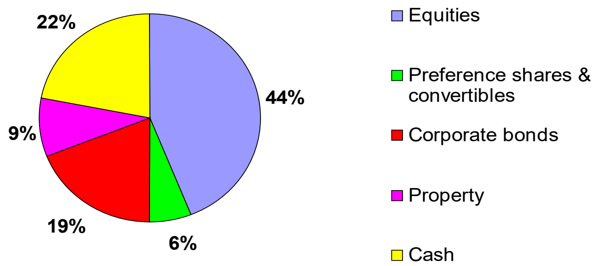
SVS Heritage Balanced Portfolio Fund

Price at 31/03/20	107.3p (launched at 100p 1/12/16)
Fund size	£21.21m
Fund type	OEIC, UCITS (UK domiciled)
Eligible for	ISAs, SIPPs, Funds at Lloyd's
Pricing and dealing	Daily
Minimum Investment	£10,000
Administrator/ACD	Smith & Williamson

Performance

Total Return	Q1 2020	2019	2018	2017	Inception 01/12/16
SVS HBP Fund	-18.28%	18.29%	-3.48%	12.30%	7.30%
UK CPI	0.40%	1.82%	2.51%	2.72%	7.24%

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 coronavirus pandemic has severely impacted the Fund which has suffered the worst quarter since its inception with a loss of just over 18%. 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.

Heritage Capital Management Limited
Broadway House, Tothill Street, London SW1H 9NQ
Tel: +44 (0) 20 7799 2110 Fax: +44 (0) 20 7222 1599
General email: info@heritage-capital.co.uk
Website www.heritage-capital.co.uk