Heritage

Quarterly Newsletter & Investment Review

Issue 97 Quarterly news & investment review from Heritage Quarter 1 2022

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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Rising inflation and Ukraine war make it a difficult start to the year for investors

Following a strong year in 2021 it has been a much more challenging start to 2022 for markets, with inflationary pressures leading to rising interest rates to contend with further compounded by the geopolitical uncertainty caused by the Russian invasion of Ukraine.

The Heritage funds also had a tough start to the year but a decent recovery towards the end of the quarter and relatively defensive positioning meant that the overall loss for the Heritage Managed Portfolio Fund was limited to 2.3%. As usual further details on the Heritage Managed Portfolio Fund are on page 3 and the SVS Heritage Balanced Portfolio Fund on page 4.

"Spotlight On" - Investing in Fixed Interest

Much of our investment commentary quite naturally centres around equities and in our previous quarterly newsletter we also covered investing in property. This time we take a look at the third major asset class that forms an important part of the Heritage funds, fixed interest securities or bonds as they are also commonly known. Generally bonds are less risky than equities but it is important to understand that there are many different types of fixed interest securities, each with their own characteristics.

Government bonds

Sovereign bonds are the most secure type of bond, as gilts (as they are termed in the UK) are backed by the government. However, whilst these bonds offer the best security the yields are extremely low and even after the recent increases due to inflation worries 10 year government bonds are yielding around 2.3% in the US, 1.6% in the UK and close to zero in Europe and Japan. In our view lending money to governments that are running huge deficits for long periods at low rates, against a backdrop of rising inflation, does not make an attractive investment and therefore the Heritage funds currently have no exposure to government bonds.

Corporate bonds

These securities, issued by large companies, rank above the ordinary shareholders and usually offer a fixed return consisting of regular interest payments known as coupons and a repayment of capital at the redemption date. Corporate bonds offer a higher yield than cash or government bonds and a good spread of bonds can therefore enhance the level of income in a portfolio whilst also providing a good level of capital stability.
Corporate bonds are rated in terms of their security with AAA bonds in solid blue chips with strong balance sheets at the top of the investment grade ratings tree, with a whole range of bonds below that, all the way down to riskier but high yield corporate bonds. The key to investing in corporate bonds is to analyse the issuing companies balance sheets and operations to find those with attractive yields but crucially are also financially strong enough to meet the interest and redemption payments.

Floating rate notes

Most conventional bonds pay a fixed coupon making them vulnerable to rising interest rates. However, it is also possible for bonds to pay coupons which reset periodically. A decent proportion of the bonds currently held within the Heritage funds are currently either floating rate notes or are bonds that will switch from a fixed to a floating rate at a future date, which will benefit from any increase in interest rates from their current low levels.

Continued on page 4.

Heritage Capital Management Limited

Review for the quarter ended 31st March 2022

Market Commentary and Outlook

Following the huge worldwide disruption caused by the Coronavirus pandemic over the past two years, any hopes that 2022 would see a return to calmer times were quickly replaced by increased volatility caused by rising inflation and the war in Ukraine, which left the World index down by 5.3% in the first quarter.

Whilst the hope is that the military conflict will be contained to Ukraine itself the economic implications for the wider world are already being felt. In particular energy prices have soared as sanctions are introduced on Russia and western European countries such as Germany scramble to find alternative sources of oil and gas. Overall it appears that the world may have now passed the peak of economic globalisation as individual countries become more concerned with the safety and security of crucial energy and food supplies and defence spending starts to rise.

On top of these new worries there are still risks associated with the pandemic to be aware of. Whilst it appears that in the west we have now moved on to a new phase of learning to live with the virus, China's zero Covid policy seems less well suited to moving beyond the pandemic stage. The latest draconian lockdowns in major commercial centres such as Shanghai mean that for the first time in many years Chinese GDP growth is set to be a drag on rather than an engine for global economic growth.

United Kingdom

The UK market has managed to buck the overall negative trend and the FTSE 100 was the only major market index to finish the first quarter in positive territory. However it is worth taking a closer look behind the headline figure at what is happening at the underlying level. The FTSE 100 has a large weighting to energy and commodity companies such as Shell, BP and Rio Tinto which are all currently benefitting from surging prices, whilst the large majority of companies were actually down. For example the FTSE 250 index which is made up of mid caps was down just under 10% this quarter, as were small caps and even within the FTSE 100 itself, 70 of the 100 constituents saw their share prices fall in the first quarter.

With UK inflation currently rising at the fastest rate for over 30 years the Bank of England's Monetary Policy Committee has made two further 0.25% interest rate rises this quarter and the base rate now stands at 0.75%.

United States

The US market was down by just under 5% in the first quarter. One of the major reasons behind this has been a sell-off in technology stocks and the tech heavy Nasdaq index was down by around 10%.

Some of the previously high flying stocks that have suffered setbacks include Netflix and PayPal which were both down 38% this quarter, Zoom down 35%, Facebook (recently renamed as Meta) down 33% and Docusign, Intuit, and Adobe all down by 20% or more.

As widely anticipated, the Federal Reserve has finally started to raise Dollar interest rates with a 0.25% increase to 0.50% being the first increase since 2018. With the current US inflation rate soaring to 7.9% and the unemployment rate decreasing to just 3.6%, the market is now expecting another 4 or 5 increases this year taking the overall rate to 2% by 2023.

Europe

Europe was the weakest of the major markets this quarter with an overall fall of 9.2%.

In common with other regions, inflation is also currently of major concern with the current rate of 7.5% being driven by surging energy prices, which are up 44% over the past year. However, despite inflation now being substantially above its stated 2% target, the ECB has so far been slower to react and interest rates have not yet even made it back into positive territory.

Japan

The Japanese Nikkei has held up relatively well with a fall of 3.4% in the first quarter. This fall however did make it the worst quarter since early 2020 and some of the recent weakness can be explained by profit taking after a good run, as unlike most western companies that tend to have December year ends, nearly all Japanese companies adopt a March year end in line with the Japanese government's fiscal year end.

Emerging Markets

Not surprisingly with two of the major emerging market "BRIC" companies embroiled in a war (Russia) and struggling with Covid (China), the overall emerging market index was weak in the first quarter. However, there were some exceptions including the more commodity based markets of the likes of Brazil and South Africa which did manage to buck the overall trend.

Investment Statistics - 31/03/2022

Equity Markets	Q1 2022	2021	2020	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
								vs GBP	vs USD
TR Global ($)	-5.33%	18.84%	15.73%						
US (S&P 500)	-4.95%	26.89%	16.26%	23	1.8%	0.50%	2.33%	1.3133	1.0000
UK (FTSE 100)	1.78%	14.30%	-14.34%	14	3.5%	0.75%	1.61%	1.0000	1.3133
Europe (STOXX 50)	-9.21%	20.99%	-5.14%	15	3.2%	0.00%	0.55%	1.1868	1.1065
Japan (Nikkei 225)	-3.37%	4.91%	16.01%	15	1.8%	-0.10%	0.21%	159.83	121.66

Total returns- including dividends

Source: Thomson Reuters

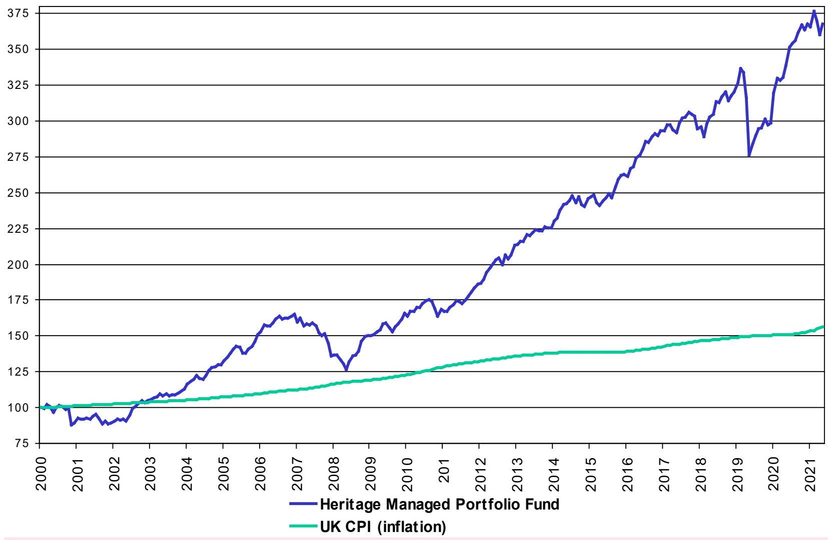
Heritage Managed Portfolio Fund

Review for the quarter ended 31st March 2022

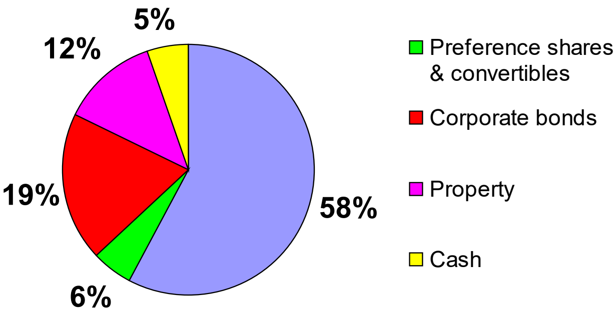
Performance	Managed Portfolio Fund	Inflation (UK)
Return for the quarter & 2022 ytd (net)	-2.31%	1.43%
Year 2021 return (net)	14.07%	2.20%
Year 2020 return (net)	-1.87%	0.93%
Year 2019 return (net)	16.31%	1.82%
Year 2018 return (net)	-2.76%	2.51%
Year 2017 return (net)	11.50%	2.72%
Year 2016 return (net)	7.48%	0.68%
Year 2015 return (net)	6.80%	0.04%
Year 2014 return (net)	7.74%	1.47%
Compound annual return since 2001	6.35%	2.12%

Fund information	
Price at 31 March 2022	£367.89
Fund size	£221.0 million
Fund domicile	Guernsey
Fund status	Non-distributor (“roll-up”)
Subscriptions/redemptions	Monthly dealing
Further Information	www.heritage-capital.co.uk
Risk	**Annual Volatility**
Managed Portfolio Fund	7.4%
TR World Index	13.9%

Price Performance



Asset Allocation



Commentary

The Managed Portfolio Fund seeks to generate attractive long-term investment returns 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 a weak start to the year for global markets generally, with the Russian invasion of Ukraine and rising inflation being the major concerns and against this background the Fund has held up relatively well to end the quarter down by 2.31%.

The majority of our holdings have been negatively impacted by the general market volatility this quarter and positive contributions were limited to a few individual companies that have been reporting strong trading news such as Bloomsbury Publishing and AstraZeneca, or resources companies including BHP and Shell that are benefitting from rising commodity prices. We also received a boost from a take-over at a 40% premium for our holding in our small cap aircraft broker, Air Partner.

Our property holdings had a mixed quarter with falls from most holdings balanced by a 15% jump in the price for Circle Property where positive action is being taken by the board to reduce the discount to the underlying net asset value and further good progress by Secure Income and Supermarket Income REITS.

It continues to be a tough environment for bonds generally, with rising interest rates and inflation hurting investment grade bond prices and general risk aversion weighing on higher yielding bonds, although overall we remain comfortable with our portfolio of fixed interest securities which yields over 6.5%.

Whilst the near term outlook remains uncertain, we believe that our portfolio of investments is well positioned to generate attractive returns for long-term investors, whilst our relatively defensive positioning should provide some protection against the risks of any short term continued market weakness.

“ Spotlight On” - Investing in fixed interest (continued)

Convertible bonds

These are bonds that in addition to providing the usual interest payments, also offer the holder the option of converting the bond into shares of the issuing company as an alternative to the repayment of capital at redemption. This can provide the possibility of capital gains if the company does well, whilst still providing the additional security of a bond if the shares do not perform.

Over the years we have been able to profitably convert a number of these bonds and we currently hold a convertible bond that has the potential to offer a decent capital gain, as the shares already trade close to the conversion price with another 3 years to go until the bond matures or converts in 2025.

Preference shares

Another type of security held in the Managed Portfolio Fund exhibiting properties of both equities and bonds are preference shares, which despite the reference to “shares” in their name actually have characteristics that are more akin to bonds as they rank ahead of the ordinary shareholders, pay a fixed dividend and can either have a set redemption date or be issued as perpetual securities. Also, there are still a few well managed split capital investment trusts which offer attractive opportunities to investors with a good understanding of the zero dividend preference share sector.

Overall our portfolio of fixed interest holdings in the Heritage funds is a blend of the securities mentioned above which offers an attractive average yield of just under 7%, providing a good combination of lower risk returns and diversification to go along with our equity shares and property holdings.

“We’ll meet again”

Following a very frustrating two years of disruption to our office life and a couple of false starts when attempting to get back to normal, the recent lifting of all Coronavirus restrictions has been most welcome. Throughout this period our team has adapted well, first to working from home entirely during the lockdowns and then adopting a hybrid model with a combination of office and remote working.

Most importantly we are now very happy to be able to welcome clients to our office at Broadway House for face to face meetings once again and with international travel set to become easier this year we are also hopeful that we will be able to catch up with a good number of our many clients in South Africa and elsewhere. Please do get in touch if you are interested in meeting up as we very much look forward to seeing you again.

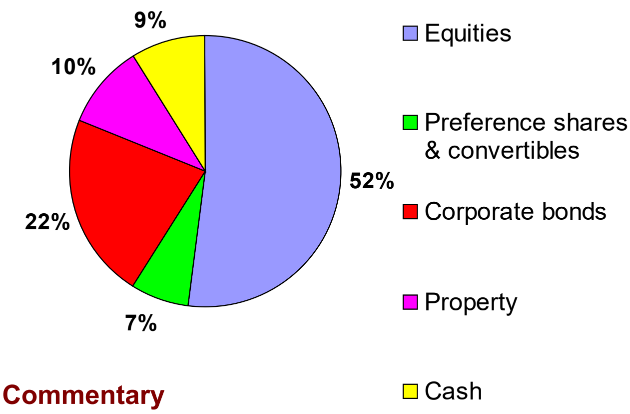
SVS Heritage Balanced Portfolio Fund

Price at 31/03/22	144.0p (launched at 100p 1/12/16)
Fund size	£34.7 million
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

Return	2022 Q1	2021	2020	2019	2018	Inception 01/12/16
SVS HBPF	-3.16%	15.00%	-1.52%	18.29%	-3.48%	44.00%
UK CPI	1.43%	2.20%	0.93%	1.82%	2.51%	12.32%

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 investment returns 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 down by 3.16% in the first quarter of 2022. The more detailed comments on the Heritage Managed Portfolio Fund 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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