Heritage

Quarterly Newsletter & Investment Review

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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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Global markets continue to suffer poor year

Following the worst first half year on records, an initially encouraging rally in July unfortunately gave way to further weakness and by the end of the third quarter world equity markets were down by 25% for the year-to-date. The problem facing investors is a complex mix of factors including the after effects of the global Covid pandemic, the war in Ukraine, soaring energy costs and a widespread surge in inflation. The resultant rise in interest rates has negatively impacted the value of all financial assets and bond prices have on average been just as weak as equities.

As a result the Heritage Managed Portfolio Fund has also had a tough year so far, with a loss of 5.9% this quarter taking the year-to-date fall to 12.7%. 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"- Alternative investments

Whilst much of our focus and commentary quite naturally centres around equities and bonds as the two major investment asset classes, at Heritage an important part of our approach to help diversify risk and enhance returns is to seek out and include other alternative investments. With so many uncertainties currently facing equities and bonds, these alternative asset classes continue to play an important role in our investment strategies and below we provide some further details of the ones that we think are of most interest.

Infrastructure – Investments in infrastructure assets including transport, utility networks, healthcare and education can provide attractive and reliable long-term cash flows which are not subject to the same economic, operational and management risks that face a typical private enterprise. Most of these assets are backed by long-term agreements with governments with income being paid on a simple and reliable "availability" basis rather than a more unpredictable "usage" basis. We first invested in infrastructure via HICL Infrastructure when it listed in 2006 and over the years we have benefitted from a reliable and rising income stream from its growing portfolio of core infrastructure assets. The fund now owns over 100 assets including Southmead Hospital, Affinity Water, the A63 toll road in France, the Home Office and UK and Dutch high speed rail.

Renewable energy assets – This is a relatively more recent asset class, with the main focus being on wind and solar which are key to producing cleaner energy and reducing carbon emissions, as the economy transitions towards its net zero carbon targets. Our main investment in this area is via TRIG (The Renewables Infrastructure Group) which owns both onshore and offshore wind turbines in the UK, France and Scandinavia as well as solar panels which are also held in Spain.

Private equity – Many of the world's best companies, both large and small, are owned privately. Furthermore they are free to take a genuinely long-term approach, away from the spotlight and obsession on quarterly earnings forecasts and day-to-day share price movements. Our largest private equity holding is Oakley Capital, a listed PE fund with a portfolio of investments focused on the education, consumer and technology industries. Following an exceptional return of 35% in 2021 the shares had been weaker in 2022 as the market expected the values of Oakley's holdings to fall in line with what has been happening in stock markets generally. However, Oakley have recently reported their interim results which show that their net asset value actually grew in the first half by 17%, due to a combination of some exits at premiums to the carrying value and strong trading by the underlying companies. *Continued on page 4.*

Heritage Capital Management Limited

Review for the quarter ended 30th September 2022

Market Commentary and Outlook

Following an historically poor first half to 2022 for investors, initial signs of a recovery in the third quarter were soon extinguished and the overall World Index is now well into bear market territory with losses of just under 25% for the year-to-date.

Furthermore the economic outlook looks fairly bleak with most analysts and commentators forecasting an economic slowdown at best and outright recession at worst. However, as investors it is important to remember that markets are generally very quick to discount bad news meaning that the current poor outlook is already largely priced in.

Helpfully history provides plenty of examples of how markets are always forward looking and the most recent previous recession caused by the Covid lockdowns is a useful reminder. In March 2020 the markets correctly and swiftly reacted to the predicted coming recession and the major equity indices all fell by over 20% in the first quarter. The result was that by the time the underlying economy was actually in recession for the rest of 2020, the markets were already looking forward to what would happen next (vaccines and recovery) and shares were recovering their losses. Of course history never repeats itself exactly but the overall pattern of markets falling heavily at the first sign of bad news and then already starting to recover during the predicted recession provides some cause for optimism that this time markets will pass their bottom well before the worst is over for the real world economy.

United Kingdom

The main reasons that the FTSE 100 index is down by just 6.7% so far this year are due to its comparatively high weighting of energy and commodity companies and the weakness of the pound, which has helped the value of the large global multinationals listed in London. For investors in the broader UK market the results this year have been more in line with the other major global markets, with both the FTSE 250 mid cap and the FTSE small cap indices now down around 25% for the year-to-date.

The past quarter has certainly been a momentous one for the UK. The passing of Queen Elizabeth II marks the end of an era and the country now has not only a new king, but also a new prime minister and chancellor. Liz Truss and Kwasi Kwarteng wasted no time in setting out a “plan for growth” based on tax reductions, deregulation and other supply side measures aimed at restoring annual economic growth to 2.5%. Under normal circumstances this might have been seen as a simple return to basic Conservative policy, but unfortunately it has arrived at short notice and at the same time that an estimated additional £100bn or more in borrowing may be required to help shield individuals and businesses from the global energy crisis, which has unsettled currency and bond markets.

Whilst the government’s foot is set firmly on the accelerator, the Bank of England’s target is to try and bring soaring inflation under control and after further interest rate rises this quarter the base rate now stands at 2.25% with expectations of more to come.

United States

The S&P 500 index was down by over another 5.3% for the quarter taking the year-to-date fall to just under 25%. Just as it was the large technology companies that drove the markets higher in the previous bull market, it has been the same group that has led the market into the current bear market with the tech heavy Nasdaq index now down by 30% for the year-to-date.

With US inflation continuing to run at over 8% the Federal Reserve has started to move more aggressively, pushing interest rates up to 3.25%, with expectations that rates could rise above 4.5% next year.

Europe

European markets have also been having a bad year with further falls in the third quarter taking the year-to-date loss to 22.8%.

In common with other regions, inflation is also of major concern with the German rate currently running at over 10%. The European Central Bank had been very slow to increase interest rates from their historically low level of 0%, but has now finally raised rates to 1.25%, including an unprecedented increase of 0.75% in September.

Japan

The Japanese Nikkei index has held up relatively well this year with a fall of just under 10%, although for international investors losses would have been much higher due to a weakening Yen which is down by 25% against the US dollar. The recent assassination of former prime minister Shinzo Abe shocked Japan. His radical economic and corporate governance reforms which became known as “Abenomics” were designed to try and revive Japan’s economy after a decades long period of stagnation and the hope is that Japan will continue to build on this legacy.

Emerging markets

Emerging markets have also had a tough year with the overall emerging market index down by around 25% for the year-to-date, although as always there has been a wide range around this from Korea’s KOSDAQ index down 35% to Brazil’s Bovespa up 5%.

Investment Statistics - 30/09/2022

Equity Markets	Q3 2022	2022 YTD	2021	2020	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
									vs GBP	vs USD
TR Global ($)	-5.61%	-24.65%	18.84%	15.73%						
US (S&P 500)	-5.28%	-24.77%	26.89%	16.26%	17	2.4%	3.25%	3.80%	1.1160	1.0000
UK (FTSE 100)	-3.84%	-6.65%	14.30%	-14.34%	10	4.1%	2.25%	4.10%	1.0000	1.1160
Europe (STOXX 50)	-3.96%	-22.80%	20.99%	-5.14%	12	3.7%	1.25%	2.11%	0.1390	0.9799
Japan (Nikkei 225)	-1.73%	-9.91%	4.91%	16.01%	14	2.1%	-0.10%	0.25%	161.50	144.75

Total returns- including dividends

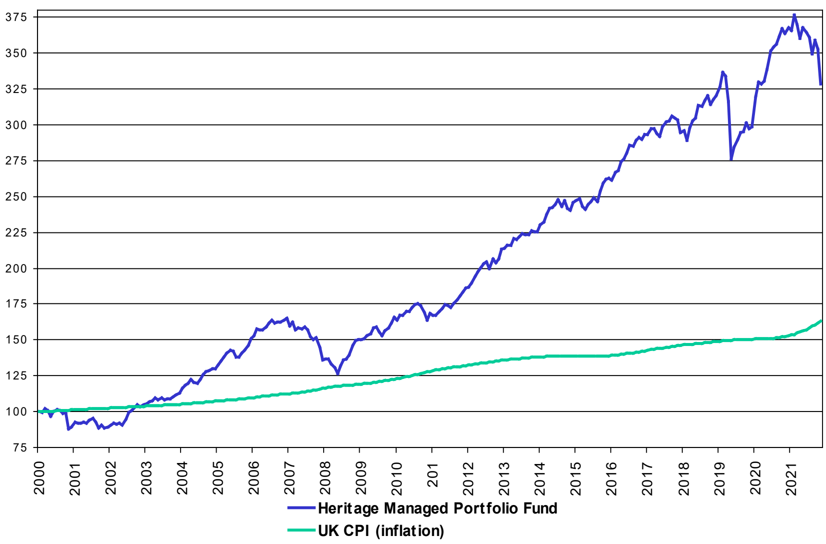
Source: Thomson Reuters

Heritage Managed Portfolio Fund

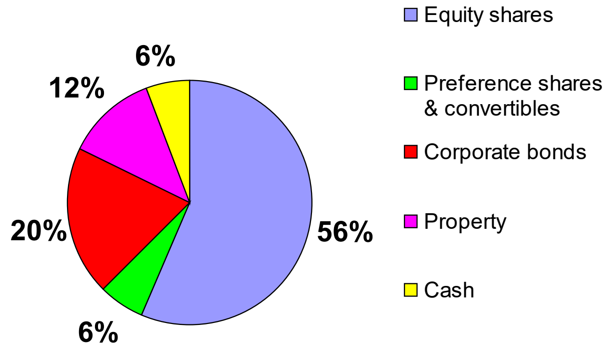
Review for the quarter ended 30th September 2022

Performance	Managed Portfolio Fund	Inflation (UK)	Fund information	
Return for the quarter (net)	-5.92%	2.47%	Price at 30th September 2022	£328.61
2022 year to date (net)	-12.74%	6.13%	Fund size	£192.5 million
Year 2021 return (net)	14.07%	2.20%	Fund domicile	Guernsey
Year 2020 return (net)	-1.87%	0.93%	Fund status	Non-distributor ("roll-up")
Year 2019 return (net)	16.31%	1.82%	Subscriptions/redemptions	Monthly dealing
Year 2018 return (net)	-2.76%	2.51%	Further Information	www.heritage-capital.co.uk
Year 2017 return (net)	11.50%	2.72%		
Year 2016 return (net)	7.48%	0.68%	**Risk**	**Annual Volatility**
Year 2015 return (net)	6.80%	0.04%	Managed Portfolio Fund	7.6%
Compound annual return since 2001	5.65%	2.28%	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.

Following an encouraging rally in July, markets were subject to a renewed bout of weakness over the remainder of the quarter and the Fund ended the quarter down by 5.92%, taking the year to date fall to 12.74%.

Due to the overall market weakness share price falls have been widespread this quarter, with several key holdings suffering double digit declines despite the underlying businesses continuing to perform well and in line with expectations. Positive contributors of any note were limited to our insurers, Beazley and Lancashire. Insurance companies have been a key position in the Fund over the years, with the one of the attractions being that the insurance cycle moves at a different beat to the general economic cycle and it's encouraging to see the current positive diversification benefits of this strategy.

Our listed property companies also had a weak quarter with even defensive holdings such as Primary Health Properties suffering large price falls. However, with much of our property portfolio on attractive current yields that are set to benefit from inflation linked rising rents the prospective returns look attractive for investors looking for long term income growth.

With interest rates rising our bond holdings have also had a difficult quarter although any price falls are at least offset by the income received with the average running yield now at an attractive level of 7.5%.

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” - Alternative investments (continued)

Property – Investing in real estate is perhaps the best known alternative to equities and bonds, as most people will have owned their own property and as a tangible asset it is relatively simple to understand. Our main focus is on commercial property where the rental yields are more attractive than for residential and we currently prefer industrial over retail which faces a structural challenge from increased online shopping. We also have exposure to specialist property sectors such as healthcare and supermarkets for their security of income. We initially invested in Primary Health Properties in 2002 and have now enjoyed 20 years of dividend growth thanks to the secure long leases on its portfolio of NHS funded surgeries and another more recent holding is Supermarket Income REIT which owns and leases omni-channel stores to the major supermarket operators.

Others – The list of other possible alternative asset classes is fairly extensive and whilst a we do not consider a number of them to be suitable for our funds (e.g. commodities, art, fine wines, Bitcoins etc.) we are always on the lookout for interesting new additions and over the past couple of years we have invested in a listed song rights fund benefitting from the rise in music streaming and have planted over 200,000 trees as part of our interest in a forestry/timber asset in Scotland.

With diversification forming an important part of our investment approach we will continue to research, analyse and selectively invest in alternative asset classes to complement our core holdings in equities and bonds.

Client communications

We are pleased to say that following a couple of years of disruption to our previously well established ways of meeting and dealing with clients generally, things have now settled down to a more regular routine. As a reminder, in addition to our quarterly reporting, which all clients receive automatically, we are also very happy to meet with clients as and when it would be helpful. This can be either in our office in central London or alternatively we are very happy to arrange to either visit clients or meet somewhere else that is convenient.

In addition to these traditional face-to-face meetings these days most of us are now also familiar with the new communication tools that we were forced to adopt during the Covid lockdowns and we are also able to offer remote meetings via Zoom or Teams. Finally, many clients also find that a good old fashioned telephone call or e-mail works perfectly well, so depending on your personal preferences please feel free to use whichever communication channel suits you best.

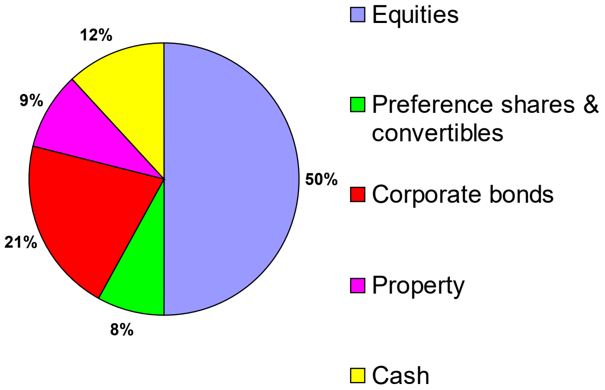
SVS Heritage Balanced Portfolio Fund

Price at 30/09/22	1.291p (launched at 100p 1/12/16)
Fund size	£31.84 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 Q3	2022 YTD	2021	2020	2019	Inception 01/12/16
SVS HBPF	-5.56%	-13.18%	15.00%	-1.52%	18.29%	29.10%
UK CPI	2.47%	6.13%	2.20%	0.93%	1.82%	17.52%

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 5.56% this quarter and by 13.18% for the year-to-date. 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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