Heritage

Quarterly Newsletter & Investment Review

Issue 102 Quarterly news & investment review from Heritage Quarter 2 2023

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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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Stubbornly high inflation continues to create headwinds for investors

Rising interest rates in response to stubbornly high inflation has acted as a headwind for investors, as it impacts the valuations of all the major asset classes including equities, bonds and property.

The Heritage funds have produced a small positive performance for the quarter and as usual further details for the Heritage Managed Portfolio Fund can be found on page 3 and the SVS Heritage Balanced Portfolio Fund on page 4. The other notable feature so far this year has been the strength of the pound. This acts as a further headwind for funds priced in sterling, but also means that measured for example in US Dollars, the Heritage Managed Portfolio Fund has returned over 5% so far this year.

"Spotlight On" - Investing in smaller companies

The Heritage funds invest in a wide variety of assets including equity shares, bonds and property and each of these broader asset classes can be further subdivided into subcategories. For example within bonds we have government and corporate debt, investment grade and higher yield bonds as well as fixed coupon preference shares and convertible bonds. Within property there is residential and commercial and within that there is industrial, office, retail. When it comes to shares these can also be subdivided into various categories such as industrial sectors and geographical location. Another distinction can be made between larger companies and smaller companies and whilst the larger "blue chips" form an important part of our portfolios, it is the small and mid caps that have provided particularly fruitful territory for us over the years.

Aside from our own experience there is good empirical evidence for investing in small companies through the Numis Smaller Companies Index. It was created by Professor Elroy Dimson and Professor Paul Marsh of London Business School, who have been instrumental in promoting a global understanding of the smaller companies effect that traces the long term outperformance of smaller companies. The key finding is that since the data has been tracked starting in 1955, the Numis Smaller Companies Index total return beat the FTSE All-Share, which is dominated by large companies, by over 3% per annum.

However despite this evidence, most large institutional fund managers simply can't invest a significant proportion in small companies, as when you have billions to manage you inevitably will need to focus on the large cap stocks. And because most large fund managers focus on investing in large companies it means that most brokers research also caters for this, leaving many listed smaller companies either under researched or completely ignored. This leaves smaller active fund managers such as ourselves well placed to exploit the inefficiencies in the market and seek out any neglected hidden gems. We see this as a real competitive advantage and it helps to explain the good long term performance of our Heritage Managed Portfolio Fund.

Having identified promising small companies it potentially could be an issue realising the value, given the lack of interest from larger institutional investors mentioned above. However, fortunately this value does not go completely unrecognised and in recent years there has been a steady stream of buyers with private equity funds, larger trade buyers, and foreign investors heading the list. Examples of holdings in our own funds that have been taken-over in recent years by these type of buyers include Clinigen, Air Partner, Charles Taylor, Tarsus, Cello, Dairy Crest, Novae, Latchways, Nationwide Accident Repair and Greene King.

Continued on page 4.

Heritage Capital Management Limited

Review for the quarter ended 30th June 2023

Market Commentary and Outlook

Thankfully the banking crisis that threatened the global financial system earlier in the year appears to have abated, although investors are still having to battle against the headwinds of stubbornly high inflation, rising interest rates and the ongoing instability arising from the war in Ukraine. With this in mind most major equity markets have in fact performed surprisingly well so far this year but the impact, in particular of higher interest rates, has made life very difficult for bond and property investors.

Whilst as ever it is difficult to predict what will happen to markets in the short term, the higher yields that are now available from a range of fixed interest securities such as corporate bonds and preference shares, should set the scene for much more attractive returns going forwards. The same applies to property, where lower valuations, higher yields and decent rental growth should provide a good starting point for long-term investors.

So whilst most of the conversation surrounding investments tends to be dominated by the binary options of buying shares or holding cash, overall we believe that holding a well-diversified portfolio of shares, bonds and property, together with some alternative assets and cash, should offer investors the best combination of returns and risk profile going forwards.

United Kingdom

The FTSE 100 index slipped back a bit in the second quarter and is marginally up for the year-to-date. Smaller companies have continued their recent run of relative underperformance, with the FTSE 250 mid cap, FTSE Small Cap and AIM indices all in negative territory for the quarter and year-to-date.

Most economic forecasters had been predicting that the UK would be in recession this year, but economic activity has actually so far held up better than expected and the pound has also continued its recovery. This year sterling is up against all of the other major currencies, including 5% against the US Dollar and over 15% against the Japanese Yen.

The main negative at the moment is that inflation is not yet under control and is not being helped by ongoing wage pressure and strikes. The Bank of England has therefore continued to raise interest rates from 3.5% at the start of the year to the current level of 5.0% and whilst previous expectations were for rates to peak at this level, it now looks more likely that further increases to around 6% by the end of the year will be required.

United States

The US market had a decent quarter with the S&P 500 gaining 8.3%. However, the rise in the overall index has been driven by a very narrow band of very large tech companies.

In fact seven of the biggest constituents of the S&P 500 – Apple, Microsoft, Alphabet (Google), Amazon, Nvidia, Tesla and Meta (Facebook) have all made large gains this year and the remaining 493 companies are in aggregate flat for the year. The newer name on the list of tech titans is chipmaker Nvidia, which has seen its valuation soar by over $600bn this year on the back of investor excitement and hype relating to AI (artificial intelligence). The result is that from a risk management point of view the index now looks potentially quite exposed to a correction, as these big seven stocks trade on an average PE ratio of well over 30, compared to nearer 15 for the rest of the market.

Having increased interest rates 10 times in a row since March 2022, the Federal Reserve voted for a pause in June, as it waits to see the impact of the rises, although expectations are still for a further increase or two later this year before we see a peak in rates.

Europe

European markets were marginally up this quarter, building on a strong start to the year.

Inflation is currently also of major concern across Europe and the European Central Bank has continued to raise interest rates which now stand at 4%. The difficult task that the ECB has balancing the varying dynamics within the Eurozone were once again highlighted by the most recent figures, which showed that whilst German inflation had unexpectedly increased to 6.8%, inflation in Spain had dropped to just 1.6%.

Japan

Japan is comfortably the strongest performing of the major markets so far this year and the Nikkei index has now reached above 33,000, its highest level since 1990 but still below the all-time high of 38,916 in 1989.

Emerging markets

Emerging markets have generally continued their underperformance of the major markets this year, although as ever there is a wide dispersion, with India and Brazil currently among the better performers and China and South Africa doing less well.

Investment Statistics - 30/06/2023

Equity Markets	Q2 2023	2023 YTD	2022	2021	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
									vs GBP	vs USD
TR Global ($)	6.32%	13.51%	-17.91%	18.84%						
US (S&P 500)	8.30%	15.91%	-19.92%	26.89%	24	2.0%	5.25%	3.82%	1.2704	1.0000
UK (FTSE 100)	-1.31%	1.07%	0.91%	14.30%	10	3.9%	5.00%	4.39%	1.0000	1.2704
Europe (STOXX 50)	1.95%	15.96%	-11.74%	20.99%	14	3.3%	4.00%	2.39%	1.1624	1.0910
Japan (Nikkei 225)	18.36%	27.19%	-9.37%	4.91%	19	1.8%	-0.10%	0.40%	183.26	144.32

Total returns- including dividends

Source: Refinitiv

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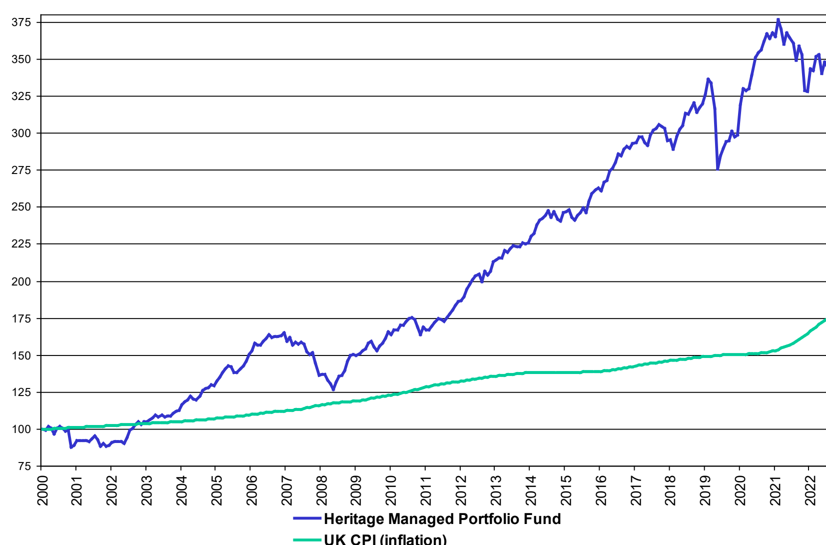
Heritage Managed Portfolio Fund

Review for the quarter ended 30th June 2023

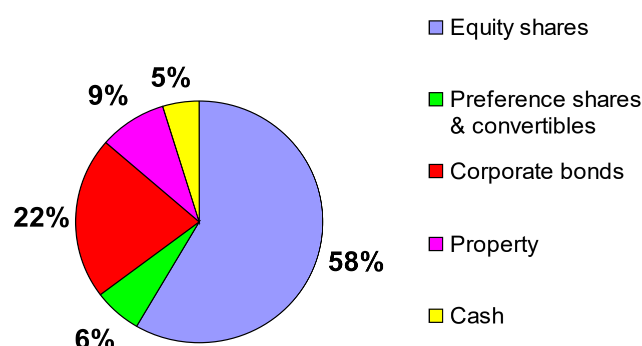
Performance	Managed Portfolio Fund	Inflation (UK)
Return for the quarter (net)	0.18%	2.31%
Year 2023 year to date (net)	-0.29%	4.97%
Year 2022 return (net)	-9.14%	8.97%
Year 2021 return (net)	14.07%	2.20%
Year 2020 return (net)	-1.87%	0.93%
Year 2019 return (net)	16.31%	1.82%
Year 2018 return (net)	-2.76%	2.51%
Year 2017 return (net)	11.50%	2.72%
Year 2016 return (net)	7.48%	0.68%
Compound annual return since 2001	5.67%	2.46%

Fund information	
Price at 30th June 2023	£341.17
Fund size	£178.6 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	7.6%
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.

The Fund managed to eke out a very small positive return of 0.18% in the second quarter, as rising interest rates in response to stubbornly high inflation have continued to act as a drag on the valuations of equities, bonds and property.

Within our share portfolio notable positive contributors this quarter include BP Marsh, Intermediate Capital Group, HSBC, Computacenter, Compass and Young’s and our private equity investment trusts also did well with ICG Enterprise and HgCapital leading the way. At the other end of the spectrum the detractors included Bellway, Victrex and Alliance Pharma.

Although higher interest rates have not helped the short term prices of our bonds, the overall yield on our bond portfolio now looks very attractive with a running income yield of 7.9%. Whilst fixed interest markets remain weak we have also been taking the opportunity to selectively top up some of our bond holdings on attractive yields.

Although we are hopeful that our property holdings will ultimately prove to be a good hedge against inflation as rising rental income feeds through, in the short term capital values remain under pressure from higher interest rates.

Whilst the near term outlook remains uncertain, we believe that our portfolio of well diversified investments is well positioned to generate attractive returns for long-term investors.

This report is not an invitation to subscribe for shares in the Heritage Investment Funds and is for the information of investors only. Investors should be aware that past investment performance is not a guide to future performance, and that the value of investments may fall as well as rise. An investor may get back less than the original amount invested.

"Spotlight On"- Investing in smaller companies - continued

Whilst the short term boost that we receive from such takeovers is welcome, with the premium paid generally being around 25% to 50% higher than the previous share price, the downside is that we lose the ability to capture potentially more significant long-term returns. It also means that we need to constantly be on the lookout for new opportunities to refresh our portfolio of small companies.

Without wishing to tempt fate, we thought it would also be helpful to include a couple of examples of current small company holdings within our funds.

Bloomsbury Publishing – We first invested in Bloomsbury in 2015 and its success in recent years has been down to its canny founder, Nigel Newton (who is known for signing the then unknown author, JK Rowling, who had been turned down by all the major publishers) and his team who have reinvested the cashflows from the Harry Potter success to build a well diversified international publishing business.

They have also managed the transaction to digital publis extremely well. Since our investment the annual profits increased from under £10m to £25m and the prospect further growth still look attractive.

BP Marsh is another small company where we first inve in 2015. The founder, Brian Marsh, is a veteran of the i ance industry who established a small team (just over the from our own office) to back new ventures in various r insurance sectors, supporting their growth. A good examp their investment in Kentro where they helped grow prem from £55m to over £500m.

They have recently announced the sale of Kentro and are due to receive £51.5m, providing an excellent return on the £15m that they invested. Deals such as these have helped BP Marsh grow their own net asset value from around £70m when we first invested to £190m today. Despite this excellent record the shares still trade on a significant discount to their NAV and offer a combination of excellent value and prospects for future growth.

Whilst there are never any guarantees with investing, we believe that our tried and tested approach to identifying attractive small companies, operating in niche markets with good growth prospects, attractive valuations and excellent founder led management will overall continue to provide us with excellent long term results.

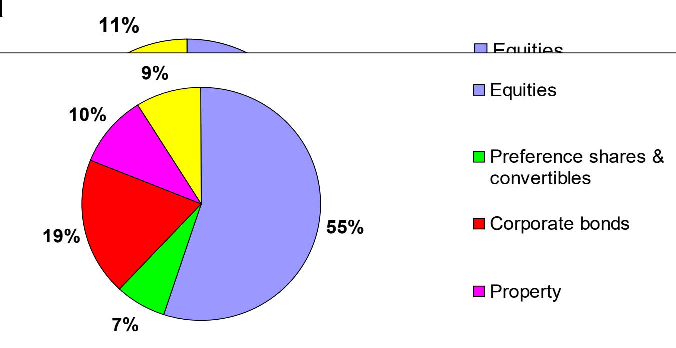
SVS Heritage Balanced Portfolio Fund

Price at 30/06/23	1.351p (launched at 100p 1/12/16)
Fund size	£31.0 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	Evelyn Partners

Performance

Return	2023 Q2	2023 YTD	2022	2021	2020	Inception 01/12/16
SVS HBPF	0.15%	-0.95%	-8.27%	15.00%	-1.52%	35.10%
UK CPI	2.31%	4.97%	8.97%	2.20%	0.93%	26.68%

Asset allocation



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 made a small positive return of 0.15% this quarter and 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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