Heritage

Quarterly Newsletter & Investment Review

Issue 104 Quarterly news & investment review from Heritage Quarter 4 2023

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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Strong final quarter rally helps make 2023 a reasonable year for investors

Whilst most of 2023 was a fairly frustrating year for investors, there was a strong and much welcome year end rally that helped make it a decent year overall. The primary driver for this has been the recent fall in inflation and therefore the strong likelihood that interest rates have now peaked and are set to start coming down again in the year ahead.

Having been broadly flat over the first three quarters of the year, the Heritage funds had a very good final quarter resulting in a fairly decent year overall with both our funds ending up with returns of just over 5%. 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.

"Spotlight On" - Investing in the insurance sector

The Heritage funds are very well diversified, both across asset classes such as equities, bonds and property and also at the sector level where we have exposure to energy, industrials, consumer goods and services, healthcare, technology and financials. These major sectors can also be divided into several sub-sectors and part of our role as fund managers is to identify which of these areas offers the most promising growth prospects and valuations and therefore the potential for superior investment returns.

One of our current favoured areas is insurance, a fairly niche sub-sector within the financials sector which is dominated by banks, life assurers, asset managers and real estate. As an industry insurance is quite cyclical and significant capital is required by insurers to ensure that they are able to pay out in the event of large claims. For a number of years, partly driven by ultra-low interest rates, capital was attracted to the industry and as usual too much capital drove down insurance premium rates, which together with a number of years of particularly large catastrophe claims, led to significant losses for insurers and depletion of capital. This forced insurers to increase premiums and has led to the start of a new "hard" market. In fact current conditions for insurers are now probably the best that they have been since the hard market that followed the large losses from hurricanes Katrina, Rita and Wilma back in 2005.

Apart from the buoyant conditions that insurers are enjoying due to hardening premium rates there is currently another significant tailwind that is helping boost returns. Traditionally one of the main attractions of insurance is that the insurer gets to hold and invest the premiums that it receives pending the potential payment of claims. Whilst interest rates and bond yields were close to zero there was little benefit from this but now that rates have finally risen to around 4-5%, insurers are able to significantly boost their total profits from the investment income earned on their investment "float" which is held in cash and short dated investment grade bonds.

Whilst insurance undoubtedly is a highly cyclical industry we see that as a positive as the cycle tends to move at a different beat to the general economic cycle and so investing in insurers offers a good form of diversification for our overall portfolio.

Having identified insurance as currently being a potentially attractive area for investment the next step is to select the best individual companies to buy. Here it is important to note that insurers come in all shapes and sizes and the ones that we are interested in are not the largest ones that tend to focus on the commodity end of the market such as online car and home insurance, but rather the niche areas that require unique and specialist underwriting skills, many of which can be found operating through the centuries old Lloyd's of London insurance market.

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Heritage Capital Management Limited

Review for the quarter ended 31st December 2023

Market Commentary and Outlook

Global equity markets ended the year with a strong rally in November and December which helped to make 2023 a good year overall. The main catalyst for the rally has been falling inflation, leading to expectations that interest rates have now peaked. In particular the US Federal Reserve, which had previously been careful to dampen expectations of rate reductions, has now indicated that it expects three interest rate cuts in 2024.

However, it is important to note that inflation is not expected to return to its 2% target until 2026. Also, interest rate and economic forecasts are notoriously difficult to accurately predict and so a measure of caution is required by investors hoping for a swift return to a lower interest rates.

Having said that, it is encouraging that rates are at least unlikely to have to increase further and as we highlighted in our previous quarterly newsletter, it would not necessarily be a bad outcome for investors if rates do stay higher for longer. Higher rates encourage more disciplined deployment of capital and allow conservative investors to benefit from more attractive yields from lower risk investments including investment grade bonds, good quality property and alternative investments such as infrastructure.

United Kingdom

Having managed to top the leaderboard in 2022, the FTSE 100 index was back at the bottom of the list of major developed markets again in 2023. The big winners in the UK this year were Rolls-Royce, which more than tripled its share price and Marks & Spencer which more than doubled, both having been previous laggards that have recently enjoyed unexpectedly strong recoveries. At the other end of the spectrum were BAT, Burberry, St James's Place and Anglo American which were all down over 30%.

Smaller companies on London's junior AIM market, which was down by 8%, have also continued to struggle this year and the hope is that the more positive end to the 2023 will continue into 2024. In fact small cap stocks now look very good value and are tending to attract take-over offers from larger international rivals and private equity buyers if left unappreciated by the domestic stock market for too long.

The final quarter produced some encouraging news on inflation which has now fallen to just 4% from its peak of 11% in 2022. This better than expected figure has provided hope that interest rates have now peaked at 5.25% and are set to fall in 2024, which should provide a boost for investors in equities, bonds and property.

United States

The US market had a strong year, driven by a narrow band of tech giants now known as the "Magnificent Seven" (Apple, Microsoft, Alphabet/Google, Amazon, Nvidia, Tesla and Meta/Facebook). However, with this group now trading on an average PE ratio of over 50 there is a question mark over how much further they can continue to run and how vulnerable they may be if they fail to meet their lofty growth expectations.

Having increased interest rates from just above zero in March 2022 to current the rate of 5.5%, the Federal Reserve Bank has now signalled that with inflation now clearly falling, it expects to be able to start cutting rates in 2024.

Europe

European markets also had a good year, boosted by a 50% share price gain for what is now Europe's largest listed company, Novo Nordisk the Danish pharmaceutical company, thanks to the huge success of its anti-obesity drug, Wegovy. Less positively for Europe, it's largest economy, Germany, looks like it may be sliding back into another recession. A technical recession is defined as two successive contractions in GDP and having only just recently emerged from its Q4 2022 and Q1 2023 recession, it now looks set to enter into another one and the German government is forecasting that overall the economy will have shrunk by 0.4% in 2023.

Japan

Japan's Nikkei index was the best performing major market this year, although the weaker Yen meant that total returns were more muted for international investors. Ongoing corporate governance reforms and the fact that company balance sheets are very strong, with an estimated £700 billion of net cash, give hope that the current bull market can continue into 2024.

Emerging markets

Emerging markets overall had a relatively poor year in 2023, with China and South Africa being two of the weaker performers in negative territory, whilst at the other end of the spectrum the Indian Sensex Index had a good year. In 2023 the emerging market BRICS countries accounted for 32% of the world's GDP overtaking the 30% held by the developed world's G7 and from January 2024 the BRICS group has been further enlarged to include Argentina, Ethiopia, Iran, Saudi Arabia and the United Arab Emirates. However measured from a total stock market value point of view it is still the major developed markets that continue to dominate the investment landscape.

Investment Statistics - 31/12/2023

Equity Markets	Q4 2023	2023	2022	2021	PE Ratio	Dividend Yield	Central Bank Interest Rates	10 yr Gvnmt Bond Yields	Exchange Rates	
									vs GBP	vs USD
TR Global ($)	11.19%	22.19%	-17.91%	18.84%						
US (S&P 500)	11.24%	24.23%	-19.92%	26.89%	24	1.9%	5.50%	3.86%	1.2729	1.0000
UK (FTSE 100)	1.65%	3.78%	0.91%	14.30%	10	3.8%	5.25%	3.54%	1.0000	1.2729
Europe (STOXX 50)	8.31%	19.19%	-11.74%	20.99%	13	3.2%	4.50%	2.03%	1.1528	1.1036
Japan (Nikkei 225)	5.04%	28.24%	-9.37%	4.91%	20	1.8%	-0.10%	0.62%	179.52	141.06

Total returns- including dividends

Source: Refinitiv

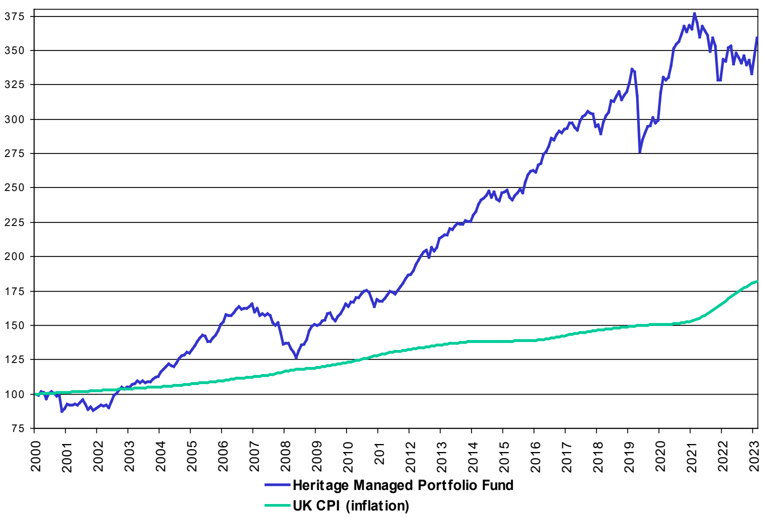
Heritage Managed Portfolio Fund

Review for the quarter ended 31st December 2023

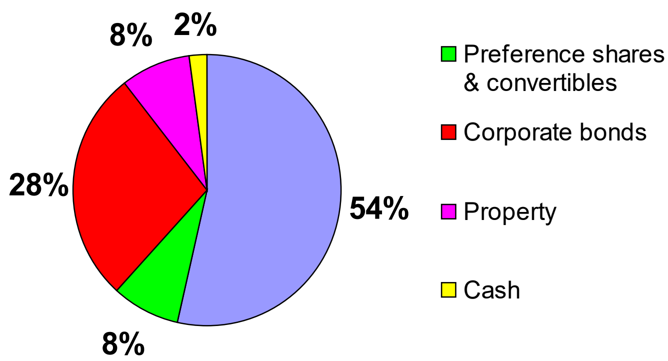
Performance	Managed Portfolio Fund	Inflation (UK)
Return for the quarter (net)	4.83%	1.27%
Year 2023 return (net)	5.02%	8.22%
Year 2022 return (net)	-9.14%	8.97%
Year 2021 return (net)	14.07%	2.20%
Year 2020 return (net)	-1.87%	0.93%
Year 2019 return (net)	16.31%	1.82%
Year 2018 return (net)	-2.76%	2.51%
Year 2017 return (net)	11.50%	2.72%
Year 2016 return (net)	7.48%	0.68%
Compound annual return since 2001	5.73%	2.61%

Fund information	
Price at 31st December 2023	£359.35
Fund size	£186.0 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	7.6%
TR World Index	13.8%

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.

Helped by better than expected inflation figures and expectations that interest rates may now have peaked, the Fund had a strong end to the year with a gain of 4.83% in the final quarter, resulting in a reasonable overall return of 5.02% for 2023.

Within our portfolio of individual shares the best contributions this year came from System1, BP Marsh, Associated British Foods, Intermediate Capital, Computacenter, RELX, Bellway, Youngs, Ocean Wilson and HSBC which all gained over 20%, and our largest percentage gain came from a small holding in Gulf Marine Services which was up over 200%. There were also strong performances from private equity funds HgCapital and Oakley Capital, whilst negative performers this year included Unilever, Diageo, Beazley and Close Brothers.

Our property holdings had a strong final quarter but overall it was another difficult year with Picton, Supermarket Income REIT, CLS and Regional REIT all ending 2023 in negative territory and the only positive contributions coming from TR Property and Target Healthcare.

Our bond portfolio currently has an attractive running income yield of over 7% and yield to redemption of over 9%, and with the interest rates cuts now expected in 2024 there is the potential for decent returns in the year ahead.

Although 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.

"Spotlight On"- Investing in the insurance sector - continued

Over the years we have successfully invested in a number of these Lloyd's insurers including Catlin, Amlin, Chaucer, Brit, Atrium, Kiln and Wellington, all of which have been taken over by larger rivals. We currently hold shares in all four of the London listed Lloyd's insurers. Hiscox has built a strong brand in a number of specialist areas such as art and kidnap & ransom. Beazley has developed a strong track record in its specialist areas including liability and more recently cyber-security. Lancashire tends to focus on reinsurance (insurance for insurance companies) as does the recent newcomer to the group, Conduit Re. All of these companies work closely with a network of brokers and have highly specialized underwriting teams focusing on particular niche areas, which should enable them to provide attractive returns on capital in the current hard market. Despite these attractive prospects the shares are currently lowly valued on prospective 2024 PE ratios of 6.1 for Beazley, 6.9 for Conduit, 9.2 for Hiscox and 6.0 for Lancashire, with all four also forecast to pay decent dividends in the year ahead.

Another small niche insurance related company that we have invested in is BP Marsh. The founder, Brian Marsh, is a veteran of the insurance industry who established a small team (just over the road from our own office) to back new ventures in various niche insurance sectors, supporting their growth. This year has been one of their best ever due to profitable exits from their two largest holdings, Kentro and Paladin where they originally provided the initial backing capital to the founders. In the past year BP Marsh's share price is up by over 50% and it still looks good value today as it trades on a 20% discount to its net asset value.

It's also worth noting that our investments in the insurance sector are not just limited to equity shares as we also hold a number of bonds issued by insurers. With these investments we are less concerned with the growth potential of the underlying companies and are looking for strong and stable groups that are sufficiently creditworthy to pay the interest and capital on their bonds. Following the recent rise in interest rates there are now some very attractive yields available on bonds issued by large insurance groups. Examples of these that we currently hold include Legal & General 2031 bonds on a yield of 8.4%, Direct Line 2027 and Phoenix 2028 bonds on yields of over 10% and Aviva perpetual bonds yielding over 7%.

Overall many large mainstream investment funds tend to just overlook the insurance sector as being too niche or small to bother with, but we believe that it has much to offer and that current market conditions in particular present some potentially rewarding opportunities.

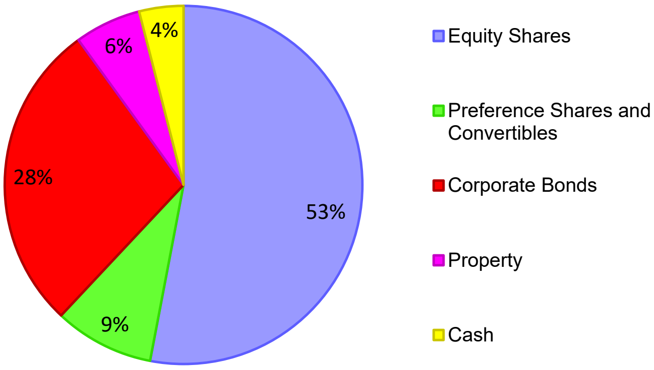
SVS Heritage Balanced Portfolio Fund

Price at 31/12/23	143.8p (launched at 100p 1/12/16)
Fund size	£33.1 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 Q4	2023	2022	2021	2020	Inception 01/12/16
SVS HBPF	5.58%	5.43%	-8.27%	15.00%	-1.52%	43.80%
UK CPI	1.27%	8.22%	8.97%	2.20%	0.93%	30.59%

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 made a positive return of 5.43% this year 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.

Heritage

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