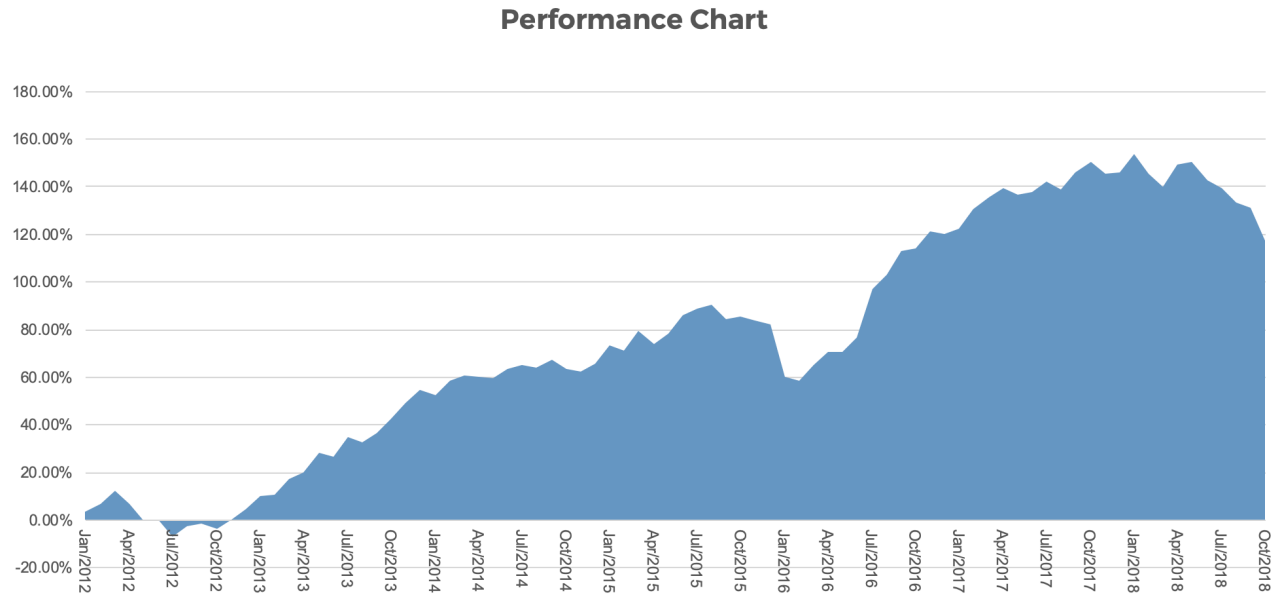
Reviewing the Market Two Years On



Year	Heritage Global Capital Fund	MSCI Asia ex-Japan Index (SGD, Dividends Reinvested)	MSCI World Index[1] (SGD, Dividends Reinvested)
2012	+4.58%	+22.73%	+9.74%
2013	+47.98%	+3.39%	+31.57%
2014	+7.09%	+4.96%	+10.68%
2015	+9.91%	-8.88%	+6.63%
2016	+20.73%	+5.71%	+10.37%
2017	+11.80%	+42.12%	+13.64%
2018 (YTD)	**-11.63%**	**-16.30%**	**+1.76%**
Cumulative	**+117.30%**	**+52.61%**	**+117.63%**
Annualised	**+12.03%**	**+6.38%**	**+12.05%**

[1] The MSCI World Index has a 62% weightage towards the US. We have added it for your reference.

For the ten months ending October 2018, Heritage Global Capital Fund has returned -11.63% in SGD terms. Our benchmarks, the MSCI Asia ex-Japan Index and MSCI World Index (Rebased to SGD with dividends reinvested) returned -16.30% and +1.76% respectively.

Since January 2012, the fund's investment strategy has generated a cumulative return of +117.30% and an annualised return of +12.03% net of fees. This compares with the MSCI Asia ex-Japan Index and MSCI World Index (rebased in SGD terms) which has returned a cumulative return of +52.61% and +117.63% and an annualised return of +6.38% and +12.05% respectively.

Market Review

It is useful to discuss market volatility in light of the recent market sell-off. Volatility is a two-way street - it refers to both prices increasing or declining.

When markets are surging, investors often cheer and think of it as the "right thing". When markets decline, investors search for reasons why sell-offs occur.

Investing in the stock market involves living with the volatility - both the upside and downside. Markets are by their nature volatile and tend to overshoot on either direction and the recent market sell-off is no exception.

MSCI Asia-Ex Japan Returns

Year	Calendar Year Return	Intra-Year Decline
2003	44%	-13%
2004	19%	-18%
2005	17%	-9%
2006	29%	-18%
2007	33%	-19%
2008	-53%	-62%
2009	68%	-21%
2010	15%	-19%
2011	-18%	-30%
2012	19%	-16%
2013	1%	-16%
2014	-0.2	-13%
2015	-12%	-27%
2016	4%	-13%
2017	34%	-4%
3Q2018	-8%	-17%

2017 was an exceptionally calm year where volatility was exceptionally low. Intra-year declines (Peak to bottom decline during the year) were the lowest on record for the last fifteen years for the last fifteen years. 2018 on the other hand as proven to be a far more volatile ride.

The important to take away is that this isn't remarkable at all. There's very little correlation between intra-year declines and the ultimate return for the end of the year. And no - the recent volatility during the Trump administration is not exceptional by any regard.

Even large capitalisation blue-chip stocks with relatively stable businesses and entrenched competitive advantages like the local three banks are not immune.

2014 – 2016

Company	Peak	Bottom	Decline
UOB	$24.53	$17.15	-30.1%
OCBC	$10.68	$7.92	-25.8%
DBS	$21.09	$13.58	-35.6%

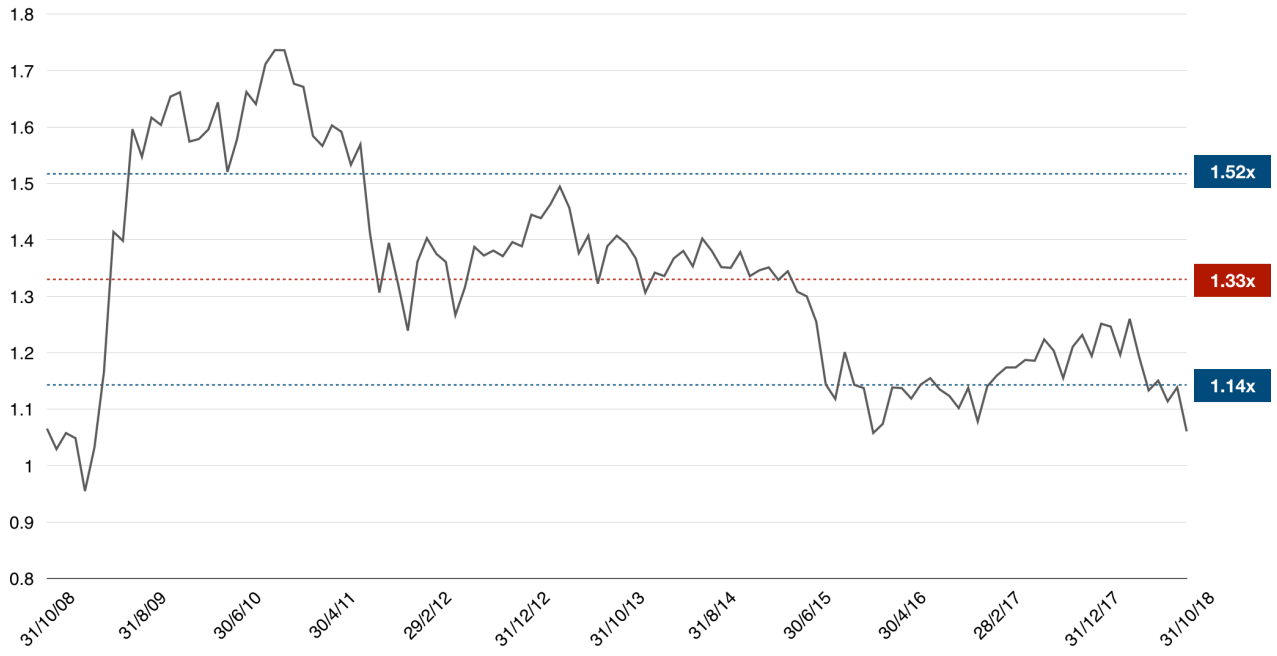
Fears then regarding the overall exposure of the three banks from the oil & gas meltdown as well as Chinese exposure led to a dramatic fall in prices to valuations even cheaper than in 2008. Prices eventually recovered as fundamentals re-exerted themselves in the latter part of 2016.

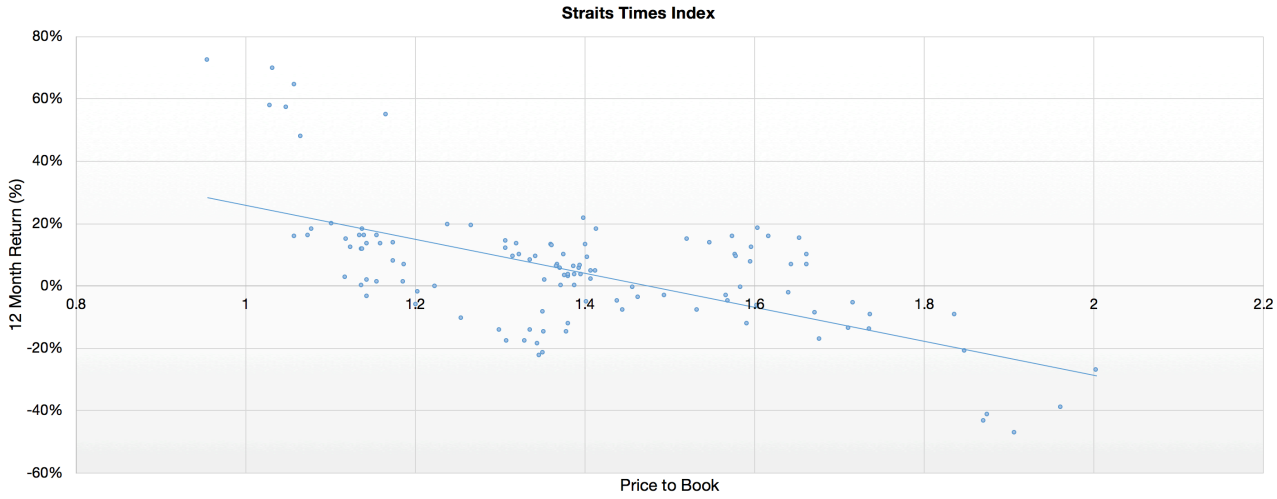
Valuations Dictates Long Term Returns

Ultimately, long term returns are always determined by market valuations and fundamental value. This is not to say that asset prices can't run up in the short run (Crypto-currencies, Bitcoin etc). It just means to say that prices will always converge upon "intrinsic value" in the end.

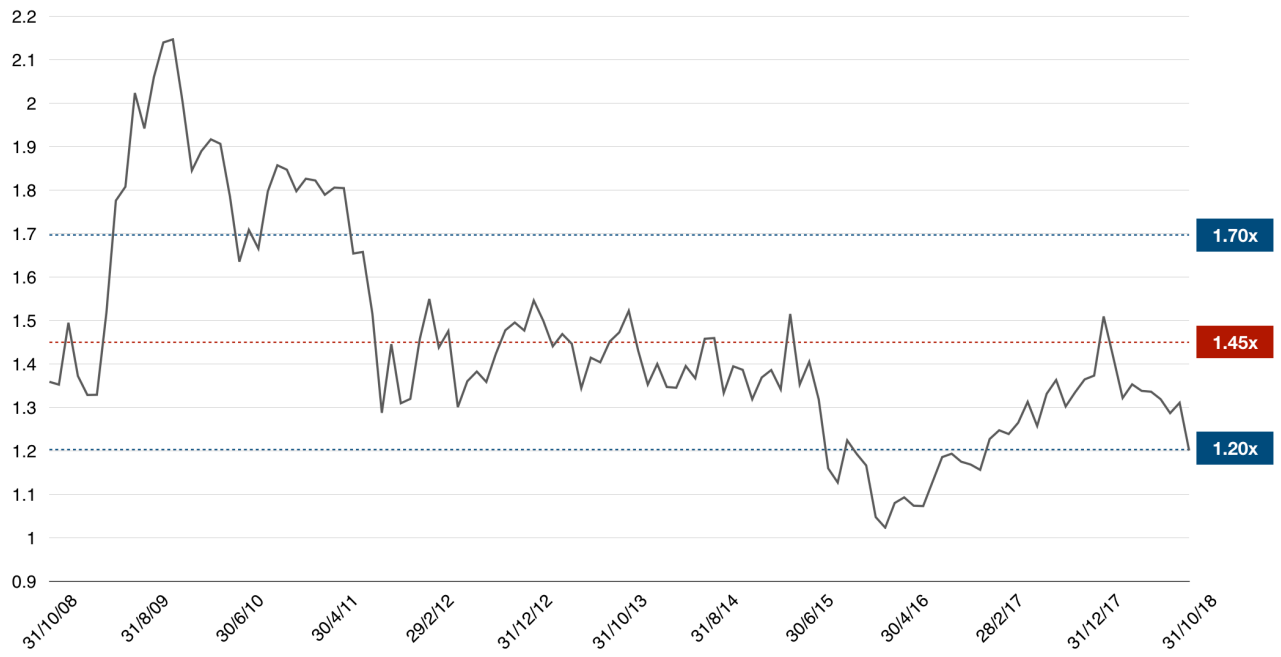
We've seen that time and time again over the course over the last six years. When we first started out - US stocks were exceptionally cheap and Chinese stocks were exceptionally expensive. The reverse now holds true (for both the Shanghai Index and the Hang Seng Index. Our fund holds stocks listed in Hong Kong but there is a strong correlation between the two indexes).

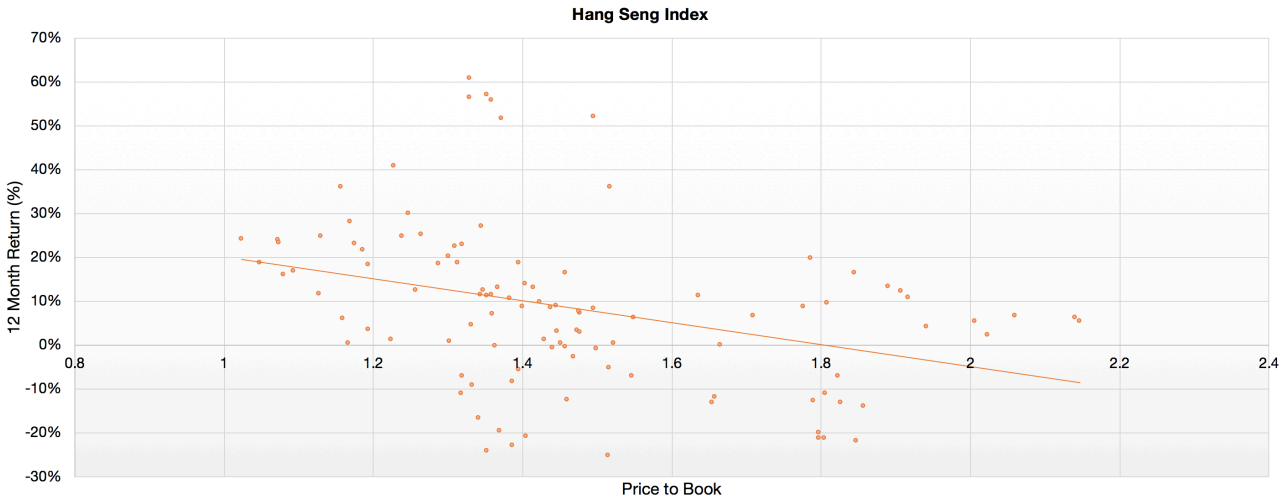
Current Straits Time Index Price to Book Ratio: 1.07x





Current Hang Seng Index Price to Book Ratio: 1.20x





The key then is to ensure whatever we own has real fundamental value

Each market downturn always ends. Sentiment is like a pendulum swinging from excessive fear to excessive optimism and back again.

The recent property cycle - from the en-bloc boom to the imposition of cooling measures in July 2018 is just such an example. If the underlying economy is threatened, governments always intervene to re-inject confidence back.

Having a confidence to hold and stay the course is essential during a market downturn as they are unpredictable.

Market timing is a tempting conclusion for many but few have the ability to do it consistently and profitably. There are plenty of one-hit wonders who make one market call right and find it impossible to repeat again.

That confidence we submit can only borne out of solid fundamental analysis. We look at hundreds of businesses each year - and only settle on ones whereby the underlying fundamentals are solid and whereby they are able to ride out the storm. We look for businesses that have solid asset backing, strong free cash flow generation capability and solid financial positions.

Such an approach may seem "boring" and "old-school" when markets are over-heated. Such was the case during the recent crypto-currency run up - and it's always tempting to abandon it. However, the tide has now turned dramatically and billions have been wiped off from the cypto-currency market. (https://www.bloomberg.com/news/articles/2018-06-28/crypto-coin-graveyard-fills-up-fast-as-icos-meet-their-demise)

What We Do, During Market Declines

Market declines are uncomfortable - even for us. The key thing is to stay calm and always default back to fundamentals. As Templeton said, the four most dangerous words in investing are: 'this time it's different'. There is no reason to believe that the recent market volatility is any different.

We have been through several market declines where average peak to bottom declines have averaged -17%. Recovery took anywhere from 5 – 8 months thereafter.

Period	Peak to Bottom	Months to Recovery	Subsequent Return to Next Peak
March 2012 to July 2012	-17%	8 Months	70%
August 2015 to February 2016	-17%	5 Months	33%

What we do in each decline is always the same. We examine each holding carefully to ensure it can withstand any economic shocks that maybe down the road. More importantly, we look to reallocate money into assets that have declined more dramatically than our own holdings.

Prices can react irrationally during periods such as these – but fundamentals do not change overnight. Our value philosophy is predated on us viewing stocks as part ownership of a business. As long-term investors, it's important to ignore market volatility.

We are often fond of saying that most money is lost in the stock market from leverage (getting margin called) or not knowing what one is doing. Shares have real underlying fundamentals and it is that intrinsic worth that gives us confidence to hold for the long term even when markets are unfavourable.

Our Interests Are Aligned

While we are structured as a fund, we think of you our investors as partners. Our fund fee structure is such that you only pay for performance with a high watermark (i.e. the last highest Net Asset Value). No management fee is accrued in the meanwhile.

This means that our incentives throughout the next few years are exactly aligned. As the largest investors in the fund, we will share both proportionately in any upside or downside that accrues to you. In short – we have plenty of skin in the game.

Ending Comments

The markets ahead maybe volatile as the outlook dims. However, as Buffett often quips – you want to be fearful when people are greedy and greedy when people are fearful. Our core markets have declined dramatically and far more so than our own holdings and valuations are now once again compelling.

Investments we have eyed for long periods of time have become dramatically cheap again (some cheaper than the 2016 market meltdown). They represent exceptional quality and present themselves with high sustainable dividends. Quality once again is on sale.

As such, we end this letter on a more upbeat note than previous letters. Valuations in our core holdings are cheap and puts us in good stead for long term returns down the road. As investor will come to know, we will often be bullish when others are bearish and bearish when others are bullish.