



Allianz : PIMCO - Bill Gross's total return fund saw USD9.6bn of outflows in July following USD1.3bn of outflows in May - could potentially weigh on the stock but not overly surprising given market discussions of asset rotation. This is a very manageable number in the context of over USD2tn of Assets under Management overall and should be at least partly offset by higher margin inflows elsewhere. PIMCO saw over USD50bn of net inflows in 1Q13. Going forward, rising interest rates will clearly adversely impact PIMCO's performance and risk of outflows but we continue to believe rising interest rates are generally positive for insurance companies and the positive implications for Allianz's insurance business can more than offset PIMCO.

Barclays: Bank of England Deputy Governors Tucker and Bailey both indicating the Prudential Regulatory Authority should impose 3% leverage ratio immediately on UK banks. Bailey commenting "There is very clear view from our side that a 3% leverage ratio is a sensible minimum point to have institutions at, and those who are not at to have plans to get to." This might become a case of politics trumping economic rationale. Applying 3.0% leverage ratio across the UK banks sector by 2013 yearend would force Barclays to raise capital, likely force mitigating measures for Lloyds/Santander-UK, and cripple Nationwide (large mortgage lender) unless regulators decide not to uniformly apply the rules. With Barclays being every UK politician's favorite dog to kick around, a 5% (GBP ~1.8bn) capital raise now looks possible (along with CoCo's and maybe mandatory convertibles) as UK banks have to reach an agreement with the regulators by the end of July.

On a PRA-defined leverage ratio, Barclays is at 2.5% (the requirement is 3.0%) after capital adjustments required to take the risk-weighted ratio to 7.0%. Simplistically, Barclays has £7.3bn too little Core Equity Tier 1 or c£240bn too many assets. Using conservative assumptions, its estimate c10% potential 2015E EPS dilution (all else equal). Even in the extreme scenario of an equity issue in isolation, the 2015E Price / Earnings ratio would move to 6.7x (from 5.8x) ex restructuring and dilute NAV by 4-5%. While near-term uncertainty will likely persist, we think the current rating overly discounts the underlying value of this franchise.

JP Morgan / Wells Fargo : Citi has reached a settlement with Fannie Mae regarding its legacy mortgage portfolio. As part of the agreement, Citi will pay Fannie Mae \$968 million, substantially all of which is covered by Citi's existing mortgage repurchase reserves, thus no material financial impact. The agreement resolves potential future repurchase claims on 3.7 million mortgage loans sold to Fannie that were originated

between 2000 and 2012. The settlement is in our view positive as it resolves substantially all potential future repurchase claims. The settlement follows Bank of America's much larger \$3.6 billion settlement and repurchase of \$6.75 billion of mortgages from Fannie in January. Banks with the largest claims from Fannie that have yet to settle include Wells Fargo and JP Morgan.

Lloyds Bank/ TSB - Lord Davies, the former UK trade minister, is leading a consortium of investors to buy the majority of the government's 39% stake in Lloyds Banking Group. The former chairman of Standard Chartered has spent much of the past year putting together a potential consortium that could take a significant chunk of the taxpayer's holding ( source : Financial Times).

Royal Bank of Scotland : RBS said that it planned to eliminate as many as 1,800 jobs at its Ulster Bank Group unit in Ireland as it aimed to make the business profitable again by 2016. The Financial Times last week reported RBS had begun its own exercise to determine the feasibility and advisability of splitting itself into a "good bank" and "bad bank", as political pressure over the future direction of the bank persists. Five of RBS's most senior executives have formed a committee to examine the idea, in parallel to an exercise being run by the Treasury. The article says RBS executives have suggested that they would welcome the formation of a state-owned bad bank in theory, because the restructuring would make reprivatisation of the remaining "good bank" easier. However, there is scepticism that such a scheme could be devised in a way that would be practicable and which would circumvent EU state aid rules. Separately, Sir Philip Hampton, chairman, has drawn up a list of four or five names for the new RBS chief and aims to finalise the process by the time of the bank's second-quarter results in a month's time.

S&P cuts ratings, as expected, on Barclays and Deutsche Bank to A from A+; S&P affirms "A" rating on UBS.

## Dividend Payers

Barry Callebaut delivered 9M/Q3 2012/13 figures about 0.5% above consensus expectations with regard to volume levels. Looking at the third quarter, this is equal to growth of 8.9%, thus representing a slight increase over the figure of 7.8% reported in H1 2012/13 (Q2: 7.4%).

As was to be expected, Barry Callebaut reiterated their new (i.e. post Petra-deal) medium-term targets: 'on average 6%-8% p.a. and EBIT/tonne restored to pre-acquisition level by 2015/16'. Juergen Steinemann, CEO of Barry Callebaut, said: "We are pleased to have again achieved such strong, broad-



based volume growth for the first nine months, especially as the general market environment in Western Europe was still challenging. Key growth drivers were our strategic partnerships, emerging markets and the Gourmet business. Now, after the closing of the acquisition, we are focusing on the integration of the cocoa business from Petra Foods, having made all the necessary preparations for this during the past six months.”

Seven & I Holdings : In results announced after the 4 July close, 1Q consolidated Operating Profit rose 9.5% Year on Year to ¥73.6bn. This is broadly in line with consensus estimates. Consolidated Operating Profit growth of ¥6.4bn was driven by profit increases of ¥2.8bn for convenience stores, ¥2.6bn for financial services, ¥600mn for superstores, and ¥400mn for food services, whereas department store profit fell ¥500mn.

Siemens : the long-awaited Siemens / Osram spin-off is finally happening today with Siemens keeping a 17% stake directly and holding 2.5% in its pension fund. This leaves 80.5% being spun out to shareholders via a separate quoted entity. For Siemens shareholders, OSRAM is estimated to be worth about Eur2.3bn or approximately Eur2.7 per Siemens share. In theory, the Siemens share should drop around Eur2.2 (c.80% of Eur2.7), akin to going ‘ex dividend’ (the majority of shareholders will now own both Siemens and Osram shares). Osram only represents c. 2-3% of Siemens Sum of the parts. The OSRAM spin off together with the recently announced sale of Siemens’ 50% stake in Nokia Siemens Networks (NSN) to Nokia is we believe positive for Siemens. We see these business exits as demonstrating an ongoing commitment to focus on core businesses and to execute on its Siemens 2014 plan. This should deliver >12% sector profit margins and around Eur8 of EPS.

## Economic Activity, Consumer and Business Conditions

U.S. economy continues to create new jobs...as it has been for the past 33 months, and the pace has steadied. June nonfarm payrolls came in at 195,000, which was better than expected and beat expectations of about 180,000. There were revisions to the prior two months but they were both to the upside....totalling 70,000, in fact. May's 175,000 is now 195,000 and April's 149,000 is now showing a 199,000 gain. Hence the “steadied” comment. The average so far in 2013 is about 202,000..... which is what the Fed would like to see. The private sector churned out a solid 202,000 which is larger than the ADP's figure of 188,000 published earlier last week. The (more volatile) household survey, meantime, also had a decent print, up 160,000 (3rd consecutive increase), with all of the gains in

private sector employment (+302,000). Alongside a 177,000 rise in the labor force (2nd in a row), this left the basic jobless rate flat at 7.6%, a near 5-year low. Unfortunately, the all-in jobless rate (U6) rose for the 2nd time in the past five months, up 0.5 percentage points to a 4-month high of 14.3%. And more cash landed in workers' pockets last month.....average hourly earnings jumped 0.4%, or 2.2% above a year ago. Employees put in more hours, as well.....aggregate hours worked grew 0.2% for the second consecutive month. The participation rate picked up for the second month in a row, it is still very low.... but it is a start!

U.S. goods & services trade deficit unexpectedly widened for the 2nd straight month, this time to \$45.0 bln, the largest shortfall since November. Exports slipped 0.3%, hinting at softer global demand (although other indicators such as various PMIs around the world suggest things have improved a bit since) and as the trade-weighted USD increased. But imports grew for the 2nd month in a row (+1.9%) and it wasn't due to higher prices as import prices have fallen for three consecutive months. Consumer goods imports excluding autos were up a solid 2.3%, which is good news considering April had a 7.5% jump. Auto parts imports were also up nicely (+3.1%), suggesting that automakers were getting everything together to prepare for ongoing production (the typical summer shutdown has been either cancelled this year, or shortened). So the good news is there are signs of decent domestic demand in April and May (from imports). The bad news is they offset soft export activity so the balance so far is weighing on GDP growth in Q2. (The real trade balance widened.)

Portugal : Euro concerns have resurfaced. Portugal Finance Minister resigned last week and now the Foreign Minister has resigned as well, plunging the country into a political crisis with the international bailout still looming in the background. Vitor Gaspar, the Finance Minister, was the architect of spending cuts and tax hikes imposed by the foreign leaders. Paulo Portas, the Foreign Minister, heads the CDS--PP party and without its support, the government no longer has the majority in Parliament. The Prime Minister, Pedro Passos, has already refused to resign so now we await to see if the new minority can garnish enough votes to force him out. If yes, then we will get a new election. If no, then it's a minority government for the next while. Or potentially we could get some type of technocrat government if the EU leaders have to step in.

## Financial Conditions

The Bank of England held rates steady at 0.5% last week and the Asset Purchase Program unchanged at £375 bln. While



policy was unchanged, Governor Carney's first policy meeting brought some changes. The Bank of England released a statement for the first time in a few years in a non-Inflation Report month, no doubt in an effort to improve policy transparency. The Bank notes that while a recovery appears to be on track, "it remains weak by historical standards and a degree of slack is expected to persist for some time". Going one step further the statement says "in the Committee's view, the implied rise by 2015 in the expected future path of Bank Rate was not warranted by the recent developments in the domestic economy." suggesting that the Bank of England could adopt a Fed-style (or perhaps more appropriately Bank of Canada-style) commitment to keep rates low until specific economic thresholds are reached as soon as next month. The statement was clearly dovish, prompting Sterling to weaken to the US\$.

The ECB held rates steady at 0.5%, as expected last week, but took the "unprecedented step" (according to ECB President Draghi) of saying that the Governing Council expects rates "to remain at present or lower levels for an extended period of time." When asked to define "extended period", Draghi wasn't willing to clarify. Interestingly, the decision to implement the guidance was taken unanimously, suggesting that the Bundesbank, which has consistently been reluctant to ease further, might be taking a more dovish turn. Also embedded in the guidance was the possibility of further rate cuts, with Draghi adding that 0.5% is not the lower bound for the refi rate and they have an open mind on negative deposit rates. The Governing Council also had an "extensive discussion" on rate cuts.

In summary: Following the significant back up in global bond yields over the past couple of months, UK and European central bankers are doing their utmost to clarify that policy rates will remain near-zero for an extended period. These actions should help limit increases in bond yields in the U.K. and Europe, even as Treasury yields grind higher amid Fed tapering speculation.

US – UK: US Federal Reserve policymakers remain determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels of interest rates until the unemployment rate falls below 6.5% (June 7.6%) which is likely to be through 2014. Fed Reserve Chairman, Ben Bernanke has indicated 1% or less would be considered exceptionally low. In September 2012, the Fed announced it would buy \$40 bn per month of agency mortgage-backed securities and in December 2012 that it would also buy \$45 bn per month of treasuries (4 year maturity and above) which means all parts of the yield curve will benefit from a near-zero anchor until late 2014. The U.S. 2 year/10 year treasury spread

is now 2.30% and the U.K.'s 2 year/10 year treasury spread is 2.09 % - meaning investment banks can no longer profit from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above their costs of capital. It seems the top tier 8-10 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the possibility of the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has recently increased at 4.29% - (3.31%, end of November the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing U.S. housing inventory is at 4.7 months supply of existing houses. So the combined effects of record low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 15.18 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

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