



## News Highlights

### Financial Services Companies

Bank of America fell the most since November 2012 last Monday, after suspending plans for a dividend increase and \$4bn of share repurchases because of an error in its stress-test submission to the Federal Reserve. The lender will resubmit its proposal after finding botched accounting on structured notes issued by Merrill Lynch. The company discovered an incorrect adjustment applied to the treatment of the fair value option adjustment for structured notes assumed in the Merrill Lynch 2009 acquisition, resulting in the overstatement of capital ratios. While it had been correctly adjusting the cumulative unrealized changes on structured notes accounted for under the fair value option, it was incorrectly adjusting for cumulative realized losses on Merrill-issued structure notes that had matured or the company had redeemed. The company revised its estimated Basel III Standardized Tier 1 common ratio to 9.0% (down 27 bp), which still exceed its proposed minimum 8.5%. It also reported that its estimated supplementary leverage ratio (SLR) was 5.0%, equal to the 2018 minimum. The company's consolidated financial statements (including shareholders' equity) for 1Q14 remained unchanged following the discovery. As a reminder, following the 2014 CCAR process, the company announced a \$0.05 quarterly common dividend (up from \$0.01), and a \$4.0 billion (~2.0%) common share buyback program.

BNP Paribas: 1Q first glance: solid set of numbers with clean pre-tax 2% ahead of consensus at €5.55bn (cons €4.9bn, MACQ €7.70bn). Headline beat is 15% but contains several one-offs including divestment gains. Divisional picture a little mixed with the beat mainly attributable to lower Corp Centre losses whereas Retail Banking is 8% light (but, importantly, France in line) and CIB 4% light. However, any disappointment here should be offset by further impressive progress on capital with CT1 rising a further 30bps to 10.6% (MACQ 10.5%) which will add further fuel to the buyback debate.

ING announced last Wednesday a pre-IPO deal with a number of Asian investors for NN Group, the European and Japanese insurance operations. Through this deal ING Group secures a €1.125bn investment via mandatory convertibles (into NN Group), and a €50m commitment at IPO. The proceeds of the mandatory convertible go to ING Group, there is no capital

injection into NN Group. ING reiterates the IPO is expected to take place in 2014. Overall, this large commitment from the Asian investors into NN Group, without having locked in a valuation for NN group.

Lloyds Bank reported 1Q14 'underlying Profit Before Tax' of £1800m, +7% v expectations. Of the c£0.1bn delta, income is £0.1m lower (-£100m pension cap, -£40m weather related claims, +£90m assumption changes), costs are in line but impairment is c£0.2bn better. 'Statutory Profit Before Tax' was £1369m with no additional Premium Protection Income charges. Tangible NAV was 50.7p, +2.2p QoQ and Core Equity Tier 1 was 10.7%. New 2014 guidance: (1) 2014 NIM of 2.40% (previously c2.30%), equivalent to c2.38% ex TSB, (2) 2014 impairment charge of 0.45% (previously 0.50%). Consensus NIM for 2014 is 2.31%. The stock trades on 1.5x 1Q14 TNAV.

Nordea's Q1 total income was 1% above consensus. Compared to consensus, the main deviation was driven by strong commissions (5% ahead) and better trading (+3%) than expected. The Q1 reported Net Interest Income came in 1% behind expectations driven by FX, while the net interest margin was stable and actually up 1bp q-o-q to 1.08%. Costs were 1% below the consensus and the Q1 net loan loss ratio was 18bp (21bp in Q4 2013 and 23bp in Q1 2013) and consensus at 19bp. Return On Equity for Q1 was 11.4% compared to 11.1% the corresponding quarter in 2013. Nordea states that it will give more details on the accelerated cost cutting programme in conjunction with the Q2 2014 report. Nordea's reported Common Equity Tier 1 (Basel III) ratio improved to 14.6% in Q1 up by 70bp q-o-q, driven by model approval at +65bp but also by further capital efficiencies helping by 40bp q-o-q while growth in Risk Weighted Assets of EUR 4bn q-o-q offsets the positive impact slightly. Moreover, Nordea writes that its pending sale of Nets and divestment of the Polish operation will boost the Core Equity Tier 1 Basel III ratio by further 25bp, respectively, in Q2 2014e meaning that as of today Nordea is already at about Core Equity Tier 1 Basel III ratio of 15.1%.

Royal Bank of Scotland: Q1 IFRS PBT £1.6bn, well ahead of £0.3bn expectations. This partly reflects much lower restructuring costs than expected (£0.1bn v £0.5bn forecast) and much lower Non-core (RCR) losses (-£0.1bn v -£0.4bn) as its Irish unit posted its first profit since the financial crisis. However even stripping those out, Core Profit Before Tax £1.6bn



was still 25% ahead of £1.3bn forecast. Key drivers were (i) better Impairments driven by Ulster and UK Corporate; and (ii) a strong Non-interest income (Trading) performance from Markets where Revenue was down only 8% yoy and +52% on Q4. The latter looks unlikely to be sustained as driven by “gains associated with continued deleverage and de-risking” and there are also £203m gains from sale of securities in Centrals suggesting much of the beat is not sustainable long term. However, most divisions look to have performed better with only US Retail weak. Outlook feels confident “economic confidence has continued and modest asset growth is resuming”. Improved Tangible NAV at 376p and Core Tier 1 Basel III ratio 9.4% better than 8.9% forecast. Royal Bank of Scotland - announced Friday it has issued 32.8mn new shares at 305.3288p, raising gross proceeds of £100mn. This is not a surprise, it has to issue shares to pay the pref divi this year but it perhaps explains some of the weakness recently. There is another £200m to issue through the rest of the year.

Santander reported net profit of €1,303mn (4Q13: €1,060mn; 1Q13: €1,205mn), +6% versus consensus. Overall, 1Q14 results were broadly in line with expectations in all the lines (+1% in PBT). By geographies, the good momentum in Spain & UK, underpinned by higher Net Interest Income & lower Loan Loss Cover whilst Mexico was again slightly disappointing dragged by weak revenues and cost pressure. Brazil's revenues were also lacklustre however, supportive cost trends and lower impairments drove the net profit slightly ahead of expectations. Regarding Asset Quality & capital, the former registered QoQ improvement after a sharp drop in net Non Performing Loans additions, whilst the latter suffered some erosion impacted (-30bps on a phased-in basis) by recent perimeter changes. The bank did not disclose the Basel III fully loaded ratio which its estimated to be at ~8.4%, very tight compared to peers. Note that the offer announce today to buyout the minorities in Brazil could add ~20bps on a fully loaded basis. We see this offer as opportunistic and financially positive for Santander although it questions the group contested strategy of having minorities in the big subsidiaries

## Dividend Payers

ABB – Swiss engineering group said it would intensify work to overhaul its power systems unit after posting an unexpected fall in first-quarter profit because of the unit's weak orders and costly delays to wind and solar power projects. ABB will now stop bidding for certain new solar power generation projects, review its business model for offshore wind power connections and change some management. This comes on top of measures

in late 2012 to be more selective about projects. Weak spending by utility customers and delays to projects have also dogged ABB's power rivals Siemens and Alstom, and contributed to an industry-wide review of its business that in turn has sparked a bid battle between General Electric and Siemens for Alstom's power turbines business.

The power systems division, which makes subsea cable systems and power links to connect renewable energy to the grid, was the only one of Swiss firm's five units to post a loss in the first quarter. Overcapacity in the mining industry and uncertainty over renewable energy policy in Europe has also delayed capital spending by mining and utility customers and depressed large orders - contracts worth over \$15 million - at ABB. Orders dipped 1% in the first quarter to \$10.36 billion, just shy of the average forecast, as large orders fell compared with the previous year. Revenues fell 3% to \$9.47 billion, compared to the average analyst forecast for \$9.76 billion. ABB stuck to its cautious outlook, saying uncertainty in emerging markets like China may offset more encouraging signs in the United States and parts of Europe.

Barrick Gold – Outgoing founder and Chairman Peter Munk gave a spirited defense of his replacement, John Thornton, on Wednesday days after his successor was lambasted by a rival gold company and investors criticized his pay package. Barrick reported a steep drop in first-quarter earnings and cut its forecast for 2014 copper production but the results were slightly ahead of market expectations. A drop in metal prices and lower gold volumes hurt Barrick's profit during the quarter through March 31, with net earnings attributable to shareholders plummeting to \$88 million, or 8 cents a share, from \$847 million, or 85 cents, a year earlier. Barrick, which has mines in the Americas, Australia and Africa, produced 1.6 million ounces of gold in the first quarter, down from 1.8 million ounces a year earlier. Barrick has sold several higher-cost mines over the past year.

Chevron – Sliding production and weak crude oil prices hampered Chevron Corp in the first quarter, leading the second-largest U.S. oil producer, to report a profit well below Wall Street's expectations. Chevron, unlike other large energy companies, derives a larger portion of its U.S. profit from crude oil than natural gas. That has generally helped the company the past few years, when natural gas prices sat near 10-year lows.



Yet a bitter cold winter in U.S. during the first quarter pushed up natural gas prices roughly 50% over the same quarter in 2013, a rally that left Chevron behind and boosted results for rivals Exxon Mobil Corp and ConocoPhillips. Chevron's average selling price for two key types of crude oil, meanwhile, fell 4%. The company posted net income of \$4.51 billion, or \$2.36 per share, compared with \$6.18 billion, or \$3.18 per share, in the year-ago quarter. Globally, Chevron's production fell 2% to 2.59 million barrels of oil equivalent per day.

Rentokil Initial - UK services firm is looking for more companies to buy as part of a strategy to beef up its presence in markets such as the United States and Brazil, after posting a 7.6 % rise in operating profit in the first quarter. The company, which offers services from pest control to work wear supply, said it was on track to generate a significant improvement in free cash flow for the remainder of the year after trimming £10 million off its restructuring and operational costs.

Royal Dutch Shell – capped a strong first quarter reporting season for oil majors with better-than-expected results which were boosted by gas earnings, while shareholders were rewarded with a higher dividend. Shell is planning to divest \$15 billion worth of assets in 2014/15 to improve profitability and payouts. Its cash flow increased to \$14 billion from \$11.6 billion in the first quarter of 2013 and \$6 billion in the fourth quarter of 2013. That allowed the oil major to announce a first-quarter 2014 dividend of \$0.47 per ordinary share, an increase of 4% year-on-year. Adjusted earnings, stripping out \$2.9 billion of writedowns mainly related to refineries in Asia and Europe, beat consensus estimates by 51%, but were still down 3% from a year ago to \$7.33 billion.

Serco – The grandson of Winston Churchill delivered his own brand of fighting talk on his first day as boss of British outsourcer Serco, pledging to reverse the “severe damage” caused by contract scandals and put “a spring in the step” of staff. Late on Wednesday the firm said a detailed review of contracts and its work prospects had revealed the extent of the damage, forcing it to downgrade 2014 profit forecasts for the third time and launch a share placing to raise cash. “The reason I joined the company is because I believe the chances of not being able to produce a good plan is next to zero,” new Chief Executive Rupert Soames said on Thursday, just eight hours into the job, having joined from power firm

Aggreko. Serco runs services in over 30 countries from prisons and air traffic control centres to school inspections. The appointment of Soames was widely welcomed, although his nine-month strategy review, which is set to conclude next March, illustrates a lengthy road to recovery. Serco expects 2014 adjusted operating profit will now be “no less than £170 million”, as much as 32% below March guidance of £220-£250 million, itself a downgrade. In 2012 operating profit was £315 million. The company said the drastic fall was due to significant reduction in margins on renewed contracts, the cost of fixing underperforming contracts, restructuring, and fewer new business wins caused by the controversy of the tagging scandal, which remains under investigation by Britain's Serious Fraud Office. Soames, who similarly launched a nine-month strategy review when he became boss of Aggreko over a decade ago that led to a hugely successful period for the firm, said all parts of the group would come under scrutiny so it could focus on growth areas and determine what may no longer be core. To avoid stretching its debt facilities and to buy himself time, Soames launched a placing of new shares representing 9.9% of its existing stock, which raised £160 million on Thursday.

Sysco – earlier today, reported third quarter net earnings of \$181 million and diluted EPS of \$0.31 (\$0.38 after adjusting for certain items) Sales rose 3.2% to \$11.3 billion over the same time period.

Total - French oil major reported a 10% drop in first-quarter net profit on Wednesday, dragged down like its rivals by shrinking margins at its European refineries and a drop in oil and gas output. Security issues hurt output from Libya and Nigeria. The group also booked a \$350 million depreciation charge on a Russian Arctic gas project it hoped to develop with Gazprom but shelved due to the huge costs. Non-adjusted net profit was up 71% due to a large impairment charge on a Canadian project booked in the first quarter of last year. Total kept its quarterly dividend at €0.61 per share, level from the previous quarter.

Thomson Reuters Corp - reported on Wednesday a 14% increase in operating profit for the first quarter on growth at its Legal and Tax & Accounting divisions. Operating profit rose to \$528 million in the first quarter from \$462 million a year earlier. Revenue from ongoing businesses increased 1% to \$3.1 billion, in line with analysts' estimates. The global news



and information provider affirmed its full-year outlook and expects revenue to be unchanged from last year's \$12.5 billion. Revenue in the Financial & Risk division decreased 1% to \$1.6 billion. The division, which accounts for more than half of Thomson Reuters' total revenue, sells its flagship desktop product, Eikon, to bankers, retail brokers and other financial professionals. Thomson Reuters said revenue in the Legal division, known for its Westlaw legal database, rose 2% to \$803 million, lifted by acquisitions last year like information provider Practical Law. Revenue in the Tax & Accounting division increased 13% to \$348 million.

Wesfarmers –chief Richard Goyder has backed the federal government's determination to reduce debt, but does not believe mooted tax rises and spending cuts in the May budget will dent earnings growth at the company's retail businesses such as Coles, Bunnings and Kmart. Mr Goyder said he was not fearful that a tough budget, to be delivered on May 13, would trigger a collapse in consumer confidence and spending. He said Wesfarmers' key retail chains, including the nation's No.2 supermarket chain, were greatly insulated against souring consumer demand as they had been investing in lower prices, value and quality. Coles' food and liquor same-store sales slowed to 3.5% after adjusting for the timing of Easter, down from 3.8% for the December quarter. Wesfarmers reported sales from its portfolio of retail businesses lifted 4.4% to A\$12.7 billion for the March quarter, with a double-digit sales jump by Bunnings - described by Mr Goyder as "fantastic" - and Coles once again doing the heavy lifting. For the third quarter, Coles recorded total sales growth of 3.6%, with its flagship food and liquor business within the supermarkets group up 3.9%. This was just below analyst expectations. The Bunnings hardware chain posted sales growth of 12.3%, while Officeworks sales rose by 6.7%. The performance by Wesfarmers' leading merchandise and apparel chains was again divergent. Kmart posted a 0.4% lift in sales, while Target, which is going through a restructure to improve its operations, continued to see sales go backwards, this time down 3.6%. Mr Goyder said Target found the trading environment difficult, especially as the business repositioned its offer to become a retailer that was on-trend and a fast-fashion specialist. He said Target was reducing its reliance on promotions in favour of lower everyday prices through a "first price, right price strategy".

EnSCO posted a solid beat this quarter with stronger revenues offsetting higher costs. Management guided 2Q14 drilling expense flat q/q. Consistent with prior quarters, EnSCO continues to high-grade its fleet through divesting older assets while ordering further newbuilds. While the newbuild capital expenditure seems quite robust, the company's strong balance sheet should keep the dividend far out of harm's way as it continues through the down cycle.

#### Economic Activity, Consumer and Business Conditions

US – The US economy delivered a stronger than expected 288,000 new non-farm payrolls in April, with broad based job gains, including business services, education, health care, construction and manufacturing. The headline unemployment rate retreated to a 6.3% level, significantly below the expected 6.6%. The drop in unemployment was chiefly due, though, to a drop in labor force participation. The US economic output was considerably lower than expected in the first quarter of 2014, as revealed by the US Department of Commerce in its advance release on Tuesday. Much as expected, the US consumer sector was a key contributor to the economic growth in the quarter, with all other areas actually detracting from growth, led by a decrease in net exports and inventories.

Key indicators of future business activity, the manufacturing Purchasing Managers Index (PMI) and its non-manufacturing counterpart (NMI), issued monthly by the Institute for Supply Management, advanced strongly in April, to a 54.9 and 55.2 index points level respectively, ahead of the expectations and indicating continued expansion. Earlier in the week, the US personal income report revealed a stronger than expected improvement, up by 0.5% in March, building on February's 0.4% advance and providing scope for continued strength in the all important US consumer sector. Part of the same report, the core personal consumption expenditures (PCE) price index, the US Fed's favourite inflation gage, moved up a notch to a 1.2% year on year rate in March, though nowhere close to hindering the central bankers' extremely accommodative policy stance.

The US housing sector saw a 3.4% jump in pending home sales in March, a welcome positive development on a backdrop of mostly downbeat indicators. The Case-Shiller



price index for US 20 metropolitan areas showed a deceleration of price growth in year on year terms for February, to 12.9% from 13.2% in the month prior, just shy of the expected 13.0% reading.

The US housing sector continued to cool off in March, with both existing home sales and new home sales retreating in the month. While the 4.59 million units of existing home sales is only a notch below the previous month's level, the new home sales took a 15% tumble in March. A lack of inventory is partly to blame, which also explains an accelerated price increase for new homes, up 12.6% year on year.

Canada – Canadian economy expanded by 0.2% in February, much as expected, driven by the resource sector (mining and oil and gas), but also helped by robust activity in manufacturing and wholesale trade. The 0.2% rate is building on a strong 0.5% improvement in January.

Canada sold 50-year bonds for the first time, locking in yields lower than on benchmarks 20 years shorter, as the swelling ranks of baby boomers entering retirement boosts demand for long-dated debt. The government doubled the size of the sale to C\$1.5bn (US\$1.36bn) and won a yield 1 basis point below its 3.5% 2045 benchmark bond. Bloomberg

China and USA : The Financial Times reported last week that China will overtake the US as the world's largest economy this year. The US has been #1 since 1872. The calculations are from a report by the International Comparison Programme, hosted by the World Bank and are based on estimates of purchasing power parity.

Portugal - Portuguese bailout lenders have given a final thumbs-up to the country's program implementation, paving the way for a smooth exit from its three-year bailout later this month. Deputy Prime Minister Paulo Portas said the lenders, the International Monetary Fund and the European Commission have acknowledged Portugal's economy is improving more than previously expected, which in turn is helping the country meet budget targets. The economy is expected to grow 1.2% this year and 1.5% in 2015, after contracting for more than two years. Unemployment is also falling.

## Financial Conditions

USA : The Federal Reserve left rates unchanged at 0-0.25% and reduced asset purchases by \$10 Billion down to \$45 Billion per month. No surprises here as this was the general consensus from analysts. The Fed highlights that the economy has picked up with consumer demand rising more quickly and labour markets improving but cites that unemployment remains too high. Inflation is running below long-run target and inflation expectations remain stable. On forward guidance, the Fed says rates will "likely" stay near-zero for a "considerable time" even after Quantitative Easing ends.

US – US Federal Reserve policymakers remain determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels of interest through 2014 with the Federal Reserve carefully calibrating the beginning of unwinding quantitative easing and undertaking that the Federal Reserve will keep rates low until mid 2015. The U.S. 2 year/10 year treasury spread is now 2.17% and the U.K.'s 2 year/10 year treasury spread is 1.95% - meaning investment banks remain constrained from profiting 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 withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.29% - (was 3.31%, end of November 2012 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 5.1 months supply of existing houses. So the combined effects of 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 14.01 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.



## Mutual Funds

Portland currently offers 5 mutual funds:

- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund

## Private/Alternative Products

Portland also currently offers 3 private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland GEEREF LP

## Net Asset Value:

At the close of business each day we publish the Net Asset Values (NAV) of our mutual funds onto our Portland website at <http://www.portlandic.com/prices/default.aspx>

## Closed-End Fund

Spreads on the closed-end fund remain, in our view, very attractively priced to purchase.

The Portland Investment Counsel's 2013 Fourth Quarter Fund update is now available on the website.

At the close of business each day we publish the Net Asset Values (NAV) of our funds onto our Portland website at <http://www.portlandic.com/prices/default.aspx>

The price details published are replicated here below from which you can see we also highlight whether the funds share prices are trading at a premium or discount to their respective NAV.

# Market Commentary



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Source: Thomson Reuters, Bloomberg, Company reports

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