Market Commentary

PORTLAND INVESTMENT COUNSEL™

May 12, 2014

News Highlights

Financial Services Companies

Barclays – Q1 statutory Profit Before Tax £1,818m in-line with consensus £1,812m. Includes £119m own credit gain. Stripping that out, adjusted Profit Before Tax £1,693m was -7% (£125m) below expectations. This is despite Restructuring charges, Operating expenses and Impairments all coming in better. Total revenue at £6.65bn is 9% (£674m) below expectations and broadly flat on Q413. Key miss unsurprisingly in the Investment Bank where PBT £668m was 36% (£370m) below expectations, with Revenue down 28% Q1 v Q1 and up only 16% on Q413. Fixed Income, Currency and Commodities was the damage -41% (Q1 v Q1). Core Tier 1 Basel III capital ratio 9.6% in line with expectations (Q413 9.3%). Net Tangible Assets per share up1p over the quarter to 284p. Management outlook - focus on costs to improve returns with management very keen to highlight good cost performance. Implications that they will revisit and potentially revise down their £17.5bn cost objective for this year (Q1 £4.2bn) but it is also important to see focus on improving the revenue.

Strategy update highlights. Increased Non-core to £115bn from £56bn (additional £59bn = +1.8% to core tier 1). £115bn is largely focussed on Investment Bank (£90bn) where c41% of Risk Weighted Assets (RWA) is now Non-core. Targeting reduction to £50bn by 2016 (running off £65bn) so going to take a while for this to happen. New Core business c£320bn of RWAs with 30% in the Investment Bank (v c45% in Investment Bank now). 2016 - Targeting a core Return On Equity of >12% (previously >COE) for 2016 on expenses of <£14.5bn. Core Equity Tier 1 capital ratio >11.0% (previously 2015 >10.5%); Dividend payout 40-50% (unchanged). Non-core to provide a drag of <3% = Implies targeting overall Return On Equity for 2016 of c10%. Restructuring charges increased from £2.7bn to £3.5bn. Head of Barclays Americas, Skip McGee left the bank a few days before the major reorganization. He is being replaced by Joe Gold, the bank's global head of client capital management, who joined Barclays 12 years ago after the failure of Enron. Barclays 'bad' bank in which will reside the business lines it ends to exit or sell – will be run by Eric Bommensath – the existing co-head of the investment bank. Also, Paul Parker head of M&A and veteran Asia Pacific chairman and chief executive Robert Morrice are stepping down, the latter after 17 years, Mr Morrice, who has led Barclays' operations in Asia for 12 years, helped to spearhead the bank's push into Asian equities and advisory work from around 2010, as it sought to diversify away from its core debt capital markets franchise. Going forward the 'new' Investment Bank will be run by Tom King, existing co-head and its focus will be on its dual 'home' markets –UK and USA. Barclays is therefore effectively maximizing its acquisition of Lehman Brothers including its US-centric equities and advisory operation and divesting the Asian and RoW trading platforms it sought to build organically.

Citi: has been chosen to safeguard the securities of the world's largest sovereign wealth fund, Norway's $865 billion oil fund, Norges Bank Investment Management, away from its rival JP Morgan. Citi is the 4th largest custodian in the world with about $14.5 trillion in assets under custody whereas JPM is one of the top three (including State Street and Bank of New York Mellon) with more than $20 trillion in assets under custody.

ING: Q1 results. Group headline numbers are in line with consensus - with underlying net income of EUR988mn vs consensus of EUR1.07bn (EUR1.12bn in Q1 13, EUR493mn in Q4 13). On a pre-tax basis, group u/l PBT came in at EUR1,386mn (flat YoY, +30% QoQ), in line with consensus of EUR1,380. The performance in the banking division was robust in Q1, with Banking PBT of EUR1.18bn (+1% YoY and +30% QoQ). Within the banking division, Net Interest Margin improved from 145bps in Q4 to 150bps in Q1 - already reaching its 2017 target of 150-155bps. And impairment charge (as% of Risk Weighted Asset) also fell for the banking division, from 81bps in Q4 13 to 65bps in Q1. Further breaking down the impairment charge, most of the improvement actually came in the retail banking division (falling from 105bps in Q4 to 78 in Q1), with the commercial cost of risk stable. In terms of capital, fully loaded Basel III improved from 10% to 10.1% in Q1. ING also announced that ING group is injecting EUR850mn into the NN Group (insurance), over and above the EUR1.3bn it secured from external investors (RRJ, Temasek and Seatown), and that should pave the way for the IPO of the insurance group in 2014.

HSBC: published its Interim Management Statement (IMS) last week – On the positive side, HSBC is delivering on costs, loan loss provisions and capital. However, revenue trends are again disappointing and the outlook is not particularly positive, reflecting management's cautious nature. Reported net operating income of US$ 15.7bn, (consensus US$ 16.5bn), loan loss provisions of US$ 0.8bn (consensus US$ 1.4bn), operating expenses of US$ 8.8bn (consensus US$ 9.1bn) and an underlying pre-tax profit of US$ 6.6bn (consensus US$ 6.6bn).

Standard Chartered: Interim Management Statement. 1Q14 IMS - Much as expected: Revenues are down by a low-single digit % in 1Q14 Year on Year, although slightly up on a constant currency basis. Ex Korea (income -U$110m YoY), income is flat. Market conditions have remained through through April and into May. Costs are flat Year on Year, suggesting slightly negative cost v income 'jaws' with the UK levy is guided to be U$350m in FY 2014 which is hopefully prudent. Impairment is up by a low single-digit %, resulting in group operating profit which is down by a high-single digit % although 1Q is typically a low impairment quarter. Overall, income appears to be tracking slightly weaker than estimated and may put some pressure on 2014 consensus revenues of U$19.2bn, but that appears to be offset by lower impairment. At this stage, management remain comfortable with 2014 consensus Profit Before Tax of U$7.1bn

Dividend Payers

Bayer – Germany's Bayer AG has trumped rival bidders for Merck & Co Inc's consumer care business in a $14.2 billion deal, adding to a string of major cross-border deals in the healthcare industry. Merck said it expects after-tax proceeds of between $8 billion and $9 billion from the sale, which is expected to close in the second half of 2014. The transaction, the largest in the German healthcare industry since Bayer bought rival Schering for €17 billion ($24 billion) in 2006, will make Bayer the world's second-biggest consumer healthcare company, as it seeks to make better use of its distribution network and sales force. OTC drugs units carry far lower margins than prescription drugs businesses, but many drug majors regard them as attractive complements due to the stable stream of cash they can generate. They also require less spending on research and development and can be less exposed to the loss of patent protection where consumers remain loyal to a brand even when cheap copies become available. Reckitt Benckiser Group, one of the final contenders in Merck's auction, said on April 30 it was no longer in active talks to buy the Merck business, leaving Bayer in pole position. Bayer also reportedly edged out other rival bidders, including Procter & Gamble Co, Boehringer Ingelheim, Novartis and Sanofi.

Johnson&Johnson commands about 4 percent of the consumer health market - worth nearly $200 billion at the retail level. Merck & Co has around 1% with brands including Dr Scholl foot care, Coppertone sunscreen and Claritin allergy medicine. The fragmented OTC industry is consolidating fast. Novartis and GSK will form a joint venture in consumer healthcare as part of their agreement last month. That deal is set to elevate the combined group, with $9.5 billion in sales, to the top of the global consumer health ranking, overtaking Johnson & Johnson and Bayer. But Bayer said the Merck deal will put it back on the second rung, with $7.4 billion in combined sales. Bayer is paying 6.5x 2013 revenue and 21x earnings before interest, taxes, depreciation and amortisation (EBITDA), a steep price at first sight. Bayer's enlarged consumer care unit will account for about 13% of group sales, up from 10% now. Bayer said it plans to finance the OTC acquisition with a bridge loan facility provided by Bank of America Merrill Lynch, BNP Paribas and Mizuho, which will be syndicated to a larger group of banks.

BHP Billiton – Global miner has signed a $6 billion revolving credit facility that will be used to refinance existing facilities, coordinating banks Deutsche Bank and Royal Bank of Scotland said in a statement on Wednesday. BHP's existing $5 billion and $1 billion multicurrency credit facilities have been cancelled as a result of the refinancing. The loan, which has a five-year maturity with a two one-year extension options, will be used for general corporate purposes and as backup for commercial paper programmes. The financing closed oversubscribed after unanimous support from the group of existing and new relationship banks invited during syndication. BHP elected not to take an increase and participating banks were scaled back. BHP has taken advantage of strong competition in the European syndicated loan market to refinance its financing on improved terms. The new financing pays a margin of around 20 basis points (bps) over LIBOR. BHP is rated A+ by Standard & Poor's, A1 by Moody's and A+ by Fitch.

Enbridge Inc - Canada's largest pipeline company, reported a 56% rise in quarterly profit, helped by higher volumes on its regional oil sands system, and the company said it was on track to meet its full-year adjusted profit forecast. Net earnings rose to C$390 million ($358 million), or 47 Canadian cents per share, in the quarter ended March 31, from C$250 million, or 31 Canadian cents per share, in the year-earlier period. Excluding one-time items, Enbridge earned 60 Canadian cents per share.

GEA Group AG – In the first quarter of 2014, revenue generated by GEA's continuing operations increased by 2.9% to €950.7 million (previous year: €924.2 million). Exchange rate developments impacted this figure by –3.1%. Organic revenue thus increased significantly by 6.0% year-on-year.

At €85.1 million, the group's operating EBITDA was up €12.7 million, or 17.6%, relative to the prior-year figure. As a result, the operating EBITDA margin improved by around 110 basis points to 9.0% of revenue. Consolidated profit amounted to €47.2 million, a 15.6% increase year-on-year. This corresponds to earnings per share of €0.25 (previous year: €0.21). Assuming that there is no unexpected slowdown in global economic growth, GEA is reiterating its previous business outlook for 2014.

Mondelez International Inc - and competitor D.E Master Blenders 1753 are merging their coffee businesses in a deal aimed at taking on market leader Nestle SA. The merger announced on Wednesday will marry Mondelez's grocery coffee brands such as Carte Noire and Gevalia with D.E Master Blenders' L'OR, Pilao and Senseo brands. The new company will be a joint venture controlled by D.E Master Blenders' parent JAB Holding Co. Mondelez said it would receive about $5 billion and a 49% stake in the new combined company. The company, to be called Jacobs Douwe Egberts, will be run by the current management of D.E Master Blenders, and will be based in the Netherlands. The deal clears the way for Mondelez to focus on its snacks business, best known for Cadbury chocolate and Oreo cookies, and is the latest move by JAB to raise its profile in the global coffee market. With annual revenue of more than $7 billion, the new company will be the world's No. 1 pure-play coffee company, though still significantly smaller than the coffee business owned by Nestle.

Mondelez, which also reported a stronger-than-expected first-quarter profit on Wednesday, separately announced a $3.5 billion restructuring program designed to cut costs, boost margins and address the main complaint of activist investor Nelson Peltz, who was recently named to the company's board. Mondelez said it would use a majority of the $5 billion proceeds to expand its $2 billion share buyback program, and the remainder to pay down debt. The deal is expected to close in 2015, subject to regulatory approvals. After that, Mondelez expects snacks to account for about 85% of net revenue, compared with 75% currently, Mondelez Chief Executive Irene Rosenfeld said on a conference call.

Total – France's Total has sold a 30% stake in Moroccan subsidiary Total Maroc to the Saudi Zahid Group for an undisclosed sum and Total Maroc plans to sell a further 15% stake on Casablanca's bourse, a company statement said. Total Maroc commercialises around 1 million tonnes of energy products annually and has more than 270 service stations across the country with an estimated 11% market share, or a third of Morocco's oil distribution. Total and Zahid Group are already partners in Saudi Arabian lubricants producer Saudi Total Lubricants Ltd.

Economic Activity, Consumer and Business Conditions

US – US net exports recorded a $40.4 billion deficit in March, much as expected, an improvement over February's negative $41.9 billion figure. Exports rebounded by 2.1% in the month, while imports rose only 1.1% over the same time period, though consumer goods and autos imports grew faster, a bullish signal for consumer spending down the road. Consumer spending has been increasing, as also attested by a $17.5 billion increase in the US consumer credit in March, on top of February's $13 billion expansion and ahead of the expected $15.8 billion advance.

Meanwhile, US productivity retreated in the first quarter by 1.7%, which was more than the expected 1% corrections, though hardly surprising given the severe weather impact for most of the quarter.

Canada – Canadian economy lost 28,900 positions in April, in contrast with March's 42,900 jobs added and against the consensus expectations calling for a positive 12,000 jobs number. The drop was due almost entirely to a retreat in the private payrolls and 30,900 full-time jobs were lost. The headline unemployment rate held steady, however, as the economy also recorded a surprise pull-back in the participation rate, currently at 66.1%. The biggest job losses in the month were in financial services and hospitality sectors, while geographically Quebec and Eastern Canada suffered the most.

Canada's balance of visible goods trade managed to stay in surplus territory, by a tune of roughly $80 million, with both exports and imports readings for March exceeded relatively modest expectations. Exports retreated by 1.4%, dragged lower by energy prices, while imports were actually up by 0.4% in the month.

Canada housing sector revealed building permits retreated unexpectedly by 3.0% in March, on top of the 11.3% retreat in the prior months, while housing starts jumped to a 194,800 units annualized, ahead of the expected 175,000 units annualized read, undoubtedly helped by a back-log of projects held back by the severe winter weather. New home prices rose 0.2% in March, as expected, driven by robust price increases in Alberta.

European Central Bank left rates unchanged (0.25% base rate, zero deposit rate, and 0.75% refinancing rate) with Draghi's statement offering nothing really new. However, in the Q&A Draghi stated he sees the rise of the exchange rate as a "serious concern" and also offered up his comment that the ECB is "comfortable with acting in June".

Financial Conditions

Russian exposure : US banks have recently filed their declining exposures to Russia. After the US imposed extra sanctions on Russian individuals and institutions Citigroup, says its exposure has fallen 9% to $9.4bn, JP Morgan by 13% to $4.7bn and Bank of America Merrill Lynch cut its exposure to the country by 22% to $5.2 bn. (Source Financial Times) .

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 2.24% and the U.K.'s 2 year/10 year treasury spread is 1.94% - 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 4.21% - (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 12.46 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.

Source: Thomson Reuters, Bloomberg, Company reports

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PIC14-041-E(05/14)