Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights

Financial Services Companies

BNP Paribas is being pushed to pay more than $3.5bn in penalties as US authorities seek to bring criminal charges against the French bank for allegedly violating sanctions, a person familiar with the negotiations said. Bank officials, including chief executive Jean-Laurent Bonnafé, met with prosecutors and regulators in Washington and New York last week, to appeal for leniency as settlement negotiations continue. A deal, if one is reached, is still weeks away, and the fine size could change as part of the talks, people familiar with the matter say, the Financial Times reports. The potential fine represents about half of the €4.8bn the group generated in net income in 2013. BNP declined to comment beyond what it said in April when it warned that it would have to pay "far in excess" of the $1.1bn it originally set aside to cover the costs of the probe into violations of sanctions against Iran and elsewhere. The figure represents one of the largest penalties ever sought by the US Department of Justice against a bank in a criminal case. HSBC paid more than $1.2bn to resolve a criminal investigation in December 2012 for violating US sanctions and laundering drug money.

Credit Suisse has tentatively agreed to pay almost $2.5bn to the Justice Department and banking regulators and is expected to plead guilty to criminal charges to settle a probe into how the firm allegedly helped Americans evade taxes, Wall Street Journal reports according to people familiar with the matter. The deal, which would mark an escalation in the U.S. crackdown on financial firms, could be announced early next week and would consist of a roughly $1.7bn settlement with the Justice Department, a $100mn payment to the Federal Reserve and about $600mn to the New York State Department of Financial Services, these people said.

Lloyds - The European Union approved an amended plan by U.K. authorities for the divestment of Lloyds Banking Group's retail business, as part of the British bank's restructuring plan. The European Commission, the EU's executive arm, said it accepted changes to the divestment, which it said would leave TSB, the retail bank being divested by Lloyds, in a better financial position and improve its ability to effectively compete in the market despite a reduced balance sheet.

Royal Bank of Scotland : Citizens Financial, the US retail bank owned by RBS, filed for its initial public offering last Monday, restoring momentum to a process that looked threatened in March after the unit failed the Federal Reserve's annual stress tests. Morgan Stanley is running a dual-track process on behalf of RBS, with expressions of interest from Japanese and Canadian banks which could result in a stock market listing for Citizens or its sale. Morgan Stanley and Goldman Sachs are lead underwriters for the IPO, the FT reports. The deal could raise up to $4.6bn (£2.75bn).

Dividend Payers

BHP Billiton - is in talks to sell its Australian nickel business in line with its aim of simplifying the company. The push towards a sale comes as nickel prices have surged 50% this year on the back of a ban on nickel ore exports from Indonesia, which has seen the value of some nickel miners nearly double. BHP said it was examining all options for Western Australia-based Nickel West, including the sale of all or parts of the business, which includes the Mt Keith, Cliffs and Leinster mines, the Kalgoorlie smelter, Kambalda concentrator and the Kwinana refinery. The company has lumped Nickel West with two other unwanted businesses, aluminium and manganese, and flagged earlier this year that one option would be to spin off all three into a separate company. Analysts expect BHP to fetch a strong price if it does go ahead with a sale, just as it has in $6.5 billion worth of asset sales over the past two years, including its stake in the Browse LNG project and its diamonds business. Glencore Xstrata CEO Ivan Glasenberg has said that Glencore would look at Nickel West. There has also been speculation that former Xstrata boss Mick Davis, leading a new mining investment firm X2 Resources, is looking at it, too. BHP declined to comment on who or how many parties the company was talking to. Goldman Sachs is advising BHP on the review. The miner is a top-tier producer of nickel, used to make stainless steel, along with Norilsk of Russia, Brazil's Vale and Glencore. BHP has not talked about the fate of its profitable stake in the Cerro Matoso nickel mine in Colombia, the most valuable part of its nickel business.

Enbridge - Canada unveiled new rules on Wednesday to enhance pipeline safety and spill response, ahead of the development of new projects proposed to carry crude from Alberta's oil sands to coastal ports for export. The new legislation will give Canada's energy regulator, the National Energy Board (NEB), more power to enforce compliance on safety and the authority to step in to lead spill response if a company is unwilling or unable to do so. Companies will also now be held liable, up to C$1 billion ($917 million), for all spills or incidents on their lines, whether or not they are at-fault or negligent, putting the onus on owners to ensure safe operations. "This approach is called 'absolute liability' and it will apply to all federally-regulated pipelines," said Natural Resources Minister Greg Rickford at a press conference in Vancouver. Companies found to be at-fault or negligent in an incident will continue to face unlimited liability. The new measures build on a pledge last year to require all companies operating major crude oil pipelines in Canada to have C$1 billion on hand to fund spill clean ups. The changes come a day after Canada moved to strengthen its response plans for oil spills at sea and just weeks ahead of its final ruling on Enbridge Inc's Northern Gateway pipeline project, which is expected in mid-June. Kinder Morgan is planning to expand and twin its Trans Mountain pipeline, which also carries oil to the Pacific coast, and TransCanada Corp has proposed a line to carry crude east to refineries in Quebec and New Brunswick. There are about 73,000 kilometers (45,360 miles) of federally-regulated pipeline in Canada, transporting more than C$100 billion worth of oil, gas and petroleum products each year.

Graincorp – Australia's largest listed agribusiness posted a fall in profit on Thursday on lower east coast grain production and could also face difficult conditions this year with the expected onset of an El Nino weather pattern. GrainCorp's net profit for the six months to March 31 was A$50 million ($46.9 million), down 43% from A$88.2 million a year ago. Most analysts do not forecast half-year profits. The grain handler blamed the fall earnings on a smaller grain harvest from Australia's east coast, where it has most of its business. Despite Australian wheat production during the 2013/14 season topping 27 million tonnes for the only the third time, production across New South Wales and Queensland suffered as hot, dry weather limited production. Wheat production across Australia's east coast fell to a four-year low of 6.6 million tonnes, according to the Australian Bureau of Agriculture and Resource Economics and Sciences. While wheat production during the current season has got of to a better start, buoyed by timely rains, the Australian Bureau of Meteorology has warned that the chance of an El Nino as early as July is about 70%. The weather pattern, which can trigger droughts across Australia's east coast, could see significant curbs on production, especially if forecasts for a strong El Nino occur. The last strong El Nino occurred in 1997 when wheat production fell to just 10.6 million tonnes.

SP Ausnet – posted a 34.8% retreat in full-year net profit as payments to the Australian Taxation Office and SPI Management Services weighed. In the year to March 31, SP Ausnet reported a net profit attributable to members of $178.3 million, down from $273.5m in the previous year. Revenue grew 9.8% in the year, lifting to $1.799 billion, from $1.640bn in 2013. SP Ausnet will pay an annual distribution of ¢8.36 per share. The group said it may have to pay $86.7m in a dispute with the Australian Taxation Office, and setting this amount aside affected its profit result. SP Ausnet may also have to pay $40.4m to Singapore Power subsidiary SPI Management Services in order to complete a restructure and terminate its management services agreement, which affected profit as well.

National Grid : For the full year the company reported ongoing earnings per share of 54.0p which was well ahead of consensus estimates of 51.7p and showed 5% growth versus last year's 51.4p. This is consistent with 5% RAV (Regulated Asset Value) growth in the UK and 5% rate base growth in the US, excluding the impacts of working capital. Results were driven by lower taxes and interest costs versus expectations. In the earnings release the company shifted reporting metrics toward a focus upon return on equity and a new metric called "value added" that demonstrate incentive performance versus the regulatory metrics under the RIIO regulatory regime and earnings power of the enterprise's earnings power and ability to support the dividend and dividend growth over time. Forecast dividend growth remained the same as a least real growth equivalent to the RPI year on year. Year over year the dividend reflects a payout increased by 2.9%.

Economic Activity, Consumer and Business Conditions

US – The key driver of US economic growth for the past several quarters, the consumer sector, suffered a retreat in April, as retail sales only grew by 0.1% in the month, short of the expectations for an 0.4% advance. Sales of auto vehicles and parts were marginally higher, up 0.7% in the month, while core retail sales, which excludes the effects of auto sales, were flat, significantly below the expected 0.6% improvement. Electronics, home furnishings and hospitality services were the key detractors in the month. To complete the disappointing consumer picture, the just announced Thomson Reuters/

University of Michigan's consumer sentiment reading dropped to an 81.8 index points level in May, from 84.1 in April, contrary to expectations for a mild improvement to an 84.5 index points read. Both the 'current conditions' and the 'expectations' component of this composite index significantly undershoot the consensus expectations. Partly at fault is the sub-par growth in wages, up only 1.9% year on year in April, however, this most reading sentiment reading is unlikely to start a trend, given the steady improvements in the employment numbers.

The US business activity also posted underwhelming numbers for April, with the US industrial production retreating 0.6% in the month, as utilities output reduced due to improved weather conditions but manufacturing output fell 0.4%, which offset some of the strength recorded in March. Consumer goods, business equipment and non-industrial supplies all trended lower. The weakness was offset by good output in the mining sector, as well as in auto production. US capacity utilization dropped to 78.6% in the month, significantly lower than the expected 79.2% level.

The recent cooling off of US housing activity has weighed on the US home builders sentiment in May, with the National Association of Home Builders' housing market index surprisingly retreating to a 45 index points reading, a 'pessimistic' reading, from 46 in April and contrary to the expectations for an improvement to a 49 points read. Meanwhile, both the US housing starts and the US building permits improved markedly in April, potentially marking an inflexion point in the US housing activity, but most likely reflecting a backlog of projects affected by the protracted harsh winter season.

US inflation numbers, as measured by the consumer price indices (CPI), arose some early concerns for a potential acceleration of price increases. While the headline CPI reading for April, at 2.0% year on year, was in line with the expectations, the core reading, which excludes the effects of food and energy prices, at 1.8%, was higher than what the consensus had priced in and an acceleration over March's values. At the headline level, gasoline prices, up 2.3%, and food costs, up 0.4%, provided the price uplift, but most other categories, including the important rents, housing and medical care costs, have also seen price increases.

Canada – Sales of existing homes in Canada advanced 2.7% in April, building on recent price strength and likely helped by a well publicized lack of new homes inventory in certain areas of the market. Home prices, as measured by the MLS, are up 5.0% year on year, lead by gains in Calgary and Toronto. Manufacturing sales in Canada exceeded expectation in March, up by 0.4%, despite the Vancouver port strike.

Australia : unveiled its toughest budget in almost two decades, slashing welfare entitlements and increasing taxes for high earners as it aims to rein in Australia's widening deficit and return the budget to surplus within five years. It is raising the pension age from 67 to 70, imposing a 2% levy on Australians earning more than A$180,000 (US$168,000) a year and introducing charges for doctor visits.

India : Narendi Modi's Bharatiya Janata Party is set to return to power after 30 years by winning a stunning landslide victory. The BJP victory is being well received by India's markets and 800 million population although expectations are now extremely high.

Ukraine/Russia - Ukrainian forces moved to flush separatists from their eastern holdouts as the top U.S. and U.K. diplomats vowed to punish Russia with industry-wide sanctions if this month's presidential election is undermined. Discord over the election risks another round of escalation as the Kiev government and its U.S. and European Union allies blame Russia for the unrest in Ukraine's easternmost regions.

Financial Conditions

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 2.15% and the U.K.'s 2 year/10 year treasury spread is 1.89% - 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 4.20% - (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 5.2 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 13.56 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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