Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights

Financial Services Companies

Barclays – Barclays' consumer banking assets in Spain & Portugal are among targets for PE firms Apollo & Centerbridge Capital Bloomberg report. Bankinter may be interested in parts of the division and Caixa and BBVA are named as interested parties for the Spanish retail network.

Credit Suisse : US settlement: Credit Suisse pleaded guilty to an "extensive and wide-ranging conspiracy" to help US clients evade taxes and agreed to pay ~$2.6bn in fines as it became the first large global bank in two decades to admit to criminal charges. The plea to one count of conspiracy entered by bank representatives in a Virginia courthouse resolves a long-running investigation into the Swiss bank's private banking business, including its Clariden Leu subsidiary, in helping Americans hide assets offshore. The New York Department of Financial Services, the state's banking regulator, said it will not seek to revoke the Swiss bank's license to operate in the state, the Financial Times reports. The fine is almost 3x the amount the market originally anticipated for this case and also above the most recent media reports of ~$2bn. Existing provisions are CHF892m ($1bn) and company has said the shortfall will be made up by booking a CHF1.598bn after tax charge in 2Q. Pro-forma 1Q Core Tier 1 put at 9.3% versus 10% reported. Its estimated its 1Q pro-forma leverage ratio is about 3.0% vs 3.2% reported. On both measures Credit Suisse is now at the bottom of the Investment Bank peer group and well short of UBS (Core Tier 1 13.2%). Press release gives no real detail on how this situation will be addressed, referring merely to Risk Weighted Asset reduction and sale of surplus real estate. Management believe there are no legal impediments for clients in doing business; and that clients have been very reassuring in the past months. Dividend: once Basel 3 Core Equity Tier 1 ratio exceeds 10% Credit Suisse will return half the earnings to shareholders – Long Term capital adequacy target remains at 11%

Deutsche Bank launched plans to raise €8bn ($11bn) in new capital last Sunday 18th May, with the Qatari royal family lined up as a major new investor, in a bid by Germany's largest bank to end questions about its capital position. The bank had already raised €10.2bn euros in equity in 2010 and a further €3bn euros in 2013, but that had not been enough to assuage investor concerns about its capital position as it faces increased regulatory demands. The long awaited capital raise of €8bn consists of ~60m shares at a price of €29.2 issued to Qatar (€1.75bn) and up to 300m (€6.75bn) new shares by way of a rights issue which implies a c33% discount. Their Common Equity Tier 1 ratio will increase by approximately 230bps from 9.5% at 1Q14 to 11.8% on a pro forma CRD4 fully-loaded basis. Deutsche Bank have also announced updated 2015 strategy targets. The glaring issue is that their updated target for Core Equity Tier 1 is just "to exceed 10%" given this raise gets them to 11.8% it seems the bank has issues re legal costs, PVA, DVA and Counterparty Risk impacts. However, management staunchly defend commitment to Fixed Income, Currency and Commodities franchise saying they're 1 of only 5-6 remaining global players. While management accepts near term outlook remains challenged, they feel 13-15% ROE deliverable in coming years and deploying more capital into the business on this basis is justified. And management saying their litigation estimates haven't changed although still have very little clarity on Asset Quality Review outcomes. Underlying estimates unlikely to change and removal of uncertainty should be beneficial for the stock looking forward as is recommitment to 12% ROE ambition.

Royal Bank of Canada reported cash operating EPS of $1.49, which beat the consensus estimate of $1.44 by about 3%. Particularly noteworthy was positive operating leverage in domestic retail banking, where margins improved both year over year and sequentially, another strong quarter for trading revenue (this time driven by equities), and exceptionally good credit quality. Canadian Banking earnings of $1.1 billion were up 8% from last year, helped by improved efficiency ratio and improving credit metrics. In Wealth Management, year over year AUM growth of 15% resulted in earnings growth of 25% to $278 million in the quarter. Capital Markets had another strong trading quarter (this time driven by equities) and account for 23% of the total bank reported earnings in the quarter. Total bank credit provision expense of 23 bps was down from 27 bps last quarter and is near long-term lows. The bank's Core Equity Tier 1 ratio of 9.7% was unchanged quarter over quarter as good internal capital generation was offset with higher Risk Weighted Assets from business growth and some methodology changes in the retail portfolios. The bank increased 2015E cash operating EPS to $6.40 from $6.35 mostly in anticipation of increased share buyback activity as the primary means of managing capital levels.

Royal Bank of Scotland has advised that it is winding down its interest-rate trading business as capital and operating costs increase. RBS cited "increasing level of capital, operating costs and investment that would be required for business to be globally competitive in a market with extremely thin margins," as the reason for winding down its Rates Prime Broking and Rates OTC Clearing businesses, according to Reuters.

Standard Chartered named telecoms executive Andy Halford to be its new finance director on Monday, as the emerging markets-focused bank looks to get its flagging business back on track. Mr. Halford, 55, will replace Richard Meddings, who said earlier this year he would leave the post in June to pursue other interests. Mr. Halford had worked at Vodafone Group for 15 years until March, including nine years as CFO. He left Vodafone as it completed the sale of its $130bn Verizon Wireless stake to Verizon Communications, having said five months earlier that he would leave when the deal was done.

TD reported adjusted cash EPS of $2.0 billion in Q2/14, or $1.09 per share, compared with consensus expectations of $1.02 per share. The earnings beat in the quarter was primarily due to record results in Canadian Retail, which benefitted from positive operating leverage, solid loan growth (25% growth in credit card balances mainly due to Aeroplan and 12% growth in business lending), and strong wealth management results. U.S. Retail also had a solid quarter, but this was primarily related to a 13% decline in loan loss provisions. Capital Markets had a good quarter with trading revenues of $365 million exceeding expectations of about $300 million. Credit was exceptionally strong in Q2/14 with loan loss provisions of $395 million coming in about 15% below expectations primarily due to lower loan losses in U.S. Retail. Capital came in slightly higher than expected with a Core Equity Tier 1 ratio of 9.2%. Management does not expect to increase the dividend next quarter but will reinstate the share buyback program.

Wells Fargo held its bi-annual investor day in San Francisco. This marked the debuts for John Shrewsberry as CFO and Tim Sloan as head of wholesale, with both appearing to have settled into their new roles. The most incremental data points were a sharp increase in its targeted payout ratio (to 55%-75% of net income as dividends and stock repurchases, minus new share issuances, up from 50-65% GROSS previously) which we think translates to 75% - 95% on a gross basis. Shrewsberry did not say when the bank expected to meet the new goal for this measure, which it calls "net payout ratio." The bank said it was keeping its targets for a 1.30% to 1.60% return on assets and a 12% to 15% return on equity despite increasing its Basel III Tier 1 Capital Ratio target to 10% from 9%. Wells Fargo also did not change the target of its efficiency ratio, or revenue relative to costs, from a range of 55% to 59%.

Dividend Payers

BHP Billiton – Tugboat workers agreed last week to suspend plans to go on strike at Australia's biggest iron ore port till at least late June, just as miners stepped up efforts to avert action that could halt a quarter of the world's seaborne iron ore supply. The deckhands, who work for 28 days and then get 28 days off for A$135,000 ($124,400) a year, want more than a 20% pay hike and four weeks extra leave. Any strike at Port Hedland would halt more than half of Australia's iron ore exports, hitting its No.2 and No.3 iron ore producers, BHP Billiton and Fortescue Metals Group Ltd, respectively, as well as Atlas Iron Ltd, who have all slammed the union's demands. "There is something wrong with our industrial relations laws when a small group of 45 people who would like to only work 22 weeks a year and be paid a base rate about three times the base wage of a first year nurse... can hold to ransom an industry that generates more export earnings than any other," Fortescue Chief Executive Nev Power said in a statement. Iron ore exports are expected to surge 35% to A$76.8 billion this year, according to the Australian Bureau of Resources and Energy Economics. Australia's top iron ore producer, Rio Tinto, would not be affected by a strike at Port Hedland, as it does not use that port.

Chevron – Argentina has won the "geological lottery" with its 1,000-foot-thick Vaca Muerta (Spanish for 'dead cow') shale oil and gas field in Patagonia, a spokesman for Chevron said on Thursday, as the U.S. energy giant increases its investments in the country. The company and state-owned oil firm YPF announced plans last month to invest an additional $1.6 billion to develop Vaca Muerta. Shale formations often resemble layer cakes, with shale squeezed between layers of unproductive rock. "But Vaca Muerta is like one big cake, 1,000 feet (305 meters) thick in places, which means one well can be much more productive," Kent Robertson, Chevron's spokeperson said. "One of the unique things about Vaca Muerta from an international perspective is that it is in an area where you've already got oil industry activity," Robertson said.

Roche/Novartis - European regulators said on Friday they had recommended approval of Roche's drug Gazyvaro, or obinutuzumab, for patients with chronic lymphocytic leukaemia, boosting the Swiss group's line-up of new cancer treatments.

The new medicine is an improved follow-on medicine to Roche's $7billion-a-year Rituxan, or MabThera, and Roche is hoping to switch as many patients as possible to the newer product before Rituxan faces competition from cheaper copies. Novartis received a mixed bag of news, with its Alcon eyecare unit winning a recommendation for Simbrinza, a treatment for open-angle glaucoma or ocular hypertension, but heart treatment Serelaxin was rebuffed once again following further re-examination by EU experts. Recommendations for marketing approval by the European Medicine Agency's Committee for Medicinal Products for Human Use (CHMP) are normally endorsed by the European Commission within a couple of months. Tim Wright, global head of development at Novartis Pharmaceuticals said he was "disappointed" that the drug would not be available for patients this year, but said the company was committed to providing further evidence. Novartis said it would re-submit the drug for approval as soon as it had data from a second late-stage trial involving 6,300 patients. Last week U.S. health regulators also turned down an application to approve Serelaxin, citing a lack of sufficient evidence. About 5 million people in the United States are living with chronic heart failure, a progressive weakening of the heart, according to Novartis. About 1 million people are hospitalised with episodes of acute heart failure, and about 22% of patients who are hospitalized die within a year.

Samsung Electronics – is developing a smartwatch that can make or receive calls without having to be tethered to a mobile phone, the Wall Street Journal reported on Friday. Samsung, the world's largest maker of smartphones, is in discussions with unidentified US, Korean and European telecommunications carriers about a so-called "watch-phone" that it hopes to unveil between June and July, the Journal reported, citing people familiar with the company's plans. The current crop of smartwatches, such as Samsung's own Galaxy Gear, have to be linked to a phone to receive and send messages and perform other basic functions. But the proposed watch-phone, which will run on Samsung's Tizen operating software, can take photos and handle email independently and will come equipped with a heart monitor, the newspaper reported. Major technology companies such as Apple, Google and Samsung are expected to be in a race to market wearable computing devices, like watches, to consumers this year.

SSE – Britain's second-largest energy supplier SSE reported a 9.6% increase in 2014 full-year adjusted pretax profit, boosted by a strong performance in its electricity transmission operations. The group, a member of Britain's 'Big Six' energy suppliers which have come under fire for consistently increasing tariffs, reported profits of £1.6 billion ($2.63 billion), ahead of the £1.5 billion pounds expected by an average of 17 analysts according to Thomson Reuters data. Despite the rise, the utility said on Wednesday the issues facing the energy sector were "very challenging". It made the bold move in March to freeze its energy tariffs until January 2016. "Customers, investors, regulators, politicians and SSE all want the same thing: an energy market that works for customers, and is trusted and seen to do so," Chairman Robert Smith said. Retail operating profit at SSE was down 28.6% to £292 million for the year to March 2014 and the firm said it had lost 370,000 customers in Britain and Ireland. The company's electricity transmission operating profit, however, rose by nearly half due to a major increase in investment which chairman Smith said would continue with a net investment of around £5.5 billion over four years in the network.

Tesco –Chief Executive Philip Clarke and Laurie McIlwee, the outgoing finance director, will not be paid an annual bonus for 2013-14, a year when Britain's biggest retailer posted a 6% fall in profit. The firm's annual report, published on Thursday, showed that neither of the men received a bonus for the year to Feb. 22. The short-term bonus available is 50% based on the company's profitability, 26% on strategic financial performance and 24% on strategic non-financial performance. A note in the annual report said the business had made good progress against its key strategic objectives that were designed to strengthen its underlying business. It said internet sales increased 15%, it received better feedback from customers and colleagues, and there was a significant reduction in the level of CO_2 used across the group.

Total – Russia's No.2 oil producer, Lukoil, and France's Total agreed on Friday to set up a joint venture to tap vast tight oil reserves in Siberia. The companies signed the deal on the sidelines of the St Petersburg International Economic Forum. Vagit Alekperov, the head of Lukoil, said the venture with Total would develop fields with around 500 million barrels of reserves. Total said in a statement seismic acquisition will start in 2014 and exploration drilling will follow in 2015. The deal finalises a preliminary agreement signed in December last year. The French oil major said last month it expected the biggest share of its oil and gas output to come from Russia by 2020 and plans to stay there for the long haul despite tensions with the West over Ukraine. Total will join majors ExxonMobil, Statoil and Royal Dutch Shell in developing Russian shale oil, a major part of Moscow's efforts to at least maintain its oil output at more than 10 million barrels per day. The U.S. Energy Information Administration estimates the possible shale oil resources in Russia at 75 billion barrels, more than the 58 billion held by the United States, current leader in shale oil production.

Economic Activity, Consumer and Business Conditions

US – The US Leading Economic Indicators (LEI) reading for April exceeded expectations, up 0.4%, relative to the consensus 0.3%, and building on March's strong 1.0% advance, flagging sustained economic expansion in the months ahead.

The US housing sector delivered some more up-beat numbers last week, a welcome change after a long string of disappointing updates. The US existing home sales reached 4.65 million units annualized level in April, an increase over March's 4.59 million annualized units read, albeit short of the expected 4.68 million read. Meanwhile, US new home sales reached a 433,000 units annualized level in the same month, up from 407,000 units in March and beating expectations for a 425,000 units read. New home activity was particularly strong in the US Midwest, but actually retreated in the Northeast.

Canada – Retail sales in Canada pulled back by 0.1% in March, a significant departure from the expected 0.3% improvement, dragged lower by a weaker month of auto sales. The core reading, which excludes the volatile auto sales category, though up 0.1% in the month, also fell short of the expectations, which were calling for a 0.4% advance. Sales of furniture and electronics were strong in the month, but offset by continued weakness in the clothing and shoes categories.

The consumer price inflation as measured by the changes in the consumer price index (CPI), was up to a 2.0% rate in April, in line with the expectations and a significant acceleration compared to March's 1.5% read. The rate was inflated by an acceleration in gasoline prices, while food costs chugged along. The core CPI rate was up as well, to 1.4% compared to 1.3% and also in line with the expectations. While still some ways from the Bank of Canada's 2.0% target, the slow and steady acceleration of the consumer prices should give some reason to the central bankers for pause and re-consideration of their easing bias.

The Bank of Japan left rates unchanged at +0.1% last week and decided to maintain its program of expanding the monetary base by 60-70 Trillion Yen per year. During the press conference, Governor Haruhiko Kuroda said he doesn't see much need for further stimulus.

Financial Conditions

Banks in Britain broadly support Bank of England plans for yearly checks on their capital levels, although they disagree on how detailed the published results should be. Eight of Britain's biggest banks, including Barclays , RBS, Lloyds and HSBC, will undergo a health check this year to see if they hold enough capital to withstand a 35% slump in house prices and a spike in interest rates to 4%. This year's exercise begins what will become an annual test. It will be expanded to include other banks, to see if they can withstand market shocks without taxpayer money. (Source : Reuters).

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 2.19% 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 6-9 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 4.14%

- (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 11.36 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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