



News Highlights

Financial Services Companies

Bank of America Corp., the second-largest U.S. lender, agreed to an \$8mn fine and returned almost \$90mn to clients of its Merrill Lynch unit who were improperly charged fees over six years. About 6,800 retirement plans for charities, ministers and public-school workers and 41,000 for small businesses paid purchase charges for mutual funds when none was required from 2006 to 2011, according to the Financial Industry Regulatory Authority. While Merrill Lynch discovered the improper charges in 2006, it didn't inform Finra until 2011, according to settlement papers released last week (Source : Bloomberg).

BNP settlement talks are now close to completion with terms reportedly now centering at (i) \$8-9bn fine, (ii) guilty plea, (iii) >30 employee departures, and (iv) temporary suspension of US dollar clearing by certain units. Based upon the reported \$30bn volume of illegal transactions, the proposed fine (30 cents on the dollar) looks good for BNP (eg. Standard Chartered paid 100 cents on the dollar and RBS paid \$3.13 on the dollar) and BNP clearly is benefitting from Too Big To Fail status (eg. US closed down oldest (but small) Swiss private bank Weglin last year). Should one or more BNP units have their USD clearing license temporarily suspended, it is also fair to assume the costs will not exceed \$1-2bn (ie. total fines would still be in the \$10bn fine range) and enough time should have passed that systemic risks would have been properly vetted by regulators (ie. regulators will not move ahead with a suspension unless they were comfortable over the potential systemic risks). While these transactions would have been legal if conducted through France and the manner of calculating the fines is hard to fathom, BNP are clearly being penalized for not assisting with the US enquiries (as did HSBC last year when found guilty of money laundering – potentially far more harmful but the fines were subsequently more modest – circa \$1.6 bn) and will be relieved to get this issue complete.

Credit Suisse: Swiss National Bank has published its annual financial stability report including encouraging comments regarding capitalisation levels of UBS and Credit Suisse. Report refers to “significant progress in improving their capital situation” and says both banks “either already exceed or are close to”

both 2019 Core Tier 1 and leverage requirements. Reason the SNB seems comfortable with capital ratios is that its focus is on total loss absorbing capital as opposed solely to core equity and Credit Suisse has significantly bolstered its loss absorbing position through Coco issuance over the last couple of years.

HSBC: 32 year veteran Irene Dorner is to retire as CEO, HSBC US and will be succeeded by Patrick Burke another HSBC ‘lifer’ who has been with HSBC since 1989 and was CEO of HSBC Finance Corp. Since 2010. Patrick Burke in the past four years has spearheaded the wind-down of the lender's legacy Household consumer finance business. He will become president and chief executive of HSBC US in November.

ING, the biggest Dutch financial-services company, is seeking as much as €1.54bn (\$2.1 billion) in the initial public offering of its European insurance unit. The firm has announced it is to offer 70mn shares of NN Group for €8.5 to €2 apiece. The offering will reduce shareholder equity at the Amsterdam-based parent by about €2bn, according to bank. ING has been selling assets since 2009, including a majority stake in U.S. insurer Voya Financial, as a condition for European Union approval of a government bailout. Shares in NN Group are expected to be listed on Euronext Amsterdam on July 2, under the listing name “NN Group” and the symbol ‘NN’.

Lloyds Bank - increased the size of the TSB share sale to 35% (25%) at 260p. TSB priced at 260p or £1.3bn. Equates to 0.87x tangible book and have sold 35% against guidance of 25%. That seems a pretty good performance for a business making an underlying ROE of c4% last year, reliant on subsidies / loans “lent” from Lloyds, which needs to grow its loan book by 40-50% over the next three years to hit return targets and with a 65% stock overhang (which will no doubt keep a healthy raft of buy recommendations). Key positive of TSB is a very strong NII gearing to rising rates. However, with a loan book dominated by mortgages I suspect that is a better relative than absolute call. The TSB stock was well received on the market last Friday with its shares jumping 12%, in the latest sign the initial public offering market for UK banks is heating up.

Dividend Payers



Enbridge : Canadian federal government granted “conditional” approval for Enbridge to move forward with the Northern Gateway Pipeline Proposal, subject first to 209 conditions being met...so project still faces hurdles. A large amount of issuance would be anticipated if the project does proceed but that is far from certain at this juncture. The \$7.9 billion project would see 525,000 bbl/d of oil shipped to the west coast with the earliest the oil could start flowing is in 2018. Enbridge has stated that it could take up to 16 months to satisfy the pre-construction conditions. In addition to satisfying the 209 conditions as laid out by the NEB, to obtain the necessary construction permits from the BC government, Enbridge must also satisfy five conditions. We view a pipeline to the Pacific Ocean that would diversify Canada’s end-markets for oil and allow large quantities of Canadian heavy oil to be priced at higher international prices (with western Canadian crude trading at discount at about \$20 per barrel) as imperative to Canada’s economy and ability to capture world oil prices.

Syngenta : announced last week a malting barley collaboration with Anheuser-Busch InBev. The Partnership to secure the sourcing of high-quality malting barley: Malting barley is the key raw material for the beer industry. Growers will have access to the best Syngenta malting barley varieties and a tailored growing approach, including training and advice on agronomy and sustainable farming practices. Growers will achieve higher yields, enabling them to supply AB InBev with consistently high-quality grain to meet the exacting standards for beer production. In the first phase of the partnership, 160 growers and 14,000 hectares in Argentina will be involved. However, as Anheuser -Busch InBev is working with more than 15,000 growers through longstanding barley programs in the United States, Canada, Mexico, Brazil, Uruguay, Argentina, China and Russia, a successful pilot phase could result in a much bigger offering. The malting barley collaboration with Anheuser -Busch InBev strengthens Syngenta’s strong number 3 global position in seeds/integrated solutions further with closed technology gap to leader Monsanto.

Tesco : Moody’s last week cut its rating on Tesco’s long-term debt to Baa2 from Baa1, one notches above the lowest ‘investment grade’ status. The rating agency attributed its cut to last year’s profit fall, weak sales in 1Q14/15 and an increase in the company’s pension deficit for the cut. It also said that it expected the conditions to impact Tesco’s profit margins and to affect its credit quality for the next 12-18 months. This has little

direct immediate impact on Tesco, but is clearly unwelcome news and will likely be a key issue of focus for the next CFO.

Economic Activity, Consumer and Business Conditions

U.S. housing starts disappointed a lot in May. Expectations were for a 3%+ gain in the month; instead, starts fell 6.5% to 1,001k annualized. The revisions to the prior two months were, on net, barely higher. Still, we have now had two consecutive months above the 1 million unit mark, which is only the second such occurrence in the past six years. But the sector is clearly having some difficulty breaking past the million mark firmly, as it continues to face a number of high obstacles....higher prices, higher borrowing costs, tougher requirements to secure a mortgage (although federal regulators were mulling over easing up on tighter mortgage rules). Singles tumbled for the first time since the start of the year, losing 5.9%, while multi-unit starts were down 7.6%. On a regional basis, less ground was broken everywhere except in the South, where starts rose for the second month in a row. And in a not-very-rosy sign, building permits, an indicator of future construction, also faltered in May down 6.4% to 991k (or 1.9% below a year ago).

UK house price inflation has hit a four-year high, according to official figures that will intensify the debate about whether policymakers need to take steps to cool the market. The average UK house price rose by 9.9% over the year to April, up from 8% inflation in March, driven largely by increases in London, the Office for National Statistics said. That was the strongest rise since June 2010. The figures were released as members of the Bank of England’s financial policy committee (FPC) meet to discuss risks to the UK’s financial system, with house prices expected to be a key point of discussion. Last week the chancellor, George Osborne, gave the committee new powers to curb house price rises, which have been flagged as a threat to Britain’s economic recovery by ratings agency Fitch and the International Monetary Fund. The ONS said house prices were increasing strongly across most parts of the UK, with prices in the capital again showing the highest growth. London prices rose 18.7%, the biggest increase since July 2007. (Source : The Guardian).

Financial Conditions



US Federal Reserve : The Fed tapered another \$10 Billion in asset purchases as expected last week – down to \$35bn per month of asset purchasing and provided a relatively upbeat assessment of the economy but remains cautious and so unwilling to turn contemplate indicating when rates will rise despite the rosy outlook. The anticipated Federal Funds Rate guidance was not revised higher in 2015, but they were revised higher in 2016 (from 2.25% to 2.50%), and the long run neutral rate was estimated at 3.75%, down from 4.0%. GDP growth forecasts changed dramatically down in 2014 as expected because of the harsh winter , but with the bottom end of the range having fallen from 2.8% to 2.1% one must view this as a bullish view on the recovery. In its accompanying statement, the Fed said that economic activity had “rebounded in recent months”. It implies, assuming a downgrade of Q1 to around -1.5%, that policy makers expect growth to average approximately 3.4% over the next three quarters. Growth in 2015 and 2016 not changed much, but the longer run estimate of growth shifted down by 0.1% to 2.1%. That is consistent with the drop in the long run neutral policy rate to 3.75%.

Swiss National Bank: left rates on hold at 0-0.25% and maintained its 1.20 EURCHF floor. It is interesting to see that the SNB decided not to follow the ECB into the negative interest rate territory. With EURCHF comfortably trading above the 1.20 floor over the past year, the SNB appears to be refraining from a negative interest rate policy until it is really needed.

Argentina's sovereign credit rating was cut two notches by rating agency S&Ps on Tuesday, a day after the US Supreme Court ruled that the country had to repay \$1.5bn to “holdout” investors before servicing its restructured debt. S&P lowered its rating to ‘CCC-’ from ‘CCC+’ , well below investment grade and maintained a negative outlook, citing the decision. Separately, Argentina’s economy minister Axel Kicillof said he wanted to restructure debt held by foreign creditors under local law and the country would continue its fight against so-called “vulture funds”.

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 2.14% and the U.K.'s 2 year/10 year treasury spread is 1.86% - 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 4.17% - (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 11.20 (compares to a post-recession low of 10.7 achieved in early June) 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 Banks Fund
- Portland Global Income Fund
- Portland Global Dividend Fund

Private/Alternative Products

Portland also currently offers 3 private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund

Market Commentary



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- 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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