



## News Highlights

### Energy Sector

Pacific Rubiales – announced a 45% increase in certified total prospective resources and a 62% increase in certified contingent resources, in an evaluation of its exploration blocks. Resource evaluation results were made available for 36 of co's 60 exploration blocks in Colombia, Peru, Brazil, Guyana, Guatemala, Papua New Guinea. Colombian assets were increased by 74 million barrels of oil equivalent (boe), mostly heavy oil, while Peru added 85 million boe to the company's contingent resources, with a large portion being natural gas.

Mexican conglomerate Alfa said on Wednesday it paid C\$189.4 (\$172.7 million) to increase its total stake in Pacific Rubiales Energy Corp to 17.07%. Alfa SAB de CV has been buying shares in Canada's Pacific Rubiales as part of a long-term effort to diversify, as well as to take advantage of a reform that will allow foreign oil companies to develop projects in Mexico for the first time in more than 70 years. Pacific Rubiales is Colombia's No. 2 crude producer, operating in partnership with national oil company Ecopetrol SA.

### Financial Sector

Bank of America - reached a record \$US16.65bn settlement with the US government to settle charges that it and companies it bought misled investors into buying troubled mortgage-backed securities, helping the bank close a major chapter tied to the financial crisis. The settlement announced on Thursday by the US Department of Justice calls for the second-largest US bank by assets to pay \$US9.65bn in cash to resolve more than a dozen federal and state investigations, and provide \$US7bn in help to struggling homeowners and communities. It is expected to resolve the vast majority of the Charlotte, North Carolina-based bank's remaining liabilities tied to its purchases of Countrywide Financial Corp, once the nation's largest mortgage lender, in July 2008 and Merrill Lynch & Co, six months later. "I want to be very clear: The size and the scope of this multibillion-dollar agreement goes far beyond the 'cost of doing business,'" US Attorney General Eric Holder said in announcing the settlement. Bank of America expects the accord to reduce third-quarter earnings by about \$US5.3bn before taxes, or about 43c per share after taxes. This settlement can be perceived as a positive, as Bank of America has largely put this issue behind

them; however, this is a large settlement that represents a headwind for Tangible Book Value growth.

Goldman Sachs Group - will pay \$US3.15bn to settle claims from the US housing finance regulator that it sold bad mortgage-backed securities. Goldman said it would repurchase the securities sold to Fannie Mae and Freddie Mac over the 2005-2007 period Goldman and Morgan Stanley are also in preliminary discussions with the US Department of Justice about settling allegations that they mis-sold MBS, the Financial Times reported on Friday, citing three people with knowledge about the issue. In its lawsuit, the FHFA said Fannie Mae and Freddie Mac bought \$US11.1bn of mortgage-backed securities from Goldman, unaware that "significant percentages of the underlying mortgage loans ... had materially poorer credit quality than was represented in the registration statements."

HSBC Holdings Plc - Chairman Douglas Flint said the cost of policing potential wrongdoing will probably decrease after the bank spent billions of dollars to toughen its internal controls in the wake of a series of scandals. "It's huge but it's necessary," Flint said in an interview, when asked about costs of boosting internal controls. "As you look back, you might as well say it was necessary -- an investment that was underspent in the past and now there's an element of catch-up and hopefully" we'll be able "to moderate that cost," he added. HSBC, fined \$1.9bn by U.S. authorities in 2012 to resolve allegations it enabled Latin American drug cartels to launder billions of dollars, has been beefing up its internal controls in the face of regulatory scrutiny. The lender increased compliance staff to 6,000 from 1,500 over the past four years and is spending an additional annual cost of between \$500mn to \$1bn, according to Flint. ( Source: Bloomberg)

Standard Chartered - Agreed to pay a fine of US\$300m regarding "deficiencies in the anti money laundering transaction surveillance system" at its New York Branch. The fine is about in-line with previous press speculation (US\$100m to US\$340m) and Standard Chartered's disclosure of 06 August 2014. In 2012, StanChart was fined \$667m by US regulators and signed a deferred prosecution agreement for breaches of US sanctions. The latest alleged fine is related to a follow-up investigation on implementation of new surveillance systems.



## Global Dividend Payers

Amcor – Five years after its transformational \$1.9 billion acquisition of Alcan’s packaging assets, Amcor is eyeing potential acquisitions worth \$3 billion as the packaging giant looks for new growth in emerging and developed markets. Chief executive Ken MacKenzie said the pipeline for potential acquisitions had grown from about \$2 billion a year ago as the group identified new targets and as vendors took advantage of historically high asset valuations. However, Mr Mackenzie said Amcor – which made four bolt-on acquisitions last year – would maintain a disciplined approach to growth. “We have a 20% pre-tax return on investment hurdle and we have to make sure the acquisitions we make are going to create solid returns for shareholders,” he told The Australian Financial Review after reporting a 24.6% increase in underlying net profit from continuing operations to \$737 million for the year ending June. Sales from continuing operations in 2014 rose 14.4% to \$10.85 billion, buoyed by a series of acquisitions, while the weaker Australian dollar boosted translated earnings, adding about \$91 million to the bottom line.

Amcor spun off its Australian paper and packaging distribution assets into a separately listed company, Orora, last December and plans to report earnings in US dollars this year to reduce exchange rate volatility. MacKenzie forecast earnings growth in 2015, with strong organic gains from emerging markets expected to augment lower rates of growth from North America and Europe. Amcor increased its final dividend by 3¢ a share to an unfranked 23.5¢, taking the full-year payout to 43¢.

BHP Billiton – The world’s biggest mining company, announced plans to spin off businesses worth an estimated \$16 billion, most of them acquired in a 2001 merger, to focus on its most profitable activities. But it held off on a share buyback, disappointing investors who had hoped to receive around \$5 billion. Chief Executive Andrew Mackenzie said the widely expected move to simplify BHP around the “four pillars” of iron ore, copper, coal and petroleum - with potash as a potential fifth pillar - would spur cashflow growth and boost returns. These assets generated 96% of the group’s underlying core profit in the 2014 financial year. The spin-off company, dubbed NewCo for now, will bundle BHP’s aluminium, manganese, Cerro Matoso nickel in Colombia, South African energy coal, some Australian metallurgical coal assets and the Cannington silver, lead and zinc mine. It will not include Nickel West in Australia, for which a separate sale process was continuing, Mackenzie

said. BHP confirmed the spin-off as it reported an 8% rise in second-half underlying attributable profit to \$5.69 billion due to higher output volume and cost cuts. The figure was below the consensus analyst forecast of \$5.94 billion. The company said it had cut costs in the 2014 financial year by \$2.9 billion and expected to achieve a further \$3.5 billion over the next three years. NewCo will be headquartered in Perth and listed in Australia, with a secondary listing in South Africa. Shareholders in BHP Billiton Ltd and BHP Billiton Plc would receive shares in the new company on a pro-rata basis. BHP said only that NewCo’s businesses, which generated more than \$1.4 billion in operating cash flow and had achieved an underlying core profit margin of 21% in the 2014 financial year, would carry “minimal debt” and it was targeting an investment grade credit rating. The company would be headed by BHP Billiton Chief Financial Officer Graham Kerr, while Brendan Harris, BHP Billiton’s head of investor relations, would be chief financial officer.

Coca-Cola Amatil – warned it expects to post a second consecutive drop in full-year earnings amid weak consumer confidence. The company has been trying to rejuvenate its strategy under new Chief Executive Alison Watkins to address the changing tastes of its core market, launching a smaller, cheaper Coke can and promising more sugar-free products. In its first set of results under Watkins, the company revealed on Monday that first-half net profit slid 15.6% to A\$182.3 million (\$169.50 million), from A\$215.9 million a year ago. That was largely in line with analyst expectations of A\$184.5 million. Watkins, who took the post in March, conceded the poor operational result was not entirely due to external factors like domestic price competition from Asahi Group Holding Ltd’s Pepsi. Decisions by the company last year to cut its sales staff and stand back from promotional activity in Australia were poorly made in hindsight, she said. Watkins is overseeing a strategic review that seeks to restore brand value and save the company A\$100 million in costs over the next three years partly by streamlining its supply business. First-half earnings before interest and tax in Australia, which generates more than 80% of profits, fell 14.1% to A\$226.5 million, while earnings in Indonesia plummeted 83.4% to A\$5.2 million. CCA returned to the beer market in December after a two-year break, but it said sales had been slower than expected due to increased competition.

Roche – has agreed to buy U.S. biotech company InterMune Inc for \$8.3 billion in cash, helping the world’s leading maker of cancer drugs expand into the treatment of rare or incurable



diseases. Roche's efforts to produce successful non-cancer drugs from its own labs have been mixed, with setbacks in recent years for experimental drugs against heart disease, diabetes and schizophrenia.

The InterMune deal brings it a promising new drug, pifrenidone, for treating a progressive and ultimately fatal scarring condition of the lungs. Roche said on Sunday it would pay \$74.00 a share through a tender offer for InterMune, representing a premium of 38% to the closing price on Aug. 22 and a 63% premium over Aug. 12 when takeover speculation around the stock began to circulate. The acquisition, which has been recommended by the boards of both companies, is the largest by Roche since 2009, when it bought out the remaining stake it did not already own in U.S. group Genentech for around \$47 billion. Industry analysts expect pifrenidone, which is given as a pill, to have sales of \$1.04 billion in 2019, according to consensus forecasts compiled by Thomson Reuters Pharma. Roche said the transaction was expected to be neutral for its core earnings per share in 2015 but would boost profits from 2016 onwards. It said guidance for this year remained unchanged. Chief Executive Severin Schwan said he believed there was a good strategic and cultural fit between Roche and the California-based biotech firm, and that it would continue to pursue "targeted" bolt-on acquisitions. Roche said its interest in a deal was triggered following positive late-stage trial results for the drug in May. The medicine also received a "breakthrough therapy" designation from the U.S. Food and Drug Administration (FDA). The term is reserved for drugs for serious diseases that appear to offer a substantial advance on existing therapies. The FDA is due to give its verdict on whether to approve pifrenidone by Nov. 23 and Roche said it expected to launch the drug in the United States this year. Citi is acting as financial adviser to Roche, while Centerview Partners and Goldman Sachs are acting for InterMune.

Super Retail Group – plans to tap global sports brands for better deals as a new wave of international competitors descends on the Australian market, challenging sales and earnings at its Rebel and Amart. The company reported a 5.6% increase in net profit to \$108.4 million for 2013-14.

The company's CEO Peter Birtles, said that the company's most recent focus is on working with its "big branded supply partners to take costs out of the supply chain" which will

enable it to be more competitive at retail levels. Super Retail hopes to potentially obtain a 20% improvement on cost of goods. Earnings from Rebel and Amart fell almost 15% to \$62.8 million in the 12 months ended June 30, while earnings from the leisure business, which includes Ray's Outdoors and Boating Camping and Fishing, fell almost 16% to \$33 million. These declines partially offset an 8.5% increase in earnings from Supercheap Auto, the group's largest and most profitable division. Group sales rose 4.6% to \$2.11 billion, in line with market forecasts. The bottom-line result was in line with market forecasts of about \$108 million and followed a series of profit warnings over the last 10 months. Group underlying net profit after tax fell 7%, excluding a one-off tax benefit of \$2.2 million and restructuring provisions of \$11.3 million in 2012-13. CEO Birtles has flagged modest profit growth in the first half of 2014-15 but expects the company to return to double-digit profit growth in the second half, underpinned by a rebound in same-store sales and stronger margins. Super Retail also plans to open between 20 and 30 new stores and refurbish between 70 and 80 to give customers more reasons to shop in store. At the same time, it is improving its online presence.

## Economic Conditions

US – The US inflation readings for July, while in line with the expectations at 2.0% year on year rate of change and marginally lower than June's 2.1%, keeps the price increases within striking distance of a monetary policy action triggering value. The core inflation, which excludes the effects of food and energy prices, was also in line with both the consensus expectations and the prior month's reading. Food, rent and clothing led the price increases in the month, while gasoline and recreation were cheaper.

On the US housing front, the housing starts for July handily exceeded the consensus expectations, at 1.09 million units annualized, relative to 970 thousand units annualized. Building permits for the same month were also ahead of the expectations, at 1.05 million units annualized, improving on June's 960 thousand units level. This data is in line with an improvement in US homebuilders morale, as measured by the National Association of Home Builders housing market index and as we discussed last week. However, the Commerce Department said on Monday that sales of new homes in the US slipped 2.4% to a seasonally adjusted annual rate of 412,000



units, the lowest level since March. Higher inventories of new homes and lower price increases, though, should stimulate sales going forward.

The leading economic indicators (LEI) reading for July was up 0.88%, ahead of the expected 0.6% improvement, signaling an acceleration of the US business activity in the following months.

Canada – June retail sales in Canada improved significantly over the previous month, up 1.12%, on top of May's 0.86% advance, well ahead of the expected 0.30% reading. Many retail categories, including general merchandise, clothing, building materials and food and beverage saw robust growth in the month. Core retail sales, which excludes the sales of autos, were up 1.55% in June, accelerating from May's pedestrian 0.33%.

Inflation rates in Canada took a breather in July, as the headline consumer price index (CPI) was only up 2.1% year on year, from June's 2.4% rate. Gasoline and food prices were lower in the month, but other series, such as automobiles and healthcare prices were also more muted in the month. The core CPI, which strips-off the effects of eight most volatile price series, was, at 1.7% year on year, lower than June's 1.8% and surprised the consensus, which was factoring in an acceleration to a 1.9% rate.

UK - economy grew by 3.2% in the second quarter compared with the same period last year, slightly higher than the original 3.1% estimate. But the Office for National Statistics' second estimate of growth in the April-to-June period left the quarter-on-quarter figure unchanged at 0.8%. The construction sector performed better than previously assumed. The figures confirm the UK economy saw its best economic performance for six years and has passed its 2008 peak. The services sector - which accounts for around 78% of UK economic activity - grew 1% in the second quarter, the ONS added. (Source:BBC News).

France's - Prime Minister tendered his resignation today. The move comes a day after the leftist Economy Minister called for new economic policies, suggesting France resist Germany's "obsession" with austerity and promote alternative policies across the euro zone. He went on to say that deficit-reduction measures carried out since the 2008 financial crisis have crippled Europe's

economies and governments need to change course swiftly or they will lose their voters to populist and extremist parties.

Russia / Ukraine - Ukraine announced a military spending increase before preliminary peace talks with President Vladimir Putin tomorrow, as German Chancellor Angela Merkel pressed for resolution of a parallel dispute over Russian natural gas supplies to Europe this winter. The armed conflict with pro-Russian rebels showed no signs of abating in war-torn eastern Ukraine. Putin will meet with his Ukrainian counterpart Petro Poroshenko during trade talks in the Belarus capital Minsk.

## Financial Conditions

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 US 2 year/10 year treasury spread is now 1.90% and the UK's 2 year/10 year treasury spread is 1.68% - 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 US 30 year mortgage market rate has increased to 4.10% - (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 US housing inventory is at 5.5 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 11.47 (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
- 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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INVESTMENT COUNSEL®

August 25, 2014

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Source: Thomson Reuters, Bloomberg, Company reports

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