Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Crescent Point Energy – reached a $378 million deal to buy producing conventional oil assets in Saskatchewan and Manitoba, along with undeveloped land, from Lightstream Resources Ltd. Crescent Point said the assets it is acquiring are free cash flowing, producing some 3,300 barrels of oil equivalent per day, and come with 76 net sections of land (1 section of land contains 1 sq mile/640 acres) adjacent to its existing land base in the area. It valued those assets at $328 million. The Calgary-based energy company will also receive 44 net sections of undeveloped freehold interests, worth about $50 million, as part of the mostly cash deal. Crescent Point also raised its 2014 forecast, based on the Lightstream deal and other acquisitions made so far this year, along with successful drilling results at its Torquay resource play in Saskatchewan. It said capital spending will increase by $200 million to $2 billion, with cash flows from operations expected to climb 3% to $2.6 billion from $2.5 billion. The deal is expected to close by September 30. Crescent Point also announced successful drilling results in its Torquay resource play in southeast Saskatchewan. To date, Crescent Point has drilled 15 vertical delineation wells and an additional 8 horizontal wells that have expanded the play's boundaries in several directions. The Company's Torquay inventory now totals more than 590 locations.

Crescent Point has entered into an agreement, on a bought deal basis, with a syndicate of underwriters co-led by BMO Capital Markets and Scotiabank for an offering of 17,290,000 Crescent Point common shares at $43.40 per share to raise gross proceeds of approximately CDN$750 million. The net proceeds will be used to fund the purchase of the Lightstream Assets and the expanded 2014 capital budget.

Northland Power – German utility RWE has agreed to sell an 85% stake in three offshore wind parks to Canadian power producer Northland Power. Under the agreement, covering the wind parks Nordsee One, Two and Three, RWE's renewable unit Innogy is keeping a 15% stake in the assets, in line with its strategy of seeking investor help for pricey offshore projects, usually costing at least €1 billion ($1.31 billion) each. No purchase price was disclosed. With an expected capacity of 1,002 megawatt (MW) each, the total estimated project costs for all three wind parks stand at €3-€3.5 billion. RWE said it expected the financial close for Nordsee One in the first half of 2015, with in-water construction to begin a year later, adding it would generate enough power to supply 400,000 households once completed in 2017. Nordsee Two and Three will be developed over the next decade, RWE said. With 70% debt for the projects, Northland Power will likely need to provide some €305 million (or some C$430 at today's rate) for the first phase, Nordsee One, which would be required in early 2015. Projects are reportedly back-stopped by a fixed feed-in tariff subsidy for 10 years, following which the power would be sold in merchant markets.

Suncor Energy – Canada's largest oil sands producer has agreed to sell some oil and gas properties in Alberta to Tamarack Valley Energy Ltd for $168.5 million as it continues to streamline its inventory of conventional oil and gas properties. Tamarack Valley, will acquire Suncor's Wilson Creek assets in central Alberta, producing 1,702 barrels of oil equivalent per day. Suncor has been narrowing its focus on Alberta's oil sands and selling off conventional properties as it expands its operations near Fort McMurray, Alberta. Last year the company sold its natural-gas operations to Centrica Plc and Qatar Petroleum International for $1 billion. The sale is expected to close by year end.

Financial Sector

Bank of America raised US$3bn in its second trip to the debt market since agreeing to pay almost US$16.7bn in fines for faulty mortgage practices that contributed to the credit crisis. The lender sold US$2bn of perpetual shares that it can repurchase after 10 years, according to data compiled by Bloomberg. The bank also sold US$1bn of perpetual preferred stock. (Source : Bloomberg).

Barclays - Moody's says that Barclays disposal of Spanish unit is credit positive, Bloomberg reports. Barclays has become the first UK bank to launch scanners that identify customers by their fingers' unique vein patterns, as the lender seeks to ramp up its fight against cyber-crime and fraud. Biometric finger vein readers will be offered to corporate clients for a fee from next year, enabling them to access their online bank accounts and authorise payments quickly without the need for a PIN number or password, Barclays said. Some banks have been reluctant in the past to use biometric technology because they have had legal and ethical concerns about the use and storage of such data. But the UK lender has sought to assuage such concerns. (Source: Financial Times)

Citigroup and 12 other banks were accused in a lawsuit of conspiring to manipulate ISDAfix, a benchmark used to set rates for interest rate derivatives and other financial instruments. The Alaska Electrical Pension Fund sued in Manhattan federal court, claiming the banks colluded to set ISDAfix at artificial levels that allowed them to manipulate payments to investors in the derivatives. The banks' actions affected trillions of dollars of financial instruments tied to the benchmark, the pension fund said. In addition to those three banks, the pension fund named as defendants Barclays, Bank of America, Deutsche Bank, BNP Paribas, HSBC, RBS, UBS, Goldman Sachs, Nomura, Wells Fargo and JPMorgan Chase. (Source: Bloomberg)

Commerzbank - Reuters reports that Commerzbank is nearing agreement with US authorities over its dealings with Iran and other countries under US sanctions, sources familiar with the matter said. The bank is expected to pay about $650mn to resolve the US probes with $300mn of that expected to go to the New York Department of Financial Services, headed by Benjamin Lawsky. An announcement could come as soon as next week but is more likely within the next month, the sources said. Note, Reuters previously reported that Commerzbank was expected to pay between $600mn and $800mn, including a demand for more than $300mn from the New York regulator. As a reminder, BNP paid a record $8.9bn fine in June over violations of sanctions, in 2012 ING paid $619mn and Standard Chartered paid $667mn (STAN was then fined a further $300mn last month for lapses in its anti-money laudering controls).

RBS - Hasan Mustafa, head of RBS's debt capital markets business in central and eastern Europe, the Middle East and Africa, is leaving amid a review of the banks' operations outside of the UK, according to two people with knowledge of the departure, Bloomberg reports. Mustafa will leave the London-based unit, which includes loans, bonds and rates, within the next two months after being told the debt team will be cut back. RBS's wider Middle East and Africa business is under a separate review and parts may be closed or sold.

Canadian Dividend Payers

Brookfield Property Partners: It has understood that Brookfield Property Partners (BPY) has agreed to purchase Capital Automotive (CARS), an automotive real estate company, for US$4.3 billion from DRA Advisors. We understand that the going-in cap rate is between 6.5%-7.0% and that BPY ultimately expects to earn opportunity fund-like returns of 15%+. While the overall transaction may appear large, it is more significant for Brookfield Asset Management due to the fees it will earn for managing the company. BPY's equity investment is likely to be just $200 million and is likely to be funded through proceeds from asset sales. CARS is a private automotive real estate company, and its primary business is the purchase and ownership of auto dealership facilities across the U.S. The company also provides automotive real estate financing services to dealers/ dealer groups (M&A support services and construction financing). While CARS owns the real estate, dealers maintain control and ownership of the dealership operations

Enbridge Inc - Canada's largest pipeline company, no longer expects to complete its controversial $7.9 billion Northern Gateway oil pipeline by 2018, a company official said on Thursday. John Carruthers, president of Enbridge's Northern Gateway unit, said a number of issues need to be sorted out before construction can begin. Canadian energy regulators approved the pipeline, with more than 200 conditions, late last year. However, the project, which would take oil sands crude from near Edmonton, Alberta, to a deepwater port at Kitimat on British Columbia's northern coast, is opposed by most of the communities along its B.C. route. Like the proposed Keystone XL pipeline to the United States, Northern Gateway is also loathed by environmentalists who fear it will hasten the development of Canada's oil sands and exacerbate climate change.

Global Dividend Payers

ABB – Swiss automation technology group formed an alliance with China's BYD to develop energy storage as it looks to find new ways to charge electric vehicles and boost usage of renewable energy sources. ABB said in a statement on Friday that the collaboration would focus on grid-connected energy storage, micro-grid applications, solar energy and marine applications, but didn't give any financial details of the partnership.

Rheinmetall – Germany's Economy Minister favours a merger of defence firm Krauss-Maffei Wegmann (KMW) with peer Rheinmetall, a German newspaper reported last Wednesday. KMW is currently in merger talks with France's Nexter but there has been speculation that Rheinmetall could join the fray to avert the creation of a strong rival and tap significant synergies. KMW said it was in constant contact with Rheinmetall on its joint ventures making Boxer armoured vehicles and Puma tanks but reiterated there were no merger talks. It expects to sign a deal with Nexter in the first quarter of 2015 if the two companies reach an agreement.

Roche – Art Levinson had resigned from its board of directors with immediate effect, in order to avoid any conflict of interest given his role as chief executive at Google's Calico. The move comes a day after Calico partnered with Roche's rival AbbVie Inc to invest in new research operations for age-related diseases. Levinson, 64, is a former chief executive and guiding force behind Genentech, a cancer company considered by many to be the most successful biotechnology company in history. He stepped down as CEO after Roche bought out the remaining stake it did not already own in Genentech for $47 billion in 2009, but became a board member at the Swiss drugmaker. Levinson, who is also chairman of Apple, has a high-calibre network and has already poached several heavy-hitters to join Google's nascent biotech company, including Hal Barron, Roche's former chief medical officer, who joined Calico last year.

Serco – has been selected as preferred bidder to continue running Australia's onshore immigration detention services, some good news for the British company after a tough year. It was its biggest contract in 2013, accounting for almost a tenth of its revenue. Serco has operated Australia's network of onshore immigration detention centres - which also includes the Indian Ocean territory of Christmas Island - since 2009. Revenue from the contract depends on the number of migrants Serco deals with. It was worth about $260 million in its first year, but that figure rose significantly as more asylum seekers arrived in Australia, exceeding $740 million in 2013. However Serco has warned the work is likely to be less lucrative in future after the Australian government announced in January it was starting to close down some mainland detention centres as it pushes ahead with tough policies to deter refugees arriving by boat.

Tesco – Dave Lewis, the new chief executive, the world's third-largest retailer, said further management changes at the troubled British grocer were inevitable. The former Unilever executive and turnaround specialist started his new job on Monday - succeeding the ousted Philip Clarke a month earlier than planned. Lewis also said he would not make any "knee jerk" decisions on pulling out of some of the 11 overseas markets Tesco operates in. The new CEO said he recognised the strength of Tesco's brand had waned and that staff morale had suffered but called on the firm's 500,000 employees, 320,00 of which are in the UK, to focus on improving the customer experience.

Economic Conditions

US - Nonfarm payrolls rose 142,000 in August, the smallest gain this year and well short of the consensus call (230,000). Figures for the previous two months were revised down by 28,000. Still, payrolls growth has averaged a decent 207,000 in the past three- and twelve-month periods. The household survey showed a slight 16,000 increase in jobs, though the private-industry tally was a stronger 279,000.

The unemployment rate pulled back to a cycle-low 6.1%, as the participation rate returned to a 36-year trough of 62.8%, resulting in a 64,000 drop in the labour force. Slowly but surely, the slack in labour markets is ebbing. The "all-in" measure of unemployment (which includes marginally attached workers) also eased to 12.0%. Meantime, the number of part-time workers for economic reasons (a measure of underemployment) fell for the third time in four months, while the average duration of unemployment, though still lofty, slipped to 31.7 weeks.

The US services sector appears to be set for further strengthening ahead, as the non-manufacturing purchasing managers index (NMI) followed in the steps of its manufacturing counterpart (the PMI), with a strong reading for the month of August. The composite index reached 59.60 points in the month, ahead of the expected 57.50, which would have been a retreat from July's 58.70 points level. One of the key components, the business activity, jumped to 65.00 index points in the month, handily beating the 61.20 consensus expectations. In a separate report, the revised productivity reading for the second quarter came in lower than expected, at 2.3% relative to 2.5%, though a welcome respite from the weather stricken first quarter's 4.5% drop. Labour costs, nonetheless, were mildly retreating in the quarter, by 0.10%, which compares to the 11.60% jump in the first quarter of the year and the expected 0.50% increase.

The US balance of trade improved in July, to a $40.55 billion deficit, from June's $40.81 billion deficit, despite the expectations for a worsening of the deficit to a $42.20 billion level. The improvement was helped by a rebound in exports, up 0.9%, driven by auto sales. Imports grew as well in the month, though only by 0.7%.

Canada – The Canadian employment report disappointed in August, with a net 11,000 positions being lost in the month, which was significantly short of the expected 10,000 new jobs being added and offset the strong job gains in July. Of note, August's payroll report included the largest private payrolls reduction on record, down 111,800 positions. Most productive sectors suffered in the month, with the exception of construction. The headline unemployment rate held steady at 7.0%, as expected and in line with July's rate, though chiefly helped by a further reduction in the labour participation rate to 66.0%. Meanwhile, Canadian productivity improved, up 1.77% in the second quarter, beating the 1.60% consensus expectations.

Canada's goods trade balance of goods improved unexpectedly to $2.58 billion surplus in July, miles ahead of the expected $1.20 billion surplus, driven by a jump in auto exports, which led to a 1.4% gain in exports, while the imports were actually lower by 0.3%.

Canada's building permits continue to defy gravity, advancing a further 11.8% in July after a strong 16.4% jump in June.

ECB: has now, as telegraphed in recent statements, introduced Quantitative Easing measures to tackle the risks of too prolonged a period of low inflation and committed themselves to buying Asset

Backed Securities, covered bonds and any other "unconventional instruments". Its main refinancing rate is cut from 0.15% to 0.05% and its deposit facility cut from -0.10% to -0.20% (i.e. a negative interest is charged to banks that deposit money at ECB). Its Marginal lending facility is cut from 0.4% to 0.3%. The rationale seems to be to boost banks' incentive to take up the LTRO (long term refinancing operation), with the first auction to take place on Sept 18th and the cost of borrowing being the Main refinancing rate +10bps. Therefore the actions reduce the cost by 10bps which should encourage a larger take up and hence more lending into the real economy It is interesting how it is likely that the bond buying is likely to be timed to start at the same time the Fed QE ends. ECB President Draghi has said that no more "technical measures are possible" and that rates were at the lower bound now, so likely all attention going forward will shift to Quantitative Easing but Draghi refrains from giving an amount. So far he's saying that it is "difficult to assess the program's size". It's expected the buying will begin in October 2014, buying a broad portfolio of simple and transparent ABS and euro-denominated covered bonds (Reuters report ABS/covered bond QE program worth up to Euro 500bn).

UK / Scotland: Scottish opinion polls over the weekend signaled for the first time the possibility of a "Yes" vote for Scottish independence (Sunday Times YouGov poll 51% to 49% in favour). Royal Bank of Scotland and Lloyds are the two banks with the greatest exposure. Both are registered in Scotland, albeit the Lloyds Head office is based in London. It's estimated that RBS has broadly £20bn of lending exposure equating to c7% of loans or c36% of tangible equity; Lloyds has £31bn of lending exposure equating to c6% of loans or c74% of tangible equity. Looking at GDP analysis (Scotland c9% of UK GDP) would suggest total Scottish lending volume of c£161bn with RBS and Lloyds sharing c70% market share or £50-60bn of total exposure each. Barclays has limited Scotland risk, materially lower litigation liability than RBS and for the first time in many years reasonable earnings expectations.

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 1.93% and the UK's 2 year/10 year treasury spread is 1.71% - 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 12.09 (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 6 Mutual Funds:
- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund
- Portland Global Dividend Fund

Private/Alternative Products

Portland also currently offers 4 private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland GEEREF LP
- Portland Advantage Plus Funds

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

Sources: Thomson Reuters, Bloomberg, Macquarie, Credit-Suisse,
KBW, Bank of America, TD, BMO

Source: Thomson Reuters, Bloomberg, Company reports

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

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