Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Saudi Arabia, the world's biggest oil exporter, has slashed its production of crude in an apparent attempt to prevent the price falling further below $100 per barrel. The kingdom, which has the capacity to pump 12.5m barrels per day (bpd) of crude, trimmed 400,000 bpd from its output last month as prices began to weaken, according to a monthly market report issued by the Organisation of Petroleum Exporting Countries (Opec). That is equal to about half the UK's total oil output at present levels. Saudi is considered to be the world's swing producer because it accounts for about 10% of global demand. The country has acted on several occasions either to pump more oil into the market to ease price pressures, or cut back to maintain prices at levels around $100. Opec has also cut its forecast for world oil demand and has warned of the risks if the 12-member group continues to pump at its current levels.

The largely Middle East group of oil producers, which meets regularly to agree on output quotas and is often accused of being a cartel, controls about a third of the world's supply of crude. However, the growth of US shale oil has challenged its market domination. Both Saudi and Iran recently warned that declines in crude prices will be short lived. Iran's Petroleum Minister Bijan Namdar Zanganeh said last month that the current weakness in oil prices, which have resulted in Brent crude falling by 13% to below $100 per barrel, will soon be reversed. "The downward crude oil price will not live long due to seasonal fluctuations," Zanganeh was quoted as saying by an Iranian state news agency. Zanganeh's remarks followed comments made by Khalid al-Falih, chief executive of Saudi Aramco, the world's largest state-owned oil company, which suggested that prices would have to remain around current levels to sustain enough investment to meet future demand. "To tap these increasingly expensive oil resources, oil prices will need to be healthy enough to attract needed investments," al-Falih was quoted as saying at an industry conference by Reuters. "Long-term prices will be underpinned by more expensive marginal barrels."

Financial Sector

Barclays - announced that John McFarlane, formerly Chairman at Aviva, will take over from Sir David Walker as Chairman at the bank. He is highly respected in the market, having presided over a sustained rise in share price at Aviva where he addressed as Executive Chairman, capital cost and restructuring concerns. The UK bank has also recruited Richard Casavechia from Bank of America Merrill Lynch to take up the role of head of M&A structuring, according to an internal memo seen by the Financial Times. Mr Casavechia, who will start at Barclays before the end of the year, comes with a pedigree for overseeing complex mergers. Among his recent transactions are Hertz's spin off of its construction equipment rental business and Actavis's acquisition of Warner Chilcott for $5bn. Separately, three senior private bankers are leaving the Spanish unit of Barclays after Caixa agreed to buy the unit. The sale is set to conclude by year end.

Citigroup's third-quarter expenses are running "slightly higher" than three months ago because of efforts to prove to regulators that its risk and balance sheet management is good enough to allow more spending for dividends and share buybacks, the bank's chief financial officer said on Monday. John Gerspach told an investor conference the company is "well on the way to making needed changes" in its capital planning for the Federal Reserve's next stress test early next year. In March, the Fed Reserve rejected Citigroup's last capital plan in a surprising rebuke for Chief Executive Officer Mike Corbat. Gerspach acknowledged that the company had been wrongly confident in that plan. He said the company had 'a false set of understanding' of Fed requirements going into that test and has since been working constantly to improve its management. (Source: Reuters).

Grupo Aval – Colombia's largest banking group, said it expects to raise $1.1 billion in an initial public offering in the United States. The banking group is controlled by Colombia's richest man, Luis Carlos Sarmiento Angulo, who holds about 955 of the company's outstanding shares. Sarmiento Angulo, estimated to be worth $16.9 billion according to Forbes, derives most of his wealth from his holding in the company. Sarmiento Angulo, 82, also owns Colombia's largest newspaper, El Tiempo, which he acquired in April 2012. The company said in an amended filing on Monday that it expects the offering of 73.5 million American Depositary Shares (ADSs) to be priced at $14.96 each. The group said it expects to list its American Depositary Shares (ADSs) on the New York Stock Exchange under the symbol "AVAL". Colombia-listed Grupo Aval, which has a market capitalization of $15.1 billion, said it expects to use part of the proceeds to increase capital in its banking unit, Banco de Bogota. Grupo Aval owns four commercial banks, a pension and severance fund manager, a merchant bank, and BAC Credomatic - a banking group in Central America. It listed JP Morgan and Goldman Sachs as underwriters for the IPO.

HSBC: Settled with the FHFA over mortgage misselling with a payment of $550m against total $6.2bn of MBS sales to Fannie and Freddie. Looks broadly in line with settlements to date (c10%) although well below a $1.6bn figure that HSBC have previously quoted.

Lloyds, RBS, and Clydesdale have confirmed they will relocate from Edinburgh to London if the Yes camp wins next week's independence referendum.

Lloyds - Continues sale of non-Core operations. The bank announced it had sold interest in Doncaster homebuilder Keepmoat for a total enterprise value of c£400m (debt and equity) to a pair of Private equity groups. No indication of price to book value.

Nordea - Bloomberg report huge interest from investors in Nordea's CoCo (contingent capital bond) issue announced earlier last week, as the low coupon reflects the reward for being one of Europe's best capitalized banks. The coupon is set to test 5%, which is said to be a first for a European benchmark Tier 1 deal.

Royal Bank of Scotland - has commenced a 2 week roadshow to present its US subsidiary, Citizens, to potential investors via an Initial Public Offering. The bank has said it will sell 140 million shares at a price range of $23-$25, raising approximately $3.5bn and that values Citizens, which has 1,230 branches and 18,000 staff at about $13-14bn - a slight premium to its tangible book value of $12.8bn in June. RBS will retain a 75% stake in Citizens after the IPO. Morgan Stanley and Goldman Sachs are acting as joint global co-ordinators and JP Morgan as joint book-runner.

Santander - Announcement that Chairman Emilio Botin has died at 79. Emilio Botin was one of the highest regarded bankers of our age and been at the helm of Santander since the 1980's (having succeeded his father) when it was the 7th largest bank in Spain, compared to now being one of the world's 20 largest banks . Despite the Botins small stake in the bank, Botin and Santander are synonymous, with Emilio seen as the driving force behind the bank's deal-making and strategy. Botin's daughter Ana Patricia (currently head of the UK business) is set to succeed her father as chairman of Banco Santander, ensuring that Spain's powerful banking dynasty will continue to hold the reins at Europe's largest retail bank. Ana, 53, who was formally put forward as his successor by Santander's board after a unanimous vote on Wednesday, will be the fourth member of the family to preside over Santander. Nathan Bostock (ex CFO, Royal Bank of Scotland) seems most likely to replace Ana Botin as head of Santander UK.

Systemically Important Financial Institutions (SIFI) - Bloomberg reported that the biggest U.S. banks must decide whether to voluntarily reduce their size and complexity or face capital charges. The Federal Reserve outlined plans for capital surcharges surpassing those of international regulators at a Senate hearing on progress in implementing rules to prevent a repeat of the 2008 credit crisis. Fed Governor Daniel Tarullo said that the formula for surcharges will hit hardest against those that lean most on short-term wholesale funding. The surcharges would be applied in addition to the risk-based capital standards approved by the Basel Committee. Global financial regulators have published a list of 29 banks, eight of them U.S.-based, that would face the capital surcharges. JPMorgan Chase and HSBC were placed at the top of the most recent list, putting them in line for extra capital requirements equivalent to 2.5% of their risk weighted assets. The Financial Stability Board has said that it will publish an updated list in November. The extra rules begin phasing in during 2016 and the capital surcharges would apply fully as of January 2019.

Apple doing payments/NFC - Apple's latest product launch included doing payments/NFC (Near Field Communication) using the existing payments infrastructure and linked in with Mastercard, Visa, etc. With 1.7bn smartphones globally, the opportunity to have mobile payments has been large. But initiatives by Google, carriers and retailers have failed to provide compelling user solution. With Apple launching payments offering, it could provide that compelling consumer solution. If Apple makes the payment options open to developers, then this could spur on ecommerce globally which is growing at 20%. Conceptually, as it affects the banking sector, possible ramifications of mobile banking, cashless payments, and/or electronic transactions on banks may include: 1) cost efficiency, with fewer branches and employees boding well for improved cost efficiency. Beyond the overhead costs, electronic transactions are generally lower costing; 2) lower fee income from payment transactions, particularly as it pertains to cheque usage, though it can also encourage greater card usage; and 3) enhancement of interest income & loans , as outstanding balances could rise (albeit currently a small share of total loans) & given the higher rates charges on these balances. We think the larger banks in each country would be the winners with the integration of technology in transactions & payments, as the bigger players have historically been at the forefront of new technology adoption due to greater resources & economies of scale.

Global Dividend Payers

ABB – the Swiss engineering group is to buy back $4 billion of shares, starting in September of which about three quarters will reduce share capital and remainder will support an employee share program with 22,000 participants. Chief Executive Ulrich Spiesshofer trimmed the medium-term sales and profit forecasts to reflect slower economic growth has crimped capital spending. ABB has raised more than $1 billion from the sale of five businesses over the past year and had $888 million in cash from operations at the end of June. German peer Siemens, which has also been beset by problems in its power business, started a €4 billion share buyback in May. Siemens is anticipating higher demand for its products as rising wage costs make labour-saving technologies such as robots more attractive and governments replace aging power networks. The group expects sales to grow 4%-7% per year on a like-for-like basis during 2015 to 2020, faster than global economic growth forecasts, but below its previous mid-term goal for annual sales growth of 5.5% to 8.5%. It is now aiming for core earnings before interest, tax and amortization (EBITDA) margins of 11% to 16%. Also, ABB has won an order worth over $800 million from Scottish Hydro Electric (SHE) Transmission plc to provide the Caithness-Moray high-voltage direct current (HVDC) power transmission link, which will connect the electricity grid on either side of the Moray Firth in northern Scotland. ABB will design, engineer, supply and commission two 320 kilovolt land-based HVDC Light converter stations, one rated at 1,200 megawatts (MW) at Blackhillock in Moray and another rated at 800 MW situated at Spittal in Caithness.

Cheung Kong Holdings – is in discussions to form a joint venture with Mitsubishi Corp's MC Aviation Partners leasing arm. The firm is already bidding for a $5 billion fleet of 100 planes that lessor AWAS Aviation Capital Ltd has put up for sale. The move is part of a strategy to recraft the group's investments outside Hong Kong, targeting stable returns in a fast-growing industry. As global air travel booms, carriers are opting to lease new planes rather than buying them, saving on huge capital outlays upfront. The group is on the hunt for stable investment options in well-regulated markets outside its home market, where expansion opportunities are becoming limited.

Kingfisher – Europe's No. 1 home improvements retailer, revealed the head of its French arm would replace Ian Cheshire as chief executive to steer the group through a period of major change. Veronique Laury will become the fifth female CEO of Britain's top 100 companies. Laury, 49, will oversee the expansion of Screwfix and Brico Dépôt into new markets, the restructuring of B&Q and the integration of newly acquired Mr Bricolage. She will also lead a five-year IT systems roll-out and complete the plan to develop common brands across the Anglo French group. Laury has worked in the home improvement sector for 26 years. She has worked in France, Kingfisher's biggest market, and in Britain. The succession plan was announced as Kingfisher, No. 3 in the world behind U.S. groups Lowe's and Home Depot, posted flat first-half profit as a boost from good weather in the first quarter was followed by a much tougher second quarter. Kingfisher made an underlying pretax profit of £364 million in the 26 weeks to August 2. The firm experienced a sharp slowdown in its second quarter, particularly in France and Poland. First half sales rose 0.9% to £5.77 billion and were up 1.8% on a like-for-like basis. An interim dividend of 3.15 pence, up 1%, is being paid.

Rheinmetall – German tank manufacturer Rheinmetall is interested in a takeover of rival Krauss Maffei Wegmann (KMW) and ThyssenKrupp's submarine business, as reported by the German daily Handelsblatt on Friday. KMW is standing by plans to merge with Nexter despite reports the German economy minister favours an all-German deal between KMW and Rheinmetall, who together build Puma tanks for Germany's Bundeswehr. Rheinmetall is also interested in buying ThyssenKrupp's Marine systems business. To help finance the deal, Rheinmetall could sell its automotive division Kolbenschmidt Pierburg IPO to Thyssen. An industry source said Thyssen was understood to be ready to talk about selling its Marine Systems unit - which includes submarines and had revenue of €1.3 billion in 2012/13 - for the right price. Rheinmetall could also buy Airbus units Atlas Elektronik or Optronics.

Syngenta – said a lawsuit that agribusiness company Cargill Inc filed against the company on Friday for damages related to China's rejections of U.S. corn is "without merit." Cargill said in a lawsuit in Louisiana state court that Syngenta had exposed the grain trader to losses by commercializing the Agrisure Viptera corn seed, known as MIR 162, before it was approved for import by China, a major buyer. The United States approved MIR 162 for cultivation in 2010 and Syngenta "strongly upholds the right of growers to have access to approved new technologies," according to a statement from the company.

Toyota Motor – Electric carmaker Tesla Motors Inc and Toyota Motor Corp, the world's best-selling automaker, could sign a new deal over the next two to three years, Tesla CEO Elon Musk said, as the two firms ready to end an existing programme. California-based Tesla has been supplying batteries and motors for Toyota's RAV4 electric SUVs that went on sale in 2012, but that partnership is set to end this year after Toyota sold just 2,000 of the vehicles. Musk said the new deal would involve higher volumes than the existing partnership but did not comment on the details of what the deal could involve and said there were no definitive plans.

Economic Conditions

US – The US retail sales were up a robust 0.6% in August, building on July's 0.30% advance and chalking-up another positive month in a half a year long string. Auto sales were up 1.5% in the month, but, even excluding the autos, the core retail sales were up 0.3%. Both the headline and the core reading were in line with the consensus expectations. Most retail categories, including building materials, sporting goods, furniture, electronics and appliances and clothing, contributed to the positive result. A factor in the continued strength of the consumer sector is the consumer sentiment, which, as measured by the University of Michigan, improved to 84.60 index points in September, ahead of the expectations, chiefly as the result of an improvement in the 'expectations' component of this composite index. The 'current conditions' component was actually mildly lower than for August and missed the consensus. Yet another factor might have been a strong increase in the US consumer credit, up $26 billion in July, handily beating the consensus expectations for a $17.35 billion addition.

Canada – The Canadian capacity utilization has improved further in the second quarter of the year, from 82.10% to 82.70%, albeit slightly missing the expectations for an 82.80% level.

On the Canadian housing front, housing starts, though cooling-off a bit in August to 192,700 units annualized, from 199,810 units annualized in July, are still showing a robust level of activity for the homebuilding industry.

Scotland/UK: Investors withdrew almost $2 billion from U.K. equity funds in the last two months amid heightened uncertainty over what a yes vote for Scottish independence will mean for assets. Funds that invest purely in U.K. equities experienced 27 days of outflows from July 1 to Sept. 8, equivalent to $1.97 billion, versus 23 days of inflows, according to data from EPFR Global, a Cambridge, Massachusetts-based company that tracks fund flows. The net outflow figure was $596.4 million. (Source: Bloomberg).

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 2.04% 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 4.12% - (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 13.31 (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

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