Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Baytex Energy – became the latest Canadian oil producer to cut its capital budget and dividend, as industry players braced for even more companies to scale back spending. Oil sands producer Baytex, which also operates in the Eagle Ford shale play in Texas, said it will spend $575 to $650 million in 2015, 30% less than originally expected, and reduce monthly dividend payments to 10 cents per share from 24 cents. Approximately 75% of capital spending will be invested in Eagle Ford assets, acquired earlier this year at a hefty premium. "Given the recent collapse in world oil prices, we believe our 2015 budget strikes the right balance between preserving our operational momentum in delivering organic production growth and managing our dividends prudently to maintain strong levels of financial liquidity," said Baytex Chief Executive James Bowzer. Baytex's cuts mirror tighter budgets announced by other companies headquartered in Canada's oil capital Calgary as global oil prices nosedive. On Monday Trilogy Energy Corp scrapped its monthly divided and cut 2015 capital spending by 38%, while Vermilion Energy Inc reduced next year's budget by 22%. Precision Drilling Corp said it expected 2015 capital spending to be 44% lower than this year, and last week Canadian Oil Sands Ltd, the largest owner of the Syncrude Canada Ltd oil sands project, reduced its quarterly dividend by 43% and capital budget by nearly half.

Financial Sector

Bank of America Corp. said it expects trading revenue to decline this quarter from the previous three months and a year earlier. The Charlotte, North Carolina-based bank said in a presentation that trading is among its "revenue headwinds" after generating $3.27 billion in the third quarter and $2.97 billion in the fourth quarter of last year. Bloomberg

Berkshire Hathaway – Warren Buffett's Berkshire Hathaway Inc announced the acquisition of oil industry logistics provider Charter Brokerage from private equity firm Arsenal Capital Partners. "Charter Brokerage is a high quality business with consistently strong financial performance that fits well within Berkshire Hathaway," Buffett, the chairman and chief executive officer of Berkshire, said in a statement. The value of the acquisition was not disclosed. Charter is a U.S. petroleum and chemical drawback services provider. A drawback is the refund of import duties and taxes on a product when a form of that same product is exported. Charter Brokerage connects importers and exporters in the petroleum and petrochemical industries to arrange such refunds.

Credit Suisse - Bloomberg report Credit Suisse are mulling a scale back in prime broking services, as part of their plan announced in October to shrink leverage exposure by CHF70bn to CHF1.05trln.

Citigroup will take about $US3.5bn (A$4.2bn) in legal and restructuring charges in the fourth quarter, as the US bank prepares to settle allegations of wrongdoing in rate-setting and anti-money laundering, and make more redundancies. Chief executive Mike Corbat announced the charges last Tuesday. They will come close to wiping out Citi's expected profit for the quarter, according to consensus analyst estimates, which predicted about $US3.5 billion in net income. Citigroup Inc is also in the final stages of talks with Sumitomo Mitsui Banking Corp on the sale of its Japanese retail banking operations for about 40bn yen ($334mn), sources with knowledge of the matter said. An agreement between SMBC, a unit of Sumitomo Mitsui Financial Group Inc, and Citigroup may be reached as early as next week, said the sources, declining to be identified as they were not authorised to discuss the matter publicly. (Source:Reuters)

JPMorgan probably will report a "high teens" percentage drop in fourth-quarter trading revenue from a year ago, Chief Financial Officer Marianne Lake said. Most of the revenue decline will stem from the sale of the bank's physical-commodities business and higher interest costs from the issuance of preferred stock, Lake said last week at an investor conference in New York. The "core performance" of the trading business probably will slip 4%, she said. (Source:Bloomberg)

Nordea Bank - Nordea's head of wholesale banking, Casper von Koskull, said in an interview on Dec 5th that Nordea is benefiting from European sanctions against Russia as a weaker rouble helps its profitability in the country. "We're probably more profitable there today than ever before because of the lower rouble as our income is in dollars and euros," Bloomberg reports.

Royal Bank of Scotland will pull out of fixed-income trading in Japan and slash staff numbers by more than 200 to about 30, with most of the jobs going by February, according to a person familiar with the plan. RBS Securities Japan Ltd. would surrender its primary dealership in the country's government bond market and retain only enough people to service clients, said two people familiar with the proposal. (Source:Bloomberg)

Standard Chartered - the US DoJ and NY County District Attorney's Office have announced an extension to the DPA for a further 3 years (to 10 December 2017) as a result of a breach of the terms of the original DPA. A possible extension was already flagged at the 1st Half 2014 results. A Monitor will be put in place (in addition to the Monitor from the NY Department of Financial Services) to improve overall procedures. Clearly not good news given the importance of the US $ clearing operations, but not entirely unexpected. In common with HSBC, higher reg/compliance costs look increasingly likely to become embedded. Separately, U.S. prosecutors are investigating employees of Standard Chartered and may file criminal charges against some individuals as officials examine whether the bank violated the terms of a 2012 settlement over transactions involving Iran and other countries, according to people familiar with the matter, the Wall Street Journal reports.

Sumitomo Mitsui Financial Group Inc. will announce an agreement to buy Citigroup Inc. Japanese consumer-banking business as soon as next week, people with knowledge of the matter said. The lending unit of Japan's second-biggest bank by market value will purchase the operations from Citibank Japan Ltd. for about 40 billion yen ($330 million). (Source : Bloomberg)

US Federal Reserve proposed new capital surcharges for global systemically important bank holding companies (G-SIBs) that go higher than the minimums that the banks face under the current rules from the Basel Committee on Banking Supervision (BCBS). The Fed indicated that the new surcharges would range from 8.0%- 11.5%, compared to a current range of 8.0%-9.5% under the BCBS rules. The Fed is inviting public comment on all aspects of its proposal through February of 2015, and the new rules, once finalized, would be phased in from 2016-2019. In our view the Fed's proposal came out better than feared for the banks overall, with the Fed explicitly saying that "almost all" the GSIBs' current regulatory capital levels are already at or above their new minimums. The Fed indicated that JPMorgan is the only bank to face a current capital shortfall of about $22b, which implies that the Fed calculates JPM's new Core Equity Tier 1 minimum at 11.5%, an increase of 2% compared to its 9.5% minimum under the BCBS rules. By comparison it appears the less interconnected Wells Fargo Core Equity Tier 1goes from 8% to 9%, Bank of America from 8.5% to 9.5%, and Citi from 9.0% to 10.5%. The Fed's new system has two approaches to determining each G-SIB's capital surcharge. The first method uses the same 5-factor analysis as the BCBS framework. The second methodology proposed by the Fed removes the "substitutability" factor from the BCBS framework and replaces it with a "reliance on wholesale funding" factor (as expected). However, it also adds a "multiplier" to the four underlying BCBS factors and its newly proposed factor, which makes the Fed's new second method meaningfully more onerous for some, and effectively the "binding" method. It therefore seems it is the global interconnectedness that hurts JPMorgan in the Fed's new calculations (just as those same factors drive JPMorgan into the highest G-SIB bucket in the BCBS framework) and causes it to have the highest minimum capital requirement again in the Fed's new system. Our estimates are that JP Morgan would already have reached the new minimum by 2016.

Economic Conditions

US – November turned out to be a very strong month for US retail sales, with the headline reading higher by 0.70%, exceeding expectations for a 0.40% improvement. Even when the strong auto-sales, up 1.7% in the month are removed, the core retail sales also exceeded expectations at 0.5% compared to 0.1%. Most retail categories advanced in the month, including building materials, furniture, apparel and hospitality, while the obvious laggard were sales at gasoline stations. The consumer sentiment, as measured by the University of Michigan, was also higher than expected in December, at 93.8 points, compared to expectations for a flattish reading around 89.40, driven by both the 'current conditions' and the 'expectations' components.

Financial Conditions

US Federal Reserve policymakers remain determined to signal that although Quantitative Easing has stopped, the stimulus remains via keeping rates at present low until mid 2015. The US 2 year/10 year treasury spread is now 1.53% and the UK's 2 year/10 year treasury spread is 1.36% - 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 3.93% - (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 5.3 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 21.61 (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, Credit Suisse, KBW, Bernstein

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Certain statements included in this document constitute forward-looking statements, including those identified by the expressions "anticipate," "believe," "plan," "estimate," "expect," "intend" and similar expressions to the extent they relate to the Fund. The forward-looking statements are not historical facts, but reflect the Portfolio Management team's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. The Portfolio Management team has no specific intention of updating any forward-looking statements whether as a result of new information, future events or otherwise.

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