Market Commentary

PORTLAND INVESTMENT COUNSEL®

December 29, 2014

News Highlights

Financial Sector

Bank of Nova Scotia / Citi : Bank of Nova Scotia announced that it had reached an agreement that would see Scotia acquire the retail & commercial banking operations of Citigroup in Peru. Terms were not disclosed, as BNS stated the purchase was 'not material'. However, based on the statement from BNS that the deal would impact the sector-best 10.80% Core Equity Tier 1 ratio of the bank by <10bp it's estimated a purchase price of ~$300m which considers (1) the Risk Weighted Average associated with $2.5bn of assets; and (2) a modest premium to the equity base of the Citi Peru operations. Citibank's Peruvian operations comprise eight branches that have more than 130,000 retail and commercial banking customers. Scotiabank has operated in Peru since 1997. Its operations there include C$15.7 billion in assets and 306 branches. The terms of the deal preserve jobs for Citibank employees who will be transferred to Scotiabank Peru. Citibank plans to continue operating in Peru with a much narrower focus on corporate and institutional banking along with international private banking.

Brookfield Residential and Brookfield Asset Management Enter Into Definitive Agreement for Going Private Transaction: BRP and BAM announced a plan of arrangement where BAM will acquire the 30.6% of BRP shares that it does not currently own. BRP shareholders will receive US$24.25 in cash per common share, which is $1.25 more than Brookfield Asset Management's initial October 23, 2014 proposal.

Manulife announced last week that it has entered into an agreement to acquire New York Life Retirement Plans Services (RPS) business. Terms were not disclosed. The transaction is not expected to have a material impact on core EPS in the short term (modestly accretive in the medium term) and is not expected to have a material impact on MCCSR (minimum contingency capital ratio) upon closing (expected in the first half of 2015).

Global Dividend Payers

Walgreens reported cash earnings per share of $0.80, after adjustments, above consensus of $0.75. The company announced that the Alliance Boots Merger would be completed by year end. Management was unable to provide updated guidance on the 2015 outlook, saying that much work was being done in relation to the closing of the transaction and an update would be provided soon after closing. On the earnings call, the company provided greater clarity than it has in the past on a number of issues. On generic inflation, management acknowledged that new contracting strategies will take an extended period (read 1-2 years) to meaningfully offset inflation. On Part D, WAG stated that while the program is profitable, volume gained in 2015 will not offset lower profitability per script, resulting in a net decline in gross profit even as it support leverage of fixed pharmacy costs. On occupancy, Walgreens acknowledged costs are too high and that there is little that can be done near term as landlords are unlikely to make concessions for Walgreen given its solid credit rating, even when leases expire. Walgreen will need to find ways to improve store productivity by better matching the offering of products and services with the needs of the local community. Having loyalty data will help this process, but to figure out what works best will take time.

Economic Conditions

US: the US economy reaffirmed its traditional role as the engine of global growth after notching up its fastest expansion in more than a decade as its annualized growth in the third quarter of 2014 came in at 5%, the fastest pace since 2003 and a large upward revision from the previous estimate of 3.9%.

Russia: ex-Finance Minister Kudrin (helped rebuild credibility after 1998 default) has warned: 2015 real incomes could fall -2-5%; Russia will be downgraded to below investment grade in 2015; andRussian 2015 GDP -2% / -4% if oil is $80bbl / $60bbl, respectively. Despite the denials, capital controls these are already in place to force state-owned companies to sell US Dollar, as follows:

- Limit on net foreign exchange assets for state-owned exporters who must be back at Oct 1, 2014 levels by March 1, 2015 (weekly reporting to central bank thereafter).
- Central bank installed supervisors at currency trading desks of top state-owned banks as of Dec 16, 2014 (i.e. presumably state-owned banks were betting against the Rouble).
- Government purportedly indicating state-owned companies do not have to adhere to guidelines but at the risk of no support if help needed.
- Rouble recently stabilized due to these controls plus receipt of year-end tax payments (presumably Rosneft refinancing needs was a major catalyst in the earlier selloff).
- Central bank (approximately $130bn) outflows for 2014

Presumably if these measures don't work, full capital controls are likely sometime in 2015). Also, the Russian Parliament has authorized a RUB 1tn (~$20bn) bailout to recapitalize banking system.

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 1.51% and the UK's 2 year/10 year treasury spread is 1.38% - 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 3.83% - (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 14.50 (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, KBW, BMO

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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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PIC14-089-E(12/14)