Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Energy holdings – Oil and gas companies could cut spending on exploration and production (E&P) in North America by 30% or more this year if U.S. crude oil prices continue to trade in the $50-$60 per barrel range, according to Barclays, reported by Thomson Reuters. Brent crude futures were at $50.50 on Friday, while U.S. crude futures were at $48.57 – both at five-year lows, having more than halved since June due to oversupply and tepid demand growth. Spending in North America will fall 14.1%, while international spending will fall 6.7%, Barclays said, noting companies' budgets had assumed Brent at about $70 per barrel and U.S. crude at $65. That would mean spending across the globe would fall about 9% to $619.43 billion this year, Barclays estimated on the basis of a survey of 225 oil and gas companies. Given the continued fall in oil prices, spending could "trend even lower", with North America being hit the hardest. Several U.S. companies have already announced much smaller budgets for this year and some are even reducing the number of rigs they use as drilling in several shale fields proves to be uneconomic at current prices. The U.S. onshore rig count is expected to fall by 500 rigs over the year to about 1,250 rigs by the end of 2015, according to Barclays. The bank said the Middle East will be the lone source of strength globally, with spending expected to rise 14.5% as companies stick with their drilling plans assuming the oil downturn will be of a much shorter duration than in the past. This is only the seventh time in the 30-year history of its survey that global spending is estimated to fall, Barclays said, noting that after almost every decline spending rose by more than 10% the following year.

Crescent Point Energy Corp announced it would cut its capital spending by 28% in 2015, becoming the latest Canadian oil and gas producer to trim its spending plans in the face of a sustained fall in global oil prices. The company would spend $1.45 billion in 2015, mostly on drilling projects. The slide in oil prices, which have more than halved since mid-2014, has resulted in a number of Canadian oil and gas companies, including Husky Energy Inc, Cenovus Energy Inc, Athabasca Oil Corp and Tourmaline Oil Corp slashing capital spending plans for the year. Crescent Point said it expected to spend about $408 million of its budget in the Viewfield Bakken play in southeast Saskatchewan and about $301 million in its Shaunavon field in southwest Saskatchewan. The company said it expected average daily production of 152,500 barrels of oil equivalent per day, a 9% increase over its estimated 2014 production. The company also announced it has hedged just over 50% of its 2015 oil production at an average price of over $90/bbl.

Pacific Rubiales announced that the Kangaroo-2 well flows oil at 3,700 bbl/d from Paleocene intervals, adding to earlier success, in the offshore Santos basin, Brazil. The company is looking forward to continuing the exploration and appraisal drilling campaign throughout the first half 2015.

Financial Sector

Bank of Nova Scotia - led investment banks in Canada in the value of equity issues it advised on in 2014, driven by a few high-profile initial public offerings and some big oil and gas deals before the oil-price rout in the year's second half. Equity issues worth $37.3 billion were done in Canada last year, up from $34.1 billion in 2013. Scotiabank advised on $5.5 billion, followed by RBC Capital Markets with $5.4 billion and BMO Capital Markets with $4.7 billion. Strength in oil and gas in the first half of the year overcame sluggishness in the mining and real estate sectors. Robust merger and acquisition activity also helped as companies financed deals by issuing equity. Multibillion-dollar deals included Baytex Energy's $1.5 billion bought deal to help finance its Aurora Oil & Gas acquisition, and Turquoise Hill Resources Ltd's $2.6 billion offering. PrairieSky Royalty, spun off from natural gas producer Encana, was involved in two of them. Its IPO was one of the biggest ever in Canada, and Encana later sold a stake in PrairieSky for $2.6 billion. Energy IPOs dropped as oil prices retreated, and bankers don't see an immediate pickup. Debt issues dropped 6.1% to $166.6 billion in 2014. RBC led the pack, followed by TD Securities and CIBC World Markets.

Citi: Article in Risk Magazine last Wednesday titled "Citi buys $250bn Deutsche Bank single-name CDS portfolio" saying leverage exposure drives big portfolio sale, with Citi aiming to collapse notionals by the end of 1Q 2015. Deutsche Bank sold a portfolio of single-name CDSs with a notional value of nearly $250bn to Citi at the end of Sept last year as it reined in its single-name CDS trading business.

JP Morgan: Litigation - According to the Financial Times, JPMorgan Chase became the first bank to settle civil lawsuits claiming damages for the alleged manipulation of foreign currency markets, which could put pressure on other groups to follow suit. JPMorgan agreed to pay about $100mn in lawsuits brought by US counterparties, market participants and others who say they were harmed by alleged efforts to rig the foreign exchange markets, according to people familiar with the case. The settlement, which was revealed in a legal filing on Monday and still needs court approval, marks an unusually quick resolution for the civil lawsuits and reflects JPMorgan's desire to put the matter quickly behind it, the people said. The details of the settlement will be filed in court documents by the end of January.

Santander announced a long awaited capital raise yesterday via a €7.5bn accelerated book-build. The deal is priced at €6.18, the bottom end of the announced range of €6.18 to €6.5, a 10% discount to the price prior to yesterday's suspension. The capital increase adds c.140bps to the reported 8.3% Core Equity Tier 1 ratio for Year End 2014. Santander's capital increase and dividend rationalisation (effectively a 2/3rds cut) represent a long-awaited reality check, in our view.

Standard Chartered are to close their global equities business eliminating 200 jobs ahead of plans to cut a further 2000 staff. This is not a particularly big move on its own. The bank's cost base in 2016 is estimated at U$11.3bn, so it's less than 1% of 2016 costs and 1.5% of Profit Before Tax (ex the associated revenue loss).

Wells Fargo: Article in last Tuesday's Nikkei titled "Wells Fargo CEO thinks a rate hike could be good for the US -- and his bank" with an interview with WFC CEO John Stumpf. Select quotes include: a) "We don't think of our customers as counterparties; we think of them as our guests…Everything that we do tends to be conservative. So if you think of a money-centered bank that's into trading, deals, transactions, that's not how we think. We are not like that."; b) "The kitchen tables are more important for us than the investment bank league tables. We think about, can we work together around a kitchen table, with our customers, to serve them. And if we do that well, the rest will take care of itself. The reason we get up in the morning and go to work is to serve customers. The result is we make money. Never the other way around. We never put the stagecoach in front of the horses."; c) "There are still 7,000 banks in the United States. It's a very fragmented business. So we have lots of opportunity to grow just within the United States as the industry consolidates, as the growth of the country continues. Our GDP is better than most places in the world. So we have years and years of growth. Let's take the mortgage business. People say, 'Wells Fargo, you're the largest mortgage lender. How can you grow from there?' Half the customers who call us their bank, have a mortgage someplace else. We have 11% of the deposits in the country, we have only 1% of the wealth. So we have a lot of opportunities to cross-sell. There are oceans of opportunity still in this country."; d) "In fact, I think the banking model of the future might look more like our model, where you're in one country as opposed to in multiple countries -- as a dominant. Because I think legislators around the world and taxpayers don't want to bail out a bank in a different country, for the business they do someplace else."; e) "The consensus (GDP) growth of 2015 is somewhere in the [2.5%] range. Our view is that the United States will be on the higher end of the consensus, and we might hit 3%."; f) "It's the best deal (acquiring Wachovia) we've ever done. Maybe the best deal ever done anytime anywhere in the world. Because we paid $15bn for it. Last year we earned $22bn after tax. Half of it is from the acquisition. We will have paid for this in two years."; and g) "I think if a rate hike happens in the proper way that reflects the strength of the economy, it'll be good for the economy, because it'll say to people, 'Oh, things are pretty good. Now's the time to buy a house. I have more confidence, because after all, the Fed is raising rates. It wouldn't be doing that unless things are good.' And for us, half of our income comes from fees from services, half of it comes from the net interest margin. And our margins have been squeezed ... because interest rates have come down. A rate hike means you're going to see expansion of the margin, and that will be good."

Global Dividend Payers

Aggreko has announced a 150MW contract win and 500MW of contract extensions, which together represent in the region of 21% of its estimated Power Project revenues in 2015, and a small increase in 2014 trading profit due to a settlement on some bad debt. The extensions were expected but welcome nonetheless as finding a new home for large chunks of kit coming off hire would be difficult in the current subdued market. The shares have been weak of late, impacted by concerns over falling oil prices. Today's announcement improves visibility for this year and 2016. The new contract is for 150MW of diesel power in Argentina. The country typically has attractive pricing, so it's estimated this is worth up to £30m a year (5% of 2015 estimated Power Projects revenue, 2% of group). Management have said that this is not part of a wider request for proposal for 700MW of additional temporary power. The tenders for this have been submitted but the successful companies still to be decided. Aggreko's existing 300MW of power in Argentina has simultaneously been extended for two years, which it's estimated represents 9% of Power Projects revenues. As part of the Argentinean contracts a settlement on overdue debt has been agreed. Total bad debt was c$80m, with three particularly large items, of which Argentina is one. If it's assumed those three were 70% of the outstanding amount and Argentina was one of the smaller of the three it would be sub £10m, so <3% of group trading profit.

Cheung Kong/ Hutchison Whampoa – Asia's richest man, Li Ka-shing, is restructuring his business empire to create two listed companies, one focusing on property and the other on telecoms, retail and energy, in a bid to boost their value and attract more investors. "This transaction is a watershed event in our group's history. It is transformational from the point of view of shareholder value," Li said in a statement on Friday. Li's two largest listed companies are Cheung Kong (Holdings) and Hutchison Whampoa, which both run a wide range of businesses. As on Jan. 7, Cheung Kong, which owns just under half of Hutchison Whampoa, traded at a 23% to its book value at the end of June 2014. The proposed reorganisation will put the property assets into a new company, Cheung Kong Property Holdings Ltd, with another, CK Hutchison Holdings Ltd, managing ports, telecoms, retail, energy, aircraft leasing and other businesses. The transaction will increase transparency of the group and give investors direct shareholding in the two companies, as per the company's statement. As part of the reorganisation, Cheung Kong will ask Hutchison Whampoa shareholders to exchange each share for 0.684 CKH Holdings share, resulting in the cancellation of Hutchison shares. The reorganisation comes at a time when Li has been trimming exposure to Hong Kong and buying utility and telecom assets in Europe. As part of the reorganisation, the Li family trust will boost its stake in Canada-listed Husky Energy to 40.2% from 35.6%. HSBC Holdings is the sole financial advisor to the Li group companies.

Novartis – A panel to the U.S. Food and Drug Administration unanimously backed the approval of Novartis AG's copy of Amgen Inc's blockbuster cancer drug Neupogen, setting the stage for the regulator's first approval of a biosimilar. Drugmakers are racing to develop biosimilars, which typically cost 20%-30% percent less than their original, as big-ticket patents on biologics expire and cash-strapped healthcare systems look to cut costs. The biosimilar could be priced at the same level as Neupogen, but cost to insurers and consumers would be lower, Novartis executives told the panel. The recommendation from the advisory panel comes two days after an FDA staff review concluded that Novartis' copy should be cleared for all the five indications Neupogen is already approved. Neupogen prevents infections in breast cancer patients undergoing chemotherapy, which reduces their white blood cells, giving rise to a condition called neutropenia. Sandoz, Novartis' generics arm, plans to launch the drug in the United States under the name "Zarxio". Sandoz is already selling a Neupogen biosimilar in more than 40 countries.

Roche Holding – Swiss drugmaker announced the U.S. regulators had approved its blood test for detecting the Human Immunodeficiency Virus (HIV) and the Hepatitis B and C Viruses (HBV, HCV) in donated blood products.

Seven & I - In 1-3Q (Mar-Nov) Operating Profit was up 0.1% YoY or JPY300mn at JPY249.5bn. This was below the Bloomberg consensus of JPY254.6bn. Seven-Eleven Japan saw strong performance with a 3.8% or JPY6.2bn increase in profits, but losses at Ito Yokado increased JPY6.2bn, and the newly consolidated mail order business, including Nissen, posted a loss of JPY5.2bn. While the strong convenience store business frequently made up for the difficulties in the general merchandising segment, at this stage not only are conditions in the general merchandising business difficult, but there is also an additional negative contribution from Nissen and this is making it difficult for the convenience store business to make up for the shortfall. While the general merchandising business has some structural problems, the external environment has also been negative since the consumption tax hike, and we think hereafter it may become easier again for the convenience store business to make up for the shortfall. However, we believe further restructuring at both Ito Yokado and Nissen will be a prerequisite for the shares to be revalued.

Toyota Motor Corp expects its pace of growth in China to almost halve in 2015 after failing to meet last year's target and as dealers demand compensation to atone for lacklustre sales.

Japan's top carmaker said on Tuesday it sold about 1.03 million vehicles in China in 2014, up 12.5% from the previous year but short of its sales target of more than 1.1 million. In 2015, the carmaker aims to sell 1.1 million vehicles in the country, representing a growth of 6.8%. Japanese carmakers in China faced the twin challenges of a slowing economy and flares of political tension between Beijing and Tokyo over the last year. Growth of China's auto market, the world's biggest, halved to around 7% in 2014. But, unlike rivals Honda Motor Co and Nissan Motor Co Ltd, Toyota chose not to trim its China sales target.

Economic Conditions

US Non Farms Payroll: NFP headlines beat the 240,000 expectations and came in at 252,000 while unemployment ticked lower to 5.6% from 5.8'% last month. Previous number was revised higher from an already lofty level to 353,000 from 314,000. The sour parts from the report was hourly earnings fell -0.2% and reversed the strong +0.4% print from last month and the unemployment rate fall was due more to a drop in the participation rate.

U.S. goods & services trade deficit narrowed for the second straight month in November. The deficit, at $39.0 bln in the month, is the smallest in nearly a year (or since December 2013), which is good news but how it came about wasn't necessarily so good. Exports fell for the 2nd time in three months, down 1% in November (or just +0.7% y/y). Imports also took a tumble, with the 2.2% drop the first in five months and the largest setback since June 2013. Some of that, however, could be pinned on lower import prices (they were down 1.5%). Some of the factors at play in November and their impact they may have on trade, include: Strong USD --- hurts exports, but should boost imports; Slower global demand – lowers exports; Plunge in oil prices --- lowers import bill (the U.S. is still a net importer) and The labor dispute at the two main ports on the West Coast --- hurts imports

US – Markets were unsettled by the most recent reading of the non-manufacturing Purchasing Managers Index (NMI), a leading indicator of the important US services sector, which for December, was, at 56.20 points, weaker than both November's at 59.30 and the consensus expectations calling for a 58.0 level. The 'Business Activity' component of this composite index dropped 7.2 points in the month. Bottlenecks at US West Coast ports are seen as partly at fault for the weaker reading. The weak NMI followed a similarly weak PMI for the manufacturing sector a couple of days before.

Canada – Canadian economy shed 4,300 jobs in December, significantly below the expected 15,000 job additions, following 10,700 jobs lost in November. However, all losses were of part-time positions, as full time positions actually advanced by 53,500 in the month. Most jobs were lost in manufacturing and hospitality, while construction and resources sectors added jobs in the month.

On the Canadian housing front, December saw a reduction in both building permits, down13.8%, and housing starts, which recorded an annualized level of 180,600 units, below November's and the consensus expectations at 193,500.

The Canadian balance of trade stayed in a deficit position for the month of November, by $680 million, as energy exports dropped 7.8%.

The Bank of England (BoE) kicked off 2015 by keeping its benchmark interest rate at 0.5%, deciding also to maintain the size of its bond-buying stimulus programme at GBP375bln. There was no surprise in the central bank's decision given the low inflation backdrop and concerns about the economic recovery. Consumer price inflation fell to a 12-year low of 1.0% in November and is expected to fall further along with the price of oil. And official figures last month showed that economic recovery during 2014 had been slower than previously thought, with GDP in the third quarter 2.6% ahead on the same period in 2013, down from an earlier estimate of 3.0%. Besides, there are increasing concerns about the Eurozone, where inflation this week turned negative.

Financial Conditions

Press reports (Il Sole) are ECB to require Italian banks to carry 10.5% average core Tier 1 ratio, with Monte dei Paschi being asked to be at 14.3% phased CT1. In my view this could signal the ECB is moving (slowly) to regulate away Europe's zombie banks if the political will isn't there to do so.

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 1.40% and the UK's 2 year/10 year treasury spread is 1.20% - 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 3.73% - (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 17.21 (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, Barclays

Source:Thomson Reuters, Bloomberg, KBW, BMO, Barclays

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