Market Commentary

PORTLAND
INVESTMENT COUNSEL®

January 23, 2015

News Highlights

Energy Sector

BHP Billiton –said on Wednesday it would cut its spending on shale drilling over the next six months as it looks to meet its promise not to reduce dividends in the face of a collapse in iron ore, copper and oil prices. BHP has been slashing spending on expansions across its businesses over the past two-and-a-half years, but has been forced to take the latest cuts targeting its onshore U.S. shale gas operations midway through its 2015 financial year. BHP said it would pare the number of drilling rigs it is using to 16 from 26 by June 2015 and would update the market on its revised shale drilling budget, originally set at $4 billion for this financial year, in February. It plans to focus on drilling in the liquids-rich Black Hawk basin, while cutting back in the Permian and Hawkville acreage. "We will keep this activity under review and make further changes if we believe deferring development will create more value than near-term production," Chief Executive Andrew Mackenzie said in a statement. The Anglo Australian giant, which differentiates itself from its mining rivals by owning oil and gas assets, said it has spent $1.9 billion on onshore drilling so far this year. BHP said it was sticking to its plan to spin off its aluminium, manganese, silver and some nickel and coal assets into a new company, South32, even as some of these assets are enjoying improving prices. BHP's iron ore output climbed 16% to 56.35 million tonnes in the December quarter. It reaffirmed it would boost annual output by 11% in the year to June 2015 to 225 million tonnes.

Suncor Energy expects Enbridge Inc's reversed Line 9B crude pipeline to start up towards the end of the second quarter of 2015. Suncor is a committed shipper on the pipeline, which will take crude from Ontario, to Montreal, Quebec. The Line 9B reversal is part of a project to expand Line 9's capacity to 300,000 barrels per day. It was originally scheduled to start up late last year but ran into delays after Canada's National Energy Board requested data on valve placements. Suncor, Canada's largest oil and gas producer, has 100,000 bpd of committed capacity Line 9B to help supply its 137,000 bpd Montreal refinery. Cowan said Line 9B will provide cheaper inland crude to the refinery, saving $2-$3 a barrel on feedstock costs. The Montreal refinery previously relied on more expensive Atlantic basin crude linked to international Brent prices.

Financial Sector

Barclays - Accused on Wednesday of obstructing the American judicial investigation into its dark pool trading activities. US regulators claim that it has defied subpoenas from NY attorney-general seeking depositions from two top executives. History would suggest that there is not a lot of mileage failing to co-operate with US authorities with the risk of a large fine, in our view, looking to be growing. However by today Barclays' lawyers confirmed they had stepped up efforts to persuade a US judge to throw out the case saying the filing by the US regulators was a last ditch attempt to bolster allegations after the judge had earlier pointed out numerous weaknesses in the lawsuit.

BNP - According to Les Echos, BNP Paribas plans to cut jobs in its corporate and investment banking division. Job losses are expected to be lower than in the last round of cuts at the division end-2011, when the bank cut 373 jobs in France, according to SNB/CFE-CGC labor union official Joel Debeausse. The bank is also cutting bonuses for top management at the corporate and investment banking division by about 50% in 2015, Les Echos reports.

Credit Suisse - Issued a statement regarding recent speculation on sudden impact of strengthened Swiss Franc. The bank says it "recorded positive trading results over the period following SNB announcement", "not suffered any material losses relating to fx volatility". Also reiterates previous guidance on on-going earnings impact, which implies that the moves in CHFUSD and CHFEUR since last week will knock c.10% off group profits. By comparison, share price is -17% since SNB announcement.

Morgan Stanley - reported 4Q Earnings Per Share of $0.47—the quarter was messy and had lots of puts and takes, all in its estimated core EPS at ~$0.32 ($0.43 ex. elevated litigation expense). The quarter was therefore a miss versus consensus expectations of $0.48). Variance versus forecast was largely weaker than expected sales & trading results. As is now customary on the fourth quarter earnings call, management provided a strategic update. The highlight was a revised Return On Equity target of 10% (up from 9%) and Bank assets are expected to grow to ~$180Bn by year-end 2016 (old target was $160Bn, by y/end 2015). Management expects lower funding costs and execution of the bank strategy to be key drivers here, albeit the low hanging fruit (Morgan Stanley Smith Barney buy-in, Fixed Income, Currency and Commodities' related risk weighted asset reduction, and non-compensation rationalization of costs to achieving an acceptable ROE are now arguably mostly underway such that meaningful improvement in returns from here will likely require a more constructive macro back drop. Albeit a reduction of unsecured funding costs by year-end 2016 (down ~25% from peak 2013) and a target compensation ratio of ≤ 39% in institutional securities for 2015 in a flat revenue environment (previously: ≤ 40%) are constructively helpful targets.

RBC to buy City National: In the largest deal post crisis, RBC is buying CYN for $5.4B, or $93.80/share, which is a 26% premium. The deal is 50/50 stock and cash and represents about 2.6x Tangible Book Value and about 23x 2015 eps. On the surface, it's logical to assume CYN could be a seller with a lot of inside ownership (CEO Russell Goldsmith owns 900K, or 1.63% of the bank, which is over $80mm) and he is 63 years old. The reality is you need higher rates to recognize their potential eps power and CYN is getting paid today for a lot of that at this valuation. CYN management have achieved a big premium, and are selling into a balance sheet that is 30x their size with a 5% dividend yield and they still get to manage their business. From an RBC perspective, they are picking up a valuable wealth management franchise, which they have been focused on, and they are picking up niche businesses in entertainment and technology, which they hope will be complementary to their capital markets business. With an acquisition premium of about 26%, RBC is acknowledging that growth outside of Canada will be dilutive to overall profitability but that it is a trade-off it is willing to make.

UBS said Friday it would pay out about CHF500m of deferred compensation a year in securities that will count as AT1 capital under Basel III rules. UBS also said it set aside the money to pay a supplementary dividend announced in May of 0.25 francs a share. The payout is separate from any dividend the company may pay out for 2014. In terms of the SNB move last week they say they had no negative revenue in the trading businesses related to the move.

Canadian Dividend Payers

Brookfield Property Partners – Brookfield Asset Management Inc said on Friday it has reached an agreement to acquire the 50% interest of its Canadian and Australian facilities management businesses that it does not already own from Johnson Controls Inc for about $200 million. The firm, which manages over $200 billion in assets, said the move is part of a broader plan to create a global facilities management business. With the termination of its joint venture agreements with Johnson Controls, Brookfield plans to immediately launch its facilities management businesses in scale in the United States and Europe.

Global Dividend Payers

Amcor chief executive-elect Ron Delia has flagged further growth in emerging markets and a stronger focus on product innovation, saying the global packaging giant is in good shape but there is room for improvement. Amcor announced that well-regarded chief executive Ken MacKenzie will retire at the end of June, after 10 years at the helm, and hand the baton to Mr Delia, Amcor's chief financial officer. Mr Delia reassured investors and customers that the company was in good shape, that Amcor's fundamental strategy would not change and he was in "lockstep" with Mr MacKenzie over its priorities and future direction. Mr Delia said Amcor was committed to becoming a world leader in packaging innovation and needed to build its capabilities. He also flagged further organic growth and acquisitions in emerging markets such as China, India, south-east Asia, Latin America and Europe, which accounts for 20% of Amcor's sales. Mr Delia ruled out further non-core asset sales, saying Amcor's portfolio was in good shape, and would not comment on the likelihood of further capital management. There has been speculation that Amcor may return surplus capital to shareholders after missing out on buying major rival Constantia, which was acquired by French investment company Wendel in December in a deal that valued the company at $US2.8 billion. Mr MacKenzie rejected suggestions that his decision to retire and the failed Constantia deal were linked. Amcor is one of the world's largest packaging companies.

Hutchison Whampoa: has announced the agreement for ThreeUK to buy Telefonica's O2UK assets for £10.25bn (£1bn deferred). Previously estimates placed the asset at a value of about £10.6bn. However O2UK is exposed to the dual threats of spectrum shortage (relative to revenue share) and bundling, which in our view helps explain the fairly modest implied purchase multiple of 7x FY15 estimated earnings

Johnson & Johnson topped analyst's expectations earning $1.27 per share (excluding special items) in its fourth quarter. However, it reported lower-than-expected quarterly sales as a stronger dollar offset higher sales of the Band-Aid maker's new drugs and older treatments. The company's international sales fell about 7% to $9.65 billion in the fourth quarter, accounting for about half of its total sales. The dollar .DXY gained nearly 13% against a basket of major currencies in 2014, its strongest performance since

1997. Revenue in J&J's pharmaceuticals business rose 9.6%, driven by higher sales of new drugs such as hepatitis C drug Olysio and older treatments such as psoriasis drug Stelara. The business accounts for about 44% of the company's total sales. However, sales in J&J's medical devices business, its second largest, fell 9%. The company's net profit fell about 28% to $2.52 billion, or 89 cents per share, including a $1.1 billion charge related to its acquisition of Synthes Inc. Total sales fell 0.6% to $18.25 billion. J&J forecast a profit of $6.12-$6.27 per share for 2015.

Novartis will review its Swiss cost base after the country's central bank scrapped a cap on the franc last week, sending the currency soaring, the Swiss drugmaker's chief executive said on Thursday. "We'll have to take a hard look at what's in Switzerland and what could move outside," Joe Jimenez told Reuters in Davos. The company has just 2% of its sales in Switzerland but 12% of its 2013 costs were in the country. Jimenez stressed Switzerland would remain Novartis' home base, reflecting the group's long history and commitment to its Basel headquarters.

In a separate announcement, the U.S. Food and Drug Administration approved Novartis' injectable drug, Cosentyx, to treat adults with a moderate to severe skin disease called plaque psoriasis. Cosentyx was approved on Wednesday with a medication guide warning about a greater risk of infection as it affects the immune system. Psoriasis is a skin condition caused by dysfunction of the immune system. Patients with plaque psoriasis, the most common form of the disease, develop thick, red skin with flaky, silver-white patches called scales. The active ingredient in Cosentyx, secukinumab, is part of an eagerly anticipated class of drugs that have shown unprecedented success in treating psoriasis by targeting the inflammation-causing protein interleukin-17 (IL-17). An advisory panel to the FDA unanimously recommended approval for the injectable biologic, or protein-based drug cultured from living cells, in October. Another class of biologics called tumor necrosis factor blockers — including Amgen's blockbuster Enbrel and AbbVie Inc's Humira — are widely used in psoriasis but have potentially serious side effects.

Pearson – Britain's Pearson said it expected to return to earnings growth in 2015, after a solid performance its North American higher education unit helped bring an end to a turbulent two years of restructuring and profit downgrades. The education and media group said for 2015 it expected adjusted earnings per share to come in between 75 and 80 pence, up from the 66 pence it expects for last year, in what would be the first rise since 2011. The 66 pence figure for 2014 was at the top of a range Pearson had previously given of 62 to 67 pence, and was higher than a current consensus forecast of 64 pence per share. Having expanded rapidly, the 171-year-old company, a world leader in education, spent 2013 and 2014 restructuring to increase its focus on the faster growth areas of digital services and emerging markets to complement its core U.S. education division. Pearson, which also owns the Financial Times, said it had faced tough market conditions throughout 2014, due to pressures on budgets in North America and Britain, its two largest markets, and weaker demand for textbooks in South Africa. It benefited from strong performances in its online services, its English language learning business in China and by improving the profitability of the FT Group.

TOTAL announced plans to guard the company against lower oil prices: 10% Capex cut from discretionary Upstream spend, accelerated $10Bn divestment programme in 2015'-17', and further Opex savings from Downstream restructuring. TOTAL will be able to deliver 8% production growth (14'-17') profitably even at lower oil prices and refining performance will improve as margins go up. Current dividend levels are in our view therefore safely guarded.

Economic Conditions

U.S. housing starts rebounded in December. The 4.4% jump burst past expectations of a more moderate 1% rise, leaving starts at 1,089k units annualized. There were upward revisions to the prior two months, as well. Although November was hit hard by an early blast of winter, starts in the month were revised 1.5% higher to 1,043k while October starts were revised 4.5% higher to 1,092k. Housing starts have remained above the 1 million mark for four months in a row, strength we haven't seen since 2008. Single-unit construction, which accounted for 2/3rds of starts, was responsible for the entire gain, up 7.2% to a near 7-year high. Multi-unit starts, however, slipped for the 2nd straight month, down 0.8% in December to a 3-month low. And, on a regional basis, the Northeast, South and the West saw more ground begin broken at year end, while the Midwest fell.

US – The US homebuilders remain mildly optimistic, as illustrated by the most recent reading (January) of the National Association of Home Builders' (NAHB) housing market index. The index moved one notch lower, to 57.0 points from 58.0 in December, yet it is still firmly anchored into the 'optimistic' territory (above 50 points). The US existing home sales were up 2.4% in December, as expected, to a 5.04 million units annualized level, driven by an increase in sales of single-family units. The growth was concentrated in the country's South and West.

Canada– Retail sales in Canada surprised on the upside in November, up 0.40% at the headline level, and up an even more impressive 0.70% at core level (which excludes sales of motor vehicles). Sales were strong in the apparel, sporting goods and electronics/appliances, stimulated likely by the Black Friday discounts.

Inflation in Canada, as most other places around the world, dropped by 0.5% to 1.5% in December, as expected. The core inflation (which excludes eight most volatile price series) was actually up a notch, to 2.20%.

Global Growth - The IMF this Tuesday lowered its forecast for global economic growth and called for governments and central banks to pursue accommodative monetary policies and structural reforms to support growth. The IMF said its 2015 global growth forecast is now 3.5% (from 3.8% in October) and 3.7% for 2016 (from 4% in October). 2015 emerging market growth has been reduced to 4.3% (vs 5% in Oct) and 4.7% in 2016 (vs 5.2% in Oct). China 2015 growth forecasts have been cut to to 6.8% (from 7.1%) (although China itself forecasts 7.4%) and the IMF predicts Beijing to limit policy stimulus to curb credit, investment risks. There are also cuts to 2015 growth forecasts most for Russia, Nigeria and Saudi Arabia. Advanced economies 2015 growth forecast has been raised to 2.4% (from 2.3%) with 2016 unchanged while the US 2015 growth forecast has been raised to 3.6% (vs 3.1% previously), the only major economy to see upward revision. The IMF says new factors supporting growth - lower oil prices, but also depreciation of euro and yen - are more than offset by persistent negative forces, including the lingering legacies of the crisis and lower potential growth in many countries.

Financial Conditions

Bank of Canada (BOC) on Wednesday announced that it is lowering its target for the overnight rate by 0.25% to 0.75%. The Bank Rate is correspondingly 1% and the deposit rate is 0.5%. This decision is in response to the recent sharp drop in oil prices, which will be negative for growth and underlying inflation in Canada.Inflation has remained close to the 2 per cent target in recent quarters. Core inflation has been temporarily boosted by sector-specific factors and the pass-through effects of the lower Canadian dollar, which are offsetting disinflationary pressures from slack in the economy and competition in the retail sector. Total CPI inflation is starting to reflect the fall in oil prices. All of the 22 economist polled on Bloomberg had called for no change on rates. The market's reaction was quick and swift and the Loonie sold 2 cents immediately. Interesting enough, TD announced that it will not be dropping its prime rate and other banks are deciding if they want to follow along. Central banks do not have a history of moving only once and with yesterday's cut not followed by the commercial banks, its effects to help the economy off the back of weak oil is diminished. The BOC also said it used a $60 oil in its models so if oil stays lower at $45, does that mean the BOC needs to cut again? We see upward pressure on USDCAD in the near term.

European Central Bank – re Quantitative Easing: The ECB announcement – to buy €60bn of assets per month from this March to Sept 2016 – has met and perhaps exceeded market expectations earlier this week and is some way ahead of what was being mooted a few weeks ago. The €60bn per month includes the existing bond purchase programmes, which amount to around €10bn per month. Most of the govt purchases will not be subject to risk pooling i.e. the risks remain with national central banks, which was also expected and has been the subject of significant discussion (and criticism) over the past few days (i.e. it was a requirement of Germany that risks remain with central banks). The wording around risk sharing is a bit vague but looks to be 20/80 loss sharing split ECB/national central bank (if confirmed, this would be in line with prior leaks). There was a positive signal from ECB President Draghi, that purchases would continue beyond Sept 2016 if needed. For now, the size of the programme and the open-ended nature of the commitment to purchase assets beyond Sept 2016 are outweighing market concerns about the lack of risk pooling. The announcement signals in our view a positive message that the ECB is prepared to take radical action and should help promote confidence in the financial markets. But it won't on its own, in our view, address the fundamental problems on growth and the need for structural reform in the eurozone. Its introduction is coming fairly late in the day and, moreover, weakness in the EU banking system, already low levels of bond yields, and demand weakness across the eurozone economies, will constrain its impact

Bank of Japan kept its monetary stance unchanged to "*conduct money market operations so that the monetary base will increase at an annual pace of about 80 trillion yen.*" The BOJ did extend the various loans programmes by one year and expanded the loan quantum. Also, while BOJ downgraded FY 2014 GDP to contraction, growth outlook is improved for 2015 and 2016.

Denmark - Denmark cut its interest rate by 15bps to -0.2% on Monday in a move said to quash speculation it may follow Switzerland and abandon its euro peg. "We have the necessary tools to defend the peg," stated Karsten Biltoft, head of communications at the Copenhagen-based central bank. Asked whether Denmark could ever consider abandoning its currency peg, he said, "Of course not."

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 1.33% and the UK's 2 year/10 year treasury spread is 1.15% - 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 3.63% - (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 5.1 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 16.40 (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, Berstein, Scotiabank, Macquarie

Source:Thomson Reuters, Bloomberg, KBW, BMO, Berstein, Scotiabank, Macquarie

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

PIC15-003-E(01/15)