Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Total: reported 4Q adjusted net income of US$2.8bn vs. consensus of US$2.55bn, down 17% YoY and 21% QoQ. The dividend was unchanged QoQ at €0.61/sh (+3% YoY). Weaker oil prices and a weaker Euro were the main earnings drivers.Total is to press ahead with further cost cutting, targeting a 10% cut in capex in FY15 to US$23-24bn, cutting the exploration budget by 30% to US$1.9bn and reducing Upstream opex by US$1.2bn, a 50% increase vs. the previous target. Overall Total is targeting US$8bn in incremental cash in FY2015 from new start-ups (US$1.5bn), asset sales (US$3bn) and cost savings (US$3.5bn). This is intended to mitigate the impact on its free cash flow from the recent drop in oil price, as at US$70/bbl in FY15 Total's Free Cash Flow would fall to c.US$1bn from US$7.5bn at US$100/bbl based on its oil and gas price sensitivity. This plan aims to cut Total's free cash flow breakeven between 2014 and 2015 by US$40/bbl. Upstream adjusted net operating income was US$1.6bn, down 48% YoY and 42% QoQ mainly as a result of weaker crude prices. Production increased 5% QoQ to 2.23mboe/d. YoY headline 4Q production was down 2%. Refining & Chemicals adjusted net income was US$856m, up 2.2x YoY and up 22% QoQ as a result of higher refinery utilisation and the SATORP refinery in Saudi Arabia reaching full capacity. Marketing & Services adjusted net operating income was US$245m, down 26% YoY and 35% QoQ. The results were impacted by a negative accounting effect of US$100m on the valuation of hedging positions. Cash flow and balance sheet: FY14 Casf flow from operations was US$25.6bn (10% YoY) vs. capex of US$26.4bn. Hence gearing increased to 31.3% at YE vs. 23.3% a year ago. Overall we believe a good set of 4Q 2014 numbers from TOTAL; with Downstream supporting weaker Upstream earnings which were impacted by temporary lower realizations. For the full year, their ROACE is the highest so far of the Majors while they also had the best 3 year organic reserve replacement which in itself would argue for a premium multiple. However, we like the company's response for the 2015 trough oil price year with:

- Production growth of 8% helped by the new ADCO licence in United Arab Emirates. Note this this licence of for 40 years and the 150kbpd of volumes are probably 4x more profitable than the same volumes which expired in January 2014.
- Capex reduction of 10% when investors still question the Majors ability to do so.
- Opex reduction target increases 50% to $1.2Bn.
- The $8Bn cash increase in 2015 from these actions (including divestments) which lowers their breakeven by $40/bbl.
- Plans to shut the UK refinery and rationalise French capacity later (source of impairments today).
- New CEO announcing TOTAL headcount reduction

Combined with the continued ramp up of long life assets and a base decline rate which is falling towards 3-4% over time (most likely sub 3% and was 1% in 4Q 2014)), we believe this business remains undervalued.

Financial Sector

Barclays lost a bid to dismiss a lawsuit by New York accusing the bank of misleading customers of its dark pool in order to boost its own profit. Attorney General Eric Schneiderman sued the London-based bank in June, saying it bilked its own customers in order to expand its dark pool through a pattern of "fraud and deceit" that began in 2011. The bank sought dismissal of the case, saying that claims under the state's Martin Act must be tied to the sale of a particular security and that misrepresentations about the platform through which trading takes place aren't covered by the law. State Supreme Court Justice Shirley Kornreich in Manhattan denied the bank's request to throw out the Martin Act claims on Friday.

Citigroup Inc., the largest provider of prime-brokerage services to firms trading currencies, is using that size to extract higher fees from clients, according to people familiar with the firm's pricing. Citigroup is raising prices for clearing and settling currency trades, according to four people with knowledge of the move, who asked not to be identified to preserve their relationship with the firm. For at least some clients, the price climbed by roughly 25%, one of the people said. The currency dealer has told customers it's charging more as heightened volatility makes the $5.3-trillion-a-day market more perilous, and as technology and client-coverage costs climb, according to a person familiar with the matter. (Source :Bloomberg)

Commerzbank: 4Q14 earnings released this morning contained a number of one-off items (higher legal provisions vs 3Q of €198mn, restructuring costs €61mn and a tax item delta of ~€90mn). We judge underlying earnings as being in-line. CBK reported a Fully Loaded Basel 3 Core Equity Tier 1 of 9.5%, slightly below expectations of 9.7% (higher pensions liability and FX impacts, target 10%) with the company highlighting further headwinds in 1Q15 from the Central and Eastern Europe division (CHF loans), and it remains thin relative to peers. We believe that future capital pressure could come from shipping (falling prices in second-hand dry bulk and container vessels, which remain 60% of the non-core shipping book). The stock trades at an undemanding 0.50x 2017 P/TNAV but for a 2017 Return on Tangible Equity adjusted of just 6%.

Goldman Sachs Group Inc. provided a rare look into the performance of the units that make up fixed-income trading, the firm's largest source of revenue. Interest-rate products generated about $14 billion, or 29% of fixed-income revenue, in the past five years, the bank said in a presentation on its website. Credit trading followed interest rates, producing 25% of fixed-income revenue. Mortgages and currencies trading each generated about 16% of revenue, while commodities accounted for about 14%, the firm said. Bloomberg

HSBC - CEO said its Swiss private bank didn't meet acceptable standards of conduct amid allegations it profited for years by handling money for clients including arms dealers and drug cartels. Stuart Gulliver and Chairman Douglas Flint have been summoned to appear at U.K. Parliament committee hearings on the scandal, the CEO said Friday in a memo to employees, which was seen by Bloomberg News. HSBC has cut the number of private accounts at the unit by about 70% and eliminated 104 of 140 clients named in media reports this week, he said. FCA are now "looking into recent revelations" and in particular the case of Sue Shelley, the former Head of compliance in Luxembourg, who successfully won a case for unfair dismissal after she was fired for pointing out compliance failures as recently as 2013. Difficult to see that UK will ever impose fines like the US, but from a business perspective I suspect that clients will hardly be viewing HSBC Switzerland in a favourable light. Generally speaking, if as a bank you are responsible for the Prime Minister getting rolled over in parliament Question Time it does not bode well.

ING reported Q4 results - a small miss to consensus. Net income for banking in Q4 coming in at EUR548mn against consensus of EUR582mn (mainly driven by weaker trading related income). The main positive is the re-instatement of the dividend as of Q4 and will pay a dividend of EUR0.12 per share for Q4; this was not in the consensus with "median" Dividend Per Share forecast of zero and average of EUR0.08. Going forward it would target a payout of 40% and that would imply a dividend yield of c4% in 2015. Dividend resumption was kind of expected post full repayment of state-aid, but the fact that it is resuming it in Q4 already (when most analysts have it for 2015) is sending a signal of how comfortable management is with capital position. Fully loaded Core Equity Tier 1 has increased to 11.4% (from 11.1%), and more importantly, in the bank's slide presentation, it gives a pro-forma Fully loaded ratio of 13.1% assuming full divestment of insurance stake - which means that it would in theory have excess capital of EUR9bn / EUR2.35 per share (vs 10% target).

Investors Group reported operating earnings of $0.83 versus consensus of $0.85. The $0.02 difference was due to a lower management fee rate, along with lower-than-expected net nvestment income (i.e., non-mutual fund ops). Wealth management EBITDA were $295 million in Q4/14, lower than estimated and down 1% from Q3/14 reflecting the lower management fee rate (due to shifting asset mix toward lower fee products) along with higher non-commission expenses. Q4/14 results also excluded a $59.2 million ($0.23 per share) after-tax charge related to distributions to clients (i.e., fee reductions) for existing HNW clients.

Standard Chartered Plc will shift its retail banking focus to affluent clients from ordinary customers and urge them to bank online as part of a broader restructuring led by embattled CEO Peter Sands, a senior executive told Reuters. StanChart's retail business is one of the first divisions the Asia-focused lender has targeted with cuts, announcing last month it would axe 4,000 retail jobs or 5 percent of its global workforce and close 80-100 branches. The costs cuts and the shift to wealthy clients in Asia, the Middle East and Africa come as Sands, who some investors would like to see replaced, is under increasing pressure to revive the bank's fortunes after a troubled two years. Reuters

UBS 4Q: Net profit CHF964m, 28% ahead of consensus (CHF754m) due to stronger than expected Deferred Tax Allowance build. However, at clean pre-tax level the operating divisions are we believe about a 5% miss (CHF1.9bn vs consensus CHF1.8bn) and the group clean pre-tax is a 38% miss, although driven by a lot of noise this quarter in the Non-Core unit. Core Wealth Mgt result slightly disappointing, a 4% pre-tax miss on weaker gross margin of 82bps vs consensus 85bps (from 85bps Q3) & net new money of only CHF3bn vs consensus CHF7.7bn, offset by a good beat in the Investment Bank. Lack of major litigation charges a relief and 1Q outlook fairly positive "solid start - gives additional confidence". The main positive in the release is the dividend: CHF0.5 core plus CHF0.25 special vs all-in consensus CHF0.6 and mgt reaffirming >50% payout target. Tier 1 Capital down to 13.4%, Swiss leverage stable at 4.1%.

Global Dividend Payers

Tesco management team changes. Tesco has been making significant changes to its management structure over the past two weeks, according to The Grocer on Friday. The retailer is bringing together c2,700 Metro, Express and One Stop stores under one management roof, as Tony Reed, currently CEO of Tesco's One Stop, is to head up Tesco's entire convenience operation. Many other directors have been appointed to new roles as part of the shake-up ahead of the planned closure of the Cheshunt HQ. One supplier was quoted as describing the news as "a truly seismic change in the management structure and many people leaving the business. Despite that, there is a widespread feeling Lewis is making the tough decisions that need to be made."

Economic Conditions

Bank Of England Inflation report was upbeat. GDP forecasts and wage growth was revised higher while the unemployment rate was revised lower. The closing of the output gap is pulled forward. Inflation forecasts sees CPI bottoming in Q2 but 2-year ahead CPI was bumped up from 1.8% to 1.96%. Although Bank of England Governor Mark Carney stressed 2-way risks, the markets saw the report as positive and gave GBP a lift.

Chinese inflation came in lower than expected with CPI at +0.8% (+1.0% exp) and PPI at -4.3% (-3.8% exp). Market therefore hopes of more easing on the horizon from the government. Only last week, the PBOC cut the Reserve Requirement Ratio (RRR) 50 bps down to 19.5% to stimulate growth.

Japan's domestic economy staged a subdued rebound of 2.2%q/q in 4Q 2014 and helped Japan emerge from its first technical recession (of 2Q-3Q 2014) since 2012.

Sweden: Riksbank cut rates 10 bps into negative territory and surprised the markets by entering into the world of Quantitative Easing and committed to purchase SEK 10 Billion of government bonds through February-March. In addition, the Riksbank signaled that it was ready to do more in both rate cuts and bond buying. The Riksbank warned it saw the recent drop in oil as concerning and although they normally look through a supply-driven shock in oil prices, it could not now given that inflation was already at such low levels.

Greece: The European Central Bank has extended another €5bn in emergency loans to banks in Greece, following fears that a spate of withdrawals could leave lenders in the country short of funding. The ECB decision, made after a call with members of its governing council last Thursday, came as Alexis Tsipras, Greek prime minister, took his case for a new financial rescue deal to an EU summit in Brussels. The Greek government also said on Thursday that tax revenues were 20.3 per cent below target — a shortfall of €933m — heightening concerns that the country will be unable to meet €4.1bn of debt repayments due in the next six weeks unless it accepts an extension of its bailout that expires at the end of the month. (Source : Financial Times). Yesterday's Eurogroup meeting ended without an agreement between Greece and its European partners, while Mr. Dijsselbloem stated that the country has until Friday to request an extension to the current bailout program, otherwise it will face the possibility of losing the pending funds. Athens rejected a proposal to request a six-month extension of its international bailout as "unacceptable". If a request for an extension is made, Greece can present alternative measures but not roll back previous reforms or take unilateral steps, said the Eurogoup Chairman, noting that Greece's demand for a "bridge" agreement is essentially another word for an extension. Bloomberg reports that Jean-Claude Juncker's 11th hour effort to strike a deal with Greece was parried by the finance ministers who sought to extend an austerity program in exchange for financial support. According to the article, talks in Brussels ended abruptly and Greek Finance Minister Yanis Varoufakis claimed a bait-and-switch, saying Juncker's commission offered a path forward that finance ministers then refused to put on the table. Instead, Dutch Finance Minister Jeroen Dijsselbloem offered a different statement tying Greece to its current agreement. Varoufakis rejected that proposal out of hand, and the euro weakened on the impasse. Varoufakis said Greece is willing to extend the country's current aid program as long as the step is done on the right terms. Prime Minister Alexis Tsipras's government will now return to the bargaining table and "we are ready and willing to do whatever it takes to reach an honourable agreement over the next two days," he said.

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 1.40% and the UK's 2 year/10 year treasury spread is 1.33% - 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 3.69% - (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 16.06 (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, Barclays, Macquarie, Credit Suisse, Canaccord

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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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