Market Commentary

PORTLAND INVESTMENT COUNSEL®

February 23, 2015

News Highlights

Energy Sector

Baytex Energy – announced a revised 2015 budget and amendments to bank credit facilities. Its board of directors has approved a revised 2015 capital budget of $500 to $575 million, down from an initial $575 to $650 million. The revised 2015 capital budget is designed to generate an average production of 84,000 to 88,000 boe/d (barrels of oil equivalent per day), which is down from the company's previous 88,000 to 92,000 boe/d guidance. The planned level of capital spending continues to be evaluated. The company expects 2015 production to be approximately evenly split between Canada and the Eagle Ford formation in Texas. In response to the steep drop in oil prices, the company managed to re-negotiate its debt covenants for its unsecured revolving credit facilities consisting of a $1.0 billion Canadian facility and a $200 million U.S. facility that mature June 2018.

Chevron Corp the second-largest U.S.-based oil producer, said on Friday its oil and natural gas reserves fell 1% last year largely due to the sale of its stake in a Chad oil field. The company had proved reserves of 11.1 billion barrels of oil equivalent on Dec. 31, about 1% lower than a year earlier. At the end of 2014, about 20% of Chevron's reserves were in Kazakhstan and 19% in the United States, the largest single areas of holdings. More than half of Chevron's 1.5 million Permian acres don't require royalty payouts to landowners, an advantage over rivals. Chevron is trying to lift Permian production to 250,000 barrels of oil equivalent per day by 2020.

Northland Power reported a good set of results for Q4 and full 2014, with record annual sales and adjusted earnings before interest, tax, depreciation and amortization (EBITDA). Initial market reaction was negative though, due to an 'as reported' result of $170 million loss for the year and (previously flagged) cost overruns at NPI's last four solar projects. The GAAP (generally accepted accounting principles) loss was caused chiefly by non-cash mark-to-market reflection of current interest rate swaps for Gemini project related debt, which will reverse over time. Cost overruns at solar projects are roughly 12% of the original estimated cost and some if not all are expected to be recovered by legal action against previous contractor, HB White. Northland Power Fourth quarter EBITDA and cash flow per share beat guidance and expectations. NPI maintained its 2015 guidance for a $380 to $400 million EBITDA. Construction at Gemini, offshore wind project, has been advancing as planned. On the development side, financing for Grand Bend and NordSee One continues to be expected by the end of the first half of this year. The company emphasized that, Gemini and NordSee notwithstanding, NPI is pursuing measured growth.

Financial Sector

Berkshire Hathaway – Warren Buffett's Berkshire Hathaway Inc agreed to buy German motorcycle apparel and accessories retailer Detlev Louis Motorrad-Vertriebs GmbH for a little more than €400 million ($456 million). The purchase enables Buffett, known for his optimism about the United States and the investment opportunities it offers, to expand in Europe despite its economic problems. Buffett told Financial Times that the purchase was a "door opener," and that "the U.S. is my first love, but I see terrific possibilities for us in Europe." Detlev Louis has annual sales of €270 million ($308 million), employs more than 1,500 people, has more than 70 outlets in Germany and Austria, and serves 25 countries through online stores, its law firm said. The purchase fits Buffett's common practice of buying entire businesses and then leaving existing management in place. Still, Detlev Louis remains a small acquisition for Berkshire, whose $62.38 billion cash hoard at the end of September 2014 left Buffett with the power to make one or more large acquisitions, which he calls "elephants." Buffett told the Financial Times that Europe was fertile ground for such purchases despite its problems.

Berkshire Hathaway Inc disclosed a 5% stake in agricultural equipment maker Deere & Co (owned in Portland Global Dividend funds) and said it shed a $3.74 billion investment in oil company Exxon Mobil Corp as oil prices plunged. Berkshire began accumulating the bulk of its 17.1 million-share stake in Deere, worth $1.51 billion at year end, in the third quarter of 2014, but had not previously disclosed it. The SEC often lets Buffett quietly accumulate large stakes to deter copycats. Berkshire also reported a new stake of 4.7 million shares in Rupert Murdoch's media company Twenty-First Century Fox Inc. It further reported a new 8.4 million-share stake in Restaurant Brands International Inc, the parent of the Burger King and Tim Hortons restaurant chains. Berkshire helped finance Burger King's purchase of Tim Hortons last year and got Restaurant Brands shares through the merger. Berkshire also added to holdings in IBM, General Motors Co, Phillips 66, Suncor Energy Inc and DirecTV, among others, and shed stakes in oil company ConocoPhillips and pharmacy benefits management company Express Scripts Holding Co.

HSBC – On a clean basis, Profit Before Tax was -39% versus consensus. Revenues (GBM-related), costs and impairments all disappointed. The 4Q dividend was U$0.20/share, slightly lower than U$0.21 consensus and the Core Equity Tier 1/Risk Weighted Asset ratio was 11.1%, -0.3% QoQ. The group has set new financial targets of (1) >10% ROE, which is equivalent to a c12% RoTE, (2) positive jaws (ex one-offs), (3) a 'progressive' dividend. All targets are modelled on the basis of a 12-13% Core Equity Tier 1 ratio and are 'medium-term' objectives. On current estimates, the stock trades on c10x 2016E EPS and 1.1x 2015E NAV for a RoNAV of c11% 2015-2017 estimate

ING issued a press release that it is selling 43mn shares in NN Group (its insurance stake), worth cEUR1.1bn based on current market valuation, in an accelerated book build. It is estimated this will boost the group fully loaded Core Equity Tier 1 ratio by about 35-40bps, taking it to 10.9%. With pro-forma Fully Loaded CET`1 ratio of 13.1%, measured against a hurdle rate of 11%, there could be a theoretical excess capital of €6bn, €1.6 a share or 13% of current share price. While this is not new news, we believe the minimum dividend yield of 4%, plus a promise for even higher dividend payout, will continue to support the shares in the medium term. The announcement of the placement of ING's NN shares is effectively a further step in the sequence towards crystallizing excess capital. Management has reiterated its payout target of 40% applicable to 1H15 interim dividend. The final FY15 dividend will be minimum 40%, and management will take into account the surplus generated from the sale of insurance stakes. In its 4Q14 presentation, ING has pointed to €5.3bn potential excess capital. This is on a static basis, and does not include ING Bank dividend upstreaming in 2015/16. ING Bank has therefore all but reached its 11% Core Equity Tier 1 target and is generating capital at a pace of about 90-100bp pa. The 40% dividend payout based on 4Q14 shows we believe, managements' confidence in the 11% Core Equity Tier 1 ratio of the bank. We view it as unlikely that the excess capital will be channeled to acquisitions. Management is focusing on organic growth and the business model of ING operates well without bricks and mortar. ING has sufficient liquidity and deposit momentum, so the way to expand market share would be to acquire credit portfolios in targeted areas such as Poland or Turkey. The NN placement is expected to settle on 20 Feb., with a lock-up period of 90 days. As a result of the sale, ING's stake will fall from 68.1 percent to 57 percent of NN Group's total capital. It has pledged to sell its remaining stake in NN Group by 2016. In line with its disposal plan, ING is also likely to reduce its 19% stake in Voya.

Royal Bank of Scotland - The Financial Times reports that bidders for RBS's Coutts private bank division are trying to use the HSBC tax evasion scandal as reason to lower their offers. Credit Suisse, Union Bancaire Privee, a partnership of SocGen, DBS are among final bidders for Coutts. The bidders have also used the Swiss franc's gains as a bargaining chip. RBS is expected to choose the final two bidders and aims to announce a deal as early as next week when it reports annual earnings.

Canadian Dividend Payers

Barrick Gold Corp. reported a Q4/14 loss of $2.45/share and adjusted EPS of $0.15 -- adjusted EPS came in at $0.15 vs. consensus of $0.14 (better on taxes and minority interest) – operationally, gold production was 1.527mm/oz at costs of $628/oz vs. estimate of 1.57mm/oz at costs $638/oz -- Copper production was 134mm/lb at $1.78/lb vs. estimate of 151mm/lb at $1.88/lb – in terms of 2015 guidance, production estimated at 6.2-6.6mm/oz at total cash costs of $600-$640/oz vs estimate of 6.1mm/oz at total cash costs of $605/oz -- AISC guidance is $860-$895/oz – on the copper front, production guidance is 310-340mm/lb at a total cash cost range of $1.75-$2.00/lb. Capital costs are ~$1.9-$2.2Bn, in-line with estimate of $2.0Bn. Reserves decreased 11% to 93.017mm/oz from 104.051mm/oz in 2013 while total resources decreased 5% relative to 2013. In summary, 2015 gold production guidance has a higher range than expected, while cost and capital were in-line and better AISC -- overall, reserves are down as expected -- ABX maintained the dividend and the write-down was thankfully lower than anticipated. In summary, Barrick provided highly anticipated strategic direction with its Q4/14 earnings release, setting tangible objectives that include: net debt reduction of $3bln in 2015, a streamlined organizational structure that will reduce G&A and other corporate costs and a capital allocation hurdle rate on new projects of 15% ROIC. We believe that all of these objectives are appropriate. We think streamlining the organizational structure is achievable in 2015 while evaluating Barrick's discipline in sticking with its 15% ROIC hurdle on new projects will be better evaluated as the company completes its four pre-feasibility studies on its Nevada opportunities throughout the year.

Restaurant Brands International Inc, the parent of Burger King and Canadian coffee and doughnut chain Tim Hortons, reported robust quarterly sales growth, crediting new menu items for driving traffic. Shares of the Oakville, Ontario-based company, which have soared more than 40% on the Toronto Stock Exchange since being listed in December, jumped another 10.1% on Tuesday to $53.14. The stock rose even though the company, which opened nearly 900 new restaurants in 2014, posted a hefty quarterly loss on one-time merger-related costs. U.S. chain Burger King bought Tim Hortons for $12.64 billion in August, creating the world's third-largest fast-food restaurant group. The two chains are managed as separate brands under the parent company.Investors are keen to see if Tim's dominance in the Canadian coffee market can help chip away at McDonald's Corp's leadership in the U.S. quick-serve breakfast market. Restaurant Brands executives credited new menu items like Burger King's A1 ultimate bacon cheeseburger and Tim Horton's dark roast blend coffee for helping drive sales gains in the quarter. The results contrasted with those of McDonald's, which has been fighting to win back customers and reported one of its worst years in decades with eight straight months of global same-restaurant sales declines. Comparable store sales grew 4.1% at Tim Hortons and 3% at Burger King in the quarter. On a constant currency basis, system-wide sales grew 7.4% at Tim Hortons and 7.7% at Burger King. Last month, the company cut some 350 corporate jobs at Tim Hortons as part of the post-merger reorganization. "We executed our organizational restructuring up front, which really focused on back office, corporate areas where we said we'd see overlap in the business," Chief Executive Daniel Schwartz told Reuters. "We have no plans to have any more job cuts." Restaurant Brands, which has more than 19,000 restaurants in 100 countries, posted a net loss attributable to shareholders of $514.2 million, or $2.52 per share, in the fourth quarter ended Dec. 31, in its first quarterly results after the merger. The company reported total revenue of $416.3 million in the quarter.

Global Dividend Payers

AT&T Inc has urged the U.S. Federal Communications Commission to relook into bidding rules for spectrum, saying licenses should not go to "speculators or stockpilers". Dish Network Corp, the third-largest pay-TV provider in the U.S. and the owner of undeveloped wireless spectrum, was a surprise winner in the record-setting sale of airwaves for mobile data in January. Dish itself did not win any licenses, but had invested in bidding partners SNR Wireless LicenseCo LLC and Northstar Wireless LLC, which bid a total of $13.3 billion. "Auctions should be designed to ensure that licenses go to those willing to deploy networks – not speculators or stockpilers," AT&T's Vice President of Federal Regulatory, Joan Marsh, wrote in a blog post. AT&T was the top buyer at the auctions, bidding a total of $18.2 billion to win licenses of so-called AWS-3 (advanced wireless spectrum).

Bunzl revenue was £6,157m and operating profit was £430m, both in-line with consensus, but EPS was 86.2p, 3% ahead of consensus 83.8p. Dividend was 35.5p for the year, ahead of consensus of 34.3p, management has pitched year /year growth closer to constant currency growth than the 5% actual. The tax reduction in 2014 relates to a one-off resolution; expectations for 2015 remain unchanged at an ongoing effective rate of 28%. Decent full-year numbers; revenue and EBITA are in-line but earnings are c3% ahead of consensus, due to lower tax, and dividend per share is 3.5% above expectations. In addition, two further acquisitions have been announced which add c£20m to annual revenues. Organic growth was 2.7% in the year, which implies a Q4 rate close to 3% which bodes well for 2015. A total of 17 acquisitions were made during the year adding annualized average revenue of £220m, or 3.6% revenue growth on 2013. Regionally, operating profit in Europe was 2.7% ahead of expectations delivering an EBITA margin of 9.0% (group 7.0%), 20bps above estimates due to stronger gross margins and tight cost control. UK & Ireland op profit was also ahead by 4.3%, margins were 23bps above estimates. North America was in line and Rest of World was slightly behind on revenue growth but in line on operating profits. The outlook statement is positive on North America and the UK but more cautious on Continental Europe and Rest of the World, although management expects growth in both in 2015. The acquisition pipeline continues to be described as promising.

Deere & Co. reported 1Q 2015 EPS of $1.12 vs. consensus of $0.83. Tax rate was a ~$0.07 tailwind. Total equipment revenue of $5.61bn was above estimate of $5.45bn and total equipment segment operating margin in the quarter was also above forecast (7.4% vs. 5.0%). Equipment revenue reflected better than expected revenue in Construction & Forestry ($1.52bn vs. $1.45bn) and to a lesser extent Ag & Turf. Both Ag & Turf margin (6.6%) and C&F margin (9.6%) were above forecast. . Equipment operations free cash flow for the quarter was -$1.0bn on net cash from operating activities of -$817mn and capex of $184mn. Management raised its FY 2015 full year equipment ops operating cash flow forecast to ~$3.3bn (from previous guidance of ~$2.9bn). Equipment operations cash and cash equivalents and marketable securities were $2.9bn as of FY1Q15 vs. $3.3bn at FY4Q14. Deere lowered its FY 2015 net sales guidance to down ~17% from its previous forecast of down ~15% (guidance now assumes a 3 point headwind related to currency translation vs. the previous forecast of 2 points). Net income guidance is now ~$1.8bn vs. the previous forecast of ~$1.9bn. Deere also updated its FY15 Ag & Turf net sales outlook to down ~23% from its previous forecast of down ~20% (guidance now assumes a 4 point headwind related to currency translation vs. the previous forecast of 2 points); C&F net sales guidance is unchanged at up ~5% y/y (but now assumes a 2 point currency translation headwind vs. the previous forecast of 1 point). Deere continues to execute well in a difficult global agricultural environment, and while we can't say we're inspired by a relatively lackluster guide for the balance of the year we also don't think it dramatically changes our view that 2015 EPS could be a bottom and Deere should continue to execute well in a more difficult agricultural equipment environment.

Diageo : Nielsen Spirits Scanner data for January showed Diageo's US sales up a sector-leading 8.7% from flat the previous month (Source:Financial Times)

Johnson & Johnson – Medical device maker Boston Scientific Corp said it has agreed to pay $600 million to Johnson & Johnson to settle a long-running lawsuit over Boston Scientific's 2005 acquisition of rival Guidant. J&J had sought more than $7 billion in damages after it lost a bidding war to Boston Scientific following an initial deal to buy Guidant for $21.5 billion in 2005. J&J accused Guidant of breaking that deal. Boston Scientific, which admitted no liability by Guidant under the settlement, said it expects to record a pre-tax litigation-related charge of about $600 million in its fourth quarter 2014 results. J&J will permanently drop its lawsuit.

Nestle, the world's largest packaged foods maker, forecast sales growth around 5% this year, at the low end of its long-term goal, as it grapples with deflation in Europe and a slowdown in China. Nestle's long-term model calls for growth of 5% to 6%, but it fell below that in 2014, coming in at 4.5%. Chief Executive Paul Bulcke called the results "solid" in a tough environment. He said 2015 would be similar, but that Nestle still aimed for growth "around 5%". The goal includes improvements in margins, helped by cost savings and efforts to turn around the struggling North American frozen foods business and food business in China. Nestle also proposed to raise its dividend to CHF2.20 per share from CHF2.15. Net profit rose CHF4.4 billion to CHF14.5 billion in 2014, helped by price increases, cost-savings and the profit realised on the sale of shares in L'Oreal. Nestle's 2014 growth was greater than that of Unilever and Mondelez International. The global consumer goods sector has toned down its expectations as once hot economies like China and Brazil have slowed, and cost-conscious shoppers in Europe and North America remain cautious. Full-year organic sales rose 5.4% in the Americas, 1.9% in Europe and 5.7% in Asia, Oceania and Africa.

Rheinmetall – Germany's Rheinmetall reported a 76% jump in fourth-quarter orders at its problem-hit defence division. Rheinmetall warned twice on profits last year as Germany cracked down on arms export licences, forcing it to abandon plans to supply a combat training centre for Russia and delaying other projects. The company said problems at its defence division, which also included a fine to settle a Greek bribery investigation, led to higher-than-expected charges of €58 million in 2014. It posted a 2014 adjusted EBIT of €102 millions, below its target, despite a strong performance at the automotive division, which made a record EBIT of €184 million. Sales rose 6% to €4.69 million versus a Reuters analysts' forecast of €4.64 billion. Demand for products to reduce pollution and emissions helped sales at its automotive division. The market focused on a fourth-quarter defence order intake of €1.22 billion as well as a 10% currency-adjusted sales increase in automotive. Germany is the world's third-largest arms exporter behind the United States and Russia, but the government endorsed a more stringent application of export rules last year after arms sales to non-aligned states soared.

WalMart reported 4Q 2015 Earnings Per Share of $1.61, $0.08 ahead of consensus. Walmart US comparables grew 1.5%, above 0.6% estimate. Operating margin fell 5 bp, driven by a 24 bp increase in SG&A as a percentage of sales, partially offset by a 21 bp improvement in gross margin. WalMart is investing to improve customers' shopping experience at its US stores, but the increase in full-time hourly wages is a tiny $0.15 (1.2%). Investments are also being made in training, but in the near term WalMart is unlikely to see benefits that offset the higher expenses, especially since these investments will continue into 2017. In addition, the acceleration in US comps in 4Q 2015 was primarily a result of lower gas prices and easy weather comparisons. The company also continues to invest in e-commerce, yet sales growth has moderated. The expectation is that lower-income consumers could increase their spending because of higher minimum wages or more rapid job growth caused by a decline in the overall unemployment rate. Customers may also respond favorably to a more pleasant shopping experience at WalMart, driven by better-trained store employees, improved in-stock positions, and an overall enhancement of service. Spending should also moderate over time on items like the compliance-related investigations.

Economic Conditions

US – US industrial production increased in January, which was a welcome change from December's 0.3% retreat. However, the 0.2% improvement fell just short of the expectations for a 0.3% advance in the month. Activity was supported by a 2.3% rebound in utilities, but also by manufacturing, with manufacturing output growing by 0.2% in the month. Oil and gas drilling dropped by 10% in the month, which caused the whole mining industry to retreat by 1.0% in January. The US capacity utilization remained flat in the month, at a 79.4% level, significantly below the expected 79.9% level.

Housing activity continues to be robust in the US, with both building permits and housing starts above 1 million annualized units. January levels were roughly in line with the expectations, at 1.07 million units annualized housing starts, though marginally lower than December's 1.09 million units level; while building permits, at 1.05 million units annualized, were marginally ahead of December's 1.03 million level, but just short of the expected 1.07 million units reading. The US homebuilders' mood continues to be optimistic, though somewhat less so in February, as the National Association of Home Builders' (NAHB) housing market index retreated 2 points to 55.0 from 57.0 in January, also falling short of the expectations.

U.S. initial claims improved in the week leading up to Valentine's Day. The number of first-time claims for unemployment insurance fell 21k (more than expected) to a 2-week low of 283k in the week of February 14th, which also happens to cover the survey period for payrolls. This is the first improvement in three weeks, although it doesn't erase the run-up over that time. But as we know, there is lots of volatility on a week-to-week basis. When you smooth it out, the 4-week moving average fell to 283,250, the lowest since October 2014 and, prior to that, since July 2000. That's a long time. Continuing claims rose, however, up 58k to 2,425k in the week of February 7th. But that is still low.

Canada – Canadian retail sales dropped 2.0% in December, with weakness spread across the retail categories, likely affected by the pull forward effect of the Black Friday's discounts. Most affected were the electronics and appliances and the clothing categories. Core retail sales, which excludes sales of autos, were even worse, down 2.3% in the month.

UK employment: Average weekly earnings roses 2.1% year/year while the claimant count dropped 38.6k (biggest fall since June).

Bank of Japan: kept its monetary stance unchanged last week to "conduct money market operations so that the monetary base will increase at an annual pace of about 80 trillion yen." The decision was again not unanimous as Kiuchi voted against it. While BOJ continues to sound optimistic on growth outlook, it took a more cautious view on consumer spending as it upgraded its view on Japan's factory production and exports outlook. We believe the BOJ is unlikely to do more quantitative easing for now and probably will choose to maintain the status quo position at least in 1H 2015.

Greece: Markets awaits Greece to provide its list of reforms today after tentatively agreeing with its EU counterparts and the IMF last Friday. The Greek government will like lay out plans to reform tax evasion, overhaul the countries labour laws, and shrink the civil service. The ECB, IMF and the European Commission will then decide whether these plans will be sufficient to provide the EUR

7.2 Billion in financial aid that will allow Greece to complete the rest of its bail-out program. If approved by the Troika, it will then go to the national parliament of the 18 member states to approve, and in essence, approve Greece to remain solvent.

Russia: Moody's follows S&P and cuts Russia's debt rating to junk. Russia's rating falls to Ba1/Not Prime (NP) from Baa3/Prime-3 (P-3) and keeps a negative outlook. Moody's cites the continuing crisis in the Ukraine, the recent drop in oil and foreign exchange shocks for its rationale in cutting the rating. RUB is down 3.5% this morning with more losses likely after Russia returns from the holiday Monday.

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 1.46% and the UK's 2 year/10 year treasury spread is 1.37% - 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 3.76% (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 15.33 (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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