Market Commentary

PORTLAND
INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Baytex Energy – reported a broadly in-line set of Q4 results. Production averaged 92,220 boe/d (85% oil and NGL – natural gas liquids) during Q4/2014, a record level and an increase of 53% over Q4/2013, and 78,321 boe/d for the full-year in 2014, an increase of 37% over 2013. Strong production was offset by lower realized oil prices. Most of production growth came from Eagle Ford, up 12% over previous quarter and 37% since acquisition. Corporate operating net-backs were $26.80 boe (pre-hedging or $33.28/boe including heges) driven by Eagle Ford at $31.58/boe versus Canada at $23.45/boed. Year-end reserves were up by 36% to 432 million boe. Fourth quarter cash-flow per share at $1.47 was in-line. The company divested a small 1,250 boed (natural gas heavy) non-core play in the quarter. Baytex maintained guidance for 84,000 to 88,000 boed on an exploration and production budget of $500 to $575 million.

Pacific Rubiales – provided a fourth quarter 2014 operational update and highlighted additional operating cost reductions. The company estimated its Q4 net oil production at 135 mbbl/d - 138 mbbl/d. Sales volumes in the fourth quarter are expected to be in the range of 160 to 164 mboe/d. Pacific Rubiales expects oil price realization in the fourth quarter to be in the range of $66 to $68/bbl. The decline in global oil prices was partly offset by cost reductions co achieved in 2014 and the company expects the cost cuts to continue into 2015. Operating costs are expected to continue to decrease in 2015 along with a rise in production of light and medium crude oil. Q4 heavy oil production from the Rubiales field was lower due to continued restricted water disposal capacity.

Financial Sector

Barclays - All in Profit Before Tax at £2,256m. There is no recognizable consensus. Large one-off items, actually drove an overall attributable loss. Including (i) a £935m charge for revaluation of a government bond portfolio (using gilts not Libor for valuation); (ii) a £750m charge relating to F/X investigations; and (iii) a further £200m charge for Principal Protection Insurance. Adj. PBT of £6,667m was -2% (-£138m) light against consensus £6,805m. We like Barclays as a straightforward bank that says it as it is – too often under-rewarded by the market. That said, an all-in attributable loss for the year and a c7% adjusted Return On Tangible Equity, clearly leaves a lot of room for improvement – even in a world where money is free. However, at 0.9x prospective 2015e tangible book, the shares are far from expensive in my view.

BlackRock Kelso Capital – reported higher-than-expected Q4 net investment income. Adjusted net investment income rose to $0.26 per share from $0.22 a year earlier, exceeding the $0.20 average estimate. Revenue, comprised of interest, fee and dividend income, rose to $37.9 million from $33.0 million a year earlier compared to the $32.3 million consensus estimate. Unadjusted net investment income fell to $3.5 million or $0.06 per diluted share from $4.6 million or $0.07 a year earlier. Earnings per share rose to $0.73 per share from $0.42. BlackRock will distribute an unchanged quarterly dividend of $0.21 a share. The dividend carries an annual yield of 9.5%.

BNS reported diluted cash EPS of $1.36, against consensus expectations of $1.37. Canadian Banking (which now also includes Canadian wealth and insurance as well) and Global Banking & Markets (which now also includes Asian corporate and commercial lending) were ahead of expectations while International Banking (which now includes International wealth and insurance as well) was slightly below forecasts. Credit remains solid with total bank Provision for Credit Losses ratio of 42bps. The Core Equity Tier 1 ratio was 10.3%, down from 10.8% last quarter, hurt in part by an increase in liabilities relating to employee benefits due to a decline in interest rates. The bank increased its quarterly dividend by about 3% to $0.68 and increased its NCIB by 4 million shares to 16 million.

Citi -: Costco announced last Monday that it entered into a new co-brand credit card program agreement with Citi and an acceptance and co-brand incentive agreement with Visa. Citi will be the exclusive issuer and Visa will be the credit card network in the U.S. and Puerto Rico beginning April 1, 2016. The implementation of the agreements will be subject to Citi purchasing the existing Costco co-brand credit card portfolio. Citi is therefore replacing AMEX as the exclusive issuer of Costco co-brand cards. The Costco spend was estimated to be ~$92bn for American Express, with ~$56bn of the total card purchases occurring outside of the Costco store. Estimates assume annual revenues for Citi of ~$440mn from this relationship. This assumes Citi captures all of the spend currently at the Costco stores and 50% of the revenues from the Costco card on transactions that occurred outside the store. In addition, we are assuming a discounted interchange fee of well below 100bps. Also, Citi announced it has agreed to sell OneMain, its subprime consumer finance unit, for $4.25b, and expects deal close in 3Q. Citi plans to use a portion of proceeds to retire high cost funding, and expects pre-tax net gain from sale and these actions of ~$1b. The sale could result in some loss of run-rate EPS, but frees up Risk Weighted Assets and capital. It is estimated a sale could free up ~$1.4-1.5b capital, in addition to gain. We don't expect OneMain-specific capital return as part of CCAR, but potentially later this year. This sale is in our view a continuation by Citi to simplify and de-risk – which over the long term should enhance ability to return capital.

ING selling its remaining stake in Voya Financial. ING announced last night that they are selling its 19% stake in Voya (its old US insurance company) in a public offering. The sale would reduce its stake to zero. The total consideration based on market price yesterday of NN of $44 would be cEUR1.8bn. But the more important aspect of the deal is that it would unwind the Basel 3 deduction (for financial holdings) and on a fully loaded basis, would enhance the Core Equity Tier 1 ratio by c50-60bps. Together with the stake of NN sold in February, ING should now have a Fully Loaded CET1 ratio of c11.5% (vs that 10.5% at FY 2014). This is not unexpected, and in fact we expect ING to continue selling down the NN stakes, but this acts as a timely reminder of how ING is now well capitalised ING.

JPMorgan Chase will pay $50 million as part of a national settlement agreement to compensate homeowners in bankruptcy over the use of robo-signing and other improper practices, the Department of Justice said last Tuesday. The settlement includes cash payments, mortgage loan credits and loan forgiveness to more than 25,000 homeowners, the department said in a statement. As part of the proposed settlement, JPMorgan Chase agreed to pay $22.4 million in credits and second lien forgiveness to about 400 homeowners. Another $10.8 million will be paid in the form of credits or refunds to more than 18,000 homeowners. (Source:Reuters)

Royal Bank of Scotland has set a target of cutting as many as four out of five jobs in its investment banking unit by 2019, the Financial Times reports, citing two people familiar. Although RBS declined to comment to the FT, the report expects the cuts are part of restructuring plan with a large proportion of the jobs RBS will cut being in U.S. and Asia.

US Banking - The Federal Reserve last week released its 2015 Stress Test Results for domestic banks with greater than $50 billion in assets. In the severely adverse scenario, which is intended to mirror a “worst-case” scenario, all of the 31 banks produced Tier 1 Common Ratios that exceeded 5%, passing Stage 1 of the two-part stress test process. The median Tier 1 Common ratio in the severely adverse scenario was 8.5% for the 31 bank holding companies.

Canadian Dividend Payers

BCE Inc – Telecommunications provider has reached a deal to transfer the longevity risk for $5 billion of pension plan liabilities to insurer Sun Life Financial Inc. The companies said the longevity insurance agreement is the first of its kind in North America. Under the deal, the Bell Canada Pension Plan will pay monthly premiums to Sun Life. In exchange, Sun Life will make monthly pension payments into the plan for the lifetime of existing pensioners. Longevity insurance plans are more common in Britain, where the pension plan for BT Group Plc struck a major deal in July to insure against the risk that its members live longer than expected. BCE Chief Financial Officer Siim Vanaselja said in a statement the deal would reduce the risk for its pension obligations without requiring additional cash contributions. Sun Life said it will reinsure a portion of the longevity risk to RGA Canada and SCOR Global Life.

Global Dividend Payers

Aggreko - Full year numbers are in-line with consensus. Divisionally in 2014, Power Projects saw 10% underlying growth (6% in 2H, 2% in Q4) and 8% from Local Business (6% 2H, 9% in Q4). Full year revenues came out at £1,577m, 1.6% ahead of Company consensus. Margins of 19.4% 20bp below were down our 19.6%. EPS at 82.5p was ahead of company consensus by 1.2%, due to a slightly lower interest charge. The announced dividend of 27.1p is in line with our estimates. Net debt increased to £494m, a little ahead of our £450m estimate. Management describes it as an encouraging start to the year, which we believe is notably better than expected as we braced ourselves for a big impact from lower oil prices on the US business and weak contract flow in Power Projects. In North America customers are reportedly reducing capex plans giving an “unclear” medium term outlook. Contract wins – 150MW from the already announced contract in Argentina, 95MW in Myanmar, plus some other smaller contracts. The 148MW Japanese contract, formerly expected to end, has been extended.

Jardine Matheson – reported underlying profit attributable to shareholders of $1.53 billion versus $1.50 billion last year. The company’s board is recommending a final dividend of $1.07 per share. For year ended December 31 revenue together with revenue of associates and joint ventures reached $62.78 billion versus $61.38 billion last year. The company’s outlook is cautious, seeing headwinds continue to put regional economies under pressure.

Novartis – U.S. regulators gave a green light to sales of the country’s first “biosimilar,” or copied version of a biotechnology drug, by approving Novartis’ white blood cell-boosting Zarxio. The drug contains the same active ingredient as Amgen Inc’s Neupogen, or filgrastim, which generated 2014 sales of $1.2 billion worldwide. The Food and Drug Administration said it approved Zarxio for the same five conditions for which Neupogen is used - preventing infections in cancer patients undergoing various treatments. The move had been expected after Zarxio, which is made by Novartis’ Sandoz generics unit, won unanimous backing from an FDA panel in January. Biosimilars have been available in Europe since 2006. The FDA, however, only received the authority to approve biosimilars with the passing of the Affordable Care Act, also known as Obamacare, in 2010.

Economic Conditions

US Nonfarm payrolls rose 295,000 in February, well above market expectations (235,000). While January's tally was lowered to 239,000, the three-month average remains high (288,000). Job gains were broad based, led by 66,000 new positions in leisure and hospitality. Granted, these aren't the best paying jobs, but the sector is benefitting from a surge in discretionary spending, partly due to cheaper fuel. The one sector not helped by cheaper fuel, of course, is the oil drilling industry, which shed 1,100 positions. More layoffs are surely coming, as the energy sector has announced over 36,000 job cuts in the first two months of the year. But other industries are more than capable of filling the slack, provided that consumer spending remains strong. Household survey jobs rose a light 96,000, but a decline was quite possible after the massive 759,000 gain the prior month. With the participation rate easing back, the unemployment rate dropped two tenths to a new cycle low of 5.5% (and we believe is well on its way to slipping below 5% at yearend). The broader U6 measure of joblessness, which includes involuntary part-time workers and discouraged workers, also hit new multi-year lows of 11.0%, and the duration of joblessness fell further.

Canada – Canada's economy advanced by 2.4% in the last quarter of 2014, ahead of the 2.0% consensus call. Much of the improvement, however, came from the build-up in inventories, in the fourth quarter, to the tune of 1.8%. The consumer sector grew a solid 2.0% while government spending and housing were also positive. Net exports and business investment were detractors from growth in the last quarter of the year.

Canadian balance of trade for January opened up to a $2.45 billion deficit, significantly lower than the expected $1.0 billion of deficit, as energy exports dropped 14.7%, leading to an overall exports retreat of 2.8%, while imports were flat at $45.06 billion.

Building permits in Canada were 12.95 lower in January, falling short of the expectations for a 4.3% retracement; whilst housing starts also posted a weak print, at 156,300 annualized units, significantly below both the expectations, at 180,000 annualized units, and January's 187,000 annualized units level, with weather likely playing a major role.

UK house prices fell by 0.1% in February as the pace of annual house price growth moderated to a 17-month low, according to the Nationwide house price index, highlighting the continued slowdown in housing market activity. The average price of a UK home in February fell to £187,964 from January, the first monthly fall since September, when prices also slipped 0.1%, the mortgage provider said on Monday. On an annual basis house price growth decelerated for the sixth consecutive month to 5.7%, down from 6.8% in January. The annual rate of growth has been declining every month since last June, when it hit a peak of 11.8%. (Source:Financial Times).

Financial Conditions

China's central bank cut interest rates a week last Saturday, just days before the annual meeting of the country's parliament, in the latest effort to support the economy as its momentum slows and deflation risks rise. The central bank said the 25 basis point cut in the benchmark interest rate to 5.35% - its second cut in just over three months - and a 25 basis point cut in the benchmark saving rate to 2.5% would be effective from Sunday. "The focus of the interest rate cut is to keep real interest rate levels suitable for fundamental trends in economic growth, prices and employment," the People's Bank of China (PBOC) said in a statement. "This does not represent a change in the direction of monetary policy." Reuters

The Reserve Bank of Australia left rates unchanged last week at 2.25%, surprising the 60% of dealers who saw a cut coming. They did however introduce an explicit easing bias and AUD shorts were cut quickly, sending the cross up 1%. Perhaps the Bank felt the recent surge in housing prices and building approvals outweighed the poor capex reading Feb. 25 and 0.2% increase in Jan unemployment rate – we still see them in a "wait and see" mode for the next meeting April 7th though, to gauge how the earlier Feb 2nd cut feeds into economic data.

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 1.50% and the UK's 2 year/10 year treasury spread is 1.30% - 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 3.75% (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 15.36 (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, BMO, Macquarie, Credit Suisse

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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.

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

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