# Market Commentary

PORTLAND INVESTMENT COUNSEL®

March 16, 2015

## News Highlights

### Energy Sector

Baytex Energy undertook a $500 million bought deal financing, in order to reduce its indebtedness, increase its working capital and finance its capital expenditure projects. The issues was well received by the market and the company ultimately raised $550 million by issuing 31.7 million shares at a $17.35 price.

Crescent Point Energy, Canada's fourth largest independent oil and gas producer, reported a jump in production of over 20% in the fourth quarter of 2014. The company, which focuses on light and medium crude production and is active in the Bakken fields of southern Saskatchewan, said average production rose 21% in the quarter to 153,822 barrels of oil equivalent per day (boepd). That helped cash flow from operations climb 7% to $572.9 million from $533.3 million a year earlier, despite the slide in oil prices. Crescent Point credited its cost cuts as well as increased output for its performance. The company slashed its 2015 capital budget by 28% to $1.45 billion in January, and said it would review spending plans again after the spring break-up. The company said it expected savings of 15% - 20% in some projects this year and said further savings could be achieved. Crescent Point also reported fourth-quarter net income of $121.4 million, up from a loss of $13.7 million in the year-before quarter. The company's cash flow per share was up 7% year on year to $1.28 for the last quarter, roughly in line with the expectations.

Crescent Point reported 2P (proven plus probable) reserves 7% higher, including a 4 million boe addition due to the company's waterflood program and a doubling of reserves in the company's prospective Torquay field. The company's total 2P reserves are 807 million boe, including about 8 years of primary recovery drilling inventory. Production of crude and liquids rose by more than a fifth to 140,767 bpd but average selling prices plunged 16% to $69.51 per barrel. The company's 2014 netback was $50.4/boe, while Q4 closed at $43.8, including hedges. Crescent Point hedged 56% of 2015 production at $89 and 33% of 2016 production at $84. The company increased its financial flexibility with the addition of $1 billion of a bank syndicated facility; increasing total credit facilities to $3.6 billion, of which only roughly 35% was drawn. Crescent Point re-iterated its commitment to both dividends and growth.

Northland Power – The Ontario Superior Court issued a decision on March 12 in relation to Northland Power's dispute with Ontario Electricity Financial Corporation (OFEC). The court ruled in favour of the power producers in its decision. The company is assessing the implications of the decision in relation to possible retroactive recoveries and future payments. The decision requires OFEC to recalculate amounts payable under agreements; it is also subject to OEFC's right to appeal until April 13, 2015.

Pacific Rubiales – Ecopetrol announced it would not renew a contract in mid-2016 under which Pacific Rubiales operates the field, putting the latter's 65,000 barrel per day share of output back in the Colombian state-run company's hands. Pacific Rubiales still has the option of submitting a new proposal to continue operating the field under different terms, Ecopetrol said, without specifying. Ecopetrol, which produces more than 70% of Colombia's million barrels daily output, also takes on challenges by resuming control of the mature field, with large investment required to avert a slide in output.

Royal Dutch Shell is pulling back from its shale projects in South Africa due to lower energy prices and delays in obtaining an exploration licence for the onshore Karoo Basin. Chairman Bonang Mohale, who said the company was going to a "low cost holding position", told Reuters oil prices would need to be between $60 to $80 a barrel and South Africa would need to present "excellent commercial terms" for the company to resume its operations. An estimate by the U.S. Energy Information Administration, gives South Africa the world's eighth biggest shale reserves, with the potential to transform an economy that has always been a big oil and gas importer.

### Financial Sector

Citigroup Inc. is close to selling its Central America retail units to Banco Popular Espanol SA and is seeking $1.5 billion, people familiar with the matter said. The sale price probably will slightly exceed the units' book value, the person said, adding the deal isn't finalized and could change. Citigroup is selling its retail operations in Costa Rica, El Salvador, Guatemala, Nicaragua and Panama as Chief Executive Officer Michael Corbat seeks to simplify the company and exit markets with poor returns.(Source:Bloomberg)

Credit Suisse: Tidjane Thiam (currently CEO Prudential plc) will replace Brady Dougan as CEO from end-June. While the candidate is somewhat of a surprise the fact of Dougan leaving is less so given reports at the end of last year the co. had approached BAER CEO Boris Collardi. We believe the move will be positively received although likely to be a lot of speculation on the timing and it seems no coincidence the change comes as Swiss regulators are finalizing new capital rules. While we believe Dougan did a good job steering Credit Suisse through the crisis relatively unscathed the subsequent muddle- through approach to capital has become an increasing source of discontent with shareholders. As of 4Q Credit Suisse's capital ratios are the lowest of the Investment Bank peer group by some margin (10.2% Core Tier1, 2.4% leverage). Mgt announced a further deleveraging plan in 4Q but Thiam's arrival could precipitate a more aggressive approach and a capital raise can't be ruled out in our view. Getting to a 5% leverage level would require ~CHF5bn additional capital on current balance sheet levels or 15% of market cap.

Lloyds Bank: The UK government has taken advantage of a recent jump in the share price of Lloyds Banking Group to sell a further £500m of its stake, after the lender announced it was restarting its dividend for the first time since the financial crisis. Lloyds said last Monday that UK Financial Investments had sold another 1% of Lloyds stock following the launch of a programme in December to drip-feed shares into the market. The government now owns 22.9% of the bank, down from a peak of 40% in 2009. (Source:Financial Times)

Prudential: Along with Full Year numbers they have announced that current CEO Tidjane Thiam will leave in June to join Credit Suisse. Mike Wells the US CEO is being speculated on as the likely replacement. We think this is a good choice; he seems dynamic, smart and gets on well with investors. We believe he has done a good job at managing the US business through the credit crisis and came out as an industry leader. In terms of the Full Year 2014 numbers Prudential have reported 2014 IFRS operating profit of £3,233m, 2% ahead of consensus, and +14% yoy. The dividend of 36.9p is +10% yoy, +2% vs consensus of 36.1p.

Royal Bank of Scotland is exploring options for the sale or wind-down of its corporate and institutional banking operations in central and eastern Europe, the Middle East and Africa (CEEMEA). Under a drastic shrinking of its investment banking operations, RBS said last month it will pull out of 25 countries, while substantially cutting its presence in Asia and the United States within its corporate and institutional banking business. The bank was considering selling or winding down operations in the Czech Republic, Russia, the Middle East and Africa, Kazakhstan, Turkey and Poland, a source familiar with the matter told Reuters. The bank will exit Romania and Slovakia, the source said. RBS's credit exposure to the CEEMEA region, as well as central Asia and institutions such as the World Bank, was £19.1 billion in 2013, representing 3.4% of its £573 billion of credit risk assets, according to its annual report for that year. It had £1.7 billion of exposure to CEEMEA's oil and gas industry at the end of 2014, its 2014 annual results show. In the Middle East and Africa -- where it has offices in the United Arab Emirates, Qatar and South Africa -- it is gauging interest for the sale of its corporate debt and debt capital markets business, but will wind down the operations if buyers are not found.

UBS AG lowered its previously reported net profit for 2014 after reaching a $135 million settlement of litigation in which investors accused Switzerland's largest bank of colluding with rivals to rig the foreign exchange market. In its annual report, UBS reduced its fourth-quarter profit by 105 million Swiss francs and boosted its litigation reserves to 3.05 billion Swiss francs. The $135 million settlement resolves antitrust claims by hedge funds, pension funds and other investors that UBS impeded competition in the currency markets by conspiring to manipulate the WM/Reuters Closing Spot Rates, known as the Fix, in chat rooms, instant messages and emails. JPMorgan Chase & Co, the largest U.S. bank, in January agreed to pay $99.5 million to settle.

## Canadian Dividend Payers

Barrick Gold Corp may put its Chilean copper mine on the block as the Canadian miner tries to meet an ambitious debt reduction target, the Financial Times reported. A sale of the Zaldivar copper mine could raise more than $1.5 billion and draw interest from Chinese companies looking to acquire resources as well as private equity firms such as Mick Davis's X2 Resources. Davis headed Xstrata before its 2012 sale to Glencore. X2 has raised $5.6 billion and is hunting for mining deals. Barrick has not said it would definitely sell Zaldivar but the miner would find a substantial offer difficult to resist for what has become a "non-core commodity", the newspaper said, adding that some of Barrick's investors have also urged a divestment of the mine. The miner said last month it was focused on gold mining and had no plans to boost its copper operations. Barrick also said it would sell its Porgera gold mine in Papua New Guinea and its Cowal gold mine in Australia to help reduce net debt by at least $3 billion by the year-end. Barrick has total outstanding debt of $11.65 billion. The Zaldivar copper mine, one of Barrick's key assets, is located next to Escondida - the world's largest copper mine.

## Global Dividend Payers

ABB – Swiss engineering group has won a 1.1 billion crown ($134 million) contract from Norway's Statoil to supply power equipment for the giant Johan Sverdrup oilfield in the North Sea, 200 kilometres offshore. Statoil will supply the first phase of Sverdrup with power from the shore and ABB will deliver equipment for both the offshore platform and the onshore facility. Statoil added that total cost of the power supply to phase 1 of the projects is around 6 billion crowns. ABB will deliver the equipment in the first half of 2017. The company also announced it won a $130 million cable system order from Walney Extension wind farm, one of the world's largest.

## Economic Conditions

US – The US consumer seemed to be affected by the winter blues as retail sales for February unexpectedly dipped 0.6%, adding to the 0.8% retreat recorded in January. Most of the retail categories, including autos, electronics, home furnishings and furniture, building materials, health care and general merchandisers experienced weakness in the month. Harsh winter weather in parts of the country was likely to have played a role, however, the University of Michigan's latest preliminary reading (month of March) of the US consumer sentiment was also weaker than expected, at 91.2 index points, compared to 95.5 and February's 93.6. Both the 'current conditions' and the 'expectations' components of the composite index were lower in the month. A rebound of gasoline prices as refineries are entering their scheduled maintenance season is also likely to have affected the consumer's mood.

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The US industrial production inched higher by 0.1% in February, just short of the expected 0.2% improvement and only partly offsetting the lowered January read. As expected, the oil and gas drilling activity was badly hit, down 17% in the month, but manufacturing also retreated, by 0.2%, led by a 3.0% and 3.7% drop in motor vehicles and parts as well as computers and office equipment production, respectively. Utilities helped offset the weakness with a 7.3% surge. The US capacity utilization followed the pattern, surprising on the downside to a 78.9% level, compared to January's 79.1% and expectations for a 79.5% reading.

Canada – Canadian economy lost 1,000 jobs in February, marginally better than the expected 5,000 payroll reduction, as a 35,000 part-time jobs decline more than offset a robust 34,000 full-time jobs addition. The headline unemployment rate moved to tenths higher, to 6.8%. The gains were led by education and healthcare, while manufacturing and natural resources lost most of the positions. Also gains were recorded in the public sector, with the private sector shedding 29,000 jobs.

Canadian existing home sales were up 1.0% in February, as the strong Toronto market, up 10.6% year on year, seconded by Vancouver's, more than offset the weakness being felt in Calgary and Edmonton markets. The Canadian new housing price index meanwhile retreated 0.1% in January, surprising on the downside, though the change is admittedly modest.

## 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 1.44% and the UK's 2 year/10 year treasury spread is 1.22% - 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 3.86% (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 16.00 (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, Macquarie, Credit Suisse, KBW

Source:Thomson Reuters, Bloomberg, Macquarie, Credit Suisse, KBW



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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