Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Suncor Energy Inc – Canada's largest oil and gas company said that it expected to largely implement operating budget cuts of $600 million to C$800 million in 2015, ahead of the previously projected two-year period. The company had said in January that it would also cut about 1,000 jobs, freeze hiring and slash $1 billion in capital spending in response to falling crude oil prices. The reductions in operating budget will begin to be reflected in first quarter costs. The Calgary-based company also said that the workforce reduction by about 1,000 employees and contractors was largely complete. Suncor said it produced 598,000 barrels of oil equivalent per day (boepd), excluding production from Libya, in the first quarter ended March 31, up from 545,300 boepd a year earlier. Production from the company's oil sands operations, the country's largest, averaged about 440,000 barrels per day (bpd), up from 389,300 bpd a year earlier.

Financial Sector

Ares Capital Corporation – announced the upsizing, extension and price reduction on its revolving credit facility. The firm amended and extended its senior secured revolving credit facility with 20 banks, including 19 existing lenders and one new lender. Total commitments to facility grew from $1.25 billion to $1.29 billion, whilst the final maturity of facility was extended by one year to may 4, 2020. The stated interest rate on the facility is LIBOR plus 1.75%. Ares, through wholly owned financing subsidiaries, has two other revolving funding facilities with total commitments of $940 million.

Bank of England released the key elements of the 2015 stress test last Monday. As expected, relative to the 2014 test, the thrust of the stress scenario has shifted to international and trading exposures, with a particular focus on Asia and the Euro area driving deflationary pressures. Conversely, the UK economic parameters look less severe than last year with peak-to-trough GDP -3.2% (2014 -3.5%), house prices -20% (2014 -35%), unemployment +3.5% (2014 +4.6%) and a fall in interest rates. There is a more negative influence on corporate exposures based on an externally driven decline in profits and peak-to-trough equity prices -36% (2014 -30%). The duration of the stress is longer than previously at 5 years (2014-19), the hurdle rate is the same at 4.5% Core Equity Tier 1/Risk Weighted Assets and a 3% leverage requirement has been added. Publication of the results will be in December 2015. On first sight, the release looks supportive to Lloyds Bank given its predominant UK exposures. On the other hand, the Asian stress and commodity assumptions (eg, oil price to U$38 per barrel) will shift attention to Standard Chartered and HSBC relative to last year. All of the large listed banks (Barclays, HSBC, Lloyds, RBS and Standard Chartered) will participate, together with Santander UK and Nationwide. The list is the same as 2014, with the exception of Co-Op, which will not be included.

HSBC - Bloomberg report HSBC is is falling short on its agreement with the U.S. to clean up operations after clients laundered drug money and did business with terrorist regimes, according to two people familiar with a report from the bank's monitor. The 1000 page report raises doubts about how effective the government's use of deferred- and non-prosecution agreements is in reining in wrongdoing and changing culture at the world's largest banks. Separately, HSBC reported an update on issuance of $2.45B contingent convertible securities. They announced that all of the conditions precedent under the Securities Terms agreement have been satisfied and $2.45B 6.375% Perpetual Subordinated Contingent Convertible Securities were issued on 30-Mar in accordance with the terms of such agreements. Application has been made for the Securities to be admitted to listing on the Official List of the Irish Stock Exchange and to trading on its Global Exchange Market

Royal Bank of Scotland has confirmed the disposal of its internationally managed Private Bank and Wealth Management, Coutts International, to Union Bancaire Privee, the family owned Swiss private bank for about $600m-$800m. The price will be determined based on AUM at closing (CHF32bn at end-2014), with RBS only confirming that it expects to receive a premium, resulting in a modest benefit to capital. This deal is only a small part of the downsizing of the group, which is expected to complete by 2019. Royal Bank of Scotland executive Rory Cullinan is to leave its investment bank at the end of April, the lender said only a month after putting him in charge of the business. Cullinan, who was previously in charge of RBS's "bad bank" and had been praised for running down its unwanted assets more quickly than expected, was promoted to executive chairman of its Corporate and Institutional Bank on Feb. 26. A source familiar with the matter said that his departure is because of a disagreement over the implementation of strategy.

Activist Influenced Companies

Cable & Wireless (CWC) – announced that it has completed the $1.85 billion acquisition of 100% of the equity of Columbus International Inc. Including debt, the overall acquisition is valued at $3.025 billion. CWC chief executive officer, Phil Bentley, said the company would begin immediately to roll out the $1.5 billion of investments planned under the integration. Jamaica has already approved the merger of local assets, and Trinidad also signalled on March 13 that it would approve the deal once CWC agreed to divest its 49% stake in Telecommunications Services of Trinidad and Tobago. CWC has said it would comply. On Friday, Barbados also announced its conditional approval of the merger, whilst the decision of other jurisdictions - Grenada, St Lucia and St Vincent & the Grenadines - was still pending.

In markets where regulatory approval is outstanding, no funds will be spent until approval is granted, the company indicated. CWC said the integration of the companies will involve a review of all brands, including LIME and Flow, but he said no decision has yet been made about how these would be treated. CEO Bentley said the merger adds “significant fibre-optic submarine backhaul and terrestrial broadband and TV capability” to CWC’s mobile and legacy copper networks, and that the complimentary B2B (business-to-business) divisions in each company “can now offer geographical focus and a wider product offering in the faster-growing Latin American markets.” CWC operates in 16 countries throughout the Caribbean and Latin America under main brands Mas Movil in Panama, LIME in most of its Caribbean markets, BTC in The Bahamas and Cable & Wireless in Seychelles. Columbus operates in Trinidad, Jamaica, Barbados, Grenada, St Vincent & the Grenadines, St Lucia, and Curacao under the brand name Flow, and in Antigua under the brand name Karib Cable. It also operates Columbus Business Solutions. Its subsidiary, Columbus Networks, operates throughout 42 countries in the greater Caribbean, Central American and Andean regions. Under the merger deal, three Columbus shareholders - Brandon Paddick, John Risley and John Malone - will take a 36% stake in CWC.

Mondelez – Billionaire activist investor Nelson Peltz said on Thursday he is not pushing Mondelez International Inc to do a big deal. “I’m not pushing them to do any transaction,” Peltz said during an interview on CNBC. Peltz is a Mondelez board member and a principal of hedge fund Trian Fund Management LP. Peltz also said he wants Mondelez to continue improving its profit margin, sales and market share.

Global Dividend Payers

BHP Billiton Ltd (Australia) and BHP Billiton plc (UK and South Africa) shareholders will vote on 6 May on the demerger of South32 from BHP Billiton. If approved, which we expect South32 will begin trading on 18 May. The demerger will be effected through an in-specie dividend on the basis of one South32 share for each BHP Billiton share. On the commencement of trading, shareholders of BHP Billiton Ltd, the Australian register of the Dual-Listed Company, will own 60.3% of the equity of South32 and we expect 100% of the equity to qualify for Australian indices, which should create demand in Australia for South32 equity. However, shareholders of BHP Billiton plc (the London-registered stock and the secondary Johannesburg register) representing 39.7% of South32’s equity, will likely find that their South32 shares are not included in any UK or European index, and will not (initially at least) be included in any Johannesburg indices. As a result, we anticipate that there could be stock flow from the UK (and to some degree from Johannesburg) to Australia. We expect that many UK index funds and quasi-index funds will need to sell their South32 shares in a relatively short period of time and believe that by the end of 2015 as much as 25% of the equity of South32 could move from London and Johannesburg to Australia.

Dufry: It has understood for quite some time that Dufry would want to buy World Duty Free (WDF) whenever the opportunity would arise as Dufry never tried to hide its interest. Over last weekend the expectation became reality. Dufry has bought 50.1% of WDF for EUR 10.25 / share, valuing WDF’s equity at EUR 2.6bn and its enterprise value at ~EUR 3.6bn. The total consideration will be financed by new debt (~40%) and equity (~60%). Combined, the company will generate CHF 7.8bn in sales and > CHF 1bn in EBITDA, and control ~24% of the airport retail market. The acquisition of World Duty Free (WDF - no. 6 globally) brings Dufry the clear market leader position. Dufry/WDF is twice as big as no. 2. With the acquisition of WDF, Dufry will increase its market share from 14% to 20% in the travel retail market (24% in airport retailing). WDF has its strength in UK (44%) and Spain (25%), Americas is 18%, Asia 7%. Synergies of EUR 100mn are expected till FY17 (restructuring cost of EUR 50mn) - impact on cash EPS estimated to be >+10% in FY 2017. Dufry has offered EUR 10.25 per share (= EUR 2.6bn), below last Friday’s closing (EUR 11) and together with WDF’s debts of EUR 0.97mn it gives an Enterprise Value of EUR 3.6bn, representing an Enterprise Value /EBITDA 2015 of 13x (incl. synergies 10x), clearly higher than recent acquisitions (Nuance and HDF 10x).

Kingfisher – Europe’s biggest home improvement retailer, plans to close 60 B&Q stores in Britain over the next two years at a cost of £350 million, as it is trying to right-size its business. New Chief Executive Veronique Laury announced the closure of 15% of B&Q’s space as she set out her vision for the group, which also trades as Screwfix in Britain and Castorama and Brico Depot in France and other countries. Britain’s home improvement sector is overspaced and last October Homebase, the country’s number two player, said it would close a quarter of its 323 stores by 2018 as Britons had fallen out of love with home improvement. The announcement came as Kingfisher posted a 7.5% fall in 2014-2015. It said that while it was encouraged by Britain’s improving economy, it remained cautious on the outlook for France, its biggest market. Management was hopeful there would be little impact on jobs due to staff leaving and redeployments to other B&Q and Screwfix stores. The group is this year opening another 60 Screwfix stores - which are smaller than B&Q outlets, and targeted at the building trade rather than ordinary consumers. CEO Laury also plans to close a handful of loss-making stores in Europe, develop unified garden and bathroom businesses and start a revitalisation programme for big stores across Europe. Kingfisher made a pretax profit of £675 million in the year to Jan. 31, in line with analysts’ expectations but down from £744 million in 2013-2014. The fall reflected slower sales in France since the summer of 2014, £34 million of adverse currency movements and £22 million in charges for entering new countries. Sales rose 2.9% on a constant currency basis to £10.97 billion. Kingfisher ended the year with net cash of £329 million, is paying a dividend of 10 pence, up 1%, and plans to return a further £200 million to investors during 2015-2016.

Novartis – Swiss drugmaker is digging deeper into cancer immunotherapy, one of the hottest areas of drug research, through a tie-up with Aduro Biotech worth up to $750 million. The move comes as the privately owned California-based biotech group prepares for a $86 million initial public offering (IPO). Novartis will make an upfront payment of $200 million and Aduro could be eligible for a further $500 million if drug projects pan out. In addition, Novartis is making an initial equity investment in Aduro of $25 million, with a commitment for another $25 million at a future date. The move gives Novartis access to Aduro's experimental STING (Stimulator of Interferon Genes) technology, which is a next-generation method to harness the body's immune system to combat cancer. In a further sign of its commitment to cancer immunotherapy, Novartis also launched an immuno-oncology research group led by Glenn Dranoff, a leading cancer vaccine expert from the Dana-Farber Cancer Institute in Boston.

The Basel-based group is already working on a number of immunotherapies to fight cancer. Mark Fishman, president of the Novartis Institutes for BioMedical Research, said the new technologies could be used both on their own and in combination with other medicines. Aduro will lead commercialisation and will book sales from any eventual products in the United States, with Novartis taking the lead in the rest of the world. The companies will share in profits in the United States, Japan and major European countries, with Novartis will paying Aduro a royalty for sales in the rest of the world.

Seven & I Holdings: Full Year 2015 results came as no surprise, but seem slightly negative: Operating Profit rose 1.1% Year on Year or JPY3.67bn to JPY343.3bn (compared to guidance of JPY356.0bn). This was below expectations the Bloomberg consensus of JPY346.9bn and the Nikkei preview of JPY345.0bn published on 18 March. In percentage terms the shortfall was relatively minor and came as no surprise, but since over the last few quarters results have consistently been below expectations, our impression is slightly negative. In 2016, we expect the slump in sales following the hike in the consumption tax to run its course, and since we expect earnings in the convenience store business to remain strong, we believe just the cyclical recovery at Ito-Yokado, which has been doing poorly, will lead to an improvement in earnings visibility. Over the past year, the share price has performed in line with TOPIX, but has been a laggard compared to the major retail stocks and we believe there is scope for a review of the share price. The main reason for missing 2015 projections was performance at Ito-Yokado and in the distance sales business. While there are structural problems in the general merchandising business, since the external environment was unfavorable following the hike in the consumption tax, we believe it should be easy to cover this again through the convenience store business in future. However, we feel we still need to see further restructuring at Ito-Yokado and Nissen to support a full-scale review of the share price.

Tesco announced that it will merge its Polish, Czech, Hungarian and Slovakian management teams. The Central European operations will be overseen by David Morris, currently CEO of Tesco's Czech unit, whilst Ryszard Tomaszewski is retiring from his CEO position at Tesco Polska after 20 years with the company. A Tesco spokesman stated that the aim of this consolidation is to improve efficiency and to "make business stronger", and that job cuts will be one consequence of the consolidation.

Toyota Motor will reportedly spend about ¥150 billion to build two new car plants in Mexico and China, ending a three-year freeze imposed after fast expansion burdened the world's biggest auto maker with too many idle production lines. Reuters reported in January that plans were in place for new plants in the two countries, awaiting a green light from top management that has now been given. President Akio Toyoda had been cautious about expanding after Toyota was hit by a capacity glut following the global financial crisis. The new plants will raise Toyota's annual production capacity by nearly 300,000 cars, the two people said - 200,000 in Mexico and up to 100,000 in China. The renewed expansion drive by Toyota will put more pressure on rivals such as General Motors Co and Volkswagen AG, in a global automotive industry still burdened by being able to make more cars than it can sell. The increase in global production capacity of up to 300,000 compares with sales of just over 10 million in 2014. The Mexican pant is set to build the next-generation Corolla sedan for the North American market starting in 2019. It would be Toyota's first passenger car plant in Mexico, where it currently only has a small factory building less than 100,000 Tacoma pickup trucks a year.In China, the world's biggest auto market, the new plant will be located in the city of Guangzhou. It will produce up to 100,000 Yaris subcompacts a year, starting in 2018.

Wal-Mart is looking at how it sources its products in an effort to reduce prices, especially as commodity prices fall globally. Speaking at a briefing for analysts and investors, Greg Foran, the company's US division head, said the Wal-Mart had launched several projects aimed at re-establishing price gaps over its rivals, including looking at how it works with its suppliers. "While we have pockets of leadership, in more competitive markets our gap is too small. And against some competitors we are beaten," said Foran, who took over the helm of the U.S. operations in August. He said that investments in lower prices would be balanced against the need to invest in customer service. Last month Wal-Mart announced that it was investing $1 billion to raise the wages of half a million store employees. Foran said there was room for improvement across its stores, including better stocking of shelves and rotation of fresh produce. He said improvements would be implemented so that "by the time we hit holiday season our stores are clean, tidy, well-merchandised and run by engaged associates. Today in the main we are not."

Economic Conditions

US trade deficit: For the second month in a row, the U.S. goods & services trade deficit narrowed….with the recent move leaving the deficit of $35.4 bln at its lowest level since October 2009.

U.S. pending home sales jumped 3.1% in February (or +12.0% year/year). So much for the weather impact. Remember: Mother Nature dominated in February, with the Midwest battered by a major winter storm early on, then record-breaking cold temps gripping the East, and an icy winter storm bore through the central states. Despite all of that, there was an 11.6% surge in contracts signed in the Midwest, a sizeable jump which will likely be reversed in March (due out April 29th). There was also a 6.6% increase in the West, while the South and the Northeast saw fewer signings.

US housing prices, as measured by the Case Shiller index for the 20 US metropolitan areas, were mildly ahead of the expectations in January, growing at a 4.6% year on year pace.

US payroll gains, at 126,000 positions, were significantly short of the expectations, which were calling for 245,000 additions, for the month of March. Private jobs creation fell short of the expectations as well, at 129,000 positions versus 237,000, while government shed 3,000 positions in the month. Manufacturing lost 1,000 payrolls, against expectations for a gain of 10,000 jobs. The headline unemployment rate kept steady at 5.5%. The average hourly earnings were ahead of the expectations by one tenth, up 0.3% in March. The relatively muted job growth report seems to be adding to the arguments for a measure approach to rate tightening and perhaps even delay the first hike.

The Institute for Supply Management's leading indicators were consistent with other indicators of business activity, which all point towards a short term soft patch for the US economy. The Purchasing Managers Index (PMI) was lower, at 51.50 points in March, relative to February's 52.90 reading, whilst its non-manufacturing counterpart, the NMI, was also lower, at 56.50 index points, albeit in line with the expectations.

The all-important consumer sector however, might turn out to be the deciding factor in near term economic expansion, and the early signs are encouraging. The US personal income for the month of February was 0.4% higher, ahead of the expectations and building on January's 0.4% advance; while the consumer confidence, as measured by the Conference Board, was also high in March, up to 101.30 index points, well ahead of the expectations and February's 98.80 reading. Part of the personal income report, the core personal consumption expenditures (PCE) price index, the US Fed's favourite inflation gage, inched one notch higher, to 1.4% in February.

Canada – The Canadian economy shrank by 0.1% in January, which was actually marginally better than the expected 0.2% contraction, as expansion in the utilities, agriculture and mining, oil and gas sectors were offset by weakness in manufacturing, transportation and hospitality.

Canada's goods trade balance improved to a deficit of 'only' $0.98 billion in February, from January's $2 billion deficit, as exports advanced 0.4% in the month, likely helped by the weaker dollar and a partial recovery in energy prices, while imports retreated by 0.7%, as imports of energy products, autos and industrial machinery all tapered in the month.

U.K. House prices are increasing less than half as fast as they were last summer, Nationwide Building Society has reported. At £189,454 on average in March, UK property values are 5.1% higher than a year ago. The annual pace of house price growth has been slowing for seven months in a row, and has reached less than half the rate of growth seen for much of last summer, when the year-on-year increase was in double digits. Nationwide said that all regions except the North of England have seen a further slowing in the annual pace of house price growth during the first three months of this year. London remains the strongest-performing region and Wales remains the weakest area in the UK for annual house price growth.

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 1.37% and the UK's 2 year/10 year treasury spread is 1.16% - 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 3.70% (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 15.41 (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, Credit Suisse, KBW, Barclays, BMO, Bernstein

Source:Thomson Reuters, Bloomberg, Credit Suisse, KBW, Barclays, BMO, Bernstein
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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