Market Commentary

PORTLAND INVESTMENT COUNSEL®

May 25, 2015

News Highlights

Energy Sector

Pacific Rubiales Energy Corp. : is seeking consent from its bondholders by close of business June 4th to approve amendments to the terms of the bonds so as not to trigger the change of control event which would necessitate immediate repayment of the bonds at 101% of the aggregate principal and to facilitate increased borrowing. In our view while the bondholders would likely want more than the 0.5% provided with the consent, it is recognized that the acquisition of the company would be untenable unless the bondholders agree. Also, the acquirer, the conglomerate Alfa, is investment grade rated, and as such the Pacific Rubiales bonds have – since the announced acquisition - seen their yields tighten, more reflective of the higher rated prospective new parent and tacit agreement, in our opinion, that they approve of the acquisition.

Financial Sector

HSBC has become one of the biggest global banks to say it will begin charging clients on deposits in a basket of European currencies. The decision underlies the extraordinary measures banks are taking to prevent their profit margins being crushed in the record low-interest rate environment. HSBC has written to other banks to warn it will start charging them for deposits in euros, Swiss francs, Danish krone and Swedish krona — all currencies of countries that have negative interest rates — at its UK, German and Hong Kong operations from this summer. It is the first UK bank to announce such charges following similar announcements from Swiss, German and Nordic institutions. (Source:Financial Times)

ING/NN Group - ING Group has made a capital injection into NN Group of €57 million by subscribing for newly issued shares for an aggregate amount of €57 million and ING has provided NN Bank a €63 million facility which allows the bank to draw additional Tier 1 capital. ING are fulfilling a commitment made to the EC on capitalising NN Group, to create a competitive bank in the Netherlands separate from ING Group. ING has achieved full compliance with the EC commitment on the capitalisation of NN Bank. The transactions have no material impact on the capital position of ING Group and no impact on the capital position of ING Bank.

Royal Bank of Scotland - Fitch, one of the three major credit agencies, hit the taxpayer-owned bank with a double downgrade. The ratings agency warned that the bank's profits are under "significant pressure" as it cut its credit rating by two notches from "A" to "BBB+". It came as Fitch upgraded Lloyds, praising the bank for its financial health, and kept HSBC's and Barclays' ratings intact.

Royal Bank of Scotland is paving the way for the Government to sell down its 79% stake in the lender by asking shareholders to vote on costs related to a sale at its annual general meeting. Philip Hampton, the chairman, has written to investors urging them to support the "related party transaction", which will see RBS cover the costs of publishing any documents needed for the share sale. Mr Hampton writes that RBS should have held the vote and got the green light from shareholders when the Government completed a £45bn bail-out in 2009 but this was "not obtained". He did not elaborate on why. (Source:The Telegraph)

Bank Foreign Exchange Settlements

JPMorgan announced its settlements with both the Dept Of Justice and the Fed relating to its foreign exchange trading business. It will pay a fine of $550 million to the DOJ and a fine of $342 million to the Fed. The combined fines of $892 million have previously been reserved for by the company. Thus, there should be no impact to earnings. Under the DOJ resolution, JPM will plead guilty to a single antitrust violation. However, the company indicated that with today's agreements and the remediation efforts it is making, the company is able to continue to serve its clients and does not anticipate future material constraints on its business activities.

Bank of America was not fined by the DOJ, but it did incur a civil money penalty of $205 million by the Fed. We think it is reasonable to assume that this relatively small fine is also covered by previous legal reserve builds.

Citi: announced it will settle FX-related litigation with the DoJ and Federal Reserve, and will also settle private class action claims. The $1.66B settlement includes a guilty plea and is in line with previous reports. In the circumstances it appears that Citi was able to resolve the FX investigation/litigation without additional expense impact.

Barclays. A total of U$2.4bn/£1.5bn which settles the FX and ISDA fix investigations with the CFTC, New York DFS, DOJ, Fed and FCA. It has agreed to plead guilty to a violation of US anti-trust law. The fine is inclusive of £39m in relation to the Non-Prosecution Agreement, but a breach of the NPA has not been declared. The fines imposed are covered by existing provisions of £2.05bn. However, the DFS order does not release Barclays from claims concerning electronic systems used in FX trading where investigations will continue.

Royal Bank of Scotland. A total of £0.4bn and £0.8bn inclusive of the fines in November. It has agreed to a guilty plea, subject to approval of the federal court in Connecticut. In addition, it has entered into a cease and desist order with the Fed relating to defined FX activities and has undertaken to submit enhanced plans. The fines are covered by the existing £0.7bn provision.

Global Dividend Payers

AT&T will reportedly stop offering traditional contract-based postpaid plans at third-party retailers and authorized dealer locations starting June 1. Customers signing up with AT&T at these locations will have to use AT&T's Next equipment installment plan if they buy a new device. For now, the company will continue offering traditional plans at its own stores and online. Also, AT&T plans to provide exclusive content such as videos and games that can be streamed onto mobile devices inside connected cars later this year. Chris Penrose, AT&T's Senior Vice President of Emerging Devices, said that the company is exploring business models that involve revenue sharing with automakers, content companies, and retail partners. AT&T currently has connected-car deals with eight automakers including General Motors, Audi, and Ford.

Cable & Wireless - The company reported full year results for the year ended March 31, 2015, i.e. not including any impact from the Columbus acquisition. Results were encouraging as the pre-Columbus business performed slightly ahead of the expectations, providing in our view a good starting base for the combined entity, however, Columbus' 2014 EBITDA is seen as a material miss and impacted CWC's view on the acquisition as 'dilutive' for next year (from 'neutral') and accretive subsequently.

- Revenue in the second half of the year was up 3% year on year, to $905 million, while EBITDA was up 10% from a year ago, to $308 million (34% margin).
- CWC guided for annual mid to high single digit top line growth in the three years to 2018 and significant EBITDA improvement (our view is potentially double digit?).
- Capex deployment of $252 million was ahead of schedule (Marlin network overhaul project is budgeted for $442 million), due to encouraging early improvement in key metrics, but management is guiding for a reduced capital intensity, to about 14% by 2018.
- In the Caribbean, CWC achieved its run-rate operating costs reduction of $100 million.
- Columbus results, to December 31, 2014, released earlier showed 18.5% growth in its top line and adjusted EBITDA of $258 million (43% margin). Columbus' capital deployment was also extensive at $182 million (30% of sales), while revenues suffered somewhat from a weak Colombian peso. Management sees the acquisition of Columbus as 'dilutive' for FY15/16 (from 'neutral' previously) and accretive thereafter.
- Management sees run-rate synergies of $85 million on the Columbus acquisition, including total capex synergies of $145 million for the next three years (re-confirmed).
- LIME (mobile) grew by 13% in the second half, including a 15% increase in customer base in Jamaica. Competition remained intense in Panama, with declining ARPU in the four player mobile market, while the enterprise business is lagging given current political arrangements in the country (minority government). For the full year, data revenue was up 25%, while voice was down 8% in Panama. LIME-wide data revenue was up 24%, while voice was up 5%.
- CWC is maintaining its USD0.04 dividend per share. Current level of payout is expected to be covered by cash flow by Fy17/18.

Economic Conditions

U.S. consumer prices came in exactly as expected, up a modest 0.1% in April (3rd increase in a row) or 0.2% below a year ago, the fourth straight sub-zero reading. Excluding food & energy, prices were a little stronger, rising 0.3% in the month (consensus: 0.2%), the biggest monthly increase since 2008, or 1.8% above a year earlier. Energy prices continue to limit the gains in prices, along with declining import prices (shown in apparel, although this also reflects other factors such as competition among retailers). After falling in March, food prices were flat last month, but we will likely see higher prices hatched in coming months as the bird flu outbreak slashes egg supplies. (Note: Eggs make up 0.13% of total CPI.) Meantime, we're still seeing some upward pressure in rents (four months in a row of +0.3% readings), while medical costs jumped 0.7% (biggest monthly gain since 2007), primarily in hospital services (+1.9%).

U.S. existing home sales fell 3.3% in April to 5.04 mln units annualized, the first decline since January and the lowest in two months although it follows a slight upward revision to March. There has however been three consecutive monthly gains in signed contracts (aka pending home sales), and, new mortgage applications jumped in both March and April.

Japan's 1Q-2015 GDP grew for the second straight quarter with a pace of 0.6%q/q, 2.4%q/q SAAR (much better than the market forecast 0.4%q/q or +1.6%q/q SAAR), while the 4Q-2014 GDP rebound was revised to a weaker 0.3%q/q, 1.1% (previously estimated at 0.4%q/q, +1.5%), reflecting improvement in private consumption (+0.4%q/q) & corporate spending (+0.4%q/q) it was somewhat of a relief that the impact from the April 2014 sales tax hike is dissipating. The stronger quarter was also helped by an increase in inventories which added 0.5ppt to the 0.6%q/q increase. External demand remains a question mark for the export-oriented economy as net exports shaved off 0.2ppt of growth in 1Q despite trade finally turning a corner for Japan which recorded its first trade surplus in March 2015 since June 2012.

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 earliest mid-late 2015. The US 2 year/10 year treasury spread is now 1.59% and the UK's 2 year/10 year treasury spread is 1.38% - 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 3.84% (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 4.6 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 12.13 (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 5 private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland GEEREF LP
- Portland Advantage Plus Funds
- Portland Private Growth

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, Bernstein, Credit Suisse, BMO

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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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