Market Commentary

PORTLAND INVESTMENT COUNSEL®

July 6, 2015

Energy Sector

Crescent Point Energy Corp, Canada's No. 4 independent oil producer, said it will acquire privately owned light oil producer Coral Hill Energy Ltd, operating in west central Alberta. The deal comes just days after Crescent Point's plan to buy another Canadian light oil producer, Legacy Oil + Gas, was approved by Legacy shareholders. "We are very pleased to have recently acquired Legacy Oil + Gas Inc and to acquire Coral Hill, as they both possess a large inventory of highly economic wells with significant waterflood upside," Scott Saxberg, chief executive of Crescent Point, said. Crescent Point already owns 8.7% of Coral Hills' outstanding shares. Under the terms of the agreement, Coral Hill shareholders will receive 0.0567 of a common share of Crescent Point for each Coral Hill share, and Crescent Point will also assume $132 million of net debt. Crescent Point said the deal values Coral Hill at roughly $258 million. Coral Hill produces around 2,600 barrels per day of light oil, primarily from the Swan Hills Beaverhill Lake resource play, in which it already partners Crescent Point. As a result, Crescent Point has upped its 2015 production guidance to 163,500 bpd. The company's capital budget remains unchanged at $1.55 billion. "Acquiring Coral Hill allows us to assume full operatorship of our Swan Hills assets and to increase our position in the highly economic core of the Swan Hills play," Saxberg said. Coral Hill's board of directors has unanimously approved the deal and is recommending shareholders to vote in favor of it. The deal is expected to close around Aug. 14.

Shell gives the green light to its Appomattox deepwater project in the Gulf of Mexico. The 650Mboe (barrels of oil equivalent) resource will be developed using a floating platform 80 miles offshore of Louisiana at the Appomattox and Vicksburg fields. This marks a significant addition to Shell's portfolio of deepwater assets in the Gulf of Mexico. First production is expected by the end of the decade and is estimated to peak at 175kboed. This represents 6% of Shell's 2014 oil and gas production. There is also potential to add volumes from tie-backs to the Gettysburg and Rydberg prospects, which are currently under review but could bring the total resource to more than 800Mboe.Total cost savings of 20% have lowered the break-even price to $55/boe. We estimate capex savings of around $2.7Bn could have reduced the total investment from $13.7Bn to $10.9Bn. Shell has indicated that these savings were achieved through supply chain efficiencies, design improvements, and by reducing the number of wells required for the development. At $70 oil Bernstein estimate $1.6Bn Net Present Value and Internal Rate of Return of 12.1%. Under this price scenario Cash Flow/boe will peak at $43.5 and average $30.9 over the project life, which is comfortably above Shell's upstream average of $29.6/boe in 2014. Royal Dutch Shell's plans to drill in Alaska are controversial, both from the perceived environmental risk along with a sizable financial spend on undiscovered resources at a time when the oil price languishes at close to $60/bl. The Alaska Outer Continental Shelf (AOCS) could contain several billion barrels of oil, and given Shell's position as the largest acreage holder in the area it could eventually provide the company with up to 500kb/d of production – a meaningful contribution. Commercially, we see the decision to drill as sensible given the investment already made, but we identify two further important criteria to be met. First, it is critically important that any wells can be drilled safely, given the sensitivity of the environment in which they are located. Second, any work would need to be supported by the indigenous population. Based on the plans presented it does appear that Shell has taken what we believe are unprecedented steps for containment in the unlikely event of a spill, with several separate layers of protection. Given the provision that it can be done safely, leading members of the Inupiat community have confirmed their support for the drilling programme, as evidenced by the formation of Arctic Inupiat Offshore, which has an agreement to enter the project.

Financial Sector

Commerzbank has agreed to sell two portfolios of commercial real estate loans with a face value of €2.9bn, or 17% outstanding loans as it continues to wind down its pile of unwanted assets. The lender will sell a European portfolio of loans with a face value of €2.2bn to JPMorgan and Lone Star, and a German portfolio with a face value of €0.7bn to Oaktree. Discount was only 3% but this is we believe the best performing part of the non-core portfolio. These sales mark the latest step in the group's arduous journey back to health, following an emergency investment of €18.2bn by the German government at the height of the financial crisis. Although Commerzbank did not disclose details of the transactions, it said that by releasing €1.9bn of risk-weighted assets, its loan disposals would free up €105mn of capital in the third quarter. (Source:Financial Times)

HSBC Holdings Plc said it was "monitoring the developments" in Greece after the country imposed capital controls and shut banks to avert financial collapse. HSBC's $6 billion of Greek assets is the most among European banks. The lender has cut its Greek assets from $7.3 billion since the end of 2013 and they account for 3.7% of HSBC's total net asset value, mainly comprised of loans to banks and the shipping industry, Sanford C. Bernstein & Co. estimates. Royal Bank of Scotland Group Plc has $376 million of Greek exposure, also primarily to banks and shipping. (Source:Bloomberg)

JPMorgan is revamping its prepaid debit-card program and the way it assesses if consumers qualify for a checking account. Under an agreement JPM has reached with NY AG Eric Schneiderman, JPM will give customers of its Liquid prepaid debit card access to online bill payment and let them use the bank's person-to-person payment service. JPM also recently changed the criteria it uses to screen applicants for checking accounts. Specifically, the bank changed its rules so it won't penalize potential checking-account customers who previously were frequent users of overdraft policies as long as the activity didn't occur within the previous 2 years. The move may make it easier for some customers to get checking accounts. Note, 8% of U.S. households use prepaid cards, but that number rises to more than 22% of households without bank accounts.

Royal Bank of Scotland - US regulators say RBS could be charged a possible $13bn fee related to mortgage back securities. Comes from report in May that court ruling against RBS saying it misled Fannie Mae (FNMA) and Freddie Mac (FMCC) in selling them shoddy mortgage bonds.

Activist Influenced Companies

Hertz – Ryanair, the Irish discount airline carrier, said it received notice that Hertz was ending its exclusive car hire supply agreement with Ryanair and had instructed its lawyers to pursue Hertz for breach of contract and damages. Hertz, which lists Ryanair among its 20 key partnerships alongside Lufthansa, Etihad Airways and others, said in a statement that it was confident in its legal position which it will pursue vigorously through the courts. The Irish airline said Hertz considered Ryanair's recent agreement with global distribution system (GDS) companies as a breach of their contract, which was not due to expire until 2020. GDS systems allow some customers to buy Ryanair flights through third parties, bypassing Ryanair's website where Hertz's car hire services were promoted. Ryanair in the past has exclusively sold tickets through its website. Hertz said it had been through lengthy discussions regarding the contractual dispute and that it regretted having to end the agreement.

Canadian Dividend Payers

Brookfield Property Partners LP – our updated 'company profile' on this company is now on our Portland website – under the 'Resources' tab

Global Dividend Payers

ABB & Philips announced yesterday that Philips' Hue smart bulb will be integrated with ABB's i-Jia smart home control system. The move extends the companies' cooperation in the professional space which targets mid-and small sized commercial buildings. Philips holds a number 2 consumer brand position in China. Also, last week ABB booked a $52m robotics order from Changan Ford for its newest plant in Harbin, designed to offer a high level of flexibility to respond to changing customer demand patterns.

Diageo hosted an innovation seminar at HQ yesterday last Wednesday. Management comments on trading in recent months suggested that Diageo's own group momentum has partly captured evidence from industry data (Nielsen AND NABCA) that US sales momentum has accelerated markedly in calendar 2Q. The ongoing march of craft brands (eg Titos in US vodka) is, we believe, a headwind in some categories but we ultimately see scale of distribution as a major competitive advantage to players like Diageo as long as innovation is delivering the right products in a timely fashion. Management claim that sales from new brands in the last 12 months should be of the order of £500m, a record figure, up about 15% on last year and c.5% of group sales. Launches in US bourbon ('Orphan Barrel', 'Blade and Bow') in bitters in Africa ('Orjin') are examples of recent activity. In Beer Diageo is also launching newer brands such as Diageo Blonde in the US and Hop House in Ireland. The challenge remains for all brewers to avoid significant cannibalisation of existing sales from newer "craft beers" but we see Diageo as in a slightly better position given its weaker presence in lager and the likely more limited collateral damage to Guinness.

Novartis - US law suit brought by US Dept of Justice (DoJ) alleges Novartis violated the false claims act using strategies to induce pharmacies to boost prescriptions of two of its drugs - Myofortic and Exjade. The 2013 civil complaint filed by the US government also refers to alleged unlawful contractual discounts and rebates to specialty pharmacies in connection with Tasigna, Glivec, and TOBI which the federal government declined to pursue. A separate suit alleges the company also paid for lavish entertainmemt for Dr's to induce them to prescribe Novartis cardiovascular drugs. This first raised its ugly head in 2013 and both are cases bought through whistle blower actions. The Government's Complaint alleges that since 2005, Novartis has engaged in a scheme of paying illegal kickbacks, disguised as "performance" rebates and discounts to pharmacies with influence over prescription decisions. Express Scripts' Accredo Health Group agreed to pay $45m to the DOJ to resolve allegations Novartis illegally offered patient referrals to Accredo from 2008 to 2012 in return for it recommending patients refill Exjade prescriptions. Unfortunately Novartis has a record: in 2010, it pled guilty to criminal violation of the Federal Food, Drug & Cosmetic Act (FDCA) in connection with Trileptal and agreed to pay a fine of $185m. The Federal government also alleged that Novartis violated the False Claims Act with respect to Trileptal, Diovan, Zelnorm, Sandostatin, Exforge, and Tekturna. Novartis entered into a civil settlement to resolve those allegations agreeing to pay $237.5m to the Federal Government and State Medicaid programmes. Of particular relevance to the current allegations Novartis also entered into a 5yr Corporate Integrity Agreement with the Office of the Investigator General of the Department of Health and Human Services, signed in September 2010 and therefore still valid. The DOJ is seeking $3.35bn in fines and civil damages and based on precedence set in previous cases against big pharma will in our view probably get it. As big as the fine is it will be small beer if the court (Southern District of New York) decides Novartis breached the corporate integrity agreement. This could result in Novartis being excluded from Medicare and Medicaid and other Federal Healthcare programmes. This is not an action that has been pursued against big pharma previously and could raise issues of patients rights to access drugs. But the DOJ will want to send out a clear message to the industry that these practices are not acceptable. It is conceivable that Novartis could face marketing restrictions or some drugs being taken off federal formularies. Novartis executives may also face exclusion or prosecution. Novartis disputes the allegations but in the past companies have settled. But it could be more costly to Novartis than just the fine and damages. There is no comment out of Novartis.

Tesco closes flagship store in Birmingham. According to the Birmingham Mail on 29 June, Tesco has announced the closure of its superstore near Five Ways Island in Birmingham, with the potential loss of 225 jobs. Opened in 1977, the Edgbaston store is one of Tesco's longest-established outlets in the West Midlands. Tesco said it had 13 Express stores, one Metro and one superstore within a 2.5 mile radius of the Five Ways site. The retailer has now started a 45-day consultation programme with affected staff, with Usdaw union officials involved. It also stated that it will offer them alternative roles within Tesco wherever possible. It is understand from the company that this is separate from the 43 store closures announced in January and has been prompted by the expiry of the lease, which Tesco chooses not to renew. We would not read too much into this decision, but we do believe it does illustrate to landlords that Tesco will not automatically renew leases if the store economics do not justify this.

Economic Conditions

US Nonfarm payrolls rose 223,000 in June. This was a touch lighter than the market expected, and revisions lowered the previous two-month tally by 60,000. Job growth has downshifted somewhat in the first half of the year, averaging 208k compared with 281k in the second half of last year. Still, it's up a hearty 2.1% in the past year and has topped 200k in 14 of the past 16 months, a run last seen coming out of the early-80s recession. Business services, health care and retail led job gains in June, while construction and government were flat. Although employment in the household survey shrank 56k (after a 272k increase in May), the unemployment rate took two steps down to a new seven-year low of 5.3%, as the participation rate plunged to a 37-year nadir of 62.6%. The jobless rate for those in their prime first-time home buying years (age 25-34) dipped to 5.6%, a plus for the housing market. (Source BMO Capital Markets).

S&P Case-Shiller home prices rose 0.3% in April and 4.9% year/year. The gain was lighter than expected, trimming the yearly rate. However, home prices continue to outrun family income, as more buyers are competing for a leaner supply of homes. Leading the nation was Denver (10.3% y/y), followed by pricey San Francisco (10.0%), Dallas (8.8%) and Miami (8.5%). Close behind are Tampa, Seattle and Portland. Most other cities are seeing moderate price gains. Nationwide prices have now recovered more than half of their correction, rising 32% since early 2012.

The UK economy grew faster than previously estimated in the first three months of the year, figures have shown. The Office for National Statistics (ONS) said the economy grew by 0.4% in the quarter, compared with an earlier estimate of 0.3%. Growth was boosted by a better performance from the construction industry than previously estimated. On an annual basis, the economy grew by 2.9% from the first quarter of 2014, up from a previous estimate of 2.4%. The latest revision is the third estimate for the period. (Source:BBC News).

Europe: A jump in lending to home buyers helped drive up credit in the Eurozone in May, European Central Bank data showed last Friday, as it reported the strongest such rise in about three years. Lending to Eurozone households and firms grew by 0.5% in May, the strongest signal yet that an ECB money-printing programme is starting to boost the economy, albeit only gradually. The rise, although modest, is nonetheless an improvement over the previous years where credit had been shrinking. (Source:Reuters).

Greece / Euro: Markets are broadly lower to start the week after Greek voters rejected austerity in this weekend's referendum. Greek markets remain closed until further notice and Finance Minister Varoufakis resigned, a move that might go some way to help restart talks with creditors. Going forward, Merkel/Hollande meet today to determine the euro-group's next steps ahead of tomorrow's meeting in Brussels. Then the ECB will reconsider the Emergency Liquidity Assistance (ELA) this week ahead of their next payment of €3.5bn due July 20th. We believe the major political issue is optics. European leaders do not want to be seen as capitulating, for fear of creating moral hazard. As such, we think they could use the referendum to argue a broader program, but one that would require the current administration agreeing to a national unity government. And if that fails, we think there is still a chance that the Greek government falls apart. However, beyond the politics, we also think that if Greece does not agree to European leader's proposals, those leaders are willing to allow a 'Grexit'.

Financial Conditions

Greece: Two possible options seem (i) debt write-down / default and stay in Euro; or (ii) leave Euro. Greek government appear to favour the former, with Tsipras declaring that he goes back to the negotiating table with Europe today. Resignation of Finance minister Varoufakis seen as evidence of Tsipras' willingness to do a deal. However, tough to see what deal can be done. Having urged voters to vote yes, it's difficult for Europe to then give them a better deal as would be clear implication for other peripheral nations. Key short term question is the Greek banks and their ability to survive. Speculation that ECB will maintain ELA programme at least until the heads of state meeting. Without ECB support, evidence suggests that they would collapse near term followed by chaos.

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 September 2015. The US 2 year/10 year treasury spread is now 1.70% and the UK's 2 year/10 year treasury spread is 1.43% - 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 4.08% (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 16.79 (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 7 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
- Portland Value 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,BMO, Credit Suisse, Mirabaud, Barclays, Bernstein

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PIC15-034-E(07/15)