News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments July 20th 2015

Energy Sector

BHP Billiton said it will take a $2 billion impairment on its U.S. shale operations - the third writedown in three years. The charge on fiscal 2015 financial results, pushed BHP's Australian shares to their biggest fall in a week -- down 1.7 percent to $26.64. The gas-focused Hawkville field in Texas accounts for the substantial majority of the charge to be included in results for the fiscal year that ended on June 30, which BHP estimates will be around $2.8 billion on a pre-tax basis. BHP announced a $328 million write-down on the Permian field in February and a $2.84 billion impairment on the gas component of the shale division in 2012. BHP's annual spending on its overall U.S onshore operations, which was set at $3.4 billion in fiscal 2015, will drop to $1.5 billion in the current year, BHP's petroleum division president Tim Cutt said in a statement. At an oil price of $60 per barrel and a gas price of $3.00 per thousand standard cubic feet per day (Mscf), overall, the onshore operations should be cash flow positive in the 2016 financial year, according to the company. BHP said efficiency gains in onshore drilling have reduced costs, which should help offset future price volatility in oil and gas prices. The dramatic drop in spending is likely to lead to revised production guidance for the year, which BHP said it will disclose in its July 22 quarterly operations report. Shale drilling is much easier to shut than conventional oil and gas wells as individual wells are smaller, making it a logical target for cuts.

US Energy – Reported by Bloomberg: America's refiners are running harder than ever to keep up with drivers. Refineries in the U.S. used 16.8 million barrels of oil a day last week, the most in government data going back to 1982. They are burning through stockpiles of crude that earlier this year were the highest since 1930 to provide gasoline to motorists who are driving at a record pace. The profit for turning crude into gasoline and diesel along the Gulf Coast, where about half of U.S. refineries are located, was the highest for this time of year in at least a decade yesterday, according to data compiled by Bloomberg.

Financial Sector

Barclays is considering an acquisition as the quickest way to gain the extra licence it needs to hive off its retail bank under new rules forcing big UK lenders to split in two. The plan underlines how Barclays faces a bigger challenge than rivals to comply with the so-called "ringfencing" law, which forces large banks to shift their retail operations into separate subsidiaries from other activities such as investment banking by 2019. John McFarlane, the bank's new chairman and acting chief executive, last week told executives working on the changes to either acquire an entity with a banking licence or apply for a new one. Barclays is the only bank that needs an extra licence for its ringfenced unit. (Source :Financial Times). Barclays may not pick its next chief executive until early next year, potentially leaving new Chairman John McFarlane in charge for at least eight months. McFarlane fired CEO Antony Jenkins last week and said he was in no rush to name a successor and will conduct a global search of internal and external candidates. He told staff the appointment may not take place until the spring, according to comments made at an employee meeting, people familiar with the matter told Reuters. (source Reuters).

Bank of America reported a strong headline number of $0.45 per share versus the Street at $0.36. The largest positive factor in the results was core expenses coming in at $13.8bn versus earlier estimates of $14.4bn.That said, core revenues were disappointing in the quarter at $21.2bn versus $21.6bn. In fact, after adjusting for rep and warranty recovery ($0.01), loan sale gains ($0.02), Mortgage Service Rights write up ($0.01) and Debt Value Add gains ($0.01), the core earnings are estimated to be about $0.39 per share – but still ahead of expectations which was driven by lower expenses ($0.03) and a larger-than-expected reserve release ($0.01) partially offset by lower-than-expected core revenues ($0.02). Litigations costs declined from $0.4bn to $0.2bn. Its headcount fell 1.4%. Operating revenues rose 1% y-o-y and gained 4% sequentially. Still, excluding market-related Net Interest Income, revenues decreased from the prior quarter. It posted a 8.75% ROE and 12.78% ROTCE. Tangible book rose 1.6% to $15.02 (1.2x). Bank of America repurchased $775mn of common stock (49mn shrs; ~20% of $4bn for CCAR 2015). Average diluted shares declined 0.3%. Common equity tier 1 capital (CET1) ratio was 11.2% (transition, standardized), up 10bps. On a fully phased-in basis, it was stable at 10.3% (standardized). Under the fully phased-in advanced approaches, it increased 30bps to 10.4%. Still, including Fed model modifications, it was a lower 9.3%. Its BHC SLR (liquidity ratio) was 6.3%. Average earning assets rose 0.6% with loans up 1.0% and securities increasing 0.3%. Period-end loans rose 1% with commercial up 4% and consumer up 3%. Its reported net interest margin increased 0.20% to 2.37%. Excluding market-related adjustment, its NIM fell 6bps to 2.22%. A +100bps parallel shift in interest rate yield curve is estimated to benefit NII by $3.9bn over the next 12 months.

Bank of Nova Scotia announced its intention to acquire Citigroup Inc.'s personal & commercial banking businesses in Panama and Costa Rica. BNS did not disclose any financial terms of the transaction but did note that the bank's Common Equity Tier 1 (CET1) ratio would fall by approximately 15 bps. We understand that BNS made this acquisition to bolster its market presence in these Central American economies. BNS presently has 51 branches and approximately Cdn$6.8 billion in assets within its Panamanian and Costa Rican operations. Based on the filings made by Citigroup subsidiaries in Costa Rica and Panama, it's estimated BNS will add 27 branches (BNS disclosed the branch count in its press release) and approximately Cdn$2.2 billion in assets. The Citigroup operations in these countries focused on credit cards, so BNS will increase its share of the credit card market to 15% in Costa Rica and 18% in Panama and rank number two in credit cards in each country.

Citigroup reported 2Q15 Earnings Per Share $1.51 ($1.45 ex Counterparty Value Add/Debt Value Add), well head of Consensus at $1.34. Lower credit costs and a lower tax rate drove the upside; revenues were stable; expenses remain tightly managed. Citi delivered a Return On Equity 9.1%. Continued evidence of a commitment to expense management, progress on strategic initiatives/profitability of Citi Holdings, use of Deferred Tax Allowance ($0.3Bn)/strong Core Equity Tier 1 ratio (11.4%), stable/favorable credit quality, much less in the way of legal and repositioning charges ($0.4Bn vs $0.4Bn in 1Q15 and $0.8n in 2Q14). However its Global Consumer business was again light versus forecast and trading was weak - as expected. Management updated their strategic initiatives: Japan retail, Peru, Nicaragua and OneMain ($32Bn in assets in total) sales all set to close by year end (3Q15 for OneMain). 2015 efficiency targets: Group 49-52% in Global Consumer Banking—expect results to come in ~52-53% with increased investment spend in 2H15; 53-57% for the Investment Bank—mgmt. expects to come in at the middle of the range. For Citi, we believe the first half of the year tends to be seasonally stronger, and credit costs are likely to increase from here, still mgmt are not waivering from their targets. Tangible book rose 3% to $59.18.

Goldman Sachs reported 2Q EPS of $1.98. Reported results included a significant litigation accrual of $1.45 Bn/$2.77 earnings per share impact largely related to settling Retail Mortgage Backed Securities working group issues—it seems this issue is now closer to resolution; paving the path for lower/normalizing go forward litigation costs. Ex. litigation, adjusted EPS of $4.75 was ahead of expectations ($3.89). At the core, Investment Banking and Investing & Lending were stronger than expected while FICC (fixed income, currency and commodities) was weaker. Although FICC underperformance was a lowlight, even with that, core firm-wide return on equity was still a peer leading ~12%–-this speaks to the resilience and diversity of the Goldman Sachs franchise. Total revenues of $9.1 billion (-1% yr/yr, -15% qtr/qtr) were better than our forecast–-Investing & Lending and Investment-Banking drove most of the positive variance. Core expenses were well controlled this quarter–compensation was accrued at 42% of net revenues (in line with estimates). Reported tax rate was elevated at 39% and impacted by non-deductible provisions for mortgage-related litigation. GS bought back $245 million of shares this quarter. Core return on equity (ex. litigation) was a ~12% in 2Q15. Investment banking revenues of $2.0 billion were much better than anticipated. Overall results were up 13% yr/yr and 6% qtr/qtr. On a sequential quarter basis, M&A (-15% qtr/qtr) declined from elevated 1Q levels while equity underwriting (+12%) and debt underwriting (+47%) were up. Management say there is higher backlogs compared to year ago levels but modestly lower relative to last quarter.

JP Morgan - reported 2Q15 EPS of $1.54 and consensus was $1.44. Relative to expectations, a lower than expected tax rate 25% (down from 28% last quarter) appears to be the main driver of the upside (added ~$0.07). Net interest income was a bit below expectations (asset contraction), while fee income and expenses both performed better. Trading was only slightly under late May guidance with equities outpacing Fixed Income, Currencies & Commodities. It made progress on its through-the-cycle objectives with a: 14% Return On Tangible Common Equity (15% target), 11.0% Basel III Tier 1 Common Equity ratio (target 12%), 58% adj. overhead ratio (target 55%), and 52% net payout ratio (target 55-57%). Importantly, legal costs were tame (Firm-wide legal expense were $291mn in 2Q15 ($0.05), down from $487mn last quarter) and it made progress on improving its balance sheet efficiency with loans up and low yielding categories lower. Expenses are also on track, while loan growth was solid and asset quality remains benign (though added to oil & gas reserve). The bank's outlook is to expect: YoY core loan growth to continue at 10%+/- (+12% y-o-y in 2Q); 2H15 Non Conforming Obligations to be consistent with 1H15 (0.58% in 1st half) and to expect FY2015 adjusted expense of $57B+/- ($56.8bn annualized in 2Q).

Nordea - Profit Before Tax €1,235m, +8% (+€88m) against consensus. Key driver includes better than expected Revenue +2% (+€55m) against consensus with Non interest income in particular +4% (€48m) ahead driven by better Fees and Other income (Trading profits in line). Elsewhere expenses look broadly in line whilst Impairments €103m were +€35m (-25%) ahead. Core Equity Tier 1 ratio 16.0% is +0.2% ahead of the 15.8% forecast. Net Tangible Asset per share €6.60 is +1% better than forecast and +5% over the quarter. Divisional analysis includes better Retail (+3%) and Wealth (+4%). Overall shares trading on 1.7x tangible which is currently the cheapest Swedish bank with a 14% Return On Tangible Equity with the shares yielding approximately 6%.

Royal Bank of Canada - Bloomberg reported that Banque Syz SA of Geneva is buying Royal Bank of Canada's Swiss unit as foreign financial firms retreat from Switzerland amid higher regulatory costs. The private bank, based in Geneva, had 10 billion Swiss francs ($10.5 billion) of client assets under management at the end of October, Royal Bank said in a statement. Terms of the transaction weren't disclosed. The deal includes offices in Dubai and also Miami, where Banque Syz wants to develop the onshore wealth and asset-management market, overseeing money for U.S. clients.

Wells Fargo reported 2Q15 EPS of $1.03 vs Consensus of $1.03 —materially lower credit costs offset somewhat lighter revenues (less trading; noise related to debt hedges); Return On Equity came in at an expected above-average 13%. Better than expected Net Interest Margin (2bps q/q improvement) with higher commercial loan yields (swaps helped) and lower deposit costs. Solid mortgage banking revenues, up 10% q/q on strong originations ($62Bn up 27% q/q); management indicate mortgage pipeline remains healthy into 3Q ($38Bn up 27% y/y). Non-interest revenues helped by q/q rebound in service charges, card and insurance. Solid loan (7% core growth, excluding $11.5Bn GE capital portfolio acquisition) and average deposit growth (8%). Credit costs were lower than forecast thanks to lower loss rates/more reserve release. Capital return--$2.9Bn net; Core Equity Tier 1 fully phased up to 10.5%. However, revenues q/q were flat; operating efficiency could have been better w/expense totals impacted by higher litigation accruals related to previously disclosed issues, for the most part. Management remains reasonably constructive with respect to the outlook for the U.S. economy, and with that credit quality and loan growth prospects.

Activist Influenced Companies

Herz Global Holdings – announced that it has filed its Annual Report on Form 10-K for the fiscal year ending December 31, 2014, which includes the restated results for 2012 and 2013 as well as selected unaudited restated financial information for 2011. In addition, the Company has filed its Quarterly Report on Form 10-Q for the period ending March 31, 2015. The Company is now up to date on all of its filings with the Securities and Exchange Commission and with its NYSE listing requirements. Hertz also announced progress on its planned separation of Hertz Equipment Rental Corporation (HERC) as well as its capital allocation, cost savings, capacity plans and fleet refresh. The Company reaffirmed its commitment to its previously announced $1 billion share repurchase program, and outlined its intent to execute consistent with announced year-end leverage targets, cash flow generation and other actions such as the contemplated sale of HERC operations in France and Spain, and the ultimate spin off of HERC. In late 2014, the Company established an annualized cost savings goal of $100 million by year-end 2015. It subsequently increased that goal to $200 million in February 2015. As a result of the Company's ongoing efforts to optimize costs and increase operating efficiencies, Hertz now expects to achieve $300 million in annualized cost savings by year-end 2015, with approximately $200 million being realized in calendar year 2015. The identified cost savings are expected to come largely from reductions in corporate and operations overhead, fleet management efficiency, and disciplined sales and marketing spending. Hertz expects to incur $30 million to $35 million of costs in 2015 in connection with these actions, of which $5 million to $10 million will be reflected in adjusted pre-tax income in 2015.

Syngenta – Hedge fund Paulson & Co has reportedly taken a stake in Syngenta AG and could push for the Swiss pesticide maker's board to accept a takeover offer from U.S. seed company Monsanto Co. Monsanto, the world's largest seed company, has made a $45 billion bid for Syngenta that the Swiss company rejected. The U.S. company has been hosting meetings with Syngenta's shareholders to win support for its takeover approach. Syngenta, slated to report first-half results on July 23, has said the suitor's proposed 449 francs per share offer undervalued the company, also dismissing as too low the $2 billion Monsanto offered to pay if the merger was agreed but failed to get regulators' approval. It has declined to give rival Monsanto privileged access to business data. Paulson & Co was said to have begun amassing its stake in June, but the size of the stake remained unclear. Swiss securities law requires public disclosure of stakes in listed companies of 3% and more. Paulson has in the past purchased shares of potential acquisition targets in contested mergers such as that of drug companies Mylan NV and Teva Pharmaceutical Industries Inc, the outcome of which remains unclear.

Global Dividend Payers

BHP Billiton we have updated our 'company profile' on this company which is now posted on our Portland website – under the 'Resources' tab.

Johnson & Johnson – reported a better-than-expected profit as sales of its older drugs helped to offset the impact of a strong dollar on revenue from outside the United States. The company raised its profit forecast for the full year, citing strong underlying business growth. The healthcare conglomerate raised its profit forecast to $6.10-$6.20 per share, from $6.04-$6.19. The company cut its profit forecast in April blaming the strong dollar. Excluding the impact of the strong dollar, international sales would have grown marginally, the company said. The company's net profit rose to $4.52 billion, or $1.61 per share, in the second quarter, from $4.33 billion, or $1.51 per share, a year earlier. Excluding special items, the company earned $1.71 per share. Revenue fell nearly 9% to $17.79 billion. Sales of Olysio, the company's hepatitis C treatment, fell nearly 70% to $264 million. The drug accounted for 7% of revenue last year. Sales of the company's medical devices fell 12.2% to $6.36 billion.

Economic Conditions

US retail sales surprised on the downside in June, with the headline reading retreating by 0.3%, against expectations for a 0.2% improvement and a 1.0% advance in May. Consumer sentiment, as read by the University of Michigan, weakened in July, though it is still relatively high by historical standards. The index retreated to 93.3 points from 94.6 in June, while both the 'current conditions' and the 'expectations' components of this composite index were lower.

US inflation depicts a fairly harmless pricing environment, with the headline reading at only 0.1% year on year, kept lower by significantly weaker energy prices compared to a year ago. The core reading, which excludes the effects of the most volatile price series, such as food and energy, was up one tenth, to 1.8% in June, with increases in housing and servicing costs offset by a reduction in medical care costs.

U.S. industrial production increased 0.3% in June, a bit better than expected (consensus was 0.2%). Manufacturing output was flat for the second month in a row, as the sector feels the "effects of dollar appreciation on net exports and the effect of lower oil prices on capital spending," as Fed Chair Yellen phrased it.

U.S. building permits, which surprisingly rose for the third consecutive month. Permits jumped 7.4% in June to 1,343,000 units annualized, the highest level since July 2007. This comes after two straight gains of nearly 10% per month. June's increase was well supported by both singles (highest since January 2008), and multis (highest since January 1990), and by all regions of the U.S Housing starts jumped 9.8% in June, also beating expectations to 1,174,000 units, the 2nd highest since November 2007. And, this comes on the heels of a net upward revision of 2.6% to the prior two months. The number of starts for a single-family structure fell, however, for the 2nd month in a row while the number of multis jumped 29.4%. So, in our view, as the population ages and as we see the younger demographic finding jobs and moving out, this growing trend toward multis continues.

Canada – Canadian inflation has seen a bit more impetus compared to its US counterpart, reaching 2.3% in year on year terms for its core reading, though, as Bank of Canada was quick to point out, much of it is the effect of a drastically lower currency, which makes the goods and services that Canadians import that much more expensive. It is expected as such, that much of the recent acceleration in inflationary trends to be 'temporary', as the currency stabilizes and the economy cycles through the higher import prices.

Greece - The Board of Governors of the European Stability Mechanism approved a decision to grant, in principle, stability support to Greece in the form of a loan program, paving the way for the institutions to negotiate a new Memorandum of Understanding. The EU finalized a EUR7.16bn bridge loan to Greece. Greece will use c€2.6bn out of the total bridge loan to clear arrears to IMF (€1.5bn missed installment, c€450m interest and c€650m to re-instate escrow account (used to pay May obligations to the fund). Greece are expected to pay the ECB €3.5bn (€4.2bn incl' interest) today. German Chancellor Merkel said she is prepared to consider debt relief actions for Greece, as reforms are implemented, but once more she ruled out a haircut. Tsipras proceeded to a widely anticipated cabinet reshuffle on Friday.

Italy - Reuters reports that Italian PM Mr. Renzi pledged to abolish property tax on 1st homes next year and make further tax cuts in the future, adding that his plan to bolster growth would not upset public finances.

Financial Conditions

The Bank of Canada cut its overnight rate by 25bps to 0.50%. The larger hit to economic growth over the first half of the year was viewed as widening the output gap and placing downwards pressure on inflation. The Bank remains of the view that stronger external demand will help the economy recover over the second half of the year and into 2016. Growth is not expected to consistently achieve an above-trend rate until Q4 and into 2016. This profile leaves the output gap closing in the middle of 2017. Note that the traditional measure of Canadian core inflation is expected to remain above 2.0%, further emphasizing the point that the Bank is looking at a wider measure of economic slack when gauging inflation risks. The Bank continues to eschew explicit forward guidance and instead noted that additional stimulus was required to ensure the output gap closed over the projection horizon (assumed to be the middle of 2017). A firmer US economy aided by a weaker currency is certainly a step in the right direction, in our view but there remains some chance of another cut later on this year if growth fails to live up to expectations.

UK Banks - Mark Carney, Governor of Bank of England, highlighted yesterday that "the point at which interest rates will have to rise is getting closer", in front of Treasury Select Committee. We believe any rise will be limited, given huge floating rate gearing of UK consumer. A rise in the US is more likely to be a positive for US rather than a rise in UK for UK banks, as US banks have 30 year fixed rate mortgages so rising rates gives banks the opportunity to expand margins with limited impact on volumes / credit quality. In UK, mortgages are floating rate or short term fixed.

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 1.68% and the UK's 2 year/10 year treasury spread is 1.44% - 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 4.09% (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 12.20 (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, Macquarie, Barclays, TD, NBFinancial

Source: Thomson Reuters, Bloomberg, KBW,BMO, Credit Suisse, Macquarie, Barclays, TD, NBFinancial
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.

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