



# PORTLAND ADVANTAGE PLUS - MCKINLEY FUND



**PORTLAND**  
INVESTMENT COUNSEL®

OWNERS. OPERATORS. AND INVESTORS.

(as at June 30, 2018)

	Net Asset Value Per Unit (as at June 30, 2018)	Annual Distribution Rate <sup>1</sup> (as at June 30, 2018)	PERFORMANCE (as at June 30, 2018)					Since Inception <sup>1</sup>
			1 Month	3 Months	6 Months	1 Year	3 Year <sup>1</sup>	
Portland Advantage Plus - McKinley Fund - Series A (CAD)	\$7.7029	7.8%	(8.8%)	30.8%	(3.0%)	(0.7%)	(25.5%)	(30.4%)
Portland Advantage Plus - McKinley Fund - Series F (CAD)	\$7.7077	9.1%	(8.7%)	31.2%	(2.4%)	0.4%	(24.7%)	(29.5%)
S&P/TSX Composite Total Return Index	-	-	1.7%	6.8%	1.9%	10.4%	7.0%	5.6%

## FUND FACTS

Fund Net Assets	\$3.2 million CAD
Inception Date	April 30, 2014
Fund Type	Alternative Strategies
Offer Document	Offering Memorandum
Eligible for PAC Plans	Yes, monthly minimum of \$500
Eligible for Registered Plans	Yes
Purchases and Redemptions	Monthly with no minimum investment term or redemption fee

## HOW THE FUND IS MANAGED

- Focused investing in a limited number of quality equity securities with an emphasis towards: large capitalization, high liquidity, relatively high dividend yields and long-term growth industries
- Leverage by purchasing securities on margin, ordinarily expected to be up to 50% of the Portfolio (market value of securities)

## KEY REASONS TO INVEST

- Income through targeting fully funded monthly distributions
- Above average return over the long term through a focused portfolio of quality equities, ordinarily selected from liquid, large cap, dividend-paying stocks at what we believe are attractive valuations
- Use of leverage to enhance the power of dividends
- Embedded product leverage is non-recourse to individual investors

## PORTFOLIO COMPOSITION

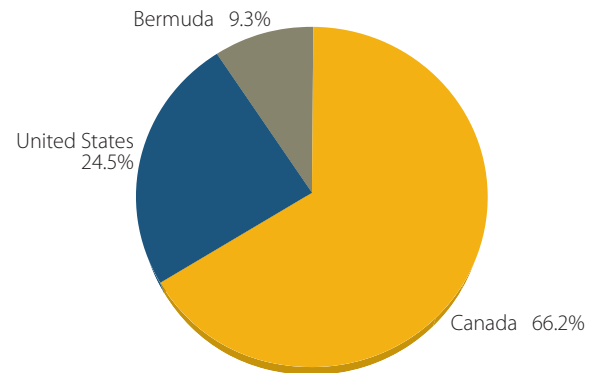
- Focused portfolio of select companies domiciled in long-term growth industries
- Emphasis on relatively higher dividend yielding securities
- Multiple sectors

## PORTFOLIO MANAGER

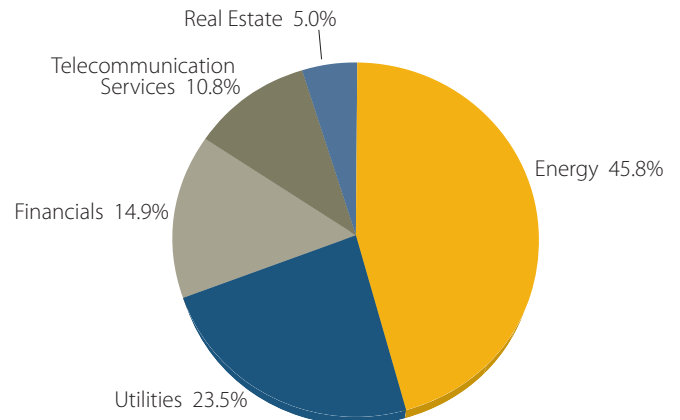
**Michael Lee-Chin**, B.Eng., LL.D (Honorary)  
Executive Chairman, Chief Executive Officer  
and Portfolio Manager

**Dragos Berbecel**, BComm., MBA, CFA  
Portfolio Manager

## Geographic Mix (as a % of total assets)



## Sector Mix (as a % of total assets)



## Asset Mix (as a % of net asset value)

Equities	302.9%
Other Net Assets (Liabilities) <sup>2</sup>	(1.1%)
Cash	(201.8%)

Leverage Ratio <sup>3</sup>	67.0%
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Top Holdings	Percentage of Total Assets	Dividend Yield <sup>4</sup>
Crescent Point Energy Corp.	18.2%	3.7%
Cardinal Energy Ltd.	10.7%	7.6%
Pattern Energy Group Inc.	10.3%	9.0%
Whitecap Resources, Inc.	8.4%	3.6%
Ares Capital Corporation	8.2%	9.2%
Baytex Energy Corp.	6.1%	0.0%
AT&T Inc.	6.0%	6.3%
TransAlta Renewables Inc.	6.0%	7.6%
Brookfield Property Partners L.P.	5.0%	6.6%
BCE Inc.	4.8%	5.7%
Brookfield Infrastructure Partners L.P.	4.3%	4.9%
IGM Financial Inc.	4.1%	5.9%
Northland Power Inc.	2.9%	4.9%
The Bank of Nova Scotia	2.6%	4.4%
Raging River Exploration Inc.	2.4%	0.0%

## FUND COMMENTARY (as at June 30, 2018)

For the period of March 31, 2018, to June 30, 2018, the Fund's benchmark, the S&P/TSX Composite Total Return Index had a return of 6.8%. For the same period, the Fund's Series F units had a return of 31.2%. Unlike the Index, the Fund's return is after the deduction of its fees and expenses. The Fund's outperformance was due to the Fund's energy sector (overweight) and financials (underweight) holdings positive relative contribution, partly offset by the negative relative contribution of the Fund being overweight and the selection effect in the telecommunications sector. The Fund's leverage amplified the outperformance.

The Fund's net asset value at June 30, 2018 was \$3.2 million.

The Fund has preserved its significant exposure to energy holdings, which, as at June 30, 2018, constituted 45.8% of the portfolio's assets.

Over the course of the past three months, the energy markets have continued their journey towards recovery, meandering around news related to the Organization of Petroleum Exporting Countries (OPEC)/Russia agreed production caps, production related developments in the U.S. shale (in particular the Permian basin) and weekly crude oil and refined product U.S. inventory levels. During the reporting period, the West Texas Intermediate (WTI), the North American crude oil price benchmark, advanced from \$64.94/barrel (bbl) to \$74.15/bbl, a roughly 14% improvement over the period. Considerable uncertainty still hangs over the levels of supply, notably having to do with the gradual removal of previously agreed OPEC/Russia group cuts under the U.S. administration's vociferous requests, combined with the level of supply constriction for Iran (U.S. sanctions related), Venezuela, Nigeria and Libya (political and social unrest).

The combination of synchronized global economic expansion

and lower oil prices led to a surge in crude oil demand, which is expected to continue through 2018, with the EIA (Energy Information Administration) estimating a further 1.8 million barrels per day (bbl/d) increase. Strong global demand and compliance with production targets by OPEC and non-OPEC partners (most notably Russia) led to consistent global inventory levels reduction throughout the period, trending towards the five-year averages. At the same time, it should be noted, the five-year averages likely underestimate the needed inventory levels given the very strong demand since 2013. Inventory levels in the U.S. have continued to trend below the five-year averages for both crude oil and refined product. The number of days of forward demand cover is at the lower end of the five-year period level range. Similarly, crude inventory levels in developed nations (OECD) have dipped below the five-year averages and are expected to be in a 70 million barrels deficit by the end of 2019.

The Manager continues to believe that the fundamental operations of our energy holdings remain robust while their economics are gradually improving in a recovering energy market. As such, we have continued to maintain elevated levels of exposure to the energy sector, through our oil and gas exploration and production holdings, and plan on doing so until we see a substantial recovery in the energy space. We've said many times in the past that low oil prices are unsustainable, and the significant curtailment in oil and gas capital expenditures, amounting to some \$1 trillion in overall spending cuts towards finding and developing reserves by 2020, has created the conditions for demand to catch up with supply. Global demand growth has accelerated over the 2015 to 2018 time horizon, at an average pace of over 1.6 million bbl/d per annum. This compares to the 2012 to 2014 period, when demand grew at a 1.2 million pace. Prices are steadily moving higher to adjust to the new demand and supply fundamentals, admittedly helped by the OPEC/Russia action, though also preserving upside risk, given the reduced inventory levels and spare production capacity.

The performance of our energy holdings during the quarter was a tale of two markets, as their stocks appreciated rapidly in advance of the U.S. Iran nuclear deal and reinstatement of the sanctions and trended lower subsequently in the run-up to the June 22 OPEC meeting. A softening of the prices available to Canadian producers due to transportation capacity availability (driven chiefly by the Keystone pipeline leak and subsequent capacity restrictions as well as Enbridge Inc.'s own capacity limitations and reduced rail availability) led to the performance of the Canadian energy and production oil and gas companies to fall short of the WTI's rate of improvement. The underperformance was worsened by the relative attractiveness of the U.S. oil and gas operators, which have been benefiting from a significantly more pro-business government stance as well as dramatic tax reductions. Some of the marketing restrictions have been addressed with crude by rail ramping up, but also increased local refining and gradual progress on volume through the Keystone pipeline. Hopefully, the Canadian government will make good on their promise to assist the extractive industry by facilitating the building of the Transmountain pipeline, which it ended up acquiring during the period. Coupled with a more disciplined approach by the oil sands producers, the recent developments led to an improvement in the level of the Western Canadian Select (WCS) differential. As upcoming quarterly reporting may reveal significantly improved profitability in the improved commodity environment, we expect our holdings to re-rate towards more normalized levels.

During the period, we had the opportunity to re-connect with the management of the energy companies held by the Fund and are re-



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assured by the measures undertaken to ensure optimum performance in the current environment. In addition, some major developments have unfolded in relation to Crescent Point Energy Corp. (change in CEO and some of the members of the executive team) as well as to Baytex Energy Corp. (announced merger with Raging River Exploration Inc.). At Crescent Point, we expect that the management change will, over time, remove one of the restrictions that has affected the relative stock performance for the company, namely the institutional investors' reluctance to invest in the company because of the former management's communication mishaps. Baytex and Raging River have agreed to a strategic combination of the two companies. The combined organization will be a well-capitalized, oil-weighted company with an attractive growth and free cash flow profile provided by its world class assets across North America. The combined organization will have an enterprise value of approximately \$5 billion and operate under the Baytex name. We see the transaction as a de facto acquisition of Raging River by Baytex in an all stock deal. If completed, the transaction has the ability to be a transformative deal for Baytex, further diversifying the company's exposure to crude oil markets through the addition of meaningful exposure to the emerging East Shale Duvernay oil field and, perhaps more significantly, meaningfully reducing the company's financial leverage, in the neighbourhood of 1.8x net debt to cash flows. We believe there are thresholds to be met in order to complete the transaction, in particular meeting the 66% support from the current shareholders of Raging River, which may not perceive the initial 10% premium offered for Raging River's share as attractive enough and/or be convinced of the benefits of the combined entity for the same. Should the deal be completed, the combined entity would be in position to produce between 100,000 to 105,000 barrels of oil equivalent per day (85% oil and natural gas liquids) by spending between \$750 million to \$850 million of development capital. This would lead to roughly \$1 billion of adjusted cash flow in the current pricing environment, upwards of \$400 million of free cash flow as well as a significant reduction in the financial leverage, as mentioned. During the period, we initiated a position in Raging River by converting some of our Baytex exposure, to take advantage of a temporary mispricing.

Outside of the energy space, the performance was mostly positive, driven by our financials, utilities and real estate holdings offset by negative performance of our telecom holdings.

From a macro-economic perspective, even though the exceptionally accommodative conditions are subsiding, bound by an accelerating economy and record tight labour markets, we are still in uncharted territory. The U.S. unemployment rate has dropped to levels not seen since the 1960s and wage growth has finally picked up, more recently to a 2.7% pace. Coupled with a 50% price increase in crude oil and its related derivatives, but also an increase in prices of some of the core goods and services, and, possibly, the imposition of tariffs, the ingredients for a more buoyant inflation environment are in place. As the U.S. Fed's feels compelled to continue on its tightening path and as the policy rates are approaching their current or longer-run equilibrium levels (which could be as low as 2.5%, i.e. three more 0.25% raises), the chance for a miscalculation increases. The fallout from a monetary policy misstep is unlikely to be significant in such a robust economic environment, however, when coupled with other potential policy errors, perhaps around trade tariffs; it could trigger more serious economic consequences. Improving economic prospects and a pick-up in the inflation pace has boosted our outlook for U.S. equity returns in nominal terms, though the risk factors mentioned earlier, in particular

trade related developments and the pace of monetary tightening, could materially affect the ultimate outcome.

Canada affords a somewhat different perspective. At 172% of disposable income, Canadian household credit continues to be stubbornly high, with the recently announced normative measures just about managing to put a dent into Canadian's propensity for accessing credit. The household credit growth slowed down at the end of 2017 and into 2018. On this background, recent retail sales growth has slowed down in Canada, and it is unlikely to recover, unless the diminished "wealth effect" from housing cooling down is replaced by either recovery in the resources space and/or acceleration of activity in manufacturing and services outside of the white-hot residential investment (housing) sector. Canada has seen significant losses in relative competitiveness as the U.S. administration implemented drastic pro-business measures, not the least of which being massive tax cuts and deregulation. Hopes for a quick NAFTA resolution, in advance of the Mexican elections and U.S. mid-terms, have dissipated. Canada is significantly more dependent on a positive NAFTA outcome due to foreign trade's larger contribution in the creation of GDP, but also because of its reduced relative competitiveness, slower economic growth and self-inflicted infrastructure shortcomings (chiefly lack of pipeline capacity). The country's abundant natural resources are presently severely restricted from reaching the fast growing Asian markets. In the U.S./Canada trade war, the warnings shots have been fired, with U.S. imposing tariffs on Canadian steel and aluminum imports and Canada retaliating with equal sized tariffs on a number of U.S. goods. It is expected that much of the steel and aluminum tariff hike would be absorbed through the value chain; however, a modest negative effect is likely to be felt in Canada. The still major (for Ontario and Canada) auto sector is next in line and is likely to be, albeit modestly, affected by the steel and aluminum tariffs. Failure to preserve NAFTA could mean falling back on the pre-NAFTA bilateral trade agreements, which are not particularly punitive to neither party and likely preferred by most businesses to the current state of uncertainty. The pick-up in inflation has marginally increased our outlook for nominal returns in Canadian equities, assuming the key risk factors, including outcome of trade negotiations, buildout of key infrastructure projects, the state of the housing market and the pace of monetary tightening, remain balanced.

As at June 30, 2018, based on the Fund's total assets, the top 5 sector exposure was constituted by energy 45.8%, utilities 23.5%, financials 14.9%, telecommunication services 10.8% and real estate 5.0%. The Fund makes use of low cost leverage to invest in a portfolio with a dividend yield that currently provides a substantial spread over the cost of borrowing. Based on settlement date activity, leverage was, as of June 30, 2018, 67.0%. As of the same date, the underlying portfolio's dividend yield was 5.6%, which, upon the application of leverage, translates into a gross 17.0% yield to the equity. The Manager believes that the stream of dividends generated by the underlying investments provide an attractive entry point for investors looking for equity based high yield. As of June 30, 2018, the Fund provides a 9.1% distribution yield for investors in the Series F units of the Fund.

Going forward, we believe that the Fund is well positioned to meet its investment objectives, which are to provide income and achieve, over the long-term, an above average return by combining a leveraged investment strategy with focused investment, primarily in a limited number of long securities positions.



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## RISK MANAGEMENT STRATEGY

The Manager relies on the following risk mitigation measures:

- Portfolio construction
- Buffers against margin calls
- Companies with relatively higher dividend yields, lower volatility and diversified by sector
- Intending to preserve excess margin or 'buffer'
- Reduce the impact of rising interest rates through emphasis on investments that are positively correlated with economic growth
- Value discipline

## POTENTIAL RISKS

While the Manager exercises prudence and due diligence throughout the investment process, no guarantees can be given to offset a risk of loss and investors should consult with their Financial Advisor prior to investing in the Fund.

The Manager believes the following risks are key to the Fund's performance: leverage, interest rate changes, dividend yields, highly volatile markets and equity risk. Please read the "Risk Factors" section in the Offering Memorandum for a more detailed description of all the relevant risks.

## FUNDSERV CODES

Fund Name	SERIES A	SERIES F†	SERIES N
Portland Advantage Plus - McKinley Fund - CDN\$	PTL940	PTL935	PTL930
Portland Advantage Plus - McKinley Fund - USD\$	PTL840	PTL835	PTL830

\*Generally only available through dealers who have entered into a Portland Series F Dealer Agreement



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† Annualized.

1. Distribution yields are based on the net asset value per unit divided by a full month distribution rate.
2. Other Net Assets (Liabilities) refers to all other assets and liabilities in the Fund excluding portfolio investments and cash.
3. Leverage ratio is calculated as the total borrowing divided by the fair value of securities and does not take into account other Net Assets (Liabilities) as defined above.
4. Dividend Yield – Annual dividends divided by the share price.

Additional Sources: Bloomberg, Thomson Reuters

The Portland Advantage Plus – McKinley Fund is not publicly offered. It is only available under prospectus exemptions and other exemptions available to investors who meet certain eligibility or minimum or maximum purchase requirements. Currently these exemptions include the accredited investor exemption and the \$150,000 minimum purchase exemption for institutional investors. Information herein is pertaining to the Fund solely for the purpose of providing information and is not to be construed as a public offering in any jurisdiction of Canada. The offering of Units of the Fund is made pursuant to an Offering Memorandum and the information contained herein is a summary only and is qualified by the more detailed information in the Offering Memorandum. If there are any discrepancies between this document and the Offering Memorandum, the Offering Memorandum is deemed correct. Commissions, trailing commissions, management fees and expenses all may be associated with investments. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and does not take into account sales, redemptions, distributions or optional charges or income taxes payable by any securityholder in respect of a participating fund that would have reduced returns. Funds are not guaranteed, their values change frequently and past performance may not be repeated. The portfolio is expected to generate income from dividends, interest and option writing income, which after deduction of expenses, will be distributed by the Fund to unitholders. Assuming the expected level of income is received, the portfolio would not be required to appreciate. If the level of income is less than the amount necessary to meet the target distribution, the Manager may either pay out a lower distribution or supplement the amount needed through net realized capital gains from the portfolio or may return a portion of the capital of the Fund to unitholders in which case the distribution would not have been fully funded as the net asset value would be reduced. Distributions are reinvested automatically in additional units of the Fund. No commissions are payable upon automatic reinvestment of distributions.

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