Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Royal Dutch Shell – Blackstone Group LP is reportedly close to a deal to buy a 50% stake worth $1.2 billion in a gas field in Louisiana currently owned by Royal Dutch Shell, according to a person familiar with the matter. The shale assets lie in the Haynesville Shale in Louisiana and Texas. Shale gas, or natural gas trapped in layered rock, has revitalized the U.S. gas market by providing an abundant new supply source. Shell entered the region in 2007 through a joint venture with Canadian energy company Encana. A deal would add to Blackstone's energy holdings in Louisiana. In February 2012, Blackstone agreed to invest $2 billion in Cheniere Energy Partners LP a deal that helped Cheniere finance construction of a gas-liquefaction plant in Louisiana for export markets.

Financial Sector

Bancolombia – second quarter net profit more than doubled versus the same period a year earlier, on the back of an expansion of its loan portfolio and lower costs. In a filing with the financial regulator, Bancolombia said consolidated net profit reached 467.3 billion pesos ($248.7 million) during the three-month period, up from 209.7 billion a year earlier. That is equivalent to 508 pesos per share, or $1.08 per American Depositary Receipt. The second-quarter profit is however 8% lower than the bank's first quarter net profit and the net result fell short of the analysts' expectations. Bancolombia's loan portfolio reached 89.5 trillion pesos, up 23.7% from the same period a year earlier, helped by the consolidation of Banistmo (HSBC Panama), but also by a robust Colombian macro-economic backdrop. Credit quality improved with the non-performing loans (NPL – 30 days) ratio lower by 39bps (12bps qoq).

Bank of America Corp – is reportedly close to a deal with the U.S. Department of Justice to pay more than $16.5 billion to end investigations into mortgage securities that the bank and companies it bought sold in the run-up to the financial crisis. A settlement would likely cap more than four years of work by Brian Moynihan, the bank's chief executive, to rid Bank of America of nearly all of the massive mortgage liabilities it took on through the acquisitions of Countrywide Financial Corp and Merrill Lynch & Co by his predecessor, Kenneth Lewis. The bank has agreed to pay about $9 billion in cash and the rest in assistance to struggling homeowners. JPMorgan Chase & Co paid $13 billion last year to resolve similar civil fraud claims that it misled mortgage bond investors, and Citigroup Inc agreed to pay $7 billion over similar charges last month. According to a regulatory filing, about $245 billion, or just over one-fourth, of the $965 billion of mortgage-backed securities and loans issued between 2004 and 2008, and sold to private investors - and now attributed to Bank of America - are either in default or severely delinquent. Countrywide accounted for $187 billion, or 76%, of the problematic securities, while Bank of America accounted for just $10 billion, or 4%. The rest came from Merrill and the former First Franklin Financial Corp, which Merrill bought in 2006. The consumer help portion of the settlement is expected to mirror past deals, which included cutting loan balances for underwater borrowers, refinancing mortgages, and other types of help to struggling homeowners. The news of the deal comes just after Bank of America said the Federal Reserve approved its plan to raise its quarterly dividend for the first time since the financial crisis.

Brookfield Asset Management – reported funds from operations (FFO) for the second quarter of $0.84/share, significantly ahead of the expected $0.61. Reported earnings were $1.19/share. Total assets under management were $192 billion at quarter end.

CI Financial – reported a 23% increase in its second quarter earnings, to $0.45/share, just shy of the expected $0.47/share. Assets under management increased to $97.9 billion,

second quarterly increase in a row, up 20% relative to the second quarter of 2013. Net sales for the quarter were $996 million.

Commerzbank – Germany's second biggest lender, accelerated its turnaround by selling unwanted assets and posted a rise in second quarter earnings as it set aside less money to cover bad loans. The quick reduction in "bad bank" assets puts the financial crisis further behind a lender that needed an €18 billion government bailout in 2009. The bad bank contains investments stemming from an expansion drive in areas such as commercial real estate that ultimately backfired for Commerzbank when the crisis hit. Commerzbank bank shares rose 2.8% as analysts pointed to the successful revamp. "The big fear from a year ago is gone. At the time, Commerzbank would have been in serious trouble in case of an external shock, but now it has restructured and that sword of Damocles is gone," said Ingo Frommen from LBBW. The division that contains unwanted commercial real estate, ship and public finance assets shrank to €92 billion in the quarter, down 32% from a year earlier. Commerzbank again improved its target for cutting back the assets. It now aims to reduce them to €67 billion by 2016, down from an earlier target of €75 billion. The German bank downplayed any threats from its exposure to Russia, which fell to €5.4 billion in the second quarter from €6.1 billion in first, but said the region remained a "particular focus" for managing risk. Exposure to Russia was mostly trade financing for German companies, which was covered by export insurance, or lending to big Russian corporations, which was well collateralised, Commerzbank Chief Financial Officer Stephan Engels said. "The recessionary trends in Russia and Ukraine have not had a noticeably detrimental effect on exports," the company said in its quarterly report.

In the second quarter, Commerzbank booked a net profit of €100 million, missing an analyst poll of €125 million, but higher than a year earlier, when it earned €40 million. Significantly improved earnings in retail banking and Eastern European operations compensated for weaker investment banking income in the quarter. Commerzbank's Mittelstandsbank unit, which caters to Germany's medium-sized companies, saw operating earnings rise by 24% percent to €267 million as lower provisions for bad loans compensated for weak demand. But in investment banking, trading revenues declined and earnings decreased by 29%, dragged down by a fall in revenue from buying and selling bonds and currencies. By contrast, buoyant equity markets and a surge in corporate debt issues have led to better-than-expected investment bank fees in Europe, helping Deutsche Bank, UBS, Credit Suisse, Barclays and others outperform U.S. peers in the second quarter. Since the global financial crisis Commerzbank has been cutting costs and selling assets in a bid to return to health, with the bank having turned a corner in 2013. The lender is widening the scope of its cost-cutting programme and plans to shed more than 450 jobs on top of the 5,200 already announced, people familiar with the matter said last month.

HSBC – reported 1st Half 2014 profit before tax of $12.3bn just 1% below consensus. However, adjusting for $920m in relation to customer redress, own credit and non qualifying hedges, underlying PBT of $13,262m is 3% better than consensus with revenues 1% ahead although down 2% YoY, costs in line and down 1% YoY and provisions 6% better than expectations and down 41% YoY. 2Q14 underlying PBT of $6.5bn is 6% ahead of consensus on stronger revenues - a 3% beat and up 2% QoQ – and better credit quality. Commercial Banking continues to drive revenue progression while credit quality improvements are broad based in developed markets.

On the balance sheet, Core Tier 1 capital ratio progression is stronger than expected, up 50bp QoQ top 11.3% and tangible book value per share is up 2% QoQ to $7.95. The outlook statement indicates slightly improved GDP expectations for the UK, China and a pick up in Hong Kong export growth in 2H, and highlights the benefit of rising rates in the UK and US. The company also highlights confidence in its ability to meet future capital requirements along with a progressive dividend policy.

ING – the biggest Dutch lender, may reimburse government aid earlier than planned after a 19% rise in second-quarter profit, paving the way for a return to dividends. The bailed-out bank, which hasn't paid shareholders since it suffered heavy losses in 2008, said it would decide on the early state repayment once it receives the results of the European Central Bank's review of its assets, due out this year. Net income rose to 1.07bn euros ($1.43bn) from 895mn euros a year earlier, beating estimates.

IGM Financial – reported underlying operating earnings per share of $0.81, just shy of the expected $0.82/share. Reported earnings per share were $0.75, affected by restructuring expenses at Mackenzie. Earnings were also affected by lower than expected mortgage related income at Investors. Total assets under management at June 30 were $141.4 billion compared to $124.8 at the end of June prior. Much of the increase is market gains, net positive sales driven by the institutional business with mutual funds still in net redemptions, though by a much lower margin. Revenue for the quarter was $720 million. Dividend kept steady, with the payout ratio lower, at 66%.

Canadian Dividend Payers

BCE – posted a 6% increase in second-quarter profit, driven by higher advertising and subscriber fee revenue from its acquisition of TV and radio content producer Astral Media. BCE added 66,186 net contract wireless subscribers in the period, compared to 96,390 in the same quarter a year ago, mostly due to the elimination of three-year phone contracts as mandated by a new wireless code of conduct. Such post-paid customers are valuable because they sign multi-year contracts and pay more each month than prepaid subscribers. Wireless market leader Rogers Communications added just 38,000 such customers in the same period, but its average wireless customer paid more. Bell's average wireless customer - a blend of contract and prepaid accounts - paid $59.49 a month for service, a 4.6% increase from a year ago. The company is also seen robust adoption of its IPTV (television through Internet via phone lines – Internet Protocol TV) offering, marketed as Fibe TV, with 46,533 customers added in the quarter for a total base of 580,643 subscribers. Net income attributable to shareholders rose to $606 million, or $0.78/share, in the second quarter, from $571 million, or $0.74/share, a year earlier. On an adjusted basis, earnings were $0.82/share. Operating revenue rose 4.4% to $5.22 billion. The results were mildly behind the consensus expectations for $0.84/share earnings but ahead of the expected operating revenue of $5.19 billion. BCE reaffirmed its earnings outlook for 2014.

Brookfield Property Partners (BPY) - second quarter results were strong with funds from operations (FFO) of $0.32/share, up 14%, while total revenue was $1.21 billion relative to last year's $1.09 billion. The fund recognized $10 million of one-time costs related to the buy-out of Brookfield Office Partners. BPY also incurred a $43 million one-time gain on a debt investment (issued by a Spanish office company). BPY generated $170 million of FFO from its office division, $112 million FFO from its retail portfolio and $3 million and $18 million FFO from its industrial and multi-family/hotels operations, respectively.

Brookfield Infrastructure Partners – reported funds from operations (FFO) for the quarter which were ahead of expectations, at $0.86/unit. The utilities segment actually exceeded expectations, with energy roughly in line, while the transport segment lagged somewhat, though was higher in year on year terms due to additions to Brazil toll road and West Coast port operations. BIP announced a 40% interest acquisition in a gas storage facility in the US, for roughly $40 million.

Northland Power – reported $0.35 of cash flow per share in the quarter, slightly below the expectations but up 25% on year on year basis. Distributable cash flow was $0.22 per share in the quarter, while the payout ratio stood at 126%. Payout ratio is guided to be 100% to 110% for 2014 from 105% to 120% previously. McLean's Mountain 60MW (net interest 30 MW) wind farm on the Manitoulin Island was completed/commissioned on time and on budget during the quarter. This project is supported by a 20 year PPA with Ontario Power Authority. The South-Western Ontario Grand Bend wind project (50MW net interest) has been seeing permitting delays, on track for spring 2016 commercial operation date. The company re-iterated its intentions to expand into Latin America (Mexico in particular). The company raised FY 2014 adjusted EBITDA guidance to be about $350 - $360 million and continues to expect FY 2015 adjusted EBITDA of $380 - $400 million.

Global Dividend Payers

Cheung Kong Infrastructure (CKI) – Hong Kong tycoon Li Ka-shing's Cheung Kong Group will secure its A$2.2 billion ($2.06 billion) takeover of Australian gas pipeline company Envestra Ltd after rival APA Group said it would accept the offer. APA, which holds a third of Envestra shares and had also bid for the company, said it would sell into the offer just one day before it was due to expire. A consortium led by CKI, part of the Cheung Kong Group, made an offer amounting to A$1.32 per Envestra share, valuing APA's 33% stake at A$784 million. The offer was a 3.1% premium to Envestra's closing price on Wednesday.

Mondelez – cut its 2014 sales target last week after price hikes to cover commodity costs sparked a backlash by consumers and retailers in some European markets. Mondelez also reported higher net income in the second quarter, topping the estimates. Mondelez said higher cocoa and dairy prices this year prompted the price increases to customers, especially in places like Venezuela and Argentina with high inflation. Irene Rosenfeld, chairman and CEO, expects the impact to be temporary as competitors catch up with price hikes and the gap closes. The company said it was reducing its 2014 net organic revenue growth target to a range of 2% to 2.5%. Organic revenue in emerging markets rose 4.7%, below company forecasts. Sales in developed markets, like Europe, were down 1.2%. Net income at Mondelez increased to $622 million, or 36 cents per share, from $601 million, or 33 cents per share, a year earlier. Revenue declined 1.8% to $8.4 billion. Organic revenue was up 1.2%. Excluding the effects from recalculating assets in Venezuela and other items, earnings were 40 cents per share, just ahead of the consensus expectations for 39 cents.

Nestle –announced an CHF8 billion share buyback on Thursday and revealed stronger sales growth in emerging markets in contrast to other big consumer products companies. The share buyback follows Nestle's sale of an 8% stake in French cosmetics company L'Oreal earlier this year. The world's biggest food group by sales is still grappling with weak demand in China, but achieved growth in many smaller markets in Asia and Africa and Latin America. The maker of Nescafe coffee and KitKat chocolate bars has been able to combat slowing demand in these markets, which make up 44% of overall sales, by investing in its leading brands and by getting rid of underperformers. "The environment in emerging markets remains a mixed picture," Nestle Chief Financial Officer Wan Ling Martello said. "We continue to see very good growth in many of the smaller markets, a recovery in South Asia, while China remains tough in some categories." She said Nestle had increased prices in some emerging markets to offset weaker local currencies. Emerging market sales growth accelerated to 9.7% in the first half, from 8.2% a year ago and 8.5% in the first quarter. That included double-digit growth in Latin America and robust growth in Turkey, Pakistan, Africa and the Philippines. Martello said conditions remained challenging in China but should improve in the second half. The company also stood by its forecast for overall organic sales growth of around 5% this year. Sales growth adjusted for currency swings and acquisitions accelerated to 4.7%, from 4.1% in the year-ago period and 4.2% in the first quarter, as volumes and pricing both picked up. In franc terms, sales fell 4.8% to CHF42.98 billion, impacted by a strong Swiss franc.

Rheinmetall – reported Friday that Bundeswehr, Germany's armed forces, extended its service contract for a combat training facility in Eastern Europe by four years to 2018. Rheinmetall said the Bundeswehr contract was worth around €70 million ($94 million), though the exact amount would depend on the Bundeswehr's utilisation. The news comes a day after Rheinmetall was forced to slash its full-year outlook this week after the German government withdrew its approval for a contract with Russia. As part of the Bundeswehr deal, Rheinmetall will provide maintenance and repair of computer hardware, tactical vehicles such as SUVs and battle tanks, communications networks and laser duel simulators.

Sysco – reported fourth quarter diluted earnings per share (EPS) of $0.43 ($0.50 after adjusting for certain items) and fiscal year 2014 diluted EPS of $1.58 ($1.76 after adjusting for certain items). Q4 adjusted earnings per share of $0.50 were in line with the consensus expectations, while revenues of $12.3 billion were marginally ahead of the expectations for the quarter. Revenues were up 5.9%.

Economic Conditions

US – The US services sector is on track for further expansion in the near future, as forecasted by the most recent reading of the non-manufacturing purchasing managers index (NMI), by the Institute for Supply Management (ISM). The NMI reached a 58.70 index points level in July, a 2.7 points jump over June's 56.0 reading and significantly ahead of the expected 56.3 reading. Many components of this composite index contributed to the improved outlook, including new orders, production, employment and the supplier delivery delays. The preliminary reading of the US productivity for the second quarter of the year revealed a higher than expected 2.5% productivity improvement, while, conversely, the US labour costs were up a more muted 0.6%, compare to the expected 1.4% advance.

On the consumer front, the US consumer credit growth fell short of the expectations for the first time in a long while, albeit only barely so, at $17.26 billion of consumer credit added in June, relative to the expected $18.55 billion.

The US balance of trade deficit surprisingly shrunk in June, to $41.54 billion, against expectations for a flattish reading, at around $44.7 billion. Exports were marginally higher, up 0.1% for the month, while imports fell 1.2%, dragged lower by a drop in auto parts, but also other consumer goods. This data, coupled with the deceleration in consumer growth credit, seems to be indicating some moderation in retail sales in the near term.

Canada – The Canadian employment report for July provided yet another disappointing set of numbers, as the 200 jobs added in the month fell way short of the expected 20,000 positions. The headline unemployment number dropped by a notch, surprisingly, to 7.0% in July, as the labour force participation rate inched lower to 65.9%. The Canadian economy lost 59,700 full-time jobs, offset by roughly 60,000 part-time jobs. Most job losses were in the construction and health-care sectors, with manufacturing and hospitality providing some respite.

On a background of an overall weaker Canadian dollar, Canada's net exports continued to improve, with June's balance of trade scoring a $1.86 billion surplus, driven higher by exports of mineral products and raw metals, but also a jump in consumer goods exports. For the month exports advanced by 1.1%, while imports dropped a symmetrical 1.1%.

Canada's building permits were up an unexpected 13.46% in June, building on May's 15.37% advance, while the housing starts, released this morning for July, also surprised on the upside, reaching a 200,100 units annualized level, compared to the expectations for a 193,000 units annualized pace and June's 198,700 units annualized reading.

France – Moody's cuts growth forecast for the French economy to 0.6% from 1% in 2014, and to 1.3% from 1.5% in 2015. Moody's thinks France's overall fiscal performance remains weaker than that of other Aa1 countries, Bloomberg reports.

The European Central Bank – has kept its benchmark interest rate at 0.15%. After announcing measures in June to kick-start Eurozone growth, the ECB says it will now keep rates low "for an extended period of time in view of the current outlook for inflation". And ECB president Mario Draghi warned there would be a "continued moderate and uneven recovery" in the Eurozone. BBC News

The Bank of England – has held UK interest rates at a record low of 0.5% for another month. The size of the Bank's economic stimulus programme - quantitative easing - was also unchanged at £375bn. Debate over the timing of a rate rise has intensified, with Bank governor Mark Carney hinting recently that it could come by the end of this year. Details of why the Bank's Monetary Policy Committee (MPC) held rates will be published later this month. BBC News

Financial Conditions

US:US Federal Reserve policymakers remain determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels of interest through 2014 with the Federal Reserve carefully calibrating the beginning of unwinding quantitative easing and undertaking that the Federal Reserve will keep rates low until mid 2015. The U.S. 2 year/10 year treasury spread is now 1.99% and the U.K.'s 2 year/10 year treasury spread is 1.69% - 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 U.S. 30 year mortgage market rate has increased to 4.14% - (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 U.S. housing inventory is at 5.5 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 13.93 (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 5 mutual funds:

- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Banks Fund
- Portland Global Income Fund
- Portland Global Dividend Fund

Private/Alternative Products

Portland also currently offers 3 private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland GEEREF LP

Net Asset Value:

At the close of business each day we publish the Net Asset Values (NAV) of our mutual funds onto our Portland website at http://www.portlandic.com/prices/default.aspx

Closed-End Fund

Spreads on the closed-end fund remain, in our view, very attractively priced to purchase.

The Portland Investment Counsel's 2013 Fourth Quarter Fund update is now available on the website.

At the close of business each day we publish the Net Asset Values (NAV) of our funds onto our Portland website at http://www.portlandic.com/prices/default.aspx

The price details published are replicated here below from which you can see we also highlight whether the funds share prices are trading at a premium or discount to their respective NAV.

Source: Thomson Reuters, Bloomberg, Company reports

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