

October 6, 2014

News Highlights

Energy Sector

Canadian Oil Sands/Enbridge – Canadian heavy crude price differentials improved on Friday to match last month's 14-month high, buoyed by increased demand for linefill on Enbridge Inc's new 600,000 barrel-per-day Flanagan South pipeline between Illinois and Cushing, Oklahoma. Enbridge is also due to start shipping crude to Montreal on its reversed Line 9 pipeline in November, further expanding market access for landlocked oil sands crude. Western Canada Select heavy blend for November delivery traded at \$13.00 per barrel below the U.S. benchmark crude West Texas Intermediate, according to Shorcan Energy brokers. Light synthetic crude from the oil sands for November delivery also strengthened, gaining 60 cents from the previous day to trade at 60 cents per barrel above WTI. Synthetic crude production is recovering after outages earlier in the summer. On Wednesday, Canadian Oil Sands, the largest-interest owner in the Syncrude joint venture, said the oil sands operation averaged 270,000 bpd in September, up 18% from the previous month.

Royal Dutch Shell – Oil major Shell has suspended development of hard-to-recover oil in Russia's Bazhenov formation with Gazprom Neft, after the West imposed sanctions on Russia over Ukraine. Last month the United States banned its firms from supporting exploration and production activities in deep water, Arctic offshore and shale projects with top Russian natural gas producer Gazprom, its oil arm Gazprom Neft, Lukoil, Surgutneftegaz and Rosneft. Shell continues working on other projects that are developing conventional oil in Russia including its Salym joint venture with Gazprom Neft. Last month, ExxonMobil said it was winding down its operations in offshore Arctic areas jointly with Rosneft because of sanctions.

Financial Sector

Berkshire Hathaway – Warren Buffett's Berkshire Hathaway Inc announced the acquisition of the Van Tuyl Group auto dealership, in what the billionaire hinted could be the first of many such purchases as his company extends its longtime bullish view on the U.S. economy. The dealership would be known as Berkshire Hathaway Automotive after completion of the sale. The Van Tuyl Group transaction is expected to be completed in the first quarter of 2015, according to the Berkshire statement, which added that the dealership has over \$8 billion in revenue. Berkshire Hathaway Automotive will be headquartered in Dallas, Texas.

BNP - According to Belgian TV (RTBF) yesterday, the negotiations on the formation of the Federal government will include an agreement on the sale of non-strategic assets, including the 10% stake in BNP. A Federal government could be in place in a few weeks. This would potentially allow the partial disposal of the BNP stake before the end of the year, allowing the Belgian debt/GDP to be capped at 100% - in line with the commitment to the European Commission. BNP no longer can proceed with share buy backs as originally planned (Core Equity Tier 1 ratio at $\sim\!10\%$ end 2014E). However, BNP management has argued that they have contacts with interested sovereign funds, which could substitute the Belgian state. This could be possible, but we would still expect some overhang weakness in the first half of December. In the meantime, the share price will be supported by the positive 3Q14 development in fixed income.

Lloyds Bank - has dismissed 8 employees and forced them to forfeit £3 million in bonuses that had been awarded but which had yet to vest, after finding they had attempted to manipulate benchmark interest rates between 2006 and 2009. This follows similar 'claw backs' from Barclays and Royal Bank of Scotland which state they had reduced bonuses by £300 million and £56 million respectively in 2012 – most of which was also for rate rigging. (Source:Financial Times).

Royal Bank of Scotland (RBS)- says third-quarter results to beat expectations: RBS said it was on track to beat expectations for the second consecutive quarter as the bank's recovery gathers pace thanks to an economic rebound in the UK and Ireland. In a statement last Tuesday, RBS said improved economic activity and rising property prices – particularly in Ireland – were expected to produce a positive £800mn net release of impairments in its results for the three months to September when they are published on 31 October. RBS said it expected to "significantly outperform" its previous guidance of about £1bn total impairments for this year. The bank said its RBS Capital Resolution unit would generate £500mn of net impairment provision releases. It added that Ulster Bank, its Irish operation which has cost the bank £15bn in losses, would record net provision releases of about £300mn.

Sumitomo Mitsui Financial (SMFG) announced a revision to its H1/2015 earnings targets, raising its expectation for ordinary profit to ¥750bn from ¥560bn and its net profit outlook to ¥460bn from ¥330bn. According to the bank, the revisions reflect a ¥60bn increase in expected reserve releases at SMBC as well as a better than expected performance from the Treasury Unit, which it's understood are further equity-linked trust gains. The bank made no change to its full year numbers but may announce these when H1 results are formally released in mid-November. In our view, any



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further economic weakness in Japan will likely be met with a new round of central bank stimulus.

Six banks are each facing record-breaking UK fines of hundreds of millions of pounds after they began settlement negotiations with the financial regulator over allegedly rigging the foreign-exchange market. Barclays, Citigroup, HSBC, JPMorgan Chase, RBS and UBS have all begun meeting with the Financial Conduct Authority this week to thrash out the details of a so-called global settlement to the regulator's probe into the manipulation of the US\$5.3tn-a-day forex market, said people familiar with the situation. Two of those people estimated the total fine to be £1.5bn once 30% discounts for cooperation were applied. Simultaneous negotiations with all six banks may also protract the FCA's normal eight-week settlement process. (Source:Financial Times).

Canadian Dividend Payers

Brookfield Property Partners – won the auction for Atlantic City, New Jersey's bankrupt Revel Casino Hotel with a \$110 million bid. The losing bidder, however, told press he planned to fight the sale. The shuttered Revel hotel and casino \$2.4 billion to build. Revel filed for its second bankruptcy in June, and was put up for sale as a way to raise money to repay its creditors. Brookfield Property Partners suggested it plans to reopen as a casino. The company said it anticipated "material synergies" between Revel and two of its other gaming-related investments, the Atlantis Paradise Island resort in the Bahamas and the Hard Rock Hotel and Casino in Las Vegas.

Global Dividend Payers

Samsung - announced its plan to spend KRW15.6tn (\$14.7bn) on a new chip facility from next year. The world's biggest memory chip maker commented that the new plant would be located in Pyeongtaek, in the Gyeonggi province, south of Seoul. Construction will commence in the first half of next year with initial product shipments likely to begin from 2H17. The final decision is still pending as to whether the new fab will make memory chips (DRAM/ NAND) or logic. This is the biggest investment in a single plant. This announcement comes as a very support to two important convictions: In Memory, the new market structure will drive sustained and stable investments. In Logic, the new fab announcement leaves little doubt on Samsung's eagerness to continue to gain traction. The silicon war is on. The \$15bn investment announced by Samsung (of which \$10bn in equipment) is very likely to fuel directly (leading edge logic capacity) and indirectly (response from TSMC and others) the silicon wars. We do not expect material Lithography investments for this new fab in 2015, but more in 2016 and 2017. Next year, Samsung will be busy enough modernising both Logic and Memory existing lines for

continued shrink, though, contributing materially more than in 2014 to Lithography spending.

Seven & i – Japanese retail giant Seven & i Holdings' operating profit rose 1.6% in the six months to Aug. 31, though it fell short of the company's own expectations amid growing questions over consumer spending trends after Japan raised its sales tax to 8% in April from 5%. Seven & i also warned consumer sentiment was being hit as the weaker yen means Japan has to pay more to import fuel and power inputs. The first-half operating profit was ¥167.2 billion (\$1.54 billion), below the company's own estimate of ¥170 billion. Still, the retailer left its full-year forecast at a record ¥356 billion, which would represent growth of 4.8% from the previous year. We believe the convenience store business, which accounts for around 80% of profits, and the financial-related business, which accounts for more than 10%, did better than expected for 1st Half as a whole, and we expect these businesses to cover downside in other businesses from 2nd Half onwards. Since the company has such an overwhelming presence in the convenience store sector, we believe the main valuation criterion is not so much short-term results as the sustainability and expansion of its competitive advantage, and we believe this came through in the 2Q results. The company left its fullyear Operating Profit guidance unchanged at JPY356.0bn.

SSE – British utility has signed a six-year gas supply deal with Norway's Statoil for 500,000 therms (1.4 million cubic metres) of gas a day, SSE said on Friday. The contract, which will start on Oct. 1, 2015, amounts to around 6% of SSE's average daily gas demand. Britain imports around 15% of its gas demand from continental Europe, and a large portion of this volume will have originally been imported from Russia. Europe's utilities are increasing looking for long-term deals to protect them from any supply disruptions or price shocks in the gas market.

Tesco - announced this morning that it has appointed two new non-executive directors (as of 1 November) – Richard Cousins (CEO of Compass) and Mikael Ohlsson (until recently CEO of IKEA). Given their extensive and senior roles in the retail / consumer world, this news should be seen as a positive.

Economic Conditions

US - the September U.S. employment report rebounded with a 248,000 advance, replete with a combined upward revision of 69,000 jobs to the two prior months. The economy has now added a meaty 2.64 million jobs in the past year (220,000 per month, or



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+1.9% y/y), which, aside from a brief spell in early 2006 (at the height of the housing boom), is the best since 2000 (the height of the tech boom). The strong news did not stop at the headline payroll result, as the companion household survey also showed a solid gain (+232,000), helping slash the jobless rate to 5.9% which is below the average jobless rate of the past 25 years, it's the lowest since July 2008 (i.e. pre-Lehman) and it's down 1.3% from just a year ago, the fastest improvement since the 1984 recovery. Yet, even with a below-average and falling-fast unemployment rate, the Fed not only has overnight rates at zero, but they are still engaged in QE at least until the end of this month.....

US – Both the Purchasing Managers Index (PMI) and the non-manufacturing equivalent (NMI) issued by the Institute for Supply Management (ISM) at the beginning of the month, re-traced some of their recent gains, signalling a less robust than previously believed US business activity growth. The PMI came in at 56.60, short of the expectations for a 58.50 level and a significant drop from August's 59.00. The NMI's reading for September was 58.60, broadly in line with the expectations, but lower than August's 59.60 reading.

The US consumer confidence, as measured by the Conference Board, fell short of the expectations in September. The actual reading of 86.0 index points was significantly below the expected 92.50 level and a large pull-back from August's 93.40 reading. Meanwhile, the US personal income improved in August by 0.30%, much as expected, accelerating from July's 0.20% advance. Part of the same report, the core personal consumption expenditures (PCE) price index, the Fed's favourite inflation gage, came in flat at 1.5%, matching July's reading.

On the US housing front, the pending home sales, a leading indicator of existing home sales, retreated 1.0% in August, offsetting July's 3.20% improvement. The Case Shiller index for US home prices in the 20 metropolitan areas recorded a 6.7% year on year advance in July, short of the expectations for a 7.50% reading and a deceleration from June's 8.10% rate.

Canada – Canada's trade balance deteriorated to a deficit position in August, amounting to \$610 million, from a \$2.2 billion surplus in July, missing the consensus expectations for a \$1.5 billion surplus. The key detractor in the month was the auto sector, exports of which fell by 11.2% in the month.

Brazil - the pro-business opposition party candidate Aécio Neves confounded pollsters with a strong performance in the first round of the country's presidential elections. With 99.99% of the vote counted late on Sunday, incumbent president Dilma Rousseff won with 41.59% against 33.55% for Mr Neves and 21.32% for one-time poll leader, environmentalist Marina Silva. Ms Rousseff's margin was half the 16% t lead predicted by poll group Ibope in news that will encourage investors, which view her Workers' party government as interventionist.

German factory orders fell 5.7% between July and August, worse than the 2.5% decline expected by economists. Orders are down 1.3% from August last year and it's the worst single-month drop since the beginning of 2009. Domestic orders also dropped 2% from July. The weakness in Germany is consistent with the latest findings from the Brookings Institute – Financial Times tracking index, which shows the global economic recovery is stalling and too reliant on the US. The index highlights a widespread loss of momentum in output growth across most emerging and advanced economies, prompting forecasters to scale back expectations for growth this year.

The European Central Bank - kept monetary policy unchanged last week, which was expected, as the impact from the steps taken so far — the covered bond purchases, the asset backed securities purchases, the TLTROs, the rate cuts, the deposit facility in negative territory — have yet to be felt. Although President Draghi continued to stress that the central bank is unanimous in its commitment to use other unconventional instruments if needed, he didn't give any hint that the next tool to be drawn from the tool box would be purchases of sovereign debt, or Quantitative Easing. The ECB continues to see downside risks to growth, and that geopolitical risks may dampen confidence and investment. The central bank expects inflation to remain at low levels over the next few months before gradually increasing in 2015 and 2016. Other policy areas need to contribute ... structural reforms need to gather momentum in some countries and the fiscal reforms made should not be unravelled. In response to a question during the press conference, he stated that this did not imply that the ECB was out of bullets and that they won't do more until the governments do more. "There's no great bargain here. 'We do this if you do that.' What we do is only effective if other policies are in place. Demand policies and structural reforms. But we have a mandate. Each actor has his role to perform." The ECB views the inflation target as the "ultimate yardstick". Although President Draghi repeated that the overall impact of the actions should be "significant" on the ECB's balance sheets, with the aim of having the balance sheets closer to what they were in 2012 (about €½-to-€ trillion), he refused to state an actual value as the target. Again, the goal is getting inflation back toward 2%. Also, while recognizing euro skepticism is understandable he stated "but it doesn't make it right. The EU is irreversible."



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Financial Conditions

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 US 2 year/10 year treasury spread is now 1.89% and the UK's 2 year/10 year treasury spread is 1.58% - 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 4.19% - (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 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 14.55 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

Mutual Funds

- Portland currently offers 6 Mutual Funds:
- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund
- Portland Global Dividend Fund

Private/Alternative Products

Portland also currently offers 4 private/alternative products:

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

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, Macquarie, Credit-Suisse, KBW, Bank of America, TD, BMO



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Source: Thomson Reuters, Bloomberg, Company reports
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