Market Commentary

PORTLAND INVESTMENT COUNSEL®

February 3, 2015

News Highlights

Energy Sector

Chevron – the second-largest U.S. oil producer, reported a 30% drop in its quarterly profit for the last quarter of 2014 due to plunging crude prices. The company posted fourth-quarter net income of $3.47 billion, or $1.85 per share, compared with $4.93 billion, or $2.57 per share, in the year-ago period. Foreign currency conversion charges dented earnings by $432 million. Production between the quarters held steady at 2.58 million barrels of oil equivalent per day (boepd). "We enter 2015 with the financial strength to meet the challenges of a volatile crude price environment and with significant efforts under way to manage to a lower cost structure," Chief Executive Officer John Watson said in a statement. He also re-affirmed the company's commitment to its dividend.

Royal Dutch Shell - Adjusted earnings of $3.455bn (excluding fx adjustments) were up 16% y/y but 16% behind consensus. Biggest area of underperformance was in the upstream driven by a lower than anticipated operating result from the Upstream Oceania and the integrated gas business. A $330m deferred tax charge in Australia explains most of the difference in the upstream result. Production down 1% y/y – a much better result than we anticipated driven by higher than anticipated volumes in most regions, particularly Europe. CEO Ben van Beurden – "We are stepping up our drive for stronger capital efficiency, whilst being careful not to over-react to the recent fall in oil prices." 2015 capex to be lower than 2014 levels but no budget given. 2015 will see new restructuring plans and efforts to reduce operating costs. Operating costs of $45bn in 2014 were well above the group's capex level and even 1-2% of reductions could offer significant savings to the group. Shell highlights that today's lower prices are creating opportunities to reduce costs and there is "multi-billion dollar savings potential for Shell" with respect to capital efficiency. To this point, Shell highlights that they have "curtailed $15bn of potential spending over the next three years." Gearing of 12.2% at the end 4Q was up 0.5pp q/q but 3.9% lower compared to last year. 2014 Reserves replacement ratio is expected to be c.26% of which organic is c.47%. 1Q 2015 dividend of $0.47/sh is flat y/y. These results did represent a 16% recovery from a low base a year ago but do serve to highlight how much more work Royal Dutch Shell has to do to improve capital efficiency. 2015 should be a year where we start to see more evidence of this emerge. With gearing of 12% Shell enters this downturn better prepared than many in the sector and has more flexibility to adjust investment next year if it becomes necessary.

Total became the first oil major to renew a 40-year onshore concession in Abu Dhabi, putting its peers under pressure to improve terms after the local partner said the French firm made the best offer. The state-run Abu Dhabi National Oil Company (ADNOC) signed an agreement on Thursday with Total giving the firm a 10% stake in the new concession to help operate the United Arab Emirates' biggest oilfields. Nine Asian and Western firms bid for stakes in the Abu Dhabi Company for Onshore Oil Operations (ADCO) concession after a deal with Western oil majors dating back to the 1970s expired in January 2014. Four oil majors, ExxonMobil, Royal Dutch Shell, Total and BP, had each held 9.5% equity stakes in the ADCO concession since the 1970s. Shell, Total and BP have made new bids, while Exxon has decided against bidding. The concession signed with Total was effective from Jan. 1, 2015, and covers Abu Dhabi's 15 principal onshore oilfields that represent more than half of the Gulf emirate's production. A Total spokeswoman said the company's margin on the deal was better than the previous concession, although commercial details could not be divulged.

Financial Sector

Bank Ring-fencing - The Financial Times reports that reforms to break up Europe's big banks are on course to be weakened by pressure from France and Britain for maximum national leeway. The European Commission has faced a wall of opposition from some EU member states and the banking industry since it made proposals last year to force some banks to hive off risky trading activities. Resistance is coalescing around options to defang the regulation. Officials from five of the most sceptical countries — France, the UK, Germany, Sweden and the Netherlands — met in Riga last Friday to discuss potential compromises.

BNP Paribas - BNP Paribas may consider buying Banca Popolare di Milano, Il Messaggero wrote last Sunday in a story looking at various merger scenarios for the popolari after the government's decree changing shareholder voting rules. The paper also said that businessman Andrea Bonomi should meet the Carige foundation's executives this week to discuss buying up its stake in the Genoa-based Bank, though there are differences on the price.

Credit Suisse -The Swiss bank is considering a cost-savings package in response to the recent appreciation of Switzerland's currency, a Swiss newspaper reported last Sunday. Credit Suise already has a CHF4.5bn cost save plan in progress that has been increased in size several times. Company guidance implies the move in USDCHF and EURCHF could reduce CHF profits by ~CHF600-700m.

Nordea - Reasonable set of Q4 numbers at first glance. Q4 Profit Before Tax E1,157m is +4% ahead of consensus. EPS 0.22c against 0.21c (+5%). Key driver looks to be Fee income with strong performances from Asset mgt and Life and Pensions and lower impairments partially offset by weaker Net Interest Income. Capital looks robust at Core Tier 1 15.7% (in line despite higher dividend) with Risk Weighted Assets 5% lower than forecast. Dividend 0.62c +9% better than expected and equates to 70% payout ratio or attractive yield of 6.0%. Tangible book +1% on the quarter. Re-iterated cost commitment - -5% constant currencies or -6% absolute for 2015. Overall a robust performance. Dividend better than expected. Nordea Russia - Better than expected. PBT E38m against Q3 E40m consensus with Pre-provision +19% which appears to be a function of it being a largely US$ denominated business (70%) where f/x strongly positive for revenues while Rouble costs down. However, hiked impairments (E12m) removed the upside (half collective).

Royal Bank of Scotland - Bloomberg reports that RBS plans to dispose of most of the toxic assets in its bad bank by the end of this year, 12 months earlier than projected, according to a person with knowledge of the matter. The U.K.'s biggest government-owned lender is on-course to divest or wind down about 85% of the £28.9bn of debt placed in the division at the start of 2014, said the person, who asked not to be identified.

Standard Chartered - The Financial Times reports that Standard Chartered is seeking a successor for CEO Peter Sands amid pressure from some of its largest shareholders, citing unidentified people close to the situation. A plan for new leadership may be announced next month or when the firm reports annual earnings March 4, the newspaper cited the people as saying. Subsequently the Wall Street Journal reports that Standard Chartered's two largest shareholders, which collectively control 28% of the bank's stock, are privately pushing for new leadership.

State Street reported 4Q GAAP EPS of $1.24. Excluding $0.13 of one-time items ($0.10 litigation charge, $0.08 merger/restructuring charges, $0.04 accretion benefits and $0.01 tax adjustments) State Street is calling operating EPS $1.37. This operating number also included $0.04 of one-time expense items (derivatives business closure, intangible asset amortization), $0.03 of revenue benefits (accelerated loan repayment and higher JV earnings) and $0.05 from a lower tax rate. All in, it is estimated core eps closer to $1.33 (well above consensus of $1.26.) However, the key negative that emerged from the conference call with management was the necessity of higher interest rates for positive operating leverage and it felt like there were few sizeable levers that management had at their disposal to mitigate some of the regulatory and environmental headwinds. Operating margins improved slightly to 30.8% compared to 4Q13 (30.1%). Operating ROE was 11.6% versus 11.5% last quarter and up from 10.3% in the year ago quarter. Capital strength: Pro-forma for the Basel III final rule, on both a standardized (10.8% vs. 10.9% in 3Q14) and advanced basis (12.5% vs. 12.8%) Tier 1 common declined but remained healthy as of December 31st, 2014. State Street repurchased $410 million of stock (5.6 million shares), in line with estimate. The company has the remaining capacity to purchase $470 million of common stock through 1Q15.

Sumitomo Mitsui Financial Group, Japan's second-biggest bank by market value, reported 9M3/15 net profit of ¥682bn, 87% of consensus full year forecast at ¥786bn. The main positive variance vs forecasts came from treasury and credit costs. However, net interest income (excluding estimated gains on equity linked trusts of ¥20bn in 3Q and ¥90bn in 9M3/15) and fees & commissions were also ahead of expectations. Non Performing Loans were slightly lower QoQ and SMFG provided some comments on their global oil & gas industry exposure (5-6% of group credit exposure), which is described as 'sound' (90% of sector exposure in SMFG's top tier of internal credit ratings). The company maintained its FY3/15E credit cost forecast of a ¥60bn charge and net profit forecast of ¥700bn, which appears conservative.

Canadian Dividend Payers

Brookfield Property Partners – A Qatari-led consortium looked set to win its long-running battle to buy Songbird Estates after the owner of London's Canary Wharf business district dropped its opposition to the $4 billion offer. Songbird said it still thought the price undervalued its properties but with no rival bid forthcoming and holders of 86% of the shares backing the deal, it said minority investors should accept. Canary Wharf, home to banks such as HSBC, Citi and JP Morgan, embody the change in London's economy in the second half of the 20th century as industry dwindled and financial services grew. The QIA already owned 29% of Songbird, which in turn owns 70% of Canary Wharf Group. Its partner in the deal, Brookfield Property Partners, has 22% of Canary Wharf Group. Songbird, backed by investment bank Morgan Stanley, had won control of Canary Wharf in 2004 with a £1.7 billion cash offer.

Rogers Communications reported net income of $297 million, or $0.62 a share, in the three months to Dec. 31, compared with $320 million or $0.57 a share, a year ago. Revenue rose 4% to $3.37 billion. The company said it saw a sharp decline in valuable wireless customers. The Toronto-based cable and telecom company, Canada's largest mobile provider, said it lost 58,000 net wireless subscribers on contracts, who typically spend more per month and are less likely to switch providers than those who pay for mobile phone service upfront. "We continued our shift from volume to value this quarter, and, as expected, we saw vibrations in both our Wireless and Cable subscriber metrics as we made certain commercial policy changes, consistent with our longer-term strategic goals," Guy Laurence, Rogers' CEO, said in the earnings statement. On the landline side, Rogers lost 36,000 cable subscribers, 4,000 Internet customers, and 18,000 landline phone lines. On an adjusted basis Rogers made $0.69 cents a share. Rogers increased its annual dividend by 5%. For 2015, Rogers expects adjusted operating profit of between $5.02 billion and $5.175 billion and free cash flow of between $1.35 billion and $1.5 billion.

Global Dividend Payers

Diageo the world's largest spirits maker, reported lower-than-expected sales for the six months to December, hurt by foreign exchange rate moves and discounting on vodka in the United States, its biggest and most profitable market. The maker of Smirnoff vodka, Johnnie Walker whisky and Guinness stout warned last month that U.S. Thanksgiving sales were disappointing and it expected sales to be broadly flat in the region, where competition among vodka makers has sharpened as trendy drinkers moved to brown spirits such as bourbon. Chief Financial Officer Deirdre Mahlan said that Diageo was not yet feeling the benefit of an improving economic picture in the United States, though it hoped to do so as lower gas prices meant more money to spend on extras such as alcohol. Overall, Diageo said net sales in the six months to Dec. 31, were £5.9 billion. On an organic basis, that represents a decline of 0.1%, with performance about flat in both developed and developing markets. There was an improving trend, however, from a dip of 1.5% in the first quarter to a rise of 0.7% in the second quarter. Earnings before one-off items were 53.7 pence per share.

Hutchison Whampoa announced that 3 Group Europe is in exclusive negotiations to acquire O2 UK for up to £10.25 bn. Finalisation of the deal is subject to due diligence, purchase terms, corporate & regulatory approvals. WE believe this consolidation is a big positive for 3 Group Europe's operations and Hutchison shareholders. The combination of 3 UK and O2 UK will create the #1 mobile player in the UK with 41% of total subscribers. Empirical evidence from past transactions implies significant synergies at £800 mn within the first two years or 8% of acquisition price. The proposed price is in our view fair at 6.7x 2015 Estimated EBITDA or attractive at 4.4x after synergies.. Consolidation will allow 3 UK to move off its sub-scale position and enhance value considerably. Its estimated this deal could be 15% NAV accretive for Hutchison.

Johnson Matthey reported underlying PBT of £96.5mn, 6% below estimates (£102.8m), and 1% up yoy. Revenues of £745m were up 5% yoy and 2% ahead of estimates (£728m). (i) Emission Control Technologies: sales of £435mn (+10% yoy) were 4% above of forecasts (£419m). European performance was strong, with light duty catalysts sales boosted by recent Euro 6bn legislation, whilst higher value Euro VI catalysts increased sales. Heavy duty in the US also positive due to strong demand for Class 8 trucks. (ii) Process Technologies: sales of £134mn (+1% yoy) were in line with our forecasts (£133m) but mix impacted EBIT. Chemicals sales decreased due to timing of customer orders. Chinese licensing demand remained weak and is expected to continue to slow into the coming year. Oil & Gas products continued to grow, however, the falling oil price has impacted investment decisions going forward by customers - expected to be a headwind if low prices are sustained. Precious Metal Products: sales of £92mn (-3% yoy) were 2% behind forecasts (£94m). Refining sales grew driven by strong volumes in platinum offsetting continued weakness through secondary gold and silver refining. Manufacturing performance was mixed through the businesses, however up yoy. Fine Chemicals: sales of £73mn (-4% yoy) were 7% below forecasts £78m. A function of weakness in European pain management. Management reiterated FY 14/15 guidance for PBT slightly ahead of last year which - implies small downgrades to consensus (<1-2%).

Procter & Gamble – the world's largest household products maker, said that impact from a strong dollar would hurt earnings this fiscal year, with full year net sales likely to fall 3% to 4%. P&G, which derives roughly two-thirds of revenue outside the United States, said the devaluation of almost every currency in the world versus the U.S. dollar hurt earnings, with the Russian ruble leading the way. Procter & Gamble said the exchange rates would reduce full-year sales by 5% and profit by 12%, or at least $1.4 billion after tax. Out of that, $1 billion would be as a result of currency devaluation in six countries - Russia, Ukraine, Venezuela, Japan, Argentina and Switzerland. Procter & Gamble said it held market share in Latin America, Europe, India, Middle East but lost share in China and Japan. The Chinese market has become very promotional in nature, he said. In November P&G sold its Duracell battery business to Warren Buffett's Berkshire Hathaway. That loss resulted in a non-cash charge of $740 million, the company said.

Roche - reported 2H-2014 results that were ahead on revenues, but light on EPS vs consensus; FX was a major driver. Roche reported 4Q14 sales of CHF 12,705 M (+6% y/y), ahead of consensus. Tamiflu US 4Q sales of 435M was a major part of the beat. EPS of CHF 6.72 (+5%) trailed consensus of CHF 7.00. Higher SG&A was the driver of the miss. Total operating expenses were about 4% higher than forecasted. Gross margin was 85 bps lower. R&D was in-line. Core operating margin at 32.3% was about 2.4% lower expected. Management gave 2015 guidance that was about as expected, given recent swings in FX and announced that it believes that biosimilar versions of Herceptin and Rituxan will likely be delayed in Europe from 2016 to 2017, a nice reprieve assuming this information is correct! The growth guidance for 2015 is the same as it was in 2014: Group sales to grow low- to mid-single digit in constant currency; core EPS growth to be ahead of sales growth in constant currency. The FX impact to revenues and EPS is likely to be around -6% and -9%, respectively.

Economic Conditions

Canada – The Canadian economy shrunk by 0.2% in November, with weakness in the energy and manufacturing sectors leading the drop, with the former affected by the fall in the oil price, whilst the latter has yet to see the benefits of a drastically lower currency value.

U.S. economy: Real GDP grew 2.6% annualized in Q4, a little softer than the market expected. Two factors that juiced the previous quarter's 5.0% gain reversed in the fourth quarter: imports rebounded strongly and federal defense spending plunged, combining to carve 2.0% from growth. As expected, business nonresidential investment slowed sharply after a couple of stellar quarters, with spending on equipment declining moderately, likely in response to cutbacks in the energy sector and to supply disruptions stemming from congestion at the West Coast ports. Exports also slowed due to the strong dollar and sluggish global demand. However, fuelled by cheap gas and new jobs, consumers ramped up spending at the fastest rate since early 2006 (4.3%), and the gains were widespread across goods and services. Residential construction also picked up in response to tumbling mortgage rates and some easing in lending standards. Apart from defense spending, the federal government increased spending, as did state and local governments, meaning the sector is now adding, rather than subtracting, from growth after several years of belt tightening. For all of 2014, the economy grew 2.4%, the fastest in four years, with a 2.5% advance in consumer spending the best since 2006.

US – The US Institute for Supply Management's (ISM) Purchasing Managers Index (PMI) reading of 53.50 points for January fell short of the expectations and signals a deceleration in the pace of growth of the manufacturing sector in the US. The US West-coast ports strike was likely an aggravating factor.

US pending home sales: unexpectedly fell in December. While consensus had looked for a 0.5% gain, signed-but-not-yet-closed contracts actually fell by 3.7% at the end of the year, while November's increase was revised down (to +0.6% instead of +0.8%).

US homes' prices, as measured by the Shiller report for 20 US metropolitan areas, kept moving along at a 4.3% year on year steady pace in November. New home sales were marginally better than expected in December, up to an annualized 480,000 units level.

US consumer's confidence has continued to grow strongly, with both the reading of consumer sentiment by the University of Michigan and the consumer confidence by the Conference board improving in January, to 98.1 and 102.9 index points, respectively; which is not surprising given the positive effects of lower oil prices on consumer budgets and an improving of the US personal income, which in December advanced 0.3%, a notch better than expected.

Greece: Syriza's strong victory in Greece's Jan. 25 election brings the problem of Greece's debt to the forefront. While Syriza, which won 36.3% of the vote and entered into a governing coalition with the anti-austerity Independent Greeks party, has promised to not unilaterally default on the country's debt and instead focus on attaining debt reduction via direct negotiations with the European Union (EU), it is hard to see where common ground will be found. At most, the EU, led by Germany, will agree to extend the maturity of Greece's debt and further lower interest rates. This is likely despite the fact that, it is hard to see how Greece can remain and prosper in the Eurozone over the long term without some form of significant debt forbearance / writedown. Germany and other creditor countries correctly, in our view, fear that if they restructure Greece's debt it is only a matter of time before other countries demand similar treatment. Ireland, Italy and Portugal all have debt to GDP ratios that are above 125%, while Spain's is close to 100%.

Japan: It seems that Japanese devaluation of the Yen has caused a spike in Japan's exports which rose more than forecast to the highest level in six years and helped pare a record annual trade deficit …… the win in exports is likely coming from some of their neighboring countries who will no doubt have a currency devaluation response of their own soon enough.

Financial Conditions

US Federal Reserve policymakers remain determined to signal that although Quantitative Easing has stopped, the stimulus remains via keeping rates at present low until mid 2015. The US 2 year/10 year treasury spread is now 1.25% and the UK's 2 year/10 year treasury spread is 1.06% - 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 3.66% - (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 5.1 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 18.23 (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, KBW, BMO, Berstein, Scotiabank, Macquarie

Source:Thomson Reuters, Bloomberg, KBW, BMO, Berstein, Scotiabank, Macquarie

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC15-004-E(02/15)