# Market Commentary

PORTLAND INVESTMENT COUNSEL™

March 24, 2014

## News Highlights

### Financial Services Companies

Allianz has confirmed that it is to buy the renewal rights of selected contracts from Unipol for up to €440mn in cash. This transaction was expected. We think investors have since digested the Allianz's intention to re-invest as well as distribute capital. An 8x P/E points to attractive accretion from this transaction, although €600k / €300 per agency / customer put the consideration into context, we think. We no longer expect cost synergies to be so significant because Allianz has selected the agencies it is acquiring and is avoiding much legacy infrastructure by the structure of the deal. Italian non-life fundamentals are likely to deteriorate as competition and claims inflation build. On balance, we view this a sensible exercise in in-market consolidation.

ING announced that its intent to sell 33.5m shares (12% stake) of ING US. The transaction would reduce ING's stake in ING US to 45%. The retained minority stake in ING US will be deconsolidated. Assuming deconsolidation, the negative P&L impact would be €2bn in the P&L in 1Q14 (difference bw end 2013 book value and market value). There will be no impact on regulatory capital for ING Bank. The minus €2bn P&L impact looks higher than expected by us. Subsequent details were that ING Group raised $1.18bn with the sale of shares in its US insurance unit. 26.5mn shares were sold at $35.23 a share. The New-York based unit agreed to buy another 7.26mn from its parent for ~$34.45 a share.

JP Morgan has sold its physical commodity business for $3.5bn to Mercuria, a Geneva based trading house, the latest bank to scale back its activities in this capital intensive sector. It's understood, the sale will not have a material impact on the bank's circa $20bn earnings.

Lloyds Banking Group reported strong initial demand for a debt swap it offered investors as a way to strengthen its capital position. The bank said it had issued institutional investors with £4.35bn of new "additional tier 1 securities" in exchange for so-called enhanced capital notes they bought after its £20bn government bailout. It had offered to buy back up to £5bn. The update on the debt swap came as Lloyds announced that it had sold a lossmaking £500mn portfolio of European commercial real estate loans to part of Marathon Asset Management, the investment management company, for £235mn. The sale is part of the bank's efforts to wind down its portfolio of non-core loans. Lloyds said the sale would not have a material effect on its capital position. (Source: Financial Times).

### Dividend Payers

ABB - Swiss engineering group ABB said on Friday it has agreed to sell its U.S. Thomas & Betts' heating, ventilation and air conditioning business to U.S. conglomerate Nortek for $260 million in cash. ABB, which is pruning its portfolio under new chief executive Ulrich Spiesshofer, said it expects the sale to close in the second quarter of this year, subject to regulatory approval.

Reuters reported last month that ABB was looking to sell several non-core businesses, including its heating and air conditioning unit operated under the Reznor brand owned by Thomas & Betts, in deals that could raise more than $1 billion. A number of industrial companies have been selling off assets to focus on their core strengths and improve earnings during a tentative economic recovery. Last year, ABB's German rival Siemens sold off the bulk of its water technology business as well its stake in mobile telecoms equipment maker Nokia Siemens Networks, and spun off its lighting business Osram. ABB bought Thomas & Betts, a U.S. maker of electrical components, in 2012 for $3.9 billion to help expand its low-voltage products business in North America. In a statement, the Swiss company said it was divesting the heating and air conditioning unit because it lacked synergies with ABB's core portfolio of electrical motors and drives. Last October, ABB said it would sell the assets of Baldor's generator-set business to Generac Holdings for an undisclosed price.

ABB said it and its consortium partner UK Power Networks have won an order worth $145 million to upgrade Britain's rail network in southern England and Wales. The order is for the turnkey delivery of more than 30 new traction substations and is the first sizeable electrification project to be undertaken by Network Rail in over 30 years, ABB said. The upgrade should help make services more reliable, reduce noise emissions from the railway and increase the frequency of trains, it added. The first substation is expected to be commissioned in 2015 and the project should be completed in 2017, ABB said.

Hutchison Whampoa: announced it is to sell 25% of its stake in its retail arm AS Watson to Temasek for HK$ 44bn ( US$5.7bn) – a valuation that was lower than market analysts had expected. The intent is to seek to list A.S. Watson in 2 – 3 years. The profile of Hutchison remains attractive in our view : 1) double-digit EPS growth in multiple segments 2) exposure to recovering Developed Markets as 39% of EBITDA from Europe 3) heightened commitment to shareholder return, paying out 69% of AS Watson divestiture proceeds in a special dividend and 4) attractive valuation given 25% discount to NAV vs. historical 15% cut.

Tesco - Britain's Tesco has sealed a joint venture agreement with a unit of India's Tata Group that will see it invest $140 million and become the first foreign supermarket to enter the country's $500 billion retail sector. Tesco said on Friday that following receipt of approval from the Indian Foreign Investment Promotion Board, it has entered into a deal with Trent Limited to form a 50:50 joint venture with the operator of the Star Bazaar retail business, Trent Hypermarket Limited. The world's third-largest retailer, which since 2008 has had a franchise agreement to provide support to Star Bazaar, had made the application to India's FIPB in December. On completion of the transaction, THL will operate 12 stores retailing a range of merchandise including food and grocery, personal and home care products, home and kitchen, fashion and accessories. The stores are operated under the 'Star Bazaar' and 'Star Daily' banners, and spread across the southern and western regions of India.

Toyota - A U.S. judge approved a deferred prosecution agreement with Toyota Motor Corp on Thursday that resolves an investigation into safety issues and could serve as a model in a similar probe of General Motors Co. U.S. District Judge William Pauley's decision, delivered at a hearing in New York, came a day after the U.S. Justice Department announced Toyota would pay $1.2 billion to settle the investigation stemming from problems that caused cars to accelerate suddenly.

## Economic Activity, Consumer and Business Conditions

U.S. economy : the current account deficit narrowed sharply to $81.1 billion in the fourth quarter from $96.4 bln in Q3, a much better-than-expected result. And, it is just 1.9% of GDP, which is a far cry from the 6.2% share reached in 2005/2006. The actual deficit is the smallest deficit in 14 years (or since 1999), supported by the boom in the energy patch. For all of 2013, the current account shortfall came in at $379 billion, the narrowest gap since 1999 and 2.3% of the overall economy.

U.S. existing home sales slipped for the second consecutive month, down 0.4% to 4.60 million annualized units in February. Sales of single-family homes fell again (-0.2%), as did multi-unit homes (-1.8%). Given that these are actual sales and reflect contracts signed a month or two before, there was likely some weather forces at play here. Sales in the Northeast and Midwest were hit, while they increased in the South and the West. Inventories rose for the second month in a row +6.4% total, or +3.6% for singles, although limited supply continues to hurt buying activity. Along with the decline in sales, this lifted the months' supply over 5 for the first time in three months, though that is still within 'normal' territory. The share of homes bought by first-time buyers rose for the first time in a few months, but at 28%, is still very low. Repeat buyers are still over half of all sales.

Britain's growth forecast has been upgraded by the biggest margin in more than a quarter of a century, though questions remained over the amount of austerity the Government would need to implement to balance the books. The Government's independent fiscal watchdog revised up its forecasts for UK growth in 2014 to 2.7%, from a December prediction of 2.4%. Growth in 2015 was also upgraded to 2.3%, from 2.2%.

Russia/Crimea - Britain and Germany have agreed that the European Union should impose further consequences on Russia, building on travel bans and asset freezes agreed earlier by European foreign ministers.

Ukraine - The European Union wants to move fast on a €1.6bn aid plan for Ukraine so that money can start flowing to the government in Kiev, said EU Economic and Monetary Affairs Commissioner Olli Rehn. The EU can start sending payments "immediately" after Ukraine reaches a deal with the International Monetary Fund on a companion package that could be about €13bn to €14bn, Rehn said in an interview in Brussels last Wednesday. A payment of about €100mn would be followed by €500mn euros "in the very short term," he said.

## Financial Conditions

The US Federal Reserve Chair Janet Yellen has hinted that interest rates in the US could start to rise in early 2015. Ms Yellen said the Fed could begin raising rates six months after it halts its monthly bond-buying programme. She made the remarks after the Fed said it will scale back bond purchases by a further $10bn (£6bn) per month. This is the third time in a row that the central bank has tightened its stimulus efforts. The latest reduction brings the Fed's monthly bond-buying down to $55bn from $85bn last year.

U.S. big banks have enough capital buffers to withstand a drastic economic downturn, the Federal Reserve said last Thursday, announcing that 29 out of 30 major banks met the minimum hurdle in its annual health check. All of the big banks except for Zions Bancorp stayed above the 5% requirement for top-tier capital in the latest round of stress tests.

Banking Union : Reuters is reporting that European policymakers agreed on Thursday to complete a banking union with an agency to shut failing euro zone banks, but there will be no euro zone backstop for the new fund to help cover the costs of such closures. The banking union, and the clean-up of banks' books that will accompany it, is intended to restore banks' confidence in one another and boost lending across the currency bloc, helping foster growth in the 18 economies that use the euro. Under the deal reached, a 55-billion-euro (£45.88 billion) fund made up by levies on banks will be built up over eight years, rather than 10 as originally envisaged. 40% of the fund will be shared among countries from the start and 70% after 3 years. It also envisages giving the European Central Bank the primary role in triggering the closure of a bank, limiting the scope for country ministers to challenge such a move. The fund, however, will not be able to rely on the euro zone bailout fund to borrow extra money if it runs out of funds. Critics say this means that the banking union will never live up to its name.

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 2.32% and the U.K.'s 2 year/10 year treasury spread is 2.07% - 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 8-10 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 4.32% - (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 5.1 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 15.00 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 Income Fund
- Portland Global Banks 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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