Market Commentary

April 21, 2014

News Highlights

Financial Services Companies

Australia & New Zealand announced last Monday that it had made an agreement with govt-owned China Development Bank, broadening a 2009 memorandum of understanding with the bank. Under the widened agreement, ANZ will operate as an adviser to CDB on its investment and lending decisions in Australia – where the Chinese bank is eyeing resources and infrastructure projects in particular. "This will not only support the growing two-way trade and investment relationship between Australia/New Zealand and China, but will also help to aid transparency and improve the economics of Chinese investments," stated ANZ's CEO of international and institutional lending, Andrew Geczy. ANZ has forecast direct investment from China in Australia could surge to $200bn by 2030 and is lobbying for negotiations over the free trade agreement to be resolved quickly.

Bank of America, the second-biggest US lender, swung to a loss as the company booked $US6bn of costs tied to mortgage disputes. The first-quarter loss was $US276mn, or US5¢ a diluted share, compared with a profit of $US1.48bn, or US10¢, a year earlier, according to a statement today from the North Carolina-based company. Adjusted earnings were US35¢ a share, beating the US27¢ average consensus estimate of 12 analysts surveyed by Bloomberg. CEO Brian Moynihan is in his fifth year of cleaning up after his predecessor's purchase of Countrywide Financial Corp left Bank of America responsible for billions of dollars in bad mortgages. Disputes over home loans and foreclosures have cost the bank more than $US50bn, including a March 26 federal accord covering bonds sold to Fannie Mae and Freddie Mac.

Goldman Sachs reported 1Q14 EPS of $4.02. Consensus was $3.55. Revenues declined 8% y-o-y and increased 6% sequentially (-4% ex. Debt Value Adjusted), to $9.3bn, compared to consensus of $8.7bn. An Earnings Per Share beat, with Fixed Income, Currency and Commodities (FICC), Investment Banking, and Investment Management all coming in above expectations, while Equities was below. Although $1.8bn of Investment Banking fees represented its highest quarterly performance since 2007, overall revenues of $9.3bn, while 7% above consensus, marked its lowest 1Q in six years. It posted an Return On Equity of 10.9%, down from 12.4% in 1Q13 and 12.7% in 4Q13. Management noted its investment banking transaction backlog decreased compared with 4Q13, though that was a record level. It also commented market-making conditions generally improved during the quarter; however, FICC continues to operate in a challenging environment and levels of activity generally remained low. Additionally, Equities experienced challenging market-making conditions, particularly in Japan and certain emerging markets as equity prices declined. Still, tangible book rose 1% to $145.04, putting shares at 1.1x.

Morgan Stanley reported 1Q14 Earnings Per Share from continuing operations of $0.72 ($0.74 with discontinued ops). Ex. Debt Value-Adjusted (DVA), EPS from continuing ops was $0.68. Consensus was $0.61. Net revenues (ex. DVA) were $8.8bn, compared to consensus of $8.6bn. DVA was +$126mn. Higher-than-expected revenues followed by controlled expenses drove an EPS beat. Relative to expectations, we believe trading (both Fixed Income, Currencies and Commodities & equities) came in better while Investment Bank fees were in-line. Although its wealth management margin did not show further improvement from 4Q13's 19% level, we do expect it to increase as the year progresses. It posted an Return on Tangible Common Equity of 9.8%, up from 7.9% in 1Q13, while tangible book grew 1% sequentially to $27.41 (so trading at 1.1x).

Dividend Payers

Barrick Gold – Talks between Barrick Gold and Newmont Mining Corp about a potential merger have hit a snag, but Reuters sources close to the situation say the companies remain keen to reach a deal and discussions are likely to resume. The talks had reportedly been on for a few weeks, and the two sides had broadly agreed to a transaction under which Toronto-based Barrick would acquire Denver-based Newmont in an all-stock deal. The sources said the talks have stalled over the issue of the spin-out of some assets from the combined entity, which is among the hurdles to a deal. After the close of a tentative deal, shareholders in the combined entity would also get shares in a new company that is likely to include assets in Australia and New Zealand. The companies are also contemplating selling some non-core assets not included in the spun-out new entity, said one source. A deal, particularly involving their big operations in Nevada, is logical from a cost-cutting perspective.

BHP Billiton – Australian miners are racing ahead with plans to expand iron ore production to capture more of the Chinese market for the steelmaking ingredient, amid strong competition from the world's biggest supplier, Vale of Brazil. Efforts to beat

already ambitious output targets comes as a crackdown in China on using commodities as collateral to raise cash risks unleashing iron ore sales from tens of millions of tonnes sitting in Chinese port warehouses, pressuring prices. BHP, the world's biggest diversified mining company, on Wednesday lifted full-year iron ore production guidance by 5 million tonnes to 217 million as it pushes ahead with new mine work in Australia. China imports more than a half-billion tonnes of iron ore annually to supplement domestic production of mostly lower-grade ore. China's crude steel production rate of some 2 million tonne a day makes it by far the world's biggest consumer of iron ore. Output from BHP's most profitable division rose 1% to 49.6 million tonnes in the three months ended March 31 versus the previous quarter. Against the same quarter last year, output was up 23%. BHP Chief Executive Andrew Mackenzie said the lift in output was helped by a limited impact from heavy rains in Australia's Pilbara iron ore belt in January and expansion work underway at the company's new Jimblebar mine.

GEA Group AG – the German industrial machinery and engineering company has struck a deal to sell its heat exchangers division for about €1.3 billion ($1.8 billion) to concentrate on its burgeoning food equipment business. GEA said it will use proceeds from the sale to private equity investor Triton for acquisitions to sharpen its focus on food-related operations, which will now account for more than 70% of group revenues. Triton is paying about €1 billion and assuming pension obligations at the heat exchangers (HX) business. The deal values the business at the upper end of market expectations. GEA said it expects the deal to close by the end of the year. Triton's acquisition will be backed with debt financing totalling about €1.25 billion from banks expected to include Deutsche Bank, Commerzbank, ING, RBS and UniCredit, banking sources said. Frankfurt-based Triton beat out a rival consortium of buyout group EQT and industrial services group Bilfinger GBFG.DE, adding to the acquisition this month of Alstom's ALSO.PA HX business for 730 million euros.

Rio Tinto – iron ore shipments fell 8% in the first-quarter from the previous quarter due to weather-related disruptions in Australia and Canada, but the miner said it was on track to meet its full-year target. Production still jumped 16% on the same quarter a year ago as the world's No. 2 iron ore producer behind Brazil's Vale ramps up production at its Australian mines to meet growing demand from China. Iron ore has replaced other industrial and precious commodities such as coal, gold and silver as the mineral with the most profit potential, delivering bumper earnings for giant low-cost miners such as Rio and BHP Billiton. Iron ore prices have recovered 12% since a steep dip in March on weaker Chinese steel prices. At the current price of $117 a tonne, Rio Tinto enjoys a profit margin of over $60 a tonne. Rio Tinto said its Iron Ore of Canada division was hit by a colder-than-average winter, which disrupted mining in Labrador over the quarter, while port closures due a cyclone late last year reduced shipments in Australia, the company said. Overall iron ore shipments in the first quarter came in at 66.7 million tonnes. Rio said it was on track to meet its target of mining ore at the rate of 290 million tonnes a year and maintained its 2014 production target of 295 million tonnes. Iron ore of Canada (IOC) is 59% owned by Rio Tinto, 26% by Mitsubishi Corp and 15% by Labrador Iron Ore Royalty Co.

Roche Holding – A strong uptake of new cancer medicines helped Roche limit a decline in first-quarter sales and the Swiss company confirmed a forecast for higher earnings this year. Roche Holding AG said currency movements, the loss of exclusivity on chemotherapy drug Xeloda and falling sales of hepatitis medicine Pegasys combined to pull sales down 1%. Excluding the impact of currency swings, sales grew 5%, thanks partly to the strong performance of its cancer drugs and rheumatoid arthritis treatment RoActemra. Roche is yet to face a real challenge to its older biotech drugs by makers of copy-cat treatments and analysts say it has a promising pipeline of expensive cancer drugs after a string of successful launches. The Swiss franc's strength against the U.S. dollar, Japanese yen and Latin American currencies shaved 6% points of quarterly sales, which slipped to CHF11.5 billion ($13.08 billion). This was slightly below the average analyst forecast of CHF11.89 billion. Sales of Perjeta, which targets the same protein found on some cancer cells as Roche's older blockbuster Herceptin, more than tripled to CHF178 million, while Kadcyla contributed CHF102 million in sales. Roche has pushed ahead with developing such follow-on medicines which it hopes will replace or breathe new life into older treatments. It is banking on a strong ramp-up to defend its market share once copycat versions of biotech drugs known as "biosimilars" arrive. Roche has taken steps to defend sales at its blood cancer business and won approval for Gazyva, a follow-on to its top-seller MabThera, from U.S. health regulators in November. Gazyva notched up CHF8 million in sales in the first quarter. Roche confirmed guidance for low-to-mid single-digits sales growth this year, while expecting core earnings per share to grow ahead of sales. It also plans a higher dividend.

Syngenta – the world's largest maker of crop chemicals, expects weak emerging markets currencies to have a bigger hit on full-year earnings than previously assumed, it said on Wednesday, as it posted higher first-quarter sales. Adverse currency moves knocked 3% off quarterly sales, which rose 2% percent to $4.7 billion, in line with the average forecast. Excluding exchange rate moves, sales increased 5%. Syngenta now expects weaker currencies to knock around $100 million off full-year earnings before interest, tax, depreciation and amortisation (EBITDA), compared with an earlier forecast for a negative impact of $50 million. Chief Financial Officer John Ramsay said the main impact had come from the devaluation of Ukraine's hryvnia, as fears of all-out war with Russia and a worsening domestic economy have seen the currency lose a third of its value versus the dollar this year. The company has raised prices to cover the hryvnia devaluation, managing to offset about two thirds of the currency impact. The Swiss company, which makes products to kill weeds and bugs as well as genetically modified seeds, gets about 4%-5% of its total sales from the Commonwealth of Independent States (CIS), which includes Ukraine. Despite the crisis in the region, Ramsay said volumes had held up well, growing by a double digit percentage at constant exchange rates in the CIS region, mainly driven by Russia. In Ukraine, volumes are just about at last year's levels, he said.

Elsewhere, Syngenta said unseasonably mild weather in Europe helped the planting season get off to a strong start and sales in its Europe, Africa and Middle East region rose 10%. This helped compensate for a 7% fall in sales in North America, where arctic weather conditions have delayed the start of planting. Ramsay said the cold weather would have to persist for some weeks longer before it became a major problem. For the full year, Syngenta expects integrated sales to grow 6% at constant exchange rates. The company confirmed its full-year guidance for growing gross margins and an increase in free cash flow before acquisitions to around $1.5 billion.

Tesco –boss Philip Clarke vowed to win back shoppers with millions of pounds of price cuts after a second year of falling profits cast doubt on his efforts to turn around the fortunes of Britain's biggest retailer. Tesco reported a 6% fall in annual group trading profit posted on Wednesday. The company took a £734 million writedown on the value of its European businesses, where trading has slowed, and a one-off charge of £540 million in China. Facing the slowest rate of growth in the British market since 2005, Clarke said customers would see prices coming down and stores modernised at a faster rate than initially planned. He added that recent price cuts of 245 on key lines such as milk, eggs and chicken had boosted volumes by 30%. Trading profit for the year to Feb. 22 was £3.3 billion, in line with forecasts. The dividend was kept at 14.76 pence a share. Overseas, group trading profit was down 5.6% in Asia and down 28% in Europe, with a slump in trade in the Czech Republic, Hungary, Poland, Slovakia, Turkey and Ireland. Many retailers across Europe have been struggling as shoppers' disposable income is squeezed by subdued wage growth and austerity measures, and most have responded with price cuts. Group underlying pretax profit fell 6.9% to £3.05 billion pounds in the year.

Economic Activity, Consumer and Business Conditions

US – The US industrial production advanced 0.7% in March, ahead of the expectations, albeit a deceleration from February's upwardly revised 1.2% pace of growth. The improvement was supported by the mining, utilities and manufacturing sectors, with only motor vehicles and parts subtracting from growth in the month. The US capacity utilization shot up above 79%, at 79.2%, four tenths above February's level and five tenths above the consensus expectations. The Leading Economic Indicators (LEI) moved 0.8% higher in March, ahead of the consensus expectations for a 0.7% improvement and building on February's 0.5% growth, pointing to continued strength in US business activity in the near term.

News from the US housing sector continued to illustrate the slower pace of activity in the sector with housing starts, at 946,000 units annualized in March, falling short of the consensus expectations, though an improvement over February's 920,000 units annualized level. The US building permits retreated to 990,000 units annualized in the month, lower than both the consensus expectations and February's reading. The forward looking National Association of Home Builders' (NAHB) housing market index inched higher, to a 47 index points level, yet it fell short of the expectations for a 50 reading, which is the threshold for an optimistic view of the housing activity.

The US inflation surprised on the upside in March, with the headline consumer price index (CPI) rate reaching 1.5%, ahead of the expected 1.4% rate, with food prices a key driver of CPI growth. The core CPI, which strips off the effects of food and energy prices, also surprised on the upside, reaching a

1.7% rate in the month, on the back of housing and apparel price increases.

Canada – Canadian manufacturing continues to show signs of recovery, as the currency headwinds have died down, with the manufacturing sales jumping 1.4% in February, ahead of the expected 1.0% improvement and on top of the 0.8% January advance.

The consumer price inflation picked up in Canada as well, with March's headline consumer price index (CPI) reading revealing a 1.5% year on year rate, ahead of the expected 1.4% rate and a significant departure from February's tame 1.1% level. The headline CPI reading, which excludes the eight most volatile price series, including food and gasoline, was also higher at a 1.3% year on year rate, compared to February's 1.2% level.

China Macro: China released 1Q GDP growth (7.4% yoy, consensus: 7.3%) and macro data for March. Overall, despite the better-than-expected GDP data, the strength of the recovery is fairly weak, evidenced by softer-than-expected activity and property data in March. With 1Q macro data, we reckon that China remains in a destocking cycle amid a tight credit condition. Therefore, the economy is still facing downside risk in late 2Q or early 3Q. GDP growth in 1Q14 moderated to 7.4% from 7.7% in 4Q13, beating the market consensus at 7.3%. In qoq terms (seasonally adjusted, not annualized), it dropped from 1.7% in 4Q13 to 1.4%, which is lower than 1Q13 (1.5%) and the same as 1Q12. Growth of power production rose to 6.2% from 5.5%. The property sector continued the down-cycle, as new starts dropped 21.9% yoy in March.

Financial Conditions

Banking Union - The European Parliament gave its final approval last Tuesday to an array of rules aimed at mending the European Union's troubled financial sector and winding down banks while sparing taxpayer money. In their final week before breaking up ahead of elections in May, lawmakers voted through previously-agreed legislations designed to place the cost of closing a failing bank on the shoulders of its investors, and a new authority that will oversee the winding down of broken euro-zone lenders. Lawmakers also approved new harmonized rules for national deposit-guarantee funds, which are mean to protect savings during a bank failure. "We have turned the idea of a banking union into reality in less than two years," said Internal Markets Commissioner Michel Barnier. "The banking union completes the economic and monetary union and ensures taxpayers will no longer foot the bill when banks face difficulties."

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 2.31% and the U.K.'s 2 year/10 year treasury spread is 1.96% - 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 4.27% - (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 13.68 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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Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

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