Market Commentary

PORTLAND INVESTMENT COUNSEL®

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News Highlights

Energy Sector

Enbridge – German utility E.ON agreed to sell an 80% stake in two wind farms in the United States to Canada's Enbridge, as the group continues to rake in much-needed cash by building and selling pricey renewable assets. The deal gives the two wind farms - with a combined capacity of 505 megawatt (MW) - an enterprise value of about $650 million, E.ON said in a statement on Friday. The two wind parks - Magic Valley 1 in Texas and Wildcat 1 in Indiana - provide enough power for more than 120,000 households. The deal bolsters Enbridge's renewable portfolio. "This strategic investment provides a significant contribution to our growth targets in power generation," said Vern Yu, Senior Vice-President of Corporate Development for Enbridge, Canada's largest pipeline company. Over the past five years, Enbridge has spent about $3 billion in renewable assets.

Total – Norway's Statoil said it has postponed a decision to invest 40 billion crowns ($5.74 billion) in a mature field, saying that it needed more time to refine the project as its profitability was under threat. Statoil said it would decide in October next year instead of March whether to go ahead with a new platform at the Snorre field in the Norwegian Sea as it hoped to cut costs and get more precise cost estimates. The project, which could squeeze another 240 million barrels of oil out of the field, has been in doubt due to high costs, and uncertainty has risen since oil prices tumbled to a five-year low. Analysts estimate that the Snorre platform's break even cost, including the investment and actual production spending, would be over $80 per barrel, well above the current $69 per barrel oil price. Petoro, the Norwegian government's holding firm, has been the biggest advocate of the project, while other shareholders have been less enthusiastic due to profitability concerns. Statoil holds 33.3% of Snorre, while firm Petoro holds 30% percent. Other shareholders include ExxonMobil, Idemitsu Petroleum, RWE and Total.

OPEC left its oil-output target unchanged last Thursday, resisting calls from Venezuela for action to halt this year's plunge in prices. The group maintained its collective ceiling of 30 million barrels a day, Ali Al-Naimi, Saudi Arabia's oil minister, said after the 12-member producer group gathered for talks at its headquarters in Vienna. Brent crude fell below $75 a barrel after the decision, for the first time since September 2010.

Oil collapsed into a bear market this year as the U.S. pumped at the fastest rate in more than three decades and threats to supply from Iraq and Russia faded. The group's production ceiling has been in place since the start of 2012.

We share the belief that the balance of power has shifted and OPEC is accepting the fact that its ability to control the long-term price of oil is limited. "The market is oversupplied," said United Arab Emirates Energy Minister Suhail Al-Mazrouei. "But the oversupply is not from OPEC." OPEC is to keep their 30Mbpd quota and it'll take some time to see if they reign back some of the 0.5-1Mbpd oversupply versus quotas. Assuming they don't then we believe what we are about to see is a knife taken to non-OPEC industry capex. In 2009, non-OPEC industry capex ex acquisitions fell 16% or close to $100Bn after the last material oil price correction. Many budgets were on pause until OPEC's decision and will now factor in new lower price decks. Russian companies like Lukoil already said 20% lower capex (that's $3Bn less already) last week when Brent was $80/bbl: We expect high cost conventional oil supply is about to be shut-in as it was in 2008/2009, 1998/1999, and 1986/1987. Bernstein research indicates there is still roughly 800kbpd of marginal US stripper well production (3bpd well avg) which will see shut-ins. There is 300kbpd of small field production in Russia which was being shut in during 2008/2009. There is 80kbpd of shallow water Gulf of Mexico production than was shut in during 2009 when Brent fell through $100/bbl with similar numbers in the UK. This leaves us strongly believing that this is one of those unique entry points to Energy again. Simply put (and referencing Bernstein Research) the 2014 market is 1% oversupplied driven by $100/bbl WTI financed by US supply and Brazil, while global demand was revised down by 50% over the last four months. Supply of +1.8Mbpd is the first time witnessed in 30 years, while global demand growth levels of +0.7Mbpd is more common to recessionary periods. Next year's IEA's numbers of +1.2Mbpd global demand and +1.3Mbpd of non-OPEC supply are already better balanced, but we can now expect the +1.3Mbpd to be revised down at $70/bbl oil given it includes +0.95Mbpd from US shale.

Besides the high cost producers, the other collateral damage from last week's OPEC move (lack of move) might just be the Russian economy. Economists now expect Russia will sink into recession at current prices. Russia, which receives about half of its budget revenue from oil and gas taxes, is closing in on its first slump since 2009 after dodging recession this year as it lurched from one crisis to another following the takeover of Crimea from Ukraine in March….. personally I don't believe oil crises are ever just about oil ….

Financial Sector

Barclays' wealth management business in Asia is expected to double its revenue by 2019 on the back of markets with burgeoning wealth that include Japan, China, and Indonesia, the Business Times reported, citing a top executive. With this, it is also boosting its sales force in the region by 25% over the next 12 to 18 months, said Didier von Daeniken, head of wealth management for the Asia-Pacific, Middle East and Africa. The bank has about 100 private bankers in Singapore and Hong Kong. "We have the full support of London in pursuing a growth strategy in Asia," he said. Reuters

BNS – Last Tuesday, the Wall Street Journal highlighted that Santander Mexico has reached an agreement to buy a consumer loan portfolio from Scotiabank Mexico, valued at 4.1 billion pesos (approximately $300 million). Terms of the deal were not disclosed. According to Scotia Mexico's press release the bank is expanding in different credit segments, consolidating its participation in products, optimizing market opportunities, and is continuing its growth plans, including 3.6 billion pesos to invest in new technologies and systems. It's estimated the portfolio sale represents roughly 2% of Scotia Mexico's loan book, and less than 1% of the bank's total loan portfolio and so we believe will have a marginal impact to bank's bottom line, as Scotia confirms its interest in growing the business in Mexico, and reiterates its commitment to the country and its growth prospects.

Credit Suisse - may announce leadership change before Christmas SonntagsZeitung reports. The Swiss newspaper cites unidentified person in report on "leadership vacuum" at Credit Suisse. SZ cites Credit Suisse as saying: "There is no reason to speculate about the resignation of Brady Dougan. He is completely focused on his job." A Credit Suisse official confirms comment made to newspaper and declines to comment further in phone call with Bloomberg News.

ING - plan to cut 1700 jobs over the next 3 years as it digitalises its banking services, the Financial Times reports. The cuts will mostly be at the ING Retail Banking HQ, back offices, call centres and IT. An "Omni-channel" approach of customers being able to do all their banking digitally across all channels is the plan. ING expect to save €270mn a year from 2018 onwards, and will take a pre-tax redundancy provision of €320mn in Q4.

Canadian Dividend Payers

BCE Inc - Canada's largest telecommunications company, said it would buy mobile phone retailer Glentel for about $594 million in cash and stock. The move was viewed as defensive in nature and greeted with muted investor enthusiasm. BCE, which operates under the Bell brand, is fighting to win market share against the two other dominant national wireless providers, Rogers Communications Inc and Telus Corp, as well as regional rivals. Burnaby, British Colombia-based Glentel sells mobile phones under the WirelessWave/Wave Sans Fil, Tbooth wireless and WIRELESS etc. banners across 494 stores in Canada. Glentel offers wireless plans from Bell as well as Rogers and its budget brands Fido and Chatr, SaskTel and Virgin Mobile. Glentel also sells mobile phones in Australia, the Philippines and the United States. Including debt and a minority interest, the deal is valued at about C$670 million.

Global Dividend Payers

Deere: reported FY4Q 2014 EPS of $1.83 vs. Consensus of $1.57. Tax rate was a ~$0.12 headwind. Total equipment revenue of $8.0bn was above expectations of $7.6bn, while total segment operating margin in the quarter was also above forecast (11.3% vs. our 9.9%). Equipment revenue reflected better than expected revenue in both Ag & Turf ($6.2bn vs.$5.9bn), and Construction & Forestry ($1.9bn vs. $1.7bn). Both Ag & Turf margin (11.1% vs. 10.1%) and C&F margin (12.2% vs. 9.0%) were above forecast. Ag & Turf decremental margin of 38.4% was ~in line with the 38.1% forecast. Deere introduced FY 2015 net sales guidance of down ~15% and net income guidance of ~$1.9bn. DE's FY15 Ag & Turf net sales outlook is down ~20%; C&F net sales guidance is up ~5% y/y. We think the drivers that set Deere apart from many others – solid free cash flow, strong share repurchases, good cost controls, and even an improving construction business are helping to support EPS in the face of a steep cyclical decline in global ag. We think the market already anticipated the reduced 2015 guidance and arguably more importantly we believe is the amount of stock Deere repurchased in the quarter. Deere bought back close to 13mn shares in FY4Q compared to a total of ~18mn over the prior three quarters of FY14. That translates to a much lower share count heading into FY 2015, with EPS potentially being closer to $5.60-$5.70 and reflects well on management for doing what it can to support relatively resilient EPS in softer-than-expected global ag markets.

Kingfisher: reported 3Q 2014/15 results that were slightly below expectations, with retail profit of £225m (-11.8% YoY), 1.7% below expectations (£229m) due to a weak performance in the Other International business. France was in line with consensus although outlook comments there are pretty weak and the UK was marginally better than consensus leaving the shortfall to come all from Other International where Poland was weaker than expected and the FX created a negative £13m adjustment mainly due to the Russian ruble. In France Like For Like sales were down 4% with both Castorama (-3.4% LFL) and Brico Depot (-4.6% LFL) showing weak performances and a sales deterioration into the quarter so despite the French retail profit being in line with consensus at £120m, it creates potential pressure into 4Q. the French gross margin was weak down 50bps y/y. In the UK B&Q LFLs were up 0.5% with Screwfix LFL surprising to the upside up 13% and UK retail profit at £70m marginally better than consensus at £68m. The gross margin in the UK was 10bps higher y/y. Finally in other international Polish LFL were down 1.1% below consensus at flat and together with a very adverse currency move resulted to retail profit of £35m down 33% y/y and £6m short of consensus expectations. Management delivers a cautious message this morning.

Economic Conditions

US – The US personal income advanced 0.2% in October, less than the expected 0.4% improvement and in line with September's 0.2% reading. Part of the same report, the core personal consumption expenditures (PCE) price index, the US Fed's favourite inflation gage, was up one tenth, to 1.6% in October, continuing to provide plenty of room for the central bankers' very accommodative stance. The indicators of consumer confidence were surprisingly soft at the end of November, with the University of Michigan's metric, at 88.8 index points, falling short of the expected 90.0 index points, while the Conference Board's counterpart actually moving lower to 88.7 points from 94.1 in October, short of the expectations for an improvement to 96.0.

On the US housing front, the Case-Shiler reading of the US home prices for 20 metropolitan areas, at 4.9% higher in year on year terms in September, was softer than August's 5.6% rate, but ahead of the expected 4.6% reading. Pending home sales, meanwhile, retreated 1.1% in October, a potential sign of weakness for existing home sales in the months to come.

Released this morning, the November purchasing managers index (PMI) by the Institute for Supply Management (ISM), a key leading indicator of business activity, inched lower to 58.70 from 59.00 in October, indicated continued expansion, though perhaps at a slightly slower pace. The consensus had expected a milder 57.80 points read. Core durable goods orders unexpectedly dropped 0.9% in October, adding to the weakness recorded in September, as primary metals, electrical and appliances and computer related industries slowed down in the month. The headline reading was up 0.4%, due to a boost from the notoriously bulky transportations industry orders.

U.S. consumer spending rose 0.2% in October, a bit disappointing but September's decline was revised to show a flat reading. In real terms, this also amounts to a 0.2% increase, which is an OK (but not terrific) way to start off Q4. Interestingly, what consumers were spending on was widespread, on all major categories except for cars (i.e. household equipment, recreational goods & vehicles, eating out, clothes, and energy).

U.S. new home sales unexpectedly rose in October, with the 0.7% gain the third increase in a row, to 458,000 annualized, the highest in just over a year. In fact, we haven't seen a trio of gains in a year. That's the good news. The bad news came in the form of history. The prior three months were revised downward, by 2.2%. So the good news is that the direction is right, but the levels are lower.

Canada – Canadian economy advanced at a 2.8% annualized pace in the third quarter, boosted by strong exports, but also helped by continued strength in the housing and consumer sectors. The reading was significantly ahead of the expected 2.1% improvement and is building on the second quarter's 3.5% advance.

Canadian retail sales also surprised on the upside, recording a 0.8% advance in September, more than offsetting August's 0.2% retreat. The key contributor to the improvement was the auto sales category, as manufacturers stimulated sales of current year models ahead of the 2015 cohort launch.

Canada's housing market is likely to achieve a soft landing but authorities may need to tighten mortgage rules more than they have already to make it less vulnerable to a crash, the International Monetary Fund (IMF) said on Wednesday. Officials at the international agency said the Bank of Canada can afford to keep its monetary policy accommodative until signs emerge of a more balanced and durable recovery with stronger business investment. (source: Reuters)

UK economy grew by 0.7% between July and September, following growth of 0.9% in the second quarter, the ONS reported. Strong consumer and government spending drove UK growth in the third quarter as business investment and exports contracted against an increasingly uncertain global backdrop. Household spending, which accounts for nearly two-thirds of UK output, grew at its strongest rate in four years as lower inflation and an ongoing supermarket price war helped to boost household incomes and support consumption. Spending grew by 0.8pc on the quarter, following growth of 0.6pc in the previous three months, according to the ONS. (Source:The Telegraph).

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 1.70% and the UK's 2 year/10 year treasury spread is 1.40% - 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 3.97% - (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 5.3 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 13.33 (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, Credit-Suisse, BMO, KBW, Barclays, Bernstein

Source:Thomson Reuters, Bloomberg, Credit-Suisse, BMO, KBW, Barclays, Bernstein

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