News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments Sep 8th 2015

Energy Sector

North American auto sales – The U.S. auto industry powered ahead in August, topping sales estimates and shrugging off gyrating stock markets as consumers continued to show their penchant for pickup trucks and SUVs. U.S. auto sales were the strongest in any month since July 2005. The annualized selling rate in August was 17.8 million vehicles, according to Autodata Corp, well above expectations of 17.3 million. The six largest automakers in the U.S. market all beat the sales forecasts of industry analysts, with Toyota, Honda, Nissan and GM reporting declines that were not as severe as expected. Ford said sales of its F-Series pickup trucks topped 70,000 for the first time this year - at 71,332, up 4.7%. Mark LeNeve, head of Ford's U.S. sales, said Ford SUV and truck sales both rose about 12% while car sedan sales fell 7%. GM's Chevrolet Silverado and GMC Sierra pickup trucks together outsold Ford's F-Series, at more than 76,000. Silverado sales rose 11.7% and Sierra sales were up 7%. A healthy appetite for light trucks pushed auto sales in Canada to a monthly record in August. Overall sales nudged 2.2% higher to 175,512 cars and light trucks, making it the strongest August on record. Year-to-date sales were up 2.3% percent at 1,285,959 vehicles. Light truck sales were up 10%, accounting for 60.9% of the market in August, with passenger cars making up the remaining 39.1%. GM sold 24,653 cars and trucks in Canada, up from 22,111 a year earlier, as truck sales jumped 14.6%, and car sales rose 3.2%. Ford's Canadian sales fell to 26,581 vehicles, down from 27,969 a year earlier, hurt by declines in both car and truck sales. Fiat Chrysler sold 26,928 cars and trucks in August, up from 26,825 a year earlier. Jeep sales rose 9.2%, while Dodge brand truck sales were up 10.1%, but Fiat Chrysler's total car sales dropped 19% to 2,036 vehicles.

Royal Dutch Shell – Russia's Gazprom and its European partners signed a shareholders' agreement on the Nord Stream-2 gas pipeline project that will run beneath the Baltic Sea to Europe, bringing Europe closer into Moscow's energy orbit, a move criticized by the U.S. energy envoy. Russia provides for around a third of EU energy needs, but around half of the gas the EU imports from Gazprom is shipped via Ukraine, with which Russia is in conflict. It wants to find new ways to deliver gas to Europe bypassing its neighbour. Gazprom, E.ON, BASF/Wintershall, OMV, ENGIE and Royal Dutch Shell formed the new consortium for the project. Gazprom is fighting to defend market share in Europe in the face of oversupplied gas markets, betting on rising long-term demand as Europe's indigenous gas sources decline. Led by Gazprom, which has put the cost of the plan at up to €9.9 billion, the group is to build a third and fourth pipeline to transport up to 55 billion additional cubic meters of gas a year. It would double the capacity of lines 1 and 2, which take the same route. The new pipelines are due to start transporting gas by the end of 2019.

Total SA's 225,500-barrel-per-day (bpd) Port Arthur, Texas, refinery may run at reduced production levels for up to two weeks due to a cut in coker operations following a fatal accident. Total is currently seeking a partner to purchase a 50% stake in the Port Arthur Refinery.

Financial Sector

Bank of America - U.S. banking regulators gave Bank of America the green light on Thursday to use its own internal models to compute their capital requirements. The Federal Reserve and the Office of the Comptroller of the Currency previously granted similar approvals for other big banks, including Wells Fargo, which won approval in March. The Fed said Bank of America can start using its own models in the fourth quarter of 2015. Reuters

Berkshire Hathaway – Warren Buffett's Berkshire Hathaway Inc disclosed a $4.48 billion stake in oil refiner Phillips 66 PSX.N, rebuilding a bet it had made in the energy industry before oil prices fell. The 57.98 million-share, or roughly 10.8%, stake was revealed in a filing with the U.S. Securities and Exchange Commission. Berkshire once held a large stake in the Houston-based company, but shed nearly two-thirds of it in February 2014 when it swapped $1.35 billion of shares for a chemicals business that it folded into its Lubrizol unit. Berkshire does not normally say whether Buffett or his portfolio managers Todd Combs or Ted Weschler make specific investments, but larger investments are generally Buffett's. Berkshire ended June owning $117.7 billion of equities. It also owns more than 80 businesses, and on August 10 said it would buy Precision Castparts Corp, which makes parts for the aerospace and energy industries, for roughly $32.3 billion.

Citigroup plans to rebuild its long-neglected equities franchise seeking to capitalize on a retrenchment by rivals in the face of new rules designed to make the financial system less risky, according people familiar with the bank's plans. A lack of investment in equities and a traditional focus on bond trading kept the No. 3 U.S. bank by assets in the lower echelons of equities league tables, which measure how much revenue Wall Street banks earn from their equity trading units. But having shored up its business and capital ratios since the financial crisis, largely by spinning off non-core assets, Citi now aims to profit from a retreat of rivals that were slow in adapting to new rules that force banks to keep more capital, two people with direct knowledge of Citi's plans told Reuters.

Fifth Third Bank - First National Bank of Pennsylvania, the largest subsidiary of F.N.B. Corporation entered into a purchase and assumption agreement to acquire approximately $383 million in retail and private banking deposits, 17 branch banking locations and related consumer loans in the Pittsburgh MSA from Fifth Third Bank. The transaction will be additive to FNB's retail delivery channel, creating access to over 100 branches in the Company's Pittsburgh region, and is expected to close in early 2016, subject to regulatory review and approval.

HSBC - Sky news reports HSBC is to rebrand its British branch network as 'HSBC UK' from the beginning of 2018.

ING Groep's talks to buy the Turkish unit of HSBC Holdings Plc have reportedly stalled amid political and market turmoil.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

The European Central Bank (ECB) has cut its inflation and growth forecasts for 2015 and the next two years. It expects inflation in the Eurozone to remain "very low" for some years as threats to economic growth increase. ECB president Mario Draghi said Europe's economic recovery would continue, "albeit at a somewhat weaker pace than expected". The ECB is now forecasting economic growth in the Eurozone of 1.4% in 2015, down from 1.5%, and 1.7% in 2016, compared with its previous projection of 1.9%. BBC News

Activist Influenced Companies

Nothing to report this week.

Canadian Dividend Payers

Nothing to report this week.

Global Dividend Payers

AusNet Services the energy company reached an out-of-court settlement with the Australian Taxation Office (ATO) in a dispute relating to intellectual property deductions claimed by AusNet. AusNet says the settlement eliminates A$27 mln ($18.77 mln) tax exposure and ensures there would be no further up-front tax payments in relation to dispute. AusNet confirms it has resolved all its disputes with the ATO.

Cheung Kong Infrastructure Holdings Ltd (CKI), part of billionaire Li Ka-shing's business empire, offered to buy all the shares it does not already own in Hong Kong utility Power Assets Holdings Ltd in an all-stock transaction valued at $11.6 billion. CKI will issue 1.36 billion new shares to buy the 61% of Power Assets it does not own, the companies said in a joint securities filing. The deal will help CKI to take advantage of Power Assets' cash pile, which stood at HK$67.8 billion at the end of June, to strengthen its balance sheet and help with future expansion, the company said.

It forms part of an overhaul begun in January aimed at tackling a valuation discount caused by the conglomerate structure in Li's business empire. That restructuring created two listed companies, Cheung Kong Property Holdings that focuses on property, and CK Hutchison Holdings with the telecoms, retail, aircraft leasing and ports assets of the group. "We will continue to carry out deals in the future and then reinvest money into the company," CKI Chairman Victor Li said at a news conference. "As an infrastructure company, the larger we get, the larger deals we can do." CKI has no plans to spin off any of its businesses for now, Li said. As part of the deal, CKI will also pay a special dividend of HK$5 per share to all its shareholders, including new ones that previously held Power Assets stock. That would cost the company nearly $2.5 billion. The merged company will have a presence in Britain, Australia and Canada, with assets including Northumbrian Water, UK Rails and Australian Gas Networks.

The transaction will dilute the stake held in CKI by Li's CK Hutchison Holdings Ltd to 49.2% from 75.7% before the deal. Shares of Power Assets will be delisted from the Hong Kong stock exchange after the transaction is completed, which CKI expects to take place by early 2016, according to the filing.

Novartis – kicked off a new era in U.S. medicine with the launch of the first "biosimilar" copy of a biotechnology drug approved in the United States, at a discount of 15% to the original. The Swiss drugmaker's generics unit Sandoz said Zarxio, its form of Amgen's white blood cell-boosting product Neupogen, would increase access to an important treatment by offering a "high-quality, more affordable version". U.S. biotech group Amgen had tried to stop the sale of Zarxio, also known as filgrastim-sndz, but the Washington-based appeals court rejected its attempt to block the launch.
The potential for copycats to take business from original biotech drug brands is increasingly grabbing investors' attention, although uncertainties remain as to how quickly so-called biosimilars will win business. Biosimilars have been on the market in Europe since 2006. However, the U.S. regulatory pathway for biosimilars, which are made in living cells and can never be exact replicas of originals, was only established by a healthcare reform in 2010. Amgen said it intended to compete effectively with the new product and would base promotion on its 24 years of clinical experience with Neupogen. "All biologics, including biosimilars, are highly complex molecules and each manufacturer's product will be distinct," the U.S. drugmaker said in a statement. The arrival of biosimilars threatens companies heavily reliant on biotech drugs, such as Amgen, AbbVie and Roche. As a result, investors have been watching the Zarxio case closely, since it could determine the way in which a wave of other lower-cost biosimilars are received by regulators, courts and healthcare providers. The 15% discount is the same price gap set when Zarxio was launched in Europe in 2009, although the discount in Europe has since widened to an average of around 20% to 30%. Insurers hope biosimilars will eventually cost the public 40% to 50% less than the original brands. Neupogen is a $1.2 billion-a-year medicine for Amgen that boosts white blood cell counts to fight infections in cancer patients. The majority of its sales are generated in the United States. An even bigger prize lies in the development of copies of multibillion-dollar antibody drugs for the treatment of diseases like cancer and rheumatoid arthritis, where Sandoz and rivals are also working to bring products to market.

Syngenta – Swiss agricultural chemicals group plans to buy back more than $2 billion worth of stock to boost shareholder returns after rejecting a takeover approach from Monsanto Co, selling its vegetable seeds business to fund the measure. The world's largest pesticides company is under pressure to offer tangible rewards to shareholders after it turned its back last week on a cash-and-shares bid from unwanted U.S. suitor Monsanto worth $47 billion at the time. The Swiss group will part with the most profitable of its seeds businesses, which has gross profit margins of well above 60% compared with about 45% for all seeds last year, complicating its efforts to widen group margins. However, finance chief John Ramsay said a sale was the best way to exploit the strength of that business. Valuation multiples in vegetable seeds are "quite easily" in the 3-6 times sales range, the CFO said. With revenues of $650 million, that implies targeted proceeds of up to $3.9 billion that should easily pay for the share buyback. The company expressed confidence in its 2018 margin goal of 24%-26% and reiterated the full-year guidance for 2015 it gave in July. It said that the share repurchase programme, which it described as "initial", would commence in the coming weeks, with no change to its policy of increasing dividends . Syngenta's Chairman Michel Demare had promised a thorough review of the company's product lineup after Monsanto walked away, and raised the prospect of taking a major investor on board.

Tesco has announced the sale of its Korean subsidiary Homeplus for £4.24bn EV (£4.0bn cash) to a consortium led by MBK Partners. Note that Tesco faces c£650m of capital gains tax and other costs, so net cash in is more like £3.35bn. The company expects the transaction to close later in this financial year. Korea generated £5.35bn of sales and £292m of trading profit (ie EBIT) in the last financial year – ie c8.5% and 21.0% of sales and EBIT respectively. However, its weight within the group may have looked different in future to the past. Homeplus generated £466m of EBITDA in 14/15 – so the pre-tax EV of £4.2bn is equivalent to a 9.0x multiple on last year's earnings – but more like 7.7x on a post-tax basis.

The sale is important because it: (i) eliminates the speculation about a rights offering; (ii) increases operational flexibility for the management team; (iii) improves negotiating leverage in the dunnhumby sale; and (iv) allows management to re-focus their attention on the UK.

Economic Conditions

US – The US economy added 173,000 positions in August, falling short of the expectations for a 220,000 payrolls gain, but upward revisions in prior months offset the headline disappointment. Private payrolls grew by 140,000, while 17,000 manufacturing jobs were lost in the month. The headline unemployment rate dropped further, to 5.1% from 5.3% in July, putting added pressure on the US Fed to initiate its tightening cycle. Both the average workweek hours and the average weekly earnings advanced in August.

The US manufacturing purchasing managers index (PMI) retreated more than expected in August, to a 51.10 index points level from 52.70 in July, though the details of the report were rather mixed, with more than half of the industries surveyed actually expanding in the month. The non-manufacturing (services) equivalent of the PMI, the NMI, retreated as well in August, though the actual reading of 59.00 index points was better than the consensus expectations. The US productivity, meanwhile, jumped 3.3% in the second quarter of the year, on a background of steadily improving labour market, a welcome addition to an otherwise mixed business activity string of data over the past week.

Canada – Employment in Canada improved by 12,000 positions in August, against expectations for a loss of 4,500 jobs in the month, driven by a 54,400 gain in full-time jobs, though most of it was driven by an increase in the public sector jobs. A significant increase in the labour force led to a surprise jump in the headline unemployment rate to 7.0% in the month, versus July's 6.80%. The labour productivity retreated by 0.6% in the second quarter of the year, in line with the expectations.

The GDP reading for the second quarter confirmed the technical recession expectations, as the economy contracted by 0.5% in the quarter, less, though, than the full 1.0% drop embedded in the consensus expectations. The economic output in the quarter was dragged lower by a drop in business investment, likely as imports of equipment became more expensive due to lower Canadian dollar, offset by continued strength in consumer spending and housing. The country's balance of trade of July turned out to be a better than expected, $590 million deficit, as exports rose 2.3% in the month, driven by aerospace and automobiles, while imports were only up 1.7% over the same period.

UK service sector growth slowed to its weakest rate for more than two years in August, a survey has indicated. The latest Markit/CIPS service sector purchasing managers' index (PMI) fell to 55.6 last month from 57.4 in July. Although the figure remained above 50, indicating expansion, it was the weakest reading since May 2013. Markit estimated the UK economy would grow by 0.5% in the third quarter of 2015, down from growth of 0.7% in the previous three months. Earlier this week, a survey of the manufacturing sector also found growth slowing, although the construction sector recorded a slight pick-up in activity. BBC News

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 earliest September 2015. The US 2 year/10 year treasury spread is now 1.445 and the UK's 2 year/10 year treasury spread is 1.22% - 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 3.89% (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 5.0 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 25.00 (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 Investment Counsel Inc. currently offers 7 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
- Portland Value Fund

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency & Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

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, Credit Suisse, Macquarie, Barclays, TD, Scotiabank

Source: Thomson Reuters, Bloomberg, KBW,BMO, Credit Suisse, Macquarie, Barclays, TD, NBFinancial

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

PIC15-045-E(09/15)