News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. December 21, 2015

It seems an unprecedented era in modern history is drawing to a close. I've been writing this Newsletter for nearly a decade and last week was the first time the US has raised interest rates during that period. Back then we had not heard of an 'iphone' or 'quantitative easing' or ISIS. And so the era of near-zero borrowing costs draws to a close, coinciding with the lifting of the US ban on crude oil exports.

Looking ahead let us hope global economic sanity and people more 'at ease' with each other prevails.

This will be our last Newsletter in 2015. We wish you a very Merry Christmas with our best wishes for the New Year.

Energy Sector

Oil - As the abbreviated holiday week commences, oil markets remain under pressure with Brent-linked crude futures contracts for January delivery reaching an 11-year low in trading in London this morning. The impact of sustained low energy prices has now rippled into every facet of the global economy.

Whitecap Resources Inc. elected to reduce its 2016 capital program by 27% to $150 million from $205 million previously announced on November 10, 2015. The revised capital program is designed to maintain financial flexibility and to prudently develop its high quality asset base through this volatile commodity price cycle. Whitecap reduced its crude oil price forecast to US$40/barrel (bbl) WTI (West Texas Intermediate) in Q1/2016, US$45/bbl WTI in Q2/2016 and US$50/bbl WTI in 2H/2016. The company's production guidance is 3% lower at 40,100 barrels of oil per day (boe/d) compared to 41,500 boe/d. It reserved the option to increase its capital program should there be a stronger commodity prices environment later in the year. Whitecap's strategy remains focused on return on capital and moderate growth on a sustainable basis. The wells included in its reduced capital program have been high-graded to ensure that individual well economics provide a minimum internal rate of return (IRR) of 40% at US$35/bbl WTI. The company is comfortable in maintaining its current monthly dividend of $0.0625/share through Q1/2016. Whitecap will re-evaluate the dividend on a quarterly basis, taking into account net debt, cost of services, capital efficiencies, current production and the commodity price outlook for the remainder of 2016. Whitecap does not have a dividend reinvestment program and remains focused on ensuring the dividend is fully funded through internally generated cash flows.

Financial Sector

Alcentra Capital Corporation invested $8.2 million to National Technologies Inc. to support a majority investment by O2 Investment Partners, LLC.

Barclays plc agreed to sell Barclays Risk Analytics and Index Solutions (BRAIS) to Bloomberg LP for approximately £520 million. Pre-tax gain to be recognized on completion, expected to be approximately £480 million, estimated to result in pro-forma increase of approximately 10 bps on the September 30 Core Equity Tier 1 ratio. BRAIS incorporates Barclays' benchmark indices, including the Barclays Aggregate family of indices. Barclays has agreed to continue to operate the portfolio analytic tool, POINT, for 18 months post completion in order to help clients transition to other providers, including Bloomberg's PORT product. Completion expected to occur by mid-2016.

Canadian Imperial Bank of Commerce has announced this morning that the bank will divest of its 41% stake in asset manager American Century Investments (ACI) for approximately US $1 billion (about CAD$1.4 billion) in a sale to Japanese bank Nomura Holdings, Inc. – the transaction ends the 4-year relationship between CIBC and ACI, as the bank had originally purchased its stake (from JPMorgan Chase & Company) in July 2011 for US $848 million -- strategically, we believe for one reason or another the path to full control of the entity was an unlikely occurrence, so instead management has opted to "trade" some near-term earnings power for a more robust capital position that will allow for deployment opportunities that are a better fit – on capital, CIBC is stating that the divestiture will improve their Core Equity Tier 1 ratio by approx. 50bps, which on a pro-forma basis bumps the already sector-best 10.78% ratio that CIBC ended 2015 with up to approx.11.3%.

Citigroup Inc. plans to cut at least 2,000 jobs around the world starting next month as Chief Executive Officer Michael Corbat restructures some of the bank's businesses. It is understood the substantial portion of cuts will be in middle or back-office positions. The reductions are part of a repositioning the firm announced this month and will occur across the New York-based lender's global footprint.

Fifth Street Senior Floating Rate Corp. (FSFR) Core earnings of $0.25/share marginally exceeded expectations while net asset value was down ~1% quarter/quarter to $12.11/share. Interest income exceeded estimates though fee income came in below expectations. Net originations were relatively flat quarter over quarter given that FSFR is already operating within its targeted leverage range and essentially fully ramped at ~0.91x debt-to-equity. Dividend coverage appears adequate and book value relatively stable even during a pretty volatile quarter for most business development companies (BDCs), so overall, it was an in-line quarter with few surprises. Following an audit, FSFR

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identified it had prematurely recognized $8.1 million in fee income though partially offset by the early payment of $1.5 million in fees to the investment advisor. Since the errors were not material in accordance to regulatory guidance, FSFR simply revised its previous financials related to fiscal 2013 and 2014 along with the first three quarters of this year. Additionally, the owner of the investment advisor, Fifth Street Holdings LP, will refund the $1.5 million of premature fees paid by FSFR. Management noted that the focus this year had been on deploying capital to grow the portfolio and reach the company's targeted leverage range. Management indicated they may look to implement a share repurchase program in 2016.

HSBC Holdings PLC names Noel Quinn CEO of Global Commercial Banking. He replaces Simon Cooper who has resigned to join Standard Chartered (see below). Quinn joined HSBC in 1987, ran commercial bank in Asia- Pacific from 2011-2015 and the UK 2008-2011.

JPMorgan Chase & Company will pay more than US $300 million to settle allegations it didn't inform clients properly about numerous conflicts of interest in how it managed customers' money over a half decade. The largest US bank by assets didn't tell customers it profited by putting their money into mutual funds and hedge funds that generated fees for the company, the SEC said in announcing US $267 million in penalties and disgorgement against JPMorgan. The bank agreed to pay US $40 million more as part of a parallel action by the Commodity Futures Trading Commission.

Royal Bank of Scotland PLC (RBS) issued an update on significant progress in separating Williams & Glyn. The banking licence application for Williams & Glyn was submitted on September 30, 2015 and RBS is now working with the UK regulators towards obtaining the licence and separating the business from RBS. RBS is now planning to launch the trade sale process in 1st Half 2016 and separate the business from RBS in Q1 2017 which remains compatible with the end 2017 divestment deadline.

Standard Chartered PLC hires HSBC's Simon Cooper to run its investment bank. Cooper is to start as CEO of corporate and institutional banking in April. Cooper replaces interim head Mark Dowie, who will get a new role at the bank. Cooper joins from HSBC where he was CEO of global commercial banking.

Sumitomo Mitsui Financial Group (SMFG) - Sumitomo Mitsui Finance and Leasing, a unit of SMFG, has agreed to buy General Electric's Japanese commercial lending and leasing business for about $4.8 billion. The purchase is expected to be completed by April. It is the second acquisition of a GE business by SMFG after it bought out GE's European buyout financing arm. (Source Bloomberg)

Activist Influenced Companies

Mondelez International is in the midst of implementing two major organization structure changes: chief amongst these is a move away from country-by-country management. The company still has five regions – North America, Europe, Eastern Europe, Middle East and Africa (EEMEA), Asia Pacific and Latin America. But within each region the company is now managing across five product categories – Biscuits, Chocolate, Gum & Candy, Beverages and Cheese & Grocery - instead of on a country-by-country basis. The company now pulls together five Profit & Loss divisions in each region at the level of 'chocolate in Europe' rather than for each individual country. So five regional product managers now report to their Regional Presidents in the region. Mondelez has just gone through its first strategic planning cycle under the new structure. In addition to the simplified organizational and reporting structure, the company has created a global shared services organization based in India. This is now where all the back office functions reside – finance, order processing, accounts payable and receivable and so on. Apparently this new approach has been able to achieve a 40% reduction in headcount within the finance function globally with similar reductions expected in other functions. Globally, headcount has been reduced from 110,000 people at the end of 2012 to 104,000 at the end of 2014. The company currently employs less than 100,000 people and these reductions could accelerate from here as the company implements its organizational changes and pursues its zero-based-budgeting agenda.

Pershing Square Holdings Ltd./Valeant Pharmaceuticals Inc. a key holding of Bill Ackman's Pershing Square Holdings, has lowered its financial outlook for 2015 and 2016, cutting its earnings forecasts for the fourth quarter of this year from up to $4.20 to $2.55-$2.65. Expected earnings per share in 2016 are now between $13.25 and $13.75.

Valeant also announced last week it has entered into a new fulfillment agreement with The Walgreen Company that will provide patient assistance, such as co-pay assistance and cash pay programs, and introduce a new direct distribution model to the retail channel. Part 1 of Walgreen Agreement: covers Valeant's branded dermatology and ophthalmology branded products -- under the 20-year agreement, Valeant will distribute its branded prescription products directly to Walgreen and will reduce prices on those products by 10% -- we understand patients with commercial insurance will have access to co-pay assistance, including reduced co-pays as low as $0, and the program will provide a cash pay component for uninsured patients. Part 2 of Walgreen Agreement: covers >30 of Valeant's older products that are facing generic competition including drugs in dermatology, ophthalmology, gastrointestinal and neurology/other therapeutic classes -- under this agreement, Valeant has agreed to cut its pricing on the branded products to match generic pricing – this will give doctors the ability to prescribe brand medication for patients knowing it will cost the same as a generic substitute -- on average, the price reduction is expected by management to reduce the economics of the product portfolio by approximately 50% (range of 5% to 95% price cuts) -- these products will also be directly distributed to Walgreen.

Overall, Valeant expects the 2 agreements to provide approximately $600 million in savings for patients and the healthcare system – the overall impact on Valeant should be <$600 million, however as the company will be saving the distribution costs on all volume flowing through this new program (Valeant intends to extend this distribution model to additional pharmacies in the future). We believe these agreements are very attractive for Valeant as they address a number of concerns that have been raised by the market: 1) Valeant has essentially recreated its Philidor direct distribution channel, including a patient assistance program, using a large independent pharmacy chain. We believe the involvement of Walgreen legitimizes Valeant's strategy of cutting out traditional distributors and offering patient assistance programs. 2) Valeant is offering lower prices to patients and payors on its branded products which should be positively received by the system and may take some of the pressure off the company in the N-T from a media perspective.

Pershing Square Holdings Ltd./Canadian Pacific Railway Ltd., another key holding of Pershing Square accused Norfolk Southern Corporation of misleading investors even as its executives rolled out a new bid with increased shareholder protections to acquire the US-based railroad. Executives from Canada's second-largest railroad said the deal is now in the hands of Norfolk Southern's shareholders, and urged its board to consider CP's latest proposal. CP executives offered an additional 0.451 of a Contingent Value Right (CVR) in a new holding company for CP and Norfolk Southern that could be converted to cash and would increase the value of the deal by up to $3.4 billion, they said. Described as a type of 15-month "insurance policy," the CVR would protect shareholders in the event that the company's stock value falls below $175 a share in October 2017. CP estimates the new holding company's stock will be worth $204 at the transaction's expected closing in May 2016. Each railroad would be run separately by two different CEOs. Norfolk Southern said in a statement on that its board will "carefully consider" CP's latest proposal. A full merger between CP and Norfolk would require the approval of the US Surface Transportation Board.

Pershing Square Holdings Ltd./Platform Specialty Products Company, a company backed by Bill Ackman`s Pershing Square, has appointed Rakesh Sachdev as its new CEO, effective January 5, sparking a rally in the stock. Sachdev has more than 28 years of experience leading public companies, and has served as CEO and President of Sigma-Aldrich since 2010. "Rakesh`s deep leadership, strategy and execution experience are precisely the strengths Platform was looking for in its next chief executive," Martin Franklin, Platform`s Chairman and CEO, said in a statement. "He is the right leader at this stage of Platform`s growth." Ackman, whose fund owns an 18.6% stake in the company, recently reiterated his confidence in the company`s prospects and said it was undergoing a leadership transition.

Zoetis, Inc. – Animal healthcare company has increased its dividend by 14.5%, one year after it announced a slightly higher payout hike. In a press release, the company said it will pay $0.095 per share to shareholders in the first quarter of 2016. "Zoetis has continued to distinguish itself as a world leader in the growing animal health industry this year, based on our global scale, diverse portfolio and track record of innovation," Juan Ramon Alaix, the company`s CEO, said in a statement. Bill Ackman`s Pershing Square won two spots on the board earlier this year, and successfully pushed the company to announce a sweeping cost-cutting plan.

Canadian Dividend Payers

BCE Inc. – Canada's Shaw Communications Inc. said it has agreed to buy WIND Mobile Corporation, the country's fourth-largest wireless provider, in a deal that gives it a much-needed presence in the cellular market. Calgary-based Shaw said the deal valued Wind, and its parent company Mid-Bowline Group Corp., at CAD $1.6 billion, much higher than the roughly CAD $300 million a consortium of investors paid for the young wireless carrier in 2014. The takeover follows Rogers Communications Inc.'s CAD $465-million purchase of smaller rival Mobilicity, which was in creditor protection, in a series of deals that allowed Wind to snap up a suite of airwaves at a discount price. Wind operates in Ontario, Alberta and British Columbia. Shaw said Wind's existing management team will stay on. Wind has roughly 940,000 wireless subscribers, lagging far behind the three big Canadian players, each of which has at least 10 times the subscribers.

Global Dividend Payers

Bunzl PLC - Overall trading is said to be consistent with expectations at the time of the third quarter results where management were comfortable with Company compiled consensus of Profit Before Tax (PBT) at £408 million and Earnings Per Share (EPS) of 89 pence. Organic revenue growth in the second half is around flat and the third quarter level of approximately 0.5%. Revenue growth at constant currency is expected to be +5%, in line, and group operating margins are said to be the same as 2014. Full year results will be on February 29, 2016. Three more acquisitions have been announced, which add annualised revenues of £41 million, (approximately +0.6% on estimated 2016 revenues) and about £6 million to earnings before interest and taxation: 1) Comatec SAS distributes high-end tableware to restaurants and hotels in France and to other distributors globally. Revenue for FY15 is expected to be €19 million. 2) Emilio Saray Y Compania Limitada (DPS) is based in Chile, distributing catering disposables, cleaning, safety and packaging products. Revenue for FY15 is expected to be approximately £24 million. 3) Faru S.L. sells personal protection equipment in Spain. Revenue for FY15 is expected to be €5 million. The Spanish and French transactions have particularly high margins due to their own label offerings and niche positions. The total acquisition spend this year is £320 million across 21 businesses; a record spend for Bunzl in any one year; we believe the pipeline remains promising.

Carnival Corporation PLC Cruise Lines reported earnings per share of $0.50 versus consensus of $0.41. Net yields improved 4.1% (constant currency) versus guidance of 3%, reflective of stronger pricing and a structural shift in the industry to limit close-in booking discounts. For next year management guided to EPS in the range of $3.10 to $3.40 for 2016. We are encouraged by positive booking trends, which ultimately create an opportunity for Carnival to take price on the remainder of its bookings next year. The company indicated it finished 2015 with 7.5% return on invested capital (ROIC) and with a target of 8.5% ROIC for 2016, we believe Carnival is on track to reach its double digit goals in the next 2-3 years.

Toyota Motor Corporation announced its 2016 sales and production plans. Toyota Motor plans for 2016 parent domestic sales of 1.55 million units (up 50,000 units, or 3%, from its 2015 estimates) and overseas sales of 7.6 million units (down 50,000 units, or 1%). It plans for global sales to hold flat at 9.15 million units. Adding Daihatsu Motor and Hino Motors, Toyota plans for group domestic sales of 2.23 million units (up 70,000 units, or 3%) and overseas sales of 7.88 million units (down 60,000 units, or 1%). Toyota's global sales outlook comprises domestic growth and overseas decline, but it expects domestic growth to be generally negated by an overseas decline. Toyota's domestic plan appears to reflect a winding down of reactions to accelerated demand prompted by the consumption tax hike in April 2014 and by competition for the top market share for mini vehicles, as well as some expectations for accelerated demand ahead of a consumption tax hike in April 2017. Toyota's overseas plan appears to assume firm trends in North America, but weakness in Southeast Asia and the Middle East. We think Toyota's overall outlook is likely conservative.

Economic Conditions

The US Federal Reserve has raised interest rates for the first time in nine years, in an historic decision that officially marks the end of the global financial crisis. The unanimous decision of the Federal Open Markets Committee meeting lifted the Fed funds rate by 25 basis points, to an effective interest rate range of 0.25% to 0.5%. In the accompanying statement, the Committee judged "there has been considerable improvement in labour market conditions this year, and it is reasonably confident that inflation will rise, over the medium term, to its 2% objective". "Given the economic outlook, and recognising the time it takes for policy actions to affect future economic outcomes, the Committee decided to raise the target range for the federal funds rate to 0.25% to 0.5%," the statement read. "The stance of monetary policy remains accommodative after this increase, thereby supporting further improvement in labour market conditions and a return to 2% inflation."

Total US industrial production fell 0.6% in November, worse than expected (consensus: -0.1%), and the largest setback since March 2012. This was also the third decline in a row and there was a downward revision to October (now -0.4%, was -0.2%). Utilities were down again (-4.3%) …. guess that happens when you have the warmest November in six years. Mining took a 1.1% drop, but that was the smallest decline in the past three months. Energy bore the brunt of the pain; in fact, non-energy production was up 0.1% whereas consumer energy products / residential utilities were down -7.4%…. and that's not going to end soon given 16-year low natural gas prices. Non-energy nondurable consumer goods were up 0.7%, the first gain since August.

China's annual economic growth is likely to slow to 6.8% next year from an expected 6.9% this year, the People's Bank of China said in a working paper published last Wednesday. "Although downward pressures on growth will persist for a while due to overcapacity, profit deceleration, and rising non-performing loans, we expect that the number of positive factors will gradually increase in 2016," it said. Recent appreciation in the yuan's real effective exchange rate has put pressure on China's exports, the central bank report said, adding that keeping the yuan's trade-weighted exchange rate relatively stable could help exports. (Source Reuters).

Russia – It is understood the European Union is set to agree a six-month extension of its economic sanctions on Russia, once Italy's prime minister has discussed the issue with his fellow leaders at a summit in Brussels.

Spain - The current government, the conservative people's party (PP), have won the elections but unlikely to be able to form a government. An alternative government could mathematically be formed by the socialists, PSOE, by getting support from Podemos and a number of smaller parties. However, this outcome would be politically difficult and likely to be very unstable. Podemos has done better than recent polling suggested and has finished 3rd. This means they would heavily influence any government formed by PSOE, a fact likely to be taken negatively by the markets. Given the results and uncertainties around post electoral pacts, new elections cannot be ruled out in our view.

Financial Conditions

The European Bank for Reconstruction and Development (EBRD) has accepted China as a shareholder, another step forward in Beijing's ambitions to widen its international influence. The green light by the bank's governors announced last Monday was expected and gives China a token but symbolic 0.1% stake in the EBRD and a new way of extending its global reach after its recent steps to boost trade links with Europe and Asia. It also gives Beijing another foothold in an international organisation and takes the number of EBRD shareholder countries to 65. (Source Reuters)

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Third Avenue Management LLC's Third Avenue Focused Credit Fund (~$800 million AUM vs. $3.5 billion reported in July 2014; top holdings include media, gaming, and energy) last Friday blocked investor withdrawals due to illiquidity in the high yield market. This is also the first mutual fund to stop withdrawals without prior SEC approval (company indicating there wasn't enough time to get SEC prior approval). Third Avenue indicated investors may have to wait up to one year or more in order to receive funds back.

Bank of Japan (BoJ) unexpectedly altered its monetary policy status quo mode in the last meeting of 2015 (December 18) but did not have the desired effects as the new measures fell short of market expectations. The BoJ ended its last Monetary Policy Meeting (MPM) of 2015 on December 17/18 with a surprise announcement for the "Introduction of Supplementary Measures for Quantitative and Qualitative Monetary Easing." The key easing measures include: 1) Extending the average remaining maturity of its Japanese Government bond purchases from about 7-10 years to 7-12 years while maintaining the purchase amount unchanged at JPY 80 trillion a year. The gross amount of the BoJ's Japanese Government Bond (JGB) purchases in 2016 is expected to increase to about JPY 120 trillion from about JPY 110 trillion in 2015, due to an increase in the redemption of government bonds held by the Bank at maturity. 2) Establishing a new program for JPY 300 billion per year purchases of exchange-traded funds (ETFs) which track the JPX-Nikkei Index 400 in addition to current JPY 3 trillion a year ETF purchase program

The US 2 year/10 year treasury spread is now 1.24 %and the UK's 2 year/10 year treasury spread is 1.23% - 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.

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). Existing US housing inventory is at 4.8 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 20.70 (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 and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

We want to share our insights with you and welcome your feedback. Our website has the latest, as well as archived videos, company profiles, and press articles. Please visit us at www.portlandic.com.

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