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. April 18, 2016

Energy Sector

Doha OPEC oil production freeze talks – A deal to freeze oil output by OPEC and non-OPEC producers fell apart on Sunday after Saudi Arabia demanded that Iran join in despite calls on Riyadh to save the agreement and help prop up crude prices. The development will revive oil industry fears that major producers are embarking again on a battle for market share, especially after Riyadh threatened to raise output steeply if no freeze deal were reached. Some 18 oil nations, including non-OPEC Russia, gathered in the Qatari capital of Doha for what was expected to be the rubber-stamping of a deal - in the making since February - to stabilise output at January levels until October 2016. But OPEC's de facto leader Saudi Arabia told participants it wanted all members of the Organization of the Petroleum Exporting Countries to take part in the freeze, including Iran, which was absent from the talks. Tehran had refused to stabilise production, seeking to regain market share post-sanctions. Russian oil minister Alexander Novak called the Saudi demand "unreasonable" and said he was disappointed as he had come to Doha under the impression that all sides would sign the deal instead of debating it. Novak said Russia was not shutting the door on a deal but the government would not restrain output for now. In December, OPEC failed to agree on output policy for the first time in years after Iran disagreed over a production ceiling proposed by Saudi Arabia, arguing again that it wanted to boost output post-sanctions. The result of the negotiations is hardly surprising to us as is, we believe, to anyone following the rhetoric of Saudi Arabia, and to some extent, Iran, going into the meeting. We believe that continued demand growth, driven by record sales of vehicles in many developed nations and steady consumption improvement in developing nations, albeit short of last year's 1.8 million barrels pace, should drive the market towards re-balancing in the second part of this year. Drastic capital expenditures cuts in many supply areas of the globe, in particular U.S. shale, is also expected to put significant downward pressure on oil production outside of OPEC.

U.S. land rig count fell 5 units to 409, led by horizontal oil (-6), directional oil (-4), and vertical gas (-1), partially offset by gains in vertical oil (+5) and directional gas (+1), while horizontal gas remained flat week/week. Total horizontal land rig count has declined 76% since the peak in November 2014.

U.S. horizontal oil land rigs decreased by 6 to 269 led by the Woodford (-4), Williston (-1), Eagle Ford (1), and Mississippian (-1), slightly offset by gains in the Permian (+1), while DJ-Niobrara, Granite Wash, and "Other" remained flat. This is the 16th consecutive week of declines for horizontal oil land rigs, but the 3rd week of single digit declines as the trajectory of decline has begun to slow. It is increasingly expected that the rig count will bottom in the next few weeks at 330-350.

U.S. offshore rig count increased 3 units to 27, and is down 50% since June 2014.

Canadian rig count was down 1 rig and remains 49% off the level this time last year.

Financial Sector

Bank of America Corporation reported 1Q 2016 Earnings Per Share (EPS) of $0.21 in line with consensus. Revenues came in below expectations as both net interest income (though core in-line) and fee income were modestly below forecast. Still expenses were well-controlled, putting EPS relatively in-line with consensus. Relative to 4th Quarter 2015, results evidenced lower reported net interest income but modestly higher core Net Interest Income (+1%) as stable average earning assets (loans up, securities flattish, deposits with the Fed down) was met with core Net Interest Margin expansion (+5bps); higher fee income (seasonal increase in trading & higher mortgage mitigated by declines elsewhere; trading -16% year-on-year); lower core expenses (-2% from 4th Quarter); a modestly higher loan loss provision (+$0.2 billion) as lower Non Performing Assets (-6bps to 1.10%) and relatively stable Non Conforming Obligations (+1bp to 0.46% core) were met with an energy reserve build (from 2.3% to 4.6% of loans); a higher preferred dividend (+$127 million); and a lower share count (-0.5%). While no formal dollar targets were laid out by management, they did say it "needs" to drive its efficiency ratio to the low 60%'s (67% in 1st Quarter). Nevertheless, its Return On Tangible Capital Equity was a relatively low 8.4%, implying that cost controls will need to be met with improved revenues in order to return to double-digits. While higher rates would be a big help, we believe the shares are proving attractive to own because they are trading below the tangible book of $16.17 per share.

Bank of Nova Scotia, Canada's third largest bank by market value, said that credit lines to oil firms will be tightened to reflect lower oil prices, a move which could make it tougher for some to survive. Energy companies across Canada and the United States are meeting with their banks to review existing loans and determine how much debt they can continue to hold as part of a bi-annual process. Scotiabank has the highest exposure to the oil and gas sector of any major Canadian bank, equivalent to 3.6% of its total loan book, and said in March that it had increased provisions for bad loans to oil and gas firms. Rival **Royal Bank of Canada** said last week that it had so far imposed a 15%-20% reduction in borrowing bases having completed redeterminations for about half of its clients' redeterminations. The bank's CEO, Brian Porter, said he expects to see more consolidation in the oil sector. "You will see increased energy M&A and I think you're going to see increased issuance throughout the sector," he told reporters, referring to companies looking to raise funds through issuing equity or debt.

Barclays plc has shed 8,000 jobs in four months, the fastest headcount reduction in at least five years, as it steps up a big cost-cutting drive. The reductions have come from a hiring freeze imposed by Jes Staley when he started as chief executive in December and cuts to the investment bank. Barclays has been under pressure from investors to improve its performance after it reported a £394 million net loss for 2015 and halved its dividend for the next two years. (Source: Financial Times)

Citigroup Inc. reported 1st Quarter 2016 EPS of $1.10 (consensus was at $1.03). Upside was revenue driven with Citi Holdings revenues a good bit above estimates (gains); the dollar amount of expenses was in line despite those higher revenues (and inclusive of stepped up investment spend in the consumer bank); credit costs a bit higher than forecast, but not surprising (reserve build). Bottom line: solid results in a challenging quarter with progress on moving this franchise forward. Earnings upside was revenue-driven, largely Citi Holdings (gains on sales); private banking and trading were above forecast with expenses lower; overall expense mgmt. good, all the more so with stepped up investment spending in the Global Commercial Bank. Holdings showed further progress on strategic initiatives (so much so that the unit will be folded into the whole at year end 2016); $1.6 billion use of Deferred Tax Allowance; strong Core Equity Tier 1 ratio (12.3%), the latter providing all the more capacity for capital return in the 2016 Comprehensive Capital Allowance Review cycle. In its corporate group, funded energy loans increased $1.8 billion quarter over quarter (QoQ) to $22.3 billion; total exposure declined to $57.2 billion (trends similar to peers); reserves are now at 4.2% of funded loans; 63% of Corporate Group's funded energy loans (73% of total exposure) are investment grade. Total energy exposure is $59.3 billion, of which $23.7 billion is funded; aggregated reserve is 4.5% of funded loans. Cost of credit related to energy increased $346 million year over year (>80% of the total increase in credit cost). … if oil drops/holds at $30 per barrel, management. is now estimating total Corporate Group cost of credit at $1.4 billion annually (old estimate $1.0 billion); the increased estimate reflects regulatory guidance and revised portfolio view. In terms of the macro environment, management is clearly cognizant of the risks of slower global growth and market volatility. With respect to the capital markets, March was better than January and February and early April has been consistent with March, but it's clearly hard to call this "robust" at present; flat trading revenues into 2nd Quarter 2016, given seasonal factors, seems fair in our view; Investment Banking pipelines/backlogs are quite strong. In terms of operating efficiency, 2016 target is now 58% up from 57% reflecting both the need to invest and slower revenue growth at the start of the year.

The Goldman Sachs Group Inc. - The US Justice Department on Monday announced a US$5 billion settlement with Goldman Sachs over the sale of mortgage-backed securities leading up to the 2008 financial crisis. The deal resolves state and federal probes into the sale of shoddy mortgages before the housing bubble and subsequent economic meltdown. It requires the bank to pay a US$2.4 billion civil penalty and an additional US$1.8 billion in relief to underwater homeowners and distressed borrowers, along with US$875 million in other claims. "This resolution holds Goldman Sachs accountable for its serious misconduct in falsely assuring investors that securities it sold were backed by sound mortgages, when it knew that they were full of mortgages that were likely to fail."

JPMorgan Chase & Company posted EPS of $1.35 vs. consensus of $1.26. EPS included a few modest positive one-timers and larger reserve build for wholesale credit. Net Interest Income was up 1% QoQ, vs. its recent guide for stable. Core fees were up nicely driven by better-than-feared trading results. Costs down 3% QoQ. Core Equity Tier 1 ratio to 11.7% and JPM's estimated G-SIB (Global Systemically Important Bank) buffer flat at 3.5%. Corporate and Institutional Non Performing Assets (C&I NPAs) were up big on energy. Net interest income up 1% QoQ on solid loan growth (1% QoQ) driven by solid loan growth and balance sheet remixing (avg. earnings asset to $2.04 trillion from $2.05 trillion in the 4th Quarter 2015) and strong deposit growth. Higher short-term rates helped the Net Interest Margin to increase 7bp QoQ. Investment banking was down 24% YoY as guided. Core trading results (fixed income plus equities) were much better than feared at down 11% vs. down 20% YoY in February. Securities Services fees were in-line at $881 million vs. recent guidance for $875 million. Card services revenue rate of 11.81% was ok vs. recent guidance of 11.75%. Mortgage banking fees increased 20% QoQ, with a little help from MSR (mortgage servicing right) gains underneath. Core asset mgmt. was soft (reported down 6% QoQ even including a $150 million gain), as Assets Under Management declined 3% QoQ including client alternative assets down 12% QoQ. Core expenses were well-controlled at $13.9 billion, as lower revenues were matched with tighter expenses. The firm-wide managed efficiency ratio declined to 57% from 60% YoY. Non-compensation expense in the Corporate & Investment Bank took a big step down as the compensation ratio was flat YoY at 32%. Tangible Book Value was up 2% QoQ to $48.96.

Morgan Stanley reported 1st Quarter 2016 EPS of $0.55 and consensus was $0.46....but consensus 8 weeks ago was $0.82. Relative to expectations, lower-than-anticipated expenses were able to compensate for weaker-than-forecasted revenues. Within IB fees, M&A was better than expected, Equity Capital Markets in-line, and Debt Capital Markets worse. Within trading, equities were better than anticipated, while Fixed Income, Currency and Commodities were worse. Wealth Management revenues were a little light, though it held its pre-tax margin stable, while Investment Management was plagued by markdowns on investments and the reversal of previously accrued carried interest in certain private equity and real estate funds. Assets under management or supervision were $405 billion (-$1 billion from 4th Quarter 2015), while it recorded net outflows of $3.6 billion, compared to $1.0 billion of outflows in 4th Quarter 2015. Excluding Debt Value Add, revenues declined 20% YoY and

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slipped 1% sequentially to $7.8 billion, below consensus of $7.95 billion. Expenses declined 14% YoY and decreased 1% sequentially. Compensation expense declined 19% YoY but increased 5% linked quarter, while non-compensation expense fell 6% YoY and improved 10% from 4th Quarter 2015. Its headcount dropped 3% from 4th Quarter 2015. The effective tax rate was 33.3%, down from 34.5% in 4th Quarter 2015. Its Return On Equity was 6.2%. Tangible book increased a slight 0.6% to $30.44 (trading at 0.9x). Its pro forma fully phased-in Core Equity Tier 1 ratio was 14.5%, up 50bps, while Supplementary Liquidity Ratio was 6.0%, up 20bps. During the quarter it repurchased $625 million (in-line with each of the past 3 quarters) of its common stock or 25 million shares. Its average diluted share count declined 1.2%.

Royal Bank of Scotland Group plc (RBS) is to close its banking operations in India, having given up on efforts to find a buyer amid concerns about an extended regulatory approval process for a deal. RBS began seeking buyers for the remainder of its India operation business in 2015 and drew interest from local lender IDFC Bank and Singapore's DBS Bank, according to people close to the situation. But concerns that process could take too long to complete- complicated by strict regulations on the acquisition of banking businesses- have led RBS to conclude it would be better to close the operations and avoid the risk of mounting costs. (Source: Financial Times)

Wells Fargo and Company (WFC) reported EPS of $0.99, which compares favorably to the street at $0.97; however, after adjusting for securities gains ($244 million), net Mortgage Servicing Rights gain ($498 million), crop insurance gain ($381 million) and hedging ineffectiveness gain ($379 million), the core earnings are estimated at $0.80, which compared unfavourably. Core revenues came in at $20.1 billion versus estimate of $21.4 billion (or $0.06 per share) due to lower than expected spread income ($11.9 billion vs. $12.1 billion) and lower core fees ($9.0 billion vs. $9.3 billion). Net Interest Margin contracted 2bps linked quarter to 2.90% partly due to increased liquidity. Core fees were lower than expected partly due to private equity and other fees. Total expenses were $13 billion, or 3.7% above expectations. The core efficiency ratio came in at 62%. Although net charge-offs were in line with expectations at 0.38%, provisions came in at $1.1 billion, or 13% higher than expectations. WFC built reserves primarily due to increased migration of its energy portfolio of $1.1 billion resulting in $1.9 billion of total nonaccrual energy loans. Total commercial nonperforming loans increased 64% linked quarter, and energy reserves now exceed 9%. The portfolio stands at 1.9% of loans including $1.2 billion of second lien and mezzanine loans. An article by Bloomberg last week titled "Wells Fargo Misjudged the Risks of Energy Financing" saying at its annual investor conference in San Francisco in May 2014, with oil trading at $102 a barrel, WFC boasted that in just two years it had almost doubled its energy exposure and seized the title of Wall Street's top oil and gas banker, though "the timing couldn't have been worse'. With oil falling to $40, it states WFC has downgraded 38% of its energy loans and set aside $1.2 billion to cover potential losses, the loans are coming under increasing scrutiny from regulators and investors, even though they make up only 2% of the bank's portfolio. It adds the growth of the high-yield bond market allowed drillers to take on far more debt than in past booms, leaving them more vulnerable to default. The emergence of shale technology allowed companies to expand reserves and the loans backed by those properties. It says WFC has been the top dealer of high-yield oil and gas debt. It notes, last year, after bank examiners marked many energy loans with tougher ratings than lenders thought necessary, the Office of the Comptroller of the Currency (OCC) was flooded with appeals, it said. In September, regulators from the OCC, the Fed and Federal Deposit Insurance Corporation (FDIC) met with dozens of energy bankers at WFC's office in Houston. The disagreement centered on how to rate the risk of reserves-based loans. Banks insisted that, in a worst-case scenario, they'd be made whole by liquidating the properties. Regulators pushed lenders to focus instead on a borrower's ability to make enough money to repay the loan. The new guidelines mean banks will have to downgrade loans and set aside more cash to cover losses, it states.

Activist Influenced Companies

Nothing new to report.

Canadian Dividend Payers

Brookfield Infrastructure Partners LP – Spain's Abertis Infraestructuras SA said that, together with a unit of Canada's Brookfield Asset Management, it will launch a bid for the shares of Brazil's Arteris SA it doesn't already own for 10.15 reais ($2.87) per share. The Spanish motorway operator and Brookfield Brazil Motorways Holding currently own 69.26% of Arteris through Participes, in which they hold 51% and 49% respectively. The offer, to be finalised May 17 and aimed at delisting Arteris from the Brazilian market, discounts the payment of a dividend, worth around 1.1 billion reais.

Global Dividend Payers

LVMH Moet Hennessy Louis Vuitton SE reported Q1 sales came in at €8,620 million, approx. 1% below Bloomberg consensus of €8,730 million. Q1 organic growth came at +3% missing consensus of +4.1%. This was boosted by 1% f/x resulting in +4% year /year growth in reported terms. For the key Fashion & Leather Goods (F&L), Q1 came in flat vs. Bloomberg consensus of +2.5%, which compares to Q4 15 up +2.5% and Q1 15 +0.9%. The group indicated that Louis Vuitton brand maintained its creative momentum, the leather line models saw good success, and that Fendi, Celine and Kenzo brands saw a good start to the year, whilst Donna Karan and Marc Jacobs are continuing to rebrand. From the conference call it emerged that organic growth at the Fashion &

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Leathers division would have been 2% higher had it not been for the discontinuation of the 2 labels at *Donna Karan* (DK). Like *Marc Jacobs*, DK is following a restructuring strategy with different labels collapsed into a single brand. As the majority of the downgrade on the F&L division is related to DK, we believe there is a limited effect on operating margin as the American brand is a lower margin business, in our view, compared to the average margin of the segment. In our view, the ongoing outperformance of leather goods (accessories) vs. ready-to-wear drives a favourable price mix too. In other divisions, Wines & Spirits came in at +6% (consensus +6.0%) with champagne experiencing a strong start to the year especially in Europe, Hennessy maintaining its strong performance in the United States. In China, the first quarter showed better momentum after the impact of destocking by distributors in 2015. Watches & Jewellery beat estimates with +7% (consensus +3.9%) driven by strong performance in jewellery at *Bulgari* and success of the *TAG Heuer* connected watch. Bulgari recorded strong performance driven by the innovation in its collection and its iconic products, while TAG Heuer benefited from the momentum gained with the connected smartwatch paired with the repositioning of the brand in 2015. Perfumes & Cosmetics delivered a strong performance up +9% (consensus +6.0%), and Selective Retail came in at +4% (consensus +5.0%) with a continued strength at Sephora partially offset by the uncertain environment in Asia. By geography at group level, management highlighted that the US market is strong and Europe remains well oriented except for France which is affected by a fall in tourism traffic. Asian markets are varied, but Japan continues to progress. The company states that it "will continue to focus its efforts on developing its brands, will maintain a strict control over costs and will target its investments on the quality, the excellence and the innovation of its products and their distribution."

Nestlé SA - A modest beat from Nestlé with 1st Q 2016 Like-For-Like sales growth at +3.9% coming 30bp ahead of consensus expectations (volume growth at +3.0% coming 50bp ahead of consensus expectations). **Main drivers**: Zone Americas, Waters and Other businesses with 5.0%, 5.3% and 5.2% Organic Growth. Nestlé mentioning solid growth of frozen food in North America. Mexico with double –digit growth. Maggi noodles gained back market share, recovering faster than anticipated. In China, ongoing challenges with Yinlu, which seems to have deteriorated from 2nd Half 2015. Solid growth at Nespresso, including VertuoLine in North America (doubtless helped by our family purchases).

Toyota Motor Corporation announced that production at most of its plants in Japan would be suspended for the entire week due to a parts shortage.

Economic Conditions

U.S. consumer prices rose 0.1% in March, lowering the annual rate a notch to 0.9%, while a similar mild advance in core prices lowered the yearly rate to 2.2% from near 7-year highs. A tame CPI report will we believe cement the Fed's go-slow approach to policy normalization in the wake of recent softer growth.

U.S. retail sales were revised so that January's decline was more modest and February is now flattish instead of slipping 0.1%. However, in March, retail sales were down 0.3%, the 2nd largest decline in over a year as auto sales have faltered recently (down 5.5% in March alone); excluding the auto sector, sales rose only 0.2%, which was half the expected increase. This is clearly a disappointing report for March and raises the question "Just how much momentum does the U.S. consumer have?"

U.S. industrial production continued to depict weakening business activity south of the border, with utilities, mining and manufacturing dragged the indicator lower in March. The reading, down 0.6%, matched February's print, though it fell significantly short of the expectations. Capacity utilization, meanwhile, dropped to 74.8% in the month, against expectations for a small improvement.

Canada – The new housing price index in Canada beat the expectations in February, improving 0.2% in the month, and building on January's 0.1% advance.

Italy / Italian Banks - Italian officials and financial firms agreed to create a multibillion-euro fund to help weakened banks raise capital and unload bad loans, as the nation tries to assuage investor jitters and avert a crisis. The new fund, named Atlante, will be supported by numerous institutions, its manager, Quaestio Capital Management SGR, said last week after more than a week of meetings among banks, insurers and state lender Cassa Depositi e Prestiti (CDP). The fund may be worth about €5 billion ($5.7 billion), said BPER Group's Chief Executive Officer Alessandro Vandelli. The fund's first priority is to provide a backstop for the capital raises of banks in trouble (€2.5 billion already planned for Veneto and Vincenza) and later to helps banks to deconsolidate Non Performing Loans (NPL) by buying junior tranches in NPL securitisation vehicles. The banking system will participate with €3 billion (led by Intesa San Paulo and Unicredito Italiano SPA). €500 million will come from foundations. €300-400 million from the CDP and the rest from insurers and pension funds. Italy will introduce measures in coming days to enable lenders to speed up the recovery of collateral, a statement said last week, after a group of financial institutions announced the formation of a fund to help shore up ailing banks. "This private operation is useful," Prime Minister Matteo Renzi said of the fund in a statement, adding that in "the coming days" the government would pass measures to make it faster and easier to recover collateral. The back stop for the Veneto and Vicenza capital raises is helpful as it avoids risks with a potential bail-and because this is private money and the government wants to do more on NPL recovery times...then we believe quicker recovery should narrow the pricing gap in the NPL market.

Brazil - President Rousseff lost an impeachment vote on Sunday, which means that she will increasingly likely be forced to give up her post.

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Financial Conditions

The Bank of England left rates unchanged at 0.5% with a 9-0 vote. The Monetary Policy Committee noted that their February forecast remained largely intact but cautioned that the possible negative impact from the upcoming EU referendum on the first half of the year and that growth could slow. In fact, the committee went as far as to say that owing to uncertainty over the referendum, they would likely react less to incoming data over this period than would normally be the case – so they will be less data dependent, and look through any downside (or upside) news. GBP versus other major currencies has fallen about 5% since the beginning of the year and over 11% since topping out last June.

The U.S. 2 year/10 year treasury spread is now 1.02% and the UK's 2 year/10 year treasury spread is 1.00% - 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 U.S. 30 year mortgage market rate has increased to 3.58% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing U.S. housing inventory is at 5.2 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, 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 14.48 (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 Focused Plus Fund
- 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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PIC16-023-E(04/16)