PORTLAND
INVESTMENT COUNSEL®

Portland Focused Plus Fund LP

ANNUAL LETTER TO INVESTORS

FOR THE YEAR ENDED DECEMBER 31, 2015

Portland Focused Plus Fund LP
Performance vs. Stock Market Indices

Year	Annual Total Return		
	Portland Focused Plus Fund LP	S&P/TSX Composite Index	S&P 500 Index (US$)
2012 (from Oct. 31)	1.9%	0.6%	1.5%
2013	34.1%	13.0%	32.4%
2014	16.8%	10.6%	13.7%
2015	7.5%	(8.3%)	1.4%
Since Inception (Oct. 31, 2012)			
Compound annual return	18.6%	4.6%	14.8%
Cumulative return	71.6%	15.3%	54.9%

Notes:
Performance for the Portland Focused Plus Fund LP is for the series F units which is the highest fee series without embedded advisor compensation. Performance shown is the Fund's net return after all fees and expenses (and taxes thereon) have been deducted. Performance for both indices is per TD Securities Inc. The S&P 500 Index is shown in U.S. dollars rather than in Canadian dollars since the Fund generally hedges its U.S. dollar exposure.

Portfolio manager's letter* to investors in the Portland Focused Plus Fund LP (the "Fund"):

This letter describes how the Fund is managed and why it is managed that way. The letter also discusses topics of general interest to investors and is intended to serve as a useful reference for current and prospective investors in the Fund.[1]

Previous Letters

Previous annual letters to investors in the Fund regarding 2013 ("2013 Letter") and 2014 ("2014 Letter") are available on the web site of Portland Investment Counsel Inc. ("PIC") at http://www.portlandic.com/focusedplusfundLP.html. Important subject areas regarding investing and portfolio management were discussed in detail in those letters. The remarks were intended to be of a lasting nature; this letter does not update or revise them. Investors are strongly encouraged to read the 2013 Letter and 2014 Letter (which are incorporated herein by reference).

Investment Objective

As stated in the Fund's Offering Memorandum ("OM"), the Fund's investment objective is "to achieve, over the long term, preservation of capital and a satisfactory return."[2] In order to gauge whether the performance of the Fund has been satisfactory, investors should compare the long-term performance of the Fund to a 50%/50% average of the returns of the S&P/TSX Composite Index ("S&P/TSX Index") and the Standard & Poor's 500 Index ("S&P 500 Index") in U.S. dollars ("US$").[3]

Performance

The performance of the Fund and that of the two benchmark stock market indices is shown in the table on the inside front cover of this letter. The Fund's factsheet ("Fund Brief"), which shows performance updated to the latest available month-end, may be found at http://www.portlandic.com/focusedplusfundLP.html.

In 2015, the Fund's series F units achieved a return of 7.5% (net of fees and expenses). That compares to a loss of (8.3%) for the S&P/TSX Index and to a total return of 1.4% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a loss of (3.4%). For the entire period since inception of the Fund on October 31, 2012 to December 31, 2015, the Fund's series F units achieved a cumulative return of 71.6%. That compares to a cumulative total return of 15.3% for the S&P/TSX Index and 54.9% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 35.1%. Accordingly, in both 2015 and for the cumulative period since the Fund's inception, the Fund met its investment objective of preservation of capital and a satisfactory return.

Operating Expenses

The Fund incurs operating expenses for such items as fund administration, audit and legal fees.[4] From the inception of the Fund on October 31, 2012 to December 31, 2015, the Fund's operating expenses as a percentage of its net asset value have been 0.50% per annum plus applicable taxes. While there can be no assurance that the Fund's operating expenses will remain at 0.50% per annum, PIC remains committed to tight management of fees and expenses so as to maximize the Fund's returns.

Offering Memorandum

On March 1, 2016, PIC renewed the Fund's OM. This is the first complete refresh of the Fund's offering memorandum since the inception of the Fund on October 31, 2012. The purpose of amending and restating the Fund's offering memorandum was three-fold, namely to: i) incorporate two previous amendments to the Fund's offering memorandum directly into the body of the OM; ii) add text regarding the proposed launch, planned for March 31, 2016, of a new trust fund similar to the Fund which, unlike the Fund, will be eligible for investment by registered plans; and iii) make such other minor changes and updates to the OM as were deemed necessary or advisable. As part of these minor changes, the Fund's former "classes" have been renamed "series" and the Fund's former class BN units and class B units have been renamed series M units and series P units, respectively.

Fund Series

The Fund has four series of units. The features of each are outlined below:[5]

- ***Series A units*** have: a minimum initial subscription amount of $2,500 for accredited investors ($150,000 for other non-individual subscribers); a management fee of 2% per annum; and a performance fee of 10% of the amount above the highest ever net asset value per unit ("High Water Mark") of the series. A trailing commission of 1% per annum is paid to financial advisors whose clients invest in series A units;
- ***Series F units*** have: a minimum initial subscription amount of $2,500 for accredited investors ($150,000 for other non-individual subscribers); a management fee of 1% per annum; and a performance fee of 10% of the amount above the High Water Mark of the series;
- ***Series M units*** have: a minimum initial subscription amount of $1,000,000; and a management fee of 1% per annum. Series M units do not have a performance fee; and
- ***Series P units*** have: a minimum initial subscription amount of $1,000,000; and a performance fee of 10% of the amount above the High Water Mark of the series. Series P units do not have a management fee.

The performance of the series F units, which is the highest fee class without embedded advisor compensation, is shown in the table on the inside front cover of this letter. The performance of all of the Fund's four series is shown in the table below.

	Annual Total Return			
Year	Series A	Series F	Series M	Series P
2012 (from Oct. 31)	1.7%	1.9%	2.0%	2.0%
2013	33.0%	34.1%	37.7%	34.4%
2014	15.6%	16.8%	18.8%	17.5%
2015	6.5%	7.5%	8.3%	8.5%

Since Inception (Oct. 31, 2012)

Compound annual return	17.5%	18.6%	20.5%	19.3%
Cumulative return	66.6%	71.6%	80.7%	74.7%

As can be seen in the last line of the table, for the period from October 31, 2012 to December 31, 2015, the Fund's series F units had a cumulative return of 71.6% while the Fund's series M units and series P units had higher cumulative returns of 80.7% and 74.7%, respectively. Going forward, the series P units are certain to continue to have returns greater than the series F units since the series P units have no management fee. Similarly, the series M units will have a performance greater than the series F units to the extent that the Fund earns performance fees. Thus, investors who have the means to meet the minimum initial subscription amounts for the series M and series P units are encouraged to do so in order to take advantage of the lower fees applicable to those series which will continue to enhance their long term performance.

Time-Weighted vs. Money-Weighted Rates of Return

Calculating the rate of return on an investment portfolio is not as simple as it might appear.

If there are never any cash flows in or out of a portfolio between its inception and its termination, then calculating performance is a relatively simple matter. In such an instance, the percentage return (R) is the ending portfolio value (V_1) divided by the beginning portfolio value (V_0) minus one times 100 (i.e., $R = (V_1/V_0 - 1) \times 100$). For example, if a portfolio started with $100,000, had no cash flows in or out and ended with $121,000, its percentage return would be 21% (i.e., ($121,000/$100,000 - 1) x 100). This calculation shows the cumulative return without any consideration of how much time elapsed. More commonly, in order to facilitate comparison of various investments, cumulative returns are converted to annualized returns. To calculate annualized returns (AR), one would modify the above equation by applying to the first term an exponent whose numerator is one and whose denominator is the number of years (Y) for which the portfolio existed (i.e., $AR = ((V_1/V_0)^{1/Y} - 1) \times 100$). In the above example, assuming that the cumulative return occurred over a period of two years (Y=2), the annualized rate of return would be 10% per annum (i.e., ($(\$121,000/\$100,000)^{1/2} - 1) \times 100$).

In the real world, there are very few portfolios that have no cash flows in or out during their lifetimes. As soon as cash flows in (through deposits or subscriptions) or out (through withdrawals or redemptions) are introduced, the method of calculating rate of return becomes more complicated. In the case of portfolios with cash flows, there are two primary methods of calculating performance: i) the *time-weighted* method; and ii) the *money-weighted* method (this is also known as the *asset-weighted* method or *dollar-weighted* method, if dollars are the portfolio's reporting currency). As we will see, understanding the difference between the two methods of calculating rate of return is crucial to successful investing over a lifetime.

Time-weighted rate of return is the standard method of calculating return used in the investment management industry. Indeed, all of the return figures for the Fund cited earlier in this letter have been calculated on a time-weighted basis. In order to perform time-weighted calculations, the portfolio must be unitized. For example, an investment fund might start by issuing 1,000 units at $100 per unit for a total initial portfolio of $100,000. Even if it was one person's portfolio (i.e., no units were issued), we would pick an arbitrary initial value per unit (say, $100) and calculate the number of units issued (in this example, 1,000). Thereafter, immediately prior to every cash flow, the portfolio is valued and its value per unit is calculated. The cash flow is then added to (or subtracted from) the portfolio value and the number of units outstanding is correspondingly increased (or decreased) at the then-prevailing net asset value per unit. The time-weighted rate of return is then calculated by dividing the terminal value per unit by the initial value per unit. An illustration will follow shortly. First, however, it would be beneficial to describe the money-weighted method of calculating return.

Money-weighted rate of return is, in essence, an internal rate of return calculation.[6] Money-weighted returns are calculated using an iterative function. The function determines the rate of return (i.e., the discount rate) which equates the net present value of all of the positive cash flows (in our example to follow, that is the ending portfolio value) with the net present value of all of the negative cash flows (in our example to follow, the initial and subsequent contributions). Iterative functions involve repeating similar calculations over and over again, using a trial and error process with diminishing errors, until the correct result is found to a specified degree of accuracy. Iterative functions are too difficult to do by hand as they could involve thousands of computations. Fortunately, the Microsoft Excel spreadsheet application does the calculation for us using its XIRR function.

It's now time to illustrate the difference between time-weighted and money-weighted returns with two examples. For both examples, let's assume that: a portfolio was started on December 31, 2014 with $5,000; another $5,000 was contributed on April 30, 2015; and the portfolio ended on December 31, 2015 with a value of $10,000. In Example 1, however, the first $5,000 grew to a value of $6,000 before the additional contribution of $5,000. The combined amount of $11,000 then declined in value by year-end to $10,000. In Example 2, the first $5,000 declined to a value of $4,000 before the additional contribution of $5,000. The combined amount of $9,000 then increased in value by year-end to $10,000. The table below shows these two examples. As can be seen, there is a striking difference between the time-weighted and money-weighted rates of return.

Example 1:	Date	Value	Units	Value per Unit
Initial portfolio value	31-Dec-14	$5,000	5,000	$1.000
Income and gains		$1,000		
Portfolio value before contribution	30-Apr-15	$6,000	5,000	$1.200
Contribution	30-Apr-15	$5,000	4,167	$1.200
Portfolio value after contribution	30-Apr-15	$11,000	9,167	$1.200
Income and (losses)		($1,000)		
Portfolio value at end of year	31-Dec-15	$10,000	9,167	$1.091
Time-weighted rate of return				9.1%
Money-weighted rate of return				0.0%

Example 2:	Date	Value	Units	Value per Unit
Initial portfolio value	31-Dec-14	$5,000	5,000	$1.000
Income and (losses)		($1,000)		
Portfolio value before contribution	30-Apr-15	$4,000	5,000	$0.800
Contribution	30-Apr-15	$5,000	6,250	$0.800
Portfolio value after contribution	30-Apr-15	$9,000	11,250	$0.800
Income and gains		$1,000		
Portfolio value at end of year	31-Dec-15	$10,000	11,250	$0.889
Time-weighted rate of return				-11.1%
Money-weighted rate of return				0.0%

Given the dramatic differences in rates of return shown in the table, it's worth exploring this matter further.

Example 1

In Example 1, the investor starts on December 31, 2014 with $5,000. The table shows the unitization of this sum by assuming that the investor has subscribed for 5,000 units with a value per unit of exactly $1.00. In the first four months of 2015, he achieves an increase in the value of his portfolio of $1,000 or 20.0%, reaching a total value of $6,000. Each of the 5,000 units is now worth $1.20. He then adds another $5,000 to his portfolio. At the deemed unit issue price of $1.20, his number of units increases by 4,167 to reach a total of 9,167 units with a market value of $11,000. Alas, the portfolio declines in value over the remaining eight months of 2015, falling by $1,000 to a value of $10,000. Dividing this amount by his 9,167 units yields a value at the end of 2015 of $1.091 per unit. Given that the value per unit a year earlier had been exactly $1.000, Example 1's *time-weighted* rate of return (using the formula described above) is (1.091/1.000 -1) x 100 for a positive performance of 9.1%.

To calculate Example 1's *money-weighted* rate of return all that is needed is to input the portfolio's cash flows, and the date of every cash flow, into Excel's XIRR function. In the case of Example 1, there is an outlay of ($5,000) at the inception of the portfolio on December 31, 2014; another outlay of ($5,000) on April 30, 2015; and a terminal value on December 31, 2015 of $10,000. The portfolio's resulting money-weighted rate of return in 2015 is 0.0%. In effect, the money-weighted calculation says "the investor invested a total of $10,000 ($5,000 on each of December 31, 2014 and April 30, 2015), and also ended with $10,000, so his rate of return is zero."

Example 2

In Example 2, the investor also starts on December 31, 2014 with $5,000. The table shows the unitization of this sum by assuming that the investor has subscribed for 5,000 units with a value per unit of exactly $1.00. In the first four months of 2015, her portfolio decreases in value by ($1,000) or (20.0%), declining to a value of $4,000. Each of the 5,000 units is now worth $0.80. She then adds another $5,000 to her portfolio. At the deemed unit issue price of $0.80, her number of units increases by 6,250 to reach a total of 11,250 units with a market value of $9,000. The portfolio then increases in value over the remaining eight months of 2015, rising by $1,000 to a value of $10,000. Dividing this amount by her 11,250 units yields a value at the end of 2015 of $0.889 per unit. Given that the value per unit a year earlier had been exactly $1.000, Example 2's *time-weighted* rate of return (using the formula described above) is (0.889/1.000 -1) x 100 for a negative performance of (11.1%).

The *money-weighted* rate of return in Example 2 is exactly the same as was calculated for Example 1 (i.e., 0.0%). That is because in both examples the inputs are the same (i.e., there is an outlay of ($5,000) at the inception of the portfolio on December 31, 2014; another outlay of ($5,000) on April 30, 2015; and a terminal value on December 31, 2015 of $10,000). In both examples, the investor contributes $10,000 and ends with $10,000. The portfolio's resulting money-weighted rate of return in 2015 in both Example 1 and Example 2 is zero.

Comparison

The time-weighted rate of return in Example 1 was 9.1% while the money-weighted return was 0.0%. The time-weighted rate of return in Example 2 was negative (11.1%) while the money-weighted return was 0.0%. Which of the two methods of measuring performance, time-weighted or money-weighted, is correct? *The answer is that they're both correct but they're measuring different things.*

Time-weighted rate of return is the method universally used to measure the performance of portfolio managers, investment funds and asset class indices (such as stock market indices). That is because the portfolio manager, investment fund or asset class generally has no control over, and often no knowledge of, when an investor chooses to add (or withdraw) funds to (or from) the portfolio, fund or index in question.

Money-weighted rate of return, by contrast, measures an investor's own experience. That is because the money-weighted rate of return, as its name implies, is calculated by using the amount of the investor's money actually invested during each sub-period of investment performance.

Understanding the difference between time-weighted and money-weighted rates of return, and the resulting portfolio management implications, is crucial to an investor's success over his or her lifetime. The next section of this letter discusses the implications.

Temporal Diversification

In order to determine the cumulative *time-weighted* performance of a portfolio over a multi-year period, one simply multiplies together the performances for the individual years. The product is the cumulative result over the multi-year period. It's important to note that, as with all multiplications, the order in which the numbers occur is irrelevant. In other words, if one multiplies a bunch of numbers together, the result is always the same regardless of the sequence in which the numbers appear. In the vernacular of finance, the cumulative result of a series of *time-weighted* returns is not path dependent.

By contrast, the cumulative *money-weighted* performance of a portfolio over a multi-year period is, in fact, path dependent. In other words, it matters a great deal to the cumulative result of a real portfolio how much money is invested in each sub-period. In Example 1 above, the money-weighted return of 0.0% was much ***worse*** than the time-weighted return of 9.1% because more than twice as much money ($11,000 vs. $5,000) was invested during the down period than during the up period. Conversely, in Example 2 above, the money-weighted return of 0.0% was much ***better*** than the time-weighted return of (11.1%) because 80% more money ($9,000 vs. $5,000) was invested during the up period.

This distinction is extremely important to long-term wealth creation. For example, as was discussed in the 2014 Letter, an investor who starts saving at age 18 and steadily builds up his investments over the next 50 years until retirement might have a portfolio amount 100 (or more) times greater in his later years than in his early years.[7] As a result, the performance achieved by the investor in his later years is much more important than the performance achieved in his early years. Many baby boomers (the huge demographic cohort of those born from 1946 to 1964) have experienced the negative impact of this very phenomenon. They have been, in effect, real world, unwitting participants in Example 1 above. Many baby boomers had comparatively small investment portfolios in the 1980s and 1990s, when real (after-inflation) returns in the three major asset classes (stocks, bonds and cash) were very strong. Conversely, boomers have had their largest portfolios since 2000, just before their planned retirements, when real asset class returns have been relatively poor. This phenomenon has been described in a recent article aptly titled "Who Ate Joe's Retirement Money? Sequence Risk and its Insidious Drag on Retirement Wealth".[8] The result (combined with rising life expectancies and, in my opinion, low prospective asset class returns) is that the largest population segment in Canada and the U.S. may be ill-prepared for its long retirement.

What can be done to address this problem and to prevent it from happening to future generations of investors? Unfortunately, with regard to the oldest boomers (who turn 70 this year), there is not much

that can be done. In many cases, boomers, given their advanced years, limited ability to obtain further employment and discomfort with volatility, have chosen low volatility, low return portfolios comprised largely of cash and government bonds. If their portfolios, combined with other sources of income such as Canada Pension Plan ("CPP") and Old Age Security ("OAS") payments, do not provide them with a desired level of income, then expenses will have to be reduced beyond prior expectations or the gap filled by support from family members. This has given rise to the term "sandwich generation", describing those who support both their own children as well as their aging parents.

Fortunately, for other people and especially for young adults, there is a solution to the problem. Since the risk of *money-weighted* returns being much lower than *time-weighted* returns arises because many people have much more invested in their later investing years than they do in their early investing years, the solution is to invest more in one's earlier years. How does one do that, considering that typically many younger people have minimal net worth and are just making ends meet? *The answer is to use leverage*. In other words, borrow money in the early years so as to increase one's earlier investment portfolios, thus spreading the size of one's lifetime investment portfolio more evenly over the years so that the cumulative, money-weighted result is less exposed to sequence risk. Spreading out one's investment portfolio more evenly over the years is called *temporal diversification*, also known as *time diversification*.

The controversial but logical advice to use leverage to spread investment portfolios more evenly over time is expounded by two professors at Yale University, Ian Ayres and Barry Nalebuff, in their book, *Lifecycle Investing*.[9] I wholeheartedly endorse their concept of using leverage, prudently, so as to spread investments more evenly over time. As I've written before, the popular prejudice against using leverage for investing is both hypocritical (for those who use, or endorse the use of, mortgages, which are another form of leverage) and is not justified by the facts.[10] Furthermore, the professors urge the use of leverage in order to increase one's exposure to equities. That is partly because equities are expected to remain the best-performing asset class over the long term. It is also because, from a recipient's point of view, government-sponsored support payments such as CPP and OAS have the characteristics of fixed income investments.[11] They are like fixed annuities, payable in one's retirement years, whose value is not dependent upon equity markets. As a result, in order to achieve an appropriate asset mix, the leveraged portfolios that we directly control ourselves should be invested in equities.

As is noted by the professors, although prudent use of leverage may be wise in theory, it is difficult to implement in practice. For example, as shown in the table below, the average margin interest rates charged by the self-directed brokerage divisions of Canada's three largest banks (based on market capitalization) for borrowings in Canadian dollars (C$) and US$ are currently 4.10% and 4.75%, respectively.[12]

Margin loan rates of three largest banks, regular accounts, all balances:	C$	US$
RBC Direct Investing	4.10%	4.75%
Scotia iTrade	3.95%	4.75%
TD Direct Investing	4.25%	4.75%
Average margin loan rates	4.10%	4.75%

I find the above rates to be extremely high given current low levels of inflation and bank funding costs. Given recent (and, in my opinion, prospective) low asset class returns, the use of leverage at the interest rates above would not, in my opinion, provide sufficient additional investment return to compensate for the additional risk. There is one independent firm, Interactive Brokers Canada Inc. ("IB"), which offers much

lower interest rates. IB's target clients, however, are financial professionals so the firm may not be suitable for most Canadians. Furthermore, IB is able to offer lower interest rates (at least in part) because its systems are highly automated including real-time, intra-day calculation of margin and automatic selling of securities (perhaps without notice) in order to restore adequate margin. In my opinion, that exposes clients using margin to material, permanent losses of capital in the event of intra-day "flash crashes" such as happened on May 6, 2010.[13] In fact, a miniature flash crash happened as recently as August 24, 2015, when the S&P 500 Index (and other markets) fell as much as (5%) in the opening minutes of trading before staging a recovery.[14]

Professors Ayres and Nalebuff also advise against traditional margin loans because of the possibility of a margin call and because many brokers charge high interest rates.[15] Their advice is for investors to leverage using deep in-the-money Long-term Equity AnticiPation Securities, known by their acronym LEAPS.[16] These are long-dated call options giving the holders the right to buy a certain amount of securities, such as an amount of the S&P 500 Index, at a specified price for a specified period of time. In my view, however, the use of LEAPS to leverage would have its own drawbacks, such as: high trading costs; incurring the cost of the options' time value (which is implied interest); and adverse tax consequences (in Canada, option transactions are generally on income account and do not receive the favourable tax treatment accorded dividends and capital gains). Also, in my opinion, using LEAPS would demand a level of financial and mathematical sophistication which is beyond the scope of many lay people (and perhaps even many financial professionals).

So if using leverage is the key to achieving temporal diversification (i.e., spreading one's investments more evenly over a lifetime so as to minimize sequence risk), but margin accounts at the big banks and the use of LEAPS are both undesirable or impractical, what's the solution? At the risk of sounding self-serving, I believe that the solution is...the Fund! The Fund offers the use of leverage to investors on attractive terms, including:

- ***Low interest rates.*** Currently, the Fund's average cost of C$ and US$ borrowing is 1.47% which is almost three percentage points lower than the average rate of 4.43% (shown in the table above) offered to retail clients by the major banks. For example, if the Fund borrows on average $0.50 for every dollar of net assets, and does so at interest rates 3.0% lower than individual investors could achieve themselves, then the interest savings of 1.5% per year alone would be enough to offset the Fund's series F management fee of 1.0% and operating expenses of 0.5%.

- ***No margin call to investors.*** Leverage is at the Fund level, not the investor level, so investors are not exposed to a margin call. The Fund has that risk but we at PIC deal with it through continuous monitoring, and active management, of the Fund's leverage. Also, in the event of temporary market dislocations, management of the Fund is aided by our long-standing relationship with the Fund's custodian.

- ***Professional management of leverage.*** As the saying goes, leverage works both ways: it both enhances positive returns and accentuates negative returns. Using leverage is not for the faint of heart or inexperienced. I believe that for most people, use of leverage in their investments would result in more harm than good. By investing through the Fund, however, clients can obtain the benefits of enhanced long-term return and temporal diversification enabled through the use of leverage, while leaving the decisions about when to use it, and how much, to a trained and experienced professional.

Mr. Market Remains Manic-Depressive

Benjamin Graham, in his classic book *The Intelligent Investor*, introduced the now-famous parable of Mr. Market.[17] Graham suggested that being a stock market investor is akin to being in private business with a partner who is sometimes rational; at other times fearful or enthusiastic. Every day, Mr. Market states a price at which he will either buy your interest in the business or sell you his. Depending upon Mr. Market's mood, these prices may seem about right, absurdly low or unduly high. You are free to act on the quoted prices, or not, at your choice and only when you believe it is to your advantage. As Graham implied, the market is there to serve you, not to guide you.

When I first began sketching an outline of this letter, in mid-2015, I titled this section "Mr. Market Is Increasingly Optimistic". In fact, we can now say, with hindsight, that the S&P 500 Index reached its all-time high in May 2015. In the second half of 2015, however, the stock market's former confidence waned and there were even two brief periods when the S&P 500 Index entered into territory commonly defined as a "correction" (i.e., a decline of 10% or more from a recent peak). The S&P/TSX Index, meanwhile, attained its 2015 high in April and then began a steady slide, ending the year firmly in correction territory. As a result, I've renamed this section of the letter to reference both sides of Mr. Market's manic-depressive nature. The next four sections of this letter, the first two of which were drafted during the stock market's happier time, further expand upon Mr. Market's volatile personality and serve as cautionary tales.

An Undertaking Of Great Advantage, But Nobody To Know What It Is

In May of 2015, when I read the use of proceeds of a $2.2 billion equity issue, I laughed out loud.

The term sheet announcing the equity issue stated that the use of proceeds was "future acquisitions." As a student of stock market history, I couldn't help but be reminded of a memorable tale related by author Charles Mackay in his book, *Extraordinary Popular Delusions and the Madness of Crowds*.[18] Mackay describes perhaps the world's first stock market mania, the South Sea Bubble of the early 1700s. The British public became infatuated with the excitement and riches of the New World that would be exploited by the South Sea Company. The company purchased the rights to all British trade in the newly-discovered regions from the Crown and purported to pay for those rights, and the cost of its voyages, by issuing shares which were listed on the nascent British stock exchange. The price of the shares soared higher than a topsail (before later sinking into the depths) and more and more companies issued shares to cash in on the public's buying frenzy. One such enterprise, started by a previously unknown adventurer, was titled "A company for carrying on an undertaking of great advantage, but nobody to know what it is." As the story goes, once the promoter received the initial subscriptions in the princely sum of £2,000, he disappeared to the Continent and was never heard from again.

I don't mean to pass any comment on the merits of the equity issue referred to above or that company's management. In fact, it is but one example among many. Recent years have witnessed the creation of a large number of "capital pool" companies. These were formerly known as "blind pools" before their promoters hit upon a moniker which is more marketable, if no more insightful. One recent article stated that as of the fall of 2015 there were 130 companies listed on the TSX Venture Exchange Capital Pool Company List.[19] What, you may ask, is the point of this story? It is simply to say that when large sums can be raised by unproven companies without specified uses, it suggests that equity markets are frothy and wariness is in order. A similar sign of the times is described immediately below.

Price Is What You Pay; Value is What You Get

There is a well-known expression of legendary investor Warren Buffett: "price is what you pay; value is what you get."[20] By this, Buffett means that with regard to common shares, there is no necessary connection between price and value. Given the earlier-noted manic-depressive tendencies exhibited by the stock market, when considering shares of a business, price (what you pay) could be materially higher or lower than the company's intrinsic value (what you get). It is the objective of the investor to buy high-quality businesses at significant discounts to their intrinsic values.

To illustrate how wide the disparity between price and value can be, let's now consider a tale of two companies. While these are actual businesses listed on the Toronto Stock Exchange, for now we'll call them Company A and Company B. A brief statistical comparison of the two companies is provided in the table below.[21]

Selected data items (C$ millions):	Company A	Company B
Market capitalization (July 31, 2015)	$110,051	$107,439
Common shareholders' equity	$51,779	$8,027
Tangible common shareholders' equity	$40,110	($42,344)
Average annual net income (loss), 2010-2014	$6,704	($31)
Dividend (July 31, 2015 indicated annual rate)	$4,441	$0
Corporate credit rating	AA-	BB-

The data items listed in the table are as follows:

- ***Market capitalization*** is the product of the number of shares outstanding multiplied by the market price per share. At the date of the comparison (July 31, 2015), both companies had a market capitalization (i.e., "price") of about $110 billion. By contrast, indicators of the disparity in "value" are listed in the remainder of the table.

- ***Common shareholders' equity*** is the amount of the company's assets (at their accounting or carrying value) minus all of the company's liabilities. Using the most recent quarterly information publicly available prior to the date of the comparison, Company A had common equity of about $52 billion, compared to Company B's common equity of $8 billion.

- ***Tangible common shareholders' equity*** is the amount of common equity (as per above) minus the carrying value of goodwill and intangible assets. Company A had tangible common equity of $40 billion. Company B had negative tangible common equity of ($42) billion.

- ***Average annual net income (loss)*** shows the average net income recorded for the five most recently completed years (i.e., 2010 to 2014, inclusive) prior to the date of the comparison. Company A had average net income of $6.7 billion. Company B had an average net loss of ($31) million.

- ***Dividend*** is the indicated rate of the company's annual amount of common share dividends as of the date of the comparison. Company A was paying annual dividends of $4.4 billion. Company B did not pay a dividend.

- ***Corporate credit rating*** shows that Company A's credit rating from Standard & Poor's ("S&P") was (and is) AA-. Of that rating category, S&P states that the issuer's capacity to meet its financial commitments is "very strong."[22] Conversely, Company B's credit rating was BB-. An issuer in that category, according to S&P, "faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment[s]."[23]

Let's assume, for a moment, that you have just won a monstrously large lottery in the amount of $110 billion (or maybe you just happen to have that much money lying around). The condition of the prize, however, is that you must invest the entire amount into 100% ownership of Company A or Company B. Furthermore, the only information provided to you about the two companies is the data in the table above. Would it take you more than a few seconds to select Company A? I think not.

Company A is Royal Bank of Canada ("RBC"), which is owned in the Fund. Company B is Valeant Pharmaceuticals International Inc. ("Valeant"), which is not owned in the Fund. Price is what you pay. Value is what you get.

In late July 2015, Valeant briefly surpassed RBC to become Canada's largest company in terms of market capitalization. The unfortunate history of the limited number of companies which have attained that height is detailed in the next section of this letter.

The RBC Curse

In overtaking RBC's market capitalization, Valeant joined a short list (pun intended) of other companies which have accomplished that feat since the turn of the century. In every case, subsequent performance was disastrous. To paraphrase Groucho Marx, this is a club to which you do not want to belong. In chronological order, its other members are:[24]

- ***Nortel Networks Corporation.*** After passing RBC in market capitalization at the height of the technology and telecommunications bubble (which peaked in the year 2000), Nortel flamed out in epic fashion, ending in bankruptcy.

- ***Manulife Financial Corporation.*** Following its acquisition of John Hancock for US$10.3 billion in stock, Manulife passed RBC, for a brief moment in March 2005, to become Canada's largest company by market capitalization. Profits boomed while Manulife issued insurance policies to protect clients against stock market declines without, ironically, insuring itself. One global financial crisis, two equity issues and a (50%) dividend cut later, Manulife limped into the end of 2015 with a market capitalization slightly more than one-third that of RBC's.

- ***Encana Corporation.*** After surpassing RBC in both 2005 and 2008 (at peaks of enthusiasm for energy companies generally), the former EnCana subsequently split into two companies: the gas-focused Encana Corporation; and the oil-focused Cenovus Energy Inc. Cyclical commodity prices then took their toll. At the end of 2015, the two companies had a combined market capitalization of less than one-fifth that of RBC's.

- ***Research in Motion Limited.*** Riding the wave of global enthusiasm for its mobile devices and their innovative email functionality, RIM reached its zenith as Canada's most valuable company in the fall

of 2007. Rapid technological change and widespread competition, most notably from Apple Inc., then took a horrible toll. By the end of 2015, the market capitalization of BlackBerry Ltd., as the company is now known, was one-nineteenth that of RBC's.

- ***Potash Corporation of Saskatchewan.*** The company's reign as Canada's most valuable company, a level reached in mid-2008, didn't last long. Potash Corp.'s stock price plunged in the fall of 2008 during the global financial crisis. It, and the price of potash itself, have never recovered to the heights reached in 2008. At the end of 2015, Potash Corp.'s market capitalization was less than one-fifth that of RBC's.

- ***Barrick Gold Corporation.*** From its depths in October 2008 (at the height of the global financial crisis) to January 2009, Barrick's stock price doubled as gold benefitted from its "safe haven" reputation during the crisis and the US$ rose sharply in relation to the C$. For one brief, shining moment, Barrick surpassed RBC in market capitalization. As life gradually settled into what has become the new normal, gold has since lost its lustre. That, compounded by the company's self-inflicted mistakes, has contributed to the company's undoing. By the end of 2015, Barrick's market capitalization was one-ninth that of RBC's.

And what has become of Valeant since its peak in July? Space doesn't permit a full re-telling of its subsequent series of unfortunate events. Suffice it to say that they include alleged improprieties, closure of an affiliated business, sharply lower financial guidance and a congressional investigation. By the end of 2015, Valeant's market capitalization was considerably less than half that of RBC's.

At least three things can be learned from the woeful tales listed above. If any Canadian company ever surpasses RBC in market capitalization, then: i) that company should be considered as a short sale candidate; ii) investors should be wary of overall stock market conditions (since many of the instances cited above occurred not long before significant stock market declines); and iii) RBC is a very profitable, cash-generating franchise which should not be underestimated.

Where She Stops, Nobody Knows

For the last several years, stock markets have been pulled in a tug-of-war-like fashion by opposing forces. On one side, the tugs down have been caused by disappointment with the historically weak economic recovery and with often-legitimate concerns such as sharply rising government debt and deteriorating finances of some businesses (e.g., commodity producers). The tugs up have come primarily from ultra-low (in some countries, negative) interest rates. These low rates have made equities look attractive compared to the very low interest rates obtainable on cash and government bonds. Accordingly, some have summarized the case for investing in equities by stating There Is No Alternative, a condition that has come to be known by its acronym, TINA. On balance, this tug of war has resulted in steadily higher equity valuations, as shown in the following table:

S&P 500 Index	2011	2012	2013	2014	2015
Average index value	1,268	1,379	1,643	1,932	2,061
Closing index value	1,258	1,426	1,848	2,059	2,044
Operating earnings	96.44	96.82	107.30	113.01	100.44
Average price-earnings ratio	13.1x	14.2x	15.3x	17.1x	20.5x
Closing price-earnings ratio	13.0x	14.7x	17.2x	18.2x	20.3x

In the last four years, the S&P 500 Index rose significantly, increasing from 1,258 at the end of 2011 to 2,044 at the end of 2015; a gain of 62%. In the same period, earnings growth was sluggish; earnings actually declined in 2015 because of the poor results of energy and materials companies and the strong US$ which reduced the international earnings of many American businesses when expressed in US$. In total, the S&P 500 Index's operating earnings increased from 96.44 in 2011 to an estimated 100.44 in 2015 (with 98% of companies having reported), a gain of only 4%.[25] The combination (over the four year period) of stock price gains of 62% with earnings growth of only 4% resulted in the S&P 500 Index's steadily higher trailing price-earnings ("P/E") ratio, which rose from 13.0x at the end of 2011 to 20.3x at the end of 2015.

Nobody knows how high the P/E ratio of the S&P 500 Index will go before it stops rising. Low interest rates, which have underpinned equity markets for the last seven years, continue to prevail. At the same time, history strongly suggests that paying too-high prices for common stocks will result in, at some point, a period of poor or negative returns. In the Fund, I have tried to buy only excellent businesses at sensible valuations and have tread carefully in the use of leverage. That caution has contributed to the Fund's strong performance to date. There are certain to be periods of weak stock prices in the years ahead. When that happens, there will likely be many opportunities to acquire excellent long-term investments at bargain prices. Those investments will enhance future returns. Accordingly, as I stated in the 2013 Letter, long-term investors should embrace lower stock prices and the higher volatility that usually accompanies them. As PIC's chairman Michael Lee-Chin says: "crisis equals danger plus opportunity."

Betting Against Beta

In the 2013 Letter, I discussed the Efficient Market Hypothesis ("EMH") and explained why I (and many others) think it's bunk.[26] Two of the assumptions of EMH are that: i) volatility is the same thing as risk; and ii) investors will only purchase assets which are riskier (i.e., more volatile) if they offer a higher return. As a result, according to EMH, actual investment experience should show that more volatile investments deliver higher returns. Unfortunately for the proponents of EMH, the facts say otherwise.

First, volatility is not the same thing as risk.[27] Second, the inconvenient truth is that more volatile investments tend to deliver *lower* returns. This was demonstrated, for example, in an academic paper published in 2015 entitled "Liquid Betting against Beta in Dow Jones Industrial Average Stocks."[28] In it, the authors show that using the 30 stocks of the Dow Jones Industrial Average over the period 1926-2013, higher volatility stocks earned lower returns than lower volatility stocks.

The most widely used measure of volatility is named after the second letter of the Greek alphabet, beta. By definition, the beta of a broad market index such as the S&P/TSX Index or the S&P 500 Index is 1.0. All stocks within the index have their own betas depending upon how volatile their prices tend to be compared to the volatility of the broad market. For example, a stock which tends to be 30% less volatile than the overall market would have a beta of 0.7, whereas a stock that tends to be 30% more volatile than the overall market would have a beta of 1.3.

The Fund invests in companies with a wide range of betas. Also, all beta calculations depend upon the measurement period (e.g., three years or five years) and the measurement interval (e.g., daily or weekly). Furthermore, betas are not stable; they change over time. Generally speaking, however, the weighted-average beta of the Fund's holdings (i.e., the percentage of total assets invested in each stock times each stock's beta, summed across the Fund's entire portfolio) is usually less than 1.0. In other words, the Fund typically has enough investments in lower-volatility companies, domiciled in sectors such as utilities, real

estate, consumer staples and some sub-sectors of financial services, that, on average, the Fund's holdings are less volatile than the overall market. This is consistent with the findings in the article noted above (i.e., the Fund generally has its portfolio concentrated in lower-volatility companies which the historical evidence shows have tended to generate superior total returns (dividends plus capital gains) over the long term). In other words, in its stock selection, the Fund is generally betting against beta.

In contrast to its *holdings*, however, the weighted-average beta of the *Fund* is usually greater than 1.0. That is because the Fund uses leverage. For example, if the Fund owned stocks with a weighted-average beta of 0.8, and the Fund was 150% invested (by borrowing $0.50 on margin for every $1.00 of net assets), then the weighted-average beta of the Fund would be 1.2 (i.e., 0.8 x 150% = 1.2). As a result, the Fund's net asset value per unit might be more volatile than the overall stock markets even though its underlying investments might not be.

I firmly believe that the Fund's careful and focused stock selection, combined with its prudent use of leverage, will continue to provide the Fund's investors with attractive long-term total returns. Investors should be aware, however, that the road ahead may be bumpier than the positive returns which the Fund has enjoyed every year since its inception. As stated in the OM, the Fund "may be suitable for those investors who plan to invest for the medium to long term, are seeking long term capital growth and are able to tolerate volatility."[29]

Outlook

I want to take this opportunity to thank all investors in the Fund for their investment and confidence. I sincerely believe that by continuing to follow the principles and procedures outlined in this and previous letters, the Fund will continue to meet its investment objective: to achieve, over the long term, preservation of capital and a satisfactory return.

"James H. Cole"

March 10, 2016

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Portland Investment Counsel Inc.

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Notes

1. In this letter, all opinions are those of, and the words "I", "me", "my" and "mine" refer to, the Fund's portfolio manager and the letter's author, James H. Cole.
2. Portland Focused Plus Fund LP Offering Memorandum, March 1, 2016, p. 2. The OM is available at http://www.portlandic.com/focusedplusfundLP.html
3. For a discussion, see 2013 Letter, p. 3.
4. OM, p. 14.
5. OM, pp. 6-7 and pp. 13-14.
6. See http://wiki.fool.com/How_to_Calculate_IRR_With_Unequal_Timing_of_Cash_Flows
7. 2014 Letter, p. 33.
8. Chiappinelli, Peter and Thirukkonda, Ram. "Who Ate Joe's Retirement Money? Sequence Risk and its Insidious Drag on Retirement Wealth," GMO LLC, August 2015.
9. Ayres, Ian and Nalebuff, Barry. *Lifecycle Investing: A New, Safe and Audacious Way to Improve the Performance of Your Retirement Portfolio* (Basic Books, 2010).
10. 2013 Letter, pp. 5-7.
11. Ayres and Nalebuff, op. cit., pp. 33-35.
12. Margin loan rates are as of February 22, 2016. See https://www.rbcdirectinvesting.com/pricing/cash-margin-rates.html#margin-balances-debit, http://www.scotiabank.com/itrade/en/0,,3693,00.html and https://www.td.com/ca/products-services/investing/td-direct-investing/accounts/rates.jsp.
13. See http://www.investopedia.com/terms/f/flash-crash.asp
14. Bloomberg L.P.
15. Ayres and Nalebuff, op. cit., pp. 16-17.
16. Ibid., pp. 11-26.
17. Graham, Benjamin. *The Intelligent Investor* (Harper & Row, Fourth Revised Edition, 1973), pp. 108-109.
18. Mackay, Charles. *Extraordinary Popular Delusions and the Madness of Crowds* (Harmony Books, 1980; originally published in 1841), pp. 55-56.
19. Zaramian, Reuben. "The capital pool company: an alternative way to go public," Deal Law Wire, October 28, 2015, available at https://www.google.ca/?gws_rd=ssl#q=capital+pool+companies+deal+law+wire
20. See, e.g., Bloch, Robert L. *My Warren Buffett Bible* (Skyhorse Publishing, 2015), p. 22.
21. In the table, market capitalizations are from TD Securities Inc.; corporation data items are from company reports; and credit ratings are from Standard & Poor's. Company B reports in US$; its balance sheet items were converted to C$ at the rate of exchange on June 30, 2015 while its average annual net loss (as originally reported) was converted to C$ at the rate of exchange on July 31, 2015.
22. See https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352
23. Ibid.
24. Sources for the companies that have surpassed RBC in market capitalization include TD Securities Inc. and several media articles. See, e.g., Berman, David. "Usurping RBC: The curse continues." The Globe and Mail, October 23, 2015, p. B12 and Pelletier, Martin. "Steer clear of market rabbits." National Post, October 27, 2015.
25. The source for S&P 500 Index earnings is Standard & Poor's itself at https://my.spindices.com/indices/equity/sp-500
26. 2013 Letter, pp. 12-13.
27. Ibid.
28. Auer, Benjamin R. and Schuhmacher, Frank. "Liquid Betting against Beta in Dow Jones Industrial Average Stocks," Financial Analysts Journal, November/December 2015, vol. 71, no. 6: 30-43.
29. OM, p. 4.

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The Manager believes the following risks may impact the Fund's performance: concentration, leverage, currency and exchange rate risk and equity risk. Please read the "Risk Factors" section in the Offering Memorandum for a more detailed description of all the relevant risks.

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