PORTLAND
INVESTMENT COUNSEL®

Portland Focused Plus Fund LP
Portland Focused Plus Fund

ANNUAL LETTER TO INVESTORS

FOR THE YEAR ENDED DECEMBER 31, 2016

Portland Focused Plus Fund LP
Performance vs. Stock Market Indices

	Annual Total Return					
	Portland Focused Plus Fund LP				S&P/TSX Composite Index	S&P 500 Index (US$)
Year	Series A	Series F	Series M	Series P		
2012 (from Oct. 31)	1.7%	1.9%	2.0%	2.0%	0.6%	1.5%
2013	33.0%	34.1%	37.7%	34.4%	13.0%	32.4%
2014	15.6%	16.8%	18.8%	17.5%	10.6%	13.7%
2015	6.5%	7.5%	8.3%	8.5%	-8.3%	1.4%
2016	39.0%	40.4%	45.5%	41.6%	21.1%	12.0%

Since Inception (Oct. 31, 2012)

Compound annual return	22.3%	23.5%	26.1%	24.3%	8.3%	14.1%
Cumulative return	131.5%	140.9%	162.9%	147.4%	39.5%	73.4%

Portland Focused Plus Fund
Performance vs. Stock Market Indices

	Annual Total Return					
	Portland Focused Plus Fund				S&P/TSX Composite Index	S&P 500 Index (US$)
Year	Series A	Series F	Series M	Series P		
2016 (from Mar. 31)	28.7%	29.3%	33.6%	30.6%	15.8%	10.5%

Notes:
Performances for the Portland Focused Plus Fund LP and Portland Focused Plus Fund are net returns 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 Funds generally hedge their U.S. dollar exposure.

Portfolio manager's letter* to investors in the Portland Focused Plus Fund LP (the "LP") and the Portland Focused Plus Fund (the "Trust") (collectively, the "Funds"):

This letter describes how the Funds are managed and why they are 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 Funds.[1]

Previous Letters

Previous annual letters to investors in the LP for 2013 ("2013 Letter"), 2014 ("2014 Letter") and 2015 ("2015 Letter") are available on the web site of Portland Investment Counsel Inc. ("Portland") at http://www.portlandic.com/focusedplusfundLP.html. Important subject areas regarding investing and portfolio management are discussed in detail in those letters. When those letters were written, the remarks therein were intended to be of a lasting nature; this letter does not update or revise them. Investors are strongly encouraged to read those previous letters (which are incorporated herein by reference).

Investment Objective

As stated in the Funds' Offering Memorandum dated March 1, 2016 ("OM"), the investment objective of each Fund is "to achieve, over the long term, preservation of capital and a satisfactory return."[2] In order to gauge whether the performance of the Funds has been satisfactory, investors should compare the long-term performance of the Funds 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 Of The LP

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

In 2016, the LP's series F units (the highest fee series without embedded advisor compensation) achieved a return of 40.4% (net of fees and expenses). That compares to a return of 21.1% for the S&P/TSX Index and to a return of 12.0% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of 16.5%. For the entire period since inception of the LP on October 31, 2012 to December 31, 2016, the LP's series F units achieved a cumulative return of 140.9%. That compares to a cumulative total return of 39.5% for the S&P/TSX Index and 73.4% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 56.5%. Accordingly, in both 2016 and for the cumulative period since the LP's inception, the LP has met its investment objective of preservation of capital and a satisfactory return.

A comparison of the LP's performance to other funds in its category is also revealing. ***I'm pleased to report that for the three years ended December 31, 2016, the performance of the LP's series M units of 23.2% per annum ranked it as the top-performing series among all alternative strategies funds in Canada as ranked by Global Investor - Funds.***[4] That performance far exceeded the average return for funds in the category of 3.8% per annum. Further, the LP's strong performance to date bodes well for its five-year performance and ranking which will first be available in November 2017.

Launch, Management And Performance Of The Trust

The LP was launched on October 31, 2012. It was (and is) intended for investment by non-registered plans for which the most tax-efficient legal form is, in my opinion, a limited partnership. Unfortunately, limited partnerships such as the LP are not eligible for investment by registered plans (such as registered retirement savings plans ("RRSPs"), tax-free savings accounts ("TFSAs") and registered education savings plans ("RESPs"). Registered plans represent a large proportion of the investment portfolios of many Canadians. Given the strong performance of the LP since its inception, there has been investor demand for a fund like the LP but in the form of a mutual fund trust which would be eligible for investment by registered plans. In response to this demand, PIC launched the Trust on March 31, 2016. The Trust's investments are managed in a virtually identical manner to those of the LP. The two Funds experience monthly cash flows arising from subscriptions and redemptions. Shortly after every month-end, the Funds make such portfolio transactions as are necessary to harmonize their two portfolios. As a result, investors should expect that the management and long-term performance of the two funds will be very similar. That is why Portland has decided to distribute this 2016 Letter to investors in both the LP and the Trust.

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

In the nine month period from the Trust's inception on March 31, 2016 to December 31, 2016, the Trust's series F units (the highest fee series without embedded advisor compensation) achieved a return of 29.3% (net of fees and expenses). That compares to a return in the same period of 15.8% for the S&P/TSX Index and of 10.5% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of 13.1%. Nine months is much too short a period to assess whether the Trust has met its investment objective of preservation of capital and a satisfactory return. Its strong initial performance is very encouraging, however, and investors should derive further confidence from the excellent performance record of the LP upon which the Trust is modelled.

Operating Expenses

The Funds incur operating expenses for such items as fund administration, audit and legal fees.[5] From the inception of the Funds to December 31, 2016, the Funds' operating expenses have each been 0.50% per annum plus applicable taxes. While there can be no assurance that the Funds' operating expenses will remain at 0.50% per annum, PIC remains committed to tight management of fees and expenses so as to maximize the Funds' returns.

Series Of Fund Units

The Funds have four series of units outstanding. The features of each are outlined below:[6]

- ***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 $500,000 or more in respect of the Trust, or $1,000,000 or more in respect of the LP; 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 $500,000 or more in respect of the Trust, or $1,000,000 or more in respect of the LP; 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.

As can be seen in the tables on the inside front cover of this letter, for the period from October 31, 2012 to December 31, 2016, the LP's series F units had a cumulative return of 140.9% while the LP's series M units and series P units had higher cumulative returns of 162.9% and 147.4%, respectively. For the period from inception of the Trust on March 31, 2016 to December 31, 2016, the Trust's series F units had a cumulative return of 29.3% whereas the Trust's series M units and series P units had higher cumulative returns of 33.6% and 30.6%, respectively.

Going forward, for each of the LP and the Trust, 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 Funds earn 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.

LP For Non-registered Accounts, Trust For Registered Accounts

In my opinion, with the limited exceptions noted at the end of this section, non-registered investment accounts should invest in the LP whereas registered accounts should invest in the Trust.

A full explanation of the differences between limited partnerships (such as the LP) and mutual fund trusts (such as the Trust) is beyond the scope of this letter. The following, however, summarizes some of the major differences between the two legal forms:

- In a limited partnership, all income and expense items retain their tax character and are flowed directly out to investors. For example, the LP has earned considerable income from eligible Canadian dividends and capital gains. These forms of income are taxed preferentially (i.e., at lower rates than regular income) as a result of the dividend tax credit and the fact that only half of capital gains are included in taxable income. However, all of the LP's expenses (i.e., management fees, performance fees, operating expenses and interest expense on margin loans) are fully deductible against income. The result is that, as was described in detail in the 2014 Letter, the net effective tax rate applicable to the LP's reported income is much lower than the tax rate normally applicable to ordinary income.[7] Conversely, in a mutual fund trust, expenses are netted against income which may result in a higher effective tax rate than if the same income and expense items arose in a limited partnership;
- Limited partnerships are able to allocate net capital losses to investors whereas mutual fund trusts are not permitted to do so. In the event that the Funds should realize net capital losses in a calendar year (which has not occurred in the history of the Funds through the end of 2016), the LP would be able to allocate such losses to its investors for utilization by them whereas the Trust would only be able to carry forward net capital losses for application against future realized capital gains;

- In a limited partnership, the partnership agreement may permit the allocation of income and expenses for tax purposes to limited partners based on their average ownership percentage of the partnership during a calendar year (a practice which is, in fact, followed by the LP). Mutual fund trusts, however, must distribute all of their income (net of expenses) in each taxation year. Any net income and capital gains not already distributed are paid to investors of record as of a specific date, typically late in every calendar year. For example, since the Trust does not pay distributions throughout the year, its net income and capital gains are distributed to investors as of December 31 (prior to giving effect to subscriptions and redemptions as of that date). The result is that an investor who subscribes for Trust units partway through a calendar year may receive a higher taxable distribution of net income and capital gains (some of which may have arisen before the investor became a unitholder) than if the investor had subscribed for units of the LP; and
- The management fees, performance fees and operating expenses of limited partnerships are subject to sales tax based on the partnership's province of residence, whereas the same items in a mutual fund trust are subject to sales tax based on the weighted average rate applicable in the provinces where the trust's investors reside. Since the LP is based in Alberta (where I live), its fees and expenses are subject only to Goods and Services Tax (GST) at a rate of 5%. By contrast, in December 2016, for example, the Trust's series F fees and expenses were subject to Harmonized Sales Tax (HST) at a weighted average tax rate of 12% (which is the weighted average rate of sales tax applicable in the provinces in which the Trust's investors reside). If, for example, the Funds' fees and expenses in a given year were 2.0% of their net asset values, and the sales tax rates for the LP and Trust were 5% and 12%, respectively, then the sales taxes (GST or HST, as applicable) for the LP and Trust would amount to (0.10%) and (0.24%) of their net asset values, respectively. While this difference of (0.14%) may seem small, compounded over a long period of time it could make a meaningful difference to cumulative returns.

For all of the reasons stated above, generally, non-registered investment accounts should invest in the LP whereas registered accounts (which are all tax-deferred or tax-free, so that all but the last of the tax considerations stated above are irrelevant) should invest in the Trust. There are, however, three special cases described below which I believe are exceptions to this rule:

1. Investors with a target non-registered investment amount of at least $500,000 but less than $1,000,000 might choose to invest in the Trust so as to access the lower fees applicable to the series M and series P units (for such series, the Trust has a minimum purchase amount of $500,000 whereas the LP has a minimum purchase amount of $1,000,000);
2. Quebec-based investors (both registered and non-registered) may only invest in the Trust. That is because, as a result of a complex and expensive administrative burden applicable to limited partnerships sold in that province, the LP is currently not distributed in Quebec; and
3. Non-Canadian investors may not subscribe for units of the LP but are permitted to subscribe for units of the Trust.

Unrealized Capital Gains (Losses)

In 2015, significant increases in income tax rates were announced at both the provincial and federal levels. For example, in Alberta (which is the home province of the holders of a large percentage of the LP's units), the highest provincial income tax rate was increased from 10% to 15%. This increase in the income tax rate of five percentage points was one-quarter effective (i.e., 1.25%) for 2015 and was fully effective (i.e., 5.0%)

for 2016 and subsequent years. Federally, the Government of Canada increased its highest income tax rate by four percentage points (from 29% to 33%) effective January 1, 2016.

I strive to manage the LP in a tax-efficient manner. That is why substantial capital gains were realized in the LP in 2015 before most of the recent income tax rate increases were effective. As a result, and combined with the fact that some of the LP's equity investments declined in market value late in 2015, the LP realized for tax purposes a larger amount of capital gains in 2015 than it earned in that year. At December 31, 2015 the LP had net unrealized capital losses of about ($747,000) or (4%) of its net asset value as of that date.[8]

This situation was reversed in 2016 during which the LP earned much more in capital gains than it realized for tax purposes. At December 31, 2016, therefore, the LP had net unrealized capital gains of about $3,219,000 or 14% of its net asset value as of that date. Similarly, at the end of 2016, the Trust had net unrealized capital gains of about $1,012,000 or 13% of its net asset value.

Unrealized capital gains are a double-edged sword. On the one hand, they are tax-efficient as they represent capital gains which have been earned and on which tax has yet to be paid. On the other hand, since the Funds are open-ended (i.e., subscriptions and redemptions may be made at any month-end), unrealized capital gains expose new investors to potentially paying taxes on gains as they are realized, even though such investors may not have enjoyed the returns in the Funds when the capital gains were achieved. In order to balance these two competing interests (deferring the capital gains tax without punishing new investors), the Funds are generally managed so as to try to keep unrealized capital gains as of any December 31 in the range of 10% to 25% of each Fund's net asset value. That way, investors who subscribe for units of the Funds at any time and hold such units for the long term (at least five years) should be allocated amounts for tax purposes during their holding period which are broadly in line with their actual investment experience.

Another consideration of which investors should be aware is that there has been recent media speculation that the federal government may increase the capital gains inclusion rate. Currently, one-half (i.e., 50%) of capital gains are included in taxable income. If the capital gains inclusion rate were increased (say, to 75% or 100%), and the increase was effective on the day the federal budget was announced (as is typically the case in such situations), then the LP's investors would face higher taxes in the future on unrealized capital gains than if such capital gains had been realized before budget day. This possibility also argues for realizing some capital gains as time goes by and not allowing unrealized capital gains to reach an excessive level relative to the Funds' net asset values.

Having said all of the above, the Funds will not let the tax tail wag the investment dog. In particular, the Funds will not refrain from selling securities simply to defer capital gains taxes. The best way to maximize after-tax returns is to maximize pretax returns. Tax consequences are an important, but secondary, consideration (and will vary with each investor in any event).

Change Of Prime Broker

During 2016, the LP changed the location of its prime brokerage account. It is now held at RBC Dominion Securities Inc. ("RBCDS"). Since the Trust's inception, its prime brokerage account has also been held at RBCDS. Some advantages of this change to RBCDS as compared to the LP's former custodian include:

- Lower interest rates on margin borrowings;
- A more robust institutional trading platform; and

- The ability to engage in short selling.

Lower interest rates and a better trading platform are unequivocally positive. With reference to short selling, however, the 2013 Letter described some of its potential perils and stated that "short selling in the Fund is likely to be limited in both amount and duration."[9] It remains true that, to date, the Funds have not engaged in short sales. Investors should be aware, nonetheless, that given the relentless rise in stock market valuations as discussed later in this letter in the section titled "TINA Is Still Rocking", and the fact that the Funds are now able to sell short using the facilities of their prime broker, short selling is a strategy which is being considered for use in the Funds.

Banks Reduced

One of the reasons for the Funds' strong performances in 2016 was their large shareholdings of leading North American banks. For example, at the end of 2015, the LP had investments in the common shares of four leading Canadian banks representing a total of 106% of the LP's net asset value at that time (enabled by the use of margin borrowings). After the Trust was created on March 31, 2016, it also bought large percentage weights in Canadian banks. Furthermore, over the course of 2016 each of the Funds bought positions in three leading U.S.-based banks: JPMorgan Chase & Co., Citigroup Inc. and Wells Fargo & Company. In all cases, the Funds bought their bank investments when valuations and media reports both suggested that the banks were deeply out of favour. Such disfavour was engendered by a combination of: industry-wide concerns (such as energy-related loan losses for the Canadian banks); political events (such as the "Brexit" vote in June 2016, in which voters in the United Kingdom decided in favour of the U.K.'s withdrawal from the European Union); and company-specific events (such as the Wells Fargo scandal regarding sales practices). In all cases, I believed that such concerns were either overblown or unfounded and that they created buying opportunities in these excellent businesses.

Confidence in the banks was quickly vindicated by their strong performance as the aforementioned concerns abated. Indeed, bank share prices rose to levels from which the risk / reward combinations were not nearly as compelling as they had been and did not justify the continued holding of such very large positions. Accordingly, the Funds substantially reduced their bank holdings, particularly in late 2016. At the end of 2016, both the LP and the Trust had shareholdings in banks totalling 30% (in the case of the LP, down from 106% at the end of 2015) of their net asset values.

Selected banks remain outstanding businesses and excellent candidates for investment. I hope that someday they again fall out of favour and that large percentage weights in leading banks are re-established in the Funds. If that should occur (as I believe is highly likely, given normal volatility of investor sentiment), then the title of a section of a future letter heralding that news may be "Banks Redux". For now, it's "Banks Reduced".

It's Electric!

At the risk of dating myself again (the 2014 Letter concluded with a reference to the Beatles), I'm old enough to remember when Marcia Griffiths released the song Electric Boogie (which gained fame as the soundtrack for the dance known as the Electric Slide). With electricity, as in the song's refrain, "You can't see it. It's electric! You gotta feel it. It's electric!"

The LP (the Fund, not the song) has previously had investments in electric utility companies. The 2014 Letter, for example, included a detailed analysis of the LP's investment in the Newfoundland-based utility company, Fortis Inc.[10] That investment was the LP's biggest winner in the history of the LP to the end of 2014. During 2016, two events, each of which precipitated a drop in the share prices of electric utility companies, were used as opportunities to buy large positions in two of such businesses on what I believe were favourable terms.

The first event was in February, when Fortis announced its planned acquisition of ITC Holdings Corp., the largest independent electric transmission company in the United States, for US$11.3 billion (the acquisition was completed in October).[11] Arbitrage activity related to the proposed acquisition caused the share price of Fortis to drop sharply, for a few days. In February, the LP established a new position in Fortis and the company was also purchased in the Trust following its launch.

The second event occurred in November, when the surprising result of the U.S. presidential election triggered a sharp increase in interest rates, and declines in the share prices of utility companies (which are widely perceived as interest-sensitive and whose share prices often decline when interest rates rise). The Funds used this period of weakness to add to their holdings in Fortis and initiate new positions in Nova Scotia-based utility Emera Inc. (which on July 1, 2016 had completed its own large U.S. acquisition, that of TECO Energy, Inc., for US$6.5 billion).[12] At the end of 2016, the shareholdings in Fortis and Emera represented combined weights in both the LP and Trust of 88%.

With the Funds' large investments in electric utilities, are we going (as Marcia would say) on a party ride? I certainly believe that these two investments will deliver satisfactory long-term returns with limited risk. If for any reason the Funds' investments in electric utility companies don't work out, I already have a title selected for the section of a future annual letter that will describe the result: "The Big Short".

TINA Is Still Rocking

As described in the 2015 Letter, persistently low interest rates have buttressed the demand for equities since they look attractive compared to the very low interest rates obtainable on cash and government bonds. This phenomenon has been widely described as There Is No Alternative, a condition that is better known by its acronym, TINA.[13]

How has TINA been doing in the last year? Very well, thank you. The year 2016 is added to the table below, which was included in the 2015 Letter.

S&P 500 Index	2011	2012	2013	2014	2015	2016
Average index value	1,268	1,379	1,643	1,932	2,061	2,094
Closing index value	1,258	1,426	1,848	2,059	2,044	2,239
Operating earnings	96.44	96.82	107.30	113.01	100.45	106.60
Average price-earnings ratio	13.1	14.2	15.3	17.1	20.5	19.6
Closing price-earnings ratio	13.0	14.7	17.2	18.2	20.3	21.0

In 2016, S&P 500 Index earnings rose to $106.60 (with 96% of companies having reported at time of writing), an increase in the year of about 6%.[14] That increase was bolstered by 2015 having been a low base year as it was adversely affected by very poor earnings of the producers of energy and other raw materials.

The average S&P 500 Index level rose from 2,061 in 2015 to 2,094 in 2016, a gain of less than 2%. As a result, the average price-earnings ("P/E") level declined from 20.5 times in 2015 to 19.6 times in 2016. The average, however, tells only part of the story. The S&P 500 Index experienced very strong gains following the November U.S. presidential election. As a result, at the close of 2016, the P/E of the S&P 500 Index based on its operating earnings for that year rose to 21.0x. ***That is the S&P 500 Index's highest closing P/E in a non-recession year since the year 2000.***

As stated in the 2015 Letter, nobody knows how high the P/E ratio of the S&P 500 Index will go before it stops rising (or declines). Indeed, some of the recent increase may prove to be justified based upon proposed economic measures which might be enacted in 2017. With the Republicans in control of all three of the presidency, Senate and House of Representatives, they have no excuse for not enacting some of the measures which they have long espoused. Chief among these, from an investor's perspective, may be corporate tax reform. It is certainly possible that during 2017, the U.S. federal corporate tax rate might be lowered from 35% to about 20% together with a temporary tax rate of about 10% applicable to the repatriation of accumulated foreign earnings. These measures would, all other things being equal (as economists like to say), result in a significant increase in corporate profitability and financial strength. The expectation of these measures being implemented resulted in a significant increase in U.S. stock prices late in 2016 (which has continued in early 2017).

While some of the recent stock market gains may thus be justified based on fundamental factors, I'm wary about counting too many chickens before they're hatched. As stated in the 2015 Letter (as adjusted to pluralize "Funds" following the launch of the Trust), 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 Funds, 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 Funds' strong performances 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."[15]

As a final thought on stock market valuations, those despairing that TINA may cause stock prices to stay permanently high (thereby preventing attractive buying opportunities) may wish to consider the following words which I recently read in a book written by a corporate shareholder about his investment:

> A high price of shares causes concern to many who are not accustomed to it. But reasonable men [and women] need not be disturbed about the matter, since every day the position of the Company becomes more splendid, the state wealthier, and the revenue from investments at fixed interest becomes less, inasmuch as it is difficult to find ways of investing money. The rate of interest on ordinary loans amounts to only 3 per cent a year, and, if the creditor receives security, to only 2½ per cent. Therefore, even the wealthiest men are forced to buy stocks, and there are people who do not sell them when the prices have fallen, in order to avoid a loss. But they do not sell at rising prices, either, because they do not know a more secure investment for their capital.[16]

The foregoing passage was written (probably with a quill pen) by author Joseph de la Vega in the year 1688. The company referred to in the text is the Dutch East India Company, one of the world's earliest corporations.

I cite the passage above to make the point that the world has experienced the phenomenon of low interest rates before, at least as far back as 1688. Yet for more than three centuries since then, investment opportunities have continued to abound. All that is necessary to succeed is for investors to supply two of the most difficult of virtues: patience and fortitude. The next section of this letter discusses that investment opportunities did, in fact, arise in 2016. What was critical was the patience to wait for such opportunities and the fortitude to seize them when they arose. The strong performance of the Funds is a testament to the rewards that await those who exhibit those traits.

The Immaculate Correction

Given the recent ebullience in global stock markets, it's worth remembering that it wasn't that long ago that investors were much more pessimistic. The table below shows, for selected major stock market indices, the percentage decline (excluding dividends) from their highest levels in 2015 to their lowest levels in 2016. The table also shows the subsequent percentage increases in the indices from their 2016 lows to their highest levels to date in 2017 (through February 24, 2017).

Selected Stock Market Indices Index	Country / Region	% decline from 2015 high to 2016 low	% gain from 2016 low to 2017 YTD high
S&P 500	U.S. large capitalization	-15.2%	30.8%
ASX All Ordinaries	Australia	-20.1%	23.5%
FTSE 100	U.K.	-22.8%	33.7%
MSCI EAFE	Europe, Australia & Far East	-24.8%	20.0%
S&P/TSX Composite	Canada	-25.7%	38.3%
Russell 2000	U.S. small capitalization	-27.2%	49.5%
Nikkei 225	Japan	-29.1%	32.0%
Euro Stoxx 50	Europe	-30.3%	25.5%
Hang Seng	Hong Kong	-36.1%	32.5%
Shanghai SE Composite	China	-49.0%	23.7%

In stock market parlance, the widely-accepted definition of a "correction" is a price decline from a recent high of at least 10% but less than 20%. A "bear market" is a decline of 20% or more. By that definition, all of the major stock market indices listed above, except one, experienced a bear market that ended in 2016. The sole exception was the biggest stock market index listed, the S&P 500 Index. Its percentage decline from its 2015 peak to its 2016 trough was only (15.2%), which was even less of a decline if its dividends were included. Not only did the percentage decline stay muted, but also the volatility in that period was generally subdued. That, and the fact that the decline seemed to lack traditional fundamental causes, is why one commentator dubbed the decline that ended in 2016 as the "immaculate correction".[17]

Many people have long lamented persistently high stock prices, thinking that they would invest more capital if only stock prices would decline. Yet when share prices dropped sharply by early 2016, did those people load up on the more attractively priced equities? Some did. Most famously, it was widely publicized on February 11, 2016 that the chief executive officer of JPMorgan Chase, Jamie Dimon, had just bought with his own money 500,000 shares of the company (which closed that day at $53.07 per share and ended 2016 at $86.29 per share, for a gain versus its February 11 closing price of 63%).[18] That day proved to be the lowest level of the S&P 500 Index in 2016, from which it has since soared. In fact, Dimon's action was strongly reminiscent of the actions of financier J.P. Morgan himself, who is widely credited with ending the Panic of 1907 by making large deposits into leading U.S. banks.[19]

Jamie Dimon's (very profitable) heroics aside, did investors en masse take advantage of the lower stock prices in early 2016? Alas, there is no evidence to suggest that. In fact, historical evidence suggests the opposite: that the owners of equity mutual funds tend to invest more after periods of strong market performance and redeem investments after periods of weak market performance.[20] The fact that, despite their stated intentions, many (perhaps most) investors do not buy equities when the news is negative and stock prices are low reminds me of the words of world champion boxer Mike Tyson: "everyone has a plan until they get punched in the mouth."[21]

Coin Flipping And Its Lessons For Investors

A recent newspaper article discussed a computer-simulated coin flipping experiment in which participants are informed at the start of play that there is a 60% chance that the coin will come up heads (and therefore only a 40% chance that the coin will come up tails).[22] Participants start the game with $25, the game's time limit is 30 minutes and flippers may bet as often as they like within that time frame. Before each coin flip, participants decide whether to bet on heads or tails and how much of their virtual pot to bet. The article was based on an experiment conducted by Victor Haghani and Richard Dewey which was described by them in an academic paper published in 2016.[23] Before reading on, please take just a few minutes to visit http://coinflipbet.herokuapp.com/ and try it yourself.

The actual experiment was played by 61 subjects. They were primarily university students studying economics and finance and young professionals at finance firms. The sample consisted of 49 males and 12 females. The experiment involved real money (subject to a cap on any flipper's pot of $250 which they would be informed of if they got close).

One might think that with a known probability of winning each bet of 60%, and with well-educated and motivated coin flippers involved, the flippers would do very well. That was not the case. As Haghani and Dewey noted, "while we expected to observe some suboptimal play, we were surprised by the pervasiveness of it. Suboptimal betting came in all shapes and sizes: over-betting, under-betting, erratic betting and betting on tails were just some of the ways a majority of players squandered their chance to take home $250 for 30 minutes of play...[t]he straightforward notion of taking a constant and moderate amount of risk and letting the odds work in one's favor just doesn't seem obvious to most people."[24] In brief, 28% of players went bust (i.e., ended with less than $2); 5% ended with between $2 and the initial $25; 31% ended with between $25 and $100; 15% ended with between $100 and $200; and only 21% maxed out by attaining over $200. For the record, having previously read a great deal in the field of behavioural finance, I knew to bet a fixed percentage of 20% of the pot every time (as discussed below). Also, of course, one should bet on heads every time. After 32 bets (which took just over six minutes), my pot reached $219 and the game was stopped, being within range of the experiment's maximum payout of $250.

The experiment demonstrates a specific example of what is known as the Kelly criterion.[25] According to the criterion, a player who wants to maximize the rate of growth of his wealth should bet a fraction of his wealth defined by the function 2*p-1, where p is the probability of winning. Thus, in the coin flip experiment in which the probability of winning was 60% (i.e., p = 0.6), the percentage of the pot which a flipper should have bet every time is 20%.

The Kelly criterion has real-world application in investing, including in the management of the Funds. For example, if an investment is believed to have solidly favourable odds with limited downside risk, it argues for having about 20% of net assets in the investment, which is routinely the case in the Funds (from February 2013 to the end of 2016, the LP's average percentage invested was 144% of its net asset value spread over about seven companies, for an average investment per company of about 20%). For even better investments with high odds of outperformance of, say, 75% with very limited downside risk, the criterion would call for making an investment of 50% of net asset value (which happens to be the Funds' self-imposed limit for the purchase weight in any single security). Conversely, if the odds are not in one's favour, the only correct amount to bet is nothing. That underscores the importance of patience: to be a successful investor, wait until the odds are distinctly in your favour and then invest significantly. That is how the Funds strive to be managed.

Outlook

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

March 3, 2017

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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 Funds' portfolio manager and the letter's author, James H. Cole.
2. Portland Focused Plus Fund LP and Portland Focused Plus Fund Offering Memorandum, March 1, 2016, p. 2. The OM is available at www.portlandic.com/focusedplusfundLP.html and www.portlandic.com/focusedplusfundtrust.html.
3. For a discussion, see 2013 Letter, p. 3.
4. As ranked by The Globe and Mail in the Alternative Strategies asset class in the 3 year category out of 480 funds. In the 1 year category the LP's ranking is 19th. Ranking is subject to change every month. See http://globefunddb.theglobeandmail.com/gishome/plsql/gis.fund_filter?pi_type=B.
5. OM, p. 14.
6. OM, pp. 6-7 and pp. 13-14.
7. 2014 Letter, pp. 10-13.
8. The amount of unrealized capital gains (losses) at any year-end has been calculated as the fair value of total investments minus the cost of total investments, both as shown in the Schedule of Investment Portfolio in the financial statements of the LP and Trust which are mailed together with this letter and which may be found at http://www.portlandic.com/focusedplusfundLP.html and http://www.portlandic.com/focusedplusfund trust.html, respectively.
9. 2013 Letter, pp. 10-11.
10. 2014 Letter, pp. 8-10.
11. See press releases dated February 9, 2016 and October 14, 2016 available at https://www.fortisinc.com/news-and-media/news-releases.
12. See http://investors.emera.com/file.aspx?IID=4072693&FID=34951054.
13. 2015 Letter, pp. 14-15.
14. Data is as of February 28, 2017. The source for S&P 500 Index earnings is Standard & Poor's itself at https://my.spindices.com/indices/equity/sp-500.
15. 2015 Letter, p. 15.
16. de la Vega, Joseph. *Confusion de Confusiones* (Martino Publishing, 2013), p. 13. The book was originally published in Spanish in 1688. German and Dutch translations were completed in 1919 and 1939, respectively. An English translation was published by Harvard University Press in 1957.
17. David Kelly, chief global strategist at J.P. Morgan Asset Management; see the video at http://video.cnbc.com/gallery/?video=3000493655.
18. http://www.cnbc.com/2016/02/11/jamie-dimon-buys-more-than-25m-in-jpmorgan-stock-source.html.
19. https://en.wikipedia.org/wiki/Panic_of_1907.
20. https://www.bloomberg.com/view/articles/2014-07-09/how-not-to-beat-the-market-ritholtz-chart.
21. This quotation has been popularized by replacing "mouth" with "face", which I believe results in a catchier phrase, but it's not what Tyson actually said. See http://articles.sun-sentinel.com/2012-11-09/sports/sfl-mike-tyson-explains-one-of-his-most-famous-quotes-20121109_1_mike-tyson-undisputed-truth-famous-quotes.
22. McGugan, Ian. "How a simple coin-toss game can make you a better investor." The Globe and Mail, December 3, 2016 p. B14.
23. Haghani, Victor and Dewey, Richard. "Rational Decision-Making under Uncertainty: Observed Betting Patterns on a Biased Coin," October 19, 2016, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2856963.
24. Ibid., p. 3 and p. 7.
25. https://en.wikipedia.org/wiki/Kelly_criterion.

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