



PORTLAND
INVESTMENT COUNSEL®

Portland Focused Plus Fund LP

ANNUAL LETTER TO INVESTORS

FOR THE YEAR ENDED DECEMBER 31, 2014

**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%

Since Inception (Oct. 31, 2012)

Compound annual return	24.1%	11.1%	21.6%
Cumulative return	59.7%	25.7%	52.8%

Notes:

Performance for the Portland Focused Plus Fund LP is for the class F units which is the highest fee class 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.

Past performance is no guarantee of future results. This information is not to be construed as a public offering of securities in any jurisdiction of Canada. The offering of the Fund is made pursuant to an offering memorandum to eligible investors. Read the offering memorandum carefully before investing. For the Fund's offering memorandum which contains information including investment objectives, fees and expenses and risks, visit www.portlandic.com/plusfund.html or contact Lana Nicosia at 1-888-710-4242 or by email at lnicosia@portlandic.com.

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

2013 Letter

The 2013 annual letter to investors in the Fund ("2013 Letter") is available on the web site of Portland Investment Counsel Inc. ("PIC") at <http://www.portlandinvestmentcounsel.com/plusfund.html>. The major subject areas covered in the 2013 Letter are: investment objective; performance; investment strategies (focus and leverage); investment vs. speculation; investments; short selling; foreign currency; volatility vs. risk; trading costs; portfolio turnover; taxes; inflation; fund fees and expenses; and future value formula. As those subject areas were discussed in detail in the 2013 Letter, this letter provides concise references to those subjects only as necessary. Investors are strongly encouraged to read the 2013 Letter before reading this letter.

Investment Objective

As stated in the Fund's Offering Memorandum (the "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 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 www.portlandic.com/plusfund.html.

In 2014, the Fund's class F units achieved a return of 16.8% (net of fees and expenses). That compares to a total return of 10.6% for the S&P/TSX Composite Index and 13.7% for the S&P 500 Index in US\$. A 50%/50% blend of the two indices would have returned 12.1%. For the entire period since inception of the Fund on October 31, 2012 to December 31, 2014 the Fund's class F units achieved a cumulative return of 59.7%. That compares to a cumulative total return of 25.7% for the S&P/TSX Composite Index and 52.8% for the S&P 500 Index in US\$. A 50%/50% blend of the two indices would have returned 39.2%. Accordingly, in both 2014 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 to December 31, 2014, the Fund's operating expenses were 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 control of fees and expenses so as to maximize the Fund's returns.

Management Fee Reductions

Effective July 1, 2014, PIC reduced the management fee on each of the class B and class BN units by 0.75% per annum to nil and 1.0% per annum, respectively.⁵ To my knowledge, the Fund's class B units are the only class of any investment fund in Canada with no management fee.

Fund Classes

The Fund has four classes of units. The features of each are outlined below:⁶

- *Class A units* have a minimum initial subscription amount of \$5,000 for accredited investors (\$150,000 for all others). Class A units have a management fee of 2% per annum and a performance fee of 10% of the amount above the class's highest ever net asset value per unit ("High Water Mark"). A trailing commission of 1% per annum is paid to financial advisors whose clients invest in class A units;
- *Class B units* have a minimum initial subscription amount of \$1,000,000. Class B units do not have a management fee; they have a performance fee of 10% of the amount above the class's High Water Mark;
- *Class BN units* have a minimum initial subscription amount of \$1,000,000. Class BN units have a management fee of 1% per annum; they do not have a performance fee; and
- *Class F units* have a minimum initial subscription amount of \$5,000 for accredited investors (\$150,000 for all others). Class F units have a management fee of 1% per annum and a performance fee of 10% of the amount above the class's High Water Mark.

The performance of the class 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 classes is shown in the table below.

Year	Annual Total Return			
	Class A	Class B	Class BN	Class F
2012 (from Oct. 31)	1.7%	2.0%	2.0%	1.9%
2013	33.0%	34.4%	37.7%	34.1%
2014	15.6%	17.5%	18.8%	16.8%

Since Inception (Oct. 31, 2012)

Compound annual return	22.9%	24.6%	26.7%	24.1%
Cumulative return	56.4%	61.0%	66.9%	59.7%

As can be seen in the last line of the table, for the period from October 31, 2012 to December 31, 2014, the Fund's class F units had a cumulative return of 59.7% while the Fund's class B and class BN units had higher cumulative returns of 61.0% and 66.9%, respectively. Going forward, the class B units are certain to continue to have returns greater than the class F units since the class B units have no management fee. Similarly, the class BN units will have a performance greater than the class 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 class B and class BN units are encouraged to do so in order to take advantage of the lower fees applicable to those classes which will continue to enhance their long term performance.

Oil Prices

One of the major economic events of 2014 was the dramatic decline in oil prices. This had a significant impact on the Fund's performance. As a result, a discussion of world oil markets is merited.

For the three and a half years ended June 30, 2014, the world price of oil, as represented by the price for Brent crude, traded in a narrow range and averaged US\$110 per barrel.⁷ By the end of 2014, Brent had fallen below US\$60 per barrel. To date in 2015, Brent has averaged less than US\$60 per barrel, a decline from its average for the three and a half years ended June 30, 2014 of more than (US\$50) per barrel or (45%).⁸ The world consumes 92.4 million barrels per day or 33.7 billion barrels per year.⁹ As a result, if the price of Brent crude oil were to remain at US\$60 per barrel then as compared to the prior several years the world's oil consumers would save US\$1.7 *trillion* per year. This would be, in effect, an enormous tax cut which would benefit the world's largest net oil consuming countries. That list includes almost all of the world's major economies: the United States ("U.S."), China, Japan, India and most of continental Europe. Conversely, the tax cut will be paid by the world's net oil producing countries: the 12 member states of the Organization of the Petroleum Exporting Countries ("OPEC"), Russia, Mexico and a few other smaller countries (including, alas, Canada). On balance, the decline of crude oil prices in the second half of 2014 and early 2015, if sustained, can be expected to be hugely beneficial to the world economy.

Beginning in 2004, I became a believer in the Peak Oil Theory. This theory asserts that global crude oil production is at or near a peak, after which production will begin to decline. The world is critically dependent on crude oil, particularly for transportation fuels consumed by planes, trains and automobiles. Alternative energy sources for those consumption needs are either unavailable or are uneconomic. In the absence of alternatives, the world will continue to rely on crude oil which, once used, is gone forever. Given the increasing difficulty of maintaining and increasing oil supply, the price mechanism must serve to balance supply and demand. In other words, based on the Peak Oil Theory, oil prices will average much higher levels than previously in order to make it economic to find and produce increasingly expensive sources of crude oil and to encourage greater efficiency in energy consumption. For the 10 years ended in mid-2014, this theory was an accurate predictor of world oil markets as prices rose to previously unheard-of levels yet there was limited increase in either oil production or the profitability of energy companies (because of the difficulty and high cost of bringing on new reserves).

Beginning in mid-2014, the seeming stability in world oil prices began to unravel. Two technological developments, horizontal drilling and hydraulic fracturing (fracking), have been applied to known deposits of light, tight oil in shale formations that prior extraction methods had been unable to exploit. Oil production in the U.S. has experienced a dramatic renaissance, increasing from 7.4 million barrels per day in 2009 to 11.7 million barrels per day in 2014.¹⁰ At the same time, three OPEC countries, Iran, Iraq and Libya, began to restore production that had been curtailed by geopolitical events.¹¹ World oil production began to exceed consumption and prices began to fall. On November 27, 2014 that price decline accelerated sharply after OPEC decided to maintain its production when financial markets had expected an OPEC production cut.¹² Prices went into freefall and, as noted, Brent crude fell below US\$60 per barrel by the end of 2014 and has averaged less than US\$60 per barrel in 2015 to date.

For investors, it's important to attempt to predict what oil prices will be in the future. The laws of economics suggest that the long-term equilibrium price will be one which balances supply and demand and which covers oil's total production costs including a satisfactory return on the equity capital deployed in oil-producing companies. In terms of demand, one often reads that world oil demand has fallen. Almost invariably, the writer means to say that the *growth* of demand has fallen. In data going back more than 40 years, other than in times of recession or in response to a sudden major increase in oil prices (neither of which factor exists now), oil demand has never declined. In fact, over the past decade (ending in 2014), world oil demand grew by a cumulative amount of 9.4 million barrels per day (i.e., at about 1.0% per annum).¹³

In terms of supply, it's important to distinguish between marginal cost and total cost. Marginal costs are the cash costs required to produce and deliver one more barrel of oil from existing facilities, such as cash costs for production, transportation and royalties. Total costs (i.e., full-cycle costs), include marginal costs as well as exploration, development, depreciation, depletion and amortization, general and administrative expenses, interest expense and income taxes. While oil prices are currently higher than the marginal cost of all but the highest-cost sources of supply, they are far below total costs as well as the excess required above total costs to provide a satisfactory return on the shareholders' equity invested in oil producing companies.

In my estimation, the world oil price required to cover total costs and provide an adequate return on investment is at least US\$80 per barrel. Since oil prices are currently far below that level, investment in new oil production will decline which will eventually tighten up the supply/demand balance. Think of oil production as a pipeline: money goes in one end and, a year or more later, oil comes out the other end. Once the money tap is turned sharply down, which has been happening since December, oil production will inevitably decline. That is the basis for the timeless expression that "the best cure for low oil prices is low oil prices." The natural decline rate of existing production means that when spending on new production dries up, total production will soon begin to decline, thus causing prices to increase back to a level at which investment in new production is economic.

It should be noted that changes in oil prices have a leveraged effect on the profitability of oil-producing companies. For example, if oil were \$100 per barrel and a company's total costs were \$60 per barrel, a decline of (40%) in the oil price would result in a decline in the company's net income of (100%). That explains why the fall in oil prices in 2014 had a materially negative impact on the share prices of energy companies. In 2014, for example, the S&P/TSX Oil & Gas Exploration and Production sub-index fell (24.8%) while the S&P/TSX Oil & Gas Drilling sub-index declined by (39.2%).¹⁴ The share prices of global energy service companies such as offshore drillers also fell sharply. This had a material negative effect on the performance of the Fund, as is more fully discussed in the next two sections of this letter.

Sell Discipline

An important aspect of any portfolio manager's style is sell discipline. In other words, under what circumstances would an investment already held be sold? Apart from special circumstances such as takeovers, the factors that would give rise to security sales in the Fund are as follows:

- *Material adverse change.* This refers to circumstances when a business, subsequent to purchase, experiences a significant deterioration in its fundamental attributes such as earnings, financial position, operations or management;

- *Mistakes.* These are instances in which candour demands the recognition that there may not have been material adverse change. Instead, the merits of the business or the attractiveness of its valuation were misunderstood at the time of purchase; and
- *High valuation / opportunity cost.* This is the happy circumstance in which an investment in a company has performed so well (such as when its share price has risen much faster than its earnings, dividends and intrinsic value) that it no longer represents an attractive combination of high potential return with limited downside risk compared to investment alternatives. When this occurs, the investment becomes a candidate for sale with the proceeds to be re-allocated to superior investment opportunities.

From time to time, despite the fact that the Fund's investments do not meet the criteria for sale listed above, I may choose to sell securities in order to *reduce portfolio leverage*. In that instance, the Fund may sell all or part of its investment portfolio, considering such factors as valuation, fundamental performance and industry diversification. As noted in the 2013 Letter, paying down margin debt reduces portfolio risk.¹⁵

Most of the security sales in the Fund since its inception have been effected in order to reduce portfolio leverage or after strong performance has diminished a stock's prospective return and increased its downside risk. The Fund has experienced only a small number of security sales due to material adverse change or mistakes. One of those instances is reviewed immediately below.

The Biggest Loser

Some readers may be familiar with the reality television show, "The Biggest Loser". The show depicts obese contestants who compete to lose weight. The contestant who loses the most weight wins a cash prize. In investing, by contrast, the biggest loser is not anything to celebrate. Reviewing losers can, however, be useful and serve to improve future investment decision-making. In that spirit, below is the tale of the Fund's investment in Enscopl ("Enscopl").

As noted above, I believe in the Peak Oil Theory and the conclusion that flows from it: oil prices will, on average, be higher than they've been historically. As a result, I have been open to investing in oil-related businesses which meet our typical investment criteria (i.e., larger-capitalization companies with strong financial positions and superior track records that are undervalued, with a particular emphasis on companies with above-average dividend yields and satisfactory historic and prospective dividend growth).¹⁶ In late 2013, I decided that one company that met those criteria was the world's second-largest offshore oil & gas driller, Enscopl.

At the end of 2013, at about the time the Fund made its investment in the company, Enscopl traded at: a price to book value of 1.0 times; a dividend yield of 5.3%; and a trailing price/earnings ("P/E") ratio of 9.3 times.¹⁷ These are all levels which had historically indicated attractive investment value for this major business.

In light of what transpired in 2014, it's clear that I didn't appreciate how fat Enscopl was or how much market value it would have to shed to become lean. The investment was acquired in the Fund in December 2013 and January 2014 at a total cost of US\$4.87 million. When the Fund finished selling Enscopl in December 2014, the total proceeds from the investment, including dividends received during the Fund's period of ownership, totaled US\$3.55 million. The loss on the investment was thus (US\$1.32) million or (27.1%). I did sell almost half of the original holding in March at a modest loss when I began to believe that the

fundamental outlook for the business constituted material adverse change as compared to the original investment thesis. Yet, presented with several warnings over the balance of 2014, I hung onto the remaining shares (at their ever-increasing dividend yield as the stock price went down). Those warnings included Ensco's announcement in its results for the second quarter of 2014, its first under its new chief executive officer ("CEO"), that it was taking an impairment charge of (US\$1.5) billion related to its drilling rigs. I too readily accepted this as the "big bath" often taken by new CEOs which writes off old assets and enhances future earnings. The impairment charge substantially reduced the previous average earnings which had underpinned part of the original investment thesis. Also, the OPEC decision of November 27 clearly marked a sea change in at least the near-term outlook for oil prices. Only with the end of 2014 looming, and the Fund having substantial realized capital gains on other positions while still holding Ensco at an unrealized loss, did I sell the remaining shares of Ensco.

I believe that I have become better over the years at not averaging down in positions that have gone awry (i.e., not throwing good money after bad). I believe that I have also become somewhat better at selling positions for which there has been material adverse change or when I recognize that I have made a mistake (i.e., cutting losses short). The tale of Ensco described above, however, shows that in that aspect of investing I still have room for improvement.

The One That Got Away

The tale of Fortis Inc. ("Fortis") is one which is much happier and yet still bittersweet.

Fortis is a leader in the North American electric and gas utility business, with total assets of more than \$26 billion and fiscal 2014 revenue of \$5.4 billion.¹⁸ It serves customers across Canada and in the U.S. and Caribbean. In December 2013, Fortis announced that it had agreed to acquire UNS Energy Corporation ("UNS"), a utility company in Arizona, for US\$4.3 billion. Simultaneously, Fortis announced that it would finance the acquisition of UNS partly by the issuance of \$1.8 billion of convertible debentures ("Debentures"). The Debentures were sold on an instalment basis at a price of \$1,000 per Debenture, with \$333 due on closing (evidenced by instalment receipts) and \$667 due on the final instalment date (after closing of the UNS acquisition). The Debentures were sold on a "bought deal" basis, meaning that the offering's underwriters (certain major brokerage firms) agreed to acquire the Debentures in the event that there was insufficient public demand.

As sometimes happens with bought deals, the underwriters misjudged the market. There were not enough buyers for the Debentures at their original issue price so the underwriters were forced to buy the Debentures and take them into their own securities inventory. As often happens in such situations, the underwriters (rather than tie up their own capital for long periods in ownership of a security that they had clearly misjudged) soon reduced the price to sell the securities out of their inventory. In January 2014, the underwriters cut the price from \$333 (the price that they had paid on closing) to \$305. I determined that the Debentures met the Fund's investment criteria and that at their reduced price they offered an exceptionally attractive combination of high expected return with limited downside risk. The Fund therefore acquired \$4.30 million principal amount of Debentures for an initial outlay of \$1.31 million. So far, so good.

After placing the initial Debenture order, I contacted the Fund's custodian because I proposed to take a much larger position in the Debentures but before doing so I needed to determine what the custodian would provide in loan value (i.e., in a margin loan) against the Debentures as security. The custodian's answer was "zero." I argued strenuously against that position. I pointed out that since the volatility of Fortis

common shares was about one-third that of the overall stock market, even though the Debentures were triple-leveraged (since they were only partially paid), their volatility could be expected to be no greater than that of the overall stock market. Further, I considered it illogical that the custodian would readily extend 70% loan-to-value against Fortis common shares but nothing against the Debentures which ranked higher in the company's capital structure. While I argued these points vociferously, the custodian was unmoved. To be fair, at least one major competing prime broker (and one of the deal's *underwriters*) would, similarly, offer no loan value on the Debentures.

I was thus faced with a difficult choice. Either I could simply keep the Fund's initial investment in the Debentures or, to increase it significantly as I had proposed, I would have to sell many other of the Fund's investments at the low prices then prevailing in late January. Had the custodian been willing to lend against the Debentures, this choice would not have been necessary as the Fund could have financed the purchase of additional Debentures with a margin loan. In the end, I reluctantly chose simply to keep the initial investment in the Debentures, rather than sell other investments at low prices so as to buy more Debentures which would have tied up more capital in an unmarginable security.

The Debentures have proved to be the Fund's biggest winner to date. Compared to the purchase price of the Debenture instalment receipts of \$305.00, the total return on the instalment receipts, achieved in just nine months, was 75.3%. This is summarized in the following table:

Rate of return on Fortis convertible debentures

Fortis common stock price on Oct. 27, 2014	\$35.75
Times: # of Fortis shares per \$1,000 principal amount	32.5521
Equals: conversion value per \$1,000 principal amount	\$1,163.74
Subtract: final instalment payment	(\$667.00)
Equals: conversion value of instalment receipt	\$496.74
Add: interest coupon paid on instalment receipt	\$40.00
Subtract: accrued interest paid on purchase	(\$2.19)
Equals: total value of instalment receipt	\$534.55
Divided by: instalment receipt cost, Jan. 24, 2014 per \$1,000	\$305.00
Equals: simple rate of return on instalment receipts	75.3%

The following points explain the items in the table:

- The final instalment of the Debentures became due and was made on October 27, 2014 and the Debentures were converted into common shares on that date;
- Each \$1,000 principal amount of Debentures was convertible into 32.5521 Fortis common shares. At the closing price of the common shares on October 27 of \$35.75 per share, the market value of the shares (into which each \$1,000 principal amount of Debentures was converted) was therefore \$1,163.74;
- From this must be deducted the \$667 final instalment paid on the Debentures, so that the terminal value of the instalment receipts was \$496.74;

- To this must be added the coupon (i.e., interest) received on the Debentures of \$40.00. The accrued interest of \$2.19 that was paid upon the purchase of the Debentures in January, however, must be deducted; and
- Summing up all of the above items, the total value received for each Debenture instalment receipt was \$534.55. Compared to the purchase price of the Debenture instalment receipts of \$305.00, the total return on the instalment receipts, achieved in just nine months, was 75.3%.

The story got even better after October 27 when the Fortis common shares continued to appreciate. The total impact of the Fortis investment on the Fund in 2014 was as follows: the Fund sold some Fortis shares in late 2014 for realized capital gains of \$710,000 (as compared to their acquisition cost by means of the Debentures); held the remaining shares at December 31, 2014 which at their price then of \$38.96 per share had an unrealized gain of \$414,000; and the Fund had received Debenture coupon payments (net of accrued interest paid) of \$163,000. The realized gains, unrealized gains and coupon payments arising from the Fund's investment in the Debentures thus totaled \$1,287,000.

As good as the Fortis gains were, they could have been significantly larger. It was my intention (provided only that the instalment receipts had been given a normal loan value of 50% to 70%) to have the Fund purchase almost four times as much of the Debentures as it did. Woulda, coulda, shoulda are the useless pleas of investors, usually when they're employing 20/20 hindsight. Indeed, a favourite expression of PIC's chairman, Michael Lee-Chin, underscores the importance of taking action as he notes that "ideas are a dime a dozen; those who implement them are priceless." To have the Fortis idea and to take action, only to have that action severely limited by a supplier (in this case, the Fund's custodian), is a hard pill to swallow. It's not unlike hooking a huge fish only to be told by the captain to cut the line. While the performance of the Fund to date has certainly been satisfactory, its cumulative returns are and will always be less than they would have been were it not for the one that got away.

Income Taxes

In describing the Fund, I often mention the tax-efficiency of the Fund's legal form as a limited partnership ("LP"). I'm sometimes asked to explain how an LP works and what the benefits are to investors. My explanation follows.

LPs are flow-through entities. The LP itself is not subject to income tax; all of its income and expenses are allocated to its investors for inclusion in their tax returns. Such income and expense items retain their tax character as though they had been received or paid by the investors directly. For example, as stipulated for individuals under the *Income Tax Act*, only 50% of the Fund's capital gains are included in investors' taxable incomes.

An additional example may prove instructive. Assume a hypothetical investment fund which is an LP. Further assume that it has the following portfolio and returns (the portfolio, while hypothetical, is not unlike how the Fund was invested at the end of 2014):

- Net assets of \$15 million;
- Margin loan of \$15 million, for a debt: equity ratio of 1:1 and a total portfolio size of \$30 million;
- The margin loan is entirely in U.S. dollars at an interest rate of 1.2%;

- The LP is invested \$15 million in Canadian equities and \$15 million in U.S. equities;
- The Canadian equities earn an annual total return of 8%, consisting of a dividend yield of 4% and capital gains of 4%;
- The U.S. equities also earn an annual total return of 8%, consisting of a dividend yield of 3% and capital gains of 5%;
- The foreign withholding tax on the LP's U.S. dividends received is 15%;
- The LP incurs operating expenses of 0.5% of net assets;
- The LP has a management fee of 1% and a performance fee of 10% of any return in excess of all of its expenses (i.e., the combined amount of interest expense, foreign withholding taxes, operating expenses and management fee); and
- For simplicity, the management fee and operating expenses are based on beginning of year net assets (rather than average net assets); there is no change in foreign exchange rates; and the goods and services tax ("GST") and/or harmonized sales tax ("HST") applicable to the LP's fees and expenses are ignored.

Given the above assumptions, the following table shows the income statement of the hypothetical LP and how its income and expenses would be recorded for tax purposes by the LP's limited partners (the results are shown for residents of both Alberta and Ontario, where, to date, all of the Fund's investors are located).

Hypothetical LP income statement	Alberta	Ontario
LP income:		
Canadian dividends	\$600,000	\$600,000
Foreign dividends	\$450,000	\$450,000
Capital gains	\$1,350,000	\$1,350,000
Fund total income	\$2,400,000	\$2,400,000
LP expenses:		
Margin loan interest expense	\$180,000	\$180,000
Foreign withholding taxes	\$67,500	\$67,500
Operating expenses	\$75,000	\$75,000
Management fee	\$150,000	\$150,000
Performance fee	\$192,750	\$192,750
Fund total expenses	\$665,250	\$665,250
LP income as reported	\$1,734,750	\$1,734,750
Add back: foreign withholding taxes	\$67,500	\$67,500
LP income before taxes	\$1,802,250	\$1,802,250

Limited partner tax rates

Marginal income tax rates (2014, assuming taxable income of \$150,000):¹⁹

Income (including foreign dividends)	39.00%	47.97%
Gross-up rate for Canadian dividends	38.00%	38.00%
Federal dividend tax credit	15.02%	15.02%
Provincial dividend tax credit	13.80%	13.80%

Limited partner allocations & taxes

Income:		
Canadian dividends (grossed-up)	\$828,000	\$828,000
Foreign dividends	\$450,000	\$450,000
Capital gains (50% inclusion)	\$675,000	\$675,000
Total income	\$1,953,000	\$1,953,000
Carrying charges (ex foreign withholding taxes)	(\$597,750)	(\$597,750)
Income before taxes	\$1,355,250	\$1,355,250
Income taxes before credits	\$528,548	\$650,113
Federal dividend tax credit	(\$124,364)	(\$124,364)
Provincial dividend tax credit	(\$114,264)	(\$114,264)
Foreign tax credit	(\$67,500)	(\$67,500)
Income taxes after credits	\$222,420	\$343,985
Add: foreign taxes withheld from LP	\$67,500	\$67,500
Total income taxes paid by investors	\$289,920	\$411,485

Income taxes paid by investors as a % of LP income before taxes

16.1%

22.8%

Under the assumptions stated above, the LP would report income to its partners of \$1,734,750 after foreign withholding taxes of \$67,500. As a result, the LP's income before taxes, adding back the foreign withholding taxes paid, would be \$1,802,250. When the LP's income and expenses are allocated to investors, however, the investors' income before taxes would be only \$1,355,250. That is because under Canadian tax law dividends are grossed-up by 38%, which increases income, but that is more than offset by the fact that here is only a 50% inclusion rate for capital gains, which decreases income. *After accounting for the federal dividend tax credit, the provincial dividend tax credit and the foreign tax credit (which simply offsets the foreign taxes withheld from the LP at source), the taxes payable for residents of Alberta and Ontario on their allocations of the LP's income and expenses would represent only 16.1% and 22.8%, respectively, of the LP's income before taxes.* These comparatively low tax rates are achieved because two types of the LP's income (Canadian dividends and all capital gains) are taxed at preferential rates, whereas all of the LP's expenses are deductible from income at the highest marginal tax rates.

In addition, a potentially important benefit of the Fund's structure as an LP is that an LP may flow through capital losses to its investors. Conversely, a trust, which is the legal form of most investment funds, may not allocate capital losses to its investors. The Fund realized substantial capital gains in each of 2013 and 2014 and had further unrealized capital gains at the end of 2014. It is good to know, however, that if in the future the Fund should ever have net realized capital losses, it would be able to allocate such capital losses to investors rather than have them stranded at the Fund level.

Notwithstanding these positives, there is one important drawback of the LP structure. The *Income Tax Act* does not permit limited partnerships to be held in registered plans. Therefore, the target market for the Fund is non-registered assets of investors who are Canadian residents and who meet the accredited investor or minimum investment amount criteria.

Compound Interest

One of the most powerful forces that may be put to work for investors is compound interest. That is the process by which the sum initially invested first earns investment income and in each subsequent period income is earned not only on the original sum invested, but also on the accumulated investment income. The brilliant Albert Einstein spoke several times regarding compound interest. He stated that "compound interest is the eighth wonder of the world. He who understands it, earns it... he who doesn't, pays it."²⁰ Einstein also stated that compound interest is "the greatest mathematical discovery of all time"²¹ and "the most powerful force in the universe."²²

Compound interest may be illustrated using the mathematical rule of 72 (as an aside, Einstein also stated that the rule of 72 is the *ninth* wonder of the world). Dividing 72 by the growth rate calculates approximately how long it will take something to double. Thus, for example, if an investment provided a total return of 8% per annum, and all dividends or interest were reinvested, then the amount of the investment would double in nine years. If one held such an investment for 45 years, the investment would double in value five times, for a value at the end of the period of 2⁵ or 32 times the original investment.

In order for compound interest to work its wonders for creating wealth, investors must: 1) maximize both the initial amount invested and subsequent contributions to the original investment; 2) find investments which will compound for a very long period of time *without being interrupted by permanent losses*; 3) find investments which will compound at a satisfactory rate over an investor's lifetime (or longer); and 4) provide such investments with a long period of time (measured in decades, not years or months) within which to grow.

In my opinion, the most difficult of these four elements to get right is to select investments that will compound for a long time without interruption by permanent losses. Indeed, it is that element that caused renowned economist and investor John Maynard Keynes to state, "I am sure that one of the reasons why in practice we are not influenced to set more money aside by reflecting on the magical consequences of compound interest over a long period is to be found in the fact that we do not rely on the accumulation continuing uninterrupted. And indeed we are justified, on the basis of past experience, in expecting that something would happen to interrupt it."²³ Later sections of this letter discuss two investments that I believe will continue to meet the objective of being able to compound for a long period of time without interruption by permanent losses, namely equity indices and common shares of the largest Canadian banks.

I find many examples of compound interest to be unrealistic and unsatisfying because not only do they fail to account for the likelihood of interruption in the growth rate and use unsustainably high growth rates, but also they fail to account for the real-world effects of trading costs, fees, expenses, taxes and inflation. The example of compound interest with which this letter concludes is inclusive of all of these effects and shows the magical power of long-term compounding in a realistic illustration.²⁴

Exchange-Traded Funds

An exchange-traded fund ("ETF") is a fund that tracks the performance of an equity index (or bond index, commodity or other underlying investment) and that is traded on a stock exchange. The first ETF, tracking the S&P 500 Index, began trading in 1993.²⁵ Since then, ETFs have grown explosively. For example, in 2014, U.S.-based ETFs attracted \$243 billion in net new assets and total assets surpassed \$2 trillion.²⁶ In Canada, where the ETF industry is much less mature, in 2014 ETFs attracted \$10 billion in net new assets and total assets reached \$77 billion.²⁷

One of the reasons for the popularity of ETFs is that some of them offer very low fees and expenses. As Jack Bogle (the founder and retired CEO of The Vanguard Group) and others have argued, the long-term performance of most investors has been and will continue to be lower than that of market indices.²⁸ Many investors may thus be better off investing passively (i.e., by investing in low-cost ETFs that track broad market indices).

In my opinion, one of the reasons that ETFs have not attained higher asset levels in Canada is that their fees have been too high. That changed in 2014, in what may be regarded as a coming of age year for the Canadian ETF industry. In March, industry leader iShares (owned by the world's largest asset manager, BlackRock Inc.) announced significant fee cuts for ETFs tracking core asset classes, including Canadian equities and bonds as well as U.S. and international equities.²⁹ In April, the Canadian ETF industry's second-largest firm, Bank of Montreal, responded by announcing fee cuts of its own.³⁰ In October, Vanguard Canada also announced ETF fee reductions.³¹ Not surprisingly, these three firms led the Canadian industry in 2014 net sales.³² With these three large, long-established firms which are leaders in total ETF assets, Canadians now have a range of choices for low-cost investing in core asset classes.

I believe that the most compelling feature of ETFs is not the low fees and expenses now available on core asset classes, although that is certainly beneficial. Nor is it that investors can access a diversified portfolio in a single security, although that, too, is advantageous. I believe that the most compelling feature of ETFs is that *they provide investors with the opportunity to achieve satisfactory compound returns for a long period of time without interruption by permanent losses*. After all, any individual business could go to zero; stock markets overall, however, do not. Similarly, any individual asset management firm could cease to exist; all

active portfolio managers are certain to grow old and die. Conversely, it is reasonable to believe that an ETF sponsored by a very large and established asset manager investing in a core asset class could carry on forever. In fact, the first ETF, the Standard & Poor's Depository Receipt S&P 500 ETF launched in 1993, is still going strong and now has a net asset value of \$194 billion.³³

I consider ETFs to be particularly appropriate for fixed income investing. As one experienced observer stated, Canada's bond market "is a very small market and it's very hard to trade and it's got very poor liquidity and very poor transparency."³⁴ I agree with those sentiments. As a result, smaller investors are likely to be better off using ETFs for their fixed income allocation rather than trying to buy bonds directly. In fact, the Portland Canadian Balanced Fund uses ETFs for its fixed income component. Later sections of this letter discuss some of the opportunities and difficulties in using ETFs for equity investing.

Historic Asset Class Returns

The total returns of some major asset classes in Canadian dollars ("C\$") for the 25 years ended December 31, 2014 are shown in the table below. I have chosen this period because it is both long-term and it represents a fair peak-to-peak measurement period. By coincidence, the exchange rate between the C\$ and the US\$ was C\$1.00 = US\$0.86 at the end of both 1989 and 2014. As a result, US\$ returns would have been the same as the C\$ returns shown in the table.

Total returns, 25 years ended 2014 (in C\$ unless otherwise indicated) ³⁵	
S&P/TSX Banks Index	14.2%
S&P 500 Index	9.6%
S&P/TSX 60 Index	8.7%
S&P/TSX Composite Index	8.0%
Scotia Universe Bond Index	7.8%
MSCI World Index	6.9%
MSCI World ex-USA Index	4.9%
Canada Treasury bills	4.1%
Annual inflation rate - U.S.	2.6%
Annual inflation rate – Canada	2.1%

What the table shows is that over the last 25 years, U.S. and Canadian equity market returns have been much higher than the returns of fixed income and cash. The highest returns shown in the table, by far, are for Canadian banks: the S&P/TSX Banks Index had a compound annual return for the 25-year period of 14.2% per annum. The next highest compound annual return was for the S&P 500 Index which was 9.6%. Next in performance was the S&P/TSX 60 Index (generally the 60 largest, high quality companies listed on the TSX) with a return of 8.7%. That was followed by the S&P/TSX Composite Index (with a normal number of about 220 to 300 companies, including the constituents of the S&P/TSX 60 Index plus many other generally smaller companies), with a return of 8.0%. What this shows is that during this period the shares of large capitalization companies outperformed their small cap brethren. As for fixed income, this period covered most of the greatest bull market for bonds in history. Nevertheless, fixed income (as represented by the Scotia Universe Bond Index) underperformed equities and had a return of 7.8%. The compound annual return on cash (as measured by Canada Treasury bills) was 4.1%. The inflation rates during the 25-year

period in the U.S. and Canada averaged 2.6% and 2.1%, respectively. Of particular interest, the return of the MSCI World Index (which includes the U.S.) was 6.9% while the return of the MSCI World ex-USA Index was 4.9%. Thus, the returns in the U.S. far exceeded those in the rest of the world. This was not just a function of the collapse of the Japanese equity market during this period; the U.S. also outperformed Europe.

Asset Mix

I do not mean to suggest that over the next 25 years, equities will perform as well as they have in the last 25. I do believe, however, that equities will continue to outperform bonds and cash over the long term. I have some very good company in that belief. Investing luminaries Charley Ellis, David Swensen and Warren Buffett all favour equities for long-term investors. For investors who plan to leave most of their wealth in bequests, Ellis, a leading American investment consultant, warns against the conventional wisdom of owning a greater proportion of assets in bonds as investors get older: “the wiser, better decision for you and your family might be to invest 100 percent in equities because your ‘investing horizon’ is far longer than your ‘living horizon.’”³⁶ Swensen, chief investment officer of Yale University since 1985, states that effective investment portfolios should be built on “the philosophical principles of equity orientation and diversification”.³⁷ He adds that investment portfolios should have an “equity bias” as “over reasonably long periods of time stock returns exceed those of bonds and cash.”³⁸ Swensen concludes his argument for an equity bias by stating that “historical evidence clearly points to a strong equity orientation for long-term investment programs.”³⁹ Buffett, chairman of Berkshire Hathaway Inc. and considered by many to be the greatest investor of all time, simply states that in his will, his advice to the trustee for his wife is: “Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 Index Fund. (I suggest Vanguard’s.)”⁴⁰

These views may be summarized as follows:

- Investors with a long (or maybe perpetual) investment horizon should be invested primarily, perhaps exclusively, in equities;
- Among the three major asset classes (equities, fixed income and cash), equities have historically earned the highest returns over the long term; and
- Prospectively, a reasonable base-case forecast suggests that over the long term, equities will continue to provide higher returns than fixed income or cash, probably by a wide margin.

50-Year Asset Class Return Forecasts

The 2013 Letter scrupulously avoided any asset class return predictions. World-famous financier J.P. Morgan, when asked what would happen to stock prices, gave the following legendary response: “they will fluctuate.”⁴¹ I would like to defy his wise example and venture to predict the returns of selected major asset classes that might be realized over the next 50 years, from 2014 to 2064. The purpose of this seemingly foolhardy exercise is to provide some guidance to a young adult, just turned 18, who thus has an investing horizon of at least 50 years before he begins to draw on his savings to fund his retirement. Actual results will differ from these forecasts and the differences could be material. Planning for the financial success of this hypothetical young adult, however, demands that we make some reasonable predictions so as to guide long-term investment selection. The predictions contained in this letter do not account for major, low probability, outlier events which have come to be known as “black swans”. These could include, for example, a nuclear terrorist attack on the U.S. or a global pandemic which could dramatically affect investment returns. I’ve assumed, instead, that the world will muddle through as that is the high-probability scenario for which one should plan (while remaining mindful of downside risk in extreme scenarios).

S&P 500 Index: 50-Year Forecast⁴²

I believe that over the long term, investors are likely to continue to achieve higher returns with S&P 500 Index ETFs than with world index ETFs. As noted above, in the last 25 years the S&P 500 Index has strongly outperformed the S&P/TSX Composite Index and the MSCI World ex-USA Index. Certainly, some reasons for that outperformance are that the U.S. is the world's largest economy, and one of its most dynamic and free, governed by the rule of law. In fact, the U.S. represents over 58% of the MSCI World Index.⁴³ Also, in 2013 (the latest year for which data is available), foreign sales accounted for 33% of aggregate revenue of the S&P 500 Index companies.⁴⁴ Thus, the S&P 500 Index is actually very international in scope. Many ETFs now permit one to invest in the S&P 500 Index with fees that are both very low and much lower than the fees for world indices (of which U.S. companies comprise the majority percentage, anyway). As a result, for purposes of the 50-year asset class forecast, I use the S&P 500 Index as the leading large capitalization equity index.

According to the Gordon Equation, the real (i.e., inflation-adjusted) return of an equity asset such as the S&P 500 Index will equal: 1) the initial dividend yield plus 2) the real growth rate of dividends plus 3) the annualized change in valuation.⁴⁵ *One author has estimated that for U.S. stocks for the 200-year period 1802 to 2002, the initial dividend yield accounted for 78% of the real return with the growth of dividends and annualized change in valuation accounting for only 13% and 9%, respectively.*⁴⁶ To these three real factors one must add another factor: 4) the expected rate of inflation, in order to determine the expected nominal rate of return.

Initial dividend yield. One of the four factors stated above is known: at December 31, 2014, the indicated dividend rate on the S&P 500 Index was \$41.18 which, on the index level at that time of 2,059, provided an initial dividend yield of exactly 2.0%.

Real growth rate of dividends. This could be higher or lower than the real growth rate of earnings because of changes in the dividend payout ratio. Over the very long term, however, the growth rate of dividends should be similar to the growth rate of earnings. In fact, the dividend on the S&P 500 Index at the end of 2014 of \$41.18 was equal to a payout ratio of estimated 2014 "operating" earnings (i.e., earnings excluding specified items) of \$113.05 of 36.4%, similar to the 25-year average dividend payout ratio of operating earnings of 34.7%.⁴⁷ Similarly, the year-end 2014 dividend was equal to a payout ratio of estimated 2014 as-reported earnings (i.e., earnings according to generally accepted accounting principles ("GAAP")) of \$102.32 of 40.2%, not much different than the 25-year average dividend payout ratio of GAAP earnings of 42.4%. Thus, it's reasonable to expect that for the next 50-year period there will be no change in the dividend payout ratio. As a result, in order to estimate the expected real growth rate of dividends (one of the factors in the Gordon Equation) of the S&P 500 Index, one must simply estimate the expected real growth rate of earnings.

The real earnings growth rate of the S&P 500 Index will be derived in part from the following factors:

- *Population growth in the U.S. and, to a lesser extent, the rest of the world.* Over the last 25 years, U.S. population has grown at a compound annual rate of 1.0%.⁴⁸ In the same period, world population has grown at a compound annual rate of 1.3%.⁴⁹ It seems likely that population growth rates in the U.S. and world will continue to gradually decline, to 0.5% per annum or less. In fact, over the very long term, the only sustainable rate of population growth is zero; and

- *Gross domestic product (“GDP”) growth per capita in the U.S. and, to a lesser extent, the rest of the world, in real terms.* For the eight years from 2006 (just prior to the global financial crisis) to 2014, U.S. real GDP per capita increased at a compound annual rate of 0.4%.⁵⁰ From 2006 to 2013 (the most recent data available), world GDP per capita increased at a rate of approximately 2.2%.⁵¹ It seems reasonable to believe that as the world gets richer and the base of world GDP gets larger, economic growth rates will slow down, just as they have in the major developed countries in recent years. For our 50-year horizon, I assume growth in world real GDP per capita of 1.0% per annum.

Combining the above two assumptions of world population growth of 0.5% per annum with growth in world real GDP per capita of 1.0% per annum suggests a forecast for world real GDP growth over the 50-year period from 2014 to 2064 of 1.5% per annum. Other factors which will also influence the real earnings growth of the S&P 500 Index will be:

- *Corporate profits as a percentage of GDP.* These will always fluctuate. In 2014, U.S. after-tax corporate profits as a percentage of GDP were approximately 8.9% compared to their average since 1950 of 6.3%.⁵² Naysayers who have long predicted a decline in the ratio of corporate profits to GDP have proven to be wrong (at least so far). In particular, corporate tax rates have trended down over time which has boosted profitability. It may be that in a modern economy which is increasingly based on services and intellectual property, corporations are better able to reduce taxes by flowing income through lower-tax jurisdictions than they were in the past. It seems reasonable to assume that over our 50-year horizon, the ratio of after-tax corporate profits to GDP will remain at the 2014 level so that real corporate profits will grow in line with estimated world real GDP growth of 1.5% per annum; and
- *Variance in earnings per share (“EPS”) growth of the S&P 500 Index compared to the growth rate of corporate profits.* The growth rates of these two items do not necessarily match. That is partly because public companies do not pay out all of their earnings as dividends. Instead, a significant portion of earnings are retained and used for such purposes as acquisitions, internal growth and share repurchases. Companies also issue shares to finance acquisitions, pay down debt and for equity-based compensation. Determining how much the reinvestment of retained earnings and net share repurchases (or issuances) will add (or subtract) from future earnings per share growth of the S&P 500 Index is impossible. *My best guess, however, for the next 50 years is that these factors will result in a net increase in EPS growth of 0.5% above the growth rate of real corporate profits of 1.5%, so that S&P 500 Index EPS growth in real terms will be 2.0%.*

Given the assumption of an unchanged dividend payout ratio, the real growth rate of dividends is also expected to be 2.0%. That would be meaningfully lower than the compound annual growth rates in S&P 500 Index real operating EPS and real dividends per share for the 17 years ended 2014 of 3.4% and 3.3%, respectively.⁵³ The reason to refer to this seemingly odd 17-year period is that growth rates can be easily distorted by using start dates or end dates which are unrepresentative. There is nothing wrong with an end date of 2014; it is several years into an economic growth cycle and was the highest ever level to date of S&P 500 Index earnings and dividends. The base year with which to compare 2014 should be one which: is long enough in the past that the results since then would be considered long-term; was at a similar high point in the economic cycle; and had a dividend payout ratio of operating EPS similar to 2014’s level of 34.9% (so that dividend growth rates are not distorted by a material change in the dividend payout ratio).⁵⁴ In my opinion, the base year which best meets those criteria, and that therefore serves as the best base year with which to compare 2014, is 1997. It was 17 years before 2014, so the results are long-term; it was several

years into an economic growth cycle and had the highest-ever S&P 500 Index operating EPS and dividends to that time; and the 1997 dividend payout ratio of operating EPS of 35.2% was very similar to the 2014 dividend payout ratio of 34.9%.

Expected rate of inflation. When companies report their financial results, they do so not in real (constant currency) terms but instead in nominal terms. As a result, in order to facilitate comparison of these predictions with future reported results, the U.S. inflation rate must also be estimated. As noted above, for the 25 years ended in 2014, the compound annual U.S. inflation rate was 2.6%. In the most recent cycle (i.e., from 2006 to 2014), the compound annual U.S. inflation rate was 2.0%. While the U.S. does not have an explicit inflation target, the Federal Reserve (the U.S. central bank) has an objective of price stability which it interprets as a low rate of inflation. For the 50-year forecast, I assume that U.S. inflation will be at a compound annual rate of 2.0%.

Combining the above factors, my base case forecast for the compound annual growth rate ("CAGR") of S&P 500 Index EPS and dividends per share for the 50-year period 2014 to 2064 is 2.0% real plus an inflation factor of 2.0% for a total nominal growth rate of 4.0%. The forecast nominal operating EPS CAGR of 4.0% compares with the operating EPS CAGR during the 25-year and eight-year periods ended 2014 of 6.3% and 3.2%, respectively.

The enormous increases in money supplies in recent years, as various central banks have pursued loose money policies known as quantitative easing, may someday end badly in a substantial increase in the rate of inflation or even hyperinflation. Such predictions made in recent years have proven to be wrong (at least so far). If the high-inflation scenario were to arise, it would certainly throw off many of the predictions contained in this letter although it would only serve to underscore the letter's central theme which is that long-term investors should favour equities over fixed income and cash.

Annualized change in valuation. Given the prediction above of a CAGR in nominal dividends per share of 4.0%, there is only one factor remaining to consider in our 50-year forecast for the S&P 500 Index in US\$ which is the annualized change in valuation. At the end of 2014, the S&P 500 Index's level of 2,059 divided by its 2014 estimated operating EPS of \$113.05 resulted in a trailing operating P/E ratio of 18.2 times. That level is very similar to the average operating P/E ratio for the 25 years ended 2014 of 17.7 times. Most of the time, the P/E ratio of the S&P 500 is between 15 times and 20 times and at the end of 2014 it was about in the middle of that range. In general, the P/E ratio tends to be lower during periods of high interest rates and inflation (such as during the 1970s and 1980s) and higher during periods of low interest rates and inflation (such as during the last 15 years or so). On balance, I see no reason to expect the operating P/E ratio of the S&P 500 Index to be materially different fifty years' hence than it was at the end of 2014.

Putting it all together, the *S&P 500 Index dividend yield at the end of 2014 was 2.0%. To this must be added the forecasts above for real operating EPS growth of 2.0% and no change in valuation (i.e., no change in the ratio of price to earnings or dividends) so that the expected real rate of return for the S&P 500 Index for the 50 years ended 2064 is 4.0%.* Adding in the expected rate of inflation of 2.0% yields an expected nominal rate of return of the S&P 500 Index in US\$ of 6.0%.

Unfortunately, we're not done yet since we're Canadians and we're interested in what the return of the S&P 500 Index will be not in US\$ but in C\$. For the 15 years ended in 2014, the average exchange rate between the two currencies was C\$1.00 = US\$0.85.⁵⁵ Foreign exchange rates have a tendency to fluctuate

around measures of the relative purchasing power of the two currencies, an item known as purchasing power parity (“PPP”). The Organisation for Economic Co-operation and Development estimates that in 2013 (the latest year for which data is available), the PPP of the C\$ was US\$0.80.⁵⁶ The Big Mac Index, invented and popularized by *The Economist*, estimates the PPPs of currencies based on the prices of the popular hamburger. According to the Big Mac Index, in January 2015 (the last time the index was published) the PPP of the C\$ was US\$0.84.⁵⁷ One might also expect that foreign exchange rates would change over time based on differences in various countries’ rates of inflation (by definition, a higher rate of inflation means that a currency is losing real purchasing power at a faster rate). This letter has already stated an expectation for the future U.S. inflation rate of 2.0%. The Bank of Canada has an explicit “inflation-control target” of 2.0% and it has been pretty good at hitting it.⁵⁸ From 1991 (when the target was adopted) through 2014, Canada’s rate of inflation averaged 1.8%.⁵⁹ My forecast for Canada’s average rate of inflation for the next 50 years (with the same caveats as stated above for the U.S. rate of inflation) is thus 2.0%, the same as the forecast for the U.S. rate of inflation. In conclusion, it seems reasonable to expect that there will be no change in the foreign exchange rate by the end of the full period so that at the end of 2064 the rate is expected to remain as it was at the end of 2014 (i.e., C\$1.00 = US\$0.86). As a result, the nominal rate of return of the S&P 500 Index over the 50-year period from 2014 to 2064 is estimated to be the same in C\$ as in US\$ (i.e., 6.0%).

For this section’s final point (I promise), it must be noted that there is no way in the real world for an investor to replicate exactly the performance of the S&P 500 Index. For example, investors in ETFs will incur management fees, expenses, taxes thereon, brokerage commissions and tracking error (i.e., the variance of the performance of the ETF compared to the performance of the underlying index which is not explained by fees and expenses). In addition, investors in Canadian-based ETFs will incur foreign withholding tax on U.S. dividends at a rate of 15%. Considering the dividend yield of the S&P 500 Index at the end of 2014 of 2.0%, for example, Canadian-based ETFs will pay foreign withholding taxes which will diminish the ETF’s annual performance by 0.3% per annum as compared to the performance of the S&P 500 Index itself. Depending upon the type of account in which the ETF is held, there may be no means for the investor to recover the foreign withholding taxes paid. If the investor chose to buy U.S.-based ETFs instead, however, she would avoid the foreign withholding tax but would have to convert her C\$ into US\$ and, eventually, back again. Given that retail foreign currency transaction spreads (compared to the spot exchange rates) can be as high as 2.0%, it might take many years for an investor to recover round-trip foreign exchange spreads through savings in foreign withholding taxes at a rate of 0.3% per annum. Furthermore, U.S.-based ETFs are considered by the U.S. Internal Revenue Service to be “situs property” which could result in a liability upon death for U.S. estate tax. For these reasons, the rest of this letter assumes that if an investor chooses to buy ETFs, they are based in Canada.

Canadian Banks: Historic Performance⁶⁰

As noted above, the S&P/TSX Banks Index has achieved outstanding total returns over the last 25 (and more) years. There are many reasons for that. For example, unlike the commodity companies which are so prominent in the S&P/TSX Composite Index, banks have very low capital expenditure requirements. As a result, bank earnings tend to be very good proxies for their free cash flows (i.e., what you see is what you get). The banks also provide services for which there are universal and perpetual needs, such as: personal and commercial banking services; investment banking; insurance; and wealth management. The banks also have enormous barriers to entry, including the need to be very large in order to be able to profitably meet the costs of information technology and the ever-increasing regulatory burden. Bank brands and scale also serve as barriers to entry (customers are reluctant to place their deposits into small, little-known financial institutions with short track records and history has proven such reluctance to have merit). These are some

of the reasons why the six largest banks today are the same companies which were the six largest banks 25 years ago. Indeed, there has been no entry or exit from the ranks of the top six Canadian banks in the last 25 years. To my knowledge, that is a fact which is unique to the banks; it can't be said of any other industry.

In view of the positive attributes of the Canadian banks, they are often favourites of retail investors and rightly so. Perhaps the best true-life example of this is found in the book *Millionaire Down the Road* which chronicles the extraordinary story of a remarkable man, Rankin Hodgins.⁶¹ During his working career as a small-town insurance broker, Hodgins' yearly income was never more than \$65,000. He started his investment portfolio in 1978, at the age of 56, with an investment loan of \$200,000. By 2013, 35 years later, the portfolio had grown to \$9 million. How did Hodgins do it? With four key elements: leverage; Canadian bank stocks; compound interest; and time.⁶²

These four elements are central to how the Fund was invested at the end of 2014. Regarding the first two elements (i.e., leverage and bank stocks), at December 31, 2014, before giving effect to subscriptions receivable and redemptions payable, the Fund's equities represented 192% of its net assets (i.e., it had \$0.92 of margin loans for every dollar of net assets).⁶³ Furthermore, bank stocks alone represented 130% of the Fund's net assets, consisting of 103% of net assets in four of the six largest Canadian banks and 27% in the second-largest U.S. bank. Why does the Fund have so much in banks? When Willie Sutton was asked why he robbed banks, he allegedly replied "because that's where the money is."⁶⁴ I believe that for investors, also, banks are where the money is. The rest of this section details my expectations for Canadian bank stocks and how the Fund intends to combine them with the third and fourth elements (i.e., compound interest and time) to continue to deliver satisfactory long-term returns.

Before we consider the prospects for the Canadian banks, it's worth considering their historic performance. The table below shows a number of performance indicators for the six largest Canadian banks over two time periods: the long-term period from 1988 to 2014 and the most recent eight-year cycle from 2006 to 2014 (the table uses a 26-year period ending in 2014 rather than the more conventional 25-year period since the latter would have a base year of 1989 when bank earnings were already adversely affected by the impact of the early 1990s recession so it would distort calculated growth rates). The banks are sorted from left to right based on their CAGR in EPS for the 26 years from 1988 to 2014, highest to lowest. For space reasons, the columns show the banks by their stock symbol: Royal Bank of Canada, RY; Bank of Nova Scotia, BNS; Toronto-Dominion Bank, TD; Bank of Montreal, BMO; Canadian Imperial Bank of Commerce, CM; and National Bank of Canada, NA. The rightmost column also shows simple averages of the performance items for the six banks. Unless otherwise indicated, all data is for periods ending with the bank fiscal year which ended October 31, 2014 ("FY'14"). The rows for the 26-year data section show the following items (in descending order):

- *FD EPS ex items* refers to the CAGR in fully diluted earnings per share excluding certain specified items deemed to be unusual, non-cash or non-recurring;
- *Dividends per share* is the CAGR in dividends per share;
- *Book value per share* is the CAGR in book value (i.e., common equity) per share;
- *Return on equity, GAAP* refers to the average return on equity as reported (i.e., according to GAAP);
- *Return on equity, ex items* refers to the return on equity excluding specified items;

- *Earnings purity* refers to the ratio of GAAP earnings to earnings excluding items. If there were no items, the ratio would be 100%. A lower figure, e.g., 95%, indicates that on average GAAP earnings were 5% lower than earnings excluding items;
- *Dividend payout* shows, in three rows, the beginning of period, end of period and period average, respectively, dividends as a percentage of earnings excluding items;
- *Basel III CET1 capital ratio* shows the Common Equity Tier 1 (“CET1”) capital ratio, computed in accordance with Basel III banking regulations, as of the end of the fourth quarter of FY’14;
- *% chg in common shares o/s, FY’14* shows the percentage change in common shares outstanding during FY’14;
- *Stock options as % of shares o/s* shows the number of stock options outstanding at the end of FY’14 as a percentage of common shares outstanding;
- *Market cap* shows the market capitalization (i.e., common shares outstanding times share price) in billions of dollars at December 31, 2014;
- *Trailing P/E ex items* shows the trailing price/earnings ratio (i.e., the stock price at December 31, 2014 divided by FD EPS ex items for FY’14); and
- *Indicated div. yield* shows the dividend yield (i.e., the annualized dividend at its most recent indicated rate as of December 31, 2014 divided by the stock price on that date).

Canadian big six banks fundamental performance

	RY	BNS	TD	BMO	CM	NA	Simple Average
26-year data, 1988-2014							
FD EPS ex items	9.2%	8.3%	8.3%	7.1%	6.7%	6.2%	7.6%
Dividends per share	9.6%	10.5%	10.8%	7.2%	7.7%	7.0%	8.8%
Book value per share	8.7%	9.2%	9.3%	7.3%	5.3%	6.0%	7.6%
Return on equity, GAAP	16.0%	16.5%	14.0%	14.5%	13.6%	14.0%	14.8%
Return on equity, ex items	16.4%	16.5%	13.5%	14.8%	14.3%	14.4%	15.0%
Earnings purity	94%	101%	93%	97%	95%	96%	96%
Dividend payout, beg. of period	41%	28%	24%	46%	34%	34%	34%
Dividend payout, end of period	46%	47%	43%	46%	44%	42%	45%
Dividend payout (average)	45%	44%	41%	47%	52%	40%	45%
Basel III CET1 capital ratio, Q4/FY’14	9.9%	10.7%	9.4%	10.1%	10.3%	9.2%	10.0%
% chg in common shares o/s, FY’14	0.1%	0.7%	0.5%	0.8%	-0.6%	1.0%	0.4%
Stock options as % of shares o/s	0.6%	2.1%	1.1%	2.1%	1.0%	4.5%	1.9%
Market cap (\$bln, Dec. 31, 2014)	\$115.8	\$80.7	\$102.4	\$53.3	\$39.6	\$16.3	\$68.0
Trailing P/E ex items (Dec. 31, 2014)	13.0	12.1	13.0	12.5	11.2	11.0	12.1
Indicated div. yield (Dec. 31, 2014)	3.7%	4.0%	3.4%	3.9%	4.1%	4.0%	3.9%

	RY	BNS	TD	BMO	CM	NA	Simple Average
Eight-year data, 2006-2014							
FD EPS ex items	7.0%	5.6%	7.9%	3.1%	3.3%	7.4%	5.7%
Dividends per share	8.9%	6.9%	9.5%	4.5%	4.5%	8.5%	7.1%
Book value per share	9.3%	10.1%	9.9%	6.6%	5.2%	8.3%	8.2%
Return on equity, GAAP	17.5%	18.1%	14.1%	13.7%	15.0%	17.5%	16.0%
Return on equity, ex items	18.9%	17.9%	13.4%	14.9%	15.0%	19.0%	16.5%
Earnings purity	91%	103%	91%	93%	100%	93%	95%
Dividend payout, beg. of period	40%	42%	38%	41%	40%	39%	40%
Dividend payout, end of period	46%	47%	43%	46%	44%	42%	45%
Dividend payout (average)	48%	49%	42%	53%	66%	40%	50%

As you will note, the second section of the table shows only the first nine of the data items (all the rest are the same for both periods) for the most recent cycle (i.e., 2006 to 2014). In the 26 years ended 2014, using a simple average of the six banks, earnings per share grew at a CAGR of 7.6% while dividends grew at a faster rate of 8.8% as the banks raised their dividend payout ratios between the beginning and the end of the period. For the eight years ended 2014, the growth rates of earnings and dividends slowed down to 5.7% and 7.1%, respectively.

An important item shown in the table above is the CET1 regulatory capital ratio. The ratio is calculated by dividing common equity by risk-weighted assets, both as defined by Basel III regulations. Under those regulations, the largest Canadian banks are required by 2019 to have a minimum CET1 ratio of 7.0% plus a “domestic systemically important bank” surcharge of 1.0% for a total CET1 ratio of 8.0%.⁶⁵ It appears that the Canadian banks, at least partly in order to demonstrate their financial strength, are actually targeting a CET1 ratio of 10.0%. The banks achieved that threshold at the end of FY'14 (the average shown in the table for this item is on a weighted-average basis). Rules have changed so much over the years that it is not possible to make long term capital comparisons on an apples-to-apples basis. What is clear, however, is that ever since the global financial crisis of 2008-2009, which is considered by many to have been the worst financial crisis since the Great Depression, bank regulators have demanded ever-higher capital ratios. For example, from the end of FY'08 (at the apex of the crisis) to FY'14, the big six banks' weighted-average ratio of tangible common equity to risk-weighted assets increased from 6.4% to 10.1%, an increase of 58%.

In my opinion, the primary results of these much higher capital ratios is that: banks will likely have lower (but still satisfactory) returns on equity and growth rates of earnings and dividends; and they will be safer and less volatile investments than they've been in the past. *That makes investments in the banks well-suited for long-term compounding.*

Canadian Banks: 50-Year Forecast⁶⁶

With their historic performance as a preamble, it's now time to estimate the future 50-year total returns over the period 2014 to 2064 for the large Canadian banks, as was done above for the S&P 500 Index. To reiterate, the expected real (i.e., inflation-adjusted) return of equities such as the banks should equal the initial dividend yield plus the real growth rate of dividends plus the annualized change in valuation. To this must be added the expected rate of inflation in order to determine expected bank nominal total returns.

Estimates for these factors are outlined below.

Initial dividend yield. At the end of 2014, the banks had an average indicated dividend yield of 3.9%. One of the banks, however, has adopted a practice of increasing its dividends annually (the other banks all tend to increase dividends semi-annually) and was expected to announce a dividend increase in February 2015 (which it did). *As a result, adjusted for that one dividend increase, I believe that it's fair to say that the initial dividend yield of the Canadian banks at December 31, 2014 closely approximated 4.0%.*

Real growth rate of dividends. Future dividend growth could be higher or lower than earnings growth because of changes in the dividend payout ratio. That ratio for the big six banks in 2014 was an average of 45% which was equal to its 26-year average. I assume that over the 50-year forecast horizon there will be no change in the dividend payout ratio from the 2014 level. As a result, the real growth rate of dividends should equal the real growth rate of earnings, which will be derived from:

- *World real GDP growth, as estimated earlier in this letter, of 1.5%.* I estimate that in order to fund this real increase in their risk-weighted assets, plus an inflation factor, banks will have to devote about 15% of their annual net income to increasing their regulatory capital; and
- *Capital deployment.* The banks also pay out about 45% of their earnings as dividends. That still leaves about 40% of their annual net income available for further internal growth, acquisitions and share repurchases. Banks are often able to realize better returns through share repurchases than are other companies since bank stocks tend to trade at lower P/E multiples (i.e., higher earnings yields) than do shares of companies in other industries. Banks also tend to dilute their shareholders less (i.e., their use of stock-based compensation is lower) than many other industries. *On balance, I believe it's reasonable to estimate that, over the next 50 years, internal growth, acquisitions and net share repurchases will result in bank EPS growth of 1.0% above the growth rate of world GDP of 1.5%, so that Canadian bank EPS growth in real terms will be 2.5%.*

Given the assumption of an unchanged dividend payout ratio, *the real growth rate of dividends is also expected to be 2.5%.* The forecast real growth rate of 2.5% per annum would compare with the real growth in the most recent cycle (2006 to 2014) of bank EPS and dividends of 4.0% and 5.4%, respectively.

The final two factors that need to be considered in order to estimate future bank nominal total returns are:

Expected rate of inflation. In order to convert the expected real EPS growth to a nominal figure, the estimated Canadian inflation rate must be added. Earlier in this letter, that was estimated at 2.0%. *As a result, my base case forecast for the CAGR of Canadian banks' EPS and dividends per share for the 50-year period 2014 to 2064 is 2.5% real plus an inflation factor of 2.0% for a total nominal growth rate of 4.5%.* The forecast nominal EPS growth rate of 4.5% per annum would compare with the CAGR in nominal EPS excluding items for the eight years from 2006 to 2014 of 5.7%; and

Annualized change in valuation. At December 31, 2014, the banks traded at an average trailing P/E ratio of 12.1 times. I consider this to be somewhat low given the continuing low-growth, low-inflation, low-interest rate scenario that is envisaged, especially given the banks' strong capital ratios. I believe that the primary reasons that the banks are not trading at higher P/E levels are fears of higher loan losses and lower capital markets-related revenue that might arise in a normalized economic environment. These fears have some merit but I believe that, say, a (10%) decline in bank earnings that might result from those factors would

be offset by 10% higher P/E ratios, with no net change in the share prices of Canadian banks. As a result, it seems reasonable to forecast no change in the P/E ratios of the Canadian banks from those prevailing at the end of 2014.

Putting it all together, the dividend yields of the banks at the end of 2014 were 4.0%. To this must be added the forecasts above for real operating EPS growth of 2.5% and no change in valuation (i.e., no change in the ratio of price to earnings or dividends) so that the expected real rate of return for the banks for the 50 years ended 2064 is 6.5%. Adding in the expected rate of inflation of 2.0% yields an expected nominal rate of return for the banks of 8.5% per annum.

Summary of 50-Year Asset Class Return Forecasts

The following table summarizes my views on expected asset class returns for the next 50 years. Bank stocks and cash, which an investor could easily purchase and hold himself at little or no cost, are assumed to be bought and held directly by investors. The S&P 500 Index and the FTSE TMX Canada Universe Bond Index, which an investor could not replicate directly other than at great cost (if at all), are assumed to be bought and held using ETFs. The ETFs are assumed to have no tracking error (i.e., there is no difference in expected returns between the ETFs and their underlying indices other than that accounted for by fees, expenses and taxes payable by the ETFs).

Asset class total returns Base case forecast - 50 years 2014-2064

Canadian banks	
Initial dividend yield	4.00%
Real growth of dividend	2.50%
Change in valuation	0.00%
Expected real total return	6.50%
Expected rate of inflation	2.00%
Expected nominal total return of Canadian banks	8.50%

S&P 500 Index (Canada-based ETF)	
Initial dividend yield	2.00%
Real growth of dividend	2.00%
Change in valuation	0.00%
Expected real total return of S&P 500 Index	4.00%
Expected rate of inflation	2.00%
Expected nominal total return of S&P 500 Index	6.00%
Foreign withholding taxes	-0.30%
ETF management expense ratio	-0.11%
Impact of change in C\$/US\$ exchange rate	0.00%
Expected nominal total return of S&P 500 Index ETF	5.59%

Bonds	
Expected long-term real return on bonds	1.00%
Expected rate of inflation	2.00%
Nominal return of FTSE TMX Canada Universe Bond Index	3.00%
ETF management expense ratio	-0.33%
Expected nominal total return of bond index ETF	2.67%

Cash	
Expected long-term real return on cash	0.50%
Expected rate of inflation	2.00%
Expected nominal return on cash	2.50%

Inflation	
25-year CAGR of Canadian CPI inflation, 1989-2014	1.99%
Bank of Canada inflation-control target (adopted in 1991)	2.00%
Expected rate of inflation	2.00%

For ease of reference, the nominal returns for each asset class in the table above are in **bold**. In order to convert these figures to real returns, readers must subtract the expected rate of inflation of 2.00%. The following explains the basis for the forecasts shown in the table (from top to bottom):

- *Canadian Banks*. Expected returns are as outlined in the earlier “Canadian Banks: 50-Year Forecast” section of this letter. To the initial dividend yield of 4.00% is added the real growth rate of dividends of 2.50% and the change in valuation of 0.00% to reach an expected real return of 6.50%. To this is added the expected rate of inflation of 2.00% to reach an expected nominal return of 8.50%;
- *S&P 500 Index*. Expected returns are as outlined in the earlier “S&P 500 Index: 50-Year Forecast” section of this letter. To the initial dividend yield of 2.00% is added the real growth of dividends of 2.00% and the change in valuation of 0.00% to reach an expected real return of 4.00%. To this is added the expected rate of inflation of 2.00% to reach an expected nominal return of 6.00%. From this is subtracted the foreign withholding taxes for a Canada-based ETF of (0.30%) (i.e., 15% of the dividends received), and the ETF management expense ratio of (0.11%) to reach the expected nominal total return of an S&P 500 Index ETF of 5.59%. After deducting inflation of 2.00%, this would result in a real return on the S&P 500 Index ETF of 3.59%;
- *Bonds*. The real total return on bonds, as represented by the FTSE TMX Canada Universe Bond Index, is expected to be 1.00%. To this must be added the expected rate of inflation of 2.00% to derive an expected nominal return on bonds of 3.00%. That compares with the bond index yield to maturity at the end of 2014 of 2.23%.⁶⁷ The forecast implicitly assumes that the yield curve (i.e., the graphical representation of fixed income yields by maturity) will shift up from its level at the end of 2014 by at least one percentage point. If that were to occur, reinvestment rates for bond coupons and maturities would be higher than current rates, allowing the weighted average yield to maturity over the period to 2064 to be 3.00%. Implicitly, the forecast assumes that the capital losses that would initially be suffered by bondholders as interest rates rose would be more than offset over the 50-year investment horizon by the higher interest rates then available for reinvesting bond

coupons and maturities. The nominal return forecast of 3.00%, after deducting inflation of 2.00%, would result in a real return on bonds of 1.00%. Also, the bond ETF management expense ratio is estimated at 0.33% (consisting of a management fee of 0.30% plus a blended tax rate for GST and/or HST applicable to the management fee of 10%). That would reduce the bond returns to a nominal return of 2.67% and to a real return of 0.67%;

- *Cash.* The return on cash is expected to be 0.50% in real terms (i.e., 2.50% in nominal terms). That compares with the returns currently available on investment savings accounts offered by the big six Canadian banks of 1.00%.⁶⁸ The forecast thus implicitly assumes that, on average over the next 50 years, returns on cash will be 1.50% higher than they are today; and
- *Inflation.* The inflation rate of 2.00% is assumed to be equal to the Bank of Canada's inflation-control target of 2.00% and is in line with the 25-year CAGR in Canadian inflation for the period from 1989 to 2014 of 1.99%.

Given the prospective returns outlined above, it will not surprise readers to learn that for long-term investment performance I strongly favour equities, particularly common shares of Canadian banks, over bonds and cash. That is because I believe equities will both deliver superior long-term returns and offer far better inflation protection.⁶⁹

Stock Market Seasonality

A soothsayer told Julius Caesar to “beware the ides of March.”⁷⁰ Given what happened in 2014, when October 15 proved to be the low of a brief but tumultuous stock market decline, perhaps better advice to minimize financial bloodshed would be to “beware the ides of October.” Mark Twain commented on stock market seasonality when he wrote: “October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August and February.”⁷¹

Twain notwithstanding, over the long term, September has actually been the worst calendar month for the S&P 500 Index.⁷² October, while it has much better returns on average than September, is justly famous for selling climaxes. Many of the largest stock market declines in history have occurred in September and October. Some recent September examples include: September 2002, when the S&P 500 Index fell (11.0%) immediately before the bottom of the technology meltdown; September 2008, when the S&P 500 Index fell (9.6%) in the first terrible month of the 2008-2009 global financial crisis; and September 2011, when it fell (7.2%) over concerns about slowing global growth and the ratings downgrade of U.S. government debt. These all provided what proved to be excellent buying opportunities.

Examples of historic sell-offs in October include: October 29, 1929 (“Black Tuesday”), which heralded the onset of the Great Depression and punctuated a month in which the S&P 500 Index fell (26.5%); October 19, 1987 (“Black Monday”), the largest single-day decline in history, resulting in a loss for the S&P 500 Index that month of (21.8%); and October 2008, when stocks continued their rout during the global financial crisis and fell (16.8%). 2014 added another minor moment to that list when on October 15 the S&P 500 Index experienced its largest intra-day decline and its highest volatility in almost three years. The decline was very short-lived, however, lasting the better part of an hour. Nevertheless, I certainly felt like my bowel had been eviscerated. Of course, that could be because, as fate would have it, that afternoon I had a colonoscopy.

Knowing that many declines occur in September and October still begs the question, “Why?” I believe that there are three important reasons why declines tend to occur in the early fall. One is ingrained, primordial behaviour. As summer turns to fall, North American investors, not unlike squirrels, begin to put aside their frivolous ways and gather their nuts around them for the winter ahead. Loss aversion increases and investors become like Twain himself: “I’m more concerned about the return of my money than with the return on my money.”⁷³ Investors have a tendency to sell stocks to increase their cash holdings, and this selling pressure results in stock market lows in the fall. A second reason for declines in the early fall is that most U.S. mutual funds have fiscal years that end on October 31.⁷⁴ U.S. mutual funds thus have a tendency to sell stocks with unrealized losses in October so as to offset realized gains. A third reason for declines in early fall is behavioural psychology. Even casual market participants know that market declines have often happened in September and October. Thus, when those months roll around on the calendar, investors become weak-kneed and sell at the first sign of lower stock prices. Declines in September and October therefore feed on themselves and become self-fulfilling prophecies.

The well-known habit of stocks being weak in early fall is the basis for two common expressions: “sell in May and go away” and “buy when it snows, sell when it goes”. In fact, one recent academic study found that the benefits to “sell in May” were both significant and persistent.⁷⁵ I have done my own research on this topic in an effort to answer the following questions:

- Is it better for passive (i.e., equity index) investors to remain fully invested throughout the year or is there a period in the year in which it is consistently better to be out of equities (when equity returns are consistently negative)? And,
- What is the shortest period of time that one could be out of equities, and which period is it, so as to avoid the worst periods for equities and yet still be invested most of the time so as to capture the long-term superior returns?

In my view, there is no one period which can be relied upon to be consistently negative (that would be too easy). On average, however, September has historically had the most negative returns. October, while its returns are positive on average, has recorded many of the worst declines in history (as noted above). Accordingly, if I were forced to pick months in which I would be out of equities every year, I’d say September and October. The historical results of doing so are shown in the tables below (using the data I have available for: the S&P/TSX Composite Index since October 31, 1977; and the S&P 500 Index since October 31, 1988).

Value of \$10,000 invested in S&P/TSX Composite Index
Years ended October 31

Period	Decade	# of years	Oct. 31 to Aug. 31	Aug. 31 to Oct. 31	Year
Oct. 31, 1977 to Oct. 31, 1979	1970s	2	\$19,198	\$9,308	\$17,870
Oct. 31, 1979 to Oct. 31, 1989	1980s	10	\$53,259	\$6,775	\$36,083
Oct. 31, 1989 to Oct. 31, 1999	1990s	10	\$19,311	\$12,386	\$23,918
Oct. 31, 1999 to Oct. 31, 2009	2000s	10	\$28,577	\$6,488	\$18,540
Oct. 31, 2009 to Oct. 31, 2014	2010s	5	\$14,366	\$10,764	\$15,463
Total		37	\$810,660	\$5,454	\$442,158

Value of \$10,000 invested in S&P 500 Index
Years ended October 31

Period	Decade	# of years	Oct. 31 to Aug. 31	Aug. 31 to Oct. 31	Year
Oct. 31, 1988 to Oct. 31, 1989	1980s	1	\$12,993	\$9,728	\$12,640
Oct. 31, 1989 to Oct. 31, 1999	1990s	10	\$38,918	\$13,239	\$51,526
Oct. 31, 1999 to Oct. 31, 2009	2000s	10	\$11,581	\$7,849	\$9,090
Oct. 31, 2009 to Oct. 31, 2014	2010s	5	\$16,913	\$12,794	\$21,638
Total		26	\$99,052	\$12,933	\$128,102

Some of the highlights of these tables are noted below:

- For the full 37 years of data for the S&P/TSX Composite Index, \$10,000 invested on October 31, 1977 would have increased by October 31, 2014 to over \$442,000 (a testament to the wonders of compound interest over a long period of time);
- If one had sold every August 31 and gone to cash, however, and repurchased every October 31, the portfolio would have grown to \$810,000. The example excludes the trading costs for the buy and the sell and excludes interest on the cash for the two-month period. The reason for the much higher results with a market timing strategy is that results for September and October for the full 37-year period were negative. If one had invested on every August 31 and sold stocks and converted to cash on every October 31, \$10,000 would have shrunk in value to only \$5,454, a decline of (45.5%);
- Results have varied over time and this market timing strategy would not have worked in the current decade to date. In the five years 2010 to 2014 inclusive, if a market participant had sold every August 31 and repurchased every October 31, he would have missed out on a cumulative return of 7.6% (as \$10,000 turned into \$10,764);
- The results of the same market timing strategy for the S&P 500 Index would have been much worse. For example, for the 26 years shown in the table (1988 to 2014), \$10,000 invested under a “buy and hold” approach would have grown to \$128,102. If the investor had been in cash in September and October, however, the \$10,000 would have grown to only \$99,052;
- One feature that has been persistent is that Canadian stocks have performed worse than U.S. stocks in September and October: Canadian stocks rose less than U.S. ones during the 1990s; declined more during the 2000s; and rose less in the 2010s to date. Perhaps our colder climate accentuates the “gather your nuts” effect...; and
- As an adjunct to the above, it’s worth noting the dramatic differences in performance, and changes in relative performance, of the equity markets of the two countries. In the 1990s, a period of generally low commodity prices, \$10,000 invested in the S&P/TSX Composite Index turned into \$23,918. That badly trailed the S&P 500 Index which turned \$10,000 into \$51,526 (fuelled by the technology bubble). In the 2000s, as commodity prices rose in tandem with demand from China, Canadian stocks turned \$10,000 into \$18,540. U.S. stocks, however, experienced a lost decade and actually declined, turning \$10,000 into only \$9,090. In the 2010s to date, relative performance has reversed again. In the first five years of the current decade, the S&P/TSX Composite Index, struggling once more with lower commodity prices, turned \$10,000 into \$15,463. In the same period, the S&P 500 Index has more than doubled that rate of gain, turning \$10,000 into \$21,638.

Based on the foregoing analysis, I can offer no comfort to those who wish to time equity markets other than to caution wariness of September and the first few weeks of October, particularly in Canada. Investors who seek to benefit from stock market seasonality have the alluring prospect of dramatically enhancing their long-term returns, but to do so they must face the Scylla and Charybdis which threaten all investors: fear and greed. If an investor goes to cash at the end of August, and stock markets decline in September and October, he may be fearful of buying back into equities and experiencing further declines, or greedy that if he only waits stocks may become even cheaper. Conversely, if an investor goes to cash and stock markets rise, she may be fearful of buying back into equities at higher prices only to have them subsequently decline, or greedy to wait until a pullback before buying back in. In either case, the investor faces the real risk that he or she will remain in cash, not buy back into equities and miss out on their long-term returns which historically and prospectively are much higher than the returns on cash.

If one wishes to play the game of attempting to use stock market seasonality to enhance returns, I suggest the following simple annual rule: go to cash not earlier than August 31 and get back into a full equity weighting not later than October 31. In that way, the maximum amount of time that one would be out of equities would be two months of every calendar year. Like Odysseus, you must lash yourself to the mast of this strategy and stay on course despite the siren calls of emotions and market soothsayers. All other ways lie peril.

Of course, even with a clear and disciplined market timing strategy as described above, trying to benefit from stock market seasonality may not work over the long run and certainly won't work in some years. In 2010, I had reason to reorganize my family's financial affairs. To do so, I had to sell equities and, for a short while, be all in cash. Being a student of stock market history, I thought "Aha! If I have to be briefly all in cash, I'll do it in September, so that I miss what has historically been the worst month for equities!" In September 2010 the S&P 500 Index rose 8.9%, its best September since Hitler invaded Poland.⁷⁶

Registered Plans vs. Non-registered Investment Accounts

In Canada, individuals may generally invest in two types of accounts: registered plans and non-registered accounts. *Registered plans* are certain types of plans (see "Types of Registered Plans" below) that are registered with the Government of Canada and which operate according to laws and regulations created by the federal government. *Non-registered assets* are any assets that are not held in a registered plan.

Certain types of investment income earned on non-registered assets are taxed at lower rates than ordinary income. For example, to mitigate double taxation (whereby corporations pay income tax then pay out their after-tax income to shareholders as dividends which are also taxed), eligible Canadian dividends earn dividend tax credits which reduce the effective tax rate on dividends to levels far below the tax rates applicable to ordinary income. Similarly, in order to encourage investment and entrepreneurship, capital gains are taxed at only half of the rates applicable to ordinary income. In addition to these favourable tax treatments, non-registered investment accounts can be leveraged (i.e., assets held in non-registered accounts may be pledged as collateral for margin borrowings which may be used to increase the amount of investments). For all of these reasons, I believe that non-registered assets should form a key part of most investors' wealth creation plans. As noted above under "Income Taxes", the Fund is structured as a limited partnership partly in order to preserve and flow through to investors' non-registered accounts the favourable tax treatment accorded to Canadian dividends and capital gains.

Types of Registered Plans

There are several types of registered plans and they are held by millions of Canadians. Unlike non-registered accounts, registered plans generally may not be leveraged. The three types of registered plans which are the most widely available are described below.

- *Registered retirement savings plan (“RRSP”).* For 2014, the maximum annual contribution to RRSPs was the lesser of 18% of the prior year’s “earned income” or \$24,270.⁷⁷ Earned income is generally based on employment income.⁷⁸ Thus, individuals without employment income may generally not contribute to RRSPs. Contributions made to RRSPs are deductible from taxable income. Investment income within RRSPs compounds on a tax-deferred basis until the subscriber makes withdrawals. Withdrawals from RRSPs are included in the beneficiary’s total income for tax purposes and are taxed at the same rates as ordinary income. As a result, the tax advantages that would apply in non-registered investment accounts, such as the dividend tax credit and the 50% inclusion rate of capital gains, do not apply to RRSPs. Furthermore, if an individual’s marginal income tax rate increases between the RRSP contribution date and the withdrawal date, she may find that the higher tax rate more than offsets the benefit of the tax-deferred compounding. An individual’s marginal income tax rate may increase if her income increases (throughout Canada there are graduated income tax rates which impose higher rates of tax on higher levels of income); if she moves to a province with higher tax rates than the one she left; or if federal or provincial income tax rates increase between the contribution date and the withdrawal date. In fact, in recent years several provinces have increased personal income tax rates. A special form of RRSP is a spousal RRSP. Married people may contribute to RRSPs on behalf of their spouses. This may be a way for couples that have one higher income earner and one who earns little or no income to, in effect, split their income and achieve lower combined taxes. Using a spousal RRSP, the higher-income spouse uses the RRSP contribution to reduce his or her taxable income while the investment income earned inside the spousal RRSP will eventually be withdrawn by the lower-income spouse who may have a lower income tax rate;
- *Registered education savings plan (“RESP”).* These plans are intended to accumulate assets to fund post-secondary education. One of the primary benefits of RESPs is that contributions made on behalf of beneficiaries who are under 18 years of age earn Canada Education Savings Grants (“CESG”) of 20% or more of the amount contributed, to an annual grant limit of \$500 to \$600 and a lifetime grant limit of \$7,200 per beneficiary.⁷⁹ Contributions may be withdrawn tax-free. Plan assets in excess of contributions (i.e., derived from investment income and CESG) may be withdrawn in the form of Educational Assistance Payments (“EAP”). EAP forms part of the taxable income of the beneficiary in the year of withdrawal. Since beneficiaries attending post-secondary educational institutions on a full-time basis typically have relatively low earnings and marginal income tax rates, RESPs may be an appropriate means to accumulate education funds on behalf of younger beneficiaries. One negative is that, unlike for RRSPs, U.S. dividends received within an RESP are subject to a foreign withholding tax of 15%; and
- *Tax-Free Savings Account (“TFSA”).* Anyone 18 years of age or older may open a TFSA. For 2014, the contribution limit was \$5,500.⁸⁰ The annual contribution limit is indexed to the rate of inflation and will be increased by \$500 whenever the inflation indexing reaches that level. Contributions made to TFSAs are not deductible for income tax purposes. As the name of the account implies, however, all investment income earned in TFSAs is tax-free. In other words, withdrawals made from TFSAs are generally not subject to tax. As with RESPs, U.S. dividends received within a TFSA are subject to a foreign withholding tax of 15%.

In my opinion, the two types of investment accounts which investors should definitely use for creating wealth are non-registered investment accounts and TFSAs. Non-registered accounts have the overwhelming advantages of being able to: earn certain types of income at lower tax rates, namely Canadian dividends and capital gains; use leverage; select from the widest array of possible investments; and make investments of unlimited size. Indeed, the Fund is designed to take full advantage of these features for non-registered accounts. TFSAs have the overwhelming advantages of: being available to all adult Canadians; and earning income tax-free. The next section of this letter illustrates how a TFSA might be used for wealth creation. Regarding RRSPs, I believe that they should be used carefully, if at all, with an emphasis on those already in the highest income tax brackets and those who might benefit from spousal RRSPs.

Using Tax-Free Savings Accounts for Long-Term Wealth Creation

It's now time to pull together many of the previous subjects of this letter in an effort to outline how a hypothetical investor, who turned 18 in late 2014, might build wealth in order to fund his retirement 50 years' hence. The analysis makes the following assumptions:

- The investing is done within a TFSA so that the portfolio is always tax-free;
- The TFSA was opened in late 2014 with an initial contribution of \$5,500 and a subsequent contribution of \$5,500 was made in January 2015. The combined amount of \$11,000 was then invested into two or more Canadian bank stocks at the same prices as prevailed on December 31, 2014;
- At the beginning of each year after 2015, the investor contributes the maximum annual amount to his TFSA (the maximum contribution in 2015 is \$5,500 which is indexed to inflation in increments of \$500);
- Immediately after each contribution, the cash is invested into one or more Canadian bank stocks. Over time, the portfolio should be diversified across at least four banks;
- The investor enrolls in dividend reinvestment plans ("DRIPs"). These are plans offered by all of the major banks by which dividends, instead of being paid in cash, are automatically invested in more shares. Generally, the prices paid for these incremental shares are the market prices prevailing on dividend payment dates. There are two major advantages to DRIPs. They prevent the accumulation of cash which would tend to reduce portfolio returns over time (a phenomenon known as cash drag) if, as I expect, bank stocks outperform cash. Also, the dividend reinvestments are free (i.e., they do not require brokerage commissions). In non-registered plans, however, DRIPs can create headaches keeping track of adjusted cost base for tax purposes so I only recommend DRIPs in registered plans;
- Brokerage commissions are so minor that they can be ignored. With DRIPs used to reinvest dividends, there may be as little as one trade in the TFSA per year. Trades at self-directed brokerage firms typically cost only about \$10. As a result, even over 50 years, commissions would be immaterial;
- There are no withdrawals from the TFSA for the full 50-year period. A mistake some people have made is to treat their TFSAs like bank accounts; they're not. Not only may withdrawals and re-contributions have adverse tax consequences, but they also prevent TFSAs from fulfilling their ideal purpose which is to create long-term wealth;
- The TFSA account has no annual fees. That is true of at least one major brokerage firm; I believe that it's true of others, as well;
- Inflation is 2.0% per annum throughout the 50-year period. As a result of inflation indexing of the TFSA contribution limits, every few years the limit will rise by \$500. This will happen with increasing frequency in the later years; and

- All contributions *throughout the entire 50-year period* are invested at rates of return expected for Canadian bank stocks prevailing at the end of 2014 (i.e., nominal rates of total return of 8.5%). This assumption is critical. Over the full 50-year period, contributions are expected to total \$477,000 (not shown in the table below) of which only \$11,000 will be invested in early 2015. If, for example, stock prices rose a lot in the early years and remained elevated, then future contributions might earn lower rates of return than I have forecast and the value of the TFSA at the end of the period would be adversely affected. It's not necessary that every contribution is invested to earn a compound return of 8.5%. It is necessary in order to achieve the results outlined below, however, that the adverse effect of any contributions invested when returns are low (when stock prices are high) is offset by the beneficial impact of investing some contributions when returns are high (when stock prices are low).

Using the above assumptions, the following table shows the investment results of the 50-year program (for reasons of brevity, only a few years each at the beginning and end of the 50-year period have been shown):

Hypothetical TFSA account 50-year forecast period, 2014-2064

Calendar Year	Base Year	Account Holder Age	Beg. of Year Value, Nominal	Contribution	Investment Income	End of Year Value, Nominal	Cumulative Inflation	End of Year Value, Real
2014	0	18	\$0	\$5,500	\$0	\$5,500	0.0%	\$5,500
2015	1	19	\$5,500	\$5,500	\$935	\$11,935	2.0%	\$11,701
2016	2	20	\$11,935	\$5,500	\$1,482	\$18,917	4.0%	\$18,182
2017	3	21	\$18,917	\$5,500	\$2,075	\$26,492	6.1%	\$24,964
2018	4	22	\$26,492	\$6,000	\$2,762	\$35,254	8.2%	\$32,569
2019	5	23	\$35,254	\$6,000	\$3,507	\$44,761	10.4%	\$40,541
****	*	**	*****	*****	*****	*****	*****	*****
2060	46	64	\$3,611,521	\$13,500	\$308,127	\$3,933,147	148.7%	\$1,581,730
2061	47	65	\$3,933,147	\$14,000	\$335,508	\$4,282,655	153.6%	\$1,688,515
2062	48	66	\$4,282,655	\$14,500	\$365,258	\$4,662,413	158.7%	\$1,802,198
2063	49	67	\$4,662,413	\$14,500	\$397,538	\$5,074,451	163.9%	\$1,923,006
2064	50	68	\$5,074,451	\$15,000	\$432,603	\$5,522,054	169.2%	\$2,051,597

The following are some of the highlights of the 50-year investment program:

- Contributions of \$477,000 grow into a portfolio value of \$5.52 million, an increase of almost 12-fold;
- Cumulative inflation is over 169%. In other words, it would take \$2.69 in 2064 to buy what \$1.00 would buy in 2014;
- Adjusting for the effect of inflation, the real value of the cumulative amount of contributions (i.e., expressed in 2014 dollars) would be \$277,000 (not shown in the table). The real value of the portfolio in 2064 would be \$2.05 million, an increase of almost seven-and-a-half fold;

- If the account could continue to earn total returns of 8.5% beyond 2064, then the annual income (in 2014 dollars) would be over \$174,000. Since the investments are held in a TFSA, there would be no tax on that income. In other words, the TFSA alone could fund a very comfortable retirement, without even accounting for other sources of income such as non-registered investment accounts, Canada Pension Plan benefits, RRSPs, home equity and other assets that may have built up over a lifetime. Whatever one's horizon, it's crucial that, in considering returns and future amounts, investors always think in terms of real, after-tax dollars; and
- Like all compound growth rates sustained over a long period of time, the final value is highly sensitive to the assumed growth rate. If, for example, the nominal rate of return was not the 8.50% expected of the Canadian banks but was, instead, the 5.59% expected of a Canada-based S&P 500 Index ETF, then the 2064 value of the TFSA (in real terms) would not be \$2.05 million but instead would be \$787,000. This is a reduction of more than (61%).

This analysis shows that it is not necessary to do anything heroic in order to achieve dramatic long-term results. The necessary ingredients are: start young (or, if you're not young, now); invest as much as you can; earn a satisfactory return (net of fees and expenses); compound that return for a long period of time without permanent losses; and minimize taxes. If any of those ingredients are missing, it may spoil the whole recipe. If all of the ingredients are present, the results will be wonderful.

As noted above under "Stock Market Seasonality", some people might choose to seek to further enhance these returns by market timing (e.g., by selling some or all equities at the end of August of every year and being fully invested in equities again by the end of October). Whether this would add to or subtract from future returns is uncertain although it would certainly result in much higher trading costs. Similarly, the perils of failing to stick to a predetermined program, or of having too much in cash in what is generally a low-performing asset class, are not insignificant.

In conclusion, the analysis contained in this letter shows that a relatively simple investment program can yield dramatically positive results if sustained over a long period of time. With apologies to the Beatles, investors with a 50-year horizon, such as our hypothetical young adult, should be asking of their investments, "Will you still feed me when it's 2064?" If the answer to that question is "no", some portfolio changes may be in order.

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 letter and the 2013 Letter, the Fund will continue to meet its investment objective: to achieve, over the long term, preservation of capital and a satisfactory return.



March 12, 2015

James H. Cole
Senior Vice President and Portfolio Manager
Portland Investment Counsel Inc.

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 Confidential Offering Memorandum, October 22, 2012, p. 2. The OM is available at <http://www.portlandinvestmentcounsel.com/plusfund.html>
3. 2013 Letter, p. 3.
4. OM pp.13-14.
5. Amendment No. 1 dated July 2, 2014 to the OM (the “Amendment”), p. 2.
6. OM p. 6 and p. 13 and Amendment p. 2.
7. Bloomberg L.P.
8. Ibid.
9. International Energy Agency. “Oil Market Report” (“OMR”), December 12, 2014, table 1, p. 52.
10. Ibid., table 3, p. 57 and OMR, December 10, 2010, table 3, p. 65.
11. Ibid.
12. http://www.opec.org/opec_web/en/press_room/2938.htm
13. OMR, December 12, 2014, table 1, p. 52 and archived issues.
14. TD Securities Inc.
15. 2013 Letter, p. 15.
16. OM, p. 2.
17. Calculations are derived from the following data: the Fund’s cost of its investment in Ensco was US\$56.68 per share; Ensco’s book value per share at December 31, 2013 was US\$54.80 per share; its dividend at the time of purchase was US\$3.00 per share; and its earnings per share in 2013 were US\$6.07. Fundamental data is from company reports.
18. <https://www.fortisinc.com/Pages/default.aspx>
19. <http://www.taxtips.ca/>
20. <http://www.goodreads.com/quotes/76863-compound-interest-is-the-eighth-wonder-of-the-world-he>
21. <http://www.investopedia.com/university/beginner/beginner2.asp>
22. <http://www.quotesonfinance.com/quote/79/Albert-Einstein-Compound-interest>
23. Keynes, John Maynard. *The Collected Writings of John Maynard Keynes, vol. XII, Economic Articles and Correspondence: Investment and Editorial* (Cambridge University Press, 2013), p. 785; from a letter in 1928.
24. See the “Using Tax-Free Savings Accounts for Long-Term Wealth Creation” section of this letter.
25. <http://www.investopedia.com/articles/exchangetradedfunds/12/brief-history-exchange-traded-funds.asp>
26. Straus, Daniel. “U.S. ETF Flows: Full Year 2014 A Strong Finish to the Year.” National Bank Financial, January 2, 2015.
27. Straus, Daniel. “Canadian ETF Flows: December and Full Year 2014 Biggest Month Ever.” National Bank Financial, January 2, 2015.
28. John C. Bogle has written many books and articles in favour of passive investing using ETFs. See, for example, *The Little Book of Common Sense Investing* (John Wiley & Sons, Inc., 2007).
29. <http://www.blackrock.com/ca/individual/en/literature/press-release/pr-2014-03-24-en-ca.pdf>
30. <http://newsroom.bmo.com/press-releases/bmo-asset-management-inc-cuts-management-fees-on--tsx-bmo-201404210940767001>
31. <https://www.vanguardcanada.ca/individual/articles/vanguard-news/news-from-vanguard/lower-management-fees.htm>
32. “Canadian ETF Flows”, op. cit.
33. <https://www.spdrs.com/product/fund.seam?ticker=SPY>

34. Devlin, Ed. Quoted in "Canada, world's 'worst' bond market, needs transparency: Pimco." *The Globe and Mail*, July 8, 2014, p. B12.
35. The data for the Scotia Universe Bond Index and Canadian Treasury bills are from Bank of Nova Scotia. All other data is from TD Securities Inc. except for the Canadian and U.S. inflation rates which are from the Bank of Canada at <http://www.bankofcanada.ca/rates/related/inflation-calculator/> and the Bureau of Labor Statistics at <http://www.bls.gov/cpi/cpid1412.pdf>, table 24, respectively.
36. Ellis, Charles. *Winning the Loser's Game: Timeless Strategies for Successful Investing* (McGraw Hill, 2013 sixth edition), p. 169.
37. Swensen, David. *Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment* (Free Press, 2009 edition, originally published 2000), p. 128.
38. Swensen, David. *Unconventional Success: A Fundamental Approach to Personal Investment* (Free Press, 2005), p. 14.
39. *Ibid.*, p. 16.
40. Berkshire Hathaway 2013 annual report, p. 20.
41. http://en.wikiquote.org/wiki/J._P._Morgan
42. Throughout this section of the letter, for the S&P 500 Index, all price data is from Thomson Reuters Corporation and all fundamental data (i.e., operating earnings, as-reported earnings and dividends) is from Standard & Poor's Financial Services LLC ("Standard & Poor's") as of Mar. 6, 2015 (the latest data published before going to press) available at <http://ca.spindices.com/indices/equity/sp-500>. Where applicable, to convert historical nominal returns to real returns I have adjusted nominal returns using inflation figures sourced from the Bureau of Labor Statistics.
43. http://www.msci.com/resources/factsheets/index_fact_sheet/msci-world-index.pdf
44. <http://www.businessinsider.com/foreign-revenues-by-region-2014-10>
45. Bernstein, William J. *The Investor's Manifesto: Preparing for Prosperity, Armageddon and Everything In Between* (John Wiley & Sons, Inc., 2010), pp. 25-35, esp. p. 32.
46. Arnott, Robert D. "Dividends and the Three Dwarfs," *Financial Analysts Journal*, March/April 2003, vol. 59, no. 2: 4-6.
47. The indicated dividend rate at the end of 2014 of \$41.18 was slightly higher than the dividends paid in 2014 which were \$39.44. As a result, the 2014 dividend payout ratio using the year-end indicated dividend rate was 36.4% whereas using the dividends paid in 2014 it was 34.9%. The latter is the figure which should properly be compared to long-term average dividend payout ratios. Since there is little difference, however, the impact to the analysis is immaterial.
48. http://en.wikipedia.org/wiki/Demographics_of_the_United_States
49. http://www.census.gov/population/international/data/worldpop/table_population.php
50. <http://www.tradingeconomics.com/united-states/gdp-per-capita>
51. Data for world GDP growth is at http://en.wikipedia.org/wiki/Gross_world_product. From the world GDP growth of 3.3% from 2006 to 2014 I have subtracted population growth in that period of 1.1% per annum to derive estimated world GDP growth per capita of 2.2%.
52. Thomson Reuters Datastream.
53. Earnings and dividends are provided by Standard & Poor's in nominal terms; I have adjusted them for inflation as calculated by the Bureau of Labor Statistics.
54. For this purpose, the cited 2014 dividend payout ratio of 34.9% is dividends paid in 2014 divided by 2014 operating earnings per share. See the discussion in note 47 above.
55. Bloomberg L.P.
56. http://stats.oecd.org/Index.aspx?DataSetCode=SNA_Table4

57. <http://www.economist.com/content/big-mac-index>
58. <http://www.bankofcanada.ca/rates/indicators/key-variables/inflation-control-target/>
59. <http://www.bankofcanada.ca/rates/related/inflation-calculator/>
60. Throughout this section of the letter, for the Canadian banks, all price data is from Thomson Reuters Corporation and all fundamental data (e.g., earnings, dividends, book value and return on equity) is from company reports. Where applicable, to convert historical nominal returns to real returns I have adjusted nominal returns using inflation figures provided by the Bank of Canada's inflation calculator.
61. Hodgins, Douglas R. *Millionaire Down the Road: Secrets of the ultimate tax-efficient investor* (Millionaire Down the Road Media Inc., 2013).
62. The book does not provide Hodgins' portfolio as of any date although it's clear that the majority of his portfolio was consistently comprised of the largest Canadian banks. See *ibid.*, p. 57, 70, 79-80, 88, 111-112, 115, 120, 129 and 150-151.
63. The Fund's 2014 financial statements are available at <http://www.portlandic.com/plusfund.html>.
64. Sutton denied that he said those exact words but the world, not wanting to let the facts get in the way of a good story, attributes the phrase to him, anyway. See http://en.wikipedia.org/wiki/Willie_Sutton.
65. See, for example, Royal Bank of Canada 2014 annual report, p. 86, available at http://www.rbc.com/investorrelations/pdf/ar_2014_e.pdf
66. See note 60 above.
67. PC Bond Index Team.
68. See, for example, <http://www.rbcroyalbank.com/products/isa/>.
69. The prospective asset class returns discussed in this letter appear reasonable based on the assumptions contained herein and on market conditions prevailing at the end of 2014. It's hoped that the prospective returns will help illuminate the remainder of this letter. Actual 50-year asset class returns for the period 2014 to 2064 are certain to vary from those stated herein, however, and the variances could be material.
70. Shakespeare, William. *Julius Caesar*, Act 1, scene 2, 15-19, quoted at <http://www.phrases.org.uk/meanings/beware-the-ides-of-march.html>
71. Twain, Mark. *Pudd'nhead Wilson*, quoted at http://en.wikipedia.org/wiki/Mark_Twain_effect
72. http://www.moneychimp.com/features/monthly_returns.htm
73. Twain, Mark. Quoted at <http://www.foxbusiness.com/personal-finance/2013/04/01/it-is-return-my-money/>. As the article states, the quotation has also been attributed to Will Rogers although he appears to have been quoting Twain.
74. <http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2011/11/15/when-are-capital-gains-distributions-a-bad-thing>
75. Andrade, Sandro C., Vidhi Chhachharia and Michael E. Fuerst. "'Sell in May' Just Won't Go Away," *Financial Analysts Journal*, July/August 2013, vol. 69, no. 4: 94-106.
76. <http://data.okfn.org/data/core/s-and-p-500> and http://www.moneychimp.com/features/monthly_returns.htm
77. <http://www.rbcroyalbank.com/products/rrsp/contribution-limits.html>
78. <http://www.cra-arc.gc.ca/E/pub/tg/t4040/t4040-13e.pdf>, pp. 5-6.
79. <http://www.cra-arc.gc.ca/E/pub/tg/rc4092/rc4092-13e.pdf>, p. 2.
80. <http://www.cra-arc.gc.ca/E/pub/tg/rc4466/rc4466-13-11e.pdf>, p. 7. There have been media reports that if the federal government balances its budget it may increase the annual TFSA contribution limit to \$10,000 but at time of writing no such increase has been announced.

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