PORTLAND
INVESTMENT COUNSEL®

Portland Focused Plus Fund LP
Portland Focused Plus Fund

ANNUAL LETTER TO INVESTORS

FOR THE YEAR ENDED DECEMBER 31, 2017

Portland Focused Plus Fund LP
Performance vs. Stock Market Indices

Year	Annual Total Return					
	Portland Focused Plus Fund LP				S&P/TSX Index	S&P 500 Index (US$)
	Series A	Series F	Series M	Series P		
2012 (from Oct. 31)	1.7%	1.9%	2.0%	2.0%	0.6%	1.5%
2013	33.0%	34.1%	37.7%	34.4%	13.0%	32.4%
2014	15.6%	16.8%	18.8%	17.5%	10.6%	13.7%
2015	6.5%	7.5%	8.3%	8.5%	-8.3%	1.4%
2016	39.0%	40.4%	45.5%	41.6%	21.1%	12.0%
2017	16.4%	17.5%	19.9%	18.6%	9.1%	21.8%

Since Inception (Oct. 31, 2012)

Compound annual return	21.2%	22.3%	24.9%	23.2%	8.5%	15.6%
Cumulative return	169.4%	183.1%	215.3%	193.4%	52.3%	111.3%

Portland Focused Plus Fund
Performance vs. Stock Market Indices

Year	Annual Total Return					
	Portland Focused Plus Fund				S&P/TSX Index	S&P 500 Index (US$)
	Series A	Series F	Series M	Series P		
2016 (from Mar. 31)	28.7%	29.3%	33.6%	30.6%	15.8%	10.5%
2017	15.5%	16.7%	19.4%	18.1%	9.1%	21.8%

Since Inception (Oct. 31, 2012)

Compound annual return	25.5%	26.6%	30.6%	28.1%	14.3%	18.5%
Cumulative return	48.7%	51.0%	59.5%	54.3%	26.4%	34.6%

Notes:
Performances for the Portland Focused Plus Fund LP and Portland Focused Plus Fund are net returns after all fees and expenses (and taxes thereon) have been deducted. Performance for both indices is per TD Securities Inc. The S&P 500 Index is shown in U.S. dollars rather than in Canadian dollars since the Funds generally hedge their U.S. dollar exposure.

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

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

Previous Letters

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

Investment Objective

As stated in the Funds' Offering Memorandum dated March 1, 2016 ("OM"), the investment objective of each Fund is "to achieve, over the long term, preservation of capital and a satisfactory return."[2] In order to gauge whether the performance of the Funds has been satisfactory, investors should compare the long-term performance of the Funds to a 50%/50% average of the returns of the S&P/TSX Composite Index ("S&P/TSX Index") and the Standard & Poor's 500 Index ("S&P 500 Index") in U.S. dollars ("US$").[3]

Performance Of The LP

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

In 2017, the LP's series F units (the highest fee series without embedded advisor compensation) achieved a return of 17.5% (net of fees and expenses). That compares to a return of 9.1% for the S&P/TSX Index and to a return of 21.8% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of 15.5%. For the entire period since inception of the LP on October 31, 2012 to December 31, 2017, the LP's series F units achieved a cumulative return of 183.1%. That compares to a cumulative total return of 52.3% for the S&P/TSX Index and 111.3% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 81.8%. Accordingly, in both 2017 and for the cumulative period since the LP's inception, the LP has met its investment objective of preservation of capital and a satisfactory return. It's worth noting that the LP also offers two series of units with lower fees for larger investors; both of these series have even higher returns than the series F units. The different series are discussed further below and their performance is shown on the inside front cover of this letter.

A comparison of the LP's performance to other funds in its category is also revealing. **I'm pleased to report that for the five years ended December 31, 2017, the performance of the LP's series M units of 25.3% per annum ranked it as the second-best performing series among all alternative strategies funds in Canada.**[4] That performance far outstripped the average return for funds in the category of 5.3% per annum.

Private Capital Markets Association Of Canada Investment Fund Award

The strong performance of the LP has not gone unnoticed. I'm also pleased to report that the LP was the winner of the 2017 Investment Fund Award conferred by the Private Capital Markets Association of Canada. Portland and I are proud that the LP received this award as it underscores not only the strong long-term performance of the LP but also the LP's innovative product design and Portland's commitment to the best long-term interests of the LP's investors.

Performance Of The Trust

As discussed in detail in the 2016 Letter, the LP is intended, with very limited exceptions, for non-registered investment accounts; the Trust is intended for registered investment accounts and for non-Canadians.[5] The Trust's investments are managed in a virtually identical manner to those of the LP. The Funds experience monthly cash flows arising from subscriptions and redemptions. Shortly after every month-end, the Funds make such portfolio transactions as are necessary to harmonize their respective portfolios. As a result, and as discussed more fully later in this letter, investors should expect that the management and long-term performance of the two Funds will be similar. That is why Portland has decided to distribute the same annual letters to investors in both the LP and the Trust.

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

In 2017, the Trust's series F units (the highest fee series without embedded advisor compensation) achieved a return of 16.7% (net of fees and expenses). That compares to a return of 9.1% for the S&P/TSX Index and to a return of 21.8% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of 15.5%. For the entire period since inception of the Trust on March 31, 2016 to December 31, 2017, the Trust's series F units achieved a cumulative return of 51.0%. That compares to a cumulative total return of 26.4% for the S&P/TSX Index and 34.6% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 30.5%. Accordingly, in both 2017 and for the cumulative period since the Trust's inception, the Trust met its investment objective of preservation of capital and a satisfactory return. As was noted with reference to the LP, the Trust also offers two series of units with lower fees for larger investors; both of these series have even higher returns than the series F units. The different series are discussed further below and their performance is shown on the inside front cover of this letter. The Trust's strong performance since its inception 21 months ago is very encouraging. Investors should derive further confidence from the excellent performance of the LP upon which the Trust is modelled.

Series Of Fund Units

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

- ***Series A units*** have a minimum initial subscription amount of $2,500 for accredited investors ($150,000 for other non-individual subscribers); a management fee of 2% per annum; and a performance fee of 10% of the amount above the highest ever net asset value per unit ("High Water Mark") of the series. A trailing commission of 1% per annum is paid to financial advisors whose clients invest in series A units;

- ***Series F units*** have a minimum initial subscription amount of $2,500 for accredited investors ($150,000 for other non-individual subscribers); a management fee of 1% per annum; and a performance fee of 10% of the amount above the High Water Mark of the series;
- ***Series M units*** have a minimum initial subscription amount of $500,000 or more in respect of the Trust, or $1,000,000 or more in respect of the LP; and a management fee of 1% per annum. Series M units do not have a performance fee; and
- ***Series P units*** have a minimum initial subscription amount of $500,000 or more in respect of the Trust, or $1,000,000 or more in respect of the LP; and a performance fee of 10% of the amount above the High Water Mark of the series. Series P units do not have a management fee.

As can be seen in the tables on the inside front cover of this letter, for the period from October 31, 2012 to December 31, 2017, the LP's series F units had a cumulative return of 183.1% while the LP's series M units and series P units had higher cumulative returns of 215.3% and 193.4%, respectively. For the period from inception of the Trust on March 31, 2016 to December 31, 2017, the Trust's series F units had a cumulative return of 51.0% whereas the Trust's series M units and series P units had higher cumulative returns of 59.5% and 54.3%, respectively.

Going forward, with respect to each of the Funds, the series P units are certain to continue to have returns greater than the series F units since the series P units have no management fee. Similarly, the series M units will have a performance greater than the series F units to the extent that the Funds earn performance fees. Thus, investors who have the means to meet the minimum initial subscription amounts for the series M and series P units are encouraged to do so in order to take advantage of the lower fees applicable to those series which will continue to enhance their long term performance.

Performance Difference Between The LP And The Trust

Since 2017 was the first year in which both the LP and the Trust operated for a full calendar year, and since I have noted that the two Funds are managed in a highly similar manner, it's worthwhile to compare the returns of the two Funds in 2017. This is done in the table below.

Performance Year ended Dec. 31, 2017	Series A	Series F	Series M	Series P
LP	16.4%	17.5%	19.9%	18.6%
Trust	15.5%	16.7%	19.4%	18.1%
LP vs. Trust	0.8%	0.8%	0.5%	0.5%

As can be seen from the table, the LP's performance was higher than that of the Trust by about 0.8% for the series A and series F units (note that the series A column does not add due to rounding) and by about 0.5% for the series M and series P units. In my opinion, the performance differential between the two Funds is primarily a result of the following two factors:

- The Trust experienced higher net sales relative to its asset base than did the LP and these cash flows entered the Trust during a period of steadily higher equity prices, resulting in a slight lag in its performance compared to that of the LP. During 2017, the net assets of the LP and the Trust increased by 74% and 139%, respectively. On balance, therefore, the Trust experienced a higher percentage increase in its net assets from new subscriptions than did the LP (although both grew significantly). There is a lag of about two business days between the date that new subscriptions are recorded (on the last business day of every month) and when the cash is actually transferred into the brokerage accounts of the Funds for their use. In 2017, during which equity prices (particularly in the United States) marched steadily higher, this slight delay in receipt and investment of cash contributed to a slight lag in the performance of the Trust compared to that of the LP. This difference could have gone either way, depending upon how equity markets performed in the first couple of business days in every month. Since equity market returns were generally positive, there was a small impact on the performance of the Trust.

- As noted in the 2016 Letter, since the LP is based in Alberta, its management fees, performance fees and operating expenses are subject only to Goods and Services Tax (GST) at a rate of 5%.[7] The Trust's fees and expenses, however, are subject to sales tax for each series based on the weighted average rate applicable in the provinces where the series investors reside. In December 2017, for example, the Trust's series F fees and expenses were subject to Harmonized Sales Tax (HST) at a weighted average rate of 12.1%. If in a year the Trust's series F units incurred management fees, performance fees and operating expenses equal to an aggregate of 2.5% of the series net assets, and the series tax rate were 12.0%, then the tax applicable to the fees and expenses would be 0.30% of net assets (i.e., 2.5% x 12.0% = 0.30%). Conversely, for the same fees and expenses in the LP, which is taxed at only 5.0%, the tax applicable to the fees and expenses would be 0.13% of net assets (i.e., 2.5% x 5.0% = 0.13%). Thus, in this scenario, for identical pretax returns, the reported after-tax return of the LP would be higher than the after-tax return of the Trust by 0.17% (i.e., 0.30% - 0.13% = 0.17%). Provided that there are no changes to Canadian tax laws which affect the taxation of limited partnerships and mutual fund trusts, and no introduction of a provincial sales tax in Alberta, this disparity in taxation will confer a permanent performance advantage on the LP. In other words, for this reason alone, the annual performance of the LP's series A and series F units can be expected to be slightly higher than that of the series A and series F units of the Trust (because both of these Trust series have many investors who reside in higher tax rate provinces such as Ontario).

Please note that an item which did not contribute to the performance differential between the LP and the Trust was operating expenses. That is because to date, in both the LP and the Trust, operating expenses have been 0.5% per annum.

Operating Expenses

The Funds incur operating expenses for such items as fund administration, audit fees, legal fees, and preparation of income tax returns and tax slips.[8] From the inception of the Funds to December 31, 2017, operating expenses for each of the LP and the Trust have been 0.50% per annum plus applicable taxes. While there can be no assurance that the Funds' operating expenses will remain at or below this level, Portland remains committed to tight management of fees and expenses so as to maximize the Funds' returns.

As noted earlier in this letter, the net assets of the LP and Trust increased in 2017 by 74% and 139%, respectively. The net assets of the LP and the Trust as of December 31, 2017 (prior to giving effect to subscriptions and redemptions effective as of that date) were $38.2 and $17.0 million, respectively. If the Funds maintain their level of net assets as of December 31, 2017 (or better yet, increase them), then it is possible that through economies of scale their operating expense rates may be lower in the future than the levels of 0.50% per annum that have prevailed to date.

LP Metrics

In 2017, the LP celebrated its five-year anniversary. The LP has now been in existence for long enough that it's worthwhile to examine some statistical measures of the LP's operations and performance. Some measures (in all cases to December 31, 2017) that are particularly important are described below.

- Equities as a percentage of the LP's net asset value (since February 28, 2013, after creation of the LP's initial portfolio) have averaged 149%, in a range of 84% to 219%. In other words, on average, the LP has borrowed (through its margin facility) $0.49 for every $1.00 of net assets. This supports the view that the LP's use of leverage has been prudent: enough to enhance returns given the low cost of borrowing (which at December 31, 2017 was only 2.2%), but not so high so as to have jeopardized the LP in the event of a sudden, severe equity market decline.
- Foreign equities (almost entirely U.S.) have averaged 40% of total equities. This coincides with the LP's published strategy that it would invest in both Canadian and non-Canadian equities. This also supports the suggestion (noted at the start of this letter) that a reasonable performance benchmark against which to assess the LP's performance is a simple average of the returns of the S&P/TSX Composite Index and the S&P 500 Index (in US$).
- The LP's worst 12-month return for its series F units was only slightly negative, at -3.1%. That was for the 12 months ended February 29, 2016. Significantly, of the LP's 51 overlapping 12-month periods, that was the only period for which 12-month performance was negative.
- The LP's largest drawdown, meaning its largest decline in net asset value per unit (series F) from a peak to a subsequent trough, was -16.5%. That was for the period from October 31, 2014 to January 31, 2015. During that period, oil prices collapsed, as did the share prices of energy companies (some of which were owned in the LP at the start of that period) and Canadian banks. In the latter case, the declines were caused by what proved to be ill-founded concerns about the impact of possible energy-related loan losses on bank profitability and capital ratios.
- The LP's longest period between record highs in net asset value per unit (series F) was only six months. That was from October 31, 2014 to April 30, 2015. In other words, only three months after the decline noted immediately above, the LP had completely recovered its former decline and attained a new record high in net asset value per unit. That sharp rebound arose because not only did the LP maintain its non-energy holdings during that period, but also it used its margin facility to add to holdings at the low equity prices that prevailed in early 2016. When stock prices rebounded, as they quickly did, the LP's net asset value per unit jumped to a new high.

I would caution that the period since the LP's inception has been one of, on balance, steadily rising stock prices (particularly in the U.S.) and steadily declining volatility. There are certain to be periods in the future when these conditions reverse (i.e., when stock prices decline and volatility rises, such as has been the case in early 2018). Once the LP has passed through such a period, investors will be able to draw more meaningful conclusions about the LP's long-term performance.

Canadian Banks Put It Up to 11

Previous annual letters have favourably discussed the investment merits of the leading Canadian banks.[9] I remain very positively inclined toward these outstanding businesses with their variation in portfolio weight being dependent primarily upon valuation. For example, at the end of 2017, the percentage of the LP's net assets (prior to subscription and redemptions effective as of that date) invested in the common shares of three of the five largest Canadian banks was a combined amount of 56%. Excluding distributions paid in the Trust at year-end (most of which were reinvested), the percentage of the Trust's and LP's net assets held in Canadian banks was virtually identical.

Since the global financial crisis, the unimaginative but effective response of banking regulators has been to require ever-higher capital ratios as protection from future adverse events for both individual banks and more importantly the financial system. To measure capital levels, the single most important measure is what is known as the common equity tier 1 ("CET1") ratio. The calculation of this ratio is made accorded to rules issued under the Basel III international regulatory environment for banks. The table below shows the CET1 ratios of the five largest Canadian banks at two points in time: at January 31, 2013 (when the banks first published their Basel III CET1 ratios) and at October 31, 2017 (the end of the banks' 2017 fiscal years).

Canadian bank CET1 ratios	31-Jan-13	31-Oct-17
Bank of Montreal	9.4%	11.4%
Bank of Nova Scotia	8.2%	11.5%
Canadian Imperial Bank of Commerce	9.6%	10.6%
Royal Bank of Canada	9.3%	10.9%
Toronto-Dominion Bank	8.8%	10.7%
Weighted average of big five banks	9.0%	11.0%

The CET1 ratio is calculated by dividing capital by risk-weighted assets. A higher number is safer, therefore, as it shows that more capital is invested in a bank per dollar of that bank's risk-weighted assets. As the table shows, the weighted average CET1 ratio of the big five Canadian banks increased from 9.0% at January 31, 2013 to 11.0% at October 31, 2017. The latter date represents the first fiscal year-end for which the banks reported an average CET1 ratio at or above 11%. There are clear signs that global banking regulators are easing off on their pressure for ever-higher capital ratios (which come at the cost, for example, of lower bank returns on equity and a reluctance to lend). As evidence of this seeming capital plateau, the average of the big five CET1 ratios was in a tight range of 11.0% to 11.1% at the end of each of the four quarters of fiscal 2017.

What does it mean now that banks have reached a Basel III CET1 ratio of 11% if no further capital ratio increases are required? It means that bank profits, instead of being forced to be significantly devoted to increasing bank capital ratios as has been the case for the last five years, will now be much more available for shareholder-friendly measures such as internal growth, dividends and share repurchases. To paraphrase a recent brokerage research report, "it's all about that Basel – no trouble".

Tax Cuts and Jobs Act

In late 2017, a landmark event occurred when the U.S. passed into law the Tax Cuts and Jobs Act ("Act"). The Act makes sweeping changes to both corporate and individual taxation and marked the first major U.S. tax reform since 1986. The tax rate changes in the Act became effective on January 1, 2018. A full analysis of the Act is beyond the scope of this letter. Some of its major changes to corporate taxation are as follows.

- The U.S. federal tax was decreased from 35% to 21%, a decline of 14 percentage points; and
- A new provision states that currently deferred foreign profits are deemed to have been repatriated and are subject to tax at a rate of 15.5% for cash and cash-equivalent profits and 8% for reinvested foreign earnings.[10]

The Act has already had profound impacts on American businesses. Several large companies have celebrated by raising employee wages and paying special bonuses. Others have announced plans to repatriate foreign-held cash, pay taxes to the U.S. treasury and make new domestic investments. Estimated earnings for the S&P 500 Index have risen sharply. And, of course, the U.S. equity market has rejoiced, posting strong returns in 2017 with further gains in 2018 to date.

The U.S. equities held in the Funds have benefitted from passage of the Act. At the end of 2017, U.S. equities represented 29% of the LP's equity investments (equivalent to about 54% of the LP's net assets at December 31, 2017, prior to subscriptions and redemptions effective as of that date). Excluding distributions paid in the Trust at year-end (most of which were reinvested), the percentage of the Trust's and LP's net assets held in U.S. equities was virtually identical.

The impact of the Act on Canada is not so positive. In recent years, Canadian governments at the federal and provincial level have generally been raising income tax rates and imposing new carbon taxes. In addition, municipalities have been raising property taxes. All three levels of government have also tended to increase regulatory burden. In the last year, however, the United States, which is both Canada's largest customer and its largest competitor, has been moving in the opposite direction. This divergence has eroded Canada's competitiveness. For example, U.S. state corporate income tax rates range from 0% to 12% with an average of about 6%.[11] When combined with the new federal corporate tax rate of 21%, the total U.S. corporate tax rate is in a range of 21% to 33% with an average of about 27%. In Canada, the federal corporate income tax rate is 15% and most provincial corporate income tax rates are in a tight range of 11.5% to 12%.[12] The combined federal/provincial corporate tax rate is thus 26.5% to 27%, essentially the same as in the U.S. This means that the significant corporate tax rate advantage that Canada has enjoyed for more than a decade is gone. In addition, prospective investors in Canada must weigh the potential threat to Canada's access to U.S. markets that might arise from the current talks (or their failure) to revise the North American Free Trade Agreement. Finally, insufficient pipeline capacity to transport Canada's oil and gas production to market is costing the country many billions of dollars per year in foregone product sales and tax revenues.

Canadian governments at all levels ignore the large and important U.S. tax changes in the Act at our peril. Canadian governments simply must do a better job than they have done in recent years to improve, rather than worsen, Canada's competitiveness with respect to taxation, regulation and market access.

Editing

Little-known to readers of these letters is that my wife, Jamie Mason, is both a lawyer and serves as my volunteer editor (and I hereby thank her profusely for her services). Last year, perhaps in an effort to reduce her work load, she bought me a book on writing intelligible prose.[13] The book describes various websites that are available to test a written work's readability.[14] Apparently, one of the first books on the subject was *The Art of Readable Writing* by Rudolf Flesch, who inspired Dr. Seuss to write *The Cat in the Hat*. Rudolf's work also inspired the creation of the Flesch Reading Ease index. It (and other formulas) is available at www.readabilityformulas.com. The reading score value of this letter is 50.3 (equivalent to a high school grade level of 11.5), which indicates a certain level of sophistication (as demanded by the subject matter) without being inaccessible. And what if this letter had fared poorly? What if it had been scored as unreadable? Well, it wouldn't be the first time that I had been accused of committing sins of the Flesch.

Outlook

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

March 5, 2018

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 Funds Offering Memorandum, March 1, 2016, p. 2. The OM is available at www.portlandic.com/focusedplusfundLP.html and www.portlandic.com/focusedplusfundtrust.html.
3. For a discussion, see 2013 Letter, p. 3.
4. Source: Globefund at http://globefunddb.theglobeandmail.com/gishome/plsql/gis.fund_filter?pi_type=B.
5. 2016 Letter, pp. 5-6.
6. OM, pp. 6-7 and pp. 13-14.
7. 2016 Letter, p. 6.
8. OM, p. 14.
9. 2014 Letter pp. 20-25, 2015 Letter pp. 12-14 and 2016 Letter p. 8.
10. https://taxfoundation.org/final-tax-cuts-and-jobs-act-details-analysis/.
11. https://en.wikipedia.org/wiki/Corporate_tax_in_the_United_States.
12. https://www.taxtips.ca/smallbusiness/corporatetax/corporate-tax-rates-2018.htm.
13. Evans, Harold. *Do I Make Myself Clear?* (Little, Brown & Company, 2017).
14. Ibid., pp. 40-43.

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