Portland Focused Plus Fund LP
Portland Focused Plus Fund

ANNUAL LETTER TO INVESTORS

FOR THE YEAR ENDED DECEMBER 31, 2018

Portland Focused Plus Fund LP
Performance vs. Stock Market Indices

	Annual Total Return					
	Portland Focused Plus Fund LP				S&P/TSX Index	S&P 500 Index (US$)
Year	Series A	Series F	Series M	Series P		
2012 (from Oct. 31)	1.7%	1.9%	2.0%	2.0%	0.6%	1.5%
2013	33.0%	34.1%	37.7%	34.4%	13.0%	32.4%
2014	15.6%	16.8%	18.8%	17.5%	10.6%	13.7%
2015	6.5%	7.5%	8.3%	8.5%	-8.3%	1.4%
2016	39.0%	40.4%	45.5%	41.6%	21.1%	12.0%
2017	16.4%	17.5%	19.9%	18.6%	9.1%	21.8%
2018	-14.8%	-14.0%	-13.5%	-13.2%	-8.9%	-4.4%

Since Inception (Oct. 31, 2012)

Compound annual return	14.4%	15.5%	17.7%	16.4%	5.4%	12.1%
Cumulative return	129.4%	143.3%	172.6%	154.6%	38.7%	102.0%

Portland Focused Plus Fund
Performance vs. Stock Market Indices

	Annual Total Return					
	Portland Focused Plus Fund				S&P/TSX Index	S&P 500 Index (US$)
Year	Series A	Series F	Series M	Series P		
2016 (from Mar. 31)	28.7%	29.3%	33.6%	30.6%	15.8%	10.5%
2017	15.5%	16.7%	19.4%	18.1%	9.1%	21.8%
2018	-15.6%	-14.7%	-14.2%	-13.8%	-8.9%	-4.4%

Since Inception (Mar. 31, 2016)

Compound annual return	8.6%	9.6%	12.1%	10.9%	5.3%	9.6%
Cumulative return	25.5%	28.8%	36.9%	33.0%	15.1%	28.7%

Notes:
Performances for the Portland Focused Plus Fund LP and Portland Focused Plus Fund (jointly, the "Funds") are net returns after all fees and expenses (and taxes thereon) have been deducted. 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. Since the Funds do not necessarily invest in the same securities as the benchmarks or in the same proportion, the performance of the Funds may not be directly comparable to the benchmarks. In addition, the Funds' returns reflect the use of leverage. The use of benchmarks is for illustrative purposes only, and is not an indication of performance of the Funds.

Portfolio manager's letter* to investors in the Portland Focused Plus Fund LP (the "LP") and the Portland Focused Plus Fund (the "Trust") (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 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 October 25, 2018 ("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 2018, the LP's series F units (the highest fee series without embedded advisor compensation) had a negative return of -14.0% (net of fees and expenses). That compares to a return of -8.9% for the S&P/TSX Index and to a return of -4.4% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of -6.7%. Accordingly, in the one-year period of 2018, the LP did not meet its investment objective of preservation of capital and a satisfactory return. Much more importantly, however, over the cumulative period since the LP's inception, it has met its investment objective. For the entire period since inception of the LP on October 31, 2012 to December 31, 2018, the LP's series F units achieved a cumulative return of 143.3%. That compares to a cumulative total return of 38.7% for the S&P/TSX Index and 102.0% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 70.3%. It's worth noting that the LP also offers four series of units with lower fees for larger investors, two of which series have units outstanding (series M and series P). Due to their lower fees, both of these latter 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, where applicable. Additional comments on performance of both equity markets and the Funds in 2018 and January 2019 are contained below in the section titled "How The Grinch Stole Christmas."

Canadian Hedge Fund Award

I'm pleased to report that the LP was a winner of a 2018 Canadian Hedge Fund Award for achieving 3rd place in the category of Equity Focused funds, Best 5-Year Return.[4] This was the LP's second national award, following its receipt of the 2017 Investment Fund Award conferred by the Private Capital Markets Association of Canada.[5] These awards recognize the LP's superior long-term performance. Since the LP may be affected by short-term vagaries in equity markets, which may be accentuated by the LP's use of leverage, it has always been suggested that investors assess performance over periods of not less than five years.[6] It seems particularly appropriate to restate this advice given the LP's 2018 performance which was not representative of its long-term average.

Performance of the Trust

As discussed in detail in the 2016 Letter, with very limited exceptions, the LP is intended for non-registered investment accounts; the Trust is intended for registered investment accounts and for non-Canadians.[7] The Trust's investments are managed in a virtually identical manner to those of the LP. Each of 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, 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 2018, the Trust's series F units (the highest fee series without embedded advisor compensation) had a negative return of -14.7% (net of fees and expenses). That compares to a return of -8.9% for the S&P/TSX Index and to a return of -4.4% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have experienced a return of -6.7%. Accordingly, in the one-year period of 2018, the Trust did not meet its investment objective of preservation of capital and a satisfactory return. Much more importantly, however, over the cumulative period since the Trust's inception, it has met its investment objective. For the entire period since inception of the Trust on March 31, 2016 to December 31, 2018, the Trust's series F units achieved a cumulative return of 28.8%. That compares to a cumulative total return of 15.1% for the S&P/TSX Index and 28.7% for the S&P 500 Index in US$. A 50%/50% blend of the two indices would have returned 21.9%. As was noted with reference to the LP, the Trust also offers four series of units with lower fees for larger investors, two of which series have units outstanding (series M and series P). Due to their lower fees, both of these latter 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, where applicable.

How the Grinch Stole Christmas

Equity market conditions in 2018, and the Funds' performance, merit some further comment. On September 21, 2018, the S&P 500 Index reached its all-time intraday high of 2940.9.[8] The S&P 500 Index then headed south, reaching its lowest closing level for the year on Christmas Eve. After taking a day off for the holiday, the S&P 500 Index headed lower still, reaching its lowest intraday level for the year of 2346.6 on the morning of Boxing Day (which is not a holiday in the U.S.). From peak to trough on an intraday basis, the S&P 500

Index fell by (20.2%), meeting the widely-accepted definition of a bear market.[9] The S&P 500 Index then turned sharply higher for the balance of 2018, a rally which has continued in early 2019. Nonetheless, in 2018 the S&P 500 Index posted its worst December performance since 1931, resulting in its worst annual performance since 2008.[10]

The performance of the Funds was influenced by these equity market conditions. However, with very focused portfolios that do not adhere to index sector weightings, and given their use of leverage, the Funds may experience performance that is significantly different than their two benchmark indices, even over short-term periods. The performance of the Funds was negative overall for the first five months of 2018 as three of their then-largest holdings, electric utilities Fortis Inc. ("Fortis") and Emera Inc. ("Emera") and drugstore retailer Walgreens Boots Alliance Inc. ("Walgreens"), were deeply out of investor favour. Over the subsequent six months, these three companies came back into investor favour, helping propel the Funds to new record highs at November 30, 2018. Then along came the Grinch. The December declines in the S&P/TSX Index and the S&P 500 Index were accentuated in the Funds by their use of leverage and by declines in the prices of shares purchased in December, so that in that month each of the Funds declined by (19.7%), by far their worst-ever monthly performance.

I am pleased to report that in early 2019, these negative conditions largely reversed themselves. For the month ended January 31, 2019, the series F units of the LP and the Trust had by far their highest-ever monthly total returns of 36.0% and 36.6%, respectively, with both of the Funds reaching new all-time highs (adjusted for distributions). By contrast, in January, the S&P/TSX Index and the S&P 500 Index had returns of only 8.7% and 8.0%, respectively. This recent period is an excellent demonstration of the truth of the "Mr. Market" allegory described by "the father of value investing", Benjamin Graham.[11] He explained that owning publicly-traded securities is like being in partnership with a manic-depressive whose quoted price for the business may vary wildly based on his mood swings, unrelated to changes in the intrinsic value of the business.[12] The referenced period also underscores the wisdom of the adage not to get too excited about short-term results (whether negative or positive), but instead to focus on long-term averages. The long-term average results of the Funds are very good.

Monthly Fund Updates

Shortly after every month-end, I send out fund updates by email for each of the LP and the Trust. These are generally factual in nature, with data on performance, net asset value per unit ("NAVPU") and net assets. When circumstances merit, these updates may also include comments on important events impacting the LP and the Trust and the investment outlook. Canada's Anti-Spam Legislation restricts Portland's ability to add anyone's email address to the list to receive these updates without that person's written consent. If you wish to receive the monthly email updates for either the LP, the Trust, or both, please send an email to that effect to info@portlandic.com. At the bottom of every email update there is an "unsubscribe" button that you may click on to be removed from that list.

Offering Memorandum

On October 25, 2018, Portland renewed the Funds' OM. This is the second complete refresh of the Funds' offering memorandum since the inception of the LP. The first refresh was effective on March 1, 2016; its primary purpose was to incorporate the launch of the Trust. The primary purpose of the most recent update of the OM was to permit the issuance of series Q units, described more fully below.

Series of Fund Units

The Funds have designated six series of units, four of which have units outstanding. The features of each of the series are outlined below:[13]

- ***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 NAVPU (“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;
- ***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;
- ***Series O units*** are charged a negotiated management fee and/or performance fee directly to Portland. Series O units will only be issued to certain institutional or other investors. No series O units have yet been issued; and
- ***Series Q units*** have a minimum initial subscription amount of $10,000,000; and a management fee of 0.75% per annum. Series Q units do not have a performance fee. No series Q units have yet been issued.

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, 2018, the LP’s series F units had a cumulative return of 143.3% while the LP’s series M units and series P units had higher cumulative returns of 172.6% and 154.6%, respectively. For the period from inception of the Trust on March 31, 2016 to December 31, 2018, the Trust’s series F units had a cumulative return of 28.8% whereas the Trust’s series M units and series P units had higher cumulative returns of 36.9% and 33.0%, 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

The performance of the LP and the Trust in 2018 is shown in the table below:

Performance Year ended Dec. 31, 2018	Series A	Series F	Series M	Series P
LP	-14.8%	-14.0%	-13.5%	-13.2%
Trust	-15.6%	-14.7%	-14.2%	-13.8%
LP vs. Trust	0.8%	0.7%	0.7%	0.5%

As can be seen from the table, the LP's performance was higher than that of the Trust by 0.8% for the series A units, 0.7% for the series F and series M units and 0.5% for the series P units (its column does not add due to rounding). In my opinion, the performance differential between the two Funds in 2018 was primarily a result of the following two factors:

- As was noted in the 2016 Letter, since the LP is based in Alberta, its management fees, performance fees and operating expenses were (until December 31, 2018) subject only to Goods and Services Tax (GST) at a rate of 5%.[14] The Trust's fees and expenses, however, were (and 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 2018, for example, the Trust's series F fees and expenses were subject to Harmonized Sales Tax (HST) at a weighted average rate of 12.3%. There has been a change to Canadian tax law which stipulates that effective January 1, 2019 the fees and expenses of limited partnerships will be taxed in a manner similar to those of mutual fund trusts (like the Trust). As a result, the performance difference between the LP and the Trust with respect to the tax rates levied on their fees and expenses should be materially lower in 2019 and in future years; and
- The LP had a lower operating expense ratio than the Trust. This is discussed in the next section.

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.[15] From the inception of the Funds to December 31, 2017, the Funds' operating expenses were both 0.50% of net assets per annum plus applicable taxes. I'm pleased to report that in 2018, however, the LP's operating expense ratio fell to 0.37% plus tax. That is because the LP's assets rose to the point that its operating expenses, which are relatively fixed and are insensitive to asset size, fell as a percentage of the LP's net assets so that the operating expenses were below the former operating expense recovery ratio of 0.50%. All other things being equal (as economists like to say), a lower operating expense ratio results in higher reported investment performance. Thus, the economies of scale of the larger LP have redounded to the benefit of investors in the LP. Conversely, the Trust has yet to achieve the same economies of scale, so its operating expense ratio in 2018 remained at 0.50% of net assets plus tax. At December 31, 2018, the net asset values of the LP and Trust (before subscriptions and redemptions effective on that date) were $33.6 million and $15.3 million, respectively (in the latter case, after the deduction of year-end distributions of $2.3 million, almost all of which were reinvested).

While there can be no assurance that the operating expense ratios of the LP and Trust will remain at or below their 2018 levels of 0.37% and 0.50%, respectively (in both cases, plus tax), Portland remains committed to tight management of fees and expenses so as to maximize the Funds' returns.

Allocations, Distributions and Returns

The Funds earn investment income and incur expenses. Based upon communications that I have received, it is clear that there is some confusion among investors (and even financial advisors) as to how the two Funds attribute their income and expenses to their investors, and the implications for calculating returns. Since the LP and the Trust have different legal forms, the way in which they attribute income and expenses to their investors is also different, as is the method for calculating each Fund's rate of return. This is explained in the rest of this section. Please note that the discussion below is not intended to constitute tax advice; if in doubt, investors should consult their own tax professionals.

The LP does not pay distributions. Instead, the LP allocates its income and expenses to its investors on a pro rata basis. These allocations are recorded for tax purposes on T5013 slips which are issued to investors annually in March in respect of the preceding calendar year. One of the attractive features of limited partnerships is that income earned and expenses incurred by them retain their tax character when they are attributed to investors. For example, most of the LP's income is tax-advantaged as it is in the form of capital gains and eligible Canadian dividends (only half of capital gains are included in taxable income and eligible Canadian dividends earn significant tax credits). At the same time, the LP's expenses (i.e., management fees, performance fees, operating expenses and interest expense on margin loans) are all fully deductible in the computation of taxable income (with the exception of foreign dividend withholding taxes, which also earn a tax credit). For tax purposes, these expense items (other than foreign withholding taxes) are all aggregated into one number (reported on the T5013 slips) called "carrying charges". Note that since the LP does not actually pay distributions, investors must have some other means to pay any taxes owing by them on their allocation of the LP's income and expenses. In my experience, investors generally fund their LP-related tax obligations using other resources held by them or by redeeming some of their units of the LP. Upon receiving each T5013 slip, investors should adjust the adjusted cost base ("ACB") of the LP's units that they own by increasing the ACB by the amount of income items allocated, and decreasing the ACB by the amount of expense items allocated. In this way, investors in the LP avoid double taxation (which would otherwise arise if investors paid taxes on income allocated to them but not actually received by them, and then, when they eventually redeem their units, had not adjusted their ACB for the cumulative amounts of income and expenses allocated to them).

An important feature of the fact that the LP does not pay distributions is that it is extremely easy to calculate the LP's cumulative return over any period. All that is needed is the ending and beginning NAVPU. For example, as noted earlier, the cumulative performance of the LP's series F units from inception on October 31, 2012 to December 31, 2018 was 143.3%. That can be readily calculated by dividing its NAVPU at December 31, 2018 of $121.66 by its NAVPU at inception of $50.00 and subtracting one: $121.66/$50.00 – 1 = 143.3%.

A closely-related feature of the fact that the LP does not pay distributions is that for investors in the LP, "book value" equals cost. Book value is a figure that is widely reported in statements issued by brokerage firms and investment managers (including Portland). Book value is generally the sum of cost (i.e., the amount actually paid by investors for units) and reinvested distributions. Since the LP does not pay distributions, for its investors, book value equals cost. For investors in the LP, their personal, cumulative return is computed

by dividing market value by cost. Since book value equals cost, investors in the LP can compute their cumulative return by simply dividing market value by book value (as both are reported on their statements). That is not the case for investors in the Trust, however, as we shall soon see.

In contrast to the LP, the Trust does pay distributions (as it is required to do so for tax purposes). Moreover, unlike the LP, mutual fund trusts, such as the Trust, are not permitted to directly allocate their expenses to their investors. Instead, the Trust's expenses are netted against its income (such as dividend income) and the net amount of income is distributed to investors, together with a distribution of capital gains. These distributions occur annually on December 31 and are recorded on T3 slips issued to investors in March in respect of the preceding calendar year. For example, on December 31, 2018, the Trust paid a distribution of $7.40 per series F unit. For investors in registered plans who reinvested their distributions, the distribution had no financial consequence as they simply ended up with more units at a lower NAVPU with no change in their total net asset value in dollars. For non-registered investors, the distribution was tax-efficient as 94% of it was in the form of capital gains that are only taxed at half of the rates applicable to regular income.

An important consequence of the fact that the Trust pays distributions is that it is impossible to calculate the Trust's performance over any period that includes one or more December 31s without adjusting for distributions. For such periods, to determine performance, one can't simply divide the ending NAVPU by the beginning NAVPU (as one can always do with the LP). For example, the Trust's NAVPU of its series F units at November 30, 2018 was $72.28 and their NAVPU on December 31, 2018 was $50.66, a seeming decline of -29.9%. The Trust's NAVPU on December 31, 2018, however, was after the payment on that date of the above-noted distribution of $7.40 per unit. Adjusting for this, the Trust's series F NAVPU on December 31, 2018 prior to distributions was $58.06 per unit: $50.66 + $7.40 = $58.06. When compared to its NAVPU on November 30, 2018, the resulting performance was the as-reported figure of -19.7%: $58.06/$72.28 – 1 = -19.7%. Also noteworthy is the fact that, as discussed in the 2016 Letter, the Funds are generally managed so as to try to keep unrealized gains as of any December 31 in the range of 10% to 25% of each Fund's net asset value.[16] As 2018 amply demonstrated, however, volatility in equity markets, particularly toward year-end, may result in actual unrealized capital gains (or losses) being outside of the range of 10% to 25% of net assets (either higher or lower), but that is the aspiration. If that target (i.e., to keep unrealized capital gains at December 31 of any year in the range of 10% to 25% of net assets) were achieved, then the Trust's NAVPU at December 31 year-ends would generally remain in the range of $55.00 to $62.50, regardless of how strong performance might have been, or for how many years. That is because the Trust's NAVPU at inception for all series was $50.00. Adding in the goal for unrealized gains at year-ends of 10% to 25% of net assets results in target NAVPUs for the Trust of $55.00 to $62.50. This analysis underscores that to measure the Trust's performance over any period that includes one or more year-ends, one must consult performance tables (such as the one on the inside front cover of this letter), not simply look at NAVPUs. As noted earlier, performance over various periods is included in the Fund's monthly fund briefs. These are generally posted to Portland's web site within a few business days after every month-end. Further, links to the fund briefs are included in the Funds' monthly fund updates.

The fact that the Trust pays distributions means that each investor's book value of units held will tend to rise over time, even if she makes no further subscriptions after her initial investment. A numerical example will help to illustrate this point. Let's assume that on December 31, an investor subscribes for $1,000 of Trust units. With the Trust's NAVPU at an assumed level of $50.00 (as it was at inception), the investor would receive 20 units: $1,000 / $50.00 = 20. Further assume that in the subsequent year, the Trust has a net return of 15%, all of which is realized (i.e., there is no change in the Trust's unrealized capital gains in the year). That means that at the next year-end, prior to paying distributions, the Trust's NAVPU would

be \$57.50: \$50.00 x 1.15 = \$57.50. Since we assumed that all of the 15% return was realized, the Trust must pay out the return of \$7.50 per unit as a distribution. After giving effect to the distribution, the Trust's reported NAVPU on this latter December 31 would be \$50.00, the same as it was at the prior year-end, despite the 15% return in the year. On this latter date, the investor would receive a distribution of \$7.50 per unit for each of her 20 units, for a total of \$150. If she chose to have her distributions reinvested into additional units, as the vast majority of investors do, she would receive three additional units: \$150 / \$50 = 3. She now owns a total of 23 units which, at the NAVPU of \$50.00, have a market value of \$1,150: 23 x \$50 = \$1,150. From an accounting standpoint, the value of her \$150 distribution is added to her original cost of \$1,000 so that on the latter December 31, the book value of her units is reported at \$1,150, which in this example would be the same as the market value. If this result were repeated year after year, both the investor's market value and book value would grow steadily, and they would always be the same as each other. An investor could be forgiven for looking at her statements and thinking, "Geez! I've owned this fund for years and I've never made any money. Every year, market value is the same as book value!" Meanwhile, in reality, the fund has been compounding at an annual rate of 15%! The misunderstanding arises because of the confusion of book value with cost. In the above example, the investor's cost was \$1,000 and that never changed. This is the denominator that should be used by investors to compute their returns. In brief, investors in the Trust who hold units through at least one December 31 *cannot compute their cumulative return by comparing their market value to their book value*. To derive their return, they must compare market value with their original cost, or use the performance tables in the inside front cover of this letter, in the monthly fund briefs or on Portland's web site, or consult the personal rates of return that brokerage firms and investment managers are now required to provide to their clients annually.[17]

Phew! Here endeth the lesson on allocations, distributions and returns. I'm reminded of a statement that I use in some presentations and was inspired by Tim Cestnick, a former colleague who is one of Canada's foremost tax professionals: "if you took all the people in the world who'd ever fallen asleep at an accounting seminar, and laid them end-to-end…they'd be a lot more comfortable."

Electric Utilities: Lights Out

It's now worthwhile reviewing some of the Funds' former major holdings that were mentioned in previous letters or shown in the Funds' previous financial statements.

As described in the 2016 Letter, during 2016 the Funds bought large positions in two electric utility companies, Fortis and Emera.[18] Those two companies represented 88% and 60% of the LP's net assets at the end of 2016 and 2017, respectively (and a similar percentage of the Trust's net assets on those dates, before giving effect to subscriptions, redemptions and distributions). Their decline in percentage weight in 2017 did not arise from share sales; in fact, by utilizing both companies' dividend reinvestment plans, the Funds owned more shares of both companies at the end of 2017 than they had at the end of 2016. The decline in the portfolio weight in utilities in 2017 arose because the growth in the net assets of the Funds in that year exceeded the share price appreciation of both Fortis and Emera.

For most of 2018, the total returns of the utilities were fairly poor, both on an absolute basis and relative to equity markets such as the S&P 500 Index (which peaked on September 21). For the utility shares, this period could be characterized as a brownout. Then, a remarkable thing happened. On October 3, 2018, Jerome "Jay" Powell, the chair of the U.S. Federal Reserve ("Fed") (which determines short-term interest rates), gave an interview in which he stated that "interest rates are still accommodative, but we're gradually moving to a place where they will be neutral…We may go past neutral, but we're a long way from neutral

at this point, probably."[19] That was certainly the most hawkish statement by a Fed chair that I have heard since Paul Volcker (who served as Fed chair from 1979 to 1987).[20] The world took notice. If you want to know why equity markets tanked in the fourth quarter of 2018, you can trace a direct line from that interview. In the two days that followed Powell's statement, market interest rates ticked up. For example, on October 5, 2018, the 10-year U.S. Treasury yield reached 3.23%, almost its highest level for all of 2018.[21] Then, perhaps counter-intuitively, market interest rates began to decline sharply. By the end of 2018, the 10-year U.S. Treasury yield had fallen to 2.69% while equity markets had also fallen sharply. In my opinion, these market movements occurred because investors feared that the Fed would raise short-term interest rates so aggressively that it would tip the economy into recession.

The decline in long-term interest rates starting in early October caused utility share prices to shoot the lights out. From that time on, they soared in price while equity markets, in general, fell. As a result, both the absolute and relative return prospects of the utilities gradually grew dimmer. In response to this market divergence, all of the shares of Fortis and Emera that had been held in the Funds at the time of Powell's October 3 interview were sold (in November and December) at substantially higher prices. The proceeds were reallocated to what I felt were better opportunities that offered superior combinations of expected returns and downside risk.

On balance, I consider that the returns in the two utilities over the Funds' two-year holding period of them met the expectations stated in the 2016 Letter: that they would "deliver satisfactory long-term returns with limited risk."[22] The Funds' recent experience with the two utilities also demonstrates the importance of two portfolio management tenets employed in the management of the Funds: i) buy high-quality, large companies when they're out of favour (as the utilities were in late 2016); and ii) have some diversification (by sector and geography) so that, ideally, not all stocks held in the Funds will move in the same direction at the same time. Some diversification (without taking it to excessive levels) may afford profitable opportunities to reallocate capital, as was the case in late 2018.

Reports of Retailing's Death Have Been Greatly Exaggerated

Another large, high quality company that was bought in the Funds when it was out of favour was Walgreens. At December 31, 2017, the position in Walgreens was equal to 26% of the LP's net assets (and a similar percentage of the Trust's net assets).

Walgreens is the second-largest pharmacy store chain in the U.S. and one of the largest in the world. The Funds invested in Walgreens in October 2017, when bricks and mortar retailers fell far out of favour because of concern about increasing competition from Amazon.com, Inc. ("Amazon"). The Funds were quickly rewarded with substantial appreciation of Walgreens' stock price until late January 2018. Over the next five months, however, in tandem with weak equity markets and the announcement of Amazon's purchase of online pharmacy PillPack, Walgreens' stock price fell even lower than it had been at the time of the Funds' purchase. By late June, Walgreens had fallen to what would prove to be its 2018 lowest stock price of just over US$59 per share. One of the things that consoled me at that time (other than the fact that Walgreens' stock was cheap) was that its financial position was strong and that it would use that strength to repurchase a significant amount of its shares at such low prices that it would enhance the company's per-share intrinsic value to the benefit of the remaining shareholders. Indeed, during its fiscal year ended August 31, 2018, Walgreens reduced its basic shares outstanding by (7%).[23] As it happened, Walgreens began to climb back into investor favour. After the Powell interview referred to above, not only did the share prices of utilities rise strongly, but also so did the shares of consumer staples companies, such as Walgreens. I then felt,

as with the utilities referenced above, that it was desirable to reallocate the capital invested in Walgreens to better-priced opportunities. All Walgreens shares that had been held in the Funds were sold in October and November 2018 for an average of over US$80 per share. For the holding period of about one year, the Walgreens investment netted the Funds a tidy total return (in U.S. dollars) of over 20%.

The stock market was not wrong in its apparent belief that bricks and mortar retailers are losing market share to online retailing. The market simply, as it is wont to do, exaggerated the impact of a negative event or trend, resulting in the stock prices of the affected businesses (in this case, traditional pharmacy retailers) trading at far below their intrinsic values. The Funds' positive experience with Walgreens was another example of the benefits of buying high quality businesses when they're on sale (i.e., out of investor favour). It also underscores the importance of share repurchases, discussed more fully below.

Optionality and Share Repurchases

As noted previously in these letters, the Funds seek to invest in companies that are in strong financial positions.[24] In part, that is because the Funds already use leverage as one of their core strategies; the Funds don't need or want that leverage to be compounded by high and uncertain leverage in the Funds' investee companies. Also, if the companies in which the Funds invest are in strong financial positions, the businesses have optionality. That simply means that they have the financial means to pursue a range of alternatives for increasing shareholder value, including internal growth, acquisitions and share repurchases. When doing fundamental research on public companies, there is no one measure which captures financial strength. I consider a range of measures, including: income statement measures, such as interest coverage; balance sheet measures, such as debt-to-equity; cash flow measures, such as the amount of free cash flow that the business generates; liquidity; credit ratings; schedules of debt maturities; and industry-specific financial metrics.

The 2013 Letter included some comments on share repurchases.[25] Given what seem to be common, persistent misunderstandings regarding share repurchases, it's worth revisiting this topic. Despite what one may read, share repurchases are neither inherently good nor bad. Every share repurchase must be considered in light of the circumstances prevailing at the time of the repurchase. As famed investor (and our role model) Warren Buffett has noted, there are two conditions that must both be satisfied for share repurchases to be advisable: "[f]irst, the company has available funds – cash plus sensible borrowing capacity – beyond the near-term needs of the business and, second, finds its stock selling below its intrinsic value, conservatively-calculated."[26] It is amazing (and somewhat disheartening) to observe how many share repurchases fail either one or both of these two simple tests. By repurchasing shares when they do not have adequate financial strength to do so, companies place their entire business in peril. Moreover, by repurchasing shares when their stock market prices are above their intrinsic value, companies reduce the per-share intrinsic value of the remaining shares, thus they punish their remaining shareholders. The fact that some companies choose to implement share repurchases that fail one or both of these tests while the company's senior executives simultaneously exercise stock options and sell into the strength created by the share repurchase, just makes this practice even more unseemly.

Conversely, share purchases that meet both of the tests described above are unequivocally positive. Such repurchases are an intelligent and responsible use of the company's financial strength and serve to increase the per-share intrinsic value of the continuing shareholders. It is explicitly part of the Funds' investment methodology to invest in businesses that have both the ability and the willingness to repurchase shares if circumstances warrant (and only if they warrant). It is thus not a coincidence that several of the

Funds' investee companies have completed what I believe are among the largest share repurchases (as a percentage of outstanding shares) among all Canadian and U.S. businesses. That includes Walgreens; two other examples are given below.

Banks Redux

Previous annual letters have included many positive comments about banks.[27] In the 2016 Letter, which noted that the Funds had greatly reduced their former bank investments for valuation reasons, I stated that "[s]elected banks remain outstanding businesses and excellent candidates for investment. I hope that someday they again fall out of favour and that large percentage weights in leading banks are re-established in the Funds."[28] I'm pleased to report that, as was sung in the old advertising jingle, "the future is now."[29]

During 2018, especially late in the year, bank stocks fell very far out of investor favour. The Funds used that weakness as an opportunity to add to existing bank positions and to buy new ones. The LP's bank holdings are summarized in the table below. The first numerical column shows each holding's percentage weight of the LP's net assets at December 31, 2018 (before subscriptions and redemptions effective on that date). The Trust's weights in the banks named in the table, excluding the Trust's year-end distributions (almost all of which were reinvested), were virtually identical to those of the LP.

Banks held in the LP at Dec. 31, 2018

Company	% of LP's net assets	Dividend Yield	P/E ratio	P/B ratio	P/TB ratio
Bank of Nova Scotia, The	43.6%	5.0%	9.6	1.4	1.9
Canadian Imperial Bank of Commerce	21.6%	5.4%	8.3	1.4	1.8
Citigroup Inc.	43.2%	3.5%	7.8	0.7	0.8
Goldman Sachs Group, Inc., The	35.0%	1.9%	7.0	0.8	0.8
Toronto-Dominion Bank, The	44.6%	3.9%	10.5	1.7	2.3
Total / weighted average	188.0%	3.9%	8.8	1.2	1.5

Further comments on the table are listed below:

- At December 31, 2018 the LP had 188% of its net assets invested in banks (enabled by the use of margin borrowings). By comparison, at December 31, 2017, the LP's percentage of its net assets invested in banks was 56%. During 2018, the LP increased its weight in banks by 132 percentage points. Almost all of that increase arose during the fourth quarter of 2018. One of the investee companies was Citigroup Inc., which in 2018 reduced its basic shares outstanding by (8%);[30]
- The weighted average dividend yield of the LP's bank holdings was 3.9%. The dividend yield for each bank was its indicated annual dividend rate divided by its share price at December 31, 2018. It's worth noting that the average dividend yield alone exceeded the LP's cost of borrowing (i.e., its margin interest rates). Thus, the bank holdings provided positive cash flow to the LP even before consideration of the use of their retained earnings to increase their shareholder value over time;
- The weighted average price/earnings ("P/E") ratio of the banks was only 8.8 times. For each bank, that ratio was calculated by dividing its share price at December 31, 2018 by its earnings per share excluding specified items for 2018. For the Canadian banks, the figures used were their earnings for their fiscal years ended October 31, 2018 (which were reported shortly before the end of calendar

2018); for the U.S. banks, the figures were their earnings for calendar 2018 (which were reported shortly after year-end). I believed that the average trailing P/E ratio of only 8.8 times was very attractive, especially in the context of current low interest rates;

- The weighted average price/book ("P/B") ratio of the banks was only 1.2 times. For each bank, that ratio was calculated by dividing its share price at December 31, 2018 by its book value per share (for the Canadian banks, as of October 31, 2018; for the U.S. banks, as of December 31, 2018). In my opinion, the average trailing P/B ratio of only 1.2 times was also very attractive; and
- The weighted average price/tangible book ("P/TB") ratio of the banks was only 1.5 times. Tangible book value is calculated by deducting from common equity intangible assets such as goodwill and identified intangible assets that have arisen on acquisitions. For each bank, the P/TB ratio was calculated by dividing its share price at December 31, 2018 by its tangible book value per share (for the Canadian banks, as of October 31, 2018; for the U.S. banks, as of December 31, 2018). The average trailing P/TB ratio of only 1.5 times represented compelling value. In fact, at year-end the two U.S. banks traded at *discounts* to their tangible book values of about (20%). That is an uncommon condition which usually presages strong share price performance thereafter.

Given the low bank valuations that prevailed at December 31, 2018, it is not surprising that a partial recovery of bank share prices helped drive the Funds' exceptionally strong performance in January 2019. I remain very positively inclined toward the investment merits of leading banks. They have strong financial positions, excellent management teams, are diversified by both revenue and geography, have large barriers to entry and generate significant free cash flows. This view is held in common with Warren Buffett's Berkshire Hathaway Inc. ("Berkshire Hathaway"). At the end of 2018, Berkshire Hathaway counted among its largest shareholdings the following banks: Bank of America Corporation; The Bank of New York Mellon Corporation; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; U.S. Bancorp; and Wells Fargo & Company.[31] As Buffett once wryly observed when he was asked about the investment merits of ranching, "I know people that have done reasonably well in cattle but they've usually owned banks on the side."[32]

Other Investments

Normally, these letters don't dwell on the Funds' individual investments and the presentations that I give on the Funds almost never have slides on individual holdings. The primary reason for that is that I have found that the more one discusses individual holdings, the more one is likely to keep them in the Funds, even if changing valuations or other circumstances suggest one should do otherwise. The Funds' investment objective has never changed nor have the strategies used to pursue their investment objective. Those may be sacrosanct, but individual holdings are not. Holdings are always subject to change if it is deemed to be in the best interests of the Funds. Nevertheless, given the sharp equity market declines in December 2018, I thought investors might appreciate a review that underscores the high quality of the Funds' investee companies. The Funds' five bank holdings are summarized above; their three non-bank holdings are discussed briefly below (in order of percentage weight in the LP, highest to lowest; the weights of these businesses in the Trust were similar).

- ***Magna International Inc.*** ("Magna"; 46.3% of the LP's net assets at December 31, 2018). Magna is one of the world's largest automotive parts manufacturers. Its 2018 sales were US$40.8 billion. The company is highly diversified by customer, product and geography. It is in a strong financial positon and generates considerable free cash flow. In 2018, Magna reduced its common shares outstanding by (9%);[33]

- ***McKesson Corporation*** ("McKesson"; 34.2% of the LP's net assets). McKesson is one of largest drug distributors in the United States (and also owns Canada's Rexall and Rexall Pharma Plus pharmacy chains).[34] In McKesson's latest fiscal year ended March 31, 2018, its sales were US$208 billion. While drug distributors have been out of favour for some of the same reasons as Walgreens, they are not as exposed to traditional retailing; and
- ***Berkshire Hathaway*** (1.3% of the LP's net assets). It is not the Funds' normal practice to hold small positions. The LP bought shares in Berkshire Hathaway in early 2016 (before the launch of the Trust), near the stock market low at that time and at a very favourable price. As Berkshire Hathaway's stock price soared very soon thereafter, I acted quickly to reduce the holding for valuation reasons that proved to be far too conservative. The residual position remains in the Funds as a two-fold reminder: first, to follow the company's practice of investing in large, high quality businesses; and second, if I ever again get the opportunity to buy Berkshire Hathaway shares on anything like the terms that prevailed in early 2016, back up the truck and don't let them go.

In Memoriam: John C. Bogle

In January 2019, the world marked the passing of investment giant John C. "Jack" Bogle at the age of 89.[35]

Beginning with his Princeton University thesis in 1951, Bogle posited two ideas which were then revolutionary: i) most active portfolio managers will underperform their benchmark because of the impact of fees, operating expenses and trading costs; and ii) therefore, investors should invest so as to replicate the underlying benchmark as closely as possible, while keeping fees, operating expenses and trading costs to the bare minimum.[36] By doing so, investors can get closer to their benchmark's return and outperform most active managers. Bogle preached these simple, logical, powerful ideas for the rest of his life, to the massive and incalculable benefit of investors around the world.

In 1975, Bogle put these then-radical ideas into action by founding what has become The Vanguard Group, Inc. ("Vanguard") and launching the first index fund (what is now known as the Vanguard 500 Index Fund).[37] While it took many years for index funds to catch on, by the 1990s they had demonstrated the success of their model. Index funds do, however, have one major drawback: investors do not know the exact price that they will pay to buy (or receive to sell) when they submit an order because orders must be submitted before the index fund is priced, which is usually at the close of every trading day (after all orders have been received). Eventually, the quest to address this drawback led to the creation of exchange-traded funds (ETFs). These married the index fund model with pricing certainty (since one can submit limit orders during the trading day and know exactly what one will pay or receive for an ETF). The rest is history. Over the last 20 years, ETFs have taken the world by storm. Today, Vanguard manages over $5.1 trillion. It is the world's largest provider of mutual funds and the second-largest provider of ETFs (after only ETF juggernaut BlackRock, Inc.).[38] Bogle's personal benefit from this phenomenal success was relatively modest. That is because he deliberately structured Vanguard as a mutual company, meaning that Vanguard is owned by the funds managed by the company. Thus, as Vanguard grew, its economies of scale resulted in lower management fees and operating expense ratios to the benefit of the investors in its funds.

It may seem incongruous for an active manager like me to celebrate Bogle's life and influence. On the contrary, however, I have read several of Bogle's books and have benefited greatly by them. Further, I agree with Bogle's irrefutable logic that a large majority of active managers will underperform their relevant benchmark. That is why I believe that appropriate investments resemble a barbell. At one end, for those

who desire the simplicity and predictability of achieving index-like returns, are index funds and ETFs. At the other end are investments like the Funds which are highly differentiated, highly focused and un-index like. What investors should avoid is the "mushy middle": closet index funds that charge high fees and expenses for providing active management and advice while providing little, if any, of either.

Given Bogle's sound arguments, I believe that the burden of proof lies with active managers to explain how they propose to outperform. Investors may then judge whether the articulated strategy is sensible and measure each active fund's long-term performance to determine whether it has been successful. I had Bogle's teachings in mind when the first of the Funds, the LP, was designed and launched in 2012. Its key tenets, which have been employed in the Funds ever since, are as follows:

- ***Use of leverage.*** Borrowing costs for the last decade have been (and remain today) far below the long-term historic and expected rate of return on equities. I posited that careful use of a discretionary, variable amount of leverage would provide extra returns to the Funds sufficient to exceed the fees, operating expenses, trading costs and interest expense associated with deploying such a strategy. In that way, the Funds would outperform the relevant equity indices, as indeed the Funds have done to date;
- ***Focused portfolios.*** In my opinion, there is no place in active management for owning a large number of companies in small weights so that individual companies will not move the performance needle. In addition, it would be impossible to do a satisfactory level of due diligence (because of the large number of holdings). Instead, I believe in tightly focused portfolios of high quality, large, financially strong companies bought at sensible valuations that offer much greater prospect of outperforming their relevant indices over the long term;
- ***Low fees.*** The 2013 Letter explained that the LP was launched with two lower-fee series for larger investors and with a performance fee half of that typically charged by other alternative strategies funds.[39] Effective June 30, 2014, Portland reduced the management fees of these two series (what are now known as series M and series P) by 0.75% per annum, so that the management fee on the series P units is now nil.[40] Effective October 25, 2018, Portland created the series Q units which have an even lower management fee than the series M by (0.25%) per annum;[41]
- ***Low operating expenses.*** The "Operating Expenses" section of this letter stated that the LP's operating expense ratio fell from 0.50% in 2017 to 0.37% in 2018 (in both cases, plus tax). The Trust's operating expense ratio was 0.50% in both years. If the Funds continue to increase their net assets over time, there is the opportunity for further reductions in their operating expense ratios as the Funds increase their economies of scale; and
- ***Low trading costs.*** As was described in the 2013 Letter, trading costs are the sum of brokerage commissions, bid-ask spread and market impact.[42] That letter explained how the Funds would be managed to keep trading costs very low. In part, the Funds do that by only investing in large capitalization companies for which bid-ask spread and market impact are immaterial. Also, the brokerage commissions paid by the Funds are virtually zero. For example, the Funds' 2018 financial statements show that the LP's brokerage commissions incurred to amass its portfolio of $96.1 million were only $13,186, for a commission rate of only 0.014% (or 1.4 basis points).[43]

Thanks to Bogle, investors have in index funds and ETFs a well-established and credible alternative to active management. We active managers must prove our case, using logic supported by performance. In my opinion, the Funds pass both tests.

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 objective: to achieve, over the long term, preservation of capital and a satisfactory return.

March 6, 2019

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

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Notes

1. In this letter, all opinions are those of, and the words "I", "me", "my" and "mine" refer to, the Funds' portfolio manager and the letter's author, James H. Cole.
2. Portland Focused Plus Funds Offering Memorandum, October 25, 2018, p. 3. 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. http://alternativeiq.com/canadian-hedge-fund-awards/about/. The awards are based solely on quantitative performance data of 207 Canadian hedge funds to June 30th, 2018 with Fundata Canada managing the collection and tabulation of the data to determine the winners. There is no nomination process or subjective assessment in identifying the winning hedge funds.
5. 2017 Letter, p. 4.
6. 2013 Letter, p. 3.
7. 2016 Letter, pp. 5-6.
8. All S&P 500 Index data in this section is from Bloomberg LP.
9. Some market participants assess whether the bear market threshold of a decline of at least (20%) has been attained based on closing low compared to closing high, while others assess it based on intraday low compared to intraday high. I am in the latter group as is the business news network, CNBC. See https://www.cnbc.com/2018/12/24/whats-a-bear-market-and-how-long-do-they-usually-last-.html.
10. https://www.foxbusiness.com/markets/dow-sp-500-having-worst-month-since-1931-as-grinch-hits-wall-st.
11. https://en.wikipedia.org/wiki/Benjamin_Graham.
12. Graham, Benjamin. *The Intelligent Investor* (Harper & Row, Fourth Revised edition, 1973), pp. 108-109.
13. OM, pp. 6-7 and pp.13-14.
14. 2016 Letter, p. 6.
15. OM, pp. 14-15.
16. 2016 Letter, pp. 6-7.
17. The personal rate of return provided to investors by brokers and investment managers is calculated on a money-weighted basis whereas standard investment returns (such as are stated in this letter and in Portland's monthly fund briefs) are calculated on a time-weighted basis. For the difference between these two methods, please see the 2015 Letter, pp. 5-8.
18. 2016 Letter, pp. 8-9.
19. https://www.youtube.com/watch?v=IEPcPIYTMY0 and https://www.cnbc.com/2018/10/03/powell-says-were-a-long-way-from-neutral-on-interest-rates.html.
20. Volcker famously raised short-term interest rates to 20% in order to curb high inflation and inflation expectations. See https://en.wikipedia.org/wiki/Paul_Volcker.
21. https://ycharts.com/indicators/10_year_treasury_rate.
22. 2016 Letter, p. 9.

23. Walgreens' annual report on form 10-K for the fiscal year ended August 31, 2018, p. 58.
24. See, e.g., 2013 Letter, p. 9.
25. 2013 Letter, p. 10.
26. Berkshire Hathaway Inc. 1999 annual report, p. 16.
27. 2014 Letter, p. 15 and pp. 20-25; 2015 Letter, pp. 12-14; 2016 Letter, p. 8; and 2017 Letter, p. 8.
28. 2016 Letter, p. 8.
29. https://www.youtube.com/watch?v=Xg32JxTC5jc.
30. Citigroup Inc. Q4'18 Quarterly Financial Data Supplement, p. 1.
31. Berkshire Hathaway Inc. 2018 annual report, p. 12.
32. Berkshire Hathaway Inc. annual general meeting held on April 30, 2016, as transcribed by the author.
33. Magna's press release for the fourth quarter of 2018, p. 10.
34. https://www.rexall.ca/company.
35. For a biographical sketch of John Bogle as well as a 16-minute undated interview with him that appears to be from late 2017, see https://www.cnn.com/2019/01/16/investing/john-bogle-obituary/index.html.
36. This brief summary of John Bogle's life and career is based on general knowledge gleaned from Bogle's books and extensive interviews. See also his Wikipedia entry at https://en.wikipedia.org/wiki/John_C._Bogle.
37. https://en.wikipedia.org/wiki/The_Vanguard_Group.
38. Ibid.
39. 2013 Letter, p. 17.
40. The Funds' Annual Financial Report for the year ended December 31, 2018, note 1, p. 22.
41. OM, p. 7.
42. 2013 Letter, pp. 13-14.
43. The Funds' Annual Financial Report for the year ended December 31, 2018, p. 10.

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Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel: 1-888-710-4242 • Fax: 1-866-722-4242 • www.portlandic.com • info@portlandic.com

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