News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. September 17, 2018

Owner Operated Companies

Nothing signifcant to report.

Energy Sector

Nothing signifcant to report.

Financial Sector

Citigroup Inc. - last week unveiled its new organizational structure for its investment bank. Wall Street's other big banks have long run their advisory and capital markets businesses as one unit, recognizing the benefits of a one-stop shop for clients seeking advice on a big transaction who may well have the need to raise debt or equity too. Why, then, did it take until now for Citi's Corporate and Investment Banking division('CIB') (loans and advice) to be fused with the Capital Markets Origination division (CMO') (debt and equity raising)? Jamie Forese, who heads the Institutional Clients Group which sits over CIB, CMO, markets, treasury and private banking, told the Financial Times the move is about "thinking of the future" now the process of post-crisis "repairing and rebuilding" is over.

HSBC Holdings PLC aims to increase its Asia private banking headcount by two-thirds in five years and double client assets in eight as it eyes a bigger share of the business in the world's fastest-growing wealth market, top executives said. The lender's private banking expansion plan in Asia, which accounted for 75 percent of group-level profit last year, comes as the unit that caters to the rich is focusing once more on growth after years of painful restructuring. "Asia is the key driver for future profitability in the private bank ... it's been the driver for growth even through the difficult times and it's always remained profitable," Peter Boyles, CEO of HSBC's global private banking business, told Reuters. HSBC's Asia private bank will add 700 people by 2022 from a headcount of 1,100 at the end of 2017. The increase will add staff in various roles including relationship managers, product specialists and family wealth planners, said Siew Meng Tan, Asia Pacific head of private banking. (Source: Reuters)

ING Groep N.V., the Dutch bank, will start assessing its $600 billion lending portfolio based on climate impact, a first step in shifting the entire portfolio to align with the emissions reductions required by the Paris climate agreement. The policy, the first of its kind for a big bank, will include putting pressure on clients whose businesses do not conform with the climate goals of the agreement. "We will try to look at the entire portfolio and make sure that over time it aligns with Paris," Isabel Fernandez, head of wholesale banking, said. With the new climate assessment, the bank will "support and influence clients to make them more aligned with the climate agreement", she added. "We can engage with those companies that need more help." (Source: Financial Times)

JPMorgan Chase & Co. will provide $500 million over five years to promote economic opportunities in selected cities, including some outside the United States, the bank said Wednesday. The program builds on urban renewal strategies that the bank funded in Detroit with $150 million starting in 2014. It has since taken the approaches to Chicago with $40 million and to Washington, D.C., with $25 million. Half of the $500 million will be in philanthropic grants. The other half will provide low-cost, long-term development capital. The money will be used to teach job skills, finance small businesses of women and minority entrepreneurs, rebuild neighborhoods and to help families with their finances. The funding comes as JPMorgan Chief Executive Officer Jamie Dimon, 62, has turned more of his attention to public policy and economic issues as chairman of the Business Roundtable. "Businesses can and must step up to help change the status quo by creating a better future for all, no matter where they live," Dimon said in a statement. "It is in our best interest and the right thing to do." (Source: Reuters)

Activist Influenced Companies

Aryzta AG - A Swiss activist investor is mounting a campaign to block Aryzta AG's €800 million ($930 million) capital increase, arguing the troubled McDonald's bun maker should instead sell assets and slash management layers. Gregor Joos is understood to want to acquire a stake of at least 3% through his investment company Larius Capital AG. The fund is seeking co-investors and may try to reach 10% through alliances with other shareholders. Aryzta's management has failed to turn the company around, Joos has told Chairman Gary McGann. In a letter seen by Bloomberg News, he said the Zurich-based company should sell its ailing North American business and its 49% stake in French frozen-food company Picard Groupe SAS, urging Aryzta to focus more on Europe. An Aryzta spokesman confirmed the letter was received and declined to comment further. The activist has been involved in campaigns against Swiss asset manager GAM Holding AG, Credit Suisse Group AG and Gategroup Holding AG through RBR Capital Advisors AG, where he was a partner.

Dividend Payers

Compass Group PLC – we met with management last week. Their decentralized food service delivery model has been proven to work well and they are now managing 26 different businesses. They continue to look for niche entrepreneurial businesses that can be acquired and plugged into the Compass "machine". These business are often born by founders that have been able to capitalize on the many changing food preferences (organic, locally sourced, healthy, avocado-obsessed, etc.) in a localized setting. The Compass strategy is to buy these businesses, maintain the founder as part of the management team (keep the culture in tact), but then help them scale up by using the benefits that come from a large company: back office support, backfill of staff, food procurement, marketing, finance, hiring support, etc. For Compass, buying these businesses tends to be a long process as they follow and get to know potential "targets" over many years. It is often that they have met them multiple times, even bidding after the same contracts, before bringing them into the family. Private equity is of course lurking around these businesses as well and it sounded like they have been more aggressive recently. Compass continues to have a very diversified client base currently managing 55K contracts. Their top 10 clients make up less than 8% of revenue and their largest client is less than 2%. From a regional perspective, North America is the "jewel in the crown" for Compass with an impressive 7% organic growth. When asked why it is this way, Compass explained that it is beautifully homogenous, contracts are long term (up to 25 years) which allows for judicious planning, prime outsourcing area, and the runway for outsourcing in health care / education is huge. Structurally, the margins are higher in this region and no doubt due to the impressive 97% retention rates. Labour is the tough part as they are hiring 80K people per year and paying minimum wage puts them in competition with Walmart etc. Labour costs can be absorbed in the model in the North American market since there are mostly "cost plus" contracts, although Compass did admit it's been even more difficult versus a couple years ago. In San Francisco, they actually need to bus in people to meet the labour demands. For Europe it's harder to absorb any inflation costs because of the many fixed-price arrangements. Compass called out the U.K. as the underperforming region and this is due to a combination of cost inflation and depressed volumes because of a more cautious consumer (things all their competitors are dealing with as well). Technology is always challenging the status quo and with the proliferation of restaurant apps, it seems easier for business to access customers in more convenient ways. Compass had some good food for thought to consider here. They have measured that usage on restaurant apps is less than 20% and so at the present time, it does not seem to be a threat. Also, the cost that the Compass brands can charge is usually at a meaningful discount to entice customers to stay in-house. This is related to how they purchase food (Foodbuy) and the leverage they get with scale.

Economic Conditions

The U.S. Consumer Price Index rose 0.2% in August and just 0.1% excluding food and energy. This pulled the yearly rates down a couple notches to 2.7% and 2.2%, respectively, from near 7-year and 10-year highs. Clothing prices plunged 1.6%, the most since 1949 and a third straight monthly decline, likely due to the stronger dollar. Medical care costs fell for a second month in a row. After showing some acceleration in response to the metal tariffs, new vehicle prices were flat and little changed from a year ago. Some upward pressure emerged from gasoline, rent, education and airfares. The soft CPI report will, in our view, ease concerns about businesses passing higher wage costs and tariffs along to customers, as cited in the latest Beige Book. While it seems unlikely it will discourage the Fed from raising rates in two weeks, it could slow the tightening next year if the relative calmness in both wages and prices at this late stage of the business cycle persists.

U.S. industrial production came in largely as expected. Total output rose 0.4%, the third straight gain and is now up 4.9% year/year, the fastest rate since December 2010. But the revisions were mixed….. July was revised from +0.1% to +0.4%, but was offset by a downward revision to June, from +1.0% to +0.6%. Increased auto assemblies showed up in the data, but not enough to give manufacturing a significant boost. Manufacturing rose just 0.2% in the month, the smallest gain since May. This industry makes up 74% of overall output. Mining climbed for the 7th consecutive month, up 0.7% while utilities were up 1.2%. Production of business equipment was still growing steadily, up 1.2% in August, or 4.2% year/year, suggesting the business investment was still being supportive, despite all of the trade uncertainty.

Financial Conditions

The Bank of England left rates unchanged but upgraded its growth outlook but also warned of greater uncertainty around Brexit since policy makers met last month. Markets are not, in our view, pricing a full 25 bps hike until November 2019. Despite the recent optimism for a Brexit agreement, GBP will likely remain under-pressure in our view until the end of the year.

The European Central Bank statement left rates unchanged and kept forward guidance that the central bank will end asset purchases in December and will keep rates unchanged through the summer of 2019.

The Turkish central bank raised rates by 6.25% to take the one-week repo rate to 24%. The massive rate hike came just two hours after the President Recep Edrogan called for lower borrowing costs. The large hike was in response to the fact that the central bank has

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acted too late in responding to the Turkish Lira sell-off and is hoping to prevent a further slide as inflation which hit 18% in August.

The U.S. 2 year/10 year treasury spread is now 0.23% and the U.K.'s 2 year/10 year treasury spread is 0.72% - meaning investment banks remain constrained from profiting from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above costs of capital. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.60% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing U.S. housing inventory is at 4.0 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, economic recovery, job creation, and low prices are still supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now at the low end of a more normal range of 4-7 months.

The VIX (volatility index) is 12.58 (compares to a post-recession low of 9.52 achieved in early November) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 bodes well for quality equities.

And Finally

Jamie Dimon claimed last Wednesday that he could beat Donald Trump in an election, taunting the U.S. President by saying that the wealth he had made as chairman and Chief Executive of JPMorgan Chase "wasn't a gift from daddy". Asked at a JPMorgan event whether he might run in a 2020 campaign that is expected to feature several business people, Mr. Dimon said he would not get past the liberal wing of the Democratic Party. Being a banker made him "part of the elite" in the eyes of the American people even though he grew up in a poorer part of Queens than the president. But, he said he could beat Mr. Trump. "I'm as tough as he is, I'm smarter than he is. I would be fine. He could punch me all he wants, it wouldn't work with me. I'd fight right back." Within minutes, JPMorgan issued a statement clarifying that Mr. Dimon was not declaring his candidacy. "I should not have said it. I'm not running for president. [This] proves I wouldn't make a good politician. I get frustrated because I want all sides to come together to help solve big problems," he said. (Source: Financial Times).

Mutual Funds

Portland Investment Counsel Inc. currently offers 8 Mutual Funds:

- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund
- Portland Global Dividend Fund
- Portland Value Fund
- Portland 15 of 15 Fund

Private/Alternative Products

Portland also currently manages the following private/alternative products:

- Bay & Scollard Development Trust
- Portland Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value Plus Fund

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at www.portlandic.com/prices

We want to share our insights with you and welcome your feedback. Our website has the latest, as well as archived videos, company profiles, and press articles. Please visit us at www.portlandic.com.

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Glossary of Terms: 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'ROE' return on equity, 'ROTE' return on common equity.

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