News Highlights

Owners. Operators. And Insightful Investors.

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Our views on economic and other events and their expected impact on investments. October 24, 2016

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Energy Sector

U.S. land rig count increased by 15 rigs week/week to 528 and is already up 20% compared to the first 3 weeks of last quarter (Q3 2016). The rig count increase was driven by gains in Horizontal Oil (+11), Horizontal Gas (+3) and Directional Gas (+1), while Vertical Oil, Directional Oil and Vertical Gas remained flat. Total horizontal land rig count is 68% down since the peak in November 2014. The Permian currently makes up ~50% of all oil rigs.

U.S. horizontal oil land rigs increased by 11 rigs week/week to 360, driven by gains in the Permian (+9), Eagle Ford (+1), Mississippian (+1) and "Other" (+1), partially offset by declines Woodford (-1) while DJ-Niobrara, Granite Wash and Utica remained flat week/week.

U.S. Gulf of Mexico offshore rig count held flat week/week at 22 and is down 59% since June 2014.

Canadian rig count decreased by 22 rigs week/week and is 25% off the level this time last year.

Royal Dutch Shell Plc announced on October 20th that it had agreed to sell 206k net acres of non-core oil and gas properties in Western Canada to Tourmaline Oil for $1.04 billion in a combination of cash ($758 million) and shares ($279 million). The acreage includes 61,000 net acres in the Gundy area of Northeast British Columbia, Canada, and 145,000 net acres in the Deep Basin area of West Central Alberta, Canada. The assets currently produce 25kboe/d (thousand barrels of oil equivalent per day) and included within the disposal is related infrastructure which includes three gas processing plants (200-225 mcf/d, million cubic feet per day) and 719 km of pipeline. The disposal is in-line with Shell's strategy to right size the portfolio and the $0.8 billion cash inflow is welcome evidence in our view that the group can deliver on its $30 billion disposal target and will help support cash balances in Q4 2016 when the transaction is anticipated to close. Head of Upstream Andy Brown has indicated that it is currently marketing 16 assets that are likely to be valued at over $0.5 billion each. The ability of Shell to deliver on disposals is an important part of the investment case and the key way of reducing debt levels.

Financial Sector

Fifth Third Bancorp reported Q3 2016 Earnings Per Share (EPS) of $0.65. Excluding a $0.22 net positive impact from certain items the company pulled out, EPS was $0.43 and consensus was $0.41. Operating revenues rose 2% year over year (YoY) and increased 1% sequentially. Tangible book rose 2% to $17.22. Its Core Equity Tier 1 capital ratio (fully phased-in) was 10.08%, up 22bps. Its share count declined by 11 million due to the $240 million accelerated share repurchase transaction initially settled on Aug. 5. Average diluted shares declined by 1.0%. Net interest income rose 1% driven by improving investment portfolio yields including an increase in 1-month LIBOR. Average earning assets declined 0.6%. Loans declined 0.4%, while securities decreased 0.8%. Its net interest margin was unchanged at 2.88%. Average deposits were little changed. Fee income declined 1%; investment advisory revenue was unchanged; and corporate banking (-$6 million; decreases in loan syndication and FX fees partially offset by an increase in institutional sales revenue) and card & processing revenue (-$3 million; decline in the number of actively used cards and lower spend volume) declined. Mortgage originations increased 7%, while its gain on sale margin rose 39bps. Operating expenses approximated the prior quarter. Its Non Performing Assets ratio declined 13bps to 0.73%. Its Non Conforming Ratio ratio increased 8bps to 0.45% with increases in commercial (+11bps to 0.45%) and consumer (+4bps to 0.49%). Its loan loss provision declined by $9 million to $80 million, reflecting improving nonperforming loans and criticized assets. Its provision was $27 million less than net charge-offs (added $4 million to reserves in Q2 2016). Its reserve/loan ratio declined 1bp to 1.37%. The reserve allocated to the energy portfolio was 4.95%, down from 5.97% last quarter.

Goldman Sachs Group Inc. (GS) reported Q3 2016 EPS of $4.88, consensus was $3.88. Relative to expectations, trading from both Fixed Income, Currencies and Commodities (FICC) & equities drove the beat, while investment banking fees were a little light. Revenues were $8.17 billion (consensus: $7.36 billion) increased 22% YoY (ex. Debt Value Added (DVA)) and rose 3% sequentially. It noted solid performance across the franchise helped counter typical seasonal weakness. Book value increased 2.6% to $181.25. Its Return On Equity for Q3 2016 was 11.2%. Total assets were $880 billion (-$17 billion). Core liquid assets were $214 billion (+$3 billion) and averaged $218 billion (+$8 billion). Its Core Equity Tier 1 ratios (transitional) were 14.0% (standardized, +30bps) and 12.4% (advanced, +20bps). Its Supplementary Liquidity Ratio (fully phased-in) was 6.3% (+20bps). During the quarter, it repurchased 7.8 million shares at an average cost of $162.83, for a total cost of $1.27 billion. **Investment Banking** - Revenues were $1.5 billion, down 1% YoY and 14% below Q2 2016. **Institutional Client Services** – Revenues were $3.75 billion, up 24% YoY (ex. DVA) and 2% higher than Q2 2016. FICC (ex. DVA) jumped 49% YoY and increased 2% sequentially to $2.0 billion. Relative to Q3 2015, the increase was due to significantly higher revenues in interest rate products and credit products, as well as higher revenues in mortgages. These increases were partially offset by lower net revenues in currencies and commodities. Equities revenues increased 4% YoY and rose 2% from Q2 2016. Compared

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to Q3 2015, client execution (+30%; significantly higher net revenues in derivatives, partially offset by significantly lower net revenues in cash products) and securities services (+2%) increased, while commission & fees declined (-12%; lower volumes). Sequentially, client execution revenues increased (+16%), while securities services (-8%) and commission & fees (-2%) declined. **Investing & Lending** - Revenues were $1.40 billion, up from $1.11 billion in Q2 2016. Revenues from investments in equities increased from $626 million to $920 million (higher global equity prices), while revenues from debt securities & loans declined $7 million to $478 million. **Investment Management** - Revenues were $1.49 billion, up 4% YoY and 10% higher than Q2 2016. **Expenses** – Expenses (ex. legal) rose 19% YoY but declined 2% from Q2 2016, to $5.30 billion. Compensation & benefits expense rose 36% YoY and declined 4% from Q2 2016. Its compensation ratio was for the first nine months of 2016 was 41.0%, compared with 40.0% for the first nine months of 2015. The effective tax rate for the first nine months of 2016 was 26.9%, essentially unchanged compared with 26.8% for 1H 2016. Still, it was 27% in Q3 2016, up from 26% in Q2 2016.

Morgan Stanley reported GAAP EPS of $0.81, well above consensus at $0.63. The beat was largely top-line driven (similar to U.S. peers, FICC was a highlight, partly from the shake-out of weaker rivals like Deutsche Bank); non-compensation expense was also well controlled given continued pay-off from Project Streamline, its efficiency plan. All in, return on equity improved to 8.7% in the quarter - a smidgen under management's 2017 9-11% target in what is typically a seasonally slower quarter. FICC sales and trading revenues better than expected at $1.5 billion, +14% quarter over quarter (QoQ) vs. +4% peer average; expense discipline evident with non compensation expenses of $2.4 billion, 4% lower than expected; the results also showed solid organic growth in Global Wealth Management – fee based flows +$13.5 billion vs. +$12 billion in Q2 2016 and solid pretax margin, at 23.2% - nearly 100bps better than forecast; and finally there was continued progress on Project Streamline - professional services fees of $489 million declined 15% YoY, 11% QoQ.

Standard Chartered Plc reported to benefit from Essar write-back - Bloomberg is suggesting that Essar Global's owners plan to repay the c$2.1 billion owed to Standard Chartered. It's estimated that Standard Chartered's exposure = $3.1 billion: $2.1 billion to be repaid, $0.4 billion to be converted to loan to Essar Ports, $0.6 billion to be written off. Bloomberg suggest the estimated write-back is therefore c$0.1 billion given roughly c$0.7 billion of provision held. If correct, the write-back is an incremental positive versus expectations.

The Toronto-Dominion Bank (TD) announced it will acquire Scottrade Bank, a federal savings bank wholly owned by Scottrade Financial Services Inc. (Scottrade), for cash consideration equal to Scottrade Bank's tangible book value of US$1.3 billion. As of September 30, 2016, Scottrade Bank held approximately US$13 billion in cash and securities, US$4 billion in loans and leases and US$15 billion in sweep deposits from Scottrade. TD expects to recognize US$175 million of goodwill relating to the acquisition of Scottrade Bank. TD Ameritrade also announced an agreement to acquire Scottrade for cash and TD Ameritrade shares. TD intends to concurrently purchase US$400 million in new common equity or approximately 11 million shares from TD Ameritrade. On a pro-forma basis, TD's ownership in TD Ameritrade is expected to be approximately 41.4% (was 42.4% as of July 31, 2016). TD intends to fund the transaction with internal resources and expects its common equity tier 1 (Core Equity Tier 1) ratio to fall by 30 basis points, reflecting both the acquisition of Scottrade Bank and additional investment in shares of TD Ameritrade. TD last reported a CET1 ratio of 10.4% and thus on a pro-forma basis, the transaction would bring its CET1 ratio to 10.1%. TD expects these transactions to be accretive to its earnings in the first full year after closing. TD Ameritrade announced in its press release that it expects the acquisition of Scottrade to be 12-15% accretive to earnings beginning in years 2 and 3. Based on TD's pro-forma ownership of TD Ameritrade and current consensus estimates for TD Ameritrade, Scottrade would equate to $0.03-$0.04 of EPS. The transaction is expected to close concurrent with the closing of TD Ameritrade's acquisition of Scottrade, by September 30, 2017. The unique transaction structure and partnership with TD Ameritrade, in our view, should allow TD and TD Ameritrade to complete the acquisition of both Scottrade and Scottrade Bank in a favorable manner.

Activist Influenced Companies

Restaurant Brands International Inc. (QSR) –The owner of Burger King and Tim Hortons reported a better-than-expected quarterly profit, helped by new menu items and lower costs. Total comparable sales at Burger King rose 1.7% in the quarter ended Sept. 30, mostly due to higher demand in Asia Pacific and Latin America. Total comparable sales at Tim Hortons, which operates mainly in Canada, rose 2% in the quarter, compared with a growth of 5.3% last year. Total costs and expenses for QSR fell 3% to $655.2 million. The company's net profit attributable to shareholders rose to $86.3 million, or 36 cents per share, in the third quarter, from $49.6 million, or 24 cents per share, a year earlier. The company's revenue rose 5.5% to $1.08 billion, ahead of analysts' estimate of $1.06 billion.

Canadian Dividend Payers

Northland Power Inc. has reportedly engaged in an offshore wind project in Taiwan, with partner Enterprize Energy Pte. Ltd. Enterprize Energy announced the launch of the Hai Long Offshore Wind Farm Project, in which it holds a 40% stake through subsidiary Yushan Energy. Several Taiwan-based contractors have also been engaged for the project. Details on the wind park's capacity were not given, but Singapore-based Enterprize Energy said in the press statement that the wind farm will be "an up-scaled, technical evolution" of the 150-MW Ormonde offshore wind farm in the Irish Sea. Northland Power, which holds 60% in Hai Long, also has a 60% equity stake in the 600-MW Gemini wind farm in the Netherlands and an 85% equity stake in

the 332-MW Nordsee One offshore wind project. Malcolm Garrity, Enterprize Energy's CEO, said that Northland brings key experience in offshore wind project financing to Hai Long.

Global Dividend Payers

AT&T Inc. agreed to buy Time Warner Inc. for $85.4 billion, the boldest move yet by a telecommunications company to acquire content to stream over its network to attract a growing number of online viewers. The biggest deal in the world this year will, if approved by regulators, give AT&T control of cable TV channels HBO and CNN, film studio Warner Bros and other coveted media assets. The tie-up will likely face intense scrutiny by U.S. antitrust enforcers worried that AT&T might try to limit distribution of Time Warner material. The two political sides battling over the presidential elections have already expressed their concerns as well. AT&T will pay $107.50 per Time Warner share, half in cash and half in stock, worth $85.4 billion overall, according to a company statement. AT&T said it expected to close the deal by the end of 2017. Dallas-based AT&T said the U.S. Department of Justice would review the deal and that the companies were determining which Federal Communications Commission licenses, if any, would be transferred to AT&T in the deal.

BHP Billiton Plc - Petroleum Output was lower, at 55MMboe (million barrels of oil equivalent) compared with 64.5MMboe in Q1 2016 (a decline of 15%) and 56.0MMboe in the June quarter, albeit actual production beat forecasts. Compared with the September 2015 quarter, onshore U.S. liquids volumes were off 38% and gas volumes down 25%, while conventional liquids volumes fell 8% and gas volumes rose 3%. The overall decline was a function of the focus on profitability onshore U.S., and natural field decline across the conventional portfolio. **Copper** total production was 355,000 tons compared with 413,200 tons in Q4 2016 and 377,300 in last year's September quarter. The key Escondida mine produced 218,000 tons, substantially below estimate. **Iron ore and Coal** production and shipments were 66.7Mt (million tons) and 65.4Mt respectively. This was an increase from the June quarter production of 64.5Mt and 64.6Mt respectively. BHP Billiton is currently leaving its production guidance for the full year unchanged i.e petroleum at 200-210MMboe, copper at 1.66Mt (subject to the review at Olympic Dam), iron ore at 228-237Mt, metallurgical coal at 44Mt and energy coal at 30Mt.

GEA Group AG last week warned that Q3 2016 Earnings Before Interest Tax Depreciation and Amortization (EBITDA) would be €113 million versus forecasts of €171 million which is 33% below. Q3 2016 revenues were also pre-announced at €1,100 which was -1.8% on an organic basis and -11% versus expectations. Preliminary orders for Q3 were €1,084 million, also -10% below consensus. 2016 sales guidance was also cut to a moderate sales decline (from moderate increase), and operating EBITDA of around €560 million ex acquisitions vs. €645 million - €715 million previously. The new guidance is -17% below the mid-point and about -20% below consensus for 2016. The key drivers of the lower result and 2016 guidance were **1)** cost over-runs in large projects and additional provisions on these, **2)** slower execution of dairy processing projects driven by customers which also materially impacted operating EBITDA given operational leverage and **3)** decline in dairy farming demand which impacted both orders and revenues. We believe we should treat the cost over-runs this year as broadly one-off and will also give GEA some credit for re-capturing some of the growth decline in 2017 as part of this is related to customers pushing out (but not cancelling) deliveries on contracts. We believe this will lessen the consensus downgrades for 2017 vs. 2016. But the profit warning did come as a material surprise and particularly since none of these issues were flagged at its presentations on October 5th where the CEO stated GEA were confident on order trends.

Johnson & Johnson reported a better-than-expected quarterly profit and said its phamaceutical business will keep prospering despite the threatened launch of a competitor for its blockbuster Remicade arthritis drug. Its pharmaceutical sales jumped 9.2% to $8.40 billion, with strong growth for its Imbruvica and Darzalex cancer drugs and its blood thinner Xarelto. U.S. sales of Remicade jumped 9.4% to $1.22 billion. Global medical device sales rose 1.1% to $6.16 billion in the quarter, while consumer product sales fell 1.6% to $3.26 billion. J&J raised the lower end of its full-year 2016 profit forecast to $6.68 per share, from $6.63 a share. It retained the upper end at $6.73 per share. The company's net earnings rose to $4.27 billion, or $1.53 per share, in the third quarter, from $3.36 billion, or $1.20 per share, a year earlier. Excluding special items, J&J earned $1.68 per share.

Roche Holding AG reported group sales in line with consensus. Pharma Product Sales: Q3 2016 Pharma sales of South African Rand (SFR) 9,680 million were -1.5% below consensus expectations. A number of major product sales were light, with Rituxan 4%/5% below consensus and Avastin 6%/6% below consensus due to declines in the mature US market only partially offset by growth in International and Europe. Herceptin was in line with consensus expectations while Perjeta saw a weaker quarter coming in 3%/5% below consensus Tecentriq, which was approved in bladder in Q2 (and in lung last week) saw sales of SFR 58 million. Diagnostic sales of SFR 2,803 million were 2% above consensus expectations. Roche noted that Professional Diagnostics was the largest contributor to sales growth of 8%cc, led by Asia-Pacific. Diabetes care sales reversed having fallen -4% in 1st Half 2016 to see positive growth of 2% in Q3. Foreign exchange currency benefited sales by 1%. 2016 guidance was reiterated: Group sales growth low- to mid-single digit; Group Core EPS growth ahead of sales and Dividend to increase.

South32 Limited delivered a reasonable Q1 production release in our view with most of the key assets delivering production broadly in-line with estimates. The exception was Illawarra where the Appin mine struggled with challenging ground conditions (as reported in various press articles during the period) – as a result, production guidance for met coal was lowered by 7.4% (partially offset by

Illawarra energy coal) with the resultant impact on unit costs an increase of $4/ton to $75/ton in 1st half while 2nd half unit costs should revert to the original full year guidance of $71/ton. All other production, unit cost and capex guidance remain unchanged. Management did highlight the capex guidance is predicated on an AUD foreign exchange rate of 0.72 and South African Rand of 16.57 – still early days, but capex could be a touch higher if these spot foreign exchange rates persist. Nonetheless, the net cash balance at the end of the period stood at $551 million up $239 million from the $312 million balance at the end of June – this implies an annualized free cash flow yield of 9%. Given the rally in coking coal, manganese and alumina only really started accelerating from mid-August and the lagged sales contract structures for coal, we would anticipate even higher free cash flow figures coming through in next quarter and even more so in 2nd half .

U.S. existing home sales jumped 3.2% in September, the first improvement in three months and well above expectations of a mild increase. And, at 5.47 million units annualized, is the highest since June. Also, the good news was not based solely on the headline. The details were also very encouraging. All four corners of America saw an increase in September. First-time homebuyers saw their share of sales rise to 34%, the highest since 2012 and worth remembering that during a healthy market, first-timers have historically account for 40%-to-45%. So more improvement is needed. Sales of distressed homes, fell to 4%, the lowest since at least 2010. The number of homes available for sale rose for the first time since May, but it remains a tight market, which is good for sellers, not so much for buyers. The **months' supply** slipped to 4.5, the lowest since early this year. As such, prices increased 5½% from a year ago.

U.S. consumer prices rose 0.3% in September, as expected and the biggest monthly move since the spring. Higher costs for **gasoline** and **housing fuels/utilities** drove the headline, which lifted the index 2.6% above levels six months ago (annualized), the fastest pace since February 2013, or 1.5% above year-ago levels. So does this mean inflation is back, and the Fed should be on full alert? Not quite. Not yet in our view. When stripping out food & energy, core inflation only inched up 0.1%, the 2nd smallest rise in seven months (2.2% above a year ago, in line with the average over the past year), as a 0.7% drop in clothing costs weighed, along with lower prices for new and used vehicles, recreation, and education & communication.

UK inflation rises 1%. Rising prices for clothes, hotel rooms and petrol have led to the highest rate of inflation in nearly two years, official figures show. Inflation rose to 1.0% in September, up from 0.6% in August, the Office for National Statistics (ONS) said. Clothing saw its biggest price rise since 2010 and fuel, which was falling a year ago, was also more expensive. However, the ONS said there was "no explicit evidence" the weaker pound was the reason for higher prices. (Source: BBC)

The UK jobless rate held steady at a near 11-year low of 4.9% in the three months to August, figures show. Unemployment saw a "small" rise of 10,000 to 1.66 million, the Office for National Statistics (ONS) said. "These figures show that employment continued to grow over the summer and vacancies remain at high levels, suggesting continuing confidence in the economy," the ONS said. Average weekly earnings grew by 2.3%, a slight fall from the previous month. Businesses cautiously welcomed the employment figures, but said more was needed to help boost workers' pay as inflation starts to rise. (Source: BBC)

Brexit - Britain could slash corporation tax to 10% if the European Union refuses to agree a post-Brexit free trade deal or blocks UK-based banks from accessing its market, the Sunday Times reported. Separately, big international banks are preparing to move some of their operations out of Britain in early 2017 due to the uncertainty over the country's future relationship with the European Union. (Source: BBC)

Italy - Fitch affirms Italy sovereign rating at BBB+ but cut its outlook to negative from stable, saying weak growth, high debt and the uncertain outcome of a planned referendum posed risks to the euro zone's third-largest economy. Separately, Italy could receive a warning letter from the European Commission as early as today asking for clarifications over its 2017 budget plan, several newspapers said on Sunday.

France – Standard & Poor's raised its outlook on France's "AA" long-term sovereign credit rating to "stable" from "negative", citing labour and tax reforms introduced in the last two years, in a boost to President Francois Hollande's Socialist government.

Spain - A new Spanish government will be formed by the end of next week. The main opposition party, the socialists (PSOE), have decided to abstain in the upcoming vote for Prime Minister. This will allow the conservative party (PP) to form a minority government.

Ireland - Less than two months after the European Union ordered Ireland to claw back a record €13 billion from Apple Inc., saying the nation illegally allowed the iPhone maker to reduce its tax rate, the European Commission will propose legislation for a Common Consolidated Corporate Tax Base on Oct. 25. A 2011 initiative failed to muster the unanimity needed largely because of opposition by Ireland and the U.K. With Britain preparing to quit the 28-nation bloc, the fresh Common Consolidated Tax Base CCCTB proposal risks leaving Ireland politically isolated when national governments start getting their teeth back into the nitty-gritty. The U.K. and Ireland have opposed a common EU tax base for fear it would open the door to a harmonization of rates, which both countries say must remain their sovereign right to decide.

Our views on economic and other events and their expected impact on investments. October 24, 2016

Financial Conditions

European Central Bank announced last week that it would keep monetary policy unchanged: the **refi rate** will remain at 0.00%, the **deposit rate** at -0.4%, the **marginal lending facility** at 0.25%, and the €80 billion of **monthly asset purchases** will continue to run until the end of March 2017, "*or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation.*" The Governing Council expects rates to remain where they are now, or lower, "*for an extended period of time, and well past the horizon of asset purchases*". And, they will "*continue to act, if warranted, by using all the instruments available within our mandate*".

The U.S. 2 year/10 year treasury spread is now .91% and the U.K.'s 2 year/10 year treasury spread is .83% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.52% (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 4.3 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 finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 12.97 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

Mutual Funds

Portland Investment Counsel Inc. currently offers 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund
- Portland Global Aristocrats Plus Fund

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