News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. November 11, 2016

Energy Sector

U.S. oil drillers increased rigs this week for a 21st week in the last 24, as energy firms follow through on plans to add rigs made months ago when crude was still trading over the key $50 a barrel level. Drillers added two oil rigs in the week to Nov. 11, bringing the total count up to 452, the most since February, but still below the 574 rigs seen a year ago, according to Baker Hughes. Since crude topped $50 a barrel in May, June and October, drillers have added 136 oil rigs, its biggest recovery in over two years since prices collapsed due to a global oil glut.

The Baker Hughes oil rig count plunged from a record 1,609 in October 2014 to a six-year low of 316 in May as U.S. crude collapsed from over $107 a barrel in June 2014 to near $26 in February 2016.

Cardinal Energy Ltd. reported results which were slightly ahead of the expectations for its third quarter. Cardinal achieved record average production of 14,957 boed (barrels of oil per day), 87% oil and natural gas liquids (NGLs), an increase of 33% or 5% per weighted average share compared to the third quarter of 2015. Operating expenses per boe for the third quarter decreased to $19.96/boe from $20.23/boe in the second quarter of 2016. Cash flow from operations increased 7% to $18.2 million from the second quarter of 2016 and netback was $15.81/boe including realized hedging gains of $1.74/boe. The third quarter of 2016 marked the 7th consecutive quarter of Cardinal maintaining a sustainable growth capital program in response to lower commodity prices. The company expects to achieve average production for Q4 of approximately 15,000 boed. Its less than 15% production decline rate enables Cardinal to weather periods of low commodity pricing with minimum capital spending. Subsequent to quarter end, Cardinal completed its semi-annual borrowing base review and in spite of the continued depressed commodity price environment its borrowing base has continued to be held constant at $250 million. Cardinal is in a strong financial position and at quarter end had net bank debt of $35.1 million and Q3 2016 net debt to cash flow from operations of 1.2 X (including $50 million principal amount of convertible debentures). Cardinal expects to release its 2017 guidance in early December when it hopes to have more clarity on oil pricing for next year. The company has approximately 46% of its current oil production hedged at an average price of C$62.88/bbl for 2017. This hedging level would allow Cardinal to maintain its dividend at the current rate and to go through another year with a maintenance type of capital spending budget showing low single digit growth. Cardinal expects that if there is transparency to an oil price above US$50 West Texas Intermediate (WTI) that it will be able to present guidance showing double digit growth for 2017.

Crescent Point Energy Corp. (CPG) reported an in-line set of Q3 results, however market reacted negatively addition to the lack of clarity on the 2017 average production outlook. On a 2017 year exit production basis (at 175,000 to 177,000 boed) the company expects 5% to 8% growth. CPG indicated its 2017 budget will be finalized late Q4 or early 2017. Highlights from the announcement and the conference call are presented below. Q3 average production was 160,610 boed, marginally ahead of the company's budget. CPG generated $368.1 million ($0.72/share) of funds flow from operations (FFO), in-line with the expectations. Operating netback was C$29.27 (including hedge gains) on realized average selling prices of $43.71. The company is very excited with its drilling program at Flat Lake, where CPG has been building land positions for a couple of years. It expects now that about 22% of its capital for the year would be spent at Flat Lake, where netbacks are currently 24% higher than the corporate average. CPG's delineation program there is progressing very well. Similarly, delineation work at the company's Uinta (Utah) land is progressing very well with the company's recent wells in the Caste Peak zone being some of the most productive in the company's history. There are 6 unique zones that CPG is exploring at Uinta. New, low cost ($100k per well) proprietary waterflood technology has been delivering good results with production doubling at offsetting producer wells in 6 months (from 1 year previously). Capital costs have continued to come down in the quarter, 12% lower since the end of 2015, in addition to the 30% reduction over the course of 2015. CPG maintains $1.9 billion of available liquidity and exited the quarter with $3.6 billion of net debt (2.2x trailing FFO). CPG pegs the basic payout ratio at 13% and all-in payout at 101%. CPG has currently about 25% of its 2017 production hedged at about C$70/bbl.

Financial Sector

Donald Trump's victory this week creates numerous opportunities and potentially risk for financial stocks but which remain unclear at this stage. The opportunities come primarily from a steepening yield curve, increased volatility and reduced regulation (diluting Dodd-Frank framework). The risks come from a retrenchment of the U.S. from the global economy and trade agreements. The near-term benefits are clearer and more immediate than the risks. Since the Great Recession, banks across the U.S., U.K., Scandinavia and Switzerland carry multiples more capital strength but that strength has been undermined by the quantum of regulation and fines. The Dodd-Frank regulation crimped the earnings capacity of the larger banks and at least in Donald Trump's language was a 'very negative force' that stopped banks 'loaning money to people that need it' .... In his victory speech the clearest call is to rebuild America's crumbling infrastructure which will require considerable amounts of capital raising and capital....the very essence of what Goldman Sachs, JPMorgan Chase & Co. and Bank of America Corporation are all about.

JPMorgan - Message from Jamie Dimon, JPMorgan's CEO to colleagues:

Dear colleagues, we are going through a period of profound political and economic change around the world, and American citizens showed that deep desire for change in voting to elect Donald Trump as the 45th President of the United States. We have heard through democratic processes in both Europe and the United States the frustration that so many people have with the lack of economic opportunity and the challenges they face. We need to listen to those voices. We have just been through one of the most contentious elections in memory, which can make it even harder to put our differences aside. But that makes it more important than ever to bind the wounds of our nation and to bring together Americans from all walks of life. Recognizing that our diversity is a core strength of our nation, we must all come together as fellow patriots to solve our most serious challenges. Leaders from across the public, private and nonprofit sectors need to collaborate to find meaningful solutions that create economic growth and greater opportunity for all. America is best when we come together with clear leadership, expertise and the political will to take on difficult challenges and get things done. No one should ever doubt the strength and resilience of our country and our democracy. JPMorgan Chase has a proud history of supporting our communities and our countries. Through your outstanding efforts, we have built a great company that will continue to thrive — as we continue to focus on helping to serve our clients and communities. We will also continue to help address the important public policy issues of the day and the underlying economic challenges throughout the world. I'm optimistic about America's future and the role our company will continue to play as we help the nation address our challenges and move forward together. Jamie

Brookfield Asset Management Inc. reported third quarter results which were broadly in-line with the expectations. Net income for the third quarter of 2016 was $2.0 billion or $1.03 per share, and was $4.4 billion on a last twelve month basis. Net income increased over the same quarter of the prior year due to earnings on new investments, a reduction in deferred tax provisions and operational improvements, which included rent commencements on new leases, the commissioning of assets in Brookfield's infrastructure business and increased pricing and volumes in certain of its private equity operations. FFO for the third quarter of 2016 was $883 million or $0.87 per share, and was $3.2 billion on a last twelve month basis. Fee related earnings for the quarter increased 37% to $173 million, as a result of the 23% increase in fee bearing capital over the last twelve months. FFO from invested capital increased by 17% as a result of the contribution from acquisitions across Brookfield's portfolio and operating improvements, partially offset by the absence of FFO from assets sold. Brookfield sold interests in office and retail properties, generating $392 million of disposition gains, compared to $88 million in the prior period.

Royal Bank of Scotland Group Plc (RBS) has released an announcement updating on the investigation in to the, now defunct, Global Restructuring group (GRG) and its treatment of about 12,000 small & medium enterprises (SMEs) during 2008-2013. The automatic refund for complex fees charged to SMEs in GRG – is now expected to be a £400m charge in Q4 2016. New complaints procedure will also be put in place. The review on RBS' treatment is ongoing however they have released a statement as well. It finds that there were areas of poor practice from RBS, the group did not set out to artificially engineer a transfer to GRG. It does highlight that there are a number of areas of inappropriate treatment, mainly around communication and following procedures. RBS are therefore admitting fault in some areas and the fine is higher than earlier estimated. But the bank rejected allegations that it tried to profit from its customers' distress. Many of GRG's top managers have left and it has been folded into other parts of the bank. (Source: Financial Times)

Standard Chartered Plc - will seek to exit 70% of its private-equity investments within 18 months as Chief Executive Officer Bill Winters reduces risk, people familiar with the matter said, Bloomberg reports.

Activist Influenced Companies

Hertz Global Holdings Inc. – slashed its full-year profit forecast as the car rental company expects to take a hit from higher vehicle depreciation. The company, which operates its fleet under brands such as Hertz, Dollar and Thrifty, forecast adjusted profit of $0.51-$0.88 per share for the year, compared with its earlier estimate of $2.75-$3.50 per share. Revenue from the company's U.S. car rental business, which is also its biggest, fell 1.9% to $1.71 billion for the third quarter ended Sept. 30. Hertz's net income from continuing operations fell 79.7% to $44 million, or 52 cents per share, from a year earlier. "A customary vehicle depreciation rate review near the close of the third quarter resulted in a substantial depreciation adjustment, particularly on compact and mid-sized vehicles," Chief Executive John Tague said in a statement. Tague said he expected more adjustments in the current quarter. The company's revenue fell 1.3% to $2.54 billion, while total expenses rose 5% to $2.43 billion. Excluding items, the company earned $1.58 per share for the quarter. Analysts on average were expecting an adjusted profit of $2.73 per share and revenue of $2.59 billion, according to Thomson Reuters.

Canadian Dividend Payers

Northland Power Inc. reported third quarter results which slightly exceeded expectations, driven by the addition of pre-completion revenues at the company's Dutch offshore Gemini operations and its related subsidy streams. Sales and gross profit increased by 42% and 59%, respectively, over the same quarter in 2015 primarily due to pre-completion revenues earned from Gemini, additional contributions from the Grand Bend wind farm which reached commercial operations in April 2016, and the completion of additional ground-mounted solar facilities. Adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) increased by 19% over the same period in 2015 to $141.9 million. Construction at Gemini continues to progress with the project remaining on time and within budget. All 150 wind turbines have been installed, are producing power and are earning pre-completion revenues. Commissioning of the wind turbines will continue throughout 2016 and into early 2017 with full commercial operations expected by mid 2017. Nordsee One, a 332 MW German offshore wind farm, is also progressing on time and within budget. All 54 foundation monopiles and transition pieces, as well as the offshore substation and infield cables have been successfully installed. Production of the wind turbines is ongoing, with installation expected to commence in early 2017. Full commercial operations continue to be expected by the end of 2017.

Global Dividend Payers

Pattern Energy Group Inc. reported cash available for distribution (CAFD) of $20.2 million for its third quarter and is on track to meet full year guidance. During the quarter, Pattern sold 1,472 GWh (on proportional basis), up 17%. Net cash provided by operating activities was $36.4 million. Pattern declared a fourth quarter dividend of $0.408 per Class A common share or $1.632 on an annualized basis, subsequent to the end of the period, representing a 2.0% increase over the previous quarter's dividend and its eleventh consecutive dividend increase. Pattern added 90 MW in owned capacity with the acquisition of the Armow Wind project (Armow), located in Ontario, from Pattern Energy Group LP (Pattern Development), subsequent to the end of the period, which brings the total portfolio owned capacity to 2,644 MW, including the Broadview Wind projects (Broadview) which Pattern Energy has agreed to acquire.

Economic Conditions

U.S. Election - Defying polls, political pundits and predictive election models, Donald Trump will be the 45th President of the United States, winning both the national vote (narrowly) and, more importantly, the electoral college system, while the Republicans retained both the House and the Senate. Republican Donald Trump won with 289 electoral votes to Democrat Hillary Clinton's 218. Republicans retain/increase control of the House (236-191) and gain slight majority in Senate with 51 seats.

Canada – Canadian housing starts retreated more than expected in October, to 192,900 units annualized from 219,400 units annualized in September, with both single and multi-units pulling back during the month. Housing starts cooled off in British Columbia, but continued to be strong in Ontario, driven by multi-units new build. Building permits, meanwhile, retreated 7.0% in September, which was worse than the expected 5.6% pull-back and partly offsets the 11.0% advance in August.

British house prices surged unexpectedly in October, countering signs of a broad slowdown in the housing market over the last six months, a survey from mortgage lender Halifax showed on Monday. House prices shot up 1.4% in October compared with an upwardly revised 0.3% increase in September. Economists polled by Reuters had expected only a 0.2% rise. In the three months to October, house prices were 5.2% higher compared with the same period a year ago - again stronger than the Reuters poll consensus that pointed to a 4.8% rise. (Source: Reuters)

The U.K. Report on jobs – a survey of recruitment consultants – provided further evidence that U.K. employers have shrugged off the initial shock of the U.K. referendum result with job vacancies now at levels not seen since April. Demand for staff continued to rise in October and is now at its highest level since May. Permanent placements have reached their eight-month high with temporary billings growth also reaching its highest level in five months. For the first time since March, growth in permanent vacancies has been greater than in temporary staff, with the demand for both seeing an increase vs. the previous month. Permanent salaries continued to rise, at a quicker pace than the growth seen in September and its quickest since May. We now expect a more moderate impact on U.K. staffing markets but believe business confidence remains vulnerable whilst the U.K. is negotiating its new relationship with the EU.

The U.K. trade deficit widened to £5.2 billion in September from £3.8 billion in August, the Office for National Statistics (ONS) said. Exports decreased by £0.2 billion, while imports increased by £1.2 billion. The widening between imports and exports was in part driven by a record £8.7 billion deficit with the EU. Although the pound fell sharply after the Brexit vote, the ONS said there was little direct evidence so far of currency effects on trade. (Source: BBC)

Financial Conditions

Reserve Bank of New Zealand (RBNZ) cut rates 25 basis points as expected and dropped the easing bias, signaling an end to the easing cycle. The statement was more hawkish and the RBNZ upgraded its growth forecasts to 3.7% (3.4% previously) for 2017 and 3.6% for 2018.

The U.S. 2 year/10 year treasury spread is now 1.23% and the U.K.'s 2 year/10 year treasury spread is 1.13% - 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 3.57% (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 4.8 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 15.35 (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

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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