News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. February 6, 2017

The views of the Portfolio Management Team contained in this report are as of February 6, 2017 and this report is not intended to provide legal, accounting, tax or specific investment advice. Views, portfolio holdings and allocations may have changed subsequent to this date. This research and information, including any opinion, is compiled from various sources believed to be reliable but it cannot be guaranteed to be current accurate or complete. It is for information only, and is subject to change without notice. The contents of this Newsletter reflect the different assumptions, views and analytical methods of the analysts who prepared them.

Energy Sector

U.S. land rig count increased by 16 rigs week/week to 705 rigs, breaking the 700 mark for the first time since the end of 2015, and is up 71 rigs in the last three weeks, which is the largest three-week gain on record (Baker Hughes Inc. (BHI) started recording land rig count beginning in 2011). The rig count is up on average 27% Quarter to Date quarter/quarter. Gains in Horizontal Oil (+16), Directional Oil (+4), Horizontal Gas (+1) were slightly offset by declines in Vertical Oil (-4) and Vertical Gas (-1), while Directional Gas remained flat week/week. Total horizontal land rig count is down 57% since the peak in November 2014. The Permian currently makes up 52% of all oil rigs.

U.S. horizontal oil land rigs increased by 16 rigs week/week to 479, now up 51 rigs in the last three weeks, which is the largest three-week gain since December 2011, as gains in the Permian (+8), now up 30 rigs over the last three weeks, which is a record (BHI basin level data dates back to 2011), Woodford (+9), now up 19 rigs over the last three weeks (another record), Eagle Ford (+2), "Other" (+2), and DJ-Niobrara (+1), were partially offset by declines in Granite Wash (-2) and Williston (-1), while Mississippian remained flat week/week.

Canadian rig count decreased by 3 rigs week/week and is up 43% from the level this time last year.

U.S. Gulf of Mexico offshore rig count increased by 1 rig week/week to 21 and is down 61% since June 2014.

Royal Dutch Shell Group PLC having announced approx. $5.5 billion of divestments in 2016, Shell has already announced deals so far in 2017 that could amount to $5.5 billion including contingent payments, taking total divestments to $11 billion out of the planned $30 billion programme and is essentially back on track in our view. Following the announcement that it is to sell its 50% share in the SADAF petrochemical Joint Venture earlier in January, Shell has today announced that it is to sell its 22% interest in the Bongkot field in Thailand and surrounding acreage for $900 million and the sell down of its UK North Sea assets for an initial $3 billion and payments of up to $0.8 billion contingent on the future oil price and future discoveries. In contrast to most of the previous divestments, the two just announced are significant in that these are major upstream transactions, highlighting that the environment has improved enough to get deals done.

Financial Sector

Brookfield Property Partners L.P. (BPY) reported funds from operations (FFO) per diluted unit of $0.38, up 10% from $0.34 in the year-ago period, essentially above consensus of $0.35. For the full year 2016, FFO per unit was $1.36, up 15% from $1.18 in the prior year. The strong growth was led by increased fee revenue from a development fee earned in the London office portfolio, healthy internal growth across the core office and retail platforms, and contributions from acquisitions completed in the opportunistic platform. Partially offsetting was the large volume of asset sales, the impact of foreign exchange, as well as downtime at a number of hotels primarily due to renovations. Management of BPY targets a 5-8% annual increase in the distribution, and along with reporting year-end results, announced a 5.4% increase in its quarterly distribution to $0.295 per unit or $1.18 per unit on an annualized basis. The new distribution equates to a current yield of 5.2% and a 116% payout ratio on our 2018 adjusted FFO estimate. Management noted that, with the payout ratio approaching 80% of FFO, future distribution increases will be at a similar rate as cash flow growth. The reported IFRS NAV was essentially unchanged at $30.72 per unit at quarter-end Q4 2016, compared to $30.98 at Q3 2016. Asset sales continue to occur at, or above, NAV, which in our view provides evidence that the IFRS NAV is realistic. BPY's units currently trade at a 27% discount to IFRS NAV. During Q4 2016, BPY repurchased 1.6 million units at an average price of US$21.30 per unit, for a total investment of $34 million. For the full year 2016, BPY has invested $59 million to repurchase 2.8 million units at an average price of US$21.35 per unit. We expect this to continue through 2017. We expect BPY's NAV to rise over the next few years as development projects are completed and as Net Operating Income rises from increasing rental rates to market. In addition, BPY continues to recycle capital and acquire properties opportunistically, where management expects to achieve outsized returns.

Citigroup Inc. announced plans to exit its U.S. mortgage servicing operations via the sale of a portion of its servicing/servicing rights to New Residential Mortgage and the transfer of the remainder to Cenlar FSB. Citi's exit from U.S. mortgage servicing is expected to be complete in 2018; the bank will take a ~$400mn pretax charge in Q1 2017; the anticipated benefit of lower expenses is expected to begin to accrue in 2018. Two potential near term offsets to the $400 million charge… (1) potential gains on sales related to the $9bn in asset sales in contract to close in 2017, including consumer banking businesses in Brazil and Argentina, CitiFinancial Canada, and (2) additional freed up capital related to the MSR ($1.5 billion at year end 2016). The $400 million pretax charge (including loss on sale and transaction costs) would translate to about an $0.09 per share in net earnings per share (EPS) in Q1 2017; otherwise, these transactions are expected to have a minimal impact on operating revenues in 2017.

ING Groep NV, the largest Dutch lender, said profit jumped 68%, more than analysts expected, as wholesale lending revenue rose while costs and bad-loan provisions fell. Underlying profit rose to €1.38 billion ($1.49 billion) in the fourth quarter from €822 million in the previous year, the Amsterdam-based bank said in a statement Thursday. That beat the €1.15 billion average estimate of six analysts surveyed by Bloomberg. Wholesale banking, which includes trading and lending to large firms, generated €553 million, almost twice last year's result. Within wholesale banking, ING's capital-markets and treasury-management businesses benefited from "increased client activity" especially in equities, foreign-exchange and debt trading. Revenues from corporate lending rose 15% from a year ago as bad-loan provisions at the business fell to €2 million from €63 million, the bank said. (Source: Bloomberg)

Activist Influenced Companies

The Bank of Nova Scotia said it would spend C$1.3 billion over the next three years on technology that will benefit customers as well as lower operating costs and increase profits. The bank is investing in new digital technologies in response to customers transacting far less in branches and using mobile banking apps much more. It had already announced plans to cut 5% of branches in the next two years. That will support investment in projects such as new facilities set up to develop technology like blockchain and artificial intelligence. The bank, which has the biggest international presence of Canada's major lenders, said 45% of the new digital investment will be in Mexico, Peru, Colombia and Chile, which it has identified as its most important overseas markets. Scotiabank said it had set medium-term targets for at least seven out of 10 of its customers to bank online, at least 50% of products to be sold online and less than 10% of transactions to take place in branches. The bank said last year a cost efficiency program would deliver a 200-250 basis point improvement in its productivity ratio by 2019. It now says the changes are expected to result in an additional 100 basis point improvement beyond 2019. The bank's medium targets are for annual earnings per share growth of 5% to 10% and a return on equity of over 14%.

Brookfield Business Partners L.P. released its financial results for the year ended Dec. 31, 2016. The company reported a net loss attributable to unitholders for the year ended Dec. 31, 2016, of $29 million primarily due to impairments taken within the company's energy and other industrials segments related to repositioning of businesses within these segments. The company generated FFO totalling $200 million for the year compared with $264 million in 2015. The company's 2015 FFO benefited from a $40 million realized gain on the disposition of a portion of the company's facilities management business and 2016 results include certain corporate expenses for the period after spin-off which are not included in the 2015 results. In addition, company FFO in 2016 was impacted by weakened commodity pricing at the company's Canadian energy operations and a negative contribution from the company's graphite electrode operation as the company repositions that business. "This has been a successful first year for Brookfield Business Partners as we completed a number of strategic initiatives in order to position our business to create long-term value," said Cyrus Madon, chief executive officer of Brookfield Business Partners. "We believe Brookfield Business Partners is well positioned for growth as we continue to expand our operating platforms and global footprint. We are acquiring high-quality businesses at attractive valuations, advancing sales initiatives for mature businesses and enhancing our operations. In addition, we raised additional equity, increasing our flexibility to take advantage of attractive investment opportunities."

Pershing Square Holdings, Ltd. – Billionaire investor William Ackman's Pershing Square Capital Management has raised its stake in snack maker Mondelez International Inc. to 6.4%. The hedge fund previously had a 5.6% percent stake in the maker of Oreo cookies, Trident gum and Milka chocolate. Mondelez, one of Ackman's bigger investments, cost Pershing Square 1.4% in returns last year. Ackman revealed in 2015 that Pershing Square had built a stake worth about $5.5 billion in Mondelez, in what was seen as an attempt to push the company to boost earnings or sell itself.

Canadian Dividend Payers

BCE Inc. reported a slightly smaller-than-expected quarterly profit as it paid more to win wireless customers and forecast a 2017 profit below the consensus expectations. The company forecast adjusted earnings of C$3.42–C$3.52 per share for the year, lower than analysts' average estimate of C$3.62, according to Thomson Reuters. BCE said its outlook counted a 7 cent per share weight from regulatory rulings that include forcing it to lower wholesale internet rates it can charge rivals and stopping it from substituting Canadian ads into the broadcasts of U.S. networks during Sunday's Super Bowl. The company said likely free cash flow growth of between 3% and 7% in 2017 gave it confidence to raise its dividend by 5.1% to C$2.87. The company said it added 112,393 net postpaid wireless customers, up from 91,308 a year earlier. However, its cost of acquisitions rose 3% to C$541 per subscriber, partly because a weak Canadian dollar pushed up handset costs. Its media unit, which is in the process of cutting jobs in a restructuring, posted revenue of C$845 million, up 3.6% from a year earlier. Bell's net income attributable to shareholders rose 32.5% to C$657 million, or 75 Canadian cents per share. On an adjusted basis, BCE earned 76 Canadian cents per share, missing the average analyst estimate of 78 cents. Operating revenue rose 1.8 percent to C$5.70 billion, beating estimates of C$5.68 billion.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

Global Dividend Payers

Roche Holding AG reported full year 2016 sales of South African Rand (SFR) 50,576 million, in line with consensus. Both Pharma and Diagnostic sales were in line with expectations at full year. The majority of product sales were broadly as expected, though Gazyva was 5% below and Esbriet was 4% below consensus expectations. Core Group operating profit of SFR 18,420 million was 1% below consensus. At the profit level, Diagnostics missed consensus expectations by 6% while Pharma was broadly in line. Accordingly, EPS core was 1% light versus consensus. Roche declared a dividend of SFR 8.20, in line with expectations. 2017 Guidance of Group sales growth low- to mid-single digit and CORE EPS growth in line with sales is broadly in line with current expectations.

Syngenta AG - European Union antitrust regulators have extended the deadline for a decision on ChemChina's (China National Chemical Corporation) proposed buy of Swiss pesticides and seeds group Syngenta by 10 working days to April 12. Syngenta said in a statement the two companies had asked for the extension to allow "sufficient time for the discussion of remedy proposals". The European Commission opened an in-depth investigation into state-owned ChemChina's $43 billion bid in October, saying the companies had not allayed concerns over the deal. The Commission's website showed the deadline had been extended by 10 days on Tuesday. "ChemChina and Syngenta remain fully committed to the transaction and are confident of its closure," the Swiss company said. (Source:Reuters)

Economic Conditions

U.S. Nonfarm payrolls rose 227,000 in January, well above expectations, though net revisions the prior two months were -39,000. The three-month average of 183,000 is just a snick below last year's pace of 187,000. Job gains were spread among all key industries, outside of a decline in state and local government positions. Aggregate works hours rose for a second straight month, and the average duration of employment fell further. However, a soft household survey jobs print (-30k, though all in part-time as full-time positions actually jumped 457,000, and bad weather may have impacted the household survey notably manufacturing), coupled with a two-tenths bounce in the participation rate, **lifted the unemployment rate to 4.8%**. The more comprehensive U6 measure (which includes marginally attached and involuntary part-time workers) also rose to a three-month high of 9.4%. Despite rising minimum wages in many states, average hourly earnings barely budged, with a 0.1% monthly advance carving the yearly rate to 2.5% from 2.8%. Looks like there is still some slack in the labour market despite growing reports of worker shortages.

The Eurozone's economy is showing signs of recovery after the latest data pointed to a fall in unemployment while growth and inflation picked up. Rising energy prices pushed inflation to 1.8% in January, a near four-year high and up from 1.1% in December. Eurostat data also showed the jobless rate fell to 9.6% in December, the lowest rate since May 2009. GDP growth edged up to 0.5% in the final three months of 2016, up from 0.4% in the previous quarter. (Source: BBC)

U.K. house prices inched up in November, growing again after falling flat for the first time in 15 months, according to Nationwide. Month-on-month house prices rose 0.1% last month, in line with expectations and improving from the flat reading in October, said Nationwide. Compared to the same month last year, house prices were up 4.4%, slightly below the 4.6% forecast by economists ahead of the release – marking the weakest pace since January. The index shows that Britain's house price growth has slowed appreciably in the last three months, falling back from the 0.6% climb hit in August. October's flat reading was the first month without growth since June 2015. (Source: Financial Times)

Financial Conditions

The Bank of England's (BoE) rate-setting Monetary Policy Committee (MPC) decided to keep interest rates at the historically low 0.25%. It also maintained the current level of bonds it purchases at GBP435bn. There was a 9-0 vote for keeping rates unchanged, and the MPC still considered that the current monetary policy remained appropriate. The Bank ratcheted growth expectations quite a bit higher, expecting the economy to grow 2.2% in 2016, compared with an early estimate from the statistics office of 2.0%. The economy is then expected to grow 2.0% in 2017, 1.6% in 2018 and 1.7% in 2019. That compares with November forecasts of 1.4%, 1.5% and 1.6%, respectively. But at the same time, the BoE moderated inflation forecasts lower – 2.0% this quarter, 2.7% in early 2018 and 2.6% in early 2019. That compares with November forecasts of 1.8%, 2.8% and 2.6%, respectively. Unemployment forecasts were revised down, expected to be 4.9% this quarter, 5.0% in early 2018 and 5.0% in early 2019. That compares with November forecasts of 5.0%, 5.5% and 5.6%, respectively.

The Bank of Japan (BOJ) started the New Year the same way it ended 2016 as the central bank kept its monetary policy unchanged in its first monetary policy meeting (MPM) decision of 2017 (Jan 31). The Bank of Japan left rates unchanged at -0.1% for the overnight benchmark and 0% for the 10 year Japanese Government Bonds. The Bank kept asset purchases at 80 trillion JPY per month, left the inflation outlook unchanged but upgraded its GDP forecasts. This was status quo for the third straight meeting after having announced policy changes in two consecutive monetary policy decisions during July and September last year.

The U.S. 2 year/10 year treasury spread is now 1.26% and the U.K.'s 2 year/10 year treasury spread is 1.23% - 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 4.19% (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 11.75 (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

Individual Discretionary Managed Account Models - SMA

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.