News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. May 29, 2017

Owner Operated Companies

Berkshire Hathaway Inc. – LANXESS AG disclosed on Monday that Berkshire Hathaway, the conglomerate run by billionaire Warren Buffett, had acquired a 3% stake in the German chemicals maker. The shares held by General Re Corporation - whose total financial investments excluding cash holdings stood at about $22 billion at the end of last year - were worth about €180 million ($200 million) at that time. General Re's stake in LANXESS crossed the 3% threshold after LANXESS on May 11 beat consensus estimates for first-quarter earnings on strong sales of engineering plastics and synthetic rubber, but the company warned at the time that demand would soften later this year. Shares in LANXESS, a former unit of Bayer whose products include pesticide ingredients, construction pigments and leather chemicals, earlier this month reached four-year highs. LANXESS has said that after recent acquisitions worth a combined €2.6 billion more strategic steps could be in the offing in the second half of the year.

BlackRock Capital Investment Corporation – Chief Executive Officer Larry Fink said global growth was accelerating and that corporate earnings were keeping pace with higher stock prices. "Stay in equities," he said in response to a question at the asset manager's annual shareholders meeting. "They're going to be a good place for awhile." The remarks are a break in tone for Fink from more gloomy statements on the U.S. stock market's prospects in recent months. Fink also said he expected wage growth to continue, following conversations with corporate executives who say they struggle to find the right workers.

Carnival Corporation & PLC, the world's largest leisure travel company, announced that CEO Arnold Donald was named the top-ranked global executive for his strong leadership and commitment to improve diversity and inclusion in the workplace and for serving as an inspiring role model. Now in its second year, the EMpower 100 Ethnic Minority Leaders list, presented by the Financial Times, showcases the work of the top 100 black, Asian and minority ethnic (BAME) business leaders in the United States, Canada, United Kingdom and Ireland. "It is a great honor to be included in this year's EMpower 100," said Donald, who grew up in humble beginnings in New Orleans, and who has become one of the travel and vacation industry's most influential leaders as CEO of Carnival Corporation since July 2013. "I share this honor with our diverse team of brilliant and inspiring senior leaders at Carnival Corporation and our 120,000 dedicated employees from over 100 countries who support our 10 world-leading cruise line brands. As the world's largest leisure travel company with a fleet of 103 cruise ships visiting over 700 global ports, we take great pride in connecting nearly 12 million annual guests with people, cultures and places from around the world to help foster better understanding and appreciation of each other." Under the direction of Donald, the company has further focused its efforts to drive diversity of thinking initiatives that create competitive advantages to better serve guests and exceed their expectations for a great vacation experience.

Energy Sector

U.S. land rig count increased by 7 rigs to 881 rigs, which is the 19th week of consecutive gains. The rig count was driven by gains in Horizontal Oil (+5), Horizontal Gas (+2), Directional Gas (+2), and Vertical Gas (+1), partially offset by declines in Directional Oil (-3), while Vertical Oil remained flat week/week. Total horizontal land rig count is down 44% since the peak in November 2014. The Permian currently makes up 52% of all oil rigs.

U.S. horizontal oil land rigs increased by 5 rigs to 626 as gains in DJ-Niobrara (+4), Permian (+3), Woodford (+2), and Williston (+1), were partially offset by declines in "Other" (-4) and Granite Wash (-1), while Eagle Ford and Mississippian remained flat week/week.

Canadian rig count increased by 7 rigs, and is up 114% from the level this time last year.

U.S. Gulf of Mexico offshore rig count remained flat week/week at 23 and is down 57% since June 2014.

Royal Dutch Shell PLC has decided to offload a roughly C$4.1 billion ($3 billion) stake in Canadian Natural Resources Limited (CNRL) that it acquired as part of a deal to retreat from Canada's oil sands earlier this year. The energy company has been interviewing investment banks to hire a financial adviser for the share sale. The deal could be one of the biggest-ever equity sales in Canada. The largest Canadian equity deal so far was TransCanada Corporation's C$4.4 billion offering last year. In March, Shell agreed to sell most of its Canadian oil sands assets for $8.5 billion, in a major strategic pullback from the capital-intensive business. As part of the transaction, Shell acquired about 98 million CNRL shares, or about 8.8% of CNRL's outstanding shares, which are currently valued at about C$4.1 billion. In a deal that saw another global player pulling back from the oil sands, ConocoPhillips in March agreed to sell some of its Canadian assets to Cenovus Energy Inc. As part of the transaction, ConocoPhillips acquired 208 million Cenovus shares, and Conoco now owns 16.9% of issued and outstanding Cenovus common shares. Shell plans to use the proceeds to help pay down the debt it assumed with the acquisition of British rival BG Group PLC, the people said. Shell has sold or agreed to sell more than $20 billion in assets over the past two years to help finance the $54 billion BG acquisition last year. It plans to divest at least $10 billion more by 2018.

Financial Sector

Bank of Montreal reported Q2 2017 adjusted Earnings per Share (EPS) of $1.92, which was in line with consensus of $1.92. BMO's results benefited from low taxes (+7c) and lower expenses (+6c), which offset higher Provisions for Credit Losses (-9c), driven by the U.S. Personal and Commercial Banking (P&C) segment and higher losses in Capital Markets. 2% dividend increase. Canadian P&C earnings up 1% year/year; U.S. P&C reports adjusted net income decline of 7% year/year as loan balances declined by 1% sequentially owing to lower personal loan balances. Wealth Management adjusted net income up 72% year/year, which reflects good underlying growth as well as a $79 million investment writedown a year ago. Capital Markets adjusted net income up 12% year/year. Core Equity Tier 1 capital ratio of 11.3% was up from 11.1% in Q1 2017. The sequential improvement was underpinned by retain earnings (+24 bps), higher share issuances from the DRIP discount (+11 bps), and other items (+2 bps), partially offset by higher Risk Weighted Assets (-15 bps).

Barclays PLC - A U.S.-based credit card company is suing Barclays for £1.6 billion in compensation for mis-selling payment protection insurance (PPI) at a subprime lending business it bought from the British bank a decade ago. The lawsuit, which was filed in the High Court in London, represents one of the biggest claims for PPI mis-selling. Barclays said it had rejected the claim: "We will be vigorously defending our position." The claim was made by CCUK Finance Limited; the British subsidiary of a U.S. based credit card company, Atlanticus, that 10 years ago acquired a subprime credit card business called Monument from Barclays. CCUK, which used to be called CompuCredit before changing its name in 2012, has claimed £1 billion in compensation, including interest, and a further £600 million for alleged fraudulent misrepresentation by Barclays. (Source: Financial Times). We struggle to see that this action has much merit as we understand that Barclays has already been paying out PPI compensation to Monument customers under an indemnity agreement and that the total value of Monument was only £390 million. Clearly if this claim was successful it would deteriorate Barclays' capital position, knocking a proforma -0.4% off the Q1 Core Equity Tier 1 of 12.5%, in our view.

Canadian Imperial Bank of Commerce (CIBC) reported net income of $1.05 billion versus $941 million last year, as stronger performance from Wealth Management and from the Capital Markets segment offset a modest downturn in the Retail Banking segment. The credit performance was noticeably stronger, with the Provision for Credit Losses down to $179 million versus $324 million year/year (and down from $212 million quarter/quarter). Capital levels remained relatively strong, with the Core Equity Tier 1 12.2% versus 10.4% year/year (and up from 11.9% quarter /quarter). Overall, these earnings look to be stable and solid for credit quality, but with the PrivateBancorp transaction expected to reduce the Core Equity Tier 1 by more than 150bps (and Tier 2 as well), CIBC has last week boosted its Tier 2 capital with a new NVCC sub-debt issue (non-viability contingent capital), raising circa $800 million.

Citigroup Inc. is expanding its corporate banking business in key Asian markets in an attempt to capitalise on the growth in importance of China in the region as well as fears over a retreat by the U.S. from global trade. The bank is adding people to its teams in the region, committing to extra lending and rolling out a new growth strategy for eight key trade corridors, according to Gerald Keefe, head of corporate banking in the Asia-Pacific region (APAC). Citi's Asian push comes as other U.S. banks including Morgan Stanley and Goldman Sachs are also hiring selectively in the region. This reverses a trend of recent years. International investment banks cut APAC headcount by 10 to 15% between 2012 and 2015, according to data from industry benchmarking firm McLagan. (Source: Financial Times)

Royal Bank of Canada profit was up to $2.81 billion versus $2.57 billion year/year, but was down from the $3.03 billion level of the prior quarter. Earnings were up year/year almost across the board (Insurance was down modestly year/year), with the Canadian Banking, Wealth Management and the Property & Casualty segments looking particularly strong. The Provision for Credit Losses level showed good improvement year/year (down to $302 million vs. $460 million year/year), but was essentially flat quarter/quarter. Capital remained stable, with the Core Equity Tier 1 up to 10.6% versus10.3% year/year, but down from the 11.0% quarter/quarter level.

The Toronto-Dominion Bank reported net income up to $2.5 billion versus $2.05 billion last year, with stronger year/year earnings seen in all segments (although Wholesale Banking was down quarter/quarter). The largest upside was seen in the U.S. Retail segment. The Provision for Credit Losses level was down to $500 million versus $584 million year/year (and down sharply from the $633mm level of the prior quarter – due mostly to improvement in the U.S.). The Core Equity Tier 1 ratio remained relatively stable, up to 10.8% versus 10.1% year/year, although down slightly from the 10.9% level of the prior quarter. Overall, these results look relatively strong, in our view.

Activist Influenced Companies

Nomad Foods Limited reported financial results for the first quarter ended March 31, 2017, which pointed to a marked improvement in its business, and raised its full year 2017 guidance. Reported revenue decreased by 2.9% to €531 million in the quarter, whereas organic revenue increased by 1.1%. Organic revenue growth was driven by 3.0% growth in volume/mix offset by 1.9% decline in price, where U.K. price increases were more than offset by elevated planned promotions in the UK and the anniversary of unusually low promotional levels in other markets. Adjusted Operating expense

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was unchanged at €80 million. Advertising and promotion expense increased 3% to €30 million reflecting more seasonally balanced spending in 2017 versus 2016. Adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) decreased 11% to €89 million due to the aforementioned factors. Foreign exchange currency translation adversely affected adjusted EBITDA by €4 million. Adjusted Profit after tax and Adjusted EPS decreased 14% to €45 million and €0.25, respectively. Stéfan Descheemaeker, Nomad Foods' Chief Executive Officer, stated, "2017 is off to a strong start […] particularly encouraging given the later timing of Easter this year versus last. Both retailers and consumers are responding well to our targeted "Must Win Battle" activations, which continue to grow as a percentage of our overall portfolio. As expected, Q1 gross margins reflect higher planned promotions to help ease price increases into the UK market. We are pleased with the execution of these actions and expect promotions to moderate in Q2. Based on our year-to-date performance and increased visibility into the year, we are increasing our 2017 guidance." The Company raised its 2017 Adjusted EBITDA outlook to a range of approximately €315 to €325 million, versus the prior expectation of approximately €315 million, which now assumes organic revenue growth at a low-single digit percentage rate.

Canadian Dividend Payers

Nothing new to report.

Global Dividend Payers

Dufry AG announced the extension of the contract in Las Vegas. The contract includes over 18,000 square feet in retail space, including a new 6,000 square feet duty-free and duty-paid combination store. That represents an additional 6% retail space in North America or 1.5% at group's level. This update is in line with strategy and plan. At the beginning of the year, Dufry announced that it had 38,000 square feet project in the pipeline, out of which 29% in North America.

Economic Conditions

U.S. existing home sales dropped 2.3% in April to 5.57 million units, annualized, which was weaker than consensus. This comes on the heels of the highest reading in over a decade in March (5.70 million units annualized) and is still pretty elevated. The encouraging figure to note was that the share of sales by first-time homebuyers rose to 34%, the highest since last September. Yes, that is still some distance from the 40%'ish share in a healthy market but that's not bad in our view, considering that prices are still rising (+6% from a year ago). April's decline in sales was spread out across the country, and in single-family homes (-2.4%) and condos (-1.6%). Although more homeowners listed their homes in the month, the actual increase was smaller than previous Aprils (the data are not seasonally adjusted). The number of single family homes for sale rose 8.2% last month, the smallest April increase in five years. In other words, tight inventories remain a problem and continue to hold back stronger sales.

U.S. real GDP 1st quarter initial 0.7% annualized increase was revised higher unexpectedly to 1.2%, still the weakest number in a year but, again, not that bad in our view. This was supported by nearly all of the main components: Consumer - higher (more spending on medical services?); Investment - higher (mainly in structures….likely related to oil & gas…..as well as intellectual property); Government - less negative; Exports - no change; Imports - lower (so subtracted less from GDP). Inventories had a smaller build as well; final sales (or GDP excluding inventories) were up at a 2.2%. And final private sales (GDP excluding net exports, private inventories and government spending) rose 2.7%.

U.S. – Durable goods orders, a key business activity indicator for the U.S. economy, were down 0.7% in April, though better than the expected 1.2% retraction. However, when excluding the impact of the notoriously volatile transportation orders (think airplanes), durable orders were down 0.4%, which fell short of the expectations for a 0.5% advance. Defense, computer related and communications strong orders were offset by weakness elsewhere, in particular appliances and general machinery.

Financial Conditions

China - Moody's downgraded China's sovereign rating by one notch to A1 from Aa3 reflecting worsening debt outlook. The outlook is changed to stable from negative. The ratings agency expects China's financial strength will erode somewhat over the coming years, with GDP declining to close to 5% (current: 6.9%) over the next five years.

The U.S. 2 year/10 year treasury spread is now .95% and the U.K.'s 2 year/10 year treasury spread is .91% - 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 3.95% (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 4.2 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 9.81 (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 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:

- 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

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