News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. June 19, 2017

Owner Operated Companies

Carnival Corporation issued the following statement in reaction to the announced changes to the Cuba policy by the current U.S. administration: "Carnival Corporation is pleased that the policy changes announced by the Trump administration will allow our ships to continue to sail to Cuba. We will review the extent of the tightening of the travel rules, but our guests have already been traveling under the 12 approved forms of travel to Cuba since we undertook our historic first cruise to Cuba more than a year ago. Our experience in Cuba this past year has been extremely positive. We look forward to the new cruises being planned for Cuba with Carnival Cruise Line and Holland America Line. We also have requested approval for our other brands to travel to Cuba. Travel brings people and cultures together, so we are excited about the upcoming cruises to Cuba for our guests."

Walgreens Boots Alliance, Inc. – Amazon.com, Inc.'s proposed purchase of high-end food retailer Whole Foods Market Inc. for $13.7 billion severely affected the share prices of food and retail companies on Friday as the proven retail disruptor stepped boldly into another consumer space. The deal, which not only helps Amazon make deeper inroads into the grocery sector but also marks its big entry into the brick-and-mortar retail space, sent shock waves through the retail industry. The online retailer has so far avoided having much of a physical presence. Amazon had established a tentative physical footprint with a small number of Amazon Book Stores. Shares of U.S., Canadian and European retailers and supermarket chains fell as investors fretted over the wide-reaching implications of the deal. Canadian consumer staples stocks fell as much as 3.36% percent, their biggest fall since October 2008. Two of Canada's largest grocery chain operators, Loblaw Companies Limited and Metro, Inc. both fell more than 5.5% at one point. Packaged food companies were also damaged by the specter of healthier food that is less expensive targeting their customer base.

Energy Sector

U.S. land rig count increased by 6 rigs to 908 rigs, which is the 22nd week of consecutive gains. The rig count was driven by gains in Directional Oil (+4), Horizontal Oil (+2) and Vertical Gas (+1) slightly offset by declines in Other (-1) as Vertical Oil, Horizontal Gas and Directional Gas remained flat week/week. Total horizontal land rig count is down 43% since the peak in November 2014. The Permian currently makes up 51% of all oil rigs.

U.S. horizontal oil land rigs increased by 2 rig to 636 as gains in Williston (+4) and Other (+1) were offset by declines in the Permian (-1), Eagle Ford (-1) and Woodford (-1) as Granite Wash, Mississippian, DJ-Niobrara and Utica remained flat week/week.

U.S. horizontal gas land rigs remained flat week/week at 146 as gains in "Other" (+2) were offset by declines in the Haynesville (-2).

Canadian rig count increased by 27 rigs, and is up 126% from the level this time last year.

U.S. Gulf of Mexico offshore rig count held flat week/week at 21 and is down 61% since June 2014.

Financial Sector

DNB ASA announced that the Norwegian Financial Services Authority has allowed DNB to buy back shares in 2017. The approval is given on the condition that DNB meets its targets at all times (15.7% Core Equity Tier 1 targeted during 2017 rising to 16% at year-end; DNB reported 15.8% Q1) and that buybacks executed in 2017 and dividends for 2017 make up a maximum of 75% of net profit for 2016. We expect buybacks to be announced in Q2 (July 12) at the latest and implemented in H2 2017 in line with communication from DNB.

Royal Bank of Scotland Group PLC (RBS) - RBS is close to a deal with the U.S.' Federal Housing Finance Agency (FHFA) to pay over £3.5 billion to charges the bank engaged in improprieties related to the sale of Retail Mortgage Backed Securities to Fannie and Freddie prior to the 2008 crisis, Sky reports. The parties are hopeful a deal could be announced in the next several weeks.

Activist Influenced Companies

Nomad Foods Limited announced that it has entered into an agreement to repurchase 9,779,729 of its shares beneficially owned by funds advised by Permira Advisers LLP ('Permira') at a purchase price of $10.75 per share, which represents a 25% discount to the closing price of Nomad Foods ordinary shares on June 9, 2017. The transaction, which is 6% accretive to earnings per share (EPS), relates to a final settlement of indemnity claims against an affiliate of Permira, of legacy tax matters that predate its acquisition of Iglo Group in 2015. The aggregate purchase price of approximately $105.1 million will be funded from the Company's cash on hand and the shares will be retired. Stefan Descheemaeker, CEO of Nomad Foods, said, "Today's announcement represents a unique opportunity for Nomad Foods to create value for its shareholders. We continue to have significant cash on hand and financial capacity to execute acquisitions, a strategic priority, and remain encouraged by the positive momentum in our business."

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Dividend Payers

Nestlé SA has announced it is exiting the U.S. confectionary business and looking to sell its brands Butterfinger, Baby Ruth and Crunch chocolate bars with generated sales of CHF 900 million last year. Instead Nestlé is looking to focus on other growth opportunities. Nestlé was understood to only be fourth in terms of market share behind Mars, Inc., The Hershey Company and Lindt & Sprüngli (USA) Inc. and was facing fierce competition from Mondelez International Inc., the maker of Oreo biscuits. The businesses for sale could, we believe, raise up to $2 billion and in our view, Mondelez should be interested. The businesses to be exited do not include Nestlé Toll House, an iconic brand of baking products, active in a fast-growing segment.

Pattern Energy Group Inc. announced it has implemented strategic initiatives to increase its renewable energy business and double its portfolio to 5 gigawatts by 2020. The company said that it has made an initial investment of $60 million for a 20% interest in its Pattern Development 2.0 project, and has also secured $724 million in new long-term funding commitments through an investment entity managed by Riverstone Holdings LLC for the project. The company also entered into strategic partnership with Public Sector Pension Investment Board (PSP), under which PSP will acquire 9.9% of Pattern Energy stock, co-invest $500 million in certain projects acquired by Pattern Energy, and make an indirect investment interest in Pattern Development 2.0. Pattern Energy also acquired a 51% interest in the 179-megawatt Meikle project for $65 million, a 51% interest in the 143-megawatt Mont Sainte-Marguerite project for $40 million; and sold 49% of class B interest in its 182-megawatt Panhandle 2 project to PSP Investments.

Economic Conditions

U.S. consumer sentiment, as measured by the University of Michigan, dropped to 94.5 index points in June, significantly lower than the expected 97.10 index points reading, from May's 97.70 index points level. Both the 'current conditions' and the 'expectations' components of the composite index retreated in the month. Such a dramatic pull-back in consumer sentiment over the course of one month could spell trouble down the road for the all-important U.S. consumer sector.

U.S. consumer prices fell 0.1% in May, a tick below expected, with a steep 6.4% drop in gasoline prices weighing on the headline. That pulled annual inflation down 3 notches to 1.9%, a six-month low. Core Consumer Price Index was subdued as well, rising just 0.1% (0.063% to be exact), half the consensus call. The lack of price pressures was pretty broad based, with medical care, recreation, education, and other goods/services all unchanged from the prior month, while autos and clothing were down. Housing costs moved up 0.2%, contributing to the small core increase. Core inflation pulled back to 1.7% year/year, the slowest pace since May 2015.

U.S. retail sales unexpectedly fell 0.3% in May (the consensus call was flat). Auto sales were down 0.2%, leaving activity excluding autos at -0.3%. Gasoline stations' sales slumped 2.4%, consistent with the big decline in prices, pegging sales ex. autos & gas at flat for the month. Core retail sales (ex. auto, gas, food, building materials) were flat as well. Fully, sporting goods, general merchandise, miscellaneous, and restaurants all reported declines in the month. Health care and building materials were flat. The only sectors in the green were non-store retailers (online shopping), furniture, clothing and food & beverage. The one silver lining here is that there were upward revisions, with core sales lifted in April to +0.6%. That should offset May's disappointment from a growth perspective in our view.

U.S. industrial production was little changed, surprisingly, in May. Utilities received a bit of a boost from the return to normal temperatures, and mining rose for the fourth time in the past five months. But, combined, they account for just a quarter of total production. It is manufacturing that counts and it fell 0.4% in May, led by the durable goods sector, or autos. Excluding motor vehicles & parts, production inched up 0.1%. Production of nondurable, nonenergy consumer goods grew 0.3%, which was decent in our view.

U.S. housing starts unexpectedly fell 5.5% in May, the third decline in a row, to 1.09 million units annualized, the lowest level since September. The last time there were three consecutive declines was in October 2009. And, the pullback was spread out between both singles and multis. This was unexpected, as a like-sized rebound was expected from a month that saw the most rain in about 60 years. There could be some impact from the deadly tornadoes and floods in the South and the Midwest at the start of the month. All of the decrease was in the Midwest and the South; starts excluding those two regions were actually up 1.0%. The May 2017 Beige Book, using information collected up to May 23rd, cited "unusually wet weather" negatively affecting some regions.

U.K. retail sales volumes took another hit in May, dropping a hefty 1.2%, the 2nd drop in the past three months. The declines were broad-based (household goods, clothing, non-specialized stores), and support Visa's recent report, which showed consumer spending falling below year-ago levels in May for the first time in four years.

Greece - Eurozone governments threw Greece another 11th-hour credit lifeline on Thursday worth $9.5 billion and sketched new detail on possible debt relief as the IMF finally offered to help out after two years of hesitation. The €8.5 billion of loans from the Eurozone's 18 other states, including Berlin which is wary of easing terms for Greece ahead of a German election in September, lets Athens avoid defaulting on bailout repayments next month and recognizes unpopular cuts and reforms the left-wing government has made. "There is now light at the end of the tunnel," Greece's Euclid Tsakalotos told reporters after meeting fellow Eurozone finance ministers and IMF chief Christine Lagarde in Luxembourg.

Japan exports grew 14.9% year/year in May (up from 7.5% in April but below Bloomberg median forecast of 16%). This was the 5th straight month of year/year expansion and the fastest pace of increase since January 2015. However, import growth was stronger at 17.8% year/year in May (from 15.2% in April and above Bloomberg median forecast of 14.5%). This is also the 5th straight month of year/year expansion and the fastest pace of increase since January 2014. As a result, Japan turned in a slight trade deficit of JPY 203.4 billion in May, after recording surpluses in the preceding 3 months and slightly denting Japan's Q2 trade position. Japan earlier recorded a small surplus of under JPY 329.6 billion in the first quarter of 2017.

Financial Conditions

U.S. Federal Reserve's Federal Open Market Committee (FOMC): As widely expected, the FOMC increased its Fed Funds Target Rate (FFTR) by 25bps in June to 1.00-1.25%. The decision was not unanimous (8-1) as Minneapolis Fed President, Neel Kashkari, dissented as he preferred to maintain the existing target range for the federal funds rate in June. The FOMC is also forecasting one more rate rise this year.

The European Central Bank (ECB) has increased its forecasts for economic growth in the Eurozone but kept interest rates on hold. ECB president Mario Draghi also hinted that there was no need to cut rates further. He told a press conference: "We are now confident that inflation will converge with our objectives." The ECB now expects growth across the Eurozone to be 1.9% in 2017 compared with its March forecast of 1.8%. It also increased its growth projection for 2018 to 1.8% from 1.7%, and for 2019 to 1.7% from 1.6%. Mr Draghi said: "The risks surrounding the euro area growth outlook are considered to be broadly balanced". This was a marked change from his comments in April, which described the risks to growth as "tilted to the downside". (Source:BBC)

The **Bank of England**, as expected, **left rates unchanged** at a record low 0.25%. However, three members of the Monetary Policy Committee, voted to raise rates, the closest gap since 2007. Kristin Forbes had company, as Michael Saunders (who started sounding more hawkish in the past couple of months) and Ian McCafferty, added their voices. According to the Minutes, it appears that higher inflation (expected to be >3% by the autumn) was the main factor behind their dissent, and as the inflation overshoot was expected to remain above-target throughout the 3-year forecast horizon. And, "slack in the labour market" has diminished, and "demand for labour remained strong". The remaining five policymakers argued on the flipside, citing slower consumer spending, and subdued wage growth. Indeed, consumers are thinking twice about spending these days, as they face higher prices at the shops and slower wage growth.

The U.S. 2 year/10 year treasury spread is now .83% and the U.K.'s 2 year/10 year treasury spread is .86% - 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.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.91% (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 10.46 (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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