

News Highlights

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Established in 2007

Our views on economic and other events and their expected impact on investments.

August 31, 2017

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Owner Operated Companies

Alphabet Inc. – Google has submitted details of how it plans to stop favouring its shopping service to comply with a European Union antitrust order, according to EU regulators. The world's most popular Internet search engine, a unit of Alphabet, had earlier said it would meet the EU deadline to do so. The European Commission said on June 27 that Google had abused its dominance in Europe to give prominent placements in searches to its own comparison shopping service, demoting those of rivals.

Berkshire Hathaway Inc. – Warren Buffett celebrated his 87th birthday by going on record on CNBC on a number of topics related to recent developments and portfolio decisions. Below are some of the highlights. Buffett told CNBC that he had not sold a share of Apple Inc. and was not concerned about Wells Fargo & Company as a long-term investment, calling it a “terrific” bank. Comparing Apple to IBM Warren declared, “I feel more certain about the future as I look at a company like Apple than when I look at IBM now.” Berkshire has disclosed a roughly \$20 billion stake in Apple. Buffett owned about 81 million shares of IBM at the end of 2016 and sold about a third of them in the first and second quarters of 2017. Buffett also said that he continued to have faith in investments in Bank of America Corporation and Wells Fargo. Berkshire has become Bank of America's largest shareholder by exercising its right to acquire 700 million shares at a steep discount, more than tripling an investment it made six years ago. When asked if U.S. food company The Kraft Heinz Company would buy Mondelez International Inc., Buffett said: “I think the answer is no on that.” He also said Kraft Heinz, which Berkshire controls along with Brazilian firm 3G Capital, would not again seek to buy Unilever. “That was a misunderstanding, basically. We will not make hostile takeover offers, and we did not intend that to be hostile, but it turned out it was, and we immediately the next day, when I learned about it, we called it off,” Buffett said on Kraft Heinz's bid for Unilever. When asked why he was silent about U.S. President Donald Trump's administration, Buffett said: “I am not in the business of attacking any president, nor do I think I should be.” He had supported Hillary Clinton in last year's presidential election.

Energy Sector

Baytex Energy Corp. announced that due to Hurricane Harvey, on August 25, 2017 its Eagle Ford operations were shut-in and drilling and completion operations were suspended. This decision was driven by a number of factors including the safety of operating personnel and the availability of downstream markets. Baytex's Houston office was also evacuated. As of August 28, 2017, field operations

were being inspected and drilling and completion operations were expected to resume this week. There was, at the time, a limited ability to produce as downstream markets were closed or significantly curtailed. The safe start-up of field operations has begun and will be balanced with market access. The company expects to increase production throughout the week.

Financial Sector

Bank of Montreal (BMO) reported Q3 2017 adjusted EPS of \$2.03 which beat consensus of \$2.00. We note that BMO excluded a \$54 million after-tax release of collective provisions. If included, adjusted EPS would have been \$0.08 higher. Canadian Personal & Commercial earnings up 9% year/year. Operating leverage was flat. Net interest margin (NIM) expanded by 0.05% Quarter/Quarter to 2.54%. Mortgage balances were up 4% year/year, credit cards were higher by 2% year/year and commercial loans grew by 8%. Provisions for Credit Losses (PCLs) were down \$27 million year/year to \$125 million. U.S. Personal & Commercial reports flat year/year adjusted net income. PCLs rose 2% year/year (or US\$1 million), NIMs expanded by 0.07% Quarter/Quarter to 3.74%. Commercial loan growth was 5% year/year, while consumer loans fell 11% (3% excl. auto loans). Wealth Management adjusted net income up 23% year/year. Traditional wealth was higher by 17% year/year. Insurance earnings were higher by 41% year/year. Capital Markets adjusted net income down 8% year/year. Total trading revenues were \$372 million and Advisory revenues were \$226 million, higher than our forecast. Total PCLs of \$134 million, consisting of \$210 million of specific PCLs and a \$76 million pre-tax release from the collective allowance. CET 1 capital ratio of 11.2% as BMO experienced an uptick in Risk Weighted Asset (RWA) inflation which added \$5.3 billion of RWAs (i.e., about 0.30% CET 1 impact).

The Bank of Nova Scotia (BNS) reported Q3 2017 core cash EPS of \$1.68 versus consensus of \$1.64. Outperformance came mainly from lower than forecast PCLs (+2c) and real estate gains in Canadian banking (+3c) and 4% dividend increase. Canadian Personal & Commercial (ex-Wealth) reported earnings growth of 14% (~8% ex-real estate gains). NIMs was up 0.03% Quarter/Quarter, while the PCL ratio was down 0.03% year/year. International Banking reports 16% year/year net income growth (12% on a constant currency basis). NIMs declined 0.23% quarter/quarter to 4.77%. We note that management guided to lower sequential NIM. Moreover, a resumption of commercial loan growth (up 6% quarter/quarter and 7% year/year in constant currency) likely depressed the NIM. The PCL ratio improved by 0.10% year/year. Global Wealth Management earnings higher 6% year/year. Assets Under Management and Assets Under Administration balances grew 3.8% and 7% year/

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year, respectively. Capital Markets reports 5% year/year earnings growth. Total trading revenues of \$355 million and Advisory revenues of \$150 million were in line. PCLs were \$24 million, compared with \$38 million reported last year. PCLs were \$573 million (representing a PCLs ratio of 0.45%). CET 1 capital ratio of 11.3% was flat sequentially. BNS added \$5.6 billion of RWA (i.e., ~20 bps negative CET 1 impact).

Berkshire Hathaway Inc. exercised warrants to buy 700 million shares of **Bank of America Corporation**, locking in an \$11.5 billion investment gain in a move that was telegraphed earlier this year. Warren Buffett's Berkshire invested \$5 billion in Bank of America in 2011 in exchange for preferred stock and the right to buy common shares. The cash infusion helped the bank put to rest doubts about whether it had enough capital, and its shares have more than tripled since then. Berkshire said in a statement in June that it would convert its preferred shares into common stock once the Charlotte, North Carolina-based bank increased its dividend. The common shares that Berkshire received are worth about \$16.5 billion. (Source: Bloomberg).

National Bank of Canada adjusted cash EPS +5% year/year to C\$1.39, above consensus of C\$1.32, with particularly strong results in Canadian Banking which showed 21% earnings growth on back of Loan growth +5% year/year and a year-to-date cost/income efficiency ratio of 54.3%. Financial Markets showed earnings growth of \$168 million, +8% year/year with revenue +6% year/year and expenses +4%. Wealth Management earnings grew +29% year/year. Assets Under Administration +10% year/year and Assets Under Management +13% year/year. PCLs of C\$58 million or 18 bps of loans and CET 1 capital ratio of 11.2%, up from 10.8% in Q2 2017, driven by internal capital generation (+40 bps).

The Toronto-Dominion Bank adjusted cash EPS +19% year/year to \$1.51, above consensus \$1.36. Earnings were better-than-expected across all segments. Canadian Retail delivered a significant improvement (earnings +13% year/year, loan growth picked-up to 4.4% year/year and NIM increased 0.06% year/year), U.S. Retail remained strong (earnings +15%) and a lower corporate loss aided earnings (\$0.04 above consensus estimates). Wholesale's earnings of \$293 million, -3% year/year and +18% quarter/quarter. Revenues +5% year/year, expenses +15% and PCLs of nil, compared to PCLs of \$11 million last year. Trading revenue of \$463 million, up from \$425 million in Q2 2017 and \$447 million last year. Equity trading revenue \$51 million, down from \$204 million in Q2 2017 and \$59 million in Q3 2016. Interest rate and credit trading of \$207 million, up from \$85 million in Q2 2017 but down from \$239 million in the prior year. Underwriting and advisory revenues of \$161 million, up from \$147 million in Q2 2017 and vs. \$177 million in the prior year. Provisions for Credit Losses \$512 million or 33 bps of loans versus \$518 million or 35 bps of loans in Q2 2017 and \$563 million or 39 bps of loans in Q3 2016. The sequential decline reflects better credit quality across all segments in our view. TD's CET 1 capital ratio of 11% (10.8% in Q2 2017). TD amended its normal-course issuer

bid (NCIB), to repurchase up to an additional 20 million (1%) of its common shares. Operating ROE: 16.1%.

Activist Influenced Companies

Hertz Global Holdings, Inc., announced that two new officers will be joining the Company: Jodi Allen, as executive vice president and chief marketing officer (CMO), and Murali Kuppaswamy, as executive vice president and chief human resources officer (CHRO). Allen brings deep consumer experience from The Procter & Gamble Company and Kuppaswamy previously served in HR leadership roles at Baker Hughes, a GE Company, where he built strong cultures for employee growth and engagement. "Jodi and Murali have a wealth of experience leading Fortune 50 companies developing brands and building talent, respectively, and we're thrilled to have them on board," said Kathryn V. Marinello, president and chief executive officer of Hertz. Allen will join Hertz on October 2, leading global marketing efforts to re-energize the Hertz, Dollar Rent A Car, Inc., Thrifty Car Rental and Firefly Car Rental brands.

Dividend Payers

Bunzl PLC - First half results are EPS of 55.1p which is 6% higher due to interest and tax both coming in lower than estimates. The tax benefitted from a one-off credit and full year guidance is for a rate of 38.4%. The results were 2% ahead at the EBITA level as a result of slightly better organic growth and a bigger foreign contribution than expectations. The group delivered organic growth of 3.7%, the highest level in five years. We expect organic growth to accelerate to 4.6% in the second half, mainly driven by good performance in North America and UK & Ireland. On the acquisition front, a small deal in China has been announced, Bunzl's first step into a market it has been looking at in recent years. As is usual, little is said on outlook other than it being positive. Overall, we view it as a strong half with organic revenue growth at the highest level seen in five years and acquisition activity at record levels. We think the outlook for the second half remains good with organic growth likely to be above the first six months and further acquisitions likely.

Gilead Sciences, Inc., having done so well for many years via Sovaldi and Harvoni, the circa \$84,000 per person treatment hepatitis C medications, announced this week a high profile acquisition in buying Kite Pharma for close to \$12 billion in price. Essentially Gilead hopes the Kite deal will be similar in size and scope to its 2012 acquisition of Pharmasset Inc. with a potential to drive cure-like outcomes over time in certain tumors. Kite is a pioneer in the new Car-T cancer treatment, where white blood cells are extracted from the body, re-engineered and re-implanted. Its key drug Axi-Cel which treats a type of lymphoma will probably not get regulatory approval until later this year. The acquisition will consist of cash and debt and is believed will be accretive after year 3. In a way, we believe that this lifts the

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biggest overhang on Gilead over what it would do with its cash pile. We believe Gilead will remain active in the business development space though in oncology. We now view the Kite platform as the centerpiece by which Gilead will build in immuno-oncology believing Gilead intends to focus its efforts towards cellular therapy and so they are now squarely in the CAR-T mix by acquiring Kite. Therefore, we would only expect Gilead to do small bolt on deals from here in oncology perhaps to expand combination potential of CAR-T. With acquiring Kite, we do think that Gilead has much to explore and develop in a broad set of oncology indications but that as Car-T is an intravenous procedure rather than a pill it will in our opinion be more prone to the competitive responses of the likes of Novartis AG.



Economic Conditions

Canada – Canadian economy expanded at a 4.5% annualized pace in the second quarter, exceeding the already elevated 3.7% expectations. Part of the strong figure is explained by a relatively easy previous comparative period reading (remember last year wildfires). Growth in the quarter was driven by the consumer sector, business investment, net export, inventories and, less so, by government spending, offset by a 4.7% drop in housing activity.

U.S. – The U.S. personal income, a key consumer indicator, advanced a robust 0.4% in July, ahead of the expectations, whereas personal consumption, albeit up 0.3%, was short of the expected 0.4% advance. Part of the same report, the core personal consumption expenditures (PCE) price index, the U.S. Fed's favourite inflation gage, revealed a benign 1.4% year on year rate of change. The reading was well within the Fed's comfort zone, providing little impetus for further rate increases, though other considerations, such as tightness in the labour market and asset valuations might, fairly or not, take precedence.



Financial Conditions

U.S. Q2 GDP growth was revised up to 3.0% from the advance estimate of 2.6% (and topping the consensus call of 2.7%). Broad upward revisions in consumer spending (3.3%) and nonresidential fixed investment (6.9%) suggest more momentum in the economy than previously thought, which appears to be carrying into the current quarter (until Harvey struck). Capex growth was raised to 8.8%, the best in nearly two years. Inventories were marked up to a \$1.8 billion increase, and will climb more quickly in Q3, thereby supporting growth. While exports were revised lower, they still rose a solid 3.7% on the back of a weaker dollar and firmer global demand. One ongoing soft spot is state and local government spending, which was sliced to -1.7%. Unfortunately, the uncertain impact of Harvey, tempers the likelihood of any upward revisions to Q3 GDP growth in our opinion. On a yearly basis, growth of 2.2% is in line with the

post-recession norm, and, importantly, still above potential, implying further downward pressure on the jobless rate.

The U.S. 2 year/10 year treasury spread is now .81% 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 3.86 (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 4.4 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 10.77 (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.

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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](#)

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at <http://www.portlandic.com/prices/default.aspx>

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Glossary of Terms: 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'ROE' return on equity, 'ROTE' return on common equity.

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