News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. June 28, 2019

Owner Operated Companies

Danaher Corporation announced that Envista Holdings Corporation will be the name of the separate company Danaher intends to create and take public via an initial public offering in the second half of 2019. Envista will be comprised of three operating companies within Danaher's Dental segment: Nobel Biocare Systems, KaVo Kerr, and Ormco. These businesses have significant positions in dental implants, orthodontics, dental equipment and consumables, and include brands such as Nobel Biocare, KaVo, Kerr, i-CAT, Dexis, Metrex, Pelton & Crane, Ormco, Implant Direct, and Orascoptic. Envista will be led by Amir Aghdaei, who will become President and Chief Executive Officer. Mr. Aghdaei currently serves as Danaher Group Executive with responsibility for the Dental segment. Aghdaei said, "Envista's culture will be built on four core values: 'Better Choices, Better Outcomes,' 'Relationships Built on Trust,' 'Innovation in Action,' and 'Continuous Improvement as a Competitive Advantage.' Our Danaher heritage helped us shape these values and serves as a strong foundation for our business. The Envista Business System, which will be based on the Danaher Business System, will be our common operating model." Envista intends to apply to list its common stock on the New York Stock Exchange. The stock symbol will be NVST. Envista will employ 12,000 people worldwide.

Walgreens Boots Alliance, Inc. posted a better-than-expected quarterly profit as the drugstore chain benefited from a rise in branded drug prices and an increase in the number of prescriptions it fills in the United States. "Many people are looking at our company ... focusing on the immediate risk that we have to face," Chief Executive Officer Stefano Pessina said. "And understand this, we're far from complacent about the pressures we face." The company said it has been able to cushion reimbursement pressures from insurers in recent years through benefits it received in the process of procuring generic drugs. However, as prices of generic drugs stabilize, Walgreens said its dependence on these benefits has reduced. "Recognizing this, we are accelerating our other levers to mitigate the pressure," Pessina said. Walgreens said it was reviewing its retail footprint in the United States, and highlighted partnerships it had with other companies such as FedEx Corporation and The Kroger Co. to offer a range of services at its pharmacies. Same-store sales at its U.S. pharmacies rose 6% in the third quarter as it filled 290.7 million prescriptions. Excluding items, the company earned $1.47 per share in the third quarter ended May 31.

Energy Sector

Nothing significant to report.

Financial Sector

The Bank of Nova Scotia – Scotia announced that it has reached an agreement for the sale of its operations in Puerto Rico and the U.S. Virgin Islands ('USVI'), to Oriental Bank, a subsidiary of OFG Bancorp. As a result of the transaction, Scotia will record a loss of approximately $400 million after-tax in Q3 2019 and will be reported for accounting purposes in the Other segment. The majority of this loss represents the carrying value of goodwill relating to Puerto Rico. Further, Scotia states that upon closing, an after-tax gain of approximately $50 million will be recorded relating primarily to accumulated foreign currency translation gains and the premium received on the USVI operations. These amounts may be subject to adjustments at closing which may revise the Bank's total net loss to between $300 million to $360 million after-tax. The transaction will improve the Bank's credit quality, as it reduces Gross and Net Impaired Loans, and increases CET 1 ratio by approximately 5 basis points. The transaction supports Scotia's strategic decision to focus on key markets across its footprint. With this transaction and others, which have previously been publicly announced, over the last 4 years, Scotia has exited or announced its intention to exit 19 countries and redeploy approximately $4 billion of capital.

Nordea Bank Abp is reviewing its line of investment products for retail clients after Danske Bank A/S fired a top executive amid revelations that the bank charged customers too much.

U.S. banks would lose $410 billion if there were another severe global recession, but would maintain enough capital to keep lending to companies and individuals, according to U.S. regulators. Eighteen of the country's largest banks all passed the first round of their annual stress tests last week, as Federal Reserve figures showed the U.S. financial services industry is well-enough capitalized to weather a worst-case-scenario economic downturn. The results will allow banks to continue making record dividend payouts, as long as they also pass a second round of tests next week, when the Fed will make a qualitative assessment of their capital plans. Randal Quarles, the vice-chairman of the Fed in charge of banking oversight, said: "The results confirm that our financial system remains resilient. The nation's largest banks are significantly stronger than before the crisis and would be well-positioned to support the economy even after a severe shock." Across the sector, the average CET 1, a measure of financial strength, would fall to a low point of 9.2% in a severe recession, compared to 12.3% at the end of last year, according to the Fed calculations. The Fed sets a minimum CET 1 ratio for each institution of 4.5%. (Source: Financial Times)

Activist Influenced Companies

Brookfield Business Partners L.P. announced that it has closed the previously announced sale of BGRS, one of the largest global providers of executive relocation services, to Relo Group, Inc. for net proceeds of approximately $230 million. Brookfield Business Partners is a business services and industrials company focused on owning and operating high-quality businesses that benefit from barriers to entry and/or low production costs.

Dividend Payers

Bunzl PLC's pre-close trading statement - Group expectations for the full year are unchanged with overall performance in the first half said to be consistent with the slowing underlying revenue growth indicated in April. Revenue in the first half of 2019 was up 4% year/year, including approximately 1% organic and approx. 1% from acquisitions. It implies trading in Q2 was between +0.5-1.0% organically vs. 1.5% in Q1 and a 1% exit rate in April. The group has spent £100 million on acquisitions to date vs. £105 million at the same stage last year, with the pipeline said to remain active. Foreign Exchange moves since the Q1 trading update have been favourable and should add £6-9 million to EBITA, all else equal. The shares are trading on approx. 16.5x 2020 estimated Price/Earnings and approx. 13.5x Enterprise Value/EBITA, with a 2.4% dividend yield and an approx. 6.3% FCF yield.

The Kraft Heinz Company announced two significant organizational moves, which represent new CEO Miguel Patricio's first visible acts in his role. First, Mr. Patricio will assume the role of U.S. Zone President on an interim basis, and Paulo Basilio, who currently serves as U.S. Zone President will assume the new role of Chief Business Planning and Development Officer. Second, Rafael Oliveira, the current Zone President of the EMEA segment, will assume the new role of International Zone President. Regarding CEO Patricio's decision to head the U.S. Zone on an interim basis, analysts view this as a sensible move given the segment's recent challenged track record and Mr. Patricio's history as a general manager. In analysts' view, this move not only provides more immediate attention and a greater focus on the struggling business, but it should allow the new CEO to get up to speed more quickly on KHC's largest business (approx.70% of sales) and develop an intimate understanding that should enable him to make any changes, both in people and process. As such, with the new CEO now largely focused on the U.S. business, it stands to reason that Kraft Heinz would install someone else to help oversee the remainder of the business, and analysts believe that management view Mr. Oliveira as one of its more capable leaders. Furthermore, analysts think that there are opportunities to collaborate across the international markets as the category mix between Middle East/Africa, Latin America, and Asia Pacific have similarities that have yet to be maximized. Analysts note that this does not include Canada, which will continue to be run separately by recently appointed President Nina Barton. Broadly speaking, analysts see this move as a way to decentralize some of the key functions in an organization that was largely focused on centralization during its integration process.

Economic Conditions

U.S. – U.S. personal income expanded by 0.5% in May, ahead of the expected 0.3% advance. Personal consumption, meanwhile, also increased, by 0.4% in the month, in line with the consensus expectations. The core personal consumption expenditures (PCE) price index, the U.S. Fed's favourite inflation gauge, clocked in at 1.6% year/year rate of change, in line with the expectations and well below the 2.0% target, supporting Fed's easing bias.

U.S. durable goods orders fell a greater-than-expected 1.3% in May, though mostly because of another dive in aircraft bookings. Core capital goods orders beat expectations by rising 0.4%, reversing nearly half the prior month's decline and the fourth advance this year. There were broad gains across industries, including machinery. Non-defense capital goods shipments rose 0.5%. However, the huge aircraft-led decline in the prior month (-3.3%) suggests business equipment spending will contract for a second straight quarter in Q2. Overall, business investment has weakened due to the fading impact of tax reform and the mounting damage from trade protectionism.

U.S. goods trade deficit widened more than expected to $74.5 billion in May, though for a couple of good reasons: both exports and imports rose sharply (3.0% and 3.7%, respectively). The increase in imports reflected strength in both consumer and capital goods, suggesting domestic demand remains sturdy.

U.S. Conference Board's consumer confidence index fell a hefty 9.8 points in June, matching the December 2018 drop, the largest since August 2011, and the fourth largest since February 2009. And, at 121.5, that is the lowest since September 2017, dragged down by worries about not just the **present situation**, but particularly so about the future. **Expectations** fell 10.9 points in June, the second largest decline since October 2013 upon worries about **trade and tariffs** driving up the cost of living. But if one is feeling secure about the job market, that should overcome nearly everything in our view. But even the once-strong job market is looking a little more dicey these days. Fewer hands were raised when asked if jobs were plentiful, while more respondents acknowledged that jobs were harder to get. On net, the **labour differential** deteriorated for the first time since March, and by the most since February 2009. At least inflation expectations rose....

U.S. new home sales unexpectedly fell for the second month in a row, down 7.8% in May to 626,000, the lowest since December. Revisions to the prior 2 months were, on net, lower. **Inventories of homes available to be sold** rose for the first time since the beginning of 2019, which should offset the tight supply. But with the big pullback, **months**

supply is now back to 'normal' again at 6.4. Interestingly, the only homes that saw more sales were those in the $200,000-to-$299,999 price range, and those in the $750,000-plus range.

Canada – Canada's GDP monthly growth rate exceeded expectations for the month of April, up 0.3% relative to a more muted 0.1% improvement expected. The resources sector was the key contributor to growth in the month, primarily increased production of crude oil and natural gas in Western Canada.

The rise of ETFs is making life miserable for Canada's mutual fund industry – earlier this week, the Globe and Mail, reporting on the ETFs Canada conference in Montreal, highlighted the growth of the Canadian ETF market. In 2018, ETFs outsold mutual funds in Canada for the first time in a decade. And nearly halfway through 2019, ETFs are on target to outsell mutual funds again. Already in the first five months, Canadian ETFs have seen net inflows of $10.4-billion in assets, while mutual funds have brought in $4.9-billion. In 2018, ETFs had $19.8-billion in net sales, while mutual funds saw essentially negative sales, with $2.7-billion in annual net outflows. A similar pivot occurred south of the border in 2019, and in the past decade, U.S. ETFs have had net sales of US $2.3-trillion, while the U.S. mutual-fund industry has experienced US $92-billion in net redemptions. While sales trends in Canada favour ETFs, many Canadian investors continue to favour mutual funds. The Canadian ETF industry currently has 35 providers managing approximately $178.6-billion in assets, compared to $1.47-trillion invested in mutual funds. Steve Hawkins, president and chief executive of Horizons ETFs, says he believes ETF sales will remain strong this year and into 2020, but there could be future years where mutual-fund sales will pull ahead again. One major roadblock for the ETF industry in Canada is the inability for mutual-fund advisers to sell ETFs. While mutual-fund licensed representatives are legally licensed to sell ETFs, the majority of Canada's mutual-fund dealers do not have direct access to a platform to settle an ETF trade. Building that access has been a slow-moving project for many firms – and one that is unlikely to happen in any bank channel within the next five years, says Kevin Gopaul, global head of ETFs for BMO Global Asset Management. Liquid-alternative funds are typically hedge fund or private-equity strategies made available through a mutual-fund account. "Liquid alternatives are going to revitalize the mutual fund industry," Gopaul said in an interview. "As well, for many people, mutual funds are easier to trade, they come with no discussion about liquidity or trading commissions, there is no bid-ask spread to consider.'

Financial Conditions

Canadian Dollar strengthens vs. U.S. Dollar on expectations Bank of Canada will resist reducing rates. Earlier this week, the Globe and Mail highlighted the rise of the Canadian dollar as domestic data shows inflation at a seven-month high. The data supports the view that the Bank of Canada will hold off from interest rates cuts over the coming months, juxtaposed to expectations of central banks in Europe and the United States, which economists believe may ease monetary policy as early as July. Money markets are pricing in a 50% chance of an interest-rate cut by December for Canada. Canada's annual inflation rate rose to 2.4% in May, which was the first time since October 2018 that the rate had exceeded the central bank's 2.0% target.

The U.S. 2 year/10 year treasury spread is now 0.27% and the U.K.'s 2 year/10 year treasury spread is 0.22% - 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. Also, the narrowing gap between yields on the 2 year and 10 year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.73% (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 6.4 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 15.86 (compares to a post-recession low of 9.52 achieved in early November) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 bodes 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:

- Bay & Scollard Development Trust
- ITM AG Investment Trust
- Portland Advantage Plus - Everest Fund
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value Plus Fund

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) per unit of our investment funds are published on our Portland website at www.portlandic.com/prices

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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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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on common equity, 'ROTCE' return on tangible common equity.

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