# 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.* July 22, 2019



## Owner Operated Companies

**BlackRock, Inc.,** the world's largest asset manager, took in less cash last quarter as investors moved into lower-cost bond funds and it made less money lending out stocks. The company, which manages $6.8 trillion in assets, attracted $151 billion in new money, though much of that cash moved into lower-fee fixed income funds and accounts used to store cash. The company's revenue for the three months through June 30 retreated 2.2% to $3.52 billion from a year earlier, affected also by some fee cuts the company has made and lower fees for attaining performance targets. "The trend going into the second half is very positive," Larry Fink, the company's CEO, said. "Things we can control ... were exceptional. It was probably one of our finest quarters in years of flows, in terms of engagement, and more importantly, when I talk about BlackRock, no organization has a combination of passive, active and technology." Net income decreased to $1 billion, or $6.41 per share, from $1.07 billion, or $6.62 per share, a year earlier. The company cited expenses related to recent acquisitions and a higher effective tax rate. Total expenses rose nearly 4% to $2.25 billion.

**Danaher Corporation** beat estimates for its second quarter profit and revenue and has beat estimates for at least 8 straight quarters. The company also raised the lower end of its full-year adjusted EPS forecast to $4.75-$4.80 from $4.72-$4.80. The second quarter earnings beat was mainly driven by Danaher's life sciences unit, which brought in $1.71 billion sales versus consensus estimates of $1.66 billion. The life sciences unit provides tools to scientists for research and development of drugs. Sales in the company's diagnostics unit were $1.62 billion, also ahead of consensus of $1.60 billion. The company reiterated the timeline for closing its acquisition of General Electric Company's biopharma business by the second half of 2019.

## Energy Sector

Nothing significant to report.

## Financial Sector

**Bank of America** reported Q2 2019 EPS of $0.74 and consensus was $0.71. Results included a $30 million loan loss reserve release and a net debit valuation adjustment (DVA) loss of $31 million. Relative to consensus, a lower than expected loan loss provision and tax rate were used to offset a lower than anticipated net interest margin. In addition, fee income and expenses were both a touch better than forecast. Operating revenues increased 1% year/year and were little changed linked quarter at $23.3 billion. Tangible book increased 3.6% to $18.92 (trading at 1.5x). It posted a 11.62% ROE and 16.24% ROTCE. Its CET 1 ratio was 11.7%. It repurchased $6.5 billion in common stock, up from $6.3 billion last quarter. Average diluted shares declined by 2.3%. Net interest income decreased 2%, reflecting lower short-term rates (impacting variable-rate assets and improving long-term debt costs), higher bond premium amortization expense driven by lower long-term rates, and higher funding costs. Its net interest margin declined 7 basis points (bps) to 2.44%. Expenses were little changed on both a year/year and quarter/quarter basis. Its efficiency ratio was 57%. Its tax rate increased from 16.6% to 18.0%. Its loan loss provision was $30 million less than net charge-offs (added $22 million to reserves in Q1 2019). Its reserve/loan ratio decreased 2 bps to 1.00%.

**Citigroup Inc.** reported Q2 2019 EPS of $1.95. Excluding a $350 million pre-tax gain on its investment in Tradeweb Markets Inc., EPS was $1.83 and consensus was $1.80. Results also included a gain from a building sale in Asia, a $126 million credit reserve build, and a $75 million loss on corporate lending loan hedges, down from $231 million of losses in the prior quarter. Revenues increased 2% year/year and gained 1% sequentially to $18.8 billion. Tangible book increased 3.2% to $67.64 (trading at 1.1x). It posted a ROTCE of 11.9%. Its CET 1 ratio was 11.9%. During Q2 2019, Citi repurchased 54 million shares. Average diluted shares declined by 2.3%. Expenses declined 2% year/year and deceased 1% linked quarter. Relative to a year ago, the decline was driven by efficiency savings and the wind-down of legacy assets, partially offset by continued investments and volume-driven growth. Its efficiency ratio was 56.0%. Its effective tax rate was 22.3%, up from 21.2% in the prior quarter. Its reserve/loan ratio increased 1 basis point to 1.82%.

**The Goldman Sachs Group, Inc.** reported Q2 2019 EPS of $5.81 and consensus was $5.00. Relative to consensus, Investing & Lending (equity gains, equity trading and investment banking fees) came in better than expected, while Fixed Income, Currency & Commodities and investment management were below. Both compensation and non-compensation expenses were higher than anticipated, though its tax rate was lower than forecasted. While its tax rate increased from 17.2% to 22.6% bringing it to 20.1% year to date, it still expects to be at 22-23% for the full-year. Its net provisions for litigation and regulatory proceedings were $66 million. Revenues declined 2% year/year and rose 7% linked quarter to $9.5 billion. Tangible book increased 2.4% from Q1 2019 to $203.05 (trading at 1.04x). It posted a 11.1% ROE and 11.7% ROTCE. Its CET 1 ratio was 13.5% (+10 basis points; advanced). Assets increased $20 billion (+2%) to $945 billion, reflecting client demand for its balance sheet. Global core liquid assets averaged $225 billion, down $9 billion from Q1 2019. During the quarter, Goldman Sachs repurchased $1.25 billion shares (6.2 million shares). Average diluted shares declined by 1.2%.

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**JPMorgan Chase & Co.** reported Q2 2019 EPS of $2.82. Excluding a $768 million ($0.23) income tax benefit, EPS was $2.59 and consensus was $2.51. In addition to the tax benefit, results also include a $350 million gain from the IPO of Tradeweb Markets Inc. (TW), a $254 million loan loss reserve release, a $69 million legal benefit and $44 million of securities gains. These benefits were partially offset by $244 million of net Mortgage Servicing Rights losses and net valuation losses of $100 million on certain legacy private equity investments. Excluding all these items, EPS was closer to $2.50. Relative to consensus, a lower than expected loan loss provision and higher than forecasted fee income was used to help mitigate a lower than anticipated net interest margin. Revenues increased 4% year/year (+3% excluding TW gain) and declined 1% linked quarter (-2% excl. TW) to $29.6 billion. It posted a 20% ROTCE (core ~18%). Tangible book increased 3.1% to $59.42 (trading at 1.9x). Its CET 1 ratio was 12.2% (+10 basis points (bps)). It had a net $5.0 billion of share repurchase in the quarter ($5.2 billion gross). Average diluted shares declined by 1.5%. Net interest income declined 0.4%. Average earning assets rose 2%. Its net interest margin fell 8 bps to 2.49%. Its yield on average earning assets decreased 7 bps to 3.73%. Expenses rose 2% year/year and were little changed with Q1 2019. Compensation expenses rose 3% year/year and declined 4% from Q1 2019. Non-compensation expenses rose 2% year/year and grew 5% from Q1 2019. Its managed overhead ratio was 55%. Its reserve/loan ratio was stable at 1.28%.

**Morgan Stanley** reported Q2 2019 EPS of $1.23. Consensus was $1.16. Operating revenues declined 3% year/year and slipped 0.4% linked quarter to $10.2 billion. Tangible book increased 2.2% to $38.44 (trading at 1.1x). It posted a 11.2% ROE and 12.8% ROTCE. Its CET 1 ratio was 16.3%. Period-end assets increased 2% while deposits declined 2%. Consolidated loans & lending commitments increased 7%. Morgan Stanley repurchased $1.2 billion shares during the quarter. Average diluted shares declined by 1.3%. Expenses declined 2% year/year and approximated Q1 2019. Its efficiency ratio was 72% compared to 71% in the year ago and prior quarters. Its tax rate was 22.6%, up from 16.5% last quarter. Excluding a $101 million benefit, its tax rate was closer to 20% in Q1 2019 (it has pointed to the 22-23% area for 2019).

**Nordea Bank Abp -** Q2 2019 Results. Headline Profit Before Tax (PBT) of €900 million was 3% light. However, this included an unexpected release on U.S. sanctions risk towards Russia in impairment. Excluding this, underlying PBT was 5% light with weaker income and impairment the key drivers. CET 1 of 14.8% was 20 basis points ahead of consensus.

**State Street Corporation** reported Q2 2019 EPS of $1.42. Excluding 'notable items' (acquisition & restructuring cost of $12 million), EPS was $1.45. Consensus was $1.42. Higher than expected fee income (driven by management fees), lower than anticipated tax rate, and controlled costs more than offset lower than expected net interest income/margin. Revenues fell 6% year/year and declined 2% linked quarter to $2.7 billion. Its CET 1 ratio was 11.4% (-10 basis points (bps)). As expected, it repurchased $300 million shares (4.6 million shares) in Q2 2019. Average diluted shares declined by 1.1%. Assets under Custody/Administration increased 0.3% to $32.8 trillion. Assets Under Management rose 4.0% to $2.9 trillion, reflecting higher spot equity market levels and growth from institutional wins and cash inflows. Net interest income dropped 9% linked quarter (guided to down 8%) and its net interest margin dropped 16 bps to 1.38%, due to lower noninterest-bearing deposits and higher securities premium amortization. Its yield on average earning assets fell 8 bps to 2.26% with its securities yield down 7 bps. Expenses decreased 1% year/year and fell 6% from Q1 2019. The expense savings program announced in January 2019 achieved $175 million total savings year to date through resource discipline, process re-engineering and automation benefits. Compared to Q1 2019, total headcount was down 1%, the second sequential quarter decline. Year to date high cost location headcount reductions totaled over 1,800, exceeding initial 1,500 target, with new aggregate goal of 2,300 established for 2019. Its core pre-tax margin was 25.4%. The effective tax rate was 18.1% compared to 20.1% in Q1 2019. It decreased due to tax advantaged investments.

**Wells Fargo & Company** reported Q2 2019 EPS of $1.30. Results included a $721 million ($0.13) gain on the sale of $1.9 billion of Pick-a-Pay PCI, a $150 million reserve release ($0.03), and an effective income tax rate of 17.3% (compared to expectations of 18% for the second half of 2019; added $0.02). Excluding these items (the three the company specifically called out), EPS was $1.12 and consensus was $1.15. In addition, net Mortgage Servicing Rights gains were $77 million, up from $71 million last quarter; equity securities gains were $622 million, down from $814 million last quarter; and debt gains were $20 million, down from $125 million. Normalizing for all 'specials' puts core EPS closer to $1.10. Operating revenues fell 2% year/year but increased 2% linked quarter to $20.9 billion. Tangible book increased 2.9% to $33.68 (trading at 1.4x). Reported results were a 13.26% ROE and 15.78% ROTCE. Its CET 1 ratio was 12.0% (+10 basis points (bps)). It repurchased 104.9 million shares. Average diluted shares declined by 1.9%. Net interest income declined 3.6% year/year (guided to down approaching 5%) and fell 1.8% linked quarter and its net interest margin declined 9 bps to 2.82% due to balance sheet mix and repricing, including the impacts of higher deposit costs and the lower interest rate environment. Expenses declined 1%, predominantly due to a decline in employee benefits expense and incentive compensation expense. The efficiency ratio was 62.3%. Its effective income tax rate was 17.3%, up from 13.1% in Q1 2019 (which included $297 million of net discrete income tax benefits). It expects the effective income tax rate for the remainder of 2019 to be 18%, excluding the impact of any unanticipated discrete items. Its reserve/loan ratio declined 2 bps to 1.12%.

## Activist Influenced Companies

Nothing significant to report.

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## Dividend Payers

**The Boards of Barrick Gold Corporation (GOLD) and Acacia Mining PLC (ACAA)** have reached an agreement (court-sanctioned scheme of arrangement). Barrick increased its offer for ACAA by 10% as it lifted the share exchange ratio to 0.168 GOLD shares for each Acacia share it doesn't already own. This implies a deal value of about $428 million for the minority stake in Acacia. Consolidation of Acacia would be positive as it likely enables finalization of the Framework Agreement with the Government of Tanzania to resolve legacy issues. The Framework Agreement includes the staged payment of $300 million to the Tanzanian government and tax and ownership details supporting the 50/50 sharing of economic benefits, in exchange for the lifting of the concentrate export ban and settlement of tax proceedings.

**BHP Group Limited -** Reasonable operational finish to fiscal year 2019 in analysts' view particularly in Petroleum and Iron Ore but year/year group production is indicative of the challenges faced during the year. Petroleum remains a stand out from analysts' perspective – beating guidance and showcasing the breadth of exploration and potential development opportunities. Any calls for this business to be spun out near term are premature in analysts' view as it possesses exciting options over the medium term to exact value. Iron Ore and Met Coal will again have material maintenance programs in fiscal year 2020, with the path to a sustainable 290 million tonnes per annum in the former and 49-54 million tonnes in the latter perhaps still some time off.

**South32 Limited** delivered a decent set of Q4 production numbers in analysts' view, finishing the year with most assets within +/-3% of fiscal year 2019 guidance. The exceptions to that were South Africa Energy Coal (-5%) due to lower domestic sales and Australia manganese (-5%) due to wet weather, although inventory release meant sales volumes were in line with production guidance. There was no guidance update for fiscal year 2020 or net cash position reported. Realised pricing was generally ahead of analysts' estimates, while unit costs were modestly above guidance at SA Coal, Worsley and SA Manganese. On cash flow, $458 million manganese dividend received in fiscal year 2019 was below the $575 million estimate. On the strategic front, bids have been received for SA coal and an update on the sale process will come during current half. A strategic review of manganese alloy smelters is under way: closure would be positive in analysts' view given analysts forecast small negative EBIT contributions going forward, improving Return on Capital Employed and significantly reducing group CO2 emissions.

## Economic Conditions

**U.S. retail sales** rose 0.4% month/month in June, beating consensus expectations for a +0.2% print. The prior month's data, meanwhile, was revised downward slightly, from 0.5% to 0.4%. Sales of motor vehicles advanced 0.7% for the second month in a row. Without that category, consumer outlays also increased 0.4%, with gains in 11 of the 13 categories surveyed including non-store retailers (+1.7%) and miscellaneous items (+0.6%). Alternatively, sales at gasoline stations dropped 2.8% on lower pump prices.

**U.S. housing starts** fell 0.9% in June, a little more than expected, leaving total starts at 1.253 million units, annualized, a 3-month low. And, there were, on net, **downward revision**s to the prior two months. But a decline was expected. Besides, **single-family starts** bounced back 3.5% (not enough to erase the prior month's drop but the direction is right), but **multi-unit starts** more than offset that increase (with a 9.2% dive). And, the setback in starts was in the **South** (where half of starts lie) and the **West**, while the **Northeast** and the **Midwest** improved. What was not expected was the 6.1% dive in **building permits,** the biggest since March 2016, to a 26-month low of 1.22 million units annualized. But it was all in the volatile **multi-unit sector; single family permits** rose 0.4%, and this component matters more in analysts' view. Nonetheless, the decline was spread across three of the four regions of the country; only the **Northeast** saw more permits. It is not too often that permits fall below starts, although the gap has narrowed of late. This is clearly bad news for future construction but we've seen choppy moves in permits before, and multis account for 1/3 of permits.

**U.K. Earnings -** According to the Office for National Statistics (ONS), U.K. earnings, excluding the effects of bonuses, rose by 3.6% on an annual basis in the three months to May, the highest rate since 2008, and beating expectations of 3.5%. Including bonuses, wages were up 3.4% from 3.2% a month earlier. Wages have been outpacing inflation since March 2018. But the growth in employment slowed to 28,000, the weakest increase since the three months to August last year. Jobless claims also rose to a sizeable 38,000 in June following an upwardly revised 24,500 gain in May. This was the sharpest increase since May 2009, though the jobless rate remained at 3.8%, its lowest level since the mid-1970s.

## Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.22% and the U.K.'s 2 year/10 year treasury spread is 0.21% - 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 3.81% (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 14.45 (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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