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. September 16, 2019

Owner Operated Companies

Alphabet Inc. – Google won a legal battle after Europe's top court said publishers in Germany could not demand copyright fees since 2013 from the tech firm because the European Commission had not been notified of the German regulation. The group of publishers previously said they were demanding as much as US$1.1 billion from Google-owner Alphabet in copyright fees for their news snippets and other items published by the company on the internet. The lawsuit was based on a German ancillary copyright law in force since August 2013. "A German provision prohibiting internet search engines from using newspaper or magazine snippets without the publisher's authorisation must be disregarded in the absence of its prior notification to the Commission," European Court of Justice judges said.

Google agreed to pay close to US$1.10 billion to French authorities to settle a fiscal fraud probe that began four years ago. The settlement comprises a fine of 500 million euros and additional taxes of 465 million euros, as Google reported. Google pays little tax in most European countries because it reports almost all sales in Ireland. The combined tax payment is less than the 1.6 billion euros the finance ministry had been seeking from Google after the company's Paris offices were raided in 2016. "We remain convinced that a coordinated reform of the international tax system is the best way to provide a clear framework for companies operating worldwide," Google said.

Oracle Corporation announced that Chief Executive Officer Mark Hurd would be taking a medical leave. Hurd is one of Oracle's two CEOs, the other being Safra Catz. Under their tenure, the company has tried to rapidly transition to cloud computing software. Catz and Oracle founder and Chief Technology Officer Larry Ellison will cover Hurd's responsibilities during his absence. Oracle also reported results for the first quarter of its fiscal 2020, which included total revenue of $9.22 billion. Net income fell to $2.14 billion in the quarter ended Aug. 31, from $2.27 billion a year earlier. On a per share basis, Oracle earned 63 cents per share up from 57 cents per share, a year ago. Oracle also said it plans to buy back an additional $15 billion in stock.

Energy Sector

Saudi Arabia attacks and production disruption – Two plants at the heart of Saudi Arabia's oil industry suffered attacks over the weekend, knocking out more than half the country's output. The attacks will, reportedly, cut the kingdom's output by 5.7 million barrels per day, according to a statement from state-run oil company Saudi Aramco, or more than 5% of global oil supply. Saudi Arabia is the world's biggest exporter, shipping more than 7 million barrels of oil to global destinations every day. The United States condemned the attacks and the U.S. Department of Energy also said it was ready to release oil from its strategic petroleum reserve if necessary.

Financial Sector

Barclays plc last week announced that they expect to take a final provision for Personal Protection Insurance charge of between £1.2 billion and £1.6 billion in Q3. Including a Q3 charge of £1.6 billion, brings the implied half year accrual to £2 billion (in-line with peer average). The £900 million increased provision equates to -5 pence per share to a total of -9 pence a share for the year and the forecast FY19E CET 1 to 13.0% (from 13.2%), with thoughts of any share buyback pushed back until next year. Barclays has a cheap valuation price-earnings ratio estimates for 2020 at about 6.0x, and has some Brexit protection given around 50% of revenues are from overseas.

HSBC Holdings plc -The Wall Street Journal wrote last week that HSBC could sell its French retail bank (but retain its Corporate & Investment Bank in the country), as it continues its geographic streamlining, especially in Retail. This would signal management 'intent' towards a serially underperforming business than any financial impact from a French retail disposal alone. The French retail business made just €4 million in the first half of 2019, on revenues of €415 million. It was loss-making in fiscal 2018. Its market share of retail deposits and lending is around 2%. As recently as the 1H19 results call, CFO Stevenson said that HSBC had a multi-year plan to turn this business around, but clearly the WSJ article would point to a different and more immediate strategy, as it is estimated that a sale price in the range €1.0 billion-€1.5b billion, the midpoint of which could add around 20bps onto the CET 1 ratio. Earnings impact would be negligible, but there could be a sizeable goodwill write-down in P&L (albeit not hitting CET 1). Likely buyers are said to be the French banks, looking to add scale in their domestic market, presumably as an offset to the low-rate environment, by extracting cost synergies and thus running the business more profitably. During the reduction of its geographic footprint over recent years, it's HSBC's retail operations that have borne the brunt - its Corporate & Investment Bank has often remained even when retail has been exited.

Activist Influenced Companies

Nothing significant to report.

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Dividend Payers

Northland Power Inc. said it would buy most of Colombian utility Empresa de Energia de Boyaca (EBSA) in a deal valued at $1.05 billion, including debt. The proposed acquisition is Northland's second investment in Latin America, following the La Lucha solar project in Mexico that began construction earlier this year. EBSA serves a population of 1.3 million residents across 123 municipalities. The company said it expected the deal to add to its free cash flow by mid-single digit during the current regulatory period ending 2023. Based on submitted tariff, EBSA is expected to contribute about $100 million to adjusted EBITDA in 2020. The deal is expected to close in the fourth quarter this year.

Economic Conditions

The U.S. core CPI (consumer price index) rose 0.3% for a third straight month in August (though barely at 0.256%). This is the second fastest three-month rate (3.4% annualized rate.) in a quarter century, and it lifted the yearly core rate to 2.4% (highest since 2008). Tariff pass-through was evident in successive large gains in computers/peripherals prices (which have trended down for decades), as well as a rise in recreation services. Used car prices continued to unwind earlier declines. As well, medical care costs jumped another 0.7%, lifting the yearly rate to 3.5%. Airfares and tobacco product prices rose sharply for a second month. Meantime, the headline CPI increased an expected 0.1%, held down by lower gas prices and flat food costs. The inflation rate stayed at 1.7%. We believe it's too early to ring the inflation alarm bells, as most of the recent upward pressure on the core measure seems to reflect temporary factors, notably tariffs and a retracement of earlier "idiosyncratic" declines (says the Fed). Still, concerns about too-low inflation also appear misguided, with initial jobless claims just falling to their lowest level since April (204,000) and wage growth drifting higher in response to labour shortages. We believe the Fed will still cut rates next week to provide added insurance in the event that the trade war escalates, but it might think twice about moving again in October if core inflation shows any further spark.

Japan's Q2 2019 GDP growth was revised lower to 0.3% quarter/quarter (1.3% annualized rate) from the previous print of 0.4% quarter/quarter (1.8% annualized rate) with the downgrade from capital expenditure and housing investment accounting for the growth revision. Despite the still positive first half 2019 GDP growth print, it's expected GDP growth will ease further to 0.5% in 2019 (from 0.8% in 2018) in view of external trade headwinds and more importantly, the likely collapse of private spending in Q4 2019 post-sales tax hike. And notwithstanding the Tokyo Olympics next year, it's believed that Japan's GDP will contract by 0.8% in 2020 as it's expected that the sales tax hike will cause the likely collapse of private spending which will consequently drive Japan into a recession next year.

U.K. wages are rising at their fastest rate in more than a decade and the unemployment rate has fallen to a record low. Latest figures from the Office for National Statistics (ONS) show earnings excluding bonuses growing at an annual pace of 3.8% year/year in the May to July period, down slightly from the previous reading of 3.9% year/year. Including bonuses, wages rose at an annual pace of 4.0% year/year, higher from a previous revised reading of 3.8% year/year, and marking the highest rate since mid-2008. After adjusting for inflation, wage growth rose by 2.1%, breaking through the 2.0% mark for the first time in four years.

Financial Conditions

The European Central Bank (ECB), as expected, announced a 10bps interest rate cut last week, sending its deposit rate further into negative territory (0.5%). The cost to Euro-area banks will be offset somewhat by a new tiering system that will exempt some excess liquidity reserves from negative rates. Also announced was a new round of quantitative easing that will see the central bank resume asset purchases on November 1 at the pace of €20 billion per month. While this figure was slightly below expectations, the ECB left the timetable open-ended, only saying that quantitative easing will continue until shortly before the first rate increase. As for forward guidance, the central bank sees rates remaining at current or lower levels until a meaningful rebound in inflation, removing a calendar timeframe. At the follow-up press conference, outgoing ECB President Mario Draghi commented that he sees "persistence of prominent downside risks" and that fiscal policy should be a primary tool to fight slowing growth.

The U.S. 2 year/10 year treasury spread is now 0.0923% and the U.K.'s 2 year/10 year treasury spread is 0.1792% - 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 3.56% (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 14.87 (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.

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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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