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. September 23, 2019

Owner Operated Companies

Alphabet Inc. – Google will make an additional investment of €3 billion over the next two years to expand its European data centers, Chief Executive Sundar Pichai said in Finland. The investment plan includes an additional €600 million investment in the Hamina data center in Finland, bringing total investment in the site to €2 billion. Google already has one data center in Hamina, where it invested €800 million to convert an old paper mill. It said in May it would invest €600 million in a new data center on the same site. Google bought the site from paper firm Stora Enso in 2009. The location is close to the Russian border and uses seawater from the Gulf of Finland to reduce energy used in cooling. Google's other European data centers are located in the Netherlands, Ireland and Belgium.

Brookfield Asset Management Inc. and Dubai's Meraas Holding have agreed to form a joint venture valued at $1.4 billion to own and operate Meraas' retail assets. The assets include Dubai sites: The Beach, City Walk and La Mer. The assets were previously owned by Meraas, which says its portfolio includes more than 1,400 retail units. "We believe in the future of the Dubai real estate market and look forward to working together with Meraas to create the leading retail player in the regional market," Brookfield Property Group CEO Brian Kingston said in the statement.

Danaher Corp. – The shares of dental products maker Envista Holdings, a spinout of Danaher, jumped 24.5% to $27.41 in its market debut. The new company had a market value of $4.07 billion at the opening price. Envista sold 26.8 million shares for $588.9 million, excluding underwriters' option. Envista has granted the underwriters a 30-day option to purchase up to 4,015,200 additional shares of common stock at the initial price to the public, less underwriting discounts and commissions. Following the IPO, Danaher is expected to hold approximately 82.7% of Envista (80.6% if the underwriters' overallotment option is exercised in full). The net proceeds from the IPO are expected to be paid to Danaher as partial consideration for the dental businesses that Danaher is transferring to Envista in connection with the IPO. J.P. Morgan, Goldman Sachs & Co. LLC and Morgan Stanley are joint lead book-running managers for the offering. Baird, Evercore ISI and Jefferies are book-running managers for the offering. Bank of America Merrill Lynch, Credit Suisse, Stifel and William Blair are co-managers for the offering.

Walgreens Boots Alliance, Inc. – Walgreens and Wing, a member of the Alphabet family of companies, are partnering on an industry first that will offer unparalleled speed and convenience of "store to door" delivery of health and wellness, food and beverage and convenience items – via state-of-the-art drone technology – in minutes. Walgreens will be the first retailer in the U.S. to test an on-demand drone delivery service with Wing in Christiansburg, Virginia next month. "Walgreens continues to explore partnerships to transform and modernize our customer experience and we are proud to be the first retailer in the U.S. to offer an on-demand commercial drone delivery option with Wing," said Vish Sankaran, Chief Innovation Officer, Walgreens. "With a customer-led focus, we continue to create differentiated shopping experiences that provide the products and services consumers need wherever, whenever and however they may want them. This is the kind of omni-channel partnership and offering that can redefine convenience for our customers and communities – delivering items to homes in minutes, not hours or days." Eligible customers in the Christiansburg area will have access to more than 100 products and six convenient "packs" via the Wing app that include many of Walgreens most sought-after products in store. Customers can either choose the individual products they need or, for simplicity's sake, choose one of the pre-built packs in the following categories: allergy, baby, cough/cold, first aid, pain, and kids' snacks. Prescription deliveries are not available via this service. The drone delivery option meets use cases where customers may want health and wellness or food and beverage items immediately, as leaving their home may not be ideal.

Energy Sector

Nothing significant to report.

Financial Sector

Barclays plc - Bloomberg wrote last week that Deutsche Bank has completed the auction(s) of its flow equity derivatives operations, split geographically into Europe (which reportedly went to Barclays), Asia and the U.S. The winning bidders on each of the Asian and U.S. portfolios weren't cited in the article, nor were there any details on pricing, volumes, and consideration.

The Royal Bank of Scotland has finally confirmed the appointment of Alison Rose as CEO. This development was broadly expected, and so confirmation is helpful, but there's a modest sense of 'what took so long?' and there are many challenges awaiting her, especially given the operational challenges so evident with Q2 2019 results. She will take over on November 1st 2019, with current CEO McEwan stepping down at the end of October (a reminder that he will take over at National Australia Bank). The press release reads broadly as no imminent changes forthcoming: "maintaining the safety and soundness of this bank will continue to underpin everything we do, as will our commitment to our customers and to delivering steady returns for our shareholders", albeit she does mention a "new chapter for this bank".

Ms. Rose will be perceived as the continuity candidate, in analysts' view, and as such this may reduce (but perhaps not eliminate) the potential for a new strategic plan that could be accompanied by new restructuring charges. That said, RBS (under McEwan's leadership) essentially dropped the key 2020 targets (>12% Return on Tangible Equity and <50% Cost / Income), so there is more flexibility for Ms. Rose to shape the bank in her own identity.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Mondelez International, Inc. - CFO Luca Zaramella in a meeting last week with Credit Suisse analysts reinforced the positive tone that he and CEO Dirk van de Put have been articulating in recent investor presentations regarding strong momentum behind the company's "Local First" strategy. Global category growth for snacking has rebounded to 3.4% and Mondelez has hit a tipping point for marketing share gains. Regional business leaders have the right tools and incentives in place to expand distribution and marketing behind their local brands while still taking advantage of Oreo and Milka's global scale. Europe has been an "execution machine" with strong merchandising gains for Cadbury and further expansion of the choco-bakery platform. Credit Suisse tracking data indicates strong 3.1% growth in North America retail in the past 12-weeks, up sequentially from 1.9% in the period ending June 15, 2019.

Economic Conditions

Canadian retail sales posted a moderate 0.4% gain in July, slightly below consensus. This marked the first rise in sales in three months—June was revised down to -0.1%—but even this was flattered by a rebound in auto sales and firmer prices. Ex-auto sales were a bit disappointing down 0.1% in the month, while retail volumes overall were flat. Retail volumes are now unchanged over the past 12 months, after rising just 0.9% for all of last year. While outlays on services are keeping real consumer spending growing at a moderate clip, the big picture is that households are being restrained by heavy debt burdens and mild income growth in our view (in spite of strong headline job gains). Note that clothing, shoe, and sporting goods stores saw a big pullback after a June, Raptor-inspired spike. On the flip side, cannabis retail outlets jumped 14% month/month and surpassed $100 million in sales for the first time - although they still account for just 0.2% of all retail activity.

Canada's manufacturing sales fell 1.3% in July - The Globe & Mail reported yesterday that Statistics Canada says manufacturing sales fell 1.3% to $57.2 billion in July as sales in the primary metal and motor vehicle industries moved lower. The agency says sales were down in 11 industries in July, representing 66.8% of total manufacturing sales. Economists had expected a decline of 0.2%, according to financial markets data firm Refinitiv. Statistics Canada says primary metal industry sales fell 7.3% in July as every primary metal industry except alumina and aluminum production and processing reported lower sales. Motor vehicle industry sales dropped 4.7% due in part to an extended shutdown at a major assembly plant for maintenance projects to support new model production. Manufacturing sales in constant dollars were down 1.6% in July, indicating that a lower volume of products was sold.

U.S. housing starts jumped 12.3% in the month, bringing to an end three straight declines, and the largest increase since October 2016 (and that particular surge was a rebound from a few soggy/windy months). The current level of 1.364 million units is the highest since June 2007. There was support from all sides as **singles** and **multis** were up (4.4% and 32.8%, respectively), and **all regions** were either higher or, in the case of the **West**, flat. Those builders asking for the go ahead to break ground also showed promise. **Building permits** rose for the second month in a row, up 7.7% in August (or 12.0% year/year) to 1.419 million units, the highest since May 2007. And, given that the level of permits is running above starts, there is room to move higher. **It looks like we will see the first quarterly increase in residential construction in seven quarters.**

U.S. existing home sales unexpectedly rose for the second straight month, up 1.3% to 5.49 million units annualized, the highest since March 2018. Sales for both **singles** (+1.2%) and **condos** (+1.7%) were up, and **across most of the country**, except for the West (-3.4%). However, the options facing homebuyers remain limited as the inventory of homes available to be bought fell again, lowering the **months' supply** to just 4.1 (or 4.0 for single-family homes), well below normal. Tight housing supply means higher prices with the **median sales price** rising 4.7% from a year ago. And it is an enticing case, with mortgage rates down considerably from their November peak of almost 5%. But limited options and higher prices are tough for prospective **first-time homebuyers** as their share of sales slipped for the second consecutive month and landed at 31%, the lowest in nearly a year and far from a healthy 40% level. **Repeat homebuyers** accounted for a six-month high of 50%.

U.S. industrial production jumped 0.647% in August, tripling expectations, which is a rare feat these days. July's 0.2% decline was trimmed a bit to -0.1% but that was offset by a slight trim to June's 0.2% increase to 0.1%. August's jump was the largest in one year and was supported by broad-based gains in the three major components. The key one, **manufacturing**, which accounts for three-quarters of total output, rebounded 0.5%, which is surprising as the trade war ramped up at the start of the month. **Mining** also bounced back after June's setback (1.4%). Even utilities put in a 0.6% increase, the second in a row. Interestingly, output in the motor vehicles sector was one of the lone negatives with its 1.0% drop. This could be attributed to production adjustments to avoid inventory accumulation as demand slows. The **capacity utilization rate** rose 0.4% to 77.9%, the highest level since the start of the year but still far from raising any inflation concerns in our view.

The Eurozone flash composite Purchasing Managers' Index (PMI) fell to 50.4 in September and hit its lowest level on record. German manufacturing PMI hit a new low at 41.4 while factory orders dropped at its fastest pace since July 2012 (43.1 vs 45.9.) led by declining export sales.

Japan's August trade balance recorded another month of deficit amounting to JPY136.3 billion but it was smaller than the JPY250.7 billion deficit recorded in July and the Bloomberg median estimate of –JPY365.4 billion. On an adjusted basis, the deficit was JPY130.8 billion (from JPY104.0 billion in July). August saw another month of declining exports which contracted by a more severe 8.2% year/year (from the -1.6% in July but better than Bloomberg's median estimate of -10.0%). In spite of the weak exports, the deficit was smaller in August because the decline in imports was even sharper at -12.0% year/year (from -1.2% in March, and Bloomberg's median estimate at -10.7%). The trade situation remained dismal for Japan in our view with exports declining for 9 straight months (year/year basis) since Dec 2018 while imports fell for four straight months since.

Financial Conditions

U.S. rates - As was widely expected, the U.S. Federal Open Markets Committee (FOMC) cut the target range for the fed funds rate last week by 25 bps to 1.75%-2.00%. And it dropped the interest rate on excess reserves (IOER) by 30 bps to 1.80%, in order to address recent upward pressure on the fed funds rate (it also announced that reverse repos would be conducted at 5 bps below the fed funds range instead of the usual bottom of the range). The statement emphasized the current dichotomy in the economy, stating that "although household spending has been rising at a strong pace, business fixed investment and exports have weakened." Partly reflecting this dichotomy, the decision to cut rates was not unanimous. As was the case on July 31, Kansas City President Esther George and Boston's Eric Rosengren both dissented in favour of no rate cut. But also dissenting this time was St. Louis President Bullard in favour of a 50 bps rate reduction. There were no other major changes to the statement. In the Summary of Economic Projections (SEP), there were only tiny tweaks to the median forecasts for real GDP growth (up a tenth to 2.2% in 2019 and 1.9% in 2021) and the unemployment rate (up a tenth to 3.7% in 2019). In the press conference, Chair Powell said the Fed was "highly data dependent", that trade policy uncertainty was having a negative effect on the economy, and that persistent sub-target inflation was a concern. In other words, the reasons why the Fed cut rates last week were comparable to the reasons why it cut rates in July. If the economy continues to weaken and if trade policy continues to stoke uncertainty another rate cut this year, based on the same rationale, is quite possible in our view.

The U.S. 2 year/10 year treasury spread is now 0.024% and the U.K.'s 2 year/10 year treasury spread is 0.077% - 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 15.35 (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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