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. October 21, 2019

Portland Product Call

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Owner Operated Companies

Berkshire Hathaway Inc. – BHE Canada, a unit of billionaire Warren Buffet's Berkshire Hathaway Energy, will start construction on a $200 million wind farm in southeast Alberta next year. The 117.6 megawatt (MW) Rattlesnake Ridge Wind project will produce enough energy to supply the equivalent of 79,000 homes. The project will be built without government subsidies and is being privately financed by BHE Canada through a combination of equity and debt. It will be developed by U.K.-based Renewable Energy Systems (RES). A large Canadian corporate partner has signed a long-term power purchase agreement for the majority of the energy output from Rattlesnake Ridge, which will begin generating energy in December 2021. BHE Canada and RES have also secured permits for the proposed Forty Mile Wind Farm in south eastern Alberta and are looking for partners in long-term power purchase agreements. Forty Mile would have generation capacity of 398.5 MW, potentially making it the largest wind power project in Canada.

BlackRock, Inc., the world's largest asset manager, exceeded analysts' estimates for its third quarter profit, as investors poured money into its fixed-income funds and cash management business amid worries about global growth. The company attracted $84.25 billion in new money during Q3 2019, boosting its total assets managed to $6.96 trillion. Investors preferred BlackRock's low-fee passive-investment products over its actively managed funds. BlackRock's iShares ETFs took in $41.5 billion of new money, up 15% from the prior quarter. BlackRock's cash management business drew net inflows of $32 billion in the third quarter, taking total assets for this business to $510 billion. "Whether there is risk-on trade in a quarter or risk-off trade in a quarter, we seem to be winning more share of wallet," Chief Executive Larry Fink said in an interview with Reuters. Revenue rose by 3% to $3.69 billion, driven by higher base fees and technology services revenue, offset in part by lower performance fees. BlackRock, which is trying to become a bigger provider of technology used by Wall Street firms to combat competitive pricing pressures in the asset management business, grew technology unit revenue by 30% to $259 million.

Danaher Corporation announced that it has signed an agreement to sell its label-free biomolecular characterization, chromatography hardware and resins, and microcarriers and particle validation standards businesses to Sartorius AG for approximately $750 million. The combined revenue of the businesses, which are part of Danaher's Life Sciences segment, was approximately $140 million in 2018. Danaher entered into the agreement to sell these businesses as a step towards obtaining regulatory approval for its pending acquisition of the General Electric Company (GE) BioPharma business, and the closing of the Sartorius AG agreement is conditioned upon Danaher's closing its acquisition of the GE Biopharma business. Danaher's acquisition of the GE Biopharma business, the proposed regulatory remedies (the package of businesses being sold), the approval of Sartorius as the buyer in such remedies, and Sartorius' acquisition, described above, remain subject to approvals from various regulatory authorities. Thomas P. Joyce, Jr., President and Chief Executive Officer, stated, "This represents a significant step in the regulatory process toward closing the GE Biopharma acquisition. While timing around meeting all closing conditions, including regulatory approvals, is still uncertain, we remain very encouraged by the progress to date and expect closing of the transaction in the first quarter of 2020."

Oracle Corporation – Oracle's 62-year-old co-chief Mark Hurd died on Friday morning, the company said, an unexpected development that raises pressure on co-CEO Safra Catz to lead the business software maker's ongoing transition to cloud computing. Last month, Hurd went on a medical leave for unspecified health reasons, while Catz and founder Larry Ellison took over his responsibilities during the absence. "Oracle has lost a brilliant and beloved leader who personally touched the lives of so many of us during his decade at Oracle," Ellison wrote in an email to company employees. Hurd and Catz were named co-CEOs in 2014, after Ellison decided to step aside to focus on his role as chief technology officer. Under their tenure, Oracle has been aggressively pushing into cloud computing to make up for a late entry into the fast-growing business dominated by Microsoft Corporation and Amazon.com, Inc. Catz, trained in finance and law, was a Wall Street banker from 1986 until she joined Oracle in 1999 and has been a central figure in Oracle's many acquisitions.

Energy Sector

Nothing significant to report.

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Financial Sector

Bank of America Corporation reported Q3 2019 EPS of $0.56. Excluding an expected $2.1 billion impairment charge tied to its First Data Corp joint venture termination, EPS was $0.75. Consensus was $0.68. Operating revenues rose 1% year/year and were little changed with Q2 2019 at $23 billion. Tangible book increased 1.8% to $19.26 (trading at 1.5x). Excluding the impairment charge, its ROE was 11.16% and ROTCE was 15.55%. Its CET-1 ratio was 11.4%. Average diluted shares declined by 2.2%. Net interest income (NII) was little changed from Q2 2019 as the benefits from loan and deposit growth, higher trading-related NII, and one additional accrual day were offset by impact of lower short-end and long-end rates. Average earning assets increased 0.7%. Its net interest margin declined 3bps to 2.41%. Fee income rose 2% year/year and declined 1% linked quarter. Core expenses (excluding litigation) decreased 2% year/year and fell 4% linked quarter. Its Non-Performing Assets ratio declined 8bps to 0.39%. Its reserve/loan ratio declined 2bps to 0.98%.

Morgan Stanley reported Q3 2019 EPS of $1.27. Excluding an intermittent net discrete tax benefit ($89 million), EPS was $1.21 and consensus was $1.10. Results also benefited from a non-recurring realized performance fee in Investment Management. Revenues increased 2% year/year and declined 2% linked quarter to $10.0 billion. Tangible book increased 3.4% to $39.73 (1.1x). It posted an 11.2% ROE and 12.9% ROTCE. Its CET-1 ratio was 16.2% (-10bps). It repurchased $1.5 billion of its shares (25% of its $6 billion ask). Average diluted shares declined 1.7%. Institutional Securities – revenues increased 2% year/year and declined 2% linked quarter to $5.0 billion. Investment banking fees increased 5% year/year and rose 4% linked quarter. Relative to Q2 2019, fixed income underwriting (+39%) and advisory (+9%) increased, while equity underwriting (-27%) fell. Wealth Management - revenues declined 1% on both a year/year and quarter/quarter basis to $4.4 billion. Relative to Q2 2019, asset management (+4%) and net interest income (+3%, though -3% year/year) increased, while transactional (-18%; potentially reflecting losses on investments associated with certain employee deferred compensation plans) and other (-33%) fell. Investment Management – revenues increased 17% year/year but fell 9% from Q2 2019 to $764 million. Relative to the prior quarter, asset management fees increased 8% to $664 million (includes non-recurring realized performance fee). Long-term AUM was little changed at $335 million. Net flows were +$13.3 billion, up from $7.9 billion last quarter and included $4.2 billion of long-term flows. Expenses increased 4% year/year and were little changed linked quarter. Its compensation ratio was 44% and its cost / income efficiency ratio was 73%.

State Street Corporation reported Q3 2019 EPS of $1.42. Excluding $27 million of acquisition & restructuring costs and $18 million of legal costs, EPS was $1.51. In addition, Net Interest Income (NII) included $20 million ($0.04) of episodic market-related benefits, putting core EPS closer to $1.47. Relative to Q2 2019, results evidenced stable fee income; an increase in NII on a slightly larger balance sheet, a stable core Net Interest Margin, and an additional day; a decrease in expenses; a higher tax rate; and a reduced average share count (-1.8%). Assets Under Custody increased 0.4% to $32.9 trillion and Assets Under Management rose 1.2% to $3.2 trillion. Servicing mandates announced were $1 trillion, while Investment Management inflows were $13 billion.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Barrick Gold Corporation reported Q3 2019 preliminary gold production of 1.31 million ounces (Moz) which was modestly (2%) ahead of analysts' 1.28 Moz estimate. Continued strong attributable production from Loulo-Gounkoto and Kibali, along with significant sequential improvements at the Tanzanian assets and Porgera, were partially offset by a (slightly) softer-than-expected quarter at Nevada Gold Mines, Tongon, and Kalgoorlie. Barrick noted that Q3 2019 gold cash costs are expected to be 8-10% higher than Q2 2019 (cash costs of $651/oz). Barrick also noted Q3 2019 gold cost of sales is expected to be 11-13% higher than Q2 2019 of $964/oz due to higher depreciation from purchase price adjustments in Nevada. Copper production was 111 million pounds (Mlb) in the quarter, up 14% from the prior quarter (97 Mlb). The Jabal Sayid project had another strong quarter. At Lumwana, sales lagged production as one of the three smelters used by the mine closed for a major refurbishment over the summer and is expected to remain closed for the balance of the year. Barrick is evaluating alternative smelter opportunities while maintenance work continues. For Q3 2019, Barrick expects a slight (2-4%) quarter/quarter increase in copper cash costs (Q2 2019 cash costs of $1.59/lb) and a 13-15% quarter/quarter increase in copper due to lower sales volumes. It is anticipated Barrick will have a relatively stable production profile over the next five years (average gold production of 5.2 Moz at cash costs of about $700/oz).

Dufry AG signed a new contract for Mexico City airport, which will add 3 new duty-free stores (1,400 square meters (sq. m)). Dufry already has 26 stores (duty-free and duty-paid) with 6,000 sq. m. In Cancun Dufry has 6,300 sq. m. Latin America (18% of Dufry sales) was weak in the first half of 2019, but Mexico had positive growth –it is estimated that Mexico (present in 12 airports) makes 3% of Dufry sales. The new contract at Mexico City airport (1,400 sq. m) just adds 0.3% to Dufry's total retail space and 1.1% to Latin America's retail space but its strengthen the leading position in this market further and gives additional growth potential in our view.

Nestlé S.A. delivered Q3 2019 organic sales growth of 3.7% (of which -0.2% is price impacted by lower coffee prices) benefitting around 10bps from Skin Health; consensus was 3.9%. As anticipated,

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developed market performance was strong with organic sales growth of 3.0% (price was -0.3%) with U.S. growth accelerating and emerging markets delivering 4.7% (price was 1.0%) with some softness in China. Reported sales increased by 1.8% to SFr 22.91 (consensus SFr 23.28 billion). Q3 2019 organic sales growth by category: Beverages 3.0% (Starbucks roll-out, offset by negative pricing), Waters -1.1% (impacted by the poor summer weather in Europe), Milk 3.0% (Pakistan still a drag), Nutrition 3.8% (China infant formula up low single digit), Culinary 3.6%, Pet Care 9.6% (strong U.S. performance) and Confectionery 1.9%. As expected, management re-iterated Fiscal year 2019 organic sales growth guidance of "around 3.5%" (consensus 3.6%) and underlying trading operating margin of at least 17.5% (consensus 17.6%). Having recently completed the SFr 10.2 billion disposal of Skin Health, management announced a new SFr 20 billion capital return program (potentially in the form of buybacks and special dividends) over 2020-22. Meantime the existing share buy-back program is ongoing with a further SFr 2.3 billion to be completed by year-end. The group also announced the decision to integrate the Waters business into the three geographical zones beginning in 2020.

South32 Limited delivered a solid set of Q1 2019 production figures in our view, with the key manganese, alumina and coking coal tracking at 25-26% of fiscal year guidance – fiscal year 2020 guidance for all operations was maintained. The net cash balance increased by $163 million to $527 million, reflecting $98 million proceeds received for an insurance claim from the Klipspruit dragline outage last year, an unquantified Working Capital inflow and $65 million of dividends received from equity accounted investments, partially offset by share buy-backs of $74 million in Q1 2020 ($190 million of the buy-back remaining) and increase in finished goods inventory. This implies Free Cash Flow of around $139 million excluding insurance proceeds (6.7% yield). On the strategic front, negotiations with Seriti for the SA energy coal sale is continuing with the company on track to provide an update in Q4 2019. The strategic review of manganese alloy smelters is under way and an update will be provided in Q2 2020.

Economic Conditions

In Canada, the consumer price index fell 0.4% in September, leaving the year-on-year inflation rate at 1.9%. In seasonally adjusted terms, CPI fell 0.1%, as three of the eight broad categories saw price declines. Indeed, lower prices for transportation (-0.4%), recreation/education (-2%) and alcohol/tobacco/cannabis (-0.1%) more than offset rising prices in other categories including a notable +0.9% increase for clothing/footwear and 0.3% increases in both health care and food categories. The Bank of Canada's three core inflation measures on a year-on-year basis were as follows: 1.9% for CPI-common, 2.2% for CPI-media and 2.1% for CPI-trim. The Canadian headline inflation numbers were a bit lower than expected. But the decline was far from widespread with only three categories seeing lower prices including the transportation category which was dragged down by lower pump prices. The economy's lack of excess capacity is arguably better represented by the three measures of core inflation which are currently averaging higher than 2%. In other words, September's below consensus headline inflation is unlikely to change the Bank of Canada's thinking with regards to monetary policy in our view.

U.S. housing starts slipped 9.4% in September, weaker than expected, to 1.26 million annualized units (the prior month was revised up slightly). Keep in mind that activity surged to a cycle high in August, so some payback was due. For all of Q3 2019, that leaves starts at a solid 1.28 million units, up from 1.26 million in the prior quarter and the best level since Q1 2018. In fact, given the uptick in starts and firm resale activity, it looks like residential investment will expand in Q3 2019 for the first time in seven quarters. Single-units starts edged higher in the month, leaving all of the decline in the multi-unit segment. All regions of the country were lower in September, with the Northeast and Midwest seeing the biggest swings. Meantime, building permits were down 2.7% in September, which was less of a pullback than expected after the outsized gains seen over the prior two months (also to a cycle high). At 1.39 million annualized units, the level still suggests that residential construction activity should hold firm in the months ahead. The plunge in mortgage rates and still-solid job market conditions have helped drive a positive turn in U.S.

U.S. retail sales fell 0.3% in September, much weaker than consensus which had expected an increase. However, there were upward revisions to the prior month from +0.4% to +0.6%. September sales were restrained by motor vehicles/parts (-0.9%). But even excluding autos, sales fell 0.1%, which also disappointed consensus which looking for an increase. Ex-auto sales were hammered by lower receipts at gasoline stations, as well as for sellers of building materials, food/beverage, sporting goods, and even non-store retailers which offset gains for sellers of furniture, health care products, and clothing. The U.S. retail data was weaker than expected, although not by much considering upward revisions to the prior month. The data confirms a moderation in U.S. consumption growth in Q3 2019, albeit not unexpected after a massive Q2 2019.

'Brexit' - British Prime Minister Boris Johnson was unable to get his Brexit deal through parliament this weekend. MPs voted 322-306 in favor of the Oliver Letwin Amendment which requires the House of Commons to pass all necessary Brexit legislation before holding a formal "Meaningful Vote". As a result, PM Johnson complied with his legal obligation to request an extension from the EU, but without his signature. So he 'kept his promise' by asking for more time, but has he upheld his principles by not signing it? The request was also accompanied by a second letter, signed this time, saying he believes a delay would be a mistake. The EU will likely approve the extension if PM Johnson is unable to get his deal past MPs this week, however, analysts believe approval will come right at the last minute, as all things seem to happen in the EU. With regards to a possible meaningful vote today, it will likely not be allowed by Speaker John Bercow as this would be the same deal that was proposed on Saturday, and the amendment that passed on Saturday specifically forbids approving the deal before all legislation is approved. Focus would then immediately turn to Tuesday, where a vote on the Withdrawal Agreement Implementation Bill will serve as a proxy "meaningful vote" and Oliver Letwin has confirmed he would now vote with the Government in favour of accepting the deal.

China's Q3 2019 GDP growth slowed further to 6.0% year/year (1.5% quarter/quarter) from 6.2% year/year (1.6% quarter/quarter) in Q2 2019, a new low on record in the quarterly data series (starting from 1992). This missed Bloomberg's consensus of 6.1%. Tertiary industry continued to anchor growth while secondary and primary industries registered a moderation in their growth rates. Industrial production and retail sales saw stronger growth in September but fixed asset investment and trade weakened. Jobs creation in the first three quarters registered 10.97 million, nearly achieving the full-year target of more than 11 million. This remains an important indicator that the Chinese government can maintain social stability even as economic growth slows, in our opinion. Accounting for the latest growth print, China's economy expanded by 6.2% year/year in the first three quarters of 2019, as trade conflicts with the U.S. continue to pose significant uncertainties to the outlook.

Australia's unemployment rate fell to 5.2% in September, surprising the market who had expected it to hold at 5.3%. Employment rose by 14,700, down from a revised 37,900 in August and below expectations for a 15,000 increase. This was largely driven by full-time employment, which rose by 26,200 in September, up from a 13,200 decline in August. Part-time employment fell by 11,400 in September, down from the 51,100 increase in August.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.191% and the U.K.'s 2 year/10 year treasury spread is 0.196% - 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 3.69% (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 14.35 (compares to a post-recession low of 18.00 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.

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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