News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. February 18, 2020

Owner Operated Companies

Brookfield Asset Management Inc. (BAM) reported steady results in line with our expectations that highlight the continued growth in its core operations and management fee business. For the quarter, BAM reported operating funds from operations (FFO) per share of $0.77 up from $0.66 in Q4 2018. For the full year 2019, BAM reported operating FFO per share of $2.78, up from $2.61 in 2018. Most of BAM's publicly traded subsidiaries have been performing extremely well in our view and fundraising for new private funds has been exceptionally successful. Fee-related earnings have grown to $1.4 billion (annualized), up from $927 million as of the end of 2018. In addition, annualized net carried interest is now $1.6 billion, up from $1.0 billion as of the end of 2018. BAM also announced that its Board of Directors have approved a three-for-two stock split. The stock split will be implemented by way of a stock dividend; each shareholder of either Class A or Class B shares will receive one share for every two shares held. The stock dividend will be payable on April 1, 2020 to shareholders of record at the close on February 28, 2020. **BAM's dividend has grown at a compound annual growth rate of 8.5% over the last four years.** While releasing year-end results, BAM announced that it would raise its quarterly dividend 12% to $0.18 per share, $0.72 annually. On a post stock-split basis, the dividend will be $0.12 per share. BAM discloses its internal estimate of its value, which is now $85.39 per share, up from $80.14 in Q3 2019. The management fee business is being valued at $53.8 billion ($51.10 per share), up from $50.7 billion ($48.09 per share) in Q3 2019. Driving the increase in BAM's internal estimate is primarily greater fee-related earnings. Rising unit prices for BAM's listed partnerships and closing larger private funds has contributed to strong growth in management fees. BAM owns an extremely high-quality portfolio and a growing stream of recurring management fees. In the near term, as BAM continues to successfully raise new funds, NAV growth should be driven by its rapidly growing management fees and FCF. Longer term, BAM should generate meaningful cash flow growth from its substantial unrealized carried interest and continued strong performance from its various divisions.

Energy Sector

Nothing significant to report.

Financial Sector

Barclays PLC produced a reasonable set of Q4 2019 numbers. Profit before tax in Q4 2019 was £1,097 million. Excluding litigation profit before tax in Q4 2019 was £1,264 million or +14% (+£158 million) ahead. Pre-provision £1,767 million was +8% (+£129 million), although the bulk of the beat is due to debt sales. Revenues £5301 million (+4%), Costs £3534 million (-9%). Cost-Income ratio 67%. Dividend per share was at 6 pence. Tangible Book was at 262 pence per share. ROTE was 5.1%. CET-1 ratio was at 13.8%. Barclays guiding to upgrades for 2020 and maintained the greater than 10% ROTE guidance but removed 2020 date (as expected). However, management do expect a "meaningful" improvement on 2019 which implies at least +6% upgrade. The Prudential Regulation Authority investigation into Jes Staley re his relations with Jeffrey Epstein when an executive at JP Morgan is an unhelpful backdrop – albeit we understand that the issue has already been thoroughly investigated by Barclays internally. Barclays trades at less than 8x 2021 earnings (which look set to see positive revisions) and under 0.7x 2020 estimated tangible book, indicating that the shares remain attractive.

Standard Chartered PLC and HSBC Holdings PLC are offering billions of dollars in relief measures to borrowers as the coronavirus outbreak threatens to deal a further blow to the Hong Kong economy. Standard Chartered said it would allow clients with good repayment histories to make six months of interest-only mortgage payments, and would offer a similar moratorium on principal payments for some commercial loans. HSBC announced that it would provide more than HK$30 billion in liquidity relief for businesses. This includes HK$10 million in cash flow support for its trade finance customers and a moratorium on principal payments for commercial loans secured against property.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Ares Capital Corporation reported Q4 2019 core net investment income per share of $0.45, in line with the consensus of $0.45. Interest income was modestly lower than some estimates, but was offset by higher structuring fees and dividend income. Book value per share was flat quarter/quarter and up approximately 1% year/year. Overall, it was another solid quarter as Ares continues to produce consistent results. While the company continues to maintain a conservative stance at this point in the cycle, it also remains well positioned with its expanded leverage capacity to be opportunistic going forward. Ares had $1.6 billion of new commitments during Q4 2019 (down 41% year/year) of which 75% were in first lien, 12% in subordinate secured loans, 7% in the subordinate certs of the Senior Direct Lending Program (SDLP), 5% in second lien, with the remainder in other equity and preferred securities. Against that, Ares had approximately $1.2 billion of exits (up 20% year/year). The portfolio mix at quarter end was 44% first lien (vs. 45% previously), 30% second lien (vs. 32%), and 6% in certificates of the SDLP (vs. 6% previously). Overall yield on debt and income producing securities at amortized cost was down 20 basis points quarter/quarter at 9.6%. Leverage was approximately 0.93x debt to equity, up from 0.89x the prior quarter. Ares sold approximately 3.5 million shares of common stock during the quarter for $64 million in an "at the market offering" and has approximately $435 million remaining available under its Equity Distribution Agreement (entered into in November 2019).

Economic Conditions

U.S. – In January, U.S. payrolls expanded by 225,000, not only beating the consensus forecast, but also forecasts from every single economics group. Since January 2019, both payrolls and civilian employment – an alternative measure of jobs that includes small-business start-ups – are up 2.1 million. The labor force – those who are either working or looking for work – is up 1.5 million, while the jobless rate fell to 3.6% from the 4.0%. The labor force participation rate (the share of adults who are either working or looking for work) increased to 63.4% in January, the highest reading since early 2013. Participation among "prime-age" adults (25 to 54) hit 83.1%, the highest since the Lehman Brothers bankruptcy in 2008. Meanwhile initial claims for unemployment insurance hit 202,000 in the last week of January, and initial claims as a percent of all jobs are at the lowest level ever. In other words, the job market and the economy look strong. Only a few months ago, some analysts were saying that the inversion of the yield curve - with short-term interest rates above long-term rates - was signaling the front edge of a U.S. recession. Now a recession seems nowhere in sight.

President Trump is presenting his budget plans to Congress this week, and early reports suggest some proposals to rein in entitlement spending. We wouldn't hold our breath waiting for these policies to get implemented. No matter who controls Congress, the one bi-partisan thing Washington, DC is able to do is spend more taxpayer money. And even with a slowdown in spending growth for entitlements, the President's budget proposal still won't balance the budget until 2035. To be clear, we do not think deficits are the proper tool to use for economic forecasting. What matters is spending, and federal spending has grown to be too large a share of U.S. GDP. The bigger the government, the smaller the private sector. In 1983, according to the Office of Management and Budget, federal spending was 22.9% of GDP. In 1999, under President Clinton, it had fallen to 18%, and from 1983 through 1999, real GDP grew 3.7% at an annual rate. This trend was reversed with government spending rising to 21.1% of GDP in 2019, and from 2002 to 2019, real GDP grew just 2.1% annualized.

Canada - The Globe & Mail reported that Bill Morneau is warning that the coronavirus outbreak will have a significant impact on the Canadian economy, hitting the tourism and petroleum industries particularly hard. The Finance Minister said he expects the economic fallout from the outbreak, which has killed more than 1,000 people and infected tens of thousands, will be a major topic as he attends meetings in the coming weeks with Group of 20 finance ministers and central bank governors. "I do want to acknowledge that the virus is undoubtedly going to have an economic impact," Mr. Morneau said during a speech in Calgary. "We know the impact is real. It's going to be felt across the country but perhaps even more so here in the oil and gas sector." Mr. Morneau said the exact economic toll of the outbreak isn't clear. He added the health risk to Canadians remains low. The spread of coronavirus has prompted fears about the potential economic impact both inside and outside of China, where the outbreak began. Oil prices have fallen 15 per cent in the past three weeks, as refineries in China curtail production to reflect lower requirements for fuel in the country, and the Canadian dollar is at a four-month low. The tourism industry is also coping with travel advisories and flight cancellations, which have further reduced demand for fuel, and the Chinese manufacturing sector has been hit by plant closings. The Bank of Canada estimated the impact of the 2003 SARS outbreak was about 0.1 per cent of gross domestic product, but also that most of that was later reversed. In contrast to SARS, which killed 44 people in Canada and led to advisories against travel to Toronto, there have only been a handful of coronavirus infections in this country so far.

The Globe & Mail reported that consumer insolvencies rose by 9.5 per cent in 2019 to the second-highest total on record, raising concerns about the financial well-being of Canadian households and their ability to manage burdensome debt loads. Just more than 137,000 consumer insolvencies were filed in 2019, an increase of nearly 12,000 from a year earlier and the largest total since 2009, according to new figures from the Office of the Superintendent of Bankruptcy. Insolvencies include both bankruptcies and proposals, which are offers to settle debts under new terms. During Q4 2019, consumer insolvencies rose 10.2 per cent from a year earlier, driven entirely by an increase in proposals. The upturn has confounded some economists, given the underlying strength of the labour market, but also follows a multi-decade boom in borrowing that's seen Canadians pack on billions in additional debt, for which payments are more onerous than ever.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.15% and the U.K.'s 2 year/10 year treasury spread is 0.08% - 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 3.47% (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 3.9 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 14.93 (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.

Portland Investment Counsel Inc. currently offers Mutual Funds & Private/Alternative Products - visit www.portlandic.com

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) 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.

Portland Investment Counsel Inc. portlandinvestmentcounsel Portland Investment Counsel Inc. @PortlandCounsel

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 tangible equity, 'ROTCE' return on tangible common equity.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC20-010-E(02/20)