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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. May 30, 2016

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Energy Sector

Whitecap Resources Inc. – has completed its previously announced bought-deal financing. Pursuant to the offering, Whitecap issued a total of 51,087,000 subscription receipts of Whitecap at a price of $9.20 per subscription receipt for gross proceeds of approximately $470 million. The syndicate of underwriters was led by National Bank Financial Inc. and TD Securities Inc. and includes Scotia Capital Inc., GMP Securities L.P., RBC Dominion Securities Inc., BMO Nesbitt Burns Inc., CIBC World Capital Markets Inc., FirstEnergy Capital Corp., Peters & Co. Limited, Cormark Securities Inc., AltaCorp Capital Inc. and Macquarie Capital Markets Canada Ltd.

U.S. land rig count fell by 1 rig to 374, led by vertical oil (-2), horizontal oil (-1), offset by directional gas (+2), while directional oil, horizontal gas, and vertical gas remained flat week/week. Total horizontal land rig count has declined 77% since the peak in November 2014.

U.S. horizontal oil land rigs decreased by 1 rig week/week to 247 led by losses in the Permian (-2), Williston (-1), and “Other” (-1) were offset by gains in Granite Wash (+2) and DJ-Niobrara (+1), while Eagle Ford, Mississippian, and Woodford remained flat week/week. Additionally, the Permian gained 2 vertical oil land rigs.

U.S. offshore rig count was flat week/week at 23, and is down 57% since June 2014.

Canadian rig count was flat w/w and remains 56% off the level this time last year.

Financial Sector

JPMorgan Chase & Co.’s private bank announced internally another round of layoffs affecting nearly 100 employees. The moves, which affect employees in a range of positions and locations, follow previous rounds of layoffs across the country in recent months. The shift is one of the boldest yet among banks that are increasingly focused on managing the money of wealthy clients, who generate more fees and entail less risk than middle-class and lower-income customers. (Source Wall Street Journal)

Prudential plc - On February 1st Prudential announced Michael McLintock had decided to retire as Chief Executive of M&G Investments and as an executive director of Prudential and that he would be succeeded by Anne Richards. Anne Richards’ appointment will be June 7th.

Royal Bank of Canada reported Q2 2016 cash Earnings Per Share (EPS) of $1.71 which beat consensus of $1.64. The beat was largely attributable to stronger trading & investment banking revenues (+6c). We note that RBC’s adjusted EPS include a $50 million collective allowance (-2c). ***Canadian Personal & Commercial banking*** earnings growth was 4% year-on-year (YoY) (was flat during Q1 2016). Loan growth was flat quarter-on-quarter (QoQ), reflecting 1% QoQ growth in mortgages, 1% growth in commercial offset by declines in credit cards (-2% QoQ) and personal lending (-1% QoQ). Net Interest Margin was up 2bps QoQ. **Capital Markets’** earnings were down 7% YoY and up 2% QoQ. Trading revenues of $778 million (consolidated) compared to our $600 million forecast. ***Wealth Management*** reported earnings were up 42% YoY, and included $66 million of earnings from City National (or $108 million ex. integration). Excluding City National, Wealth earnings were up 18% YoY and up 28% QoQ. ***Insurance*** earnings were up 44% YoY and up 35% QoQ, largely reflecting a positive tax item. Excluding a $50 million collective allowance, total bank Provisions for Credit Losses were $410 million versus ~$430 million forecast. Basel III Core Equity Tier 1 ratio of 10.3% up 40 bps QoQ. RBC announced an Normal Course Issuer Bid program to repurchase up to 20 million of common shares, 1% of shares outstanding.

Royal Bank of Scotland Group Plc (RBS) - small share issue. RBS has issued 38.5 million shares at 221p per share, raising £85 million. The shares have been sold in the market with the subscription price determined by reference to the average price since Q1 results and April 29th. This is to neutralise the cash impact of the hybrid coupons.

RBS is also cutting 450 service jobs as it retrenches its operations in the U.K. “As RBS becomes a smaller UK-focused bank, we are restructuring our support services to better align with the business we are becoming,” according to an e-mailed statement from the bank that didn’t include any job figures. “These changes unfortunately mean some job losses.” (Source:Bloomberg)

The Toronto-Dominion Bank reported core cash EPS of $1.20, above consensus of $1.17. Total revenues were $7,869 million this quarter, slightly below expectations due to lower “other” income. Overall, TD’s revenue growth of 8% compares favourably to the 5% growth at BMO and CIBC. Non-interest expenses came in at $4,556 million for the second quarter, better compared to estimates of $4,699 million. Loan loss provisions totaled $584 million in the quarter, slightly above the $562 million forecast. Oil and gas loan losses were $49 million in the quarter, higher than $11 million last quarter, but still reasonable in the context of the bank’s $6.6 billion portfolio. TD’s loss rate on oil gas is equivalent to 3% and would compare to BMO’s loss rate of 1.71% and CIBC’s loss rate of 5% (this ratio is expressed as oil and gas Provision for Credit Losses divided by the size of the drawn oil and gas loan portfolio). The bank’s Core Equity Tier 1 ratio was 10.1%. The bank highlighted that based upon preliminary analysis, the fires in Fort McMurray are unlikely to have a material impact on the financials of the bank.

Wells Fargo & Company on Tuesday highlighted the pain persistently low interest rates and tougher regulations are inflicting on banks when the world's largest lender by market capitalisation issued lower financial targets. Low interest rates are squeezing the spread banks earn between the rates at which they borrow and lend. Wells also cited regulators' push to require the industry to hold more assets that can be quickly turned into cash, the so-called liquidity coverage ratio. CEO Mr. Shrewsberry gave a new target to generate return on equity over the next two years of between 11% and 14% that is down from a previous target range, set out in 2014, of 12% to 15%. Wells also cut guidance for return on assets, from between 1.3% and 1.6% to between 1.1% and 1.4%.

Activist Influenced Companies

Hertz Global Holdings Inc. – said that its units have priced $610.0 million aggregate principal amount of 7.50% senior secured second priority notes due 2022 and $625.0 million aggregate principal amount of 7.75% senior secured second priority notes due 2024 to raise funds related to the spinoff of the global equipment rental business. Each series of notes will pay interest semi-annually in arrears. The closing of the offering is expected to occur on or about June 9, 2016, subject to customary closing conditions.

Canadian Dividend Payers

Brookfield Infrastructure Partners LP – Australia's antitrust watchdog raised fresh concerns about a planned AUD$9.1 billion (US$6.5 billion) takeover of rail and port giant Asciano Ltd., potentially forcing the Canadian-led buyout consortium to restructure the deal. The Australian Competition and Consumer Commission (ACCC) had been due to give a final decision but instead warned the deal may give Asciano's new owners too much control of the freight chain, and said it needed two more months to consult with industry players before it could make a ruling. The buyout group - led by Canada's Brookfield Asset Management Inc. and including companies from China, the Middle East and Australia, may have to appease the regulator by offering to sell some assets. Brookfield agreed to modify its initial solitary bid for Asciano in January after the regulator expressed concern that it would have freight trains and tracks in Western Australia state. A month later, it offered to end a bidding war with Australian stevedoring company Qube Holdings Limited and make a joint offer for Asciano's port assets only, leaving the rest to China Investment Corporation (CIC) and others. That move was also partly aimed at easing anti-trust concerns. The deal would cement Sydney-based Qube's position as Australia's biggest stand-alone ports company, and give Beijing's sovereign wealth fund CIC a slice of the railways business in one of China's biggest trading partners. But the regulator said that as Qube already had nationwide cargo handling operations, taking ownership of Asciano's ports could give it unfair access to services contracts. The ACCC said it would take industry submissions and give its final decision on July 21. In a statement, Qube said it was confident it could overcome the regulator's concerns. Asciano said it still recommended the takeover, due to be voted on by shareholders on June 3.

Crown Capital Partners Inc. has closed a $15 million, five-year term loan through Crown Capital Fund IV (CCF IV) with Bill Gosling Outsourcing Holding Corp. (BGO), a provider of call center solutions and other business process outsourcing services. BGO was founded in 1955 and is headquartered in Newmarket, Ontario. BGO offers a full suite of customer contact solution services (i.e. accounts receivable management, customer care, and customer sales & acquisition) and operates nine call centers in Canada, the U.S., the U.K. and Philippines. The company's key customers include Fortune 100 and Fortune 1000 companies in the financial, communication, utility and government sectors. BGO maintains a stable relationship with its customers, with average tenure of more than 10 years for its top 10 customers. This deal is characterized as a specialty finance loan, which includes a bonus feature based on growth of the company over term of loan, deal fees (~2% of investment), and management fees (~1.7%) off LP capital. BGO expects to increase revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) significantly over the next three years, driven by key customers and its Philippines expansion. This is the third loan made through CCF IV, the portfolio is diversifying nicely in our view with Petrowest (infrastructure/energy services), Distinct (design/engineering/ construction/maintenance services) and now BGO (business process outsourcing services).

Transalta Renewables Inc. announced that it priced a bond offering of approximately $159 million which will be secured by a first ranking charge over all assets of the Issuer. The bonds are amortizing and bear interest from their date of issue at a rate of 3.963%, payable semi-annually and mature on June 30, 2032. Net proceeds of the financing will be used to, among other things, make advances to Canadian Hydro Developers, Inc. on a subordinated basis pursuant to an intercompany loan agreement, the proceeds of which will be used to finance certain facilities of the Issuer's affiliates and for other general business purposes. Closing of the financing is expected to occur on June 3, 2016. The assets consist of the 67.8 MW New Richmond wind facility located in the Gaspé Peninsula near the town of New Richmond, QB and began commercial operations in March 2013. The wind project is 100% contracted to Hydro-Québec for a term of 20 years from commercial operations and utilizes proven Enercon turbine technology.

Global Dividend Payers

AT&T Inc. – has made a bid for Yahoo Inc's internet business, Bloomberg reported on Wednesday, citing people familiar with the matter. AT&T had previously decided against making an offer, people familiar with the matter told Bloomberg in April. Reuters, citing sources, reported on April 29 that Yahoo had shortlisted close to 10 bidders in an auction for its internet business, including Verizon Communications Inc, the biggest U.S. wireless carrier. While Verizon remains a favorite, it didn't submit one of the highest first-round bids, Bloomberg reported on Wednesday, citing two of the people.

Roche Holding AG surprised investors last Friday with the news that Gazyva (obinutuzumab; anti-CD20; follow-on to Rituxan) showed superior progression-free survival compared (at the interim) to Rituxan in people with previously untreated follicular lymphoma at an interim analysis of GALLIUM Phase 3 trial in indolent NHL (iNHL). The surprise comes in both result and direction. We believe the market were mixed on the longer-term prospects for the ROG anti-CD20 franchise in NHL, with modest revenue expectations for GAZVYA and material erosion to Rituxan revenue due to biosimilar competition. Investors were also watching for results from a different GAZYVA trial, called GOYA, in aggressive NHL (aNHL), which were anticipated by year-end. However we now believe investors can now re-value the CD20 franchise markedly higher. Rituxan sales were just over 7B CHF in 2015, and iNHL represents the largest slice. As part of its biosimilar defense strategy for the CD20 franchise, Roche aimed high: to elevate the standard of care by taking on its own drug Rituxan in head-to-head trials. In CLL (the smallest cancer indication for Rituxan), Roche did just that. But it was not clear that Roche would do the same in NHL, which is commercially what mattered more in our opinion. The specific details for GALLIUM were not disclosed but we can draw two meaningful inferences. A positive result at the interim implies a strong drug effect. Consequently, Roche can argue that the cost savings offered by biosimilar rituximab brings with it an inferior outcome for the patient. This argument will at least be heard by the developed market payers. Second, success in iNHL does incrementally raise the chances for a tripling of GAZYVA sales (currently forecast CHF 1.3 billion for GAZYVA in 2021). This assumes a strong drug effect in iNHL and a 'decent' result in aNHL from GOYA in a few months' time, and we think this is the appropriate, given the facts we know today. In aggregate, it means that Roche maintains its CD20 franchise at about 2015 levels.

Economic Conditions

U.S. durable goods orders surpassed expectations with a 3.4% jump in April, the largest increase since January. Most of the gain was due to a surge in the aircraft component, as orders excluding transportation were up a more moderate but as-expected 0.4%. Still, those are pretty decent figures, and the **upward revisions to March** helped as well. The details were encouraging, as nearly all major areas saw orders rise…..from fabricated metals, to computers & electronics, to electrical equipment….however, general machinery orders were a standout, down for three straight months, or the seventh time in the past eight months. For the purposes of what gets fed into the national accounts, **core orders** (nondefense capital goods orders excluding aircraft) have fallen for three consecutive months, or five in the past six, which does not bode well for future capital spending. Whether this is a product of businesses reluctant to order due to weak activity, or concern about what will happen on November 8th, isn't clear. Probably a little bit of both? The proxy for current spending, however, was better…….core shipments (nondefense capital goods) snapped two straight declines with a 0.6% rise in April. So that's good news and a better start to Q2, which is needed as the last two quarters plunged at double-digit rates.

The 2nd estimate of the U.S. first quarter economic growth fell short of the expectations, calling for a 0.9% improvement, though it did moved the broader economic growth rate higher, to 0.8% compared to the first reading of 0.5%. Foreign trade and inventory destocking were less of a drag compared to the initial estimate. The report included revisions to fourth-quarter personal income that showed wages accelerated more than previously estimated. Salaries grew by $125.5 billion, the largest quarterly gain in the last two years and an improvement from the $81.7 billion gain revealed by the initial estimate.

U.S. pending home sales, a good leading indicator of near term existing home sales, jumped 5.1% in April, far exceeding the expectations for a 0.6% advance and accelerating significantly from March's 1.6% rate.

U.S. new home sales surged by 16.6% (most since January 1992) to 619,000 units annualized, the highest since January 2008. The data were revised slightly higher, on average, back to 2014. The gains were fairly broad……everywhere except in the Midwest. Inventories slipped for the first time since July, which cut the months' supply to 4.7 in April from 5.5 in May…..pretty tight, by historical standards. This is great news for the sector that is providing some momentum to the U.S. economy, with the new builds benefitting from tight inventories in the existing home sale market. This should continue as long as job creation forges ahead, rates stay relatively low, and prices remain steady.

Greece - Euro zone finance ministers agreed with Greece and the International Monetary Fund last Wednesday on a deal that will address Athens' requests for debt relief, French Finance Minister Michel Sapin said. "This agreement is act of confidence in today's Greece," he told reporters as he left a meeting in Brussels in the early hours. He said the agreement was comprehensive and covered short-, medium- and long-term measures on the debt. Euro zone governments led by Germany have been resisting IMF calls for debt relief for Greece and have been reluctant to go beyond a commitment to look at easing the debt burden in a couple of years time. Details: Eurogroup agreed to release €10.3 billion with €7.5 billion of that released in June so Greece can service its debts. The Eurogroup also agreed on a package of debt-relief measures, mainly in 2018. IMF will examine its participation by end 2016.

Financial Conditions

Bank of Canada left rates unchanged at 0.5% as expected. The Bank remains optimistic on a U.S. recovery and says the wildfires could knock off 1.25% from GDP growth.

The U.S. 2 year/10 year treasury spread is now .94% and the UK's 2 year/10 year treasury spread is .98% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.64% (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 4.7 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 finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 13.12 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

Mutual Funds

Portland Investment Counsel Inc. currently offers 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund
- Portland Global Aristocrats Plus Fund

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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