

News Highlights

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PORTLAND
INVESTMENT COUNSEL

Our views on economic and other events and their expected impact on investments.

July 11, 2016

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Energy Sector

U.S. land rig count increased by 9 rigs to 417. **The rig count has seen a weekly increase in 5 of the last 6 weeks.** This week's increase was led by horizontal oil (+10) and horizontal gas (+1), partially offset by directional gas (-2), while vertical oil, directional oil, and vertical gas remained flat week/week. Total horizontal land rig count is 75% down since the peak in November 2014.

U.S. horizontal oil land rigs increased by 10 rigs week/week to 282, led by gains in Permian (+5), Williston (+2), Woodford (+2), DJ-Niobrara (+1), and Mississippian (+1), were slightly offset by losses in Granite Wash (-1), while Eagle Ford and "Other" remained flat week/week.

U.S. offshore rig count was flat week/week at 18, and is down 67% since June 2014.

Canadian rig count was up 4 rig week/week as we come out of breakup season and is 53% off the level this time last year.

BHI international rig count is down 28 rigs month/month in June and down 219 year/year. **International rigs** averaged 927 in June, reversing course after last month's gains, with land rigs down 22 and offshore rigs down 6 month/month, led by LatAm (-10), Asia Pac (-8), Europe (-4), Africa (-4), and Middle East (-2). The international rig count finished the quarter down on average 9% compared to Q1 2016.

Financial Sector

Berkshire Hathaway Inc. – Brooks Sports Inc., the running brand owned by Warren Buffett's Berkshire Hathaway, believes that the U.S. marathon boom has peaked and it is looking to broaden its appeal to a younger gym generation according with an interview with Jim Weber, the company's chief executive, published by Reuters. Founded in 1914, the Seattle-based firm was close to bankruptcy when Jim Weber took over as chief executive in 2001. Weber decided to concentrate solely on running, a strategy Buffett bought into when he acquired the brand in 2006. Brooks is now the market leader in the U.S. specialty running shoe market with a 29%. It had total sales in 2014 of \$548 million, still only a fraction of overall leader Nike's sales of \$32 billion in the year to May 31. However, the number of people completing U.S. running events peaked in 2013 at 19 million, according to trade group Running USA, falling to 17 million last year. "We're going to change some of our communication and connection and make sure our product is friendly for the gym. Runners are doing

a lot of different things today," Weber told Reuters in an interview in Amsterdam where Brooks is sponsoring the European Athletics Championships. He said millennials -- those aged 25 to 35 -- were increasingly trying out sports such as aerobics, cross fit and yoga and that his company would respond to that trend.

Berkshire Hathaway's The Lubrizol Corporation unit has acquired Diamond Dispersions, a maker of water-based dye and pigment dispersions for inks used in digital printing, for an undisclosed sum. Headquartered in Sheffield, U.K., Diamond Dispersions will advance Lubrizol Performance Coatings' goal to grow its portfolio of products that enable digital printing.

BNP Paribas SA - said it expects to recognize a €565 million after-tax gain in the second quarter from the disposal stake in Visa Europe. The transaction will probably have a "negligible" impact on the bank's common equity Tier 1 ratio, a key capital indicator, the Paris-based company said in a statement last Monday. Note, Visa Inc. last month won European Union antitrust approval to take over Visa Europe, which was owned by more than 3,000 banks.

HSBC Holdings Plc has completed the sale of its Brazil business after receiving all necessary regulatory approvals for sale of its entire business in Brazil. The transaction successfully completed on July 1, 2016. (Source: Reuters)

IGM Financial Inc. – announced June 2016 mutual fund sales and total assets under management. Mutual fund assets under management were \$128.7 billion as at June 30, 2016, compared with \$129.8 billion at May 31, 2016. Total assets under management were \$134.7 billion at June 30, 2016, compared with \$135.1 billion at May 31, 2016.

U.K. Banks - Standard & Poor's carried out a mass-cull of British bank rating outlooks last Thursday in the wake of the country's vote to end its membership of the European Union, but stopped short of downgrading them despite its brutal cut of Britain's sovereign rating. The country's big institutions including Barclays plc, Lloyds Bank plc and well as the U.K. arms of banks like Banco Santander SA all saw their rating outlooks cut to negative from stable, while Royal Bank of Scotland plc (RBS) dropped to stable from positive. The decision not to deliver full downgrades is likely to be of some relief. S&P stripped Britain of its last remaining top-notch credit rating last month following the Brexit vote, slashing it an unprecedented two grades from "AAA" to "AA". "In our view, the "leave" result in the U.K.'s June 2016 referendum on EU membership ("Brexit") has increased the risks of adverse economic developments," S&P said in note following last Thursday's banking outlook cuts. (Source: Reuters)

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Activist Influenced Companies

Hertz Global Holdings, Inc. said it reached an agreement under which Icahn Group (IEP) designees have been appointed as directors of New Hertz, a company that was re-named Hertz Global Holdings following the spin-off of equipment rental company Herc Holdings. The new directors are Vincent Intrieri, Samuel Merksamer and Daniel Ninivaggi.

Hertz has also reached an agreement with Uber Technologies, Inc. to supply its U.S. partner drivers with cars under specified rental agreements. The agreement provides set rates for partners, who can rent from specified off-airport Hertz locations that give on-site support. The cars can be used for personal driving as well as for Uber business. Initially, Hertz is supplying partners in the Los Angeles area with other markets expected to follow as part of the national agreement. "This is a positive agreement for both Hertz and Uber," said John Tague, president and CEO of Hertz Global Holdings. "Utilizing cars that are rotating out of our consumer rental fleet creates a model that works for Hertz and for Uber partners by providing them with well-maintained, good condition cars. We consider this agreement to be largely complementary to our car rental business, and it enables us to leverage our fleet and distribution infrastructure to participate in the dramatic growth in the ride sharing, or e-hailing, segment."

Hertz has also reached an agreement with Lyft to supply its U.S. drivers with cars under specified rental agreements, expanding upon two pilot markets where Hertz and Lyft have partnered together since November 2015. Built on the model used in pilots in Las Vegas and Denver, the agreement provides set rental rates for drivers, who will be serviced from dedicated off-airport Hertz locations that give on-site support. The cars can be used for both Lyft business and personal driving. In addition to Las Vegas and Denver, Hertz will begin renting cars to Lyft drivers in Los Angeles and San Francisco with more markets expected to follow as part of the national agreement. "This agreement builds on the work we've been doing with Lyft for the past eight months," said John Tague, president and CEO of Hertz Global Holdings. "Based on that experience, Hertz and Lyft were ready to take the next step, which resulted in this U.S. supply agreement."

Canadian Dividend Payers

Northland Power Inc. – announced it has entered into agreements with H.B. White Canada Corporation (HBWC) and certain HBWC affiliates to settle all disputes and claims between HBWC and Northland and certain Northland affiliates, concerning five ground-mounted solar projects located in and around Cochrane and Burks Falls West. The settlement agreements between HBWC and Northland are conditional upon the plan of compromise or

arrangement proposed by HBWC being approved by the court and its applicable stakeholders and the plan providing for the payment of \$6 million to Northland, as well as other relief. Northland also expects that, upon successful conclusion of the CCAA process, all of HBWC's liens and filed claims relating to Northland's projects will be released.

Global Dividend Payers

Barry Callebaut AG – Barry reported 9 month volume growth in line with expectations at 4.2%, which represents an acceleration to 3.7% in Q3 from 2.3% in Q2. All regions contributed to this result. Sales revenue up +11.4% in local currencies (+7.8% in CHF), fueled by a better product mix and higher ingredient prices. Strong growth in chocolate was supported by all geographic regions and segments. The company is phasing out less profitable cocoa contracts and capacity reduction (Thailand, Malaysia): volume decrease of 7.8% after 9 months. By contrast, sales per tonne growth increased significantly by 17% on the back of strong pricing/mix (23%). We believe there is ongoing strong momentum at Barry ex Cocoa, which is significantly outperforming the market, which declined by 2.0% in the period. Barry remains cautious with guidance for full year 2016, knowing that Q4 is facing tough comparisons (10.7% volume growth last year). Recent cocoa price peak, in spite of devaluation of British pound, weighs on working capital although the impact should be modest in our view.

Roche Holding AG – U.S. Food & Drug Administration (FDA) has approved Xolair for uncontrolled allergic asthma in children aged six years and older. Friday's approval makes Xolair the only approved biologic for children six years and older with uncontrolled allergic asthma (previous approval was for patients 12 years and older). In Europe, Xolair is already approved for children six years and older. Today's approval does not come as a surprise. Moreover, as Xolair's U.S. patent expiration is nearing (May 18), the pediatric approval should add six months patent life although we don't expect a biosimilar competitor any time soon. Bloomberg has reported that Roche is considering an acquisition of BioMarin. BioMarin is a US-based biotech company with five marketed products for rare genetic diseases. BioMarin invests heavily in R&D and has a broad pipeline for PKU, achondroplasia, haemophilia and Sanfilippo syndrome. The press reports cite a proposed offer price of \$130-150 per share, a 73% premium to yesterday's close at the mid-range. BioMarin has been highlighted as a potential acquisition target for a number of companies in recent months. Given the company's rare disease focus it is often linked to both Sanofi (Genzyme) and Shire.

Economic Conditions

U.S. June employment report – Payroll employment expanded 287,000 in June, well above expectations (180k consensus), with 6k in net downward revisions (May down 27k to 11k, April up 21k to

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144k). The figure was flattered by returning Verizon strikers (+28k telecom workers), so call the underlying growth 259k. The three month average is now 147k. The labour force jumped 414k, lifting the participation a tenth to 62.7% (also where it was in January). Given current annual population growth, if the part rate remains unchanged, it is estimated the U.S. needs a 120k-to-125k job growth trend to stabilize the unemployment rate over the near term. This requirement might head higher over the near term (more discouraged workers coming back) but fall meaningfully (below 100k) over the longer term owing to an aging population. So even a 150k pace is okay at this point in our view. The headline jobless rate moved up a couple tenths to 4.9%, given the surge in the labour force (not necessarily a "bad" thing). Importantly, the "underemployment" (U6) rate dropped a tenth to 9.6%, a new cycle low. Both part-timers for economic reasons and discouraged workers dropped a lot. Average hourly earnings rose 0.1%, slower than expected (0.2% consensus, but this still lifted the annual change a tenth to 2.6% year/year, matching the cycle high... another step in the right direction.

U.S. goods & services trade deficit widened to \$41.1 billion in May, worse than expected and the largest since February. **Exports** continued their trend this year of being up one month, and down another. In May, they were down...off 0.2% (mild), or 4.2% below a year-ago. **Imports**, rose for the second straight month, up 1.6% in May (but 3.1% below a year ago). And it wasn't just due to higher oil prices. It was encouraging to see consumer goods imports (excluding autos) rise 2.7% in May (2nd consecutive pickup) - suggests decent domestic demand. And despite some slippage in auto sales, **auto parts imports** were also up again (+0.9%). Ditto for industrial supplies & materials (+6.9%). It was a similar pattern for real exports and imports (-1.5% and +1.0%, respectively). The **real trade deficit** has narrowed so far in the second quarter (April and May) versus Q1.

Britain has announced plans to cut corporation tax to less than 15% in an attempt to cushion the shock of the country's decision to leave the European Union, raising the prospect of competitive tax cuts across the bloc. Finance Minister George Osborne told the Financial Times he wanted to build a "super competitive economy" with low business taxes and a global focus, signaling a determination to remain in his job when a new prime minister takes over in September. The new rate, which was announced without a target date, compares with Osborne's previous target to cut corporation tax to 17% by 2020 from 20% now. The average rate among the world's most developed countries is 25%. (Source: Reuters).

Britain's new Prime Minister - News is out this morning that one of the two main candidates to replace the U.K. Prime Minister David Cameron has dropped out of the race. Andrea Leadson, who received 25% of support from Conservative lawmakers last week, decided she did not have sufficient support to beat out front runner Theresa May. In addition, she felt a leadership campaign would be detrimental to the UK and that it needed a leader as soon as possible to manage the UK's departure from the EU. As the only candidate left in the race, Theresa May is set to become Britain's next Prime

Minister. Theresa May supported the Remain camp during the referendum but has said that she will make no attempts to keep the UK inside the EU with her as leader. Her plans were to try and negotiate some concessions from the EU prior to triggering Article 50 in 2017. GBP bounced off the 1.2851 lows to trade to a 1.3020 high.

Japan Prime Minister Shinzo Abe won the majority of seats in Japan's upper house and clears the way for more economic reforms known as Abenomics. With the new mandate, speculation is that the Abe government will provide a stimulus package as much as 20 Trillion JPY (US\$200 billion). Nikkei was up 4% overnight while USD/ Japanese Yen rallied 1.8%.



Financial Conditions

The U.S. 2 year/10 year treasury spread is now .77% and the UK's 2 year/10 year treasury spread is .61% - 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 US 30 year mortgage market rate has increased to 3.41% (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 13.15 (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.

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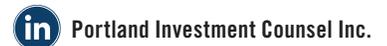
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PIC16-037-E(07/16)