News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. August 26, 2016

Energy Sector

Venezuela – The struggling oil producing Venezuela has not been able to import all the crude and fuel it needs this year to cover shortfalls at oilfields and refineries as state-run gas and oil company, PDVSA, struggles to pay suppliers on time, according to trade sources and internal company data seen exclusively by Reuters. The decline is the largest in five years as the worst economic crisis in decades undermines PDVSA's ability to buy oil imports, which fell 21% in the first seven months of this year to 154,465 barrels per day (bpd). Venezuela is also on track to suffer its steepest annual oil output drop in 14 years, after years of state mismanagement and under investment. Risk-averse suppliers are refusing to discharge cargo to cash-strapped PDVSA without being paid first, unusual in an industry in which buyers normally have 30 to 60 days to pay after delivery. Others have stopped dealing with PDVSA entirely as it resorts to bartering its own oil in swap deals. PDVSA's oil import needs started growing in 2012 after a severe explosion hit its largest refining complex, Paraguana. Despite having the world's largest crude reserves, Venezuela's purchases grew further in 2015 as a decline in crude production forced the company to carry out regular imports of lighter crudes and naphtha to dilute its extra heavy oil into exportable grades. The payment issues have driven a 34% decline this year to 51,350 bpd in imports of naphtha PDVSA uses as a diluent. That has contributed to a 5% drop in crude exports to 1.42 million bpd.

Financial Sector

Barclays PLC has announced that it completed the sale of Barclays Risk Analytics And Index Solutions Ltd. to Bloomberg L.P. for approximately £615 million. Pre-Tax gain recognised on completion of transaction is approximately £535 million. Also, Barclays mandated itself as sole book-runner and structuring adviser for a U.S. dollar Reg S Additional Tier 1 offering. The joint lead managers will be Danske Bank, Deutsche Bank, ING, Morgan Stanley, Santander Global Banking & Markets, Scotiabank, SMBC Nikko, Societe Generale, UBS and Wells Fargo Securities. The transaction is expected to be launched in the near future, subject to market conditions. (Source: Reuters)

Bank of Montreal: Q3 2016 adjusted Earnings Per Share (EPS) of $1.94, up 4% Year over Year (YoY), above consensus $1.81. Earnings growth was led by U.S. Property & Casualty +22% (+19% USD), Capital Markets +18% and Canadian Banking +1%, offsetting a 2% decline in Wealth. Return On Equity 13.5%, Book Value +5%, Core Equity Tier 1 capital 10.5% up from 10.0% (Q2 2016). Provision for Credit Losses (PLC) 29 bps vs. 23 bps in Q2 2016 and 20 bps a year earlier. PCLs are expected to be 25-29 bps over the next year. Oil & Gas PCLs of $58 million or 77 bps of loans, up from $31 million last quarter. Cumulative energy PCLs at 170 bps. Oil & gas impaired were stable, up $11 million to $421 million or 5.6% of the portfolio.

Canadian Imperial Bank of Commerce (CIBC) cash operating earnings up 9% YoY to $2.67 per share, above consensus $2.35. Earnings were driven by Capital Markets +15% YoY, Canadian Retail +6% YoY offsetting a 12% decline in Wealth (+10% ex-sale of American Century). Reported PCLs of $203 million or 26 bps of loans versus $284 million or 38 bps of loans in the previous quarter and $189 million or 25 bps of loans a year earlier. Oil & gas PCLs $2 million or 0.03% of oil & gas loans, down from $81 million last quarter. Gross impaired loans were down 8% quarter on quarter (QoQ) while new formations of $574 million were down from $1.03 billion last quarter but up from $317 million last year. Oil & gas impaired loans declined to $409 million from $708 million last quarter. Core Equity Tier 1 capital ratio of 10.9% was up from 10.4% in the previous quarter, driven primarily by the sale of American Century. Operating Return On Equity: 19.8%.

Nordea Bank AB plans to do more deals to remove risk from its balance sheet through synthetic swaps after completing the region's first such transaction. Investors bought notes linked to the junior credit risk of an €8.4 billion ($9.5 billion) chunk of Nordea's loan portfolio. The transaction creates enough "credit loss protection" to cover both "expected and unexpected losses," the bank said. "We are in a position to look at doing more deals," Tom Johannessen, head of group treasury and asset liability management, said. "I would hope to be able to start thinking about doing another deal within the next six to 12 months." Nordic pension funds were "anxious to work with" Nordea, but didn't make it "over the finishing line" because of the "relatively accelerated time frame for this first transaction," Johannessen said. "I feel really good about the feedback from them as to what the next structure might look like," he said. The deal, the largest of its kind in Europe this year, is a seven-year credit default swap that provides protection against losses on the first 5% of the portfolio, or roughly €420 million, he said. Nordea expects to have to meet a minimum requirement of common equity Tier 1 capital ratio of 17%, after the Financial Supervisory Authority imposed tougher rules on the risk weighting of corporate assets. The bank's capital by that measure was 16.8% at the end of June. Johannessen said the bank has worked hard to ensure the synthetic swap meets with approval from Sweden's Financial Supervisory Authority.

Royal Bank of Canada: Q3 2016 adjusted EPS was $1.76, up 5% YoY, above consensus of $1.71. Earnings growth was led by strong Wealth Management, up 36% YoY, aided by City National (+7% ex-City National), solid Capital Markets +17% and Canadian Banking +4%, offsetting declines in Investor & Treasury Services -6% (+13%

adjusted) and Insurance -25%. Return On Equity 16.9%, Core Equity Tier 1 capital 10.5%, Book Value +10%. PCLs were 24 bps, down from 36 bps in Q2 2016 with year to date PCLs at 30 bps. The bank expects PCLs of 30-35 bps for fiscal 2016. Oil & gas PCLs of $30 million or 0.43% of loans were down from $115 million in Q2 2016. The bank has taken cumulative provisions of 422 bps on its oil & gas portfolio, not including any sectoral PCLs. Oil & gas impaired loans rose 9% or $97 million to $1.14 billion or 16% of the portfolio.

Royal Bank of Scotland Group Plc (RBS) - Lawyers for RBS sat down with representatives of angry shareholders to broker an end to what may end up being the costliest case in British legal history. The meeting was convened to persuade investors to drop claims they were misled into stumping up £12 billion ($16 billion) just a few months before the bank's bailout in 2008. But the low-profile gathering came to nought, an outcome that could have huge implications for RBS's recovery as it risks adding up to £6 billion to the lender's litigation bill, lawyers said. At the meeting, RBS offered investors about £700 million, according to two sources present, but the claimants reckon they should get £4 billion in damages, plus another £2 billion in interest and legal fees. "They are offering pennies when we are after pounds," said one lawyer, who asked not to be named because the talks are confidential. "We are never going to meet in the middle. So we are now focused on pursuing the actions through the courts." The next pre-trial hearing is scheduled for Sept. 8 at the High Court in London. Over the next few months, lawyers on both sides will learn who will be called as witnesses. Former RBS Chief Executive Fred Goodwin, who has shouldered the blame for the bank's rapid demise from national treasure to national disgrace, is likely to be called, dealing another blow to the lender's efforts to draw a line under its troubled past. RBS, which is now 70% state owned, has always denied any wrongdoing and said its former bosses did not act illegally. "We continue to strongly defend these claims," the bank said in a statement. "We have always been clear that the bank is open to exploring an out of court resolution to matters, consistent with our legal obligations," RBS said.

Some big corporate clients of RBS face the prospect of paying to hold deposits with the bank as it becomes the first lender in Britain to charge negative interest rates. The move, announced by the bank last Friday, is linked to the European Central Bank's negative deposit rate and not to the Bank of England's decision this month to cut its main lending rate to a record low 0.25%. The bank has contacted about 70 investment banking customers to warn them of the charges, which are expected to hit clients who trade futures and options contracts that must be processed via clearing houses in Europe, a source close to the bank said. RBS said in a statement it is passing on the negative rates those clearing houses have charged to handle those trades since the ECB cut its base rate earlier this year. "Due to the sustained low interest rate environment, RBS will now be passing the cost of holding such deposits on to a limited number of our institutional clients," the bank said. RBS gave no details of the size of the charges. (Source: Reuters).

The Toronto-Dominion Bank reported Q3 2016 adjusted EPS of $1.27, +6% YoY, above consensus of $1.21. Earnings were driven by Wholesale +26%, U.S. Property & Casualty +21% (+16% USD), Canadian Wealth +10%, Canadian Personal & Commercial Banking (P&C) +1%, offsetting a 44% decline in Insurance due to elevated claims from Fort McMurray fires. TD earnings were driven by high Capital markets earnings, the best of the bank group with Underwriting & Advisory earnings particularly strong. Canadian retail earnings were solid in our view but U.S. P&C was a bright spot with margin improvement of 3 bps QoQ, 13% loan growth YoY and 16% earnings growth. Return On Equity 14.5%, Core Equity Tier 1 capital at 10.4%, Book Value +7%. Oil & gas provisions for credit losses of $8 million or 0.11% of the portfolio declined from $49 million last quarter. Oil & gas impaired loans of $240 million or 3.3% of the portfolio increased from $211 million last quarter.

UBS Group AG, the Swiss Bank is indicating the group will save as much as CHF 2.5 billion capital by merging the European legal entities of wealth management units into branches of a single unit located in Frankfurt by the end of 2016 and to also benefit from lower IT costs. Also, UBS has pioneered the 'utility settlement coin' and has now joined forces with Deutsche Bank, Santander and BNY Mellon, to pitch the idea to central banks, aiming for its commercial launch by 2018. The banks believe this will be a new form of cash and be the industry standard to clear and settle financial trades using blockchain technology.

Activist Influenced Companies

Brookfield Business Partners LP – Brookfield Global Integrated Solutions (Brookfield GIS) launched its Asian headquarters in Singapore, hoping to capture the growing property and facilities management business in the region. The real estate facility management service provider is a subsidiary of the newly listed Brookfield Business Partners in Toronto and New York, which in turn was spun off from the parent, Brookfield Asset Management Inc. In an interview with The Business Times, Jon McCormick, president and managing director of Brookfield GIS in the Asia-Pacific (Apac) region, said the Australian market, where it operates the most within Apac, is already mature. Mark Harrison, the executive managing director of Brookfield GIS's operations in Asia, added: "We have moved into Asia as our clients from our other markets have asked us to come here, and specifically into China as they want us to service their assets and businesses in those countries. So that is a very strong reason for us moving into the Apac region. We see Asia as a growth market. In Singapore, we see a lot of our clients in New Zealand, Australia and Asia headquartered here and we feel that it is a very sensible place to start." Singapore afforded the firm a very easy entry into Asia and it was easier to manage the business from Singapore rather than Sydney, where Brookfield has an office, he said. The company's clients include oil and gas giant Exxon Mobil, miner Rio Tinto, Microsoft, and carrier Virgin Australia. It also helps that Asian clients are starting to recognise the importance of property and facilities management, and the growing professionalism of the industry, Mr. McCormick said. On top of managing office buildings, it also runs hospitals, education facilities and defence airbases.

Pershing Square Holdings Ltd. – Valeant Pharmaceuticals International Inc., one of the holdings of Pershing Square Holdings, named Zoetis Inc. executive Paul Herendeen as its chief financial officer, replacing Robert Rosiello, the latest in a series of management changes at the Canadian drugmaker. The embattled drugmaker is trying to regain investor confidence following a tumultuous past year in which its pricing strategy and ties to a specialty pharmacy led to a wider political and regulatory scrutiny, hammering its stock. Valeant also named a new general counsel and announced the departure of its public relations head earlier this month. Rosiello will remain at Valeant as executive vice president, corporate development and strategy, the company said. Zoetis on Sunday promoted Glenn David as its CFO.

Restaurant Brands International Inc. (QSR) – The Globe and Mail reported that Tim Hortons has shaken up its top ranks as its parent rushes to slash costs at the fast-food chain. David Clanachan, president of Tim Hortons Canada, has been replaced by Sami Siddiqui, previously head of finance at Tim Hortons and, before that, senior director of global finance at Burger King in Miami. Mr. Clanachan was appointed chairman of the Canadian division of parent Restaurant Brands International, reporting to QSR chief executive officer Daniel Schwartz. QSR was created in late 2014 after the company that owned Miami-based Burger King acquired Tim Hortons in a $12.5 billion deal, merged the two chains and set up its head office in Oakville, Ont. Since then, there has been significant turnover in head-office staff at Tim Hortons, with a growing array of officials from Burger King coming to the offices in Canada.

Carrols Restaurant Group, Inc. announced that it completed the acquisition of seven Burger King restaurants located north of Portland, Maine. Carrols is the largest Burger King franchisee in the United States and has operated Burger King restaurants since 1976. The Company has purchased 29 restaurants to date in 2016 and currently operates a total of 734 Burger King restaurants in 16 states, including 11 restaurants in Maine.

Canadian Dividend Payers

Northland Power Inc. announces that its Gemini Offshore Wind Project has successfully completed installation of all turbines.

Global Dividend Payers

Dufry AG operated a 515m2 duty free store in Guadeloupe since 2000; it has renewed this concession till 2026 and will increase the space to 783m2 - in addition there will others stores, bring the total retail space to 1'100m2, making up 1% of Dufry's Latin America's retail space. Most important concession in Caribbean is Puerto Rico (2500m2, till 2029). The renewal and extension of the Guadeloupe airport shows Dufry's strong leading position in the Caribbean and Latin America region in our view; there are no important renewals upcoming in 2017 but we still expect extension at some locations.

GEA Group AG received feedback from a roadshow in Oslo with GEA's investor relations team (sourced from Barclays European Capital Goods Equity Research). The company said that the EBIT margin target of 13-16% will not be changed, with the immediate focus being on getting to 13%, but new initiatives should see GEA comfortably hit the upper end of this margin range by 2020. The new self-help initiatives will centre around manufacturing footprint (~70 sites) and supply chain optimisation. GEA will quantify the cost savings associated with these in next few months. On capital allocation, management believes it has €1.4 billion of re-leverage potential, moving from €600 million net cash to €800 million net debt ex-pension deficit without adversely affecting the credit rating. GEA's Investor Relations team says it will layout its plan and timeline by the end of 2016 for a potential re-distribution to shareholders. The company will keep a kitty for immediate mergers & acquisitions pipeline, short-term liabilities and additional restructuring. In terms of colour on the dairy market, GEA doesn't see another leg down in farming, but expects to see continued declines here in the high single-digits in 2H 2016. In dairy processing, GEA still sees a big opportunity in emerging markets for liquid milk.

South32 Limited reported EBITDA (earnings before interest tax depreciation and amortization) of $1131 million which was 12% ahead of estimates, EBIT of $356 million, 46% ahead and EPS over 200% ahead of estimate at US$2.6/share. The company also introduced a modest yet welcome dividend of US$1 per share. The reason for the beat was generally better costs with the company pointing to the effects of weaker currency on top of their in house cost programmes. We generally like the investment case of South 32. The company has an increasingly strong balance sheet in our view, following its split from BHP Billiton, steady operations that management work well to deliver decent performances vs. expectations, and valuations are reasonably supportive with a Free Cash Flow yield of 10.4% in 2017. The company's main product lines are manganese, aluminium and coal.

Syngenta AG – On Monday, China National Chemical Corporation (ChemChina) and Syngenta announced that the companies have received clearance on their proposed transaction from the Committee on Foreign Investment in the United States (CFIUS). In addition to CFIUS clearance, the closing of the transaction is subject to anti-trust review by numerous regulators around the world and other customary closing conditions. Both companies are working closely with the regulatory agencies involved and discussions remain constructive. The proposed transaction is expected to close by the end of the year. ChemChina offered to acquire Syngenta at SFr (swiss franc) 465 per share plus a special dividend of SFr 5.

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Economic Conditions

U.S. new home sales surged 12.4% to 654,000 the fifth increase in a row, the highest level since October 2007 and the biggest monthly jump since May 2014. There was an interesting regional breakdown: the **Northeast** and the **South** saw double-digit gains, while the **Midwest** edged higher and the **West** was flat. The South accounts for the largest share of sales (averaging over 45%, historically) so one can't shrug off its 18% gain. The number of new-builds available to be bought slipped for the 3rd time in the past four months, but given the lack of supply of previously-lived-in homes, look for new home construction to make up for the short supply. **Median prices** fell, which is welcome news for those first-time buyers who want to be first-time buyers. Note that the share of homes sold, priced in the $200,000 to $299,999 range, rose to 34%, the highest since March.

U.S. Existing Home sales cooled in July following an impressive four-month winning streak. Supply is constraining activity, to some extent, but fundamental support for the sector remains in place (mortgage standards have loosened and borrowing costs remain low). Excitement over the surge in U.S. new home sales was tempered by a larger-than-expected 3.2% decline in **existing home sales** in July. The drop followed four consecutive monthly advances but, at 5.39 million units, is the lowest since March. Supply remains an issue, particularly for single-family homes. The inventory of singles was flat in July and at 1.88 million, is well below the long-run average of over 2.2 million. And in another indication of the lack of supply, the months' supply of previously lived-in homes remained low at 4.7. First-time homebuyers saw their share slip to 32% from 33%. That is still above last year's 30% average but still well below the normal, or healthy, range of 40% to 45%. Slower rising price growth will help.

U.S. Durable goods orders jumped 4.4% in July, largely due to soaring aircraft bookings but also because of the strongest increase in core capital goods orders in six months. The latter rose 1.6% to extend June's 0.5% advance and more than offset the prior two monthly declines, though it wasn't enough to erase the past year's slide (-4.9%). Unlike in June, the recent advance was widespread, with notable gains in computers, electrical gear, metal products, and, importantly, machinery. The 1.6% increase in machinery orders flags a welcome pickup in business capital expenditure in Q3 after three straight quarterly contractions. Further supporting Q3 GDP growth will be a 0.3% upturn in factory inventories after a lengthy pullback.

U.S. – The National Association of Home Builders' (NAHB) housing market index advanced a couple of points in August, to 60, in line with the expectations, showing increased conviction in the strength of the US home building by the home builders themselves.

Canada – Canadian retail sales retreated by 0.1% in June, surprising analysts which were expecting a 0.5% advance in the month and adding to the weakness experienced in June. Core retail sales, which excludes the impact of vehicles and parts transactions, were weaker still, down 0.8%, as other retail categories, such as building materials, clothing and general merchandising suffered in the month (the unusually warm weather might have played a role).

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .78% and the UK's 2 year/10 year treasury spread is .41% - 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 3.43% (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 13.86 (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

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