News Highlights

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

PORTLAND INVESTMENT COUNSEL®

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

Energy Sector

OPEC lines-up production cut – Just when everyone least expected, OPEC (Organization of the Petroleum Exporting Countries) managed to reach an agreement, albeit preliminary, for a production target of 32.5 to 33 million boed (barrels of oil equivalent per day). If implemented, such a target could effectively translate in a production cut of as much as 750,000 boed, down from the current level of about 33.25 boed, if the lower limit is achieved. The higher limit of the production target range is meant to accommodate any potential recovery from the conflict affected OPEC nations of Libya and Nigeria. While individual countries production targets are still to be formalized, it is expected that Saudi Arabia, who is facing significant budget headwinds and was undoubtedly the artisan of the current deal, and other Gulf Cooperation Countries (GCC) will support the brunt of the production cuts. A formal decision is to be made at OPEC's next scheduled meeting in November, however this week's announcement is likely to provide some support and deter short trading in crude oil until then.

Financial Sector

Berkshire Hathaway Inc. – Reuters reports that Warren Buffett, chairman of Berkshire Hathaway, has had one conversation with Wells Fargo & Company boss John Stumpf since a sales scandal erupted on Sept. 8, knocking billions of dollars in market cap off the company. Berkshire Hathaway is Wells Fargo's largest shareholder, owning 9.51% of the outstanding shares as of the latest available filings. Stumpf told the House Financial Services Committee that he and Buffett had one conversation since the scandal broke, but would not elaborate. Buffett previously told Fox News he would not comment on the scandal until November. On Thursday he shot down rumors he had expressed "extreme dissatisfaction," with Wells Fargo's board of directors, according to CNBC.

Deutsche Bank AG (not held in Portland Funds): The Financial Times reports that some institutional clients have begun to reduce exposures to the bank. This will put the spotlight firmly on Deutsche's near-term liquidity position. The liquidity reserve at end-2nd Quarter 2016 was €223 billion, comprising cash and near-cash equivalents. Deutsche's Liquidity Coverage Ratio - the key short term regulatory liquidity measurement - stood at 124% versus a required minimum of 100%. Regarding the U.S. Retail Mortgage Backed Securities, Bloomberg and the Financial Times are reporting that the U.S. Department of Justice (DoJ) has indicated that it would prefer to combine settlements of **Barclays Plc**, Credit Suisse Group and Deutsche into a single announcement before the U.S. elections....so we might be days away from this. Looking at what the U.S. peers paid versus their underwritten volume, and its estimated about $5 billion for Deutsche Bank, $1.6 billion for Barclays and $5.5 billion for Credit Suisse. A settlement of $5 billion for Deutsche may be a relief (they have reserves on Balance Sheet at end of Q2 + taking into account 2nd half 2016 consensus of €7.8 billion).

However, in the case of Deutsche Bank, there has been a considerable loss of confidence this year, including a confirmed run on German deposits and withdrawals in the prime brokerage. Without central bank intervention, Deutsche likely would have struggled to survive given market concerns. Indeed, there is a growing view that Deutsche Bank will survive because liquidity is not an issue. My view is saying liquidity is not the problem misses the issue in that there is a symbiotic relationship between confidence and liquidity and Deutsche cannot survive in its current form if confidence continues to weaken. My view remains the negative spiral underway will be extremely difficult to stop and investors should continue to be wary of the systemic risks (note a long weekend is upcoming with Germany Unification Day and traditionally bank bailouts happen over a long holiday weekend) and today's comments of a combined DoJ settlement (Barclays/Credit Suisse/Deutsche Bank) may lower hopes of the removal of a regulatory overhang.

ING Groep NV - the Dutch local press provides some information on the key themes of ING's upcoming Investor Day (3 October). The plan is likely to include (1) restructuring of Belgium/Netherlands operations; (2) a better coherence in managing euro balances cross border; and (3) a convergence of best practices across the group. Analyst estimates point to potential net cost savings of €300 million and revenue enhancement of €150 million, potentially adding ~6% to 2020 earnings per share, all else equal.

The Royal Bank of Scotland Group Plc (RBS) is to pay $1.1 billion to settle two claims it mis-sold toxic mortgage securities in the run-up to the financial crisis. RBS sold the securities to two credit unions, which failed after the U.S. housing bubble burst in 2008. The settlement is with the National Credit Union Administration Board (NCUA), which regulates credit unions. RBS, which under the deal does not admit fault, said payment was covered "substantially by existing provisions". The settlement amount is substantially covered by existing provisions as of 30 June 2016 and will have no material impact on the RBS Group's Core Equity Tier 1 ratio. Among outstanding civil and criminal actions against RBS are claims from the US Department of Justice and the Federal Housing Finance Agency. RBS chief executive Ross McEwan said at a conference in London last Tuesday that the bank was working to resolve outstanding claims, but that this could create "additional conduct provisions and noise" over the next few months. (Source: BBC)

Activist Influenced Companies

Restaurant Brands International Inc. – The Economic Times of India reports that it has been quite a speedy ride for Burger King in India. Within two years of its launch, the fast food major has expanded its presence to 66 outlets in nine cities, and India master franchisee Everstone Capital has lined up $100 million for aggressive expansion plans over the next few years. "It's a market where we are just getting started. Quick Service Restaurants (QSRs) are just evolving in India and we are in the market at the right time. In India, we now have all the ingredients in place to scale up aggressively, "says Jose Cil, global president, Burger King. Everstone is aiming to scale up the number of stores to three digits by the end of this year, or early next year. It holds a majority stake in Burger King India through its subsidiary F&B Asia Venture. Before launching its first restaurant, the Burger King and Everstone spent a year looking for right locations, understanding the Indian consumer preferences and putting together a new menu. Currently, Burger King has 11 burgers on its Indian menu that don't exist anywhere in the world. Also, despite beef burger being its global best-seller, it follows a no-beef and no-pork policy in India. All its outlets have separate kitchens for vegetarian and non-vegetarian food. "India was a unique market and we had to build the menu from scratch. We will now be taking Indian innovations like Veggie and Chicken Tandoori Burger across the globe. Its good food at a great price, "says Cil. Rolling out an unusual strategy in the segment, Burger King globally sold all its older restaurants, apart from a handful in Miami, to its franchisees and even new market strategy, like for India, is franchisee-based.

Canadian Dividend Payers

Northland Power Inc. – Canadian power group Northland Power could be taken private, sold to a strategic investor or remain a stock-market listed entity, its chief financial officer said, as the group is in the middle of a major business review. Northland Power, currently valued at C$4.06 billion (US$3.07 billion), in July announced a strategic review with the aim of boosting growth and shareholder value. "We're looking for a new owner," Paul Bradley told Reuters at a wind energy conference in Hamburg, adding this could also include selling the group to a private equity firm. "But we might end up deciding that the market price is the highest and remain listed," he said, adding that a decision was planned for the first quarter of 2017.

Veresen Inc. – The Canadian energy company has reportedly hired Toronto Dominion Bank to sell its power business, which could be worth about C$1 billion (US$758.90 million). The Calgary-based company, which owns energy infrastructure assets in Canada and the United States, said last month that it would sell the division and use the proceeds to fund growth. The move would also allow Veresen to reduce its debt, as well as focus on its pipeline and midstream businesses. While no longer seen as core to Veresen's strategy, the power business is considered attractive as the assets have long-term contracts, providing owners with a steady cash flow stream. Private equity firms, infrastructure-focused funds and pension funds are seen as potential bidders for the asset. The company has pipeline, midstream and power assets. It also owns 50% of a joint venture with KKR & Co. LP called Veresen Midstream, a natural gas midstream business focused on the Montney region that straddles the Alberta-British Columbia border.

Global Dividend Payers

ABB Ltd. announced today that it has completed its share buyback program. In total, ABB bought back shares worth $3.5 billion or 7.4% of issued capital through this buyback program. ABB said in a press release yesterday that it will build a microgrid for the International Committee of the Red Cross (ICRC) in Nairobi that runs on solar energy and diesel to maximize the use of renewable energy. It is scheduled for completion by the middle of 2017. Separately, according to Power Engineering International (29 September), ABB has won a repeat order from Doosan Heavy Industries to automate a 600 MW supercritical coal-fired power plant in Vietnam.

AT&T Inc. – The U.S. Federal Communications Commission (FCC) said it would delay a final vote on a landmark reform of the $20 billion television set-top box market -- a blow to advocates seeking to cut bills for tens of millions of subscribers. FCC Chairman Tom Wheeler has touted his plan -- backed by President Barack Obama -- to allow tens of millions of U.S. pay TV subscribers to ditch costly set-top boxes and access video programming online. But his position has faced fierce criticism from cable companies, programmers and many in Congress. The plan, first proposed in January, is aimed at ending the cable industry's long domination of the $20-billion-a-year set-top box market and lowering prices for consumers. Nearly all pay-TV subscribers lease set-top boxes from their cable, satellite or telecommunications providers at an average annual cost of $231. In recent months, the plan drew fierce opposition from television and content providers, including AT&T, Comcast Corporation and Twenty-First Century Fox Inc. Comcast and AT&T both urged the FCC to make the new proposal public. AT&T said in a statement "no FCC proceeding in recent years has drawn more unified opposition and bipartisan expressions of concern." The new rules would require companies covering 95% of U.S. TV subscribers to comply by September 2018. Wheeler in January initially proposed open standards for set-top boxes that would allow tech companies to re-tool the delivery of video content. The proposal grants device makers the ability to integrate cable company apps. Set-top box rental fees have jumped 185% since 1994, while the cost of televisions, computers and mobile phones has dropped 90%, the FCC has estimated. Cable companies have expressed concerns that rivals like Alphabet Inc. or Apple Inc. could create devices or apps and insert their own content or advertising in cable content.

Economic Conditions

Canada – Canadian economy expanded by 0.5% in July, ahead of the expectations calling for a 0.3% advance and building on June's 0.6% improvement. The economic growth in the month was driven by continued recovery in the energy sector, following May's Alberta wildfires, yet manufacturing, financial services and hospitality have also added to growth. Some weakness was experienced in construction and public administration.

The U.S. economy grew at a modestly faster pace in the second quarter than previously estimated, but the latest data confirms the expansion decelerated in the first half of the year. Gross domestic product, a broad measure of goods and services produced across the economy, expanded at an inflation-adjusted 1.4% seasonally adjusted annual rate in the second quarter, the Commerce Department said Thursday. That is up from last month's estimate of a 1.1% growth rate during the spring. Second-quarter growth accelerated from the first quarter's 0.8% pace, but was still slower than the 2.1% annual rate averaged since the recession ended in mid-2009. The current expansion's pace is the weakest of any since 1949. (Source: The Australian)

Financial Conditions

The Bank of England will likely have to provide further stimulus to the UK economy to limit an economic slowdown caused by voters' decision to leave the European Union, Deputy Governor Minouche Shafik said last Wednesday. "It seems likely to me that further monetary stimulus will be required at some point in order to help ensure that a slowdown in economic activity doesn't turn into something more pernicious," she said in a speech at an event hosted by Bloomberg in London. Recent economic data has been mixed, with a series of surveys suggesting the world's fifth-biggest economy may be bouncing back from the initial post-referendum slump. (Source: The Australian)

The U.S. 2 year/10 year treasury spread is now .82% and the U.K.'s 2 year/10 year treasury spread is .62% - 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 3.42% (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 4.3 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 13.64 (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.

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

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