News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. November 21, 2016

Energy Sector

U.S. land rig count increased by 17 rigs to 563, now up 189 rigs or 51% off the May bottom and is up on average 21% QTD quarter/quarter. Gains in Horizontal Oil (+9), Vertical Oil (+7), and Horizontal Gas (+4) were partially offset by declines in Directional Gas (-2) and Vertical Gas (-1), while Directional Oil remained flat week/week. Total horizontal land rig count is 66% down since the peak in November 2014. The Permian currently makes up 51% of all oil rigs.

U.S. horizontal oil land rigs increased by 9 rigs week/week to 375, as gains in the Permian (+4), "Other" (+3), DJ-Niobrara (+2), Granite Wash (+1), and Mississippian (+1) were slightly offset by declines in Williston (-1) and Eagle Ford (-1), while Woodford remained flat week/week. Additionally, vertical oil land rigs in the Permian increased by 7 rigs week/week, which is the largest weekly gain since August 2014.

U.S. horizontal gas land rigs increased by 4 rigs week/week to 95 led by the Utica (+3), which is the largest weekly gain in the Utica since October 2015.

U.S. Gulf of Mexico offshore rig count increased by 2 rigs week/week to 23 and is down 57% since June 2014.

Canadian rig count increased by 9 rigs week/week and is up 10% off the level this time last year.

Whitecap Resources Inc.'s board of directors has approved a $300 million capital budget for 2017 that is anticipated to deliver top-quartile production-per-share growth of 15%. The 2017 capital program and the annual dividend of 28 cents per share are expected to be fully financed by internally generated funds flow without the use of a dividend reinvestment program. The company has been able to strategically assemble and integrate an enviable suite of high-quality oil assets that have predictable production profiles, balanced decline rates, strong netbacks and a large repeatable development drilling inventory. The company has stress tested its capital budget down to a West Texas Intermediate price of $40 (U.S.) per barrel.

Financial Sector

Barclays Plc has completed the sale of its credit card business in Spain and Portugal as part of the lender's latest efforts to offload its "non-core" units. In a statement last week, Barclays said it sold the £1.2 billion unit to WiZink Bank – an online lender – in a move that would result in a £1 billion reduction in its risk weighted assets. The bank is targeting Risk Weighted Assets (RWA) to drop to £23 billion in 2017. Earlier this month, the bank called time on 150 years in Egypt by selling operations in the north African country in a $500 million deal. Jes Staley, Barclays' chief executive said:"During 2016 we have made significant headway in the reduction of our Non-Core unit, a key component of our Group strategy. (Source: Financial Times)

Berkshire Hathaway Inc. – BNSF Railway Company (BNSF) and Kansas City Southern (KCS) in the U.S. have announced a new joint service to offer intermodal transportation connecting the Chicago and Dallas /Fort Worth markets. The new service is set to operate between Toluca and Monterrey, Mexico, and Dallas/Fort Worth and Chicago, U.S. Trains moving in both directions will carry 53ft intermodal containers, and interchange at Robstown, Texas. Warren Buffett is changing his mind about airlines and buying stakes in several major carriers including American Airlines and Delta Air Lines. Buffett disclosed the new investments, which also include United Continental Holdings, in filings with the Securities and Exchange Commission. He purchased 21.8 million shares of American, 6.3 million Delta shares and 4.5 million United shares. In separate statements, Atlanta-based Delta and Fort Worth, Texas-based American both said they welcome the investment.

Brookfield Asset Management Inc. proposed to take a 50%-60% stake in bankrupt solar company SunEdison Inc. unit TerraForm Power Inc., a week after it expressed interest in buying the entity, structured as what is known as a YieldCo. YieldCos are publicly traded units that hold renewable energy assets, including those bought from the parent company, and usually provide relatively high levels of income distributions to their unitholders. The cash offer of $13 for class A and class B shares of TerraForm Power is nearly in line with the class A stock's Thursday close of $13.01. The company's shares have risen 48.7% since Brookfield took a stake in the company on June 29, when it expressed interest in buying SunEdison's stake in TerraForm.

HSBC Holdings Plc, the London-based lender scaling back its global presence, reached an agreement to sell its Lebanese business to Blom Bank SAL. The transaction is expected to be completed by the first half of 2017 and is subject to approval from Banque du Liban, Blom Bank said last week in an e-mailed statement. HSBC will continue to operate its private banking business in the country, two people with knowledge of the matter said, asking not to be identified as the information isn't public. (Source: Bloomberg)

NN Group NV – reported Q3 2016 earnings of €436 million. Headline earnings are a large beat driven by realized gains on government bonds and other marking to market items but the underlying pre-tax operating result that the market focuses on has also beaten consensus. This is largely thanks to a Dutch life private equity dividend. Dutch non-life underwriting remains disappointing but the other three divisions have over-compensated. The capital generation is good in our view but management provided nothing materially new on the potential

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acquisition of Delta Lloyd which leaves a wide implied gap on price between the two parties and a superficial feeling of stalemate. But that's negotiation. We continue to believe that a compromise will be found.

Prudential Plc - The 9-months 2016 (9M 2016) new business profit was £1,970 million, up 12% year/year (9 month 2015 (9M 2015): +17%), and continues to be supported by its Asia business. U.K. and U.S. new business profit, on the other hand, registered a -23% and -13%, respectively. The former is explained by its recent withdrawal from the U.K. bulk annuities market. Positively, excluding U.K. bulk annuity, U.K.'s New Business Profit would imply a +41% year/year change. Total Annual Premium Equivalent was £4,550 million, representing a 12% year/year growth (9M 2015: 19%). This continues to be supported by Asia, posting a 25% year/year growth (9M 2015: 31%). New business margin for the Group was 43.3% for 9M 2016, neutral vs. 9M 2015. Solvency II coverage remains healthy at 189% (1H 2016: 175%) with a surplus of £11.5 billion (1st Half 2016: £9.1 billion) as at October 31, 2016. Dividend growth guidance going forward of 5% per annum versus consensus hopes of 7.5% for 2016-2018. At the investor day, management pointed towards China being one of its key growth area going forward, tapping into its population growth, agency growth and protection gap. Indonesia, however, continues to face challenges, driven by weak GDP, although it does expect to see things turn around in 2017. It also cited that one of the key challenges in Indonesia is sustaining active agents, which is a key contributor to the country's top-line. Comments around growth outlook in other key Asia markets were reiterated, but did not provide detailed split in the trading update. Looking at the U.S., Department of Labor ("DoL") has been one of the key discussions for the day. Management reported a 9M 2016 variable annuities ("VA") volumes of 28% lower, which is equivalent to a Q3 2016 year/year change of -39%, explained by distributors adjusting to DoL standards. This is consistent with the trend observed in the first half of the year. Positively, management said that the proposals should encourage its VA volumes, not discourage.

Canadian Banks - The Globe & Mail reported last week that under pricing pressure from spiking bond yields and Ottawa's housing market crackdown, Royal Bank of Canada (RBC) is boosting its fixed-rate mortgages. RBC is also introducing a new pricing structure, charging different rates for mortgages with amortization periods of 25 years or less and for those with longer maturities - a first for Canada. The increases come as Canada's banks grapple with the federal government's crackdown on a frothy housing market. In October, Finance Minister Bill Morneau announced higher qualifying rates for mortgages with down payments of less than 20 per cent, as well as restrictions on the types of mortgages that can be covered by government-backed portfolio insurance. The latter change is likely to have fostered the new rates for different amortization lengths. Mortgages that take more than 25 years to pay back no longer qualify for bulk mortgage insurance. Even if these longer-dated loans aren't very risky, banks like to buy insurance for them, because it absolves them of having to hold any capital against the loans. The regulator deems them risk-free this way. Earlier this month, The Toronto-Dominion Bank (TD) raised its prime rate for variable-rate mortgages by 15 basis points, to 2.85% from 2.7%. BMO also adjusted its variable rate for new loans. That said, TD is taking a more measured approach than rival RBC. TD has raised the cost of its four-year and five-year fixed-rate mortgages by 5 and 10 basis points, respectively. But TD opted not to follow that RBC, which means that for home loans longer than 25 years, its mortgage rate is 35 basis points cheaper than RBC's. RBC and TD's rate decisions matter because they come from the country's two largest banks, whose mortgage portfolios are worth a combined $402 billion. The banks often act in lockstep when making changes to mortgage rates, and they typically serve as a benchmark for the rest of the market – but not always. The new mortgage rate hikes comes as bond yields spike in the aftermath of the U.S. election.

Activist Influenced Companies

Hertz Global Holdings Inc. – Picking up and returning a rental car at Hertz is now faster and easier thanks to several new service offerings. Hertz is introducing electronic rental agreements, and expanding its eReceipt and Express Return service to all customers at its U.S. corporate-owned locations. Additionally, customers now have the option to receive their rental terms and conditions, and important Hertz contact information, including roadside assistance numbers, via email for easier access. "We know our customers – especially holiday travelers – want to get on their way quickly," says Alex Marren, executive vice president of North American Rent A Car Operations. Customers can take advantage of these new services by providing an email address at the time of booking. A Hertz representative will verify the email address at the time of pick up and return. For customers who do not want to wait for an attendant to check out their car or wait for a printed receipt, they can now take advantage of Hertz's eReceipt and Express Return Service and simply leave the keys in the car and go at select locations.

Restaurant Brands International Inc. – Carrols Restaurant Group, Inc. announced it completed the acquisition of 17 Burger King restaurants. These restaurants are located in Western Pennsylvania in and around the Pittsburgh and Johnstown markets. Carrols is the largest Burger King franchisee in the U.S. and has operated Burger King restaurants since 1976. The company has purchased 49 restaurants to date in 2016 and currently operates a total of 755 Burger King restaurants in 16 states, including 65 restaurants in Pennsylvania.

Canadian Dividend Payers

Distinct Infrastructure Group (DIG) (a holding in Portland Private Income LP): At $3.0 million, Q3 2016 EBITDA (earnings before interest, tax, depreciation and amortization) came in 10% above estimates with revenue growing 85% year/year to $16.1 million. Revenue growth was largely organic and driven by strong performance in the telecommunications business, as DIG continues to experience robust demand from one of its largest customers. Additionally, iVac's

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revenue made good progress driven by strong internal and external growth. Gross margin of 37.4% increased 366 bps year/year and 859 bps sequentially as DIG takes on higher margin work, such as multi dwelling units (think large condos), which allows for greater efficiency, and road moves, which is a fairly new business for DIG.

Global Dividend Payers

AT&T Inc. – Telecommunications giant has agreed a U.S.$10 billion term loan. JPMorgan Chase and Co., Bank of America Merrill Lynch (BAML) , Mitsubishi UFJ Financial Group (MUFG), Barclays and Mizuho Bank Ltd. are joint lead arrangers and joint bookrunners. JPMorgan is agent. The company announced on October 22 that it had lined up a US$40 billion bridge loan led by BAML and JPMorgan to back its acquisition of media company Time Warner.

The U.S. Federal Communications Commission (FCC) is dropping plans to push through a proposed reform of the $45 billion business data services market in the wake of Donald Trump's election as president. FCC Chairman Tom Wheeler pulled the item previously set for a commission vote after pressure from Republicans in Congress. The move is a win for companies such as AT&T that have strongly opposed the reforms of business data services and effectively ends Wheeler's bid to complete several reforms before leaving office. Republicans may also seek to rollback landmark "net neutrality" reforms adopted by the Obama administration and are likely to reverse broadband privacy regulations adopted last month, industry analysts say.

Johnson Matthey Plc reported 1st Half 2016/2017 underlying Profit Before Tax of £219.6 million, 4% ahead of consensus (£212 million). However this result includes a net £9 million one-off gain (U.S. medical plan gain of £15.6 million, offset by higher Long Term Incentive Plan costs of £6.6 million) and additional £12 million contribution from Foreign exchange – excluding this the result was c6% below consensus. The U.S. medical plan gain is expected to be fully offset by higher Long Term Incentive Plan costs for the full year, and guidance for slightly ahead of last year at constant exchange rates is unchanged. Full year contribution from foreign exchange estimated at £65mn from £40mn previously which implies a full year 2016/17 operating profit of >£515 million (FY 2015/16 £450 million), 7% ahead of current consensus (£482 million). In detail: Emission Control Technologies achieved an operating profit £152 million with strong performance in Europe and Asia offset by weakness in North America; Process Technologies underwhelmed with an operating profit £39 million as sales lower in difficult market conditions albeit a stronger second half is expected due to a robust order book and ongoing cost savings; Precious Metal Products was steady with an operating profit £41 million; Fine Chemicals was below expectations with an operating profit of £27 million but expects performance in second half to be much better than first half – product launch led.

LVMH Moet Hennessy Louis Vuitton SE announced a share buyback program of €300 million. This represents a clear message that LVMH is looking to keep its balance sheet leveraged and reward shareholders with the extra cash originated from the strong free cash flow.

Syngenta AG announced last week that MIRAVIS™ Duo, a combination of ADEPIDYN™ and difenoconazole, has been approved by SENASA (regulatory authority in Argentina), for use on soybean for late cycle diseases. This is the first registration for a product based on ADEPIDYN™, a new fungicide belonging to the carboxamide chemical class. ADEPIDYN™ provides a step change in leaf spot disease management and delivers excellent control of powdery mildew. It is highly effective on difficult-to-control diseases such as Fusarium head blight and moulds which cause severe damage to the crop. Syngenta is currently developing several ADEPIDYN™ based products to address various disease management challenges in soybean, wheat, corn, canola, vegetables and specialty crops around the world. Jon Parr, President Global Crop Protection, Syngenta, said "MIRAVIS™ Duo builds on our strong fungicide heritage including ELATUS™ and AMISTAR® Technology. By continuing to deliver industry-leading innovation to growers, we are strengthening our global leadership in fungicides." First sales of MIRAVIS™ Duo are expected in the 2016/2017 soybean season in Argentina. Regulatory approvals are pending in several other markets.

Wal-mart Stores Inc. reported 3rd quarter earnings per share (EPS) of $0.98. EPS benefit from a gain (~$0.02) and a lower tax rate (~$0.04 vs. consensus). Importantly, traffic growth remained solid in the quarter and came in steady on a two-year stacked basis. Comparisons were just below expectations but may have beat had it not been for unusually warm weather which hurt apparel and other sales. Expectations were elevated going into the quarter, in our view, for at least two reasons: 1) Walmart set a positive tone at its recent Investor Meeting, and 2) Target "raised the bar" for Walmart as it reported better than expected Q3 profits.

Economic Conditions

U.S. retail sales beat expectations in October, with the headline rising 0.8% (or 4.3% year/year) following September's upwardly revised gain of 1.0% (originally 0.6%). The overall increase was well supported by most of the various categories, from cars, to building materials, to sporting goods and to clothing…all items that are not necessities. The only two major areas that disappointed were furniture (after a strong September) and dining out. Core sales (include food but exclude autos, gas and building materials) matter for GDP and they also beat handily, up an impressive 0.8% after an upwardly revised September and they suggest that consumer spending started the final quarter off on a very solid note.

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U.S. industrial production rose just 0.1% in October, which was a little soft but not a surprise. Utilities were responsible for all of that 'softness' (the warmest October in half a century would do that). Utilities tumbled for the second month in a row… down 2.6% in the latest period. Excluding utilities, total output was up 0.3%. Manufacturing, which accounts for ~80% of total production, climbed 0.2%, the second consecutive monthly improvement. And mining is slowly returning, up a solid 2.0%, the biggest monthly increase since March 2014 (but still down 7.0% year/year).

U.S. consumer prices rose an as-expected 0.4% in October, or a 2-year high of 1.6%, on the back of higher gasoline prices. Food inflation is still pretty low, though….in fact, food prices were flat for the fourth month in a row. Excluding food & energy, consumer prices edged up just 0.1% (actually, it was a high 0.1%-----0.1488%). From year-earlier levels, core CPI rose 2.1%, the 12th straight month above 2%. Housing also gained 0.4% in the month, while clothing prices rose 0.3%. Although various components remain pretty subdued, the 3-month annualized trend in headline and core inflation have edged up, suggesting that inflation pressures are starting to percolate moderately.

Britain's house price growth remained steady at 7.7% in the year to September, according to official figures, despite expectations that property prices would nudge up more than 8%. The latest figures are in line with a 7.7% rise for the year to August, although August growth had originally been estimated at a more robust 8.4%. Economists had expected September's data to show a stronger increase of 8.1%. The average U.K. house price in September was £218,000, £16,000 higher than a year ago and unchanged from August. Data on the U.K. housing market has been mixed since the Brexit referendum but has generally pointed to softening growth since the start of 2016. (Source: Financial Times)

The U.K. inflation rate registered a surprise fall in October, although there were signs that the pressure on consumer prices is starting to build. Consumer Prices Index (CPI) inflation fell to 0.9%, from 1% in September, the Office for National Statistics said. That was below the 1.1% predicted by economists, who said sterling's fall would push October's CPI higher. However, the ONS said factory gate prices and the costs of raw materials rose much faster in October. The price of goods leaving factories rose by 2.1%, faster than expected and the biggest increase since April 2012. And costs faced by producers for raw materials and oil showed a record monthly jump in October, up by 4.6%. (Source: BBC)

U.K. unemployment fell by 37,000 to 1.6 million in the three months to September, hitting an 11-year low. The jobless rate fell to 4.8% in the same period, while the number of people in work went up by 49,000, said the Office for National Statistics (ONS). Average weekly earnings grew by 2.3% in the year to October including bonuses and by 2.4% excluding bonuses. The Bank of England has forecast that unemployment is set to rise amid uncertainty over Brexit. However, the ONS said the latest figures brought the unemployment rate to its lowest level since the three months to September 2005. The total number of people in jobs remained at a record high of 31.8 million, the figures showed. (Source: BBC)

Financial Conditions

The Bank of Japan (BOJ) announced its first operations to purchase an unlimited amount of Japanese government bond (JGB) in a bid to re-assert the central bank's control of the yield curve. The unexpected BOJ move came after the recent global government bond rout post-US presidential election saw Japanese government bond (JGB) yields rising as well but not as sharply as US Treasury yields although the 10-year JGB yield returned to positive territory since Nov. 15 after having languished in negative yield for most of 2016. The JGB purchase announcement on Thursday Nov. 17 targeted two tranches, the first for JGB maturing in 1-3 years with the yield for the 2-year note fixed at **-0.09%** and the second for JGB maturing in 3-5 years with the yield for the 5-year note fixed at **-0.04%**. We believe the market perceived these rates as the BOJ's upper limits even though the operation drew no bid, according to the BOJ.

The U.S. 2 year/10 year treasury spread is now 1.26% and the U.K.'s 2 year/10 year treasury spread is 1.25% - 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 3.94% (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 4.8 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 13.17 (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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