News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. December 12, 2016

Energy Sector

OPEC and non-OPEC discussions – The Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC producers reached their first deal since 2001 to curtail oil output jointly and ease a global glut after more than two years of low prices. Russia, which 15 years ago failed to deliver on promises to cut in tandem with OPEC, is expected to perform real output reductions this time. "This agreement cements and prepares us for long-term cooperation," Saudi Energy Minister Khalid al-Falih told reporters after the meeting, calling the deal "historic". Russian Energy Minister Alexander Novak told the same news conference: "Today's deal will speed up the oil market stabilisation, reduce volatility, attract new investments." Last week, OPEC agreed to slash output by 1.2 million boe/d (barrels of oil equivalent per day) from Jan. 1, with top exporter Saudi Arabia cutting as much as 486,000 boe/d. Falih said Saudi Arabia may cut even deeper. Over the weekend, producers from outside the 13-country group agreed to reduce output by 558,000 boe/d, short of the initial target of 600,000 boe/d but still the largest contribution by non-OPEC ever. Of that, Russia will cut 300,000 boe/d, minister Novak said. Apart from Russia, the talks were attended by or had comments or commitments sent from non-OPEC members Azerbaijan, Bahrain, Bolivia, Brunei, Equatorial Guinea, Kazakhstan, Malaysia, Mexico, Oman, Sudan and South Sudan. Novak said OPEC and the non-OPEC countries at the meeting were responsible for 55% of global output. Their joint reduction of around 1.8 million boe/d would account for about 2% of global oil supply. Many non-OPEC countries such as Mexico and Azerbaijan face a natural drop in oil production.

Baytex Energy Corp. announced that its Board of Directors has approved a 2017 capital budget of $300 to $350 million, which is designed to generate average annual production of 66,000 to 70,000 boe/d. Baytex also announces that Ed LaFehr, President, will succeed James Bowzer as Chief Executive Officer in May 2017. Commenting on the budget announcement, James Bowzer, Chief Executive Officer, said: "We have three high quality resource plays in our portfolio and believe 2017 will be a year that builds operational momentum for Baytex. In Canada, after a drilling hiatus, we are excited to get back to work with an active first quarter drilling program. In the Eagle Ford, we expect to maintain a consistent pace of development on our lands throughout 2017. We have designed our 2017 budget to be flexible should we continue to experience a volatile commodity price environment." Baytex's expected exit production rates for 2016 and 2017 reflect an organic growth rate of approximately 3-4%. A key attribute of Baytex is the strong capital efficiencies of its asset base. The company's 2017 development program reflects capital efficiencies on an annual basis of approximately $11,500 per boe/d ($13,500 per boe/d including facilities). For the full-year, approximately 70% of Baytex's planned capital expenditures will be directed to its Eagle Ford operations. The balance of the spending will be in Canada, largely toward heavy oil assets at Peace River and Lloydminster. The 2017 capital budget will be heavily weighted to drilling and completion activities (approximately 89%) with the balance for facilities (approximately 10%) and land and seismic (approximately 1%). Based on the mid-point of the company's 2017 annual average production guidance range of 68,000 boe/d, its production is expected to be equally split between Canada and the Eagle Ford. The 2017 guidance includes an annual contribution of approximately 3,000 boe/d from Baytex's recently announced heavy oil acquisition at Peace River.

Crescent Point Energy Corp. has a $1.45 billion capital expenditure budget for 2017. This budget is expected to generate a 2017 exit production rate of approximately 183,000 boe/d, or exit to exit growth of approximately 16,000 boe/d. This represents production growth of approximately 10% on both an absolute and per-share basis. On an annual average basis, production is increasing by 3% from previously inferred to be flat (on the basis of the early September announcement), as most of the step-up in drilling is likely to happen in the second half of 2017. "We've had a very successful 2016 operationally and are ahead of our budgeted December exit production of approximately 167,000 boe/d," said Scott Saxberg, president and chief executive officer of Crescent Point. "We also increased our drilling inventory this year by approximately 1,000 new internally identified drilling locations, which was supported by our new play development program. This more than replaces our 2016 drilling program and provides us with over 12 years of drilling inventory to continue our long-term growth." Crescent Point's active fourth quarter 2016 capital program is expected to result in first quarter 2017 production of more than 170,000 boe/d. For 2017, approximately $1.29 billion, or 89% of the budget, has been allocated to drilling and development activities, including the drilling of approximately 670 net wells. The remaining $160 million, or 11% of the budget, has been allocated to infrastructure and seismic investments across its core areas. Crescent Point also plans to continue investing in long-term growth objectives, including its new play development, to further build on the company's success during 2016. Based on Crescent Point's current monthly dividend of three cents per share and aforementioned capital expenditure plans, the company expects a total payout ratio of 100% in 2017 at a WTI (West Texas Intermediate) price of $52 (U.S.) per barrel.

U.S. land rig count increased by 27 rigs week/week to 601, which is the largest weekly gain since April 2014, a surprising jump in light of heading into the holiday season, although we suspect part of the week/week increase may include some reclassification of rigs previously classified as idle. The rig count is now up on average 21% Quarter to Date quarter/quarter and is averaging 475 rigs for 2016. Gains include Horizontal Oil (+16), Vertical Oil (+3), Directional Gas (+3), Directional Oil (+2), Horizontal Gas (+2) and Vertical Gas (+1). Total horizontal land rig count is down 63% since the peak in November 2014. The Permian currently makes up 52% of all oil rigs.

U.S. horizontal oil land rigs increased by 16 rigs week/week to 400, as gains in the Permian (+5), DJ-Niobrara (+5), Eagle Ford (+3), Granite Wash (+2), “Other” (+2), Williston (+1), partially offset by declines in Woodford (-2) while Mississippian remained flat week/week. Additionally, vertical oil land rigs in the Permian increased by 5 week/week.

U.S. Gulf of Mexico offshore rig count remained flat week/week at 22 rigs and is down 59% since June 2014.

Canadian rig count increased by 29 rigs week/week (now up 54 rigs over 2 weeks) and is now up 30% from the level this time last year.

International rigs averaged 925 in September, with land rigs down 6 and offshore rigs up 11 month/month, led by gains in Europe (+1 land, +9 offshore), Asia Pac (-2 land, +8 offshore), Africa (0 land, +2 offshore), offset by declines in Middle East (-5 land, -6 offshore) and Latin America (0 land, -2 offshore).

Financial Sector

Bank of Montreal reported Q4 2016 cash Earnings Per Share (EPS) of $2.10, which beat consensus of $1.83. The bulk of the beat came from lower Provisions for Credit Losses (PCLs) (+11c) and better trading/advisory revenues (+5c). A variety of other revenue items (e.g. securities gains, insurance) explains the rest of the outperformance. Canadian Personal and Commercial (P&C) banking earnings were up 5% year/year and up 5%quarter/quarter. Loan growth was +6%year/year, driven by growth in commercial loans (+12% year/year) and residential mortgages (+6% year/year). Net Interest Margin was down 2bps quarter/quarter. U.S. P&C banking (USD basis) earnings were up 35% year/year and up 2% quarter/quarter. Capital Markets earnings were up 64% year/year (Q4 2015 was an easy comparison) and up 23% quarter/quarter. Wealth earnings rose 5%; Insurance earnings were up 37%. Basel III Core Equity Tier 1 ratio of 10.1%, up 0.1% quarter/quarter. The bank also delivered a 2% dividend increase.

Barclays PLC has joined the list of top banks to exit energy trading, an exodus that analysts say raises concern among oil producers that falling liquidity means they cannot use derivatives for their basic function: to hedge risk by locking in future prices. Wall Street firms have scaled back in commodity markets since the 2008 financial crisis from owning physical assets or taking positions in the market in the face of regulatory scrutiny. The banks were big players in the market for derivatives years into the future. The departure of Barclays exacerbates the scarcity of counterparties for trade when producers are trying to hedge their production for 2018 and beyond, potentially raising the cost to lock in that output. (Source: Reuters)

The Bank of Nova Scotia - the Bank of Nova Scotia and Industrial Insurance announced last week that the Bank of Nova Scotia is selling the adviser network to the insurer. Industrial Alliance Insurance and Financial Services Inc. is buying HollisWealth, adding $34 billion in assets under administration for an undisclosed price. To help fund the purchase, Industrial Alliance announced a $139 million equity financing. Final sales price will depend on the level of assets under administration at closing. HollisWealth has 800 licensed advisers and became part of Scotiabank when the lender acquired DundeeWealth in 2011. Since then the investment adviser business has evolved remarkably, owing to a mix of regulatory changes, the proliferation of low-cost fund providers and the emergence of digital money management products such as robo-advisers. Canada’s banks own the country’s largest full-service adviser networks, but in the past few years they have started reforming them to focus on high net worth clients. Clients with less than $500,000 in investable assets are now often referred to the bank branch networks. On a conference call last week, Scotiabank chief financial officer Sean McGuckin was asked about a potential Holliswealth sale, following a report in The Globe and Mail. The CFO declined to comment, but added that in wealth management, “a lot of the value comes through our branch distribution,” suggesting an independent adviser network is less desirable to the bank. (Source: The Globe and Mail)

Activist Influenced Companies

Pershing Square Holdings, Ltd. released its third quarter, 2016, letter to shareholders. Some of the highlights from the letter are outlined below. “Chipotle’s sales recovery will be neither smooth nor predictable over the next few quarters”. Pershing Square Holdings said it harvested investments in Canadian Pacific Railway and Zoetis Inc. to free up capital for new commitments. Pershing Square Holdings said it has yet to disclose the second investment in which it has built a half-sized position, in addition to its investment in Chipotle Mexican Grill, Inc. The company said it would “remain short Herbalife International because” it believes “its intrinsic value is zero”. Pershing Square Holdings says Valeant Pharmaceuticals International Inc. now represents approximately 5% of Pershing Square, L.P.’s capital. The company explained that the substantial decline in Pershing Square, L.P’s performance from August 2015 through March 31, 2016 was largely due to Valeant’s decline. In the light of an increasing discount at which the company trades, relative to the NAV (net asset value of its underlying investments), at times as high as 20%, Pershing Square is “exploring potential steps to narrow the discount”. We believe that the recent expansion of the discount, relative to the value of investments which are publicly traded, large, liquid stocks, has been a buying opportunity and have opportunistically added to our position.

Canadian Dividend Payers

Veresen Inc. has received notice from the U.S. Federal Energy Regulatory Commission (FERC) that it has denied the request for rehearing submitted on April 8, 2016, by Jordan Cove Energy Project, L.P. and Pacific Connector Gas Pipeline, L.P. related to their applications for authorization to construct and operate a liquefied natural gas export terminal and natural gas pipeline. In its decision, FERC stated that the March 11 order properly denied the application and that it would not reopen the record and consider evidence filed subsequent to the initial decision, as the request for rehearing did not demonstrate the existence of extraordinary circumstances. The FERC reiterated that its denial is without prejudice to the applicants submitting a new application should the companies show a market need for these services in the future. "Veresen remains committed to this important energy infrastructure project," said Don Althoff, President and CEO of Veresen. "We are very disappointed by FERC's decision, especially in light of the significant progress that has been made in demonstrating market support for the project and the strong showing of public support for the project. We continue to firmly believe this project will provide significant economic benefit to Oregon, while ensuring responsible environmental stewardship and stakeholder engagement." Veresen will review all of its options in light of the FERC denial, including appeal or the submission of a new application with FERC. The company will provide an update on its strategy to advance the Jordan Cove LNG project at an appropriate time in the future.

Global Dividend Payers

AT&T Inc.'s new streaming television service, DirecTV Now, has so far exceeded expectations, AT&T's CEO Randall Stephenson told investors. Stephenson, speaking at the UBS global, media and communications conference, said the service achieved its subscriber forecast for December on launch day, Nov. 30 and is "doing very, very well." DirecTV Now, which streams live television content to internet-connected devices, was launched to help drive sales in a saturated cell phone market. AT&T acquired DirecTV for $48.5 billion last year, making it the largest U.S. pay-TV operator with 25.3 million video subscribers, in a push to diversify into the media and entertainment business. AT&T also plans to buy Time Warner Inc for $85.4 billion to gain control of premium content from networks such as HBO. The wireless company is working on gaining regulatory approval for its Time Warner deal.

Economic Conditions

The October U.S. goods & services trade deficit was nearly right on expectations, with a 1.8% drop in **exports** (largest drop this year) and a 1.3% jump in **imports** (largest in four months) - USD strength contributing to the deterioration to $42.6 billion from $36.2 billion in September. In real terms, the trade shortfall widened as exports slumped nearly 3% while imports grew 1.4%. This puts net exports on a weaker footing as Q4 began, so for GDP, not good news. However, stronger imports also suggest stronger domestic demand. Nonfood consumer goods imports excluding autos surged 5.0% in October, snapping a three-month losing streak and the largest monthly increase since February.

U.S. – Consumer confidence continued to improve in December. According to the survey run by the University of Michigan, the composite consumer confidence index advanced to 98.00 index points, ahead of the expectations for a 94.50 level and compared to November's 91.6 points reading. Both the 'current conditions' and the 'expectations' components of the index participated in the improvement.

Canada – Canadian housing prices continued to strengthen in October, up 0.4%, ahead of the expectations for a 0.2% advance. Building permits for October were also ahead of the consensus expectations, at 8.7%, compared to negative 0.7%. Housing starts however, as of the month of November, were lower than expected, at an annualized level of 184 thousand units, compared to 191 thousand units expected.

Italy - Paolo Gentiloni, the Minister of Foreign Affairs since 2014, was appointed as the new Prime Minister-designate (PM) on Sunday. He is a long time career politician seen as prudent and very close to Renzi. Immediate next steps for the new Prime Minister is to propose a list of ministers to the President, potentially on Monday. After getting the President's nomination, request the Parliament's confidence, ideally by Wednesday, in order to participate in the next European Council in Brussels on Thursday. Beside dealing with the obvious problems in the banking sector the Prime Minister will be particularly focused on delivering a new electoral law that allows for early elections possibly in June or September / October, and with dealing with Italy's busy foreign affairs agenda during 1st Half 2017 (Treaty of Rome 60th anniversary celebrations in March and G7 meeting in Italy in May). But the Five Star and Lega Nord parties will be pushing for early elections as soon as possible in our view.

Financial Conditions

Bank of Canada Holds Rates Steady, Citing Economic Slack - Reuters highlighted that in the Bank of Canada's (BoC) rate decision to hold the overnight rate unchanged, the central bank pointed to a 'significant' amount of slack in the Canadian economy. However, it also used language suggesting a rate cut is off the table as global growth picks up. According to the article, the BoC sounded less dovish than several analysts had expected, as the central bank trod a fine line in moving away from a possible interest rate cut even as it pointed to all the reasons why Canada would not follow the U.S. Federal Reserve in raising rates. The central bank's decision to leave rates unchanged was widely expected, and sets the stage for a divergence in policy from that of the Fed, which is expected to hike rates later this month. Further, citing a positive for every negative it outlined, the bank moved away from a more pessimistic tone it set in October, when Governor Stephen Poloz said policymakers had actively considered cutting rates. That said, the central bank said more moderate growth is expected after a rebound in the third quarter, and said business investment and non-energy goods exports continue to disappoint. The BoC also suggested recent job growth masks weakness in the economy. "There have been ongoing gains in employment, but a significant amount of economic slack remains in Canada, in contrast to the United States," the bank said. While global economic conditions have strengthened, the bank said uncertainty, which has been undermining business confidence and dampening investment in Canada's major trading partners, "remains undiminished."

The European Central Bank will extend the timeline of asset purchases (previously scheduled to end in March 2017) to December 2017, but will trim the pace (currently at €80 billion/month) to €60 billion, starting in April.

The Reserve Bank of Australia's (RBA) eleventh and final monetary policy meeting of 2016 was an uneventful one. The official cash rate (OCR) was left unchanged at a record-low of 1.50%, as widely expected. There were few major changes in the accompanying policy statement, although the RBA did flag the prospect of a near-term slowdown in economic growth, noting that "some slowing in the year-ended growth rate is likely, before it picks up again".

Japan GDP: The latest GDP revision from Japan is a bit of a challenge to explain. 2nd cut of Japan 3Q 2016 GDP growth was revised lower to 1.3% quarter/quarter from preliminary estimate of 2.2% and well missing the Bloomberg median forecast of 2.3% while 2Q 2016 growth was revised markedly higher to 1.8% (from 0.7%) and so was 1Q 2016 which is now at 2.8% (from 2.1%). But if we look at the comparison from one year ago, Japan's growth was markedly revised higher at least in the last 5 quarters. 3Q 2016 growth was revised higher to 1.1% year/year (from 1st prelim estimate of 0.9% year/year). The even more eye-catching revisions were on the full-year growth rates of which 2015 growth was revised markedly higher to 1.2% (from 0.5%). These revisions may look small but it is a big deal in our view when it is applied to an economy the size of Japan (third biggest economy in the world). There are two reasons for the significant growth revisions. Firstly, the government adopted a new base year for the GDP calculations, changing the base year from 2005 to 2011. Secondly and more importantly, the government included the implementation of the UN's System of National Accounts (SNA2008). The SNA2008 takes into consideration research & development (which Japan excluded previously) and it also gives more weight to the service sector.

The U.S. 2 year/10 year treasury spread is now 1.35% and the U.K.'s 2 year/10 year treasury spread is 1.37% - 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 4.13% (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 12.30 (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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PIC16-075-E(12/16)