News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. January 9, 2017

Energy Sector

U.S. land rig count increased by 6 rigs week/week to 640 rigs to start 2017 and has not declined in 16 consecutive weeks. The rig count is up on average 28% quarter/quarter. RigData reported its year end rig count (reports on a 1 week lag) at 633, a week/week increase of 22 rigs, which is in line with BHI's year end rig count of 634. BHI rig count gains were driven by Vertical Oil (+2), Vertical Gas (+2), Horizontal Oil (+1), and Horizontal Gas (+1), while Directional Oil and Directional Gas remained flat week/week. Total horizontal land rig count is down 61% since the peak in November 2014. The Permian currently makes up 53% of all oil rigs.

U.S. horizontal oil land rigs increased by 1 rig week/week to 429, the 10th consecutive week of gains, as gains in the Permian (+2), "Other" (+2), and DJ-Niobrara (+1), were mostly offset by losses in Granite Wash (-4), while Williston, Eagle Ford, Mississippian, and Woodford remained flat week/week.

U.S. Gulf of Mexico offshore rig count increased by 1 rig week/week to 23 and is down 57% since June 2014.

Canadian rig count increased by 48 rigs week/week as rigs came back online after the holiday shut down and is up 24% from the level this time last year.

Veresen Inc. has sanctioned $195 million ($93 million net to Veresen) in new capital projects at Veresen Midstream. "With the sanction of this additional capital, Veresen now has over $1.4 billion of projects under construction," said Don Althoff, president and chief executive officer of Veresen. "We expect these capital projects to deliver incremental per-share growth as Veresen remains fully funded without the need to access capital markets. As Veresen Midstream's capital projects come into service, the significant increase in cash flow will reduce Veresen's leverage and bolster our financial flexibility to fund new growth opportunities generated from our strong footprint in the heart of the Montney play." Two new projects have been sanctioned by the Cutbank Ridge Partnership (CRP) to facilitate continuing development plans while also minimizing total infrastructure costs and surface footprint. The South Central Liquids Hub project has been sanctioned to allow the existing gathering system in the area to handle development anticipated over the next several years and is expected to be in service by the end of the second quarter of 2017. The South Central Liquids Hub can be expanded in the future to meet CRP's long-term liquids handling needs as well as provide services to third party producers in the area. The Tower Liquids Hub has also been sanctioned to provide a lower overall cost and more commercially flexible solution for the handling and storage of NGLs (natural gas liquids) produced at the Sunrise, Tower and Saturn phase II processing facilities. The project includes infrastructure to deliver the NGLs into a third party system. The Tower Liquids Hub is expected to be in service in the third quarter of 2017. Part of the Tower Liquids Hub will include capacity to handle third party NGLs that could be either trucked in or connected directly by a future pipeline. Both the South Central Liquids Hub and the Tower Liquids Hub are governed by the Dawson mid-stream service agreement, which is in place for the next 28 years.

Financial Sector

BNP Paribas SA - According to the Belgian press (De Standaard, December 27th), the Belgian government is evaluating the sale of its 10.2% stake in BNP Paribas. No decision has been taken and all options are on the table. A sale would help bring down the public debt/GDP by 1.8%-1.9%, with gross public debt expected at 107% of GDP end-2016.

Activist Influenced Companies

Hertz Global Holdings Inc. – Shares of Hertz moved higher early in the new year following the disclosure through a filing with the U.S. Securities and Exchange Commission that entities directly or indirectly controlled by Mario Gabelli have increased their stake in the company to 5.1% from 2.5%. This includes a 2.83% stake by GAMCO (GBL), a 2.07% stake by Gabelli Trust, and 0.18% stake by Mario J. Gabelli.

Restaurant Brands International Inc. chains Burger King and Tim Hortons plan to switch to chicken raised without antibiotics considered "critically important" to human medicine, making it the latest company to ditch the drugs over health concerns. Restaurant Brands, which owns both chains, said it aims to make the change in U.S. stores in 2017 and in Canada in 2018. An estimated 70% of antibiotics that are important to fighting human infections and ensuring the safety of invasive procedures such as surgeries are sold for use in meat and dairy production. Concern has been growing among scientists, public health experts, consumers and shareholders that the overuse of such drugs is contributing to rising numbers of life-threatening human infections from antibiotic-resistant bacteria dubbed "superbugs." "We believe that it is important to reduce the use of antibiotics important for human medicine in order to preserve the effectiveness of antibiotics in both veterinary and human medicine," Restaurant Brands said. McDonald's Corporation has already removed all antibiotics important to human medicine from its U.S. chicken supply chain, and Wendy's Company said in August it would quit using chickens raised with antibiotics important to human health by 2017. Tyson Foods Inc., the biggest U.S. chicken processor, has said it intends to stop using all antibiotics important to human medicine to raise its chickens in 2017. Yum Brands Inc.'s KFC stands out as the last major chicken chain to make a move on curbing antibiotic use. KFC has far more restaurants than any other fast-food chicken chain and is second in sales behind Chick-fil-A, which has committed to finishing its switch to chicken raised without any antibiotics by the end of 2019.

Canadian Dividend Payers

Nothing new to report.

Global Dividend Payers

AT&T Inc. expects to be able to bypass a powerful telecommunications regulator in its planned $85.4 billion acquisition of Time Warner Inc., the companies said in regulatory filings. Time Warner said that since it does not plan to transfer any Federal Communications Commission (FCC) licenses to AT&T, it would likely not need FCC approval and would only need the consent of the U.S. Justice Department. AT&T could forego the FCC by unloading a Time Warner broadcast station. Despite its big media footprint, Time Warner has only one FCC-regulated broadcast station, WPCH-TV in Atlanta. Time Warner shareholders will meet on Feb. 15 to decide whether to approve the deal. The Justice Department has to prove a proposed deal harms competition in order to block it. But the FCC has broad leeway to block a merger it deems is not in the "public interest" and can impose additional conditions. AT&T and Time Warner filed a premerger notification with the Justice Department on Nov. 4, and on Dec. 8 the Justice Department issued a second information request. AT&T, which has repeatedly clashed with the FCC over the past several years over major industry regulations, said in October that one benefit of its purchase is that Time Warner is "lightly regulated compared to much of AT&T's existing operations."

Pattern Energy Group Inc.'s Pattern Energy Group LP (Pattern Development) and Green Power Investment Corp. (GPI) have completed the financing of the 33-megawatt Green Power Otsuki GK (Ohorayama wind) power project. Pattern Development and GPI are joint venture partners on the Ohorayama wind project, which is located in Kochi prefecture, Japan. "We are making steady progress on our commitment to develop 1,000 MW of new renewable energy sources in Japan, demonstrating the value of our partnership with GPI," said Mike Garland, President and CEO of Pattern Development. "Together with GPI we have completed two solar facilities in Japan and are moving forward on Ohorayama Wind. We also have a broad and deep pipeline of new wind and solar projects, including several in the advanced stages of development." "Ohorayama is our first wind project to reach financial close and start construction since we joined hands with Pattern in early 2014," said Toshio Hori, CEO and founder of GPI. "This achievement is a reflection of the effectiveness of our partnership and we are excited about further executing on our portfolio of mature development assets. We expect our next project, a 126 MW wind farm in Aomori prefecture, to reach financial close and commence construction by mid-2017. It is anticipated to be the largest wind project in Japan." Ohorayama Wind has a 20-year power purchase agreement with Shikoku Electric Power Company for 100% of the output from the facility. The project is under construction and expected to reach completion in March of 2018. In 2016, Pattern Development and GPI announced the completion of two solar power projects in Japan, the 14 MW Kanagi Solar PV facility, located in Shimane prefecture of Japan, and the 42 MW Futtsu Solar PV facility, located in Japan's prefecture of Chiba. Affiliate company Pattern Energy Group Inc. (Pattern Energy) has previously added the Ohorayama Wind facility to its list of identified Right of First Offer (ROFO) projects.

Roche Holdings AG – U.S. Food & Drug Administration has accepted the supplemental Biologics License Application (sBLA) for Tecentriq in first -line patients with advanced/metastatic urothelial bladder (mUBC) cancer who are ineligible for cisplatin chemotherapy. This approval of Tecentriq in 1L mUBC was expected around mid-2017 with peak sales in 1L mUBC of CHF 1.4 billion.

Economic Conditions

U.S. Nonfarm payrolls rose 156,000 in December, extending the longest unbroken string of monthly advances since record-keeping began in 1939, While the headline figure fell short of expectations (around 175,000), a two-month upward revision of 19,000 suggests the report is a wash. In fact, November's gain was bounced up to 204,000. Most industries lifted payrolls last month, with a notable 17,000 advance for manufacturers, the first in five months. Household survey employment slowed (63,000), which, along with an upturn in the participation rate, **lifted the jobless rate to 4.7%**. But this followed a two-tenths drop in the prior month, and is still perched below the Fed's estimate of the natural rate. Furthermore, the more comprehensive U6 tally of joblessness plumbed a new cycle low of 9.2%. The average duration of joblessness also fell further. Of note, the available supply of workers has plunged nearly 800,000 in the past three months, the fasted drop in three years. Though still perched above pre-recession levels, this indicator will catch the Fed's attention in our view, especially the more hawkish members. It likely explains why wage growth is picking up, with annual growth in average hourly earnings bouncing to a seven-year high of 2.9%.

U.S. trade deficit rose nearly $3 billion in November to a nine-month high of $45.2 billion. Exports fell for a second month, not surprising given the 14-year high dollar. Imports rose briskly for a second month, also not surprising given recent strength in consumer spending. Trade will weigh on economic growth this year, but other sectors will more than pick up the slack in our view.

U.S. manufacturing ISM index increased a larger-than-expected 1.5 points in December to 54.7, its fourth rise in a row… now at its highest level in two years (since December 2014). The overall move was driven mostly by the new orders component (up a strong 7.2 pts… the biggest monthly jump in more than 7 years), continuing the theme of a post-election bounce in business confidence. This was followed by production (up 4.3 pts, which, along with new orders, now sits at its highest reading since November 2014), and employment was also up (which bodes well for payrolls on Friday). Despite ending 2016 on a strengthening note with tax cuts potentially looming in 2017, the prospects for America's factories are still clouded by a 14-year-high greenback and possible protectionist manoeuvres.

U.S. ISM non-manufacturing index held steady at 57.2 in December, though this was better than expected and kept the level at a more than one-year high. New orders blasted higher, as per the twin manufacturing report (where the overall index has risen four straight months to two-year highs of 54.7). The **combined ISM indexes point to real GDP growth of around 3%**, highlighting an upside risk to our Q4 growth estimate of 2.1%. Importantly, they imply solid momentum heading into the new year in our view.

U.K. 'Brexit' - Sterling was the big currency mover in the overnight session, weaker after Prime Minister May commented that the U.K. would not be trying to salvage bits of EU membership privileges here and there through negotiation. Control of immigration and lawmaking are her big priorities, and her comments once again drove home the likelihood of a "hard Brexit" outcome. Sterling hit a 1.2125 low versus US$, not far from the October 1.2080/90 lows. Prime Minister May will outline her government's opening negotiating stance at a speech later in January (date not announced yet).

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 1.18% and the U.K.'s 2 year/10 year treasury spread is 1.16% - 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 4.20% (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 4.0 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 still supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now at the low end of a more normal range of 4-7 months.

The VIX (volatility index) is 11.96 (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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