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. March 27, 2017

Energy Sector

U.S. land rig count increased by 22 rigs week/week to 787 rigs, now up 44 rigs in two weeks, and is up on average 27% Quarter To Date quarter/quarter. The rig count was driven by gains in Horizontal Oil (+13, now up 27 rigs in two weeks), Vertical Oil (+10), Horizontal Gas (+2), and Miscellaneous (+1), partially offset by declines in Vertical Gas (-2), Directional Oil (-1), and Directional Gas (-1). Total horizontal land rig count is down 51% since the peak in November 2014. The Permian currently makes up 50% of all oil rigs.

U.S. horizontal oil land rigs increased by 13 rigs week/week to 543 as gains in the Permian (+4), "Other" (+4), Woodford (+3), Eagle Ford (+2), Williston (+1), Granite Wash (+1), and Mississippian (+1), partially offset by declines in DJ-Niobrara (-3).

Canadian rig count decreased by 91 rigs week/week, but is up 254% from the level this time last year and is up on average 69% Quarter To Date quarter/quarter.

U.S. Gulf of Mexico offshore rig count decreased by 1 rig week/week to 18 rigs and is down 67% since June 2014.

Cardinal Energy Ltd. reported its fourth quarter and full year 2016 results. Average production for the year ended December 31, 2016 increased 23% to 14,611 boe/d (barrels of oil equivalent/per day) from 11,838 boe/d in 2015, with a 2016 exit rate of approximately 15,000 boe/d. Operating costs per boe for the year decreased by 5% to $21.23/boe in 2016 from $22.43/boe in 2015. Bank debt at December 31, 2016 decreased to $61.3 million, from $91.8 million at December 31, 2015. The company's bank credit facility is set at $150 million. Cardinal's fourth quarter capital program included 3 wells which were drilled in Q4 2016 but are not expected to contribute to production and adjusted funds flow until Q1 and Q2 2017. Adjusted for these wells, Cardinal's total payout ratio was less than 100%. 2016 was a transitional year for Cardinal as we recovered from low commodity prices. The company is set to benefit from the rebound in commodity prices with increased spending for 2017. Cardinal will drill a record number of wells this year targeting multiple plays across our asset base. Acquisitions are a core part of Cardinal's business strategy and although 2016 was a quiet year on the M&A front, the company closed an acquisition in Wainwright in late Q4 for $32 million. The acquisition added low decline medium oil production to its production base. Cardinal suspended its Dividend Reinvestment Plan (DRIP) and its Stock Dividend Program (SDP) in order to further maximize shareholder value by eliminating the dilution that the DRIP and SDP had on the per share performance. Cardinal's 2016 year end reserves evaluation confirms the low risk characteristics of its assets. Despite a 14% decrease in forecast reserve prices from 2015 to 2016, the value of Cardinal's total proved plus probable (2P) reserves increased slightly on, before tax basis, to $860 million.

Financial Sector

Barclays PLC aims to increase its share of the euro clearing business in the Middle East and North Africa region (MENA) from low double-digits to 25% in the next three years, a senior Barclays executive said, capitalizing on growing demand from companies for transactions in euros. Barclays is already one of the largest clearers of transactions in sterling and has stepped up efforts in euro clearing in the past few years. "It is about gaining market share in the euro clearing right now," KP Sunil Rao, director of the financial institutions group in MENA, said. "We are in lower double digit. I think it could increase to 25 percent market share, hopefully in the next three years." (Source: Reuters). Barclays' credit-card issuer unit, Barclaycard sells $1.6 billion in risky credit-card balances to Credit Shop, the Wall Street Journal reported on Sunday.

ING Groep NV - Dutch financial group ING Bank confirmed last week it is facing a criminal investigation by Dutch authorities, which local papers said was related to a bribery case in Uzbekistan. The bank said the probe could result in "significant" fines and penalties. Het Financieele Dagblad newspaper in the Netherlands said the investigation was linked to a Uzbekistan bribery case. An ING spokesman declined to provide additional comment on the charges beyond that provided in the annual report published on Wednesday. The bank said in the report that it was "the subject of criminal investigations by Dutch authorities regarding various requirements related to the on-boarding of clients, money laundering, and corrupt practices". (Source: Financial Times). The potential impact of money laundering case: assuming a fine of US$2 billion (in line with the record fine of HSBC Holdings PLC), the impact is 60bp of capital and equivalent to 3.3% of the market cap of ING. This suggests the market may be over-reacting (ING initially down ~-5%) or at least pricing in a fine of ~US$2.3 billion, higher than the largest pure money laundering fine registered so far.

JPMorgan Chase & Co. announced that it would increase its quarterly dividend from 48 cents to 50 cents. On the face of it, it's not a big move: the payout has been rising pretty steadily since a trough of 5 cents after the crisis – even through the tricky "London Whale" episode of 2012. But this is the first out-of-cycle increase in a long time. Normally, JPMorgan likes to lift the payout then keep it there for at least four quarters. This time it's only three quarters since the last bump. Just ten months after the board approved a rise from 44 to 48 cents. (Source: Financial Times)

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Royal Bank of Scotland Group PLC (RBS) - Moody's the credit agency says RBS could face costs for settling major Retail Mortgage Backed Securities (RMBS) - related cases of between $6.7 billion and $13.1 billion. $6.7 billion is the median, $13.1 billion would be "high-end settlement." Moody's estimate based on RBS's RMBS market share of 9.8% during 2004-2007, penalties for other banks. RBS can cover median scenario from existing reserves. High-end would decrease RBS Core Equity Tier 1 by ~1.6%. Separately, RBS is closing 158 UK branches and cutting 470 jobs amid online shift. RBS is making job cuts due to "dramatic shift in the way our customers are choosing to bank," RBS says in e-mailed statement. 774 staff at risk from closures of RBS and NatWest-branded branches; 300 will move to new roles, spokesman says. RBS says branch transactions are down 43% since 2010; online and mobile increased >400%. Also, RBS's Ulster Bank unit to close 22 branches, cutting 220 jobs. RBS is closing one-fifth of its branches in Republic of Ireland due to "changing customer demand," co. says in emailed statement. Bank will add services through Irish post offices.

Activist Influenced Companies

Pershing Square Holdings, Ltd. – Billionaire investor William Ackman's Pershing Square Holdings said it planned to list its shares in London as it seeks to improve liquidity and valuation. The company, which has a listing on the Euronext Amsterdam stock exchange, said it plans to apply for a premium listing on the London Stock Exchange and that it would be eligible for inclusion in the FTSE UK Index Series following the admission. The firm has appointed Jefferies International Ltd to act as the sole sponsor and financial adviser on the deal. Investors will be able to trade on both London and Amsterdam markets, the company said.

Bill Ackman walked away from Valeant Pharmaceuticals International Inc. with a loss of more than $3 billion as he sold his entire stake in the struggling drug company after trying to rescue it for some 18 months. "We elected to sell our investment and realize a large tax loss which will enable us to dedicate more time to our other portfolio companies and new investment opportunities," Ackman said in a statement. Pershing Square said the Valeant position, at its current market value, represented 1.5% to 3% of its various funds.

Canadian Dividend Payers

Nothing new to report.

Global Dividend Payers

Dufry AG - Agreement between Hellenic Duty Free Shops (HDFS) and Fraport Greece, covering 14 airports, aiming at doubling the current retail space from 5,000 m2 to over 12,000 m2 by 2021 (or less than 3% of total). The contract was signed for a period of 30 years. HDFS is Dufry's travel retailer in Greece, operating 136 duty-free and duty-paid shops in airports, ports and border stations in Greece. This agreement is further strengthening the relationship between Dufry and Fraport. Dufry is committed to upgrade the facilities and commercial spaces of the airports. Fully in line with strategy.

LVMH Moet Hennessy Louis Vuitton SE - De Beers has taken full ownership of the De Beers Diamond Jewellers (DBDJ) retail operation, Rapaport reported last week. The group bought the 50% stake owned by LVMH for an undisclosed sum, thereby ending the partnership with the luxury house that previously operated the stores. DBDJ comprises 32 stores in 17 consumer markets around the world.

South32 Limited has announced incremental $500 million of returns to shareholders in the form of an on-market buy-back in Australia, equating to 4.5% of the current market cap or 9.7% including the ordinary dividend. This is in-line with our expectations and management's commentary around the interim results.

Economic Conditions

Canada – Retail sales in Canada surprisingly jumped by 2.2% in January, against expectations for a 1.1% advance and a 0.4% retreat in December. Retail categories improved across the board in the month, with the exception of sporting equipment. Sales excluding autos were also up strongly, by 1.7%.

Inflation in Canada remained within Bank of Canada's comfort zone, at 2.0% for its headline reading and 1.7% for its core reading, which excludes the effects of eight most volatile price series, including food and energy, for the month of February.

U.S. politics - Since the health care bill was pulled on Friday, Congress will now move to other issues, including tax reform, and do so more quickly than congressional leaders anticipated. There are no committee hearings on tax reform currently scheduled, but the media will focus on the topic more closely, so there could be market-moving comments from lawmakers about the path forward on tax reform. On monetary policy, numerous Fed officials are schedule to speak this week. Janet Yellen is the headline name, but she will speak at a community investment conference and her comments may not touch on the direction of monetary policy. There are several congressional hearings about different parts of Dodd-Frank and the Chamber of Commerce will hold a conference on financial regulation. These events will be opportunities for lawmakers to comment on the timing of financial regulation.

U.S. new home sales beat expectations in February, and then some. Sales of newly constructed dwellings jumped 6.1% to 592,000, the 2nd increase in a row, leaving sales at their highest level since July 2016. Gains were spread out across the country except the North

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East (snowstorm?). Excluding the North East, sales surged 8.3%. There were revisions which were, on net, down but they weren't significant. The number of homes available for sale climbed again (9.9% above a year ago), as builders built to help offset the shortage in the existing market. As long as fundamental support remains in place (job growth, wage gains, strong economy), housing should continue to move forward.

U.S. existing home sales took a big unexpected blow in February. Sales were down 3.7%, with the pain spread between single-family homes (-3.0%) and condos (-9.2%). Sales of 5.48 million units annualized are the lowest since September. While weather may have played a role (the North East was pummeled by a snowstorm in the first half of February, tornadoes in New Orleans, and flooding in parts of Northern California), the bigger 'negative' is low inventory. Although the number of homes available for sale picked up for two months in a row, they are still bouncing around at their lowest levels in a couple of decades. First-time homebuyers are still hunting around, but their share of total home sales slipped to 32% last month, in line with the average over the past five months. Their options have limits: according to Trulia, over half of the homes listed are high-end (in the top 1/3 of the priciest homes in any metro area) and most first timers are not looking for such homes.

U.S. durable goods orders advanced by 1.7% in February, ahead of the expected 1.2% improvement, driven chiefly by a bump in airplane orders. When transportation orders are removed, durable goods orders were only up by 0.4%, just short of the expectations for a 0.5% increase, nonetheless an improvement over January's 0.2% pullback. General machinery contributed to growth, while electronics, cars and communications equipment subtracted from growth in the month.

Japan's exports grew more than expected at 11.3% year/year in February (from +1.3% in January, beating Bloomberg forecast of +10.1%), the 3rd month of year/year expansion and the fastest increase since January 2015 while imports growth moderated markedly to 1.2% year/year in February (from 8.5% year/year in January and in line with Bloomberg forecast of 1.3%), nonetheless the 2nd consecutive year/year increase. As a result of the jump in exports with the subdued increase in imports, Japan returned back into trade surplus with JPY813.4 billion in February, helping to partly defray the trade deficit of JPY1.088 trillion in January. Japan is at a small deficit of JPY137 billion in the first 2 months of 2017.

French Elections - The European Union will disappear, French presidential candidate Marine Le Pen told a rally on Sunday, promising to shield France from globalisation as she sought to fire up her supporters in the final four weeks before voting gets underway. Meanwhile, the frontrunner in France's presidential election, Emmanuel Macron, received yet another boost to his candidacy on Sunday when nine centre-right lawmakers decided to rally behind him.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 1.22% and the U.K.'s 2 year/10 year treasury spread is 1.15% - 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 4.21% (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 3.6 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 12.16 (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 manages the following 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

Individual Discretionary Managed Account Models - SMA

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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