News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. July 10, 2017

Owner Operated Companies

Brookfield Asset Management Inc. has proposed buying out Renova Energia SA's controlling bloc as part of a sweetened bid to take over the debt-laden Brazilian renewable energy firm. Brookfield, which has made a number of high-profile infrastructure and energy acquisitions in Brazil over the past year, would reportedly pay Renova's controlling bloc about 810 million reais ($247 million) for their stakes and pump about 800 million reais worth of fresh capital into the company.

Linamar Corporation has filed conditional offers with the Commercial Court in Paris to acquire selected assets of Societe Aveyronnaise de Metallurgie SA (SAM) and FVM Technologies SA from their respective bankruptcy estates and 100% of the outstanding shares of Alfisa Technologies SLU, a Spanish company, for a total consideration of approximately €6 million. SAM, FVM and Alfisa are a part of Groupe Arche SA, a French company specialized in the design, casting and machining of high-pressure die-cast (HPDC) aluminum components for the automotive industry, specializing primarily in the range of 1,400 to 2,000 metric tonnes. The FVM and SAM facilities are located in Villers-la-Montagne and Viviez, France, respectively, and Alfisa is located in Barcelona, Spain. Total revenue is in the range of €100 million with open casting capacity and floor space. The acquisitions, if completed, will represent a step forward in Linamar's light metal casting strategy to develop further leadership in integrated design, casting and machining of aluminum components in medium and medium-large press and component sizes. This strategy will strengthen and grow Linamar's relationship with customers in Europe, with facility locations strategically located near key existing and potential customers and an excellent skilled work force. Linamar expects to finance the acquisition through existing credit facilities and in the near term invest in the plants to leverage Arche capabilities to grow the business.

Energy Sector

U.S. land rig count increased by 12 rigs to 927 rigs, now up 24 out of 25 weeks (with last week flat week/week). The rig count was driven by gains in Horizontal Oil (+9), Directional Oil (+1), Horizontal Gas (+3) and Directional Gas (+2) offset by declines in Vertical Oil (-3) as Vertical Gas remained flat w/w. Total horizontal land rig count is down 41% since the peak in November 2014 (see Fig. 1). The Permian currently makes up 50% of all oil rigs.

U.S. horizontal oil land rigs increased by 9 rigs to 657 as gains in Woodford (+4), "Other" (+3), Granite Wash (+2) and Permian (+1) were offset by declines in Mississippian (-1) as DJ-Niobrara, Eagle Ford and Williston remained flat week/week.

Canadian rig count decreased by 14 rigs week/week, and is up 123% from the level this time last year.

U.S. Gulf of Mexico offshore rig count remained flat week/week at 21 and is down 61% since June 2014.

Total SA led a consortium to sign a US$4.8 billion gas deal with Iran, the deal was delayed to ensure it did not violate U.S. sanctions against Iran.

Financial Sector

Barclays PLC has picked Dublin to become its post-Brexit European hub as banks step up plans to protect their access to the EU once the U.K. leaves. The bank has agreed terms to rent bigger premises in the Irish capital as it looks to ensure it can continue to service EU clients. Barclays had narrowed the search to Dublin and Frankfurt but has finally settled on Ireland. It already has about 120 staff in the country but it is now expected to add an extra 100 to 150 employees. The move comes as other City firms press ahead with Brexit contingency plans. Many international banks have their European bases in London and are now looking at moving jobs to other EU cities. (Source: The Telegraph)

Berkshire Hathaway Inc. agreed to pay $9 billion to buy the parent of Texas power transmission company Oncor Electric Delivery Company, stepping up its pursuit of steady profits from utilities and infrastructure deals. If the all-cash purchase wins approval from federal and state regulators and a bankruptcy judge, Buffett's Berkshire Hathaway Energy unit will assume control of one of the largest U.S. electricity transmission companies. Dallas-based Oncor delivers power to more than 3.4 million homes and businesses through roughly 122,000 miles (196,000 km) of transmission and distribution lines. It is 80% owned by Energy Future Holdings Corp., the company Berkshire has agreed to buy out of bankruptcy. Oncor posted $431 million of profit in 2016, and similar sums in the prior three years. Buffett values such consistency, telling Berkshire shareholders in February that utilities generate "recession-resistant" earnings because they offer an "essential service" that generates "remarkably steady" demand. Berkshire Hathaway Energy typically generates nearly 10% of its parent's profit, contributing $2.29 billion to an overall $24.07 billion in 2016. Berkshire expects to complete the Oncor purchase in the fourth quarter. Energy Future was created from the $45 billion leveraged buyout in 2007 of the former TXU Corp by KKR & Co., TPG Capital Management and Goldman Sachs Group Inc.'s private equity arm. The buyout was a bet that natural gas prices would rise, allowing for higher electricity prices. Natural gas prices plunged instead, and Energy Future went bankrupt in 2014.

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Elliott Management, the largest creditor of the bankrupt parent of Oncor Electric Delivery Company, said it was putting together an offer that values the utility at about $18.5 billion, including debt. Warren Buffet's Berkshire Hathaway made the $9 billion offer on Friday for Oncor's parent, Energy Future Holdings Corp., valuing the utility at $18.1 billion (including debt). Elliott, run by billionaire Paul Singer, said on Monday it was working on a $9.3 billion offer for Energy Future. In a letter to the board of Energy Future, Elliott said it would support a deal with Berkshire or a third party if those bids exceeded the value proposed by the hedge fund.

HSBC Holdings PLC has received approval from regulators to set up a majority-owned securities joint venture in China, the first for a foreign group in the country. Hong Kong-based Bank of East Asia was also granted approval by the China Securities Regulatory Commission to open a securities house in a special economic zone in southern China but it will take a 49% stake. The awards for the banks came on the eve of the 20th anniversary of Hong Kong's handover to Chinese control. Foreign banks have had mixed luck with minority-owned joint venture securities companies in China since 2004, when they were first set up. (Source: Financial Times)

Wells Fargo & Company announced updates on Sunday to the settlement agreement for a class-action lawsuit concerning improper retail sales practices (Jabbari v. Wells Fargo & Co., et al.) following a July 8 order from the U.S. District Court for the Northern District of California granting preliminary approval. With the court's preliminary approval of the settlement agreement, Wells Fargo and the plaintiffs are preparing to issue notices that will provide information about the process for making claims. Wells Fargo expects this settlement to resolve substantially all claims in 10 other pending class actions that allege unauthorized accounts were opened in customers' names or that customers were enrolled in products or services without their consent. The settlement agreement sets aside funds for a total of $142 million for customer remediation and settlement expenses.

Activist Influenced Companies

Nothing new to report.

Dividend Payers

Northland Power Inc., the Canadian renewable energy producer, failed to find a buyer after running a sale process, according to people with knowledge of the matter, Bloomberg reported. The China Three Gorges Corporation and Beijing-based State Power Investment Corporation (SPIC) were among companies considering second-round bids for the Toronto-based utility earlier this year, said the people, who asked not to be identified because the matter is private. China Three Gorges didn't secure Chinese regulatory approval to proceed with an offer, while SPIC's final bid didn't meet Northland Power's expectations, the people said. Some Canadian pension funds looked at Northland Power earlier in the sale process and balked at its valuation, Bloomberg added. The company announced a strategic review last July, led by Canadian Imperial Bank of Commerce and JPMorgan Chase, just weeks after its stock hit an all-time high. Since the announcement, the company's shares had risen 1.3% until the close of trade on Tuesday.

Economic Conditions

Canada Employment rose a hefty 45,300, lifting the 12-month gain to a significant 350,000 and trimming the jobless rate to match the cycle-low of 6.5%. Earlier in the year, the Central Bank somewhat disregarded the initial burst of strong payroll gains by pointing to soft hours worked but totals hours surged in Q2 at the fastest pace since 2003 and are now up a solid 1.4% year/year.

U.S. payroll report beat consensus: +222,000, most since February with revisions …. higher (May's 138,000 is now 152,000 and April's 174,000 is now 207,000). Jobless rate (U3) …. lifted 0.1% to a decade-low of 4.4%, outside of the prior month's 16-year low of 4.3% but still very low. The jobless rate for those potential first-time homebuyers (25-34 years) fell to 4.4%. Overall, a decent report in our view. Through revisions, it is difficult to contend that job creation in the U.S. has slowed since the start of the year (average gains over the past 6 months = 171,000, and 12 months = 187,000), but in our view the roadblocks to stronger growth are still in place: difficulty to find skilled workers and some hesitancy of employers to increase headcount when there is much uncertainty about fiscal stimulus and reform.

U.S. manufacturing Purchasing Managers' Index (PMI) hit 57.8 in June, up 2.9 points from May and the highest level since August 2014. New orders jumped 4 points to 63.5, the highest since March. Good news for the future in our view. Production grew 5.3 points to 62.4, the highest since February. Employment rose 3.7 points to 57.2, the highest since March. Inventories slipped 2.5 points to 49, which isn't too worrying in our view. However, with a number of inflation indicators these days pointing to very little pricing pressures, today's prices measure was of interest and it showed a 5.5 point drop to 55.0, the lowest since November 2016. The level itself indicates that prices for raw materials are still rising, but of the 18 industries, only 9 paid higher prices.

The U.S. nonmanufacturing ISM surprisingly rose in June, up 0.5 points to in June to a 2-month high of 57.4. The pattern that has been in place so far in 2017 continues: down (Jan)/up (Feb)/down (Mar)/up (Apr)/down (May)….and now, up (June). New orders inched 0.1 points higher to 60.8, and business activity climbed 2.8 points to 60.5…both encouraging moves in our view and although they're not as high as they were earlier this year, both point to a decent expansion. The one negative was employment, which declined 2.0 points to 55.8, but that reading is still the 2nd highest in ten. Prices paid rose to a 2-month high of 52.1.

The U.K. Report on Jobs: a survey of recruitment consultants, June shows the rate of growth eased slightly in the month for both permanent placements and temporary billings but remained high overall. Growth was reportedly dampened by risk aversion linked to Brexit uncertainty and the general election. The pool of available candidates continued to shrink markedly in the month, however, which is thought to be due to EU citizens leaving the U.K. The combination of increased demand for labour and fewer people looking for jobs is reported as putting sharp upward pressure on salaries. Permanent placements softened in June to 55.9 following 57.6 in May which was the highest increase since April 2015 (50 signals expansion). Panelists generally commented on client demand being robust but growth was somewhat dampened by risk aversion linked to Brexit uncertainty and the general election. Scotland saw the sharpest growth in perm placements followed by the Midlands whilst London saw the slowest growth. The availability of suitable permanent candidates declined at a softer rate in June, reaching 34.8 in the month from 33.2 in May. All regions registered a drop in candidate availability with the steepest drop continuing to be in the South of England. Availability of temporary/contract staff declined at the fastest rate in a year and a half with the index coming in at 38.6 in June from 40.2 in May, following 38.8 in April and 42.0 in March.

The Reserve Bank of Australia (RBA) left the overnight cash rate (OCR) unchanged at the record-low of 1.50% last week. There were expectations going into this meeting that RBA Governor Philip Lowe could join the chorus of global central banks like the European Central Bank (ECB), Bank of Canada (BoC) and Bank of England (BoE) in moving towards near-term interest rate hikes. Last week, former RBA board member John Edwards warned there could be as many as eight interest rate rises in the next two years as economic growth picks up.

Financial Conditions

Global regulators have claimed victory in the drive to tame the toxic parts of the "shadow banking" market that made a devastating contribution to the global financial crisis a decade ago. Reforms put in place by the G20 nations have successfully tackled the most pressing issues that contributed to the crisis, according to the annual report from the Financial Stability Board, an international group of policymakers and regulators, including to improve the supervision of shadow banks, institutions which perform bank-like functions such as lending but do not have the same safeguards. But Mr. Carney warned that the job was not complete, and that economic growth could be undermined if regulators gave in to "reform fatigue" and failed to finish their reforms. This included improving the transparency of the over-the-counter derivatives markets. He also called for the next-step Basel III banking reforms to be completed "urgently and then implemented faithfully". (Source: Financial Times)

The U.S. 2 year/10 year treasury spread is now .98% and the U.K.'s 2 year/10 year treasury spread is .97% - 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 costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.96% (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 4.4 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 11.62 (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 8 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
- Portland 15 of 15 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

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