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 24, 2017

Owner Operated Companies

Danaher Corporation reported results for the second quarter of 2017, with earnings per share (EPS) ahead of the consensus expectations. For the quarter ended June 30, 2017, net earnings were $557.3 million, or $0.79 per diluted share which represents a 31.5% year/year increase. Non-GAAP adjusted diluted net EPS was $0.99. This represents a 10.0% increase over the comparable 2016 period. For the second quarter 2017, revenues increased 6.5% year/year to $4.5 billion, with core revenue growth of 2.0% (non-GAAP). For the full year 2017, the Company anticipates that diluted net EPS will be in the range of $3.16 to $3.23. The Company is raising its 2017 non-GAAP adjusted diluted net EPS guidance, and now expects a range of $3.90 to $3.97.

Liberty Global LiLAC – John Reid, CEO of Cable &Wireless Communications PLC (CWC), announced that CWC has completed a groundbreaking pre-5G (fifth generation wireless broadband technology) trial in Antigua. CWC's pre-5G technology trial, a combined effort with parent company Liberty Global, is based on LTE Advanced Pro (LTE-A Pro). 5G is a new set of standards beyond traditional 4G/LTE technologies. This set of standards will allow operators to deliver wireless data connections above 1 Gbps and to enable the Internet of Things (IoT). CWC's pre-5G trial and 5G prototype trials are part of a partnership with Ericsson, who will provide the equipment and software in Antigua and across the Caribbean.

Energy Sector

U.S. land rig count decreased by 4 rigs to 924 rigs, breaking its streak of 26 weeks without a decline. The last weekly decline came in January 2017. The rig count was driven by declines in Vertical Gas (-3), Horizontal Oil (-2), Vertical Oil (-2), partially offset by gains in Directional Oil (+1), Horizontal Gas (+1), and Directional Gas (+1). Total horizontal land rig count is down 41% since the peak in November 2014. The Permian currently makes up 50% of all oil rigs.

U.S. horizontal oil land rigs declined by 2 rigs to 653, which is the second consecutive week of declines and the first time since May 2016 we've seen back-to-back weeks of declines, driven by declines in Eagle Ford (-2), Woodford (-2), "Other" (-2), and Mississippian (-1) were partially offset by gains in Permian (+3), Williston (+1), and DJ-Niobrara (+1) with Granite Wash flat week/week.

Canadian rig count increased by 15 rigs week/week, and is up 106% from the level this time last year.

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

OPEC meeting – OPEC and some of its competitors met in the Russian city of St. Petersburg to review market conditions and examine proposals related to their pact to cut output. Leading Organization of the Petroleum Exporting Countries (OPEC) producer Saudi Arabia pledged to cut its exports to help speed the rebalancing of global supply and demand. Saudi Energy Minister Khalid al-Falih said his country would limit crude oil exports at 6.6 million barrels per day (bpd) in August, almost 1 million bpd below levels a year ago. Falih also said the OPEC and non-OPEC partners were committed to extending their existing 1.8 million bpd supply reduction deal beyond next March if necessary but would demand that any non-compliant nations stick to the agreement.

Financial Sector

Bank of America Corporation reported Q2 2017 EPS of $0.46. Consensus was $0.43. Relative to expectations, a lower than expected loan loss provision and modestly better than anticipated capital markets revenues (trading and Investment Banking fees) more than compensated for lower than expected net interest income/margin and higher than forecasted expenses. The sale of its non-U.S. consumer credit card business resulted in a $103 million ($0.01) after-tax gain (includes $0.8 billion pre-tax gain partially offset by $0.7 billion from the tax impact of the foreign currency hedging). Results also included $0.4 billion ($0.02) of expense for the combined impact of impairment charges related to certain data centers in process of being sold and increased severance. It released $182 million of loan loss reserves, booked $159 million in Debt Value Add losses, and recorded $101 million in debt security gains. Operating revenues increased 4% year-on-year and slipped 1% sequentially. Tangible book increased 3.2% to $17.78 (1.4x). It posted a Return On Equity (ROE) of 8.0% and Return On Tangible Common Equity (ROTE) of 11.2%. Its Core Equity Tier 1 ratio (fully phased-in) increased 0.5% to 11.5% (Risk Weighted Assets fell -2.3%). Average diluted shares declined 0.8%. Net interest income slipped 0.3%, reflecting the benefits from higher short-end rates and one additional day. Period-end loans increased 1.2%. Its Non-Performing Assets ratio declined 0.08% to 0.82%, due primarily to improvements in energy exposures. Its reserve/loan ratio declined 0.04% to 1.19%.

Citizens Financial Group Inc. reported Q2 2017 EPS of $0.63, consensus was $0.59. Results included a pre-tax $26 million ($0.03) impact related to impairments on aircraft lease assets which, in addition to provision expense of $70 million, resulted in total credit-related costs of $96 million (its provision guidance was stable to slightly higher than $96 million). The lease impairments, which largely relate to a non-core runoff portfolio, reduced fee income by $11 million and increased expenses by $15 million. Higher than expected fee income and a lower than anticipated tax rate was able to compensate for less than expected net interest margin expansion and drove the EPS beat. Operating revenues increased 10% year/year and rose 2% linked quarter. Tangible book increased 2.3% sequentially to $26.61 (1.3x). It posted an adjusted ROTE of 9.6. Its Core Equity Tier 1 ratio was 11.2%, stable with Q1 2017. Its repurchased 3.7 million shares during the quarter. Average diluted shares declined by 0.8%. Its reserve/loan ratio declined 1bp to 1.12%. As expected, Citizens announced the launch of the next phase of its Tapping Our Potential (TOP) efficiency programs. Its new TOP IV program is expected to deliver pre-tax run-rate expense and revenue enhancements in the range of $90-$105 million (in-line with expectations). This includes initiatives to shift loan portfolio mix to higher-return categories continue to deliver benefits and stepped up efforts in Commercial Banking to exit lower-return relationships and recycle capital towards new business with greater cross-sell opportunities.

Fifth Third Bancorp reported Q2 2017 EPS of $0.45. Excluding the $0.01 impact resulting from a $9 million pre-tax charge related to the valuation of the Vantiv total return swap, EPS was closer to $0.46. Consensus was $0.43. A lower than excepted loan loss provision and controlled costs more than offset softer than expected fee income. Its provision was $12million ($0.01) less than net charge offs (NCOs) ($15 million release in Q1). Operating revenues increase 1% year/year and increased 2% sequentially. Tangible book increased 1.3% to $17.11 (1.5x). It posted a ROE and ROTE 9.0%, and 10.7%. Its Core Equity Tier 1 ratio (fully phased-in) was 10.52%, down 14bps. Average diluted shares declined by 1.1%. The reserve/loan ratio declined 1bp to 1.34%.

The Goldman Sachs Group Inc. reported Q2 2017 EPS of $3.95. Consensus was $3.42 (consensus was $3.89 in early May). Relative to expectations, a lower than expected tax rate and higher than anticipated revenues in Investing & Lending (driven by equities) and equities trading were used to compensate for lower than anticipated Fixed Income, Currency & Commodities revenues. We note if it posted a tax rate consistent with forecast of 29.5% instead of 27.0%, EPS would have been $0.15 lower. Provisions for litigation and regulatory proceedings were $22 million ($0.04), down from $139 million in Q1 2017. This was its lowest quarter in recent memory (5+ years). Overall revenues slipped 1% year/year and declined 2% sequentially to $7.89 billion (consensus $7.65 billion). Tangible book increased 1.2% to $177.20 (1.3x). Its ROE was 8.7%. Its Core Equity Tier 1 ratios (transitional) were 13.9% (standardized, -30bps) and 12.5% (advanced, -40bps). During the quarter, it repurchased 6.6 million shares for a $1.5 billion (6.2 million shares for $1.5 billion in Q1 2017). Average diluted shares declined by 1.6%. Its tax rate increased from 11.2% in Q1 2017 (included benefits from the settlement of employee share-based awards) to 27.0%. We believe its core tax rate in Q1 2017 was closer to 30.0%.

Morgan Stanley beat Wall Street's profit expectations last Wednesday, reporting gains across most of its businesses and producing more trading revenue than rival Goldman Sachs, a rare feat. The sixth-largest U.S. bank by assets reported an 11% rise in second-quarter profit, generating more revenue from giving corporations advice, underwriting securities, trading equities and managing customers' money. The one dark spot, bond trading, fell 4%, much less than at Wall Street rivals that reported earnings in recent days. The $1.3 billion in revenue from that business topped Chief Executive Officer James Gorman's $1 billion quarterly target and beat Goldman's $1.2 billion. (Source: Reuters) Morgan Stanley reported Q2 2017 EPS of $0.87. Consensus was $0.76. Results included a provision related to a U.K. indirect (value-added) tax matter, which increased expenses (it is believed this cost it around $0.04). Tangible book increased 2.3% to $33.24 (1.4x). Its ROE was 9.1%. Last quarter it was 10.7% (10.1% ex. tax benefit). Its 2017 target is 9-11%.

Nordea Bank AB reported Q2 total revenues 2% below consensus driven by clearly lower Net Interest Income (NII) than expected. NII is 3% below and down by 2% quarter/quarter (flat in local currencies). Commissions are in line with expectations but here market expectations have most likely come up a bit after clear beats from SEB Group and Swedbank AB on Q2 commissions. Nordea sees the same trends with good savings related fees, advisory and payment fees (cards). Trading is 1% below which could be seen as a slight positive based on previous peer reports for Q2. Nordea reports total costs at €1,291 million, 3% above consensus at €1,259 million. The cost guidance for 2017 is hiked to 3-5% (2-3%) but the 2018 versus 2016 flat cost target is maintained. The higher costs are driven by IT-implementation costs, costs for reviewing domicile and compliance costs, which, according to Nordea are front-loaded into 2017. Nordea reported loan losses at 13 basis points compared to 16 basis points expected by consensus. Loan losses were 14 basis points in Q1 2017 and 15 basis points in Q2 2016. Nordea comments on general asset quality as stable/strong and guides for 'lower than the historical average of loan losses of 16 basis points in H2 2017' from previously 'in line with the historical loan loss level'. Operating profit comes in 5% below consensus driven by the lower NII and clearly higher costs.

Activist Influenced Companies

Nothing new to report.

Dividend Payers

ABB Ltd. reported operational earnings before interest tax and amortization (EBITA) 3.5% below consensus on sales 1% below.

Orders came in 1% ahead of market. Operating EBITA margin of 12.3% was down 60 basis points year on year and was 30% below consensus, driven by raw materials impact (mainly in Industrial Automation and some in Robotics & Motion) and over-capacity in Robotics & Motion (RM). The over-capacity issue that weighed on margins in Q2 (and Q1) has been in the Process industries exposed part of the business and the company is now taking measures to adjust capacity. The profitability trend is expected to improve in 2nd half while growth in the Discrete part of the business should generate operational gearing (RM division orders up 14% like-for-like in Q2 and c10% in 1st half. Organic orders growth has accelerated to +3% in Q2 vs Q1 driven by RM (+14%) and Industrial Automation (+8%) while Grids stabilized.

Johnson & Johnson (J&J) said it expects sales growth to pick up in the second half of the year on strong demand for newer, more expensive treatments such as cancer drugs Darzalex and Imbruvica. J&J, which reported better-than-expected quarterly earnings and raised its full-year profit forecast, is banking on newer pharmaceuticals to counter slowing demand for some of its older, best-selling products, including Remicade and diabetes drug Invokana. Excluding special items, J&J earned $1.83 per share in the second quarter, beating analysts' estimates by 3 cents. While sales in J&J's consumer and medical device divisions rose, sales for pharmaceutical products - its largest business - fell marginally to $8.6 billion. The diversified healthcare company, which completed its $30 billion acquisition of Swiss biotech Actelion last month, raised its 2017 profit forecast to a range of $7.12 to $7.22 per share, from a range of $7.00 to $7.15.

Novartis AG reported Q2 2017 results broadly in line with expectations as sales and core operating income growth were flat and so operating profits were 3% above consensus expectations. Both Pharma and Alcon sales and operating profits grew marginally above expectations, offset slightly by Sandoz with continuing price pressure in the U.S. Pharma sales grew 1% in Q2 2017 coming in 1% ahead of consensus. Alcon grew 3% (its first quarter of growth since mid-2015) ahead of consensus by 2%. Sandoz sales declined 4% and 3% below consensus. Similarly, on profits Pharma (3% ahead of consensus) and Alcon (3% ahead of consensus) outperformed expectations, somewhat offset by Sandoz (2% behind consensus).

South32 Limited delivered a slightly soft production quarter in Q4; however, this is outweighed by strong realized pricing in met coal and manganese versus expectations, leading to an expected upgrade for EPS going into full year 2017 results. Overall we see the investment case unchanged predicated on strong cashflow generation, exposure to aluminum/alumina, a rapidly building net cash position, management willingness to return it to shareholders, and attractive valuation metrics relative to peers.

Economic Conditions

Canada – Canadian retail sales advanced by 0.6% in May, ahead of the expectations for a 0.2% improvement and building on April's 0.4% growth. Sales of vehicles and parts were the chief growth driver, 2.4% higher over the month. Excluding auto sales, core retail sales were actually 0.1% lower, with health and personal care, general merchandise and sporting goods weakness more than offsetting the strength in electronics and food and beverage categories.

Consumer prices, as measured by the changes in the consumer price index (CPI), slowed down their rate of growth in June, to 1.0% from 1.3% year on year in May, dragged lower by a drop in fuel prices. The core reading, which excludes the effect of eight most volatile price series, including food and energy, was flat at 0.9% year on year rate of change.

The International Monetary Fund updated its World Economic Outlook with previous forecasts that the global economy will grow at 3.5% in 2017 and 3.6% in 2018. The IMF shaved its forecasts for the US down to 2.1% for 2017 and 2018, down slightly from 2.3% and 2.5% respectively but the IMF boosted growth outlooks for the Euro zone and China.

Housing sales fall in most markets across Canada – The Globe & Mail reported last Monday that house sales fell in a majority of markets across Canada in June, suggesting the real estate sector is cooling just as interest rates are starting to climb and Ottawa is proposing tougher mortgage rules. Sales fell in Toronto and most nearby cities throughout Southern Ontario in June compared with the same month last year, but were also down in an array of markets outside Ontario, including major markets in British Columbia. Data from the Canadian Real Estate Association show sales fell in 16 of 26 major markets across the country in June compared with June 2016 and compared with May this year. The total number of homes sold nationally fell 6.7% in June from May – the largest monthly decline since 2010 – while sales were down 11.4% compared with June last year. Prices are also dipping in many markets, falling an average of 3.4% nationally in June compared with May on a seasonally adjusted basis, with home prices in the Greater Toronto Area falling 5.8% and Greater Vancouver dropping 3.2%. The Hamilton-Burlington area had the biggest price drop of any major market in June, falling 9% from May on a seasonally adjusted basis.

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Financial Conditions

European Central Bank left rates unchanged: the refinance rate at 0.0%, deposit facility at -0.4%, and the marginal lending facility at 0.25%. Their net asset purchases of €60 billion/month will run until the end of December 2017, or beyond, if necessary, or until they see a sustained adjustment in the path of inflation consistent with its inflation aim. During the press conference, President Draghi repeated a lot of the usual comments…..risks to the growth outlook were broadly balanced but have yet to translate into stronger inflation dynamics………headline CPI dampened by energy but underlying inflation remains subdued….a very substantial degree of accommodation still needed and they stand ready to increase purchases in terms of size/duration.

The Bank of Japan (BOJ) as expected kept its monetary policy unchanged in its July 19/20 2017 monetary policy meeting (MPM) decision. This was status quo for the 7th straight meeting after having announced policy changes in two consecutive monetary policy decisions during July and September last year. In the latest Outlook for Economic Activity and Prices (July 2017), the key takeaways are the timeline for achieving the 2% price inflation is pushed back to a more plausible dateline of around fiscal 2019 (from "around fiscal 2018" previously) while BOJ is more upbeat about economic assessment, upgrading growth forecasts for fiscal 2017-2019. Note that BOJ maintained the assumption that the Japanese government is scheduled to hike the consumption tax rate in October 2019.

The U.S. 2 year/10-year treasury spread is now .90% and the U.K.'s 2 year/10-year treasury spread is .91% - 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 9.80 (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

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.