News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. December 4, 2017

Owner Operated Companies

BlackRock Inc. said it had agreed to buy the asset management business of Mexico's Citibanamex, a subsidiary of Citigroup Inc., in a sign of the growth potential the world's largest asset management sees in the country. Under the deal, BlackRock with nearly $6 trillion in assets under management will offer asset management products to Citibanamex clients in Mexico, the companies said in a joint statement. Through its network of 1,500 branches in Mexico, Citibanamex provides wealth management products and services to more than 20 million clients. The transaction involves approximately $31 billion in assets under management of Citibanamex, across local fixed income, equity and multi-asset products, primarily for retail clients. The transaction is part of Citi's emphasis on expanding access to best-in-class investment products, rather than manufacturing proprietary asset management products. Jane Fraser, CEO of Latin America for Citi, said: "Our goal is to create a state-of-the-art bank in Mexico focused on delivering a richer, smarter, more intuitive experience." Fraser said Citi had seen 8% annual revenue growth in Mexico's financial markets system since 2010 and it expected that to continue. BlackRock's business in Mexico currently focuses mostly on institutional clients, offering international investment and risk management products and services.

Energy Sector

U.S. land rig count increased by 8 rigs week/week to 908, which is the fourth consecutive week of gains. The rig count was driven by increases in Horizontal Oil (+3), Horizontal Gas (+3), Directional Oil (+1) and Vertical Gas (+1) as Vertical Oil and Directional Gas remained flat w/w. Total horizontal land rig count is down 2% since the peak in August 2017. The Permian currently makes up 54% of all oil rigs.

U.S. horizontal oil land rigs increased by 3 rigs week/week to 647, as gains in Permian (+3), Williston (+1), and Mississippian (+1) were partially offset by declines in Woodford (-1) and "Other" (-1) as Eagle Ford, DJ-Niobrara, and Granite Wash remained flat week/week.

Canadian rig count increased by 7 rigs week/week to 221, and is up 12% from the level this time last year.

U.S. Gulf of Mexico offshore rig count decreased by 2 rigs week/week to 20 rigs and is down 63% since June 2014.

Financial Sector

The Bank of Nova Scotia has agreed to buy Spanish lender Banco Bilbao Vizcaya Argentaria SA's (BBVA) stake in BBVA Chile for $2.2 billion in a move that would make it Chile's third largest privately-owned bank. Scotiabank, Canada's third-biggest lender, has the biggest foreign presence of any Canadian bank and has focused its international strategy on the Pacific Alliance, a Latin American trading bloc comprising Mexico, Peru, Chile and Colombia which it expects will generate strong growth in the next few years. Chief Executive Brian Porter said in September that the potential acquisition of BBVA's retail business in Chile was a "once in a lifetime opportunity." Despite weak growth in the world's No. 1 copper producer, Chile's banking industry surged nearly 9% in the first three quarters of 2017, boosted by growth in consumer loans and commissions. Scotiabank said its acquisition of BBVA Chile would double its share of the Chilean market, worth around C$390 billion, to 14%. BBVA owns 68% of BBVA Chile, while the Said family of Chile owns another 29% of the listed retail bank, which had a total market capitalisation of $2.2 billion. The purchase will be the biggest ever acquisition outside of North America by a Canadian bank. Scotiabank also reported fourth-quarter earnings of C$1.64, up from C$1.57 a year ago.

Canadian Imperial Bank of Commerce (CIBC) profit was up to $1.16 billion vs. $931 million year/year, as the addition of new operations and a focus on expense management helped to boost results. The biggest year/year jump was seen in the US Commercial Banking & Wealth Management segment due to the addition of The PrivateBank. Provisions for Credit Losses were essentially flat year/year, but did jump somewhat quarter/quarter, but are not seen as overly material. Capital levels began to improve following the PrivateBank transaction, with the CET 1 rising to 10.6% vs. 10.4% quarter/quarter, but still well down from the 11.3% level the prior year. Tier 2 capital declined modestly to 1.7% vs 1.8% quarter/quarter. The quality of these results is relatively stable in our view, but we see these Tier 2 capital levels as the lowest of the major banks (that have reported so far) – not an obvious "need" for more capital, but something we will watch.

National Bank of Canada posted operating EPS of $1.40 in Q4 2017, up 13% year/year and ahead of consensus ($1.38). It was the only member of the Canadian bank group to report last week that avoided the sector-wide weakness in trading revenue, with the contribution for the bank actually up a strong 18% quarter/quarter. Conversely, after a very strong period of capital build the CET 1 ratio flattened out in Q4, and management indicated that IFRS 9 adoption will remove a further ~16bp in Q1 2018. While National Bank clearly still boasts a strong capital base (11.04% pro forma CET 1 ratio), a less pronounced level of build seems likely as the bank steps up the pace of buyback activity.

The Toronto-Dominion Bank reported adjusted EPS of $1.36, lower than consensus of $1.39. Adjusted EPS this quarter excluded a dilution gain associated with the Scottrade transaction (-$0.11), charges associated with the Scottrade transaction ($0.02) and amortization of intangibles ($0.03). Net income of $2.55 billion vs. $2.30 billion year/year, with a strong jump in Canadian and US Retail profit more than offsetting a small downturn in the Wholesale Banking segment. A focus on expense control more than offset a quarter/quarter jump in Provisions for Credit Losses, although the loss level was down somewhat year/year. Capital levels were down quarter/quarter, with the CET 1 down to 10.7% vs. 11.0% as the company closed on the Scottrade Bank acquisition, but this is still higher than the 10.4% level year/year. Tier 2 capital was at 2.6%. In line with other banks seen so far, this result looks stable and steady for credit quality, with no obvious need seen for additional capital securities in our view.

Royal Bank of Canada (RBC) posted operating EPS of $1.92 in Q4 2017, up 14% year/year and ahead of consensus ($1.87). Though trading revenue did decline, the $744 million print was off a relatively modest 11% quarter/quarter, and RBC was able to utilize a very low 17bp Provision for Credit Loss ratio as earnings offset. More importantly, the operating trends observed in the key Retail-oriented segments (Canadian Banking and Wealth Management) appear positive in our view and RBC disclosed that the IFRS 9 adoption would have minimal impact on the capital position of the bank (10.87% CET 1 ratio). On a full-year basis the $7.57 in operating EPS was up a strong 11%, and RBC generated a healthy 17.1% operating ROE in 2017.

U.K. Banks - Mark Carney, Governor of the Bank of England (BoE), on Tuesday declared the Bank of England was “putting our money where our mouth is” by presenting the U.K.’s banking system as ready to withstand even the worst possible disruption posed by Brexit. The central bank governor said it was the first time since the BoE’s annual stress tests of the country’s biggest lenders began in 2014 that they had all come through the exercise without needing to take remedial action.

Activist Influenced Companies

Nomad Foods Limited reported a strong set of results for its third quarter and raised its guidance for 2017. Reported revenue increased 4.4% to €459 million, while organic revenue growth continued to improve in the quarter, up by 5.9%. Reported profit for the period was €42 million, while adjusted EBITDA decreased 8% to €79 million. Reported EPS were €0.24, while adjusted EPS increased 9% to €0.24. Nomad raised 2017 Adjusted EBITDA guidance to approximately €325 to €327 million. Stefan Descheemaeker, Nomad Foods’ Chief Executive Officer, stated, “We experienced strong growth in the third quarter with revenue, gross margin and adjusted EBITDA exceeding our expectation. Results, including 5.9% organic revenue growth, reflect favorable category performance coupled with market share gains. We are pleased by the momentum in the business, with Q3 representing a third consecutive quarter of organic revenue growth and market share expansion. Based on our year-to-date performance, we are raising our 2017 guidance.” Organic revenue growth of 5.9% was driven by 4.1% growth in volume/mix and 1.8% growth in price. Gross profit increased 8.6% to €139 million. Gross margin expanded 120 basis points to 30.3% driven by positive mix and improved pricing and promotional efficiency. Full year guidance now assumes organic revenue growth of approximately 3% versus the prior expectation of growth at a low-single digit percentage rate.

Dividend Payers

Nothing significant to report.

Economic Conditions

Canada – Canadian economy added 79,500 jobs in November, significantly outpacing the expectations for 10,000 job gains and October’s 35,300 positions. The job gains were driven by retail, manufacturing, education and construction. Unemployment rate dropped four tenths in the month, to 5.9% from 6.3%.

Third quarter Canadian GDP growth was broadly in line with the expectations, at 1.7% annualized, compared to 1.6% expected, though it was a significant deceleration from second quarter’s 4.5% advance. Growth was driven by the consumer sector in the quarter, supported by business investment, with the housing sector as the one notable detractor from growth during the period.

U.S. economic growth was stronger than originally anticipated. Real GDP grew 3.3% annualized in Q3, up from the advance reading of 3.0% and the fastest increase in about three years. Upward revisions to inventories helped, as did business investment (mainly equipment and intellectual property, not so much structures). Housing still fell but at a slower pace. PCE and net exports were little changed from the first go-around. Government spending also rose, surprisingly, compared to the initial estimate of a decline. The core deflator was revised up to 1.4% from 1.3% in the earlier reading. All in, good news and will keep the Fed firmly on the path to a December raise in rates in our view.

U.S. Senate passes tax reform bill, clearing biggest hurdle toward becoming law. Last-minute concessions and modifications allowed the Senate to pass its tax reform bill early Saturday morning, with all Republicans, except lone deficit hawk Bob Corker, signing on (no

Democrats supported the bill). This is a big step forward in passing the largest overhaul of the tax system in three decades, which will give the economy a moderate lift, in our view. The next step is for a bipartisan committee to resolve differences between the Senate and House versions and merge them into a single bill that can be passed by both chambers. Last-minute modifications to the Senate bill and key differences with the earlier-passed House version imply tough negotiations ahead. However, it's possible that the House will agree to pass the Senate's version to preclude another nail-biting session in the latter chamber (with its narrower margin of victory). Either way, the odds of passage—likely early next year though possibly sooner are now improved. The House and Senate will now have to reconcile the two bills and come to an agreement and then send it back to both houses for approval. If approved, it will be then sent to the White House for signing into law. The government shutdown deadline comes Friday next week so there has to be an agreement on that as well. Any time spent agreeing on this deal takes time away from negotiating the tax reform bill which President Trump had wanted to be approved by the end of year. Both house bills will not be easy to reconcile. The similarities between the House and Senate bills are that they: (i) Result in about $1.4 trillion of net tax cuts in the decade ahead. The nonpartisan Joint Committee on Taxation (JCT) estimates that a third of the increase in the budget deficit would be recouped from stronger economic growth, suggesting a cumulative increase in the deficit of about $1 trillion. (That's on top of a deficit currently running around 3.5% of GDP and expected to rise further as baby boomers tap entitlement programs.); (ii) Reduce the corporate tax rate from 35% to 20%; (iii) Reduce personal income taxes. Based on the House version, the JCT estimates that about 44% of taxpayers will save more than $500 in 2019, though some will see higher taxes; (iv) Limit net interest deductions to 30% of income and: (v) Provide a partial tax holiday on repatriated foreign earnings. The Senate plan proposes a one-time 14.5% tax for liquid assets (revised up from 10% previously) versus the House's 14%. This should encourage the repatriation of some of the over $2 trillion in earnings held abroad (most of which is apparently in US dollars), supporting investment, dividend payouts, buybacks and acquisitions. The key differences between the two bills are that: (i) The Senate plan delays the corporate tax rate reduction until 2019, saving about $127 billion over ten years compared with the House's immediate starting date; (ii) The Senate plan repeals the Affordable Care Act's individual mandate, saving $338 billion over ten years but also pushing 13 million persons off the insurance rolls by 2027 according to the Congressional Budget Office; and (iii) The Senate plan retains the current number of personal income tax brackets at seven but trims the top rate to 38.5%. The House plan reduces the number to four, but retains the top rate at 39.6% (albeit at a higher income threshold). The one-year delay of the corporate tax rate cut in the Senate plan, if retained in the final bill, would imply slightly less economic stimulus in 2018 than the House plan and an attendant greater lift in 2019. It's estimated that the tax cuts in the House plan could lift GDP growth by about 0.3 ppts next year. Importantly, the tax cuts should keep the economy cruising above its potential rate (estimated by the Fed and CBO at around 1.8% in the long run) for the next year or two (the direct economic lift will diminish after the initial years, while rising interest rates will slow growth to potential). Beyond that, the aim (or hope) is that lower business taxes, the repatriation of foreign earnings and the accelerated depreciation allowance will stoke investment, productivity and competitiveness. The near-term risk is that the lift to growth will fan inflation, prodding the Fed to more aggressively raise interest rates. The FOMC currently projects a rate hike next week and three more moves in 2018.

Financial Conditions

The U.S. 2 year/10-year treasury spread is now .59% and the U.K.'s 2 year/10-year treasury spread is .78% - 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 3.90% (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 3.9 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 11.08 (compares to a post-recession low of 9.52 achieved in early November) 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
- Bay & Scollard Development Trust

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

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.

Glossary of Terms: 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'ROE' return on equity, 'ROTE' return on common equity.

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