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. January 15, 2018

Owner Operated Companies

Berkshire Hathaway Inc. promoted two of its top executives, Gregory Abel and Ajit Jain, adding them to its board and cementing their status as the front runners to succeed Warren Buffett atop the conglomerate. Abel, 55, the chief executive officer of Berkshire Hathaway Energy, was named Berkshire's vice chairman for non-insurance business operations, while Jain, 66, Berkshire's top insurance executive, was named vice chairman for insurance operations. Buffett, 87, remains chairman and CEO of the roughly $500 billion conglomerate he has run since 1965. Charlie Munger, 94, who has worked at Buffett's side for more than four decades, remains vice chairman. Both Buffett and Munger will continue handling major capital allocation and investment decisions, including acquisitions, for Omaha, though they have reduced their responsibilities in recent years with their increasing age. While Munger had the idea to make Abel and Jain vice chairmen, Buffett said managing a large portion of Berkshire, including input on smaller acquisitions, would provide valuable experience to his successor. Buffett dismissed the idea of a horse race between Abel and Jain for the top job. Berkshire's board will grow to 14 members from 12 with the addition of Abel and Jain. Abel, who grew up in Alberta, joined Berkshire Hathaway Energy in 1992. His Iowa-based unit now runs several power companies in the United States, Canada and Britain, as well as natural gas pipelines and solar and wind farms. Jain, a native of India who joined Berkshire in 1986, runs the reinsurance operations, providing coverage against major catastrophes and unusual risks. Todd Combs and Ted Weschler, who are Buffett's investment deputies, are expected eventually to succeed Buffett as Berkshire's chief investment officer. Buffett's eldest son, Howard, is expected to become Berkshire's non-executive chairman, to help preserve the company's culture.

BlackRock, Inc. moved past a record $6 trillion in assets, its profit beating Wall Street forecasts, as investors flooded into the relatively low-cost funds of the world's largest asset manager. A new U.S. tax law, which sliced corporate and individual income rates, also helped the company's results in the fourth quarter ended December 31, 2017. BlackRock said on Friday it saw a $1.2 billion tax benefit related to the law and raised its quarterly cash dividend by 15%. Larry Fink, the company's founder and chief executive, said the tax reform was putting more money in his clients' pockets, which they would need to invest. BlackRock said its iShares ETF business took in $54.8 billion in new money in the quarter, up from $49.3 billion a year earlier. The $367 billion the company took in from investors in 2017 overall was a record, while assets under management expanded to $6.29 trillion. BlackRock's active managers also posted a strong year, with 76% of the fund's actively managed assets in funds ranked in the top half of their Thomson Reuters Lipper category over three years as of November. "**As more funds flow into passive investing, active management should have better performance**, and I think that's what we're experiencing," said Fink. "There is a need for passive, there is a need for active." BlackRock's net income surged to $2.3 billion, or $14.07 per share, from $851 million, or $5.13 per share, a year earlier. The company said its effective tax rate would fall to 23%, from closer to 30%, which could boost its profitability 6% to 7%. Excluding the benefit from the new tax law, BlackRock earned $6.24 per share. Analysts on average expected the company to earn $6.02 per share, according to Thomson Reuters.

Energy Sector

Cardinal Energy Ltd. announced the retirement of Mr. Doug Smith, Chief Financial Officer. Mr. Smith has been with Cardinal since its inception. Mr. Smith will continue to stay on in an advisory role until January 31, 2018 to ensure a smooth transition. Cardinal announced that Mr. Shawn Van Spankeren, CPA, CMA, will be joining the Company as Chief Financial Officer effective January 15, 2018. Mr. Van Spankeren has over 24 years of oil and gas industry experience focusing on accounting and finance. He was most recently the Vice-President, Finance and Administration for Crew Energy Inc. where he has been since its inception in 2003. Prior to Crew Energy, Mr. Van Spankeren was the Controller of Baytex Energy Ltd. where he was employed for six years holding positions of increasing responsibility in the accounting and finance department.

Crescent Point Energy Corp. (CPG) set its 2018 capital expense budget at $1.8 billion, before net land and property acquisitions. It hopes to produce an average of 183,500 boed in 2018 and exit at 195,000 boed. The company achieved a 2017 exit rate of 183,000 boed and expects 2018 year/year exit growth of approximately 7%. CPG's 2018 capital budget is focused on returns, with over 75% of net wells drilled expected to payout in two years or less. The company plans to increase its total corporate productive capacity by approximately 70%, driven by new horizontal locations in Uinta. CPG sold over $320 million of non-core assets in 2017 with a continued focus on debt reduction. The Company's 2018 budget is expected to generate annual average production of 183,500 boed and exit production of 195,000 boed. This represents annual growth of approximately 5% and year/year exit growth of approximately 7%. The company successfully identified new drilling locations during 2017, including additional horizontal locations in the Uinta Basin. At year-end 2017, CPG's risked Uinta Basin horizontal inventory increased to approximately 850 net locations, up from 120 at the end of 2016. CPG also updated its estimated original oil-in-place for the Uinta Basin, which grew by over 60% to approximately 8.5 billion barrels.

Financial Sector

Barclays PLC has been warned by Members of Parliament not to shut a compensation fund for customers mis-sold credit card plans amid claims it could leave customers entitled to pay-outs of more than £200 million out of pocket. Vince Cable, the Liberal Democrat leader, and John Mann, a member of the Treasury Select Committee, urged the high street bank to keep the fund open or risk getting mired in a mis-selling scandal "potentially on a par with PPI". Barclays will appear in the High Court next month after being challenged over halting pay-outs for allegedly mis-selling so-called "debt waiver" products to credit card customers under its now-defunct Monument brand. The lender has already paid out more than £350 million to around 120,000 claimed victims via CompuCredit U.K. (CCUK), which bought Barclays' Monument credit card book in 2007 and has been handling claims on behalf of the bank. (Source: The Telegraph).

JPMorgan Chase & Co. got the big banks' Q4 earnings season off to a brisk start on Friday morning, beating analysts' expectations for profits despite a jump in provisions, a particularly sluggish period for trading, and a $143 million loss relating to hobbled South African retailer Steinhoff. Analysts were largely focused on the effect of the sweeping U.S. tax overhaul passed in December: the word "tax" came up 71 times in a little more than an hour as top executives at the New York-based bank discussed the immediate $2.4 billion hit to earnings as well as the long-term potential benefits of the law. The underlying business of the biggest U.S. bank by assets also seems in decent shape. Credit quality held up across most parts of the retail business, said Marianne Lake, the bank's finance chief, with relatively small increases in charge-offs in the credit card business. (Source: Financial Times). **JPMorgan** reported Q4 2017 EPS of $1.07. Results include $2.4 billion ($0.69/share, 25bps of CET 1 capital) estimated net impact of the Tax Cuts and Jobs Act. Deemed repatriation (-$3.7 billion) and the revaluation of tax-oriented investments (-$0.8 billion) weighed, while its deferred tax revaluation (+$2.1 billion) helped. Excluding this impact, EPS was $1.76 and consensus was $1.68. This marks the 12th straight quarter JPMorgan exceeded the consensus (operating) EPS estimate. Relative to expectations, higher than expected net interest income (both loans and Net Interest Margin above) and a lower than anticipated loan loss provision (though wholesale Non Performing Assets increased, slight net reserve build) were able to more than compensate for higher than anticipated expenses. Tax-oriented investments reduced Fixed Income, Currency and Commodities by $259 million (tax-oriented investments) but added $115 million to its commercial bank (investments that receive tax credits in the Community Development Banking business). Revenues increased 5% year/year but declined 3% linked quarter to $25.5 billion (consensus was $25.2 billion). Excluding the tax charge, it posted a ROTE of 13% (11% ROE). Tangible book declined 0.9% to $53.46 (trading at 2.1x). Its CET 1 ratio (fully phased-in, standardized) was 12.1% (-40bps). It repurchased a net $4.7 billion of common stock in Q4 2017 (net $4.5 billion in Q3 2017). Average diluted shares declined by 1.3%. Its reserve/loan ratio declined 2bps to 1.27%.

Two of the biggest U.S. banks have vowed to share the spoils of a big cut in the corporate tax rate, holding out the prospect of higher investment, better pay and cheaper prices for their services. **Wells Fargo & Company** said on Friday its Q4 profits had been boosted by $3.4 billion thanks to Washington's sweeping package of tax reforms passed last month, which reduced the size of a tax liability on its balance sheet. **JPMorgan Chase**, which has extensive overseas assets now taxed under the law, took an immediate $2.4 billion hit from the legislation. But Jamie Dimon, chief executive, said it stood to benefit significantly from the cut in America's headline corporate rate from 35% to 21%. (Source: Australian Financial Review)

Activist Influenced Companies

Brookfield Business Partners L.P. – Brookfield's private equity arm, Brookfield Business Partners, has agreed to acquire 75% stake in Schoeller Allibert Group B.V., a Netherlands-based returnable plastic packaging manufacturing company, from an indirect subsidiary of JPMorgan Chase, for a consideration of €205 million (US$246.96 million). As a part of transaction, Brookfield completed the transaction by partnering with the founding Schoeller family. Following the transaction, the remaining 25% stake in Schoeller Allibert will be retained with Schoeller family. Cyrus Madon is the CEO of Brookfield Business Partners. The transaction is expected to close in Q2 2018.

Dividend Payers

Nothing significant to report.

Economic Conditions

The World Bank says global economic growth is likely to speed up this year, after a stronger than expected 2017. The bank's new forecast is that the world economy will expand by 3.1% this year before slowing slightly. It will be the first time since the financial crisis that growth is operating at its full potential. However, the report warns the upswing will be short-term, with gains in improving living standards and reducing poverty levels at risk long-term. For the immediate future, the bank sees a reasonably upbeat prospect. The bank's president Jim Yong Kim said: "The broad-based recovery in global growth is encouraging". The forecast is better than what the bank was expecting in its previous assessment last June. Among the large economies, the up-rating is especially marked for the Eurozone, though the bank still thinks it will slow somewhat this year, but by less than its previous forecast. (Source: BBC)

U.S. retail sales rose 0.4% in December following an upwardly-revised 0.9% gain in November, marking the fourth straight month of strength. "Core" sales (excluding food services, autos, gasoline and building materials) rose 0.3%, as expected, but the prior month's advance was revised sharply higher to 1.4% (from 0.8%), and sales spiked 8.9% annualized in Q4—the most in the post-recession period. While the increase in spending wasn't as broadly based as one would like, the show of strength in recent months is a testament to the strong financial tailwinds (relating to wealth, income, credit and confidence) pushing on consumer backs. Online sellers and other non-store retailers extended their dominance in December (1.2% after 4.2% in November) at the expense of traditional department stores (-1.1%). Furniture sales are glistening (up 7.5% in the year), reflecting strength in home sales.

U.K. manufacturing output is expanding at its fastest rate since early 2008 after recording a seventh consecutive month of growth in November. Renewable energy projects, boats, aeroplanes and cars for export helped make output 3.9% higher in the three months to November than in 2016. Official figures also show industrial output rose by 0.4% in November. Construction output in the three months to November fell by 2%, compared with the previous three months. That was the industry's biggest quarterly fall since August 2012, with the only bright spot for the sector being a 1.2% increase in new housing. For the month of November, total production was estimated to have increased by 0.4% compared with the previous month, with the biggest contribution coming from energy supply. This increased by 3.2%, mainly because the temperature was warmer than average in October, but colder than average in November. Economic growth had slowed in the first nine months of 2017 with higher inflation caused by the fall in sterling after the Brexit referendum, although the U.K. economy did grow by 0.4% in the three months to September. (Source: BBC)

Financial Conditions

Canada's banking regulator said last Tuesday it would introduce new capital rules stricter than those proposed by global regulators to ensure banks can withstand financial shocks. The Office of the Superintendent of Financial Institutions (OSFI) said the changes were designed as an interim step before new global rules are phased in over a five-year period from 2022. The regulator said it would replace the current capital output floor used by Canada's banks with the more risk-sensitive Basel 2 floor, calibrated at 75%. That compares with a floor of 72.5% based on a standardized approach that global regulators agreed on in December. "We are strong advocates of the value of international standards in Canada but we have also never shied away from deviating from those standards where it makes sense in our domestic market," OSFI Assistant Superintendent Carolyn Rogers said at the 2018 Canadian Bank CEO conference in Toronto. (Source: Reuters).

Canada's mortgage-rate trendsetter, Royal Bank of Canada, hiked its posted five-year fixed mortgage rate Thursday. Government regulations now force most Canadians to prove they can afford much higher rates before getting approved for a mortgage called 'stress testing'. The Bank of Canada's posted five-year fixed rate is used for most mortgage stress testing in this country, and it has been four years since it last exceeded 5%, its qualification rate has increased from 4.99% today to 5.14% this week.

The U.S. 2 year/10 year treasury spread is now .55% and the U.K.'s 2 year/10 year treasury spread is .73% - 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 3.99% (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 10.16 (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 Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value Plus Fund

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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