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. January 7, 2019

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Owner Operated Companies

Carnival Corporation reported adjusted earnings of $0.70 per share for the fourth quarter of its financial year, beating analysts' estimate of $0.69. Net revenue climbed 4.6% to $4.46 billion, above estimate of $4.44 billion, according to Institutional Brokers' Estimate System data from Refinitiv. Carnival forecast current-quarter profit below analysts' estimates though, as the company faces higher fuel costs, and a stronger dollar that has crimped demand for cruises. Fuel constitutes a large part of cruise operators' operating costs, accounting for about 15% of Carnival's total operating expense in its latest fiscal year. Miami-based Carnival is refreshing its fleet of over than 100 ships and will add 18 new ships between 2018 and 2022, to replace some of its older, less efficient ships. Carnival said net revenue yields, a keenly watched metric that measures spending per available berth, would be flat in the first quarter from a year earlier. Yields rose 3.7% in constant currency in its latest quarter.

Oracle Corporation forecast current-quarter profit above estimates after growth in its cloud services and license support unit helped the business software maker surpass Wall Street expectations for the second quarter. The company said that, excluding fluctuations in exchange rates, it expected third-quarter adjusted profit to be between $0.86 and $0.88 per share. Revenue at Oracle's cloud services and license support unit, its biggest, rose 2.7% to $6.64 billion and beat analysts' estimate, as more companies shifted to cloud computing from the traditional on-premise database model to cut costs. The company created a new revenue reporting structure in 2018 that merged its cloud and software license businesses. Oracle is a late entrant to the rapidly growing cloud-based software business, but has aggressively stepped up its efforts to catch up with rivals such as Workday, Inc., Microsoft Corporation and Salesforce.com, Inc. The company's net income rose to $2.33 billion, or $0.61 per share, in the second quarter ended November 30. Excluding items, the company earned $0.80 per share, beating the average analyst estimate of $0.78. Total revenue fell marginally to $9.56 billion, but exceeded analyst expectations of $9.52 billion.

Walgreens Boots Alliance, Inc. – As part of its reporting for the first quarter of its 2019 fiscal year, Walgreens announced it would consolidate warehouses and shut some stores as part of a cost-cutting plan aimed at saving more than $1 billion annually. The company's international business suffered mainly due to weak demand in Britain, where a weak retail environment offset its market share gains. The company operates nearly 2,500 stores in the U.K., roughly half its non-U.S. stores, making it vulnerable to Brexit-related uncertainties. The cost-cutting program, which is expected to save more than $1 billion by the end of the third year, comes as the company consolidates 1,932 stores acquired from Rite Aid Corporation last year for $4.38 billion. The company said its pharmaceutical wholesale division and retail businesses in Chile and Mexico were part of its cost-saving plan, which is expected to result in significant restructuring and other special charges. International retail sales fell 5.9% to $2.9 billion, while same-store sales at its U.S. retail stores, where it sells over-the-counter drugs and personal care products, fell 3.2%. U.S. retail sales also took a hit as the company scaled back sales of certain products including tobacco. However, its U.S. pharmacy business posted a strong quarter, helping Walgreens beat profit estimates. Same-store sales at its U.S. pharmacies rose 2.8%, beating analysts' estimates of a 2.6% increase, according to data from Refinitiv. Net income attributable to the company rose to $1.12 billion, or $1.18 per share, in the first quarter ended November 30 FCF from $821 million, or $0.81 per share, a year earlier. Excluding items, Walgreens earned $1.46 per share. Sales rose 9.9% to $33.79 billion. Analysts on average had expected a profit of $1.43 per share and revenue of $33.78 billion.

Energy Sector

Royal Dutch Shell PLC - One of the key questions for Royal Dutch Shell is the company's ability to deliver on its $25-$30 billion organic FCF target by 2020. In a fascinating interview with Shell CEO Ben Van Beurden published on the Shell website and entitled "The power of perseverance" there is a reiteration that the company is on track to meet its cash flow ambition. Given this comes less than a month before the full-year results, we see it as an indication that there will be no change in guidance at that point. Shell has also announced the start of production at the Geismar petrochemicals unit in the U.S. – on time and within budget. We see both of these as incrementally positive.

Whitecap Resources, Inc. revealed a cautious capital program for 2019, given the expected volatility in the commodity prices and the uncertainty surrounding market access for Western Canadian producers. Its board of directors has approved a $425 million to $475 million capital budget for 2019 that includes the drilling of 220 (191.5 net) horizontal wells. The 2019 capital program and the annual dividend of $0.324 per share is expected to be fully financed by internally generated funds flow. Canadian crude oil price differentials, and associated short-term contracts, have been positively impacted by the Alberta government's recent announcement curtailing 325,000 barrels a day of Alberta crude oil production effective Jan. 1, 2019, to help reduce the excess crude in storage, and its intention to purchase railcars to transport an additional 120,000 barrels a day out of the province starting in late 2019. Longer term, Canada needs additional export pipelines (Keystone XL, Trans Mountain

Expansion and Enbridge Line 3 Replacement) to ensure that the company receives a fair price for its natural resources for the benefit of all Canadians. With the extreme volatility in both West Texas Intermediate (WTI) and Canadian differentials, Whitecap has elected to take a cautious and defensive approach in the first half of 2019 by reducing capital spending compared with the prior year with a focus on debt reduction. The company will continue to monitor the impact of the production curtailments, progress of the export pipelines and commodity prices to determine if any adjustments are required to the company's preliminary second half 2019 plans. In 2016 and 2017, Whitecap was opportunistic in acquiring premium light oil assets with low base production declines and strong operating netbacks. In aggregate, the company acquired approximately 30,000 boed for $1.4 billion with a base decline rate of less than 10%. With WTI prices currently at about $50 (USD)/barrel, in combination with wider Canadian crude oil differentials, the benefits of having assets with long life, low production declines and high operating netbacks become increasingly more important. The company's compounded annual growth rate (CAGR) on organic production over the next three years is anticipated to be 6%. The first half 2019 budget is defensive and focused on balance sheet strength in this time of economic uncertainty in the Canadian energy industry. It is designed to ensure capital spending and dividend payments are fully covered by anticipated funds flow. The second half 2019 capital program is designed to provide maximum flexibility allowing the company to increase or decrease capital spending depending upon the realized crude oil pricing environment.

Financial Sector

Barclays PLC - has appointed 100 investment bankers in Europe as part of an aggressive push to bolster its position in the E.U. ahead of Brexit. European hires include 12 managing directors, and has also brought in a further 65 graduates in the region.

Standard Chartered PLC - Faces an extra three months on probation with U.S. authorities as it haggles over a £1.2 billion fine for allegedly busting sanctions in Iran.

Activist Influenced Companies

Brookfield Business Partners L.P. in connection with its normal course issuer bid (NCIB), which commenced on August 15, 2018, has entered into an automatic purchase plan with its designated broker. The automatic purchase plan, which has been precleared by the Toronto Stock Exchange, will allow for the purchase of Brookfield Business Partners' outstanding limited partnership units, subject to certain trading parameters, at times when Brookfield Business Partners ordinarily would not be active in the market due to its own internal trading blackout periods, insider trading rules or otherwise. Outside of these periods, units will be repurchased in accordance with management's discretion and in compliance with applicable law. The automatic plan commences on January 3, 2019, and terminates on August 14, 2019. The actual number of units purchased under the automatic plan, the timing of such purchases and the price at which units are purchased will depend upon future market conditions. Brookfield Business Partners believes that in the event the units trade in a price range that does not fully reflect their value, the acquisition of units may represent an attractive use of available funds. All units acquired under the NCIB will be cancelled.

Dividend Payers

Nothing significant to report.

Economic Conditions

Canadian employment increased 9K in December according to the Labour Force Survey, in line with consensus calling for a 10K rise. The jobless rate remained unchanged at a record low of 5.6% as the participation rate remained unchanged at 65.4%. There were job gains in self-employed (+46K) while private sector (-20K) and government (-17K) experienced losses. Employment in the goods sector jumped 23K as gains in manufacturing, resources and agriculture more than offset declines in utilities and construction. Services-producing industries saw a 13K drop in employment with trade, public administration and information/recreation being the worst performers. Full time employment was down 19K, while part-time positions increased 28K. Hourly earnings accelerated to 2.0% year/year, increasing from 1.7% the prior month.

Toronto, Vancouver Housing Sales Plummet to Decade-Lows in 2018 after new data was released from the Toronto Real Estate Board, Bloomberg highlighted that higher borrowing costs and stricter mortgage rules dampened real estate sales. Sales in the Toronto region fell 16% to 77,426 transactions in 2018 while the average price fell 4.3% to CAD $787,300 (USD $583,400). That's the worst year for sales in Canada's biggest city since 2008. In Vancouver, full-year sales fell 32% to 24,619, the lowest since 2000 and 25% below the 10-year average. The benchmark price, which measures the value of a typical home, rose 3% to CAD $764,200 in December from a year ago in Toronto. The condo sector performed strongest, with benchmark prices jumping 9% while detached homes were little changed at CAD $907,900. Vancouver benchmark home prices dropped to CAD $1.03 million in December, down 2.7% from a year earlier.

U.S. nonfarm payrolls in December, rose 312,000, the biggest gain in ten months, while the prior two monthly gains were revised up by 58,000. The gains were spread widely across sectors, with a 38,000 increase in construction likely partly benefitting from post-hurricane rebuilding. Manufacturing jobs accelerated 32,000, allaying concerns

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about weakness in the sector following the big lurch down in the ISM index. Education and health care belted out an unusually large 82,000, flagging some payback in January. Still, payrolls expanded 2.6 million in 2018, surpassing the prior year's already solid gain of 2.2 million. The index of aggregate work hours jumped 0.5%, lifting the quarterly pace by 2.1% annualized. Average hourly earnings spiked 0.4%, hauling the yearly rate to 3.15%, a new cycle high and the third straight month above 3%. While wages aren't rising fast enough to fan inflation in our view they, along with sturdy job gains, will support consumer spending...which looks to top 3% annualized growth for a third straight quarter in Q4. A two-tenths leap in the participation rate increased the unemployment rate to a five-month high of 3.9% from the 49-year low of 3.7%.

U.S. Purchasing Manufacturers' Index (PMI) dropped to 54.1 (59.3 last month) – the biggest sequential decline since October 2008 – with new orders down to 51.1 (62.1 last month)

U.S. existing home sales unexpectedly rose in November, up 1.9% to 5.32 million units annualized, the second increase in a row (a streak not seen since the start of the year) and to the highest level since August. (No revisions.) The gains were broadly based, with gains seen everywhere except in the West. The Northeast jumped 7.3% …. One must imagine that housing in that region will get tighter with Amazon offices opening up in the D.C. area, and Google in New York. Also encouraging was that both single-family homes and condos chalked up more sales for the second straight month.

U.S. Housing starts increased 3.2% to 1.256 million annualized in November after pulling back 1.6% in October (revised down from an increase). Unfortunately, all of the increase was in the volatile multiple units, up 22.4%, while singles fell for a third straight month, by 4.6%. Similarly, building permits jumped 5% to 1.33 million annualized, but almost entirely due to a sprint in multiples, as singles were largely flat. Starts rose in two of the four major regions, with a decline in the Midwest possibly aggravated by snowstorms.

U.K. annual inflation eased to 2.3% year/year in November, from 2.4% year/year in October, meeting expectations. Core CPI eased slightly to 1.8% year/year from 1.9% year/year previously, also within expectations. Downward pressure came from the cost of auto fuel, which fell 1.1% compared with a 1.6% increase in November last year. Other drivers include food, computer games and admissions for live music. Upward pressures came from clothing prices, hotels and restaurants. Tobacco prices were boosted by budget tax increases. With inflation falling and the annual nominal wage growth rising to 3.3% for the three months to October, households will begin to feel an ease in the cost of living, a welcomed bonus at this time of year where disposable incomes are at their most stretched.

Euro area manufacturing PMI continued to move lower in December to 51.4 (51.8 last month) – lowest since February 2016 – as new orders remained in contraction territory at 48.8 (49.5 last month) driven by slowing global demand, trade wars and weak auto sector.

China PMI entered contraction territory in December with National Bureau of Statistics of China manufacturing PMI dropping to 49.4 (50.0 last month) – a 34-month low – with trade-related indices moving deeper into the 40s (new import orders at 45.9 and new export orders at 46.6); China real money supply contracted by 1% in November, its first decline since January 2014 setting the stage for continued PMI weakness in early 2019.

PMIs in key **EMs** outside of China are holding up well – **Brazil** stands out with accelerating industrial data/consumer confidence.

Financial Conditions

The Bank of Japan (BOJ), in a widely expected decision, kept monetary policy unchanged on December 20, 2018 in a 7-2 vote. Once again, it was not a unanimous decision as BOJ policy board members, Goshi Kataoka and Yutaka Harada dissented for the 4th consecutive meeting for similar reasons highlighted in the previous October 30/31 meeting. The BOJ is still upbeat about economic outlook as the "economy is expanding moderately, with a virtuous cycle from income to spending." And the "economy is expected to continue its moderate expansion" supported by uptrend in domestic demand and exports. It upgraded its assessment of corporate profits "having been at high levels" from "improving trend" previously in October. The BOJ still held on to the belief that Japan's inflation "will likely to increase gradually toward 2 percent" due to output gap remaining positive and medium- to long-term inflation expectations rising.

The U.S. 2 year/10 year treasury spread is now 0.16% and the U.K.'s 2 year/10 year treasury spread is 0.50% - 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. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.51% (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 22.36 (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 bodes 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:

- Bay & Scollard Development Trust
- ITM AG Investment Trust
- 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 Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen 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 www.portlandic.com/prices

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.

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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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