News Highlights

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. November 25, 2019

Owner Operated Companies

Alphabet Inc. - Google will stop giving advertisers the ability to target election ads using data such as public voter records and general political affiliations. The move coincides with pressure on social media platforms over their handling of political advertising ahead of the U.S. presidential election in 2020. Google said it would limit audience targeting for election ads to age, gender and general location at a postal code level. Political advertisers also can still contextually target, such as serving ads to people reading about a certain topic. Google will enforce the new approach in the United Kingdom within a week, ahead of the Dec. 12 general election. Google said it would enforce it in the European Union by the end of the year and in the rest of the world starting on Jan. 6, 2020. The changes are expected to prompt political campaigns to shift some ads to television and Google's smaller rivals. Google also clarified that its policies for political and non-political ads prohibit doctored and manipulated media. Twitter, Inc. has banned political ads, while Facebook, Inc. is reviewing its policies after criticism from lawmakers and regulators over its decision to not fact-check ads run by politicians.

Facebook, Inc. / Alphabet Inc. – Four top U.S. tech companies, Alphabet's Google, Facebook, Inc., Amazon.com, Inc. and Apple Inc., responded to questions from a congressional committee by defending their practices and declining to answer some questions. The House of Representatives Judiciary Committee had sent the queries as part of its antitrust probe of the four giants, which face a long list of other antitrust probes. The companies, long a symbol of the dynamism of the U.S. economy, have seen their reputations tarnished by privacy lapses and allegations they abused their perch on top of the market to hurt small and nascent rivals. In its responses, Google, which owns YouTube, denied favoring its own services over those of competitors in search, video and internet browsers. It said "the vast majority" of clicks following a Google search go to non-Google websites, that results from its YouTube offering are not given greater weight than rivals', and that its word processing and analytics tools are designed to work well with all browsers, not just its Chrome browser. Google also said its "vertical integration" of advertising tools benefits advertisers in part through better consumer targeting, but that the ability of rivals to compete is not "meaningfully affected" because it takes steps to level the playing field. For its part, Facebook acknowledged cutting off certain third-party apps from its developer platform for replicating core functionalities, such as Twitter's now-shuttered Vine, which it said replicated a Facebook product. Amazon.com said in its response that it uses aggregated data from merchants on its third-party marketplace for "business purposes," but denied using the data to launch, source or price private-label products. Amazon also acknowledged asking third-party merchants to lower their price on Amazon.com, when it finds merchants sell items for less on a competing website. Amazon declined, however, to say how many Amazon private label products are sold at cost or below cost, how much revenue and profit Amazon makes from selling private brands or how it prices such items. Amazon said it has 45 brands encompassing 158,000 private-label products, as well as some private brand items that are part of its Amazon Fresh grocery delivery service.

Energy Sector

Crescent Point Energy Corp. entered into a definitive agreement to sell certain associated gas infrastructure assets located in Saskatchewan to Steel Reef Infrastructure Corp., for a cash consideration of $500 million. Steel Reef will finance the consideration from its existing investors and financers. The assets consist of nine natural gas processing facilities and their associated gathering systems and two gas sales pipelines with a total throughput capacity of more than 90 million cubic feet per day. RBC Capital Markets is acting as financial advisor and GMP FirstEnergy is acting as strategic advisor to Crescent Point in the transaction. The transaction will enable Crescent Point to unlock value for its shareholders and further strengthen its financial position. The transaction is expected to close in Q1 2020, subject to customary closing conditions and regulatory approvals. "Through the sale of these gas infrastructure assets, we will unlock value for our shareholders and further strengthen our financial position. We have now entered into agreements to sell, or have sold, in aggregate approximately $1.45 billion of assets in 2019," said Craig Bryksa, President and CEO of Crescent Point. "This sale is also aligned with our strategy, as it allows us to further focus on our core competencies to strengthen our corporate returns."

Financial Sector

The Toronto-Dominion Bank announced that it supports the acquisition of TD Ameritrade, of which the Bank is a major shareholder, by The Charles Schwab Corporation, through a definitive agreement announced by those companies. TD will exchange its approximate 43% ownership in TD Ameritrade for a 13.4% stake in Schwab, consisting of up to 9.9% voting common shares and the remainder in non-voting common shares. TD and Schwab have entered into a new Stockholders' Agreement that will become effective upon closing, under which TD will have two seats on Schwab's Board of Directors. Under the agreement, TD will be subject to customary standstill and lockup restrictions. TD and Schwab have also entered into a revised

Insured Deposit Account (IDA) agreement that will become effective upon closing, and that will continue to provide TD with a profitable earnings stream. Starting on July 1, 2021, IDA deposits, which were US$103 billion as at July 31, 2019, can be reduced at Schwab's discretion by up to US$10 billion a year, with a floor of US$50 billion. The term of the revised IDA agreement extends to 2031. The servicing fee under the revised IDA agreement will be set at 15 bps upon closing. This transaction adds significant value to TD's investment and TD expects to record a sizeable revaluation gain at closing.

The Toronto-Dominion Bank announced that it has been named a global systemically important bank (G-SIB) by the Financial Stability Board (FSB), based in Basel, Switzerland. The bank stated that the designation reflects the size and scale of TD's global operations. In its designation, TD is ranked in the lowest G-SIB capital surcharge bucket (Bucket 1) and already meets the requirement of a 1% capital buffer. As a result, management does not expect any impact to TD's capital position with this designation. TD will publicly disclose an updated breakdown of all the 12 G-SIB assessment indicators in the first quarter of 2020, consistent with normal practice. In a separate release, Canada's banking regulator, OSFI confirmed TD's G-SIB designation and outlined that TD is already subject to the regulator's framework for domestic systemically important banks (D-SIBs), and therefore is well positioned to meet the G-SIB requirements starting in November 2020.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Northland Power Inc. – Japan-based Shizen Energy Inc. has signed an agreement with Canada-based power producer Northland Power to jointly work for the development of an early stage offshore wind capacity in Chiba Prefecture, Japan. As per the deal, the firms will establish an equally owned joint venture named Chiba Offshore Wind to work as the development vehicle for the projects that will have a combined capacity of around 600MW (megawatt). The government of Japan plan to achieve 22-24% of renewable-based electricity generation by 2030, for which it targets to have 10GW (gigawatt) of offshore and onshore wind capacity.

Novartis AG plans to acquire U.S.-based The Medicines Company (MDCO) for US$85 per share in cash, a premium of around 41% over MDCO's 30-day volume weighted average price; valuing the company at US$9.7 billion on a fully diluted basis. The transaction is expected to close in Q1 2020. MDCO's lead compound, Inclisiran, is a small interfering RNA (siRNA) that, injected subcutaneously 2 times a year, can reduce low-density lipoprotein cholesterol (LDL or bad cholesterol) by more than 50% - as just demonstrated in phase 3 studies. Filing is expected for Q4 2019 in the U.S. and Q1 2020 in the European Union. Reducing LDL is key for atherosclerotic cardiovascular disease (ASCVD) or familial hypercholesterolemia (FH) patients. An estimated 50 million secondary prevention patients do not achieve LDL goal and remain at risk for cardiovascular events. While expected to be accretive to core EPS in the medium term, the acquisition is expected to modestly dilute during the next few years. Novartis expects to expand Innovative Medicines' core margins to reach mid-thirties in the near term, and mid to high-thirties in the medium term. This acquisition is fully aligned with Novartis acquisitive strategy of novel and innovative therapies. The company needs to acquire growth in order to compensate for upcoming generic erosion. Inclisiran adds to the cardiovascular franchise, that currently only distributes Entresto, but failed to add Entresto in a second indication (HFpEF) or canakinumab as heart a drug. As such, the acquisition makes strategic sense in our view.

Economic Conditions

U.S. existing home sales rose somewhat less than the market expected in October, by 1.9% to 5.46 million annualized from a downward-revised level. Still, it was the third advance in four months and extends the upswing in housing market activity this year on the back of lower mortgage rates and continued job growth. A lean supply is weighing on demand, with a 3.9 months' supply at the current sales rate. The upward trend in housing markets and relatively sturdy consumer spending are reasons we believe why the Fed believes the economy is in a good place and likely in no need of further support for now.

U.S. Consumer prices rose 0.4% in October on higher gasoline costs, nudging the yearly rate up to 1.8%. However, core prices rose a light 0.16% after a milder advance the prior month, which lowered the yearly rate a tick to 2.3%. It also cooled the 3-month annualized core rate to 2.2% from 2.8% in September and a scary 3.4% in August, though the six-month metric held at 2.5% for a third straight month. Despite new tariffs on China's goods in September, clothing prices surprisingly fell 1.8% after slipping the prior month, indicating that someone is absorbing the duties and it's not consumers. Computer prices also plunged 2.4%, more than usual. These declines were countered by a big 1.0% spike in medical care costs, a rebound in used vehicle prices, and more expensive recreational goods. However, rents and food prices were tame, each rising 0.2%, despite new tariffs on the latter.

U.S. industrial production fell much more than expected, down 0.8% in October, the second decline in a row and the largest since May 2018. **Manufacturing** was down for the second straight month, down 0.6% in October alone. This largely reflects the GM strike as manufacturing excluding autos was down a more palatable 0.1%. The strike has since ended but note that, although we're only partway through November, one regional survey was still sluggish. The Empire

State Manufacturing Survey hit a four-month low of 51.3 on an ISM-adjusted basis. Despite this big special factor, manufacturing is a huge part of this survey, with 75% of the weight.

Japan's Q3 2019 GDP growth slowed visibly to 0.1% quarter/quarter (0.2% annualized rate) from 0.4% quarter/quarter (1.8% annualized rate) in Q2 2019 as the growth pace of both private and public demand slowed but still managed to offset the drag from net exports and private inventories.

Financial Conditions

New Zealand's central bank surprised investors by holding interest rates at an all-time low of 1% saying it saw no urgency to ease policy further, sending the kiwi dollar sharply higher. Increases in wage growth and non-tradable inflation together with a weaker local dollar helped by a surprise 50 basis point cut in August, aided the Reserve Bank of New Zealand's (RBNZ) decision. A majority of economists polled by Reuters had predicted further quantitative easing in the final policy meeting for the year.

The U.S. 2 year/10 year treasury spread is now 0.14% and the U.K.'s 2 year/10 year treasury spread is 0.17% - 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 2 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 3.66% (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. 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 12.38 (compares to a post-recession low of 18.00 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.

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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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on tangible equity, 'ROTCE' return on tangible common equity.

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