News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. April 6, 2020

The views of the Portfolio Management Team contained in this report are as of April 6, 2020 and this report is not intended to provide legal, accounting, tax or specific investment advice. Views, portfolio holdings and allocations may have changed subsequent to this date. This research and information, including any opinion, is compiled from various sources believed to be reliable but it cannot be guaranteed to be current, accurate or complete. It is for information only, and is subject to change without notice. The contents of this Newsletter reflect the different assumptions, views and analytical methods of the analysts who prepared them.

Owner Operated Companies

Berkshire Hathaway Inc. – Warren Buffett's Berkshire Hathaway Inc. said it sold about 18% of its stake in Delta Air Lines, Inc. and 4% of its holdings in Southwest Airlines Co. this week, as the coronavirus pandemic drives the airline industry into perhaps its biggest crisis ever. According to regulatory filings, Berkshire sold nearly 13 million Delta shares for about $314 million and roughly 2.3 million Southwest shares for about $74 million. Berkshire previously owned about 11.1% of Delta stock and 10.4% of Southwest stock. No reasons for the sales were given. The Omaha, Nebraska-based conglomerate is among the biggest shareholders of the four largest U.S. carriers - Delta, Southwest, American Airlines Group Inc. and United Airlines Holdings Inc. Buffett has said three of the airline stakes are overseen by him, while one of his portfolio managers, Todd Combs and Ted Weschler, oversees the fourth. The pandemic has punished the industr, as passengers stay home and carriers worldwide slash their schedules and ground planes. Delta projected that its second-quarter revenue would fall 90%.

Walgreens Boots Alliance, Inc. reported results for the second quarter of its fiscal 2020, which included earnings of $1.52 per share in the second quarter, beating estimates of $1.46 per share. Nonetheless, the drugstore retailer reported a steep decline in U.S. same-store sales in the last week of March as customers stayed indoors due to the coronavirus outbreak. The company said retail sales in the United States dropped after March 21, before which consumers were stockpiling items in preparation for a lockdown. If the current trend continues, the company said the gains from the early sales bump were likely to be erased soon. Walgreens executives said the situation was temporary as they fielded several questions from analysts on a conference call. "We believe the evidence is very clear that discretionary spending will come back, particularly in areas like beauty, which are really well-known for being a place where people spend when things are tougher," Co-Chief Operating Officer Alexander Gourlay said. The drugstore chain said its results for the second quarter, ended February 29, had exceeded its expectations. The company said it would revisit its outlook for adjusted profit in the third quarter after having forecast roughly flat growth for the full year.

Energy Sector

Oil output cuts – A Texas state regulator has reportedly called Russia's energy minister to discuss possible oil production curbs and is prospecting talks with Saudi Arabia as many producers in the U.S. state's biggest industry warned it was near collapse. U.S. energy companies are losing money on oil production, cutting tens of thousands of workers, and some are struggling to obtain financing. Texas shale producers have been hurt the most as oil prices have crashed two-thirds this year. Last month alone, prices fell by half, to near $20 a barrel, as the coronavirus slashed fuel demand. It is rare for Texas officials to seek production cuts. But this week, top shale oil producers Pioneer Natural Resources Co and Parsley Energy Inc urged the state to mandate 20% production cuts at larger oil and gas firms. Pioneer's chief executive also called for regulators to consider blocking higher foreign oil imports. State law allows Texas to take steps to limit local production, but it has not done so since the 1970s. The Oklahoma Energy Producers Alliance this week urged the state's energy regulator to take steps to curtail crude oil production as oil prices in the state fell below $20 a barrel. The Alliance also asked regulators to "stop authorizing, permitting and approving the drilling of wells which result in 'economic waste,'" according to a letter sent to the three commissioners for of the Oklahoma Corporation Commission. Texas regulators will meet on April 14 to discuss curtailments in the state, and may vote on any resolution a week later.

Financial Sector

Barclays PLC has announced it will waive overdraft fees for a fixed period in a bid to help customers suffering from financial hardship during the coronavirus pandemic. Barclays said it would not charge any interest on all overdrafts from Friday March 27 until the end of April to give customers extra headroom in times of financial uncertainty. Customers of the bank do not need to call the bank to set this up, the interest will automatically be removed. On the same day, Lloyds Group (Lloyds, Halifax and Bank of Scotland) announced that from April 6, all customers with an agreed overdraft would be given the first £300 interest free for three months. The changes will be made automatically.

The UK's largest banks are calling a halt to dividends and share buybacks after the Bank of England warned them against paying out billions of pounds while the coronavirus pandemic drives millions out of work and small businesses into bankruptcy. In a series of statements, banks say they intend to stop dividend payments, accruing dividends or share buybacks for the rest of 2020 in a move that will provide a greater cushion against potential coronavirus-induced losses, but disappoint some shareholders.

HSBC Holdings PLC has been hit hard by the UK Regulator's formal request last week for it (and the other major UK banks) to cancel its 2019 final dividend - press articles have suggested that this is the first such dividend action in over 7 decades. The implications on its Hong Kong retail investor base remain a negative (differentiator) for the bank, and was reportedly a key point in HSBC's initial lobbying to the regulator against this move. There are more press articles in recent days. Bloomberg today writes briefly that HSBC's yield - presumably the quantum, but also its predictability (e.g. even through the financial crisis) - has been a key attraction for HK investors. It also references the potential for collective legal action in response to the dividend cancellation (which also extends to the 2020 interim dividends). New HSBC CEO Quinn is clearly aware of the need though to handle this situation delicately, and has already written to HK-based shareholders in apology for the dividend action.

The Canadian Imperial Bank of Commerce (CIBC) – in an interview with BNN Bloomberg, CIBC CEO Victor Dodig stated that the bank has no plans to cut its dividend as a result of the COVID-19 pandemic. "Our goal is to make sure that those dividends are flowing," Victor Dodig told BNN Bloomberg's Jon Erlichman in an interview, noting the bank has never cut its payout to shareholders. "The Canadian banking sector is incredibly well-capitalized. We've worked with the Bank of Canada, the department of finance, and our regulator to make sure that we have all the tools in place, to ensure that credit is moving to businesses." Further, Mr. Dodig noted that the Office of the Superintendent of Financial Institutions (OSFI) has told banks not to increase dividends or offer share buybacks during this period, which Mr. Dodig said is "completely understandable. I'd say one thing that's incredibly important: the Canadian investors that invest in our banks rely on those dividends for income," he added. "And every source of reliable income that we can provide to Canadians – and Americans, and our other shareholders that are investing in our banks – is incredibly important in this moment in time where cash flow reduces anxiety."

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Bunzl PLC - trading so far this year has been robust but this is set to worsen due to foodservice and retail exposure. Q1 group constant currency sales up 6%, with organic sales up approximately 3%. By division, trading is said to have been strong in safety in Q1 and has strengthened more recently in grocery, healthcare and cleaning & hygiene. The foodservice and retail sectors (approx. 35% of Group sales), have been increasingly negatively impacted by COVID-19 in the latter part of March. Going forward, parts of the group's foodservice and retail sectors are expected to be significantly affected by closures happening globally. Trading in cleaning & hygiene and safety sectors are expected to be mixed given the end markets that they serve while sectors such as grocery and healthcare are expected to be robust. In response, the final dividend for 2019 is being withdrawn and the Board, Executive Committee and Business Area Managing Directors are taking a 20% pay cut in Q2 to support the business. The dividend decision will not have been taken lightly, given the company's proud position as the only company in the Financial Times Stock Exchange 100 Index (FTSE100) to have raised its dividend every year for over 20 years. It would have been questionable to maintain it if they do access government support schemes. Bunzl has a leverage ratio of 1.9x net debt/EBITDA and significant headroom in its committed facilities of over £0.6 billion. There are no debt maturities in 2020. The group's covenants are 3.5x and interest cover of 3x. The shares are on 12x 2020 and 2021 earnings before any earnings cuts. Analysts believe the nature of the COVID-19 situation will impact Bunzl more severely than a typical recession, which is likely to mean the company will have its worst ever year. Despite this, it should still be manageable given resilience analysts believe in around 65% of the group. Withdrawing the dividend, suspending mergers & acquisitions (M&A) and other cost saving exercises are important not just for liquidity but to control the level of debt the company has when exiting this period, as if it were to constrain acquisitions, a key strategic pillar would be weakened.

WPP PLC has issued a statement giving the first impact of COVID-19. Organic was down 0.6% for the first two months with greater China down 16.1% within that (February worse but not significantly worse than January). WPP are suspending guidance, buyback and final dividend and unveiling a £700-800 million cost savings exercise. Organic down approx. 20%+ during peak COVID-19 disruption. The press release states: "Encouraging financial performance, pre COVID-19 impact: first two months Group LFL [like for like] revenue less pass-through costs ex Greater China +0.4%; Group -0.6%; 1; USA -0.9%. In Greater China (approximately 7% of WPP by revenue less pass-through costs) the impact from COVID-19 led to a 16.1% fall in LFL revenue less pass-through costs over the two-month period". "March performance is weaker, reflecting spread of virus and government containment actions... In March, we have begun to see a range of different responses from clients globally, depending on the client sector, country and agency services. In the short term, media spend has largely remained committed, or diverted to alternative channels, although we have seen an increasing volume of cancellations. Project and retained work has continued in most sectors, but activity has begun to decline. New business pitches continue where the process was already underway, albeit we have less certainty over our future pipeline. In some markets, we are seeing additional demand in our PR [public relations] and specialist communications businesses." "Strong balance sheet supported by further immediate action to maintain liquidity: buyback and 2019 final dividend suspended given current uncertainty; final dividend will remain under review". At the end of 2019, WPP had £3.0 billion of cash, £4.8 billion of liquidity and net debt of £1.5 billion or 0.8x net debt to EBITDA. £330 million of the £950 million buyback has been done. "At the peak of the crisis in China, almost all of our colleagues were working remotely, but as health restrictions are now being lifted, 55% of our local workforce are back in our offices."

Economic Conditions

The global number of coronavirus cases and deaths slowed over the weekend, notably in crisis-stricken Italy, Spain and France, while New York state reported its first daily decline in fatalities. Still, the total number of coronavirus cases in the U.S. has surpassed 337,000. While the trend rate of increase (the 5-day average change in cumulative cases) has slowed from 40% two weeks ago in response to distancing measures, it's still running too high for comfort at above 10%. Cumulative deaths are nearing 10,000 and the growth rate remains elevated.

Canada's mortgage rates are ....rising - even though the country's central bank has slashed borrowing costs to combat the COVID-19 pandemic. That's due to the "enormous pressure" Canadian banks face amid disruptions caused by the outbreak, said Sherry Cooper, chief economist at Dominion Lending Centres Inc. "The costs of funds for banks is skyrocketing and bank earnings are plunging," Cooper said Monday in a phone interview. "Every single business they have ever loaned to is subject to a massive decline in revenues, and therefore their own revenues are going down because nobody is taking out new business with banks except to extend debt." As rates have dropped, banks have been eliminating discounts off prime on variable mortgages. At the start of the month, qualified borrowers could get a rate of prime minus 1% from HSBC Canada, for example, while Canada's large domestic lenders were also offering "prime minus" deals as well. But those discounts have shrunk by 75 to 85 basis points, said Rob McLister, founder of mortgage comparison website RateSpy.com. Typical five-year fixed rates are also rising. Rates at large Canadian banks are now at 2.99% to 3.04% versus around 2.49% to 2.59% at the end of February, McLister said. "The big banks are leading the charge higher here, on both the fixed side and the variable side," he said. Preferred borrowers can still get some prime minus deals at big banks, but they're more like prime minus 10 or 15 basis points.

U.S. initial claims filing for unemployment soared to an astronomical 6,648,000 in the week of March 28th, which nearly doubled already high estimates. That's an increase of 3.341 million from the prior week, the second week in a row of 3 million+ gains. And the disturbing fact is this may be underestimating the real figures, given reports of how completely overwhelmed the unemployment offices are in processing the requests for Unemployment Insurance so there is a backlog. At the same time, this could reflect some catch-up from the prior week. There are all sorts of stories about how these figures can be off … too many applications flooding the system, businesses holding back on the layoffs until they're certain employees can receive assistance, workers rushing to file because of government assistance… regardless, this is a brutal report.

U.S., non farm payrolls sank 701 thousand in March, the first decline since September 2010 and the worst decline since March 2009. That was much worse than the 100 thousand decline expected by consensus. Adding to the bad news were downward revisions to prior months which chopped 57 thousand from payrolls. In March, the private sector cut 713 thousand jobs. Cyclical sectors like construction (-29 thousand) and manufacturing (-18 thousand) weighed on goods sector payrolls (-54 thousand). Services-producing industries in the private sector cut 659 thousand jobs, with declines in the large majority of sectors including -459 thousand for leisure/hospitality. Government add 12 thousand to payrolls. Average hourly earnings were up 3.1% on a year-on-year basis. Unfortunately, this is just a preview of what's in store for the next few months. March non-farm payrolls, despite the massive losses, likely understated the dire situation during the month because respondents were asked about the state of employment during the so-called reference week (which includes the 12th day of the month), i.e. before mandated operational shutdowns (to stem the spread of the coronavirus) were fully implemented. As such, April's job losses are likely to be worse and the jobless rate should climb fast into double digits in coming months.

U.S., the household survey suggested 3 million jobs were lost in March. Those losses caused the unemployment rate to jump from 3.6% to 4.4%, the largest one-month increase since 1975. The participation rate dropped to 62.7%.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.41% and the U.K.'s 2 year/10 year treasury spread is 0.23% - 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 3.33% (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 3.1 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 44.56 (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.

Portland Investment Counsel Inc. currently offers Mutual Funds & Private/Alternative Products - visit www.portlandic.com

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.

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.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC20-021-E(04/20)