# 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.* October 1, 2018



## Owner Operated Companies

**Brookfield Asset Management Inc.** – We were in attendance at Brookfield's annual Investor Day held at Brookfield Place in New York City and had a chance to re-connect with the firm's top management. The very well organized and attended event re-enforced the idea that Brookfield is becoming the pre-eminent global alternative assets manager with over $300 billion AUM invested primarily in property, infrastructure and private equity. Brookfield has been amassing funds from some of the world's most prominent investors, including sovereign wealth funds, pension plans, foundations and financial institutions. Over the course of last year, the firm raised $20 billion in its private and public funds and deployed $33 billion in investments as it realized about $13 billion from asset sales over the period. Equally, as the company's CEO, Bruce Flatt, emphasized, Brookfield is not trying to become the largest institutional investor, but rather focus its firepower in areas of most interest and were it holds the most expertise. Brookfield believes institutional investors are currently under-allocated to real assets by as much as $3 trillion, partly explained by the novelty of the asset class. The attractiveness of Brookfield's investment offerings also leverages the size of its existing funds, which allow large institutional investors to deploy assets at scale. Brookfield is seeing great momentum in its fund raising. The recently closed global real estate opportunistic private fund reached $11 billion and is likely to be larger in the end, the private equity fund, which is currently raising capital is targeting at least $10 billion and the upcoming infrastructure fund is likely to close north of $20 billion. As investments mature and on the basis of a larger fee base, Brookfield expects significant growth in cash generations with significant uses including re-deployment in real asset opportunities around the globe, increased pay-outs to investors and share (unit) buybacks when warranted.

**Carnival Corporation** forecast fourth-quarter profit below Wall Street estimates due to a strong dollar and rising fuel prices. The outlook overshadowed the world's largest cruise operator's better-than-expected third-quarter results. Carnival, which owns the Queen Mary II and Queen Elizabeth cruisers, said it would take a hit of 11 cents per share in the fourth quarter even as it expects booking trends to be strong in the future. Brent crude has been trading at its highest in nearly four years and U.S. dollar has risen 2.7% this year. The oil prices are expected to remain high owing to controlled global supply. However, Carnival benefited from higher ticket prices and on-board spending in the third quarter. Revenue from passenger tickets rose 5% to $4.35 billion, while on-board spending, which accounts for about a quarter of total revenue, rose 7.6% to $1.32 billion. Net income rose to $1.71 billion, or $2.41 per share, in the third quarter ended Aug. 31. Excluding certain items, the company earned $2.36 per share, beating analysts' average estimate of $2.32 per share. Carnival's net revenue rose to $5.84 billion from $5.52 billion, above estimates of $5.81 billion.

**Facebook Inc.** said that hackers stole digital login codes allowing them to take over nearly 50 million user accounts. Facebook, which has more than 2.2 billion monthly users, said it has yet to determine whether the attacker misused any accounts or stole private information. It also has not identified the attacker's location or whether specific victims were targeted. Its initial review suggests the attack was broad in nature. Chief Executive Mark Zuckerberg described the incident as "really serious" in a conference call with reporters. His account was affected along with that of Chief Operating Officer Sheryl Sandberg, a spokeswoman said. Facebook's latest vulnerability had existed since July 2017, but the company first identified it on Tuesday after spotting a "fairly large" increase in use of its "view as" privacy feature on Sept. 16, executives said. "View as" allows users to verify their privacy settings by seeing what their own profile looks like to someone else. The flaw inadvertently gave the devices of "view as" users the wrong digital code, which, like a browser cookie, keeps users signed in to a service across multiple visits. Facebook fixed the issue on Thursday. It also notified the U.S. Federal Bureau of Investigation, Department of Homeland Security, Congressional aides and the Data Protection Commission in Ireland, where the company has European headquarters. Facebook reset the digital keys of the 50 million affected accounts, and as a precaution temporarily disabled "view as" and reset those keys for another 40 million that have been looked up through "view as" over the last year.

## Energy Sector

**Royal Dutch Shell PLC (Shell)** and the 4 other companies backing the LNG Canada project have agreed to invest in the ~$40 billion project. Shell has consistently stated that it expects to make a decision before year-end 2018 – this most recent report follows two positive developments last week: On September 26th, it was reported that Canada's Federal Government had told LNG Canada that it agreed that the export terminal would need to be constructed from imported steel modules, paving the way for the project to avoid import tariffs; and on September 28th, Bloomberg reported that PetroChina Co. (15%) and Korea Gas Corp. (5%) had formally approved their share of the project. We believe this to be: a positive signal for the "investability" of the Canadian energy sector – especially in light of the negative sentiment toward the sector following the Federal Court of Appeal ruling against the Trans Mountain Pipeline Expansion; a positive development for Canadian natural gas producers in general and NW Alberta / NE BC Montney producers in particular; and a longer term positive for the Canadian natural gas market as analysis indicates that most of the supply required for the project is already being produced and sold into the market.

## Financial Sector

**Nordea Bank AB** – Today, the number of banks deemed too big to fail in the euro zone will grow to eight from seven. The new arrival is Nordea Bank Abp, which is moving its headquarters to Helsinki from Stockholm. The bank, whose $670 billion in assets are more than twice Finland's gross domestic product, has made clear its move was driven by regulatory considerations and a wish to be inside the European banking union. "We'll be in the core of Europe," Chief Executive Officer Casper von Koskull told reporters at a recent breakfast meeting in Stockholm. "I think it's important that we also can influence Europe."

**HSBC Holdings PLC** / TSB - HSBC & TSB Banking Group PLC are experiencing problems with their mobile banking, with thousands of clients unable to access their online accounts on the day they are set to be paid. The issues come just a week after Royal Bank of Scotland Group PLC and Barclays PLC suffered online outages, causing the head of the influential U.K. Treasury Committee, Nicky Morgan, to write to the chief executives of the lenders demanding an explanation.

## Activist Influenced Companies

Nothing significant to report.

## Dividend Payers

**Aryzta AG: 2018 results are** broadly in line with €19 million cash flow ex Picard – fiscal year (FY) 2019 EBITDA increase in the mid to high single digits, medium-term EBITDA margin of 12% to 14%. In terms of sales (organic growth below expectations) and EBITDA (margin of 8.5% vs 9.0% in 1H, FY 2018 8.8%, a drop of 2.3%). Interestingly, raw materials accounted for 43.7% of sales (vs 47.5% in FY 2017), and employment costs decreased by 6% (-1.3% in % of sales). Storage and distribution costs were down 3.7%. We note another significant one-off costs of €433 million (or €232 million in 2H), out of which €70 million cash. Excluding €91 million dividends from Picard, vs €196 million in FY2017. Net debt to EBITDA at 3.83x, respectively 5.0x excluding Picard dividends. New financing: Increase of leverage covenant from 4.0x to 5.75x on 31/1/2019 and from 3.5x to 5.25x on 31/7/2019 with a margin increase to 3.5% until 31/12/2018 and to 4.0% form 1/1/2019. €800 million capital increase with closing and settlement expected on November 19th. The guidance of the EBITDA increase for FY 2019 and mid-term guidance seems reasonable in our view.

**Roche Holding AG** last week presented positive results at the World Conference on Lung Cancer (WCLC) 2018 regarding the data from its phase 3 IMpower 133 trial that tested Tecentriq + etoposide + carboplatin vs carboplatin + etoposide in 1L ES-SCLC. The standard of care for these patients has not been changed in close to 40 years. Tecentriq added two months in overall survival and improved the 12-months survival rate to 51.7% vs 38.2%. Median progression-free survival (PFS) was 5.2 months vs 4.3 months (p=0.017). objective response rate (ORR) and median duration of response results were similar for the active arm and the control arm. In our view, the additional two months medium overall study (mOS) benefit is moderate, but the 30% reduction in the risk of death is clearly clinically relevant. Moreover, considering this against the background of decades without any improvement of the standard-of-care for these patients. These results represent a remarkable achievement and should be practice changing. Roche has already filed the IMpower 133 with the FDA and is working rapidly to file globally.

## Economic Conditions

**U.S.- Mexico-Canada** - After 13 months we have an agreement to replace NAFTA. Talks nearly went down to last night's deadline for submitting an in-writing deal to Congress, but the U.S. and Canada have agreed in principle on a new deal, which both leaders have endorsed. Clearly, this is a major relief for Canada, lifting a heavy cloud of uncertainty from the outlook in our view and likely means one more Bank of Canada rate hike in 2019 (in January). From Canada's perspective, the biggest concession appears to be giving up access to about 3.5% of the dairy market, in exchange for the preservation of some key areas (such as the dispute resolution mechanism) and some assurances, however technical, that Canada would not be hit by a 25% tariff on autos under Section 232. In our view, Canada has made concessions, but is coming out intact considering the array of potentially negative options or threats that were on the table.

**U.S. manufacturing ISM index fell** to 59.8 in September from a 14-year high of 61.3 in August. Production strengthened, as did employment (58.8), suggesting the sector remained strong. But new orders decelerated, despite a pickup in export bookings. On the plus side, delivery times lengthened at a slower pace, helping to ease pressure on prices paid. 15 of 18 industries reported growth in the month, one fewer than in August. Overall, manufacturing remains robust on the back of strong investment in machinery and solid consumer spending. Tariffs are a growing concern, but not to the point of seriously dampening activity. Still, given the current momentum in the economy, the damage should be limited, provided that the trade war (notably with China) doesn't escalate.

**U.S. construction spending rose less than expected**, up 0.1% in August after a modest prior advance. Ongoing weakness in residential building (-0.7%) was aggravated by a second monthly decline in private non-residential construction (-0.2%) amid a continued slide in commercial building. Government spending on roads and other infrastructure provided an offset. Overall, housing markets and business structures spending are softening, the latter after double-digit annualized gains in Q2.

**Germany** reduced its overall public debt by 2.3% to 1.93 trillion euros ($2.27 trillion) in the first half of the year, pushing it to the lowest level since 2011, data showed on Wednesday. Sustained economic growth means Germany's government is enjoying a budget surplus which enables it to hike public spending without taking on new borrowing. (Source: Reuters)

## Financial Conditions

**The U.S. Federal Open Markets Committee** raised policy rates by 25 bps, with the economic assessment identical to the last one on August 1st -- all is "strong"! The only significant change to the statement was the removal of the phrase: "The stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation." We judge this is nothing more than a nod to the fact that, with this raise, the midpoint of the fed funds target range is now 2.125%, unequivocally above core personal consumption expenditures (PCE) inflation (currently 2.0% year/year) for the first time since March 2008. Real policy rates are no longer negative, and, thus, are no longer overtly accommodative. Through the forecast horizon, the jobless rate remains well below its longer-run level of 4.5%, to the tune of 0.8-to-1.0 percentage points. Meantime, inflation remains constant at 2.1%, as real GDP growth converges on its longer-run pace of 1.8%. The Fed is in our view believing the current secular forces of disinflation continue in which case we should expect the next rate increase on December 19th. The Fed continues to forecast one more hike in 2018, 3 hikes in 2019 and one hike in 2020.

The U.S. 2 year/10 year treasury spread is now 0.25% and the U.K.'s 2 year/10 year treasury spread is 0.76% - 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 4.72% (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 4.0 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 11.86 (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

*Our views on economic and other events and their expected impact on investments.*

October 1, 2018

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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