News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. June 10, 2016

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Energy Sector

Baytex Energy Corporation has reportedly restarted nearly all the heavy crude output it shut last year, encouraged by the months-long rally in oil prices. It is among the first signs of a North American producer restarting wells that were deemed uneconomic during the deepest part of the global crude price slump. Around 95% of the idled Baytex wells have been turned back on, roughly half of them in May and the rest in June. A year ago, Baytex starting shutting 7,500 barrels per day of low-margin and loss-making conventional heavy oil production in the Peace River and Lloydminster regions in western Canada. Canada's heavy crude producers were among the first to close active wells last year during the steepest rout in crude prices in a generation. Many have slashed costs and ramped up efficiencies to survive a lower-for-longer market. Unlike oil sands operations, conventional heavy oil production is quick and relatively cheap to shut and restart in response to changing prices.

BP plc announced a combination of their Norwegian Upstream business with Det Norske. Det Norske will acquire BP Norge via issuance of 135.1 million shares at NOK80/share. Det Norske's shareholder Aker ASA will then acquire 33.8 million shares in Aker BP from BP for cash of $318 million. Given BP Norge's net cash position of $178 million, ultimately BP will be paid by a net of $140 million, plus a working capital adjustment. The combined entity will be renamed Aker BP ASA and listed on the Oslo Stock Exchange. It will be owned by Aker (40%), other Det Norske shareholders (30%) and BP (30%). The transaction is expected to close by year end. In our view, this transaction strengthens BP's position in Norway where it has long been underweight and crucially gives exposure to one of the lowest risk, high margin oil developments globally i.e. Johan Sverdrup. BP Norge produced 57kboed (thousand barrels of oil equivalent per day) in 2015 and had proven & probable reserves of 225Mboe (million barrels of oil equivalent) at year end. We believe the combined entity has one of the fastest growing production profiles in Norway today, with total production expected to be reach 250kboed by 2023. This gives BP an additional of c.32kboed Norwegian volumes at this time.

German Energy Policy – Economy and Energy minister Gabriel (SPD) on Thursday spoke out against the country's quick exit from coal-fired generation at the annual congress of energy association. He reportedly warns against a coal exit along the lines of the nuclear phase-out: "the nuclear phase out was a bold decision (..) I will not convene a commission which deals solely with the coal exit", he was quoted – instead he plans to form a commission of experts on a 'broad concept of the decarbonisation of the energy sector'. In our view, despite its leadership in renewables (33% of power mix in 2015) Germany still relies heavily on coal and lignite generation (42% of power mix in 2015) and according to a draft version of the German 2050 Climate Action Plan, Germany aims to end coal–fired power 'significantly before 2050', the Green Party in fact is calling for a coal phase out by 2040. Further, as Germany's emission reduction targets for 2030 imply a ~50% reduction of power emissions (vs. 2015) from the power sector, then coal and lignite have to lose market share, in our view. Hence, we believe comments of Gabriel are rather of political nature; the social democrats are currently losing support on a structural basis and with the 2017 election campaign now starting, he has to ensure not to lose even more middle-class voters, in our view.

Financial Sector

HSBC Holdings plc is to restructure its global banking division to cut costs and make the business more "agile", according to an internal memo seen by Reuters last Monday. The reorganization is part of HSBC's plans announced last June to slash nearly one in five jobs and shrink its investment bank by a third as it seeks to boost profits. HSBC did not say how many jobs would be cut in this cost-saving drive, which follows the re-integration of the capital finance business back into global banking, which was announced in February. (Source: Reuters).

Brazil antitrust regulators approved Banco Bradesco SA's acquisition of the local unit of **HSBC**, adding a restriction that the buyer refrain from additional purchases for 30 months. Bradesco will also have to improve quality control, invest in worker training and disclose to its clients the local law that allows customers to switch banks, Cade, the antitrust regulator, said in a ruling Wednesday in Brasilia.

JPMorgan Chase & Co. Chairman and Chief Executive James Dimon warned that the bank could cut jobs in the U.K. and shift positions to elsewhere in Europe in the event of a vote to leave the European Union. "If the U.K. leaves the EU, we may have no choice but to reorganize our business model here," Mr. Dimon said at a JPMorgan town hall meeting for staff in Bournemouth, U.K.. "Brexit could mean fewer JPMorgan jobs in the U.K. and more jobs in Europe." U.K. Chancellor George Osborne, who is campaigning to remain in the EU ahead of the June 23 referendum, was in attendance. (Source: Wall Street Journal)

JPMorgan's Chase unit announced that it has signed a multi-year agreement with Shell to accept Chase Pay at its stations across the U.S. Chase Pay is a payment service that lets Chase credit and debit customers pay at the pump, in stores, online and within an app. Chase Pay will help Shell transform its customer payment and loyalty experience by enabling a mobile payment solution and driving Fuel Rewards program participation. In 2013, Shell and Dallas-based Excentus rolled out the Fuel Rewards program across the U.S. Chase Pay, which eliminates merchant fraud liability because it runs on a closed-loop platform called ChaseNet, is currently live with select ecommerce merchants and is expected to be available later this year for Chase customers to use at participating merchants' registers and in apps. Shell is the largest fuel retailer in the U.S, while Chase is the largest U.S. credit card issuer based on loans outstanding. Shell is a member of the Merchant Customer Exchange (MCX), an initial Chase Pay partner.

Top US investment banks have signalled a rebound in revenue growth in the second quarter from a year ago, potentially bringing relief to the industry after four quarters of year-on-year declines. Revenues in May appear to have improved from April, though bankers said not all banks have enjoyed the same level of growth and the performance in June will dictate if the overall industry shows a rise from a year ago.

JPMorgan, Bank of America Corporation, Merrill Lynch and Citigroup Inc. executives last week said revenues for their investment banks are on course to be higher than the second quarter of 2015. "It will be solidly up," said Daniel Pinto, head of JPMorgan's corporate and investment bank. He said revenues should be up by about 15% from a year ago. (Source: Reuters)

Activist Influenced Companies

Hertz Global Holdings, Inc. – Carl Icahn reported a 15.24% stake in Hertz as of June 6 versus a stake of 14.34% as of Dec, 7 2015, according to an SEC filing. News of higher stake arrived a day after Hertz said its board approved a plan to separate company's car rental and equipment rental businesses.

Canadian Dividend Payers

Brookfield Property Partners LP is gearing up to significantly increase its real estate investments in India, on the back of a well-performing office market, a residential sector that promises to turn around soon and huge demand for capital from developers, two people familiar with the company's plans said. As part of the plans, Brookfield will invest in residential projects in top cities from its new $9 billion global real estate fund. Brookfield is a relatively late entrant in the real estate investment scenario in the country, and joined the big league when it bought out Unitech Corporate Parks Plc (UCP), a portfolio of six assets including special economic zones and information technology (IT) parks, in 2014 for around £205.9 million. Acquiring commercial office assets, a sector that has fared much better than its residential counterpart over the last three years, will continue to be Brookfield's focus. Brookfield employs its global strategy here as well, by which it makes big acquisitions across sectors and then keeps adding assets to each of them. In the office-space sector too, Brookfield is at an advanced stage of investing $1 billion to buy out the office and retail assets of Hiranandani Developers Pvt. Ltd in the Mumbai suburb of Powai. The office and retail space, totalling about 4.5 million sq. ft, is part of Hiranandani Business Park and Hiranandani Gardens, Mint had reported on 7 April. Apart from the residential and office sectors, Brookfield is also present in the industrial realty space. Last year, it partnered with Embassy Industrial Parks Ltd, in an asset-specific deal, to develop an industrial and warehousing park on a 200-acre plot near Sriperumbudur, Chennai. Brookfield's global construction arm Brookfield Multiplex is also active here and is developing the UCP projects. Apart from real estate, Brookfield has also invested in India's roads sector and is in the process of making more acquisitions in the space.

Global Dividend Payers

AT&T Inc. – Yahoo Inc. is set to put together a new shortlist of bidders for its core internet assets after several parties, including Verizon Communications Inc. and AT&T, made second-round offers. In a boon to the prospects of AT&T and other bidders in the auction, Verizon's offer was at the low end of those received, despite the synergies it could benefit from thanks to its ownership of media unit AOL. CNBC reported, citing sources, that Verizon's bid of more than $3.5 billion was topped by multiple offers at or above $5 billion. A group led by a founder of Quicken Loans Inc., Dan Gilbert, and backed by Berkshire Hathaway Inc. Chairman Warren Buffett also submitted an offer, one of the Reuters sources said. TPG Capital LP and a consortium of Bain Capital Private Equity and Vista Equity Partners Management LLC also made offers. A sale of Yahoo's internet assets would leave the company just owning a 35.5% stake in Yahoo Japan, as well as its 15% stake in Chinese e-commerce company Alibaba Group Holding Ltd., which accounts for most of its value.

Mondalez International Inc. - On average, U.S. Food sales in Western Europe decreased -4.4% in the 4 weeks ending May 15, 2016: whereas Mondelez led sales growth across the group. Mondelez saw positive sales growth (+1.3%) as increases in volume (+4.3%) were only partially offset by decreases in price (-2.9%). For General Mills, sales fell by -1.5% led by lower pricing (-2.7%), even as volumes were up +1.3%. Kellogg's sales were down - 7.2% with lower volumes (-6.5%) and a marginal decrease in price (-0.7%). For Kraft-Heinz, sales declined -10.1% as volumes deteriorated (-9.4%) and price was slightly down (-0.7%).

Tesco plc agrees to sell 95.5% controlling stake in Tesco Kipa (Turkey) to Migros Ticaret A.Ş Expected proceeds for the deal are £30 million and reduction in net debt of £110 million. Management have not disclosed the profitability of the Turkish business for the 2015 but we estimate losses of around £20 million in 2016. Tesco was only a small player in Turkey and suffered from a highly competitive market. As a result the main Tesco business had to support Tesco Kipa. The sale of the business means that the focus can be on the other parts of the International business. Also, Tesco sold the Giraffe restaurant chain for small loss. We don't expect this to have a significant financial impact on the group. Tesco bought the Giraffe restaurant chain in 2013 for £49 million, they have sold the chain for a small loss (purchase price has not been disclosed as part of the sale agreement). These sales further simplify the group and will allow management focus on core business. While Turkey and Giraffe were a small part of the Tesco business from a financial point of view, we believe there is a greater impact on the business through focusing management's attention on the core business.

Economic Conditions

The U.K. Jobs Report for May: shows slower growth of both permanent and temporary staff appointments. Permanent appointments rose at the weakest rate in eight to the slowest rate of expansion since September 2015 with the May figure coming in at 52.9 from the 53.4 in April and 53.7 in March (50 signals expansion), reflecting ongoing uncertainty in the market place on U.K. employment. Panelists commented on the additional uncertainty around Brexit and also on the difficulties in finding suitable candidates. Temporary billings growth eased from the 13-month high registered in April but remained marked overall with some reports that the National Living Wage had contributed to a higher value of agency billings. May came in at 56.4 following 59.1 in April and 56.4 in March. Temporary billings grew strongest in the North during the month. Both permanent and temporary saw demand for their services increase at a faster rate than April. By sector, Engineering workers were the most in demand category for permanent jobs in May (following Accounting/financial workers in April), whilst Nursing/Medical/Care workers continue to be the most sought-after category for temps, with the slowest growth for Executive/Professional staff.

Canada – Canadian economy added 13,800 jobs in May, ahead of the expected 3,800 positions gains, while the unemployment rate improved a couple of notches, to 6.9% from 7.1%, ahead of the expectations penciling in a flat reading. The growth was driven exclusively by government positions as the private sector actually lost 5,400 positions.

Housing starts in Canada retreated to a 188,600 units annualized level in May, from 191,400 in the month prior, while building permits also pull back, by 0.3%, against expectations for a 1.5% advance.

Bank of Canada says Household Vulnerabilities are Higher - yesterday, Reuters highlighted the Bank of Canada's semi-annual Financial System Review (FSR) which indicates that while the overall level of risk to Canada's financial system was largely unchanged since its last FSR, vulnerabilities in Canada's household sector had increased and warned potential home buyers in hot markets like Toronto and Vancouver that prices were unlikely to continue to rise rapidly. While the Bank of Canada estimated the chances of a severe recession were low, given the economy was continuing to grow as the U.S. expanded and interest rates stayed low, the central bank still marked such a scenario as the most important risk to the financial system as a sharp rise in unemployment and broad correction in home prices would put strains on the system and the economy. The Bank of Canada also said that the share of households with large mortgages relative to income was increasing in Vancouver, Toronto and adjacent areas, which it said left the household sector more vulnerable. 'Stronger growth in household income, combined with a gradual normalization of interest rates, will likely diminish the extent of this vulnerability over time,' the review said.

Financial Conditions

The Reserve Bank of Australia (RBA) kept the official cash rate (OCR) unchanged at a record low 1.75%. Last Tuesday's decision to keep rates steady follows a raft of strong economic data. However, indicators still point to weak inflation. While the RBA could lower official interest rates again, but it would also, inflate an already inflated housing market. Another major factor in play at the moment is the Fed. If the Fed does lift its policy rate in coming months and this pushes the AUD lower, it could discourage the RBA from cutting.

The U.S. 2 year/10 year treasury spread is now .89% and the U.K.'s 2 year/10 year treasury spread is .84% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.60% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing US housing inventory is at 4.7 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 finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 16.05 (compares to a post-recession low of 10.7 achieved in early June) 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 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund
- Portland Global Aristocrats Plus Fund

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