

News Highlights

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PORTLAND
INVESTMENT COUNSEL®

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

September 19, 2016

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Energy Sector

U.S. land rig count decreased by 3 rigs week/week to 482 and is trending up 16% quarter/quarter. The rig count decrease was driven by declines in Horizontal Gas (-2), Directional Gas (-1), Vertical Oil (-1), and Miscellaneous (-1), partially offset by gains in Directional Oil (+2) as Horizontal Oil and Vertical Gas remained flat. Total horizontal land rig count is 71% down since the peak in November 2014. The Permian currently makes up ~51% of oil rigs.

U.S. horizontal oil land rigs remained flat week /week at 325, as gains in Eagle Ford (+1), DJ-Niobrara (+1), and Woodford (+1) were offset by declines in Williston (-2) and "Other" (-1) as Permian, Granite Wash, Mississippian remained flat week/week.

U.S. offshore rig count increased by 2 rigs week/week to 20 and is down 63% since June 2014.

Canadian rig count decreased by 3 rigs week/week and is still 27% off the level this time last year.

Financial Sector

Barclays Plc - CEO Jes Staley at the Barclays Global Financial Services Conference in New York says Barclays will sell more non-core assets in 2nd Half 2016 and is 'firmly committed' to exiting all non-core businesses by 2017. Iberian cards, Asian wealth businesses will close soon and the bank is making 'progress' on sale of French business, 'steadily reducing' non-core derivatives and has 'increased confidence' in exiting African subsidiary. Separately, Bob Diamond's Atlas Merchant Capital is still interested in buying some or all of Barclays' remaining stake in its African unit, even after Carlyle Group walked away from a potential deal, the Financial Times reports.

Citigroup Inc. said its trading revenue is performing above expectations so far in the third quarter. CFO John Gerspach, speaking at a financial-services conference last Wednesday, said that trading revenue would be up by mid-single digits compared to a year ago, driven by strength in rates and currencies. Trading includes Citigroup's large fixed-income division and smaller equities division. But trading revenue will be down slightly from the second quarter, Mr. Gerspach said. Banks including Citigroup reported big jumps in second-quarter trading revenue over the summer, fuelled partly by uncertainty caused by the Brexit vote in June. (Source: Wall Street Journal)

Royal Bank of Scotland Group Plc (RBS) - CFO Ewen Stevenson says in presentation to the Barclays Global Financial Services Conference in New York that RBS may have to take "material" provisions beyond current \$5.6 billion for various litigation claims.

RBS says it aims to "materially address" overhang from litigation and conduct issues by end of next year. RBS is also in discussions with plaintiffs for possible early settlement of U.K. 2008 rights issue shareholder litigation and is still in talks with various governments, regulators on FX-market rigging investigations.

UBS Group AG expects to resolve major legal cases over the next three years and to have greater clarity over regulatory requirements, putting it in a position to pay healthy returns to shareholders, finance chief Kirt Gardner said last week. "Over the next three years, once we have all of that behind us, it really puts us in a really, really strong position to consistently return capital at attractive levels to our shareholders," Gardner said. Gardner also said the Swiss bank remained committed to its current dividend policy of paying out at least 50% of net profit to shareholders if capital requirements are met. (Source: Reuters)

Activist Influenced Companies

Restaurant Brands International Inc. (QSR) - has announced the establishment of a master franchise joint venture with an investor in Great Britain. The joint venture company will be the master franchisee of the Tim Hortons brand in England, Scotland and Wales, responsible for developing and growing the brand in the market. "This deal is part of our growth plan to take the iconic Tim Hortons brand around the world," said Daniel Schwartz, CEO of Restaurant Brands International. "Great Britain is an attractive QSR market with a strong and growing coffee culture so it is a natural fit for the brand." "This is an incredibly proud moment for the Tim Hortons brand as we enter this dynamic market," said Elias Díaz Sesé, President of Tim Hortons. "We are thrilled to introduce the iconic Tim Hortons brand and Canada's favourite coffee to Great Britain," said Gurprit Dhaliwal, CEO of the joint venture company. "Our Guests in England, Scotland and Wales are sure to be delighted with our focus on delivering great products and an exceptional Guest experience." This announcement is the most recent by QSR regarding its plans to develop and grow the Tim Hortons brand around the world. Last month, QSR announced a master franchise joint venture agreement to develop the Tim Hortons brand in the Philippines. Today, the brand has restaurants across Canada, the U.S. and the Middle East.

Canadian Dividend Payers

Nothing new to report.

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Global Dividend Payers

Barry Callebaut Group, the world's leading manufacturer of high-quality chocolate and cocoa products, announced last Thursday its intention to acquire and integrate the chocolate production facility of **Mondelēz International Inc.** in Halle, Belgium. Mondelēz would enter into an agreement with Barry Callebaut for the long-term supply of 30,000 tonnes of liquid chocolate per annum. Under a toll-manufacturing agreement, Barry Callebaut would make certain consumer products for Mondelēz that are currently produced at the chocolate plant in Halle. As a result of this transaction, Barry Callebaut would be better equipped to capture business opportunities in the fast growing segment of specialty chocolate and fillings "Made in Belgium". CEO Antoine de Saint-Affrique said: "This is an excellent opportunity for Barry Callebaut to strengthen our global strategic supply partnership with Mondelēz International. As a result, we would also be able to expand our manufacturing capacity for quality Belgian chocolate needed to support the continuous growth of our business with both Food Manufacturers and Gourmet & Specialties customers. This all demonstrates our continued commitment to Belgium and reflects the excellent reputation that Belgian chocolate enjoys globally." The expected closing of the transaction is by the end of December 2016, after completing works council consultation. The transaction is subject to closing conditions. The two parties have agreed not to disclose any financials of the transaction.

Johnson & Johnson said it is paying more than \$4.3 billion in cash to buy the eye health unit of Abbott Laboratories as it seeks to boost its vision business. The unit, called Abbott Medical Optics (AMO), makes lasers and other equipment used for cataract surgeries and laser vision correction procedures. It also makes eye drops and cleaners for contact lenses. AMO posted sales of \$1.1 billion last year. Johnson & Johnson said that the purchase will enter it into the cataracts surgery market and grow its own vision business, which includes Acuvue contact lenses. Abbott, based in North Chicago, Illinois, said that it is selling the unit to focus on its treatments for the heart and arteries and its disease testing equipment. The deal is subject to antitrust clearance and is expected to close in the first quarter of 2017.

Economic Conditions

U.S. retail sales retreated 0.3% in August, more than the expected 0.1% pull-back and more than reversing July's 0.1% advance. Sales of motor vehicles were down 0.9% in the month. Core sales, which exclude sales of vehicles and parts, were also lower than expected at negative 0.1% compared to a 0.2% improvement. Most retail categories were weak in the month, including sales of building materials, furniture, sporting goods, healthcare and department stores. The release significantly tempered expectations for a Fed interest rate increase in September. However, the following day, the publishing of the August inflation numbers were less comforting for those counting

on Fed's inaction, as the headline consumer price index (CPI) inflation moved three notches higher, at 1.1% from 0.8%, ahead of the expected 0.1% reading. The core number, which excludes the effects of food and energy prices, was also higher than expected, at 2.3% relative to 2.2%. The increase in consumer prices was driven in the month by higher housing costs (rent and utilities) as well as a surge in medical care costs.

U.S. consumer sentiment, as measured by the University of Michigan, slumped in September to 89.8 index points, compared to August's 90.4 index points and the consensus expectations for a 90.8 index points level. The reading of this composite index was dragged lower by the 'current conditions' component, as the 'expectations' component actually improved in the month.

U.S. industrial production fell 0.4% in August, but this is roughly in-line with expectations and follows two consecutive and impressive gains of 0.6%. Manufacturing took a hit, down 0.4% in the month but that came as no surprise, given when we already knew about the # of hours worked in the industry. Utilities were also down (-1.4%) following two months of extreme heat. Mining was a surprise, rising for the fourth consecutive month, with the latest 1.1% reading the strongest in a year. This is an encouraging step, although production remains 9.4% below year-ago levels. Consumer goods fell for the first time in three months, despite support from the automotive industry. But oil & gas well drilling jumped 2.4%, which is the 2nd increase in a row. That speaks to anecdotal reports about a few shale drillers heading back to the oil patch. Information processing equipment (i.e. tech products) grew 1.3%, which is the first improvement in three months but this still won't help productivity.

Financial Conditions

The Bank of England (BOE) will begin a £10 billion (\$13 billion) corporate-bond buying program on Sept. 27 as it seeks to bolster the U.K. economy. The central bank will hold reverse auctions to buy notes on Tuesdays, Wednesdays and Fridays, it said in a statement detailing plans first announced last month. The 18-month program will cover sterling bonds from investment-grade non-financial issuers based in the U.K. or with sizable operations in the country. BOE Governor Mark Carney introduced stimulus measures and cut interest rates to a record-low 0.25% to help ease the economic shock of the U.K.'s June vote to leave the European Union. Corporate-bond purchases will include debt from companies such as Apple Inc., BMW AG and power generator SSE Plc, the BOE said. (Source: Bloomberg)

The U.S. 2 year/10 year treasury spread is now .93% and the U.K.'s 2 year/10 year treasury spread is .74% - 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.

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Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.50% (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 4.3 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 15.07 (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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