# News Highlights

*Owners. Operators. And Insightful Investors.*

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

PORTLAND INVESTMENT COUNSEL®

*Our views on economic and other events and their expected impact on investments.* December 22, 2016

*The views of the Portfolio Management Team contained in this report are as of December 22, 2016 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.*

## HAPPY HOLIDAYS & BEST OF 2017. We will see you again January 9, 2017.

## Energy Sector

**Total SA –** Petroleo Brasileiro SA (Petrobras) said it will sell $2.2 billion worth of assets to France's Total SA, including stakes in oilfields and two thermal power stations. Petrobras will receive $1.6 billion in cash in 60 days, when the agreement closes. The rest will be received over time. With the agreement, the total divestment for the last two years ending in 2016 reached $13 billion, Monteiro said, still $2 billion short of the target the company set to reduce its $125 billion debt, the largest in the world's oil industry. Chief Executive Officer Pedro Parente said the remaining $2 billion may have to be added to the company's 2017 asset sale target. Under the agreement Total will acquire stakes in two oilfields in Brazil's so-called Subsalt Polygon, which covers most of the giant discoveries in undersea reservoirs trapped deep beneath the seabed by a layer of salt.

The French company will get a 22.5% stake in prospect area Iara, currently under development in the Santos Basin. Petrobras will keep a 42.5% interest in the field and continue to be the operator. Total will buy 35% and operate the Lapa field, also in the Santos Basin, which began producing this week. Petrobras will keep a 10% stake. The French company will also acquire 50% of two thermal power stations in Bahia state. Parente said the two companies want a partnership beyond the mere transfer of assets. Petrobras and Total are already partners in 19 oil fields worldwide.

## Financial Sector

**Bank of America (BoA)/ Lloyds Banking Group Plc -** Lloyds has announced this morning that it has agreed to acquire MBNA credit card business from BofA for £1.9 billion in cash, financed from own funds. Lloyds Says MBNA business comprises gross assets of ~£7 billion and will add £650 million a year to Lloyds group revenues. £6.2 billon Risk Weighted Assets. Earnings Per Share accretion 3% and 5% on statutory basis in first two full years after the deal completes. Credit card market share will go from 15% to 26%. £100 million cost synergies in two years (30% of MBNA's cost base). £0.8 billion of acquired equity is included in the purchase price with a Principal Protected Insurance (PPI) indemnity capped at £240 million so if future PPI is anything above £240 million then MBNA will be liable to pay. The deal is set to complete by end 1st Half 2017. Lloyd's expects to maintain the MBNA brand as a challenger brand.

**BCE Inc.** welcomed Canadian Radio-television and Telecommunications Commission (CRTC) approval of the transfer of the broadcasting distribution undertaking licence held by Manitoba Telecom Services Inc. (MTS) to Bell. 'We continue to make progress toward uniting Bell and MTS as we work with federal regulators to complete the remaining transaction approvals,' said George Cope, President and CEO of BCE and Bell. "Bell and MTS look forward to implementing our billion-dollar capital investment program to bring innovative broadband fibre and wireless services to Manitobans everywhere." Expected to close in early 2017, the Bell MTS transaction has been approved by MTS shareholders, the Manitoba courts and the CRTC, and is subject to approval by the Competition Bureau and Innovation, Science and Economic Development (ISED). Bell announced the $3.9 billion MTS transaction on May 2, and a 5-year, $1 billion plan to roll out new broadband network infrastructure and next-generation services - including Fibe TV, Gigabit Fibe Internet and Canada's fastest LTE wireless services from Bell Mobility - across Manitoba.

Broadband internet access will be considered a basic service in Canada, the country's telecom regulator ruled, paving the way for universal access to high-speed services in rural and isolated areas of the country. The CRTC said it was establishing a fund providers will pay into to invest $750 million over five years to build or upgrade broadband infrastructure to improve access in underserved areas. The CRTC set a target download speed of 50 megabits per second, 10 times its previous, and recommended providers offer unlimited data for fixed broadband. About 82% of Canadians had access to those speeds last year. Declaring broadband an essential service means it should be available to all Canadians, though establishing high-speed access in remote areas remains an expensive proposition for providers. The regulator did not set a price cap, which could have eroded the profits of telecom operators whose revenue from internet access has outstripped television services. Companies that make $10 million or more already contribute a percentage of their profits to subsidize basic phone services. Companies currently pay about 0.5% of their telecom revenue, with the fund at about C$100 million. Companies made $9.81 billion from the supply of internet connections in 2015, topping the $8.92 billion they made from television subscriptions, the CRTC said recently.

**Brookfield Infrastructure Partners LP –** Brazilian construction conglomerate Odebrecht SA is in advanced talks on selling its majority stake in a $5 billion natural gas pipeline project in Peru to Canada's Brookfield Asset Management Inc. Techint Group would also join the

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project as a junior partner and would be tasked with construction. Odebrecht is at the center of Brazil's biggest-ever graft scandal. Worries about liability for corruption have snagged financing for the pipeline and Odebrecht's attempt to sell its 55% stake in the project as required by lenders. Brookfield agreed to keep an anti-corruption clause in the pipeline contract, a condition the government had been firm on but which had been a deal breaker for U.S.-based Sempra Energy when it nearly bought Odebrecht's stake last month. The Peruvian government would likely look for a company to build smaller pipelines that would link the main pipeline to cities in southern Peru. The pipeline is expected to transport natural gas from southern Peru to the coast where it will fuel power plants and a future petrochemical complex. Spanish energy company Enagas SA controls a 25% stake in the project and Grana y Montero, a Peruvian construction group holds 20%.

**Indian telecommunications carrier Reliance Communications Ltd.** said had signed a binding pact with Canada's Brookfield Infrastructure for selling a stake in its mobile phone tower business. The two sides had signed a non-binding pact in October. Under the terms of the deal, Reliance Communications is to receive an upfront payment of 110 billion rupees ($1.6 billion), which it has said will use to cut its debt load.

## Activist Influenced Companies

**Pershing Square Holdings Inc. –** Chipotle Mexican Grill Inc., under pressure from activist investor Bill Ackman, named four new board members. Matthew Paull, a former McDonald's Corporation chief financial officer, will join the Chipotle board. Media executives Paul Cappuccio and Robin Hickenlooper, as well as Ali Namvar, a partner at Ackman's hedge fund Pershing Square Capital Management, round out the additions. Pershing Square, Chipotle's largest single investor with a nearly 10% stake, sought to end the company's co-CEO arrangement and replace some long-serving directors. Chipotle investors are agitating for a deep overhaul at the company, which is struggling to get back on track after a string of 2015 food safety stumbles that bruised sales and its reputation. The company addressed some of those issues this week with the announced departure of Chipotle co-CEO and director Monty Moran. "We are pleased that Chipotle has taken the important step of refreshing its board," Ackman said in a statement. Paull was McDonald's CFO from 2001 to 2008 and is credited with making major contributions to a company turnaround. Paull and Steve Ells, who founded Chipotle and returned to the role of sole CEO this week, worked together under the McDonald's umbrella until 2006, when the burger giant spun off the burrito seller. Chipotle's board has been criticized for being too entrenched and too cozy with management. Five of the eight existing directors have served more than 18 years. Institutional Shareholder Services, an influential proxy advisory group, this year urged shareholders to oppose the reelection of directors Patrick Flynn, Darlene Friedman and Albert Baldocchi at the company's annual meeting in May. The trio survived those challenges. It remains to be seen if they'll be able to keep up with Bill Ackman.

## Canadian Dividend Payers

Nothing new to report.

## Global Dividend Payers

**Johnson & Johnson –** Swiss biotech company Actelion has turned back to prospective bidder Johnson & Johnson for exclusive talks about a "strategic transaction", in an about-turn that appears to sideline rival suitor Sanofi. Actelion said it was in exclusive negotiations with the U.S. healthcare giant but that there could be "no assurance any transaction will result from these discussions". Actelion had reportedly told J&J before initial talks collapsed last week that it was confident it could attract an offer significantly higher than the approximately 250 Swiss francs per share the U.S. company had offered. There were also disagreements about the proposed deal's structure, the person added at the time. Actelion co-founder and Chief Executive Jean-Paul Clozel has fended off previous takeover attempts, including a reported takeover approach by Shire last year and an activist campaign in 2011 by U.S. hedge fund Elliott Advisors. Acquiring the Swiss biotech firm would boost J&J's drug pipeline and diversify its prospects.

**Roche AG** announced positive Phase III results from emicizumab's (ACE910) inhibitor trial (HAVEN 1). This study compared prophylactic emicizumab, given once-weekly by subcutaneous injection, versus no prophylaxis in haemophilia A patients with inhibitors. The most common adverse effects were injection site reactions, but importantly no additional severe thromboembolic events were seen beyond the four previously disclosed. Adverse events were consistent with what was seen in previous clinical trials, with injection site reactions the most prevalent. The four serious thrombotic adverse events (two of which were thromboembolic events and two events of thrombotic microangiopathy) in patients who were treating a break-through bleed with Shire's Feiba, previously flagged last month, remain a concern. Detailed results will be presented at an upcoming medical meeting. Emicizumab continues to remain one of Roche's key pipeline products, and we expect filing in 2017. These results clearly demonstrate emicizumab reduces bleeding. We look to see the magnitude of benefit at a future meeting. The four serious thrombotic events in 100 patients will need to be thoroughly investigated by the US Food & Drug Administration (FDA). In discussions with Roche management they highlight the doses of Feiba used in these cases were higher than normal practice, although we expect if a patient will not stop bleeding, very high doses of bypassing agent could be used when treating bleeds given the lack of other options.

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## Economic Conditions

**U.S. existing home sales** unexpectedly picked up in November, rising for the third month in a row and now, to the highest since February 2007 at 5.61 million units, annualized. The 0.7% increase erases the negative news, which was a downwardly revised October. With pricier homes becoming more of a challenge for first-time homebuyers (they accounted for 32% of sales, the lowest since August but still 2 percentage points above a year ago), condo sales jumped 10%, while single-family homes slipped 0.4%. Supply has, and still does, remain an issue…….the months' supply hit a near one-year low of 4.0 in November. All in, this is solid news for the housing sector, in our view, although we will likely see some cooling in coming months as mortgage rates continue to move off their lows.

**U.S. personal incomes** were unchanged in November. Although incomes grew nicely in September and October, the lack of further increase held personal spending back. Consumption inched up just 0.2% in November, and in real terms, that translated into two straight monthly gains of 0.1%. There were cutbacks in purchases of cars, gasoline, and recreation services, while fine dining (or otherwise), hotels, financial services, clothing, household durables, recreational goods & vehicles saw stronger demand. So it was definitely a mix.

## Financial Conditions

**The Bank of Japan (BOJ)** kept its monetary policy unchanged in its last monetary policy meeting (MPM) decision of 2016 today (Dec. 20). This was status quo for the second straight meeting (previously was the Oct. 31/Nov. 1 MPM) after having announced policy changes for its preceding two consecutive monetary policy decisions in July and September. The central bank even raised its growth outlook, stating that "Japan's economy is likely to turn to a moderate expansion", thanks to a "virtuous cycle from income to spending", and "on the back of highly accommodative financial conditions and fiscal spending". The weaker Japanese Yen may be playing a role in the slightly more optimistic outlook. In any event, the Bank of Japan's appetite for further easing (much like other central banks) has ebbed recently in our opinion.

The U.S. 2 year/10 year treasury spread is now 1.36% and the U.K.'s 2 year/10 year treasury spread is 1.31% - 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 4.16% (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 11.25 (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

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.

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

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