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Our views on economic and other events and their expected impact on investments. January 23, 2017

Energy Sector

U.S. land rig count increased by 36 rigs week/week to 670 rigs, which is the largest weekly gain since August 2011. The rig count is up on average 26% Quarter To Date quarter/quarter. Gains in the rig count were driven by gains in Horizontal Oil (+18), Vertical Oil (+11), Horizontal Gas (+4), Directional Oil (+1), Vertical Gas (+1), and Directional Gas (+1). Total horizontal land rig count is down 59% since the peak in November 2014. The Permian currently makes up 53% of all oil rigs.

U.S. horizontal oil land rigs increased by 18 rigs week/week to 446, which is the largest weekly gain since January 2014, as gains in the Permian (+11), Woodford (+9), Williston (+3), and Eagle Ford, were partially offset by declines in "Other" (-6), while DJ-Niobrara, Granite Wash, and Mississippian remained flat week/week.

U.S. vertical oil land rigs increased by 11 week/week to 63, which is the largest weekly gain since July 2015, as gains were driven by "Other" (+8) and Permian (+3).

Canadian rig count increased by 28 rigs week/week as rigs continue to come back online after the holiday shut down and is up 38% from the level this time last year.

U.S. Gulf of Mexico offshore rig count decreased by 1 rig week/week to 23 and is down 57% since June 2014.

Baytex Energy Corp. announced the closing of its acquisition of heavy oil assets located in the Peace River area of northern Alberta. Cash consideration for the acquisition of $65 million (net of adjustments) was funded by drawing on Baytex's revolving credit facilities. The assets are located immediately adjacent to Baytex's existing Peace River lands, add approximately 3,000 barrels of oil equivalent per day (boed) of production and more than double its land base in the area. The company sees the potential to significantly increase crude oil production on the acquired lands over the next two years.

Royal Dutch Shell having announced C$5.5 billion of divestments in 2016, Shell has announced its first divestment of 2017. The company will sell its 50% share in the SADAF petrochemical Joint Venture for $820 million, ending early the joint venture agreement which was due to expire in 2020. The transaction is set to close later this year. Given Saudi Arabia's growth ambitions in the petrochemical arena, it is likely that Shell would have needed to commit to further capital expenditure within the Joint Venture at a point when it has many competing uses of cash. As such this appears to be a good deal for both sides in our view.

Financial Sector

American International Group Inc. (AIG) has agreed to pay roughly $10.2 billion to Warren Buffett's Berkshire Hathaway Inc. to take on many long-term risks on U.S. commercial insurance policies it has already written. The reinsurance transaction covers "long-tail" exposures, which are liabilities that emerge long after policies are issued, from excess casualty, workers compensation and other AIG policies issued before last year. Berkshire's National Indemnity Company unit, led by Buffett's reinsurance chief Ajit Jain, will take on 80% of net losses in excess of the first $25 billion, with a maximum liability of $20 billion. The payment to Berkshire represents nearly 3% of AIG's investment portfolio.

Berkshire Hathaway Inc.'s subsidiary, BNSF Railway, has unveiled a $3.4 billion capital expenditure plan for 2017. Bulk of the investment, worth $2.4 billion, will be used for replacement and maintenance work on BNSF's core network and related assets. Work will include replacing and upgrading rail, crossties and ballast and maintaining the railroad's rolling stock. The states on the BNSF network securing the largest investments are Texas, Illinois, Washington, California, Kansas, Missouri, Montana, and Nebraska.

Brookfield Property Partners L.P. has made a proposal to Brookfield Canada Office Properties (BOX) to acquire the approximate 16.9% equity interest in BOX that it or its affiliates do not own (approximately 15.8 million units) for $30.10 cash per unit. The proposed price represents a premium of 14.2% to the 30-day volume-weighted average price of BOX units on the Toronto Stock Exchange and 14.5% to the 30-day volume-weighted average price of BOX units on the New York Stock Exchange. "Our proposal provides BOX unitholders with an attractive all-cash offer at a significant premium to recent public market pricing," said Brian Kingston, CEO of Brookfield Property Group. "The acquisition of the remaining interest in BOX will allow Brookfield Property Partners to fully integrate its North American office operations and further simplifies our structure." Unitholders holding approximately 3.65 million units of BOX, representing approximately 23% of the unaffiliated BOX units, including Morgan Stanley Investment Management, who holds approximately 1.5 million units of BOX on behalf of certain client accounts, support the proposal and have agreed, subject to certain conditions, to vote the units of BOX they still hold at the time an agreement is entered into in favor of the transaction.

Citigroup Inc. reported Q4 2016 Earnings Per Share (EPS) of $1.14 whereas consensus was $1.12. Legal costs were $280 million down from $306 million in Q3 2016, while repositioning costs were $102 million, up modestly from $96 million in Q316. Combined, these cost EPS $0.08. Losses on loan hedges were $107 million, down from a $218 million loss last quarter. Securities gains were $275 million. Citi Holdings net income was $87 million, up from $74 million in Q3 2016 (guided to a modest loss). Relative to Q3 2016 results evidenced lower Net Interest Income as both its average earning assets and Net Interest Margin declined (-7bps after guiding to stable; driven by lower trading Net Interest Margin, higher funding costs, and the higher mix of promotional rate balances in cards); lower fee income (principal transactions); lower core expenses (compensation), a slightly lower loan loss provision with decrease in Non Performing Assets but a pickup in Non Conforming Obligations, a lower tax rate (-120bps), and a reduced share count (-2.7%). It repurchased 79 million shares, up from 56 million in Q3 2016. Since it disallowed Deferred Tax Allowances (DTA), Citi generated a 9% Return On Tangible Common Equity (ROTCE) in full-year 2016 and given its trajectory, it expects to reach at least a 10% ROTCE by 2018 (when including full DTA, it expects to achieve a 10% ROTCE by 2019). While we welcome these ROTCE targets (and view them as achievable), Citi had to renege on similar targets in 2015 due to a tougher operating environment. Looking forward to full-year 2017, it expects to demonstrate progress towards its 10% ROTCE target as it continues to drive efficiencies across its franchise and begins to see the full benefit of its cards investments made in the 2nd Half of 2016. Citi is targeting a 58% efficiency ratio for total Citigroup in 2017 (no rate hikes) and a 'mid-50%' efficiency ratio as early as 2018 (with one 25bps rate hike).

Citizens Financial Group Inc. (CFG) reported Q4 2016 EPS of $0.55, consensus was $0.52. Net interest income increased 4%. Average earning assets rose 2.3% with loans up 2.4% and securities rising 2.9%. Average commercial loans increased 3%, driven by strength in Mid-corporate and Industry Verticals and Commercial Real Estate, while retail loans rose 2%, due to strength in mortgage, student and other unsecured retail loans. Period-end loans increased 2.1% with commercial (+2.5%) and retail (+1.7%) both higher. Average deposits increased 2%, while period-end balances rose 1%. Its net interest margin expanded 6bps to 2.90%, reflecting improved commercial and consumer loan yields, including the benefit of an increase in LIBOR, and lower pay-fixed swap costs, partially offset by the impact of an increase in securities portfolio balances as well as the impact of higher deposit and borrowing costs. In 2016, its 'TOP II' efficiency initiative delivered $105 million of annual pre-tax benefits (was targeting $95-$100 million), while TOP III is now expected to deliver pre-tax revenue and expense run-rate benefits of $100-$115 million, including $20 million of tax benefits in 2017 (up from $90-$110 million last quarter). Still, its medium-term targets remain 10%-plus Return On Tangible Common Equity, and ~60% efficiency ratio. Securities gains were $3 million, compared nil in Q316, while it released $2 million of loan loss reserves, compared to a $3 million build in Q316. CFG also announced a $0.02, or 17%, increase in its quarterly dividend to $0.14 (1.6% yield). Tangible book declined 1.9% to $25.69 (1.4x), largely reflecting mark-to-market losses on its securities portfolio ($334 million). It posted a 5.7% Return On Equity. Its Core Equity Tier 1 ratio was 11.2%, down 10bps. It repurchased 6.3 million shares for $180 million. This is down from Q3 2016 when it repurchased 11.1 million shares for $250 million. Its average diluted share count declined 1.4%.

The Goldman Sachs Group Inc. reported Q4 2016 EPS of $5.08. Consensus was $4.81. Its Return On Equity was 11.4% (9.4% for 2016). Tangible book rose 0.7% to $172.60. Revenues (ex. Debt Value Adjusted) increased 11% year-on-year and were little changed from Q3 2016 at $8.17 billion (consensus: $7.78 billion). Relative to Q3 2016, Investment Management rose 8% (driven by higher incentive fees) and Institutional & Loans increased 6% (equities up, debt/loans down). Goldman was the only bank to post sequential growth in Fixed Income Currency & Commodities (+2%) but underperformed in equities (-11%) and Investment Banking declined 3% (M&A up, but Debt Capital Markets/Equity Capital Markets lower). Its Core Equity Tier 1 ratio (advanced, fully phased-in) was 12.7%, up a full 80bps, aided by a reduction in the size of its balance sheet.

HSBC Holdings PLC - Chairman Douglas Flint says banks want guidance on the timing of Brexit and whether there is likely to be a transitional arrangement. "If you don't know where you are going you have to plan for the worst and execute faster -- this isn't rocket science:" Flint. "The industry is saying 'help us understand where we are trying to get to so we can take a decision on how long we have to make plans and action them.'" He predicts banks will apply for licences in Europe. "Nobody wants to move anybody because it's clunky and expensive:" Flint.

Morgan Stanley reported GAAP EPS of $0.81. Excluding $135 million of net discrete tax benefits (~$0.07 per share) it is estimated core EPS closer to $0.74, still well above Consensus at $0.65. Better-than-expected results were top line driven, with Fixed Income Currency & Commodities (FICC) the highlight. All in, return on equity was 8.7% in the quarter–more or less at the low end of management's 2017 9-11% target. FICC sales and trading revenue of $1,468 mil, -1% quarter/quarter (vs. Bank of America -29%, JPMorgan -22%); Q4/2016 compensation ratio of 34.9%/35.9% vs 2017 target of ≤37%; Wealth Management fee-based flows +$17.1Bn (strongest quarter since Q4 2014); Wealth Management net interest revenues +11% quarter/quarter (on loan growth and lower prepayment); Wealth Management compensation ratio 55.7% vs. 57%; Deposit growth +3% quarter/quarter after two quarters of no growth. However, Book value of $36.99 (-0.3% quarter/quarter) likely driven by fair market value write downs (not surprising given the uptick in interest rates).

NN Group NV - The European Central Bank (ECB) purchased at least 5 corporate bonds under its CSPP program during the week ended January 13, including NN Group corporate bonds, according to data compiled by Bloomberg. ECB lifts the number of securities

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held to 784; the ECB holds €54.01 billion (~9.7%) of €554.86 billion outstanding.

Standard Chartered PLC completed three shipping finance deals in excess of $1.6 billion for clients in Asia, Middle East, lender says in e-mailed statement.

Top bankers are confident that British Prime Minister Theresa May's government will support a transition period of several years for the financial sector to cope with Britain's exit from the European Union. May met the heads of major U.S. financial firms at the World Economic Forum in Davos on Thursday to discuss their concerns. The Prime Minister confirmed on Tuesday that Britain would quit the single market when it exits the EU, although she said she would back an "implementation" period. Financial firms have accepted that they will lose their 'passporting' rights to freely sell services across the 28-nation bloc after Brexit, but want more time to adapt to whatever terms are agreed with the EU. "I think the government does [support it] because I think they understand the complexity of this," Barclays Chairman John McFarlane, who is also chair of financial industry lobby group TheCityUK, told Reuters earlier on Thursday. A source familiar with the talks in Davos, which included executives from Goldman Sachs and Morgan Stanley, said May had been receptive to their points on transition. (Source:Reuters).

Activist Influenced Companies

Brookfield Business Partners L.P. – Brookfield Asset Management Inc. is selling Canadian bathtub supplier Maax to the American Bath Group for an undisclosed price. The Quebec-based company founded 47 years ago will maintain its production operations as a division of the Tennessee company and continue to be headed by CEO Mark Gold. Maax has 1,200 employees at eight plants, including three in Quebec, one elsewhere in Canada and four in the U.S., along with three North American distribution centres. Maax was purchased in 2008 by a division of Brookfield for about $270 million while it was under court protection from creditors at the height of the U.S. housing crisis.

Restaurant Brands International Inc. (QSR) has reportedly planned to launch an app nationwide this spring that would allow customers to order and pay in advance on their smart phone. The move by Restaurant Brands International follows a similar one by Starbucks. "The first feature we're going to be introducing is the ability for a customer to have Tim Hortons [and Burger King] in their pocket," said Steve Greenwood, QSR's head of digital.

Canadian Dividend Payers

Northland Power Inc. said that the Supreme Court of Canada has refused to grant the Ontario Electricity Financial Corporation (OEFC) leave to appeal the legal case concerning the interpretation of power purchase agreements related to Northland's wholly-owned subsidiaries, including Iroquois Falls Power, as well as Northland's managed facilities, Cochrane Power and Kirkland Lake Power. This final decision confirms that the Northland Applicants will retain all payments received to date from OEFC and will continue to earn revenues per Northland Applicants' interpretation of the contracts.

Global Dividend Payers

The Procter & Gamble Company reported better-than-expected quarterly sales, driven partly by strong organic sales in its beauty and health care businesses, and raised its fiscal 2017 forecast for organic sales growth. P&G has been shedding unprofitable brands as it focuses on core brands, including Tide and Gillette, to boost sales. The company sold 41% of its brands last year, including Clairol and COVERGIRL, to Coty Inc for $12.5 billion. The company's total organic sales, which excludes the impact of foreign exchange, mergers and acquisitions, rose 2% as pricing and product mix remained flat. P&G's health care unit, which sells Oral-B and Vicks, was its best performing business with organic sales jumping 7%. Its beauty business, which houses brands like Head & Shoulders and Olay, rose 3%. The health care and beauty business together accounted for about 30% of P&G's total sales. P&G said it now expects organic sales growth of 2% to 3% for the year, up from its prior forecast of a 2% increase. This is faster than the 1% organic sales growth P&G reported in 2016. Core earnings per share, which excludes restructuring charges and other items, was $1.08 in the second quarter ended December 31.

Roche Holding AG has confirmed the data from APHINITY is in-house. Although there will be no disclosure at the full year results, 1st February headline results will be released in Q1. APHINITY is comparing Herceptin plus Perjeta plus chemotherapy against Herceptin plus chemo in the adjuvant setting. The primary endpoint is disease free survival. If positive, it is seen as the final brick in the wall in ring-fencing Roche's Herceptin franchise from biosimilar competition. Realistically, therefore, the expectations are to be looking for 2 year disease-free survival of greater than 90%. However, if the end results are no better than Herceptin in APHINITY, then up to 75% of Herceptin sales (CHF4.9 billion) could be exposed to biosimilar competition in our opinion. But if positive, Roche effectively has all the bases covered, and bundle pricing on the combination could give Roche the pricing flexibility on Herceptin mono to erode biosimilars commercial proposition. Either way it is a major pivot point for the share, in our opinion.

South32 Limited delivered a mixed production quarter in Q2. Despite this, the company has retained full year production guidance across the business, in expectation of a 2nd Half recovery at those assets which suffered a tricky H1. Overall we see the investment case unchanged predicated on: strong earnings momentum and cash flow generation, a rapidly building net cash position, management willingness to return it to shareholders and very cheap valuation metrics relative to peers.

Economic Conditions

Canada – Retail sales in Canada fell short of expectations for the month of November, at 0.2% increase relative to 0.5% advance expected. The core retail sales, which exclude sales of vehicles and parts, were also weaker than expected, up 0.1% in the month, compared to the 0.2% consensus expectations. The shortfall was driven by muted growth in sales at grocery stores, clothing and general merchandise. Part of the weakness was also due to significant discounting in the month proceeding the holidays, which was also reflected in the inflation numbers. The headline inflation clocked in at 1.5% year on year, relative to expectations for a 1.7% read, while the core inflation, which excludes the changes in prices for eight most volatile series, including food and energy, was also more muted, at 1.6% relative to an expected 1.7% rate of price change.

U.S. housing starts rose a stronger-than-expected 11.3% in December to 1,226 thousand annualized, and even November's tally was revised up a tad (to 1,102 thousand from 1,090 thousand). Some of this strength represents payback for November's still hefty 16.5% fall, even after the revisions. Building permits were a bit softer than expected in December (-0.2% to 1,210 thousand), but have still been averaging above starts, pointing to a pick-up in the latter. In our view it's looking good for housing in 2017.

U.S. industrial production rose 0.8%. It is the largest increase since November 2014 and 2/10ths above consensus. However, milder weather pushed utilities 6.6% higher, which accounted for the bulk of the gain. Excluding utilities (which make up just under 10% of the index), production edged up just 0.2%. The components were, in general, not particularly celebratory. Manufacturing edged up 0.2%, which is disappointing as aggregate hours in the sector grew 0.4%. And, the workweek as measured by the various regional surveys showed a nice improvement as well. Mining was flat, although the weekly hours index for the mining & logging industries jumped 0.6%. Indeed, investment in mining structures and equipment is up, but mining output has yet to make a noticeable comeback. But production in the energy patch jumped 3.9%, the most in over six years.

Britain will not seek a Brexit deal that leaves it "half in, half out" of the European Union, says Prime Minister Theresa May in a speech setting out her 12 priorities for upcoming divorce talks with the bloc. Those priorities include leaving the European Union's single market and regaining full control of Britain's borders, reinforcing investor fears of a 'Hard Brexit' which has pushed the pound to some of the lowest levels against the U.S. dollar seen in more than three decades. "We seek a new and equal partnership, between an independent, self-governing, global Britain and our friends and allies in the EU," May says "Not partial membership of the European Union, associate membership of the European Union, or anything that leaves us half-in, half-out. We do not seek to adopt a model already enjoyed by other countries. We do not seek to hold on to bits of membership as we leave." Source:Reuters

China released its Q4 2016 and 2016 GDP report on Friday morning (20 Jan 2017), with headline slightly higher at 6.8% year/year, compared to the 6.7% year/year pace seen in Q1 to Q3 2016. The outcome is slightly ahead of Bloomberg poll of 6.7%, and after registering 3 quarters of slowest pace of expansion in more than 7 years. On a sequential basis, growth rate slowed to 1.7%, after acceleration of 1.8% quarter/quarter in Q3 2016 and 1.9% in 2Q16. For full year 2016, China's economy expanded by 6.7%, its sixth year of decelerating growth rate, the "new normal" economic environment.

Financial Conditions

European Central Bank (ECB) left rates unchanged last week. The Euro Area is experiencing stronger growth, higher inflation, and will be making fewer bond purchases starting this spring. ECB President Draghi acknowledged all of that, but he emphasized downside global risks, and that as far as tapering is concerned, "we are not there yet."

The U.S. 2 year/10 year treasury spread is now 1.28% and the U.K.'s 2 year/10 year treasury spread is 1.22% - 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 4.09% (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 12.02 (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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