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. September 11, 2017

Owner Operated Companies

Fortive Corporation said it would buy Landauer, Inc. a provider of radiation safety and outsourced medical physics services, for about $770 million, including debt. Fortive's offer represented a 9.6% premium to the stock's closing price on Tuesday. Landauer would be a part of Fortive's field solutions platform, which includes Fluke Corporation and Qualitrol businesses, which make test and measurement tools and precision equipment for utilities, power companies and other industries. Everett, Washington-based Fortive, the industrial technology spin-off of Danaher Corporation, would fund the deal with available cash and credit.

The Kraft Heinz Company – ketchup maker said 3G Capital partner David Knopf would replace Paulo Basilio as its chief financial officer, starting in October. Kraft Heinz, backed by billionaire investor Warren Buffett and private equity firm 3G Capital, also said Basilio would become president of its U.S. business, while Chief Operating Officer George Zoghbi will transition to a strategic adviser role. Knopf, 29, currently the vice president and category head of Kraft Heinz's Planters nuts business, has worked with 3G Capital on mergers involving companies such as Burger King and H.J. Heinz Company. Previously, he held positions at Onex Corporation and The Goldman Sachs Group Inc. Mr. Knopf has been a partner of 3G Capital since 2015.

Alphabet Inc. – Alphabet unit Google appealed against a record €2.4 billion EU antitrust fine, its chances of success boosted by Intel's partial victory last week against an EU sanction. The move by the world's most popular Internet search engine came two months after the European Commission fined Google for abusing its dominance in Europe to give prominent placement in searches to its own comparison shopping service, while demoting those of rivals. The Luxembourg-based General Court, Europe's second-highest, is expected to take years before ruling on the case. The Commission, which ordered Google to stop the practice by Sept. 28, is now reviewing its proposal to comply with the EU decision. The EU competition enforcer will defend its decision in court, a spokesman said. The EU Court of Justice (ECJ) told a lower tribunal last Wednesday to re-examine U.S. chipmaker Intel's appeal against a €1.06 billion fine, dealing a rare setback to the Commission. While the Google case is not the same as that of Intel, the judgment has been welcomed by companies under EU scrutiny because it raises the bar for the regulator to prove wrongdoing.

Energy Sector

U.S. land rig count remained flat at 923 rigs week/week. The rig count was driven by gains in Vertical Oil (+4), Vertical Gas (+2), and Directional Gas (+1), offset by declines in Directional Oil (-6) and Horizontal Oil (-1), with Horizontal Gas remaining flat week/week. Total horizontal land rig count is down 42% since the peak in November 2014 (See Fig. 1). The Permian currently makes up 52% of all oil rigs.

U.S. horizontal oil land rigs decreased by 1 rig week/week to 643, marking 5 consecutive weeks of declines, with declines in Eagle Ford (-1), DJ-Niobrara (-1), Granite Wash (-1), and "Other" (-1) offset by gains in Permian (+1), Williston (+1), and Woodford (+1), with Mississippian remaining flat week/week.

Canadian rig count increased by 2 rigs week/week, and is up 51% from the level this time last year.

U.S. Gulf of Mexico offshore rig count remained flat at 16 week/week and is down 70% since June 2014.

BHI international rig count is down 7 rigs month/month in August and up 15 rigs year/year. International rigs averaged 952 in August, with land rigs down 4 and offshore rigs down 3 month/month, led by declines in Middle East (-12 land, +6 offshore), Latin America (+1 land, -6 offshore), and Africa (-3 land, -2 offshore) offset by gains in Europe (+3 land, +6 offshore), while Asia Pacific remained flat month /month (+7 land, -7 offshore).

Financial Sector

Barclays PLC - The long-running pullback from non-core businesses at Barclays continues, with the bank wrapping up the sale of its French retail, wealth and investment management operations to AnaCap Financial Partners. The sale includes a network of 74 branches as well as a life insurance business, wealth and investment management, and brokerage operations. Barclays CEO Jes Staley noted that the deal "marks the sale of Barclays' last retail banking operations in Continental Europe." (Source - Financial Times).

NN Group NV says it will neutralise the dilutive effect of its current stock dividend through repurchase of ordinary shares for a total amount of ~€78 million.

Nordea Bank AB last week announced that it will move its domicile to Finland from Sweden. Nordea, in its justification, cites the fact that Finland is a member of the EBA (European Banking Authority) as a key factor for its choice. Moreover, they state that becoming a member of the banking union will make Nordea subject to the same regulatory framework as European peers, with greater consistency of application and, accordingly, more of a level playing field. There have been several attempts to implement special bank taxes in Sweden over recent years, and most recently there was a proposal to change the resolution fee scheme in Sweden. All of these attempts have been withdrawn or amended by the government after broad-based criticism, but this has clearly demonstrated that there is no regulatory predictability for Sweden-based banks. Moreover, the Swedish government has not been overly concerned about the level playing field principle versus other banks domiciled outside Sweden, but active in the Swedish market. Nordea stated that it estimates that it will save about €1-1.1 billion in net present value in lower fees (resolution fees, deposit scheme fees and tax deductibility on hybrid loans), which corresponds to about €0.26 per share. The timing of the saving is uncertain.

Activist Influenced Companies

Nomad Foods Limited – Billionaire investor Bill Ackman has decided to exit his large stake in Nomad Foods, selling out of one of his handful of investments at a time he is waging a proxy fight to push for change at another portfolio company. Nomad, which make Birds Eye fish fingers and Iglo vegetables, and Ackman's Pershing Square Capital Management, the frozen foods company's largest shareholder, said in a joint statement they were starting a public offering for the hedge fund's stake of more than 33 million shares. The stake would be worth roughly $500 million. They noted that the offering is subject to market conditions, and there can be no assurance as to its size or of whether or when it will be completed. Ackman first invested in Nomad two years ago, through a so-called special purpose acquisition company. The investment in Nomad was a bright spot for Ackman's Pershing Square, which is posting losses for the third consecutive year. Nomad will purchase some of the shares Ackman is selling. The company said in a filing it plans to repurchase $100 million worth of shares. A spokesman for Pershing Square declined to give any reason for Ackman's decision to sell now. The move may have been hinted at several weeks ago when Brian Welch, a Pershing Square analyst, left the Nomad board to focus his attention on the hedge fund's new big investment in ADP, LLC. Ackman is seeking to win three board seats at ADP and is pushing that company to eliminate inefficiencies. Britain-based Nomad Foods was formed in 2014 as a vehicle to consolidate Europe's slow-growth €25 billion frozen food market. Its anchor deal, Iglo Group, closed in June 2015 and the follow-on acquisition of Findus Group Limited closed in November 2015. Its chief executive told Reuters this year that the company was in a good position to do more deals. After selling out of Nomad, the New York-based hedge fund will own nine long positions. It oversees $9.8 billion. Remaining top investors in Nomad Foods include activist investor Corvex Management LP, former owners of Iglo, as well as Nomad Foods founders Noam Gottesman and Martin Franklin.

Dividend Payers

Northland Power Inc. has made an addition to the executive leadership team. Effective Sept. 18, 2017, Troy Patton will be joining Northland as chief operations officer. Mr. Patton brings to Northland more than 20 years of experience in the power generation industry. Most recently, he served as the chief executive officer of Northern Power Systems, a U.S.-based technology-focused product company designing renewable energy solutions for the utility and distributed power markets. Prior to that, Mr. Patton was the senior vice-president of engineering and products, based in Denmark, at Vestas Wind Systems A/S. Previously, Mr. Patton held senior roles at General Electric in both the gas turbine and wind turbine businesses, after a time as a test engineer at Pratt & Whitney Canada Mr. Patton began his career in the U.S. Navy nuclear program working as a nuclear power plant operator on aircraft carrier and submarine vessels. "We are very pleased to add Troy to Northland's executive team," noted John Brace, chief executive officer of Northland. "Troy has a long and successful track record of maximizing the value of large-scale energy assets. His operational, commercial and technical breadth positions him well to lead our fleet of thermal, solar and wind power facilities. Troy's strong focus on people development, along with his demonstrated proficiency in engaging teams to continuously improve operational performance, deliver projects on time and on budget, and adapt to changing business and market conditions, align well with Northland's values and business objectives."

Economic Conditions

Hurricane Irma - Less than 2 weeks after Hurricane Harvey devastated many parts of Houston, Texas, the U.S. endures the wrath of another, Hurricane Irma, which made landfall in the Florida Keys on Sunday (Sept. 10). This is the first time U.S. has been hit by back-to-back hurricanes since 1964, although by today as it dissipates it would seem Florida has not experienced the worst conceived outcome. On Saturday, AIR Worldwide, a catastrophe modeling firm, estimated insured U.S./Caribbean losses of $20-65 billion and RMS, another modelling firm, estimated a 90% chance of insured losses below $70 billion. We now doubt Irma will be an industry-wide capital event. While public safety is the most pressing issue at the moment, from an economic perspective, Florida accounts for 5.0% of the U.S. economy. With essentially the entire state getting hit, this could have a huge negative impact on U.S. GDP growth in Q3, depending on how broad the damage is and long it takes to restore. And this is on top of the hit from Hurricane Harvey. Together, these hurricanes have the potential to counter much of the growth registered elsewhere in the economy. Of course, reconstruction should provide a boost to Q4 and beyond.

U.S. Nonfarm payrolls rose a less-than-expected 156,000 in August following net downward revisions of 41,000 the prior two months

(189,000 July, 210,000 June). This puts the level moderately below the past year average (175,000), and more consistent with a job market that is running short of qualified workers. While manufacturing and construction posted strong gains, the service-producing sector was lacklustre. The **jobless rate** moved off 16-year lows to 4.4%, while the more comprehensive U6 measure stayed at 8.6%. Despite a tight jobs market, average hourly earnings rose a minimal 0.1%, holding the yearly rate at 2.5%. There is still little indication of any pickup in wages, as the three-month annualized rate is also 2.5%. Despite the mildly disappointing August report and lack of wage pressure, we believe the Federal Reserve is still likely to announce reinvestment tapering on September 20 and raise rates in December. It would likely take clearer signs of labour market softening, or political turbulence, to derail a year-end rate hike given recent signs of momentum in the economy and a view that labour shortages will eventually trigger some upturn in inflation.

France - On August 31, the French government announced pro-business measures to liberalise French labour market. The goal is to reduce unemployment (9.5%) and help create new jobs by introducing flexibility and making it easier to hire and fire staff. The measures are due to be adopted by Parliament in September, and include: capping the damages associated with dismissals (3 months for 2 years employment, increasing thereafter) when proven unfair, and limits the time to 2 years in order to call for damages. However, normal severance pay will be increased by 25% for each year of employment (vs 20% currently). Flexibility for Small & Medium Enterprises (<50 employers) to negotiate deals with employees (working hour, pay, overtime). Flexibility for large corporates to negotiate agreements with unions at a company level instead of at a sector level. The measures have been negotiated with employers and the unions. Only one union out of the three large ones has called for day of strike; contrary to what was expected, it does not seem that there will be an autumn of strikes. Nine out of ten French people agree that a labour reform is necessary. The French President has the backing of the Parliament to fast track those reforms.

U.K. Consumer spending growth was 2.9% year/year in August, according to the latest Barclaycard data, in-line with the three-month average of 3.0%, but below the 12-month average of 4.1%. The data covers the period from July 23 to August 19 2017.

Financial Conditions

The Bank of Canada raised interest rates last Wednesday, once again surprising many, and said future moves will be guided by economic data, financial market developments and the sensitivity of indebted households to higher rates. The 25-basis-point increase to 1% followed a hike in July and puts Canada ahead of the curve in returning borrowing costs to more normal levels after they were slashed due to the 2007-2009 financial crisis. While the U.S. Federal Reserve has begun tightening, its pace has been slower. The Bank of Canada said the hike was warranted given unexpectedly strong GDP growth in the second quarter and the bank's view that growth is becoming more broadly based and self-sustaining, with robust consumer spending and solid job and income growth. Future rate moves "are not predetermined" and will be guided by economic data and financial market developments "as they inform the outlook for inflation," the bank said in a statement. "Particular focus will be given to the evolution of the economy's potential, and to labor market conditions. Furthermore, given elevated household indebtedness, close attention will be paid to the sensitivity of the economy to higher interest rates," it said. The central bank said that while inflation remains below the 2% target, there has been "a slight increase" in both total CPI and the bank's core measures of inflation, "consistent with the dissipating negative impact of temporary price shocks and the absorption of economic slack." And so we have had two rate hikes in three months and no sign of inflationary pressures in sight. The Bank of Canada's surprise decision to tighten policy again last Wednesday night may provide a whiff of a different approach to monetary policy setting, in our view: one that blazes the trail for central banks in other advanced economies to tighten policy even in the absence of the traditional triggers such as climbing wages and consumer prices.

The European Central Bank (ECB) left rates unchanged last week: the refi rate at 0.00%, the marginal lending facility at 0.25%, and the deposit facility at -0.40%. The Quantitative Easing (QE) program, at the current pace of €60 billion/month, will run until the end of December 2017, "or beyond, if necessary", or until there's a "sustained adjustment in the path of inflation consistent with its inflation aim". President Draghi sought to assure financial markets that "This autumn, we will decide on calibration of policy beyond this year, taking into account inflation path and financial conditions" and that "the bulk of these decisions will be taken in October". He left a bit of wiggle room by stating that if they need to postpone it, they will but "judging by the work so far, we should be ready." The ECB staff revised down its projections for headline and core inflation over the next couple of years because of the stronger euro. Inflation itself, which is the ECB's sole mandate, has yet to show convincing signs of a sustained upward trend. In fact, there was "broad dissatisfaction" with inflation but it was only tempered by the Governing Council's confidence that stronger growth will cause inflation to converge to target. The ECB is therefore proceeding very slowly towards the inevitability of tapering the QE in our view.

The U.S. 2 year/10 year treasury spread is now .81% and the U.K.'s 2 year/10 year treasury spread is .82% - 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.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.78 (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 4.4

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 10.89 (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 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:

- 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

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 http://www.portlandic.com/prices/default.aspx

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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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