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. January 21, 2019

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Owner Operated Companies

Blackrock Capital Investment Corporation reported a smaller-than-expected quarterly profit due to financial market turmoil, but the company continued to report strong sales of relatively low-fee funds. Sinking performance in late 2018 led investors to pull cash from the company's typically higher fee funds aimed at beating the market but people put record cash in the company's generally lower-cost exchange traded funds (ETFs). Overall, the company sold $43.6 billion in stock, bond and other "long-term" investment funds, more than the $10.6 billion sold the quarter prior. Still, weaker investment performance and the company's own price cuts hurt. The company collects fees as a percentage of assets under management, which are now just under $6 trillion. The S&P 500 fell more than 10% in the three months ended December 31, 2018. Performance fee proceeds and revenue for lending out shares to people betting against stocks fell from the year prior. Larry Fink, the company's CEO, said the company continued to see opportunities to grow, including helping Chinese individuals save and selling technology services to other financial companies. The iShares group took in $81 billion in the quarter, compared with $34 billion in the quarter prior. Net income fell to $927 million, or $5.78 per share, in the quarter, from $2.30 billion, or $14.01 per share, a year earlier, when U.S. corporate tax cuts helped. Analysts, on average, expected $6.27 per share, according to data from Refinitiv. Excluding restructuring charges and other items, the company earned $6.08 per share. BlackRock sliced expenses, but not as fast as its revenues fell. The company said last week it was cutting about 500 jobs, or 3% of its workforce, and booked a $60 million restructuring charge in the quarter. Total staff is still expected to be higher than a year ago following the cuts. Fink told Reuters he did not expect additional "restructuring" or to make a significant asset management deal to boost growth, though he did suggest BlackRock could buy a technology company.

Liberty Latin America Ltd. has approached peer Millicom International Cellular SA with an acquisition offer. The deal would create one of the largest telecommunications carriers in Latin America, giving the combined company more heft to compete with some of the region's biggest players, such as América Móvil, Telefonica SA and AT&T Inc. Millicom said it had received a "preliminary highly conditional non-binding proposal" for all of its shares from Liberty Latin America, which is backed by U.S. media and telecommunications mogul John Malone. The potential deal reflects the importance of scale in the Latin American telecommunications market. Millicom offers mobile services to about 51 million customers under the brand Tigo, in nine Latin American countries and the African countries of Chad and Tanzania. Swedish investment company Kinnevik AB had 37.2% voting control over Millicom as of the end of December. Liberty Latin America, which operates in more than 20 countries across Latin America and the Caribbean, was spun off from Malone's Liberty Global PLC last year. Its consumer brands include VTR, Flow, Liberty, Más Móvil, BTC and Cabletica. Malone is the largest shareholder of Charter Communications Inc., the second largest U.S. cable company. He controls about a quarter of the voting power in Liberty Latin America.

Liberty Latin America (LLA) announced that it agreed with its third-party insurance provider in late December 2018 to settle claims for a gross total of $138.5 million under its integrated group property and business interruption insurance program for the damages caused by Hurricanes Maria and Irma. After the deduction of $30 million of self-insurance, the net third-party insurance proceeds for LLA are $108.5 million. LLA received net advance payments from its third-party insurance provider totalling $50 million, of which $45 million was provided to Liberty Puerto Rico and $5 million was provided to Cable & Wireless (C&W). LLA expects to receive the remaining $58.5 million in Q1 2019, which will mainly be split between C&W and Liberty Puerto Rico.

Walgreens Boots Alliance, Inc. – Drugstore chain Walgreens and Microsoft Corporation said they have entered a seven-year agreement to research and develop new methods of delivering healthcare services through digital devices. As a part of the deal, the companies will focus on virtually connecting people with Walgreens stores and provide services on therapeutic areas ranging from preventative self-care to chronic disease management. Early last year, Amazon.com, Inc., Berkshire Hathaway Inc. and JPMorgan Chase & Co. had said they will form a company that could eventually negotiate directly with drug makers and healthcare providers and use their vast databases to get a better handle on costs. Walgreens and Microsoft will also develop healthcare solutions to reduce emergency room visits and decrease hospital readmissions while lowering the cost of care, the companies said. The drugstore chain said it will pilot up to 12 stores, which will sell select healthcare-related devices, in 2019. Microsoft will become Walgreens' cloud provider through the agreement and the Microsoft 365 software will be rolled out to more than 380,000 Walgreens employees and stores globally.

Energy Sector

Crescent Point Energy Corp. cut its 2019 capital budget by 30% compared to last year, blaming the recent decline in oil prices. Brent crude has fallen by more than 30% since reaching a four-year high of $86.74 per barrel in October last year. The company sees 2019 capital expenditure in the range of $1.2 billion to $1.3

billion. Its budget forecast for 2018 was $1.78 billion. But it would be $35 million below the original forecast, as the company revealed in its announcement. The company expects 2019 production to taper as it sold some of its assets in 2018. Crescent Point expects its output to be in the range of 170,000 to 174,000 boed in 2019, under last year's forecast of 177,000 boed. Given Crescent Point's current share price compared to the fundamental underlying value of its common shares, the Board of Directors has authorized a share repurchase program. Based on current market conditions and the company's commitment to living within cash flow, Crescent Point will pursue approval from the Toronto Stock Exchange (TSX) for a normal course issuer bid (NCIB) to acquire up to 7% of its public float. The commencement of the NCIB will be announced following receipt of approval from the TSX. The Board has also approved a move to a quarterly cash dividend of $0.01 per share, with the first quarterly dividend payable on April 1, 2019 to shareholders of record on March 15, 2019. The Company's cash dividend of $0.03 per share for the month of December 2018 is payable January 15, 2019, as previously announced.

Financial Sector

Bank of America Corporation reported Q4 2018 EPS of $0.70 and consensus was $0.63. Results included $0.2 billion ($0.02) of net tax benefits, on lower tax expense on international earnings due to updated tax guidance, partially offset by charges related to a variety of other tax matters. Net Debt Value Add gains of $52 million and a $19 million of loan loss reserve release added a penny. Combined, these added $0.03. Relative to Q3 2018, results evidenced higher net interest income (NII) (+4%) helped by 6bps of net interest margin expansion and balance sheet growth (Earning assets +0.7%); lower core fee income (-3%) with seasonally lower trading and service charges, while investment banking and asset management fees increased; marginally higher core expenses (+0.5%) on flattish comparisons, though non-compensation costs were up 1%; a higher loan loss provision (+8bps) though lower Non-Conforming Obligations (-1bps to 0.39%) and a smaller reserve release ($19 million in Q4 2018 vs.$216 million in Q3 2018); a lower tax rate (-400bps; tax benefits); and a reduced average share count (-1.9%).

The Goldman Sachs Group Inc. reported Q4 2018 EPS of $6.04 and consensus was $4.45. Results included a $467 million income tax benefit ($1.21). This was mostly offset by net provisions for litigation and regulatory proceedings of $516 million ($1.00). Revenues declined 1% year/year and fell 8% linked quarter to $8.1 billion. Relative to Q4 2017, revenues in Institutional Client Services increased 2% (Fixed Income, Currency & Commodities down 18% but equities up 17%), Investing & Lending declined 2% (NII +60%, debt fees -53%, equities -18%), and Investment Management grew 2% (incentive fees and transactional revenues higher while management fees were unchanged). Most clear to us is the resilience of this franchise with revenue above forecast in the face of challenging markets and profitability supported by expense and capital management. Results net to a respectable approximately 13% ROTE. With respect to the outlook, as per CEO David Solomon… "Recently there has been quite a disconnect between the weak market sentiment and optimism we continue to see in corporate board rooms… A concern that central banks will continue to tighten into a slowing growth environment caused weakness in equity and credit markets and resulted in an increase in volatility of many macro assets. While this has created challenges for many of our institutional investing clients, it is also driving potential future opportunities for active managers to add value. In addition, for now the absolute level of activity in the real economy remains fairly robust and this is reflected in broad CEO sentiment and our Investment Banking transaction backlog." With respect to 1Malaysia Development Berhad… the firm continues to cooperate with the Department of Justice and other regulators, focused on a "timely, but deliberative process." There's only so much they can say as this is an open investigation; what was said was meant to remind all that control functions have been and remain among the firm's highest priorities. The fourth quarter's $0.5 billion litigation accrual was pretty much in line with forecast; management spoke to the high end of the range of reasonably possible losses in excess of legal reserves moving up toward approx. $2 billion (from $1.8 billion in the September 30 Form 10-Q), based on what the firm knows today. Goldman Sachs is our most levered play on the capital markets. Share price outperformance relies on earning power near term and ROTE prospects longer term.

HSBC Holdings PLC has settled $250 billion (£194.15 billion) worth of forex trades using blockchain in the last year, it said last week, suggesting the heavily hyped technology is gaining traction in a sector until now hesitant to embrace it. The bank has settled over three million forex trades and made over 150,000 payments since February using blockchain, it said in a statement. HSBC would not give data on forex trades settled by traditional processes, saying only that those settled by blockchain represented a "small" proportion. Still, the data marks a significant milestone in the use of blockchain by mainstream finance, which has, until now, been reluctant to start using the technology at any scale. Blockchain is a shared database that can process and settle transactions in minutes. Originally conceived to underpin the cryptocurrency bitcoin, the technology does not require third-parties for checks and its entries cannot be changed, making it highly secure (Source: Reuters).

JP Morgan reported Q4 2018 EPS of $1.98 compared to consensus $2.20. Relative to expectations, a higher than expected loan loss provision (added to card and wholesale reserves) and managed tax rate, as well as lower than anticipated fee income (driven by Fixed Income, Currency and Commodities) drove the shortfall. The results contained several moving pieces, potentially associated with year-end. Corporate included a $200 million contribution to the JPMorgan Chase Foundation, $150 million of markdowns on certain legacy private equity investments (both on a pre-tax basis), as well as $300 million of tax-related items. It also posted $24 million in securities losses, a $13 million MSR (Mortgage Servicing Rights) hedge loss and a legal benefit of $18 million. These items cost it $0.19. Excluding these items, EPS would be close to $2.17. Managed revenues increased 4% and declined 4% linked quarter to $26.8 billion. Tangible book increased 1.2% to $56.33 (1.8x). It posted a 12% ROE and 14% ROTCE. Its CET 1 ratio was 12.0%. Results included $5.7 billion of net share repurchases, up from $4.2 billion last quarter. Average diluted shares declined by 1.4%.

Morgan Stanley (MS) reported Q4 2018 EPS of $0.80. MS recorded an intermittent net discrete tax benefit of $111 million ($0.07), primarily associated with new information pertaining to the resolution of multi-jurisdiction tax examinations. Excluding this impact, EPS was $0.73. Consensus was $0.89. Trading was below expectations and peers, while corporate lending losses, impairments and investment losses weighed, as detailed below, also weighed. Revenues increased 10% year/year and declined 13% linked quarter to $8.55 billion as results were negatively impacted by the volatile global market environment. Tangible book increased 4.2% sequentially to $36.99 (trading at 1.2x). In Q4 2018, excluding its intermittent net discrete tax benefit, MS posted a 7.1% ROE and 8.1% ROTCE. For the full-year it posted an 11.5% ROE and 13.2% ROTCE (also excluding its intermittent net discrete tax benefit). Its CET 1 ratios were 16.8% (+10bps, standardized) and 17.0% (-30bps, advanced). During the quarter, it repurchased $1.2 billion of its common stock (27 million shares). In Q3 2018, repurchased $1.2 billion (24 million shares). Average diluted shares declined by 1.2%.

The Royal Bank of Scotland Group PLC is seeking to buy up to £1.4 billion of own shares, up to 4.99% from the Treasury, and reducing Government holding from 62.3% to 60.3%. Shareholder approval will be sought at a General meeting February 6.

State Street Corporation reported Q4 2018 EPS of $1.04. Results included a $223 million ($0.43) repositioning charge ($198 million in compensation & benefits and $25 million in occupancy), $24 million ($0.04) of acquisition and restructuring charges, $24 million ($0.05) of expenses related to a business exit (Channel Island), and $50 million ($0.12) of legal and related expenses ($42 million in expenses, $8 million in revenues). Excluding these items, EPS was $1.68. Consensus was $1.67. NII was higher than expected, while fee income lower. Operating revenues increased 4% year/year and rose 1% linked quarter. Its Q4 2018, its CET 1 ratio was 11.5% post-closing and no shares were repurchased in Q4 2018. Average diluted shares increased 1.1%. It intends to resume common stock repurchases in January and can repurchase up to $600 million through June 30.

Wells Fargo & Company reported Q4 2018 EPS of $1.21, consensus was $1.19. Results benefited from a $614 million gain ($0.10) on the sale of $1.6 billion of Pick-a-Pay PCI mortgage loans; $158 million of net discrete income tax benefits and $137 million benefit related to revisions to its full year 2018 tax rate made in the quarter ($0.06); a $117 million gain from the previously announced sale of 52 branches; and a $200 million loan loss reserve release, up from a $100 million release in Q3 2018. These gains were partially offset by a $175 million accrual for an agreement reached with all State Attorney Generals for previously disclosed retail sales practices, auto and mortgage rate lock matters included in operating losses which totaled $432 million (or $0.05 above $150 million target); $278 million net Mortgage Servicing Rights losses; and $57 million of hedge ineffectiveness. The net of these items added $0.12 to EPS. On a core basis, a lower than expected loan loss provision and a decline in expenses helped to mitigate weaker than expected fee income. Operating revenues declined 5% year/year and decreased 3% linked quarter to $21.2 billion. Tangible book expanded 1.2%. It posted a 12.89% ROE and 15.39% ROTCE. Its CET 1 ratio was 11.7%. Net unrealized losses on available for sale debt securities were $2.6 billion, compared with $3.8 billion of losses in Q3 2018, predominantly due to lower interest rates, partially offset by higher credit spreads. In Q4 2018, it repurchased 142.7 million shares of its common stock, which net of issuances, reducing period-end shares by 130.3 million. Average diluted shares declined by 2.5%.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Dufry AG - Hudson Group (Dufry North America: 22% of group sales). In Q3 2018, Hudson had an organic sales growth of +6.5% and in Q4 it showed a slowdown to +4.6%. This mainly influenced by the lower growth in like-for-like (Q3 +3.3%, Q4 +1.7%; in constant foreign exchange: Q3 +4.2%, Q4 +2.5%). For the full year organic growth was at +7.1% (like-for-like +3.7%) and total sales were at USD $1.88 billion (+6.9%) with 1,016 stores in North America. Since January 8, 2019, Roger Fordyce has become the CEO of Hudson; he was previously COO (since 2008) of the group and has already 30 years with the company. The former CEO, Joseph DiDomizio, who was the CEO since 2016 is leaving Hudson; this step comes as a surprise as he was the main driver of the successful story of Hudson Group and also responsible for the IPO in February 2018. Dufry owns 57% of the quoted Hudson Group and North America makes up 22% of group sales. Already after the Q3 results, the company expected a slowdown in growth in Q4, but for the group we expect a slight improvement in Q4 (flat) after the weak Q3 (-0.7%); first indication from number of passengers are positive in Q4 (London +3.4%, Madrid/Barcelona +8.7%, Athens +9.4%); especially from Q2 2019 we expect for Dufry a trend change into positive growth again. In analysts' view, Dufry has been through an important transformation process including transformational acquisitions in

2014 and 2015. Analysts welcome the company's decision to simplify its organization in order to increase market agility and customer focus, generate additional efficiencies at headquarter level, and further drive organic growth. 1) The current divisions Southern Europe & Africa as well as U.K. & Central Europe will be combined into a new division "Europe & Africa". 2) Integration of global and divisional commercial and corporate teams to increase customer focus (lower reaction time for decisions regarding e.g. assortment, pricing and promotion) and reduce central headquarter costs. 3) Introduction of new incentives and reward programs for sales staff and further implementation of digital tools in shops to drive organic growth. 4) Mergers & acquisitions of small-mid cap companies, while maintaining the dividend policy. Mr. Schneiter, current CFO, will step down from his position on March 31, 2019 for personal reasons. Yves Gerster will join as new CFO from April 1, 2019. Mr. Gerster joined Dufry in 2006 and has been acting as Global Treasury and SSC Director, reporting directly to the CFO.

GEA Group AG announced last week that it has launched a new box-style milking robot, called 'DairyRobot R9500', aimed at enhancing the milking process and increasing on-farm efficiency. It includes a sensor that analyzes milk flow from each individual quarter throughout the entire milking process and also helps in early detection of mastitis, which minimizes treatment time and protects the health of the herd.

South32 Limited (S32) delivered a solid set of Q2 production numbers: guidance was maintained at all assets except Illawarra, which was raised 7% for fiscal year 2019 on the back of strong longwall performance (production +2% quarter/quarter), which is likely to lead to lower unit cost guidance for fiscal year 2019. South Africa Coal was the main area of weakness (output -2% quarter/quarter) due to the Klipspruit dragline being out of operations since August but will return at the end of January. Net cash balance at December 2018 was not disclosed, but S32 received a $262 million distribution from Samancor in the first half of 2018. The buyback accelerated, with $134 million of stock repurchased in Q2 vs. $33 million in Q1. Tax rate guidance is 35-40% for the first half of 2019, but is expected to decline in the second half of 2019. Overall a decent half in analysts' view with further confirmation of operational stability at Illawarra and Cannington (third consecutive quarter of guidance maintained). FCF is likely to be strong we believe driven by increased dividends from the Samancor JV plus lagged benefits of strong alumina and manganese prices.

Economic Conditions

Canadian Home Prices - The Globe & Mail reported yesterday that Canadian home prices fell in December for the third consecutive month, led by weakness in Edmonton and Vancouver. The Teranet-National Bank Composite House Price Index, which measures changes for repeat sales of single-family homes, showed prices fell 0.3% last month from November. Prices fell in seven of the 11 markets surveyed, Teranet said. Edmonton prices fell 1.4%, while prices in Vancouver were down 1.2%. It was the fifth straight month without an index rise for the most populous metropolitan area in British Columbia. "The recent trend of home prices is clearly downward in most metropolitan markets," Teranet said in the report. Prices rose 2.5% in December on an annual basis, the smallest 12-month advance since 2009, Teranet said.

China's economy slowed in the last three months of 2018. Real GDP rose 1.5% in Q4, or 6.4% above the same period a year ago, the slowest pace since 2009 Q1 (i.e. almost a decade ago). And, for all of 2018, the economy grew 6.6%, the slowest increase in 28 years. China's statistical bureau offered some reassuring comments, acknowledging that the trade war has affected its economy but it was "manageable". Although the country faces "a more complicated and difficult external environment" this year, they have a lot of room for policy adjustments. The economy was also described as "slowing" but the trend was "stabilizing".

The British Parliament has delivered a devastating defeat to Prime Minister Theresa May's Brexit plan, rejecting it by a margin of 230 votes, forcing her to concede that more negotiation with opposition parties will be required and dealing a further blow to her already shaky authority. Dozens of Conservative Party rebels sided with opposition lawmakers to defeat her motion on the withdrawal agreement she has struck with the European Union, with 432 votes against and just 202 in favour – one of the biggest defeats in British parliamentary history. Opposition Leader Jeremy Corbyn immediate moved for a vote of no-confidence in Mrs. May's government.

The U.K. inflation rate fell to 2.1% in December, from 2.3% the previous month, according to the Office for National Statistics (ONS). The Consumer Prices Index (CPI) figure was the lowest in nearly two years, pushed down by gas/petrol price falls. The inflation reading was in line with analysts' expectations. The figure is close to the Bank of England's target of 2% and may mean the Bank is less likely now to consider any rate rises in the near future in our view. Inflation is being outstripped by average U.K. pay growth, with the most recent available figures showing that wages excluding bonuses were up by 3.3% for the three months to October 2018. (Source: BBC)

Financial Conditions

Canada mortgages - Royal Bank of Canada (RBC) has become the first of the major banks to lower its posted interest rate for five-year fixed-term mortgages, a move that has been widely anticipated amid tumbling bond yields. The bank lowered its featured five-year mortgage rate on Wednesday to 3.74% from 3.89%. The other banks are expected to follow. RBC is the first big bank to lower its publicly posted rate since August last year. While fixed mortgage rates are getting cheaper, variable-rate mortgages have been getting more expensive, narrowing the gap between them. (Source: Globe & Mail)

The U.S. 2 year/10 year treasury spread is now 0.17% and the U.K.'s 2 year/10 year treasury spread is 0.53% - 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. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.45% (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 3.9 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 17.80 (compares to a post-recession low of 9.52 achieved in early November) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 bodes 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:

- Bay & Scollard Development Trust
- ITM AG Investment Trust
- Portland Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value 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 www.portlandic.com/prices

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.

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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