News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. September 9, 2019

The views of the Portfolio Management Team contained in this report are as of September 9, 2019 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.

Owner Operated Companies

Fortive Corp. announced its intention to separate into two independent, publicly traded companies. The transaction, if completed, will create: an industrial technology company with a differentiated portfolio of growth-oriented businesses that generates significant recurring revenue, highly attractive margins, and strong free cash flow (this company will retain the Fortive name); and a global industrial company (NewCo) focused on the growth opportunities in the rapidly evolving transportation and mobility markets, with a portfolio of leading brands across retail and commercial fueling, fleet management, and automotive service and repair solutions. The transaction is expected to be structured in a tax-efficient manner and be completed in the second half of 2020. James A. Lico, President and Chief Executive Officer of Fortive, stated: "Today is a very exciting day for Fortive, as we mark the latest step in our portfolio transformation with a transaction that will create two separate, independent companies. As separate companies, each business will benefit from increased strategic focus and enhanced flexibility to invest in distinct organic and inorganic growth opportunities. We are confident this will create additional opportunities and enhanced value for our employees, customers and other stakeholders. While the two companies created by this transaction will pursue independent futures, they will carry forward a culture centered around the principles of the Fortive Business System, and the commitment to continuous improvement that remains the cornerstone of our long-term success." Following the completion of the transaction, James A. Lico and Charles E. McLaughlin will continue to serve as President and Chief Executive Officer and Senior Vice President and Chief Financial Officer of Fortive, respectively. Fortive will be comprised of the businesses from the existing company's Professional Instrumentation Segment, including the Field Solutions, Product Realization, and Sensing Technologies platforms, as well as the Advanced Sterilization Products business. NewCo will be a global industrial company focused on transportation and mobility, with a portfolio of leading retail and commercial fueling, fleet management, and professional tools brands across its transportation technologies and franchise distribution product lines.

Energy Sector

Baytex Energy Corp. provided a business update, which included strong operating performance across its asset base during the third quarter. Despite the volatility in crude oil prices, the company continued to drive capital efficiencies, deliver stable production and meaningful free cash flow. Baytex is now forecasting average production for 2019 of approximately 97,000 boed (83% oil and NGL), which compares to the original guidance range for 2019 of 93,000 to 97,000 boed, which was recently tightened to 96,000 to 97,000 boed. Baytex expects to exit 2019 producing 95,000-97,000 boed, which represents debt-adjusted production per share growth of 7-9% as compared to its 2018 exit production rate. The company now anticipates exploration and development expenditures for 2019 of approximately $560 million. This compares to the original guidance range of $550 to $650 million, which was recently tightened to $550 to $600 million. Based on the forward strip for the balance of 2019, Baytex expects to generate approximately $300 million of free cash flow, which supports its de-leveraging strategy. The company also announced the appointment of Jennifer Maki as a director of Baytex. "We are very pleased that Jennifer has joined our team. Her business knowledge, strategic perspective and financial expertise will serve the board and Baytex well in the years ahead," commented Neil Roszell, Chairman of Baytex. Ms. Maki served as Chief Executive Officer of Vale Canada and Executive Director of Vale SA, Base Metals (2014 to 2017) and previously held several other positions with Vale Base Metals, including Chief Financial Officer & Executive Vice-President (2007-2014) and Vice-President & Treasurer, and with Inco Limited as Assistant Controller. Before joining Vale/Inco, she worked at PricewaterhouseCoopers LLP for 10 years in roles of increasing responsibility. She has also been a director of Next Generation Manufacturing Canada (a not-for-profit organization) since September 2018 and is currently a Director of the Franco-Nevada Corporation. Ms. Maki has a Bachelor of Commerce degree from Queen's University and a postgraduate diploma from the Institute of Chartered Accountants, both in Ontario, Canada. She also holds the ICD.D designation from the Institute of Corporate Directors.

Financial Sector

HSBC Holdings plc completed the first yuan-denominated blockchain-based letter of credit transaction, last week. HSBC, like many of its competitors, has been looking to use digital ledger technology, or blockchain, to streamline the traditionally paper-based and bureaucratic business of financing trade. As the first such transaction to use the Chinese currency, this deal marks a step forward in the use of the Voltron trade finance platform, developed by eight banks including BNP Paribas, and Standard Chartered as well as HSBC. So far transactions using the platform have primarily been individual pilot cases, but Ajay Sharma, HSBC's regional head of global trade and receivables finance for Asia-Pacific, said that progress was being made toward a full proposition, and what could be a commercially acceptable model for banks. (Source: Reuters)

Nordea Bank Abp has issued a press release today, announcing an immediate change of CEO (a promotion for Frank Vang-Jensen),

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whilst also mentioning a need to improve revenues and efficiency. In June, Nordea announced that previous CEO Casper von Koskull would retire by the end of 2020 (at the time, mentioning "speculation in the market", but the timing has been clearly accelerated, following the conclusion of the succession process. Mr. von Koskull though will stay into 2020, to help with the handover. Frank Vang-Jensen steps up today from running Personal Banking across the group (albeit he'll retain this role until his replacement is found), and also being the Country Senior Executive for Denmark. He joined Nordea in 2017, and had previously been at Handelsbanken, including a brief stint as CEO. We don't think that Mr Vang-Jensen's appointment is a huge surprise, given his seniority, and as he carries some external / broader perspectives and experience of the Scandi banking market.

The Royal Bank of Scotland has just announced that it will take another £600-£900 million PPI-related charge with Q3 2019 results, due to higher claims volumes in August running into the deadline on August 29th. RBS still had £0.4 billion of unutilized PPI provisions as of end-June...but this outcome does read more negatively, impacting too on statutory profits (and thus capital ratios - slightly undermining the excess capital story at the bank - at the mid-point, £750 million impact is worth around 40 bps of CET1 ratio).

Activist Influenced Companies

AT&T Inc. - Activist investor Elliott Management Corp. questioned AT&T Inc.'s $85 billion takeover of Time Warner and called for the wireless carrier to sell non-core businesses to boost its stock price, driving its shares their highest in a year. Billionaire Paul Singer's hedge fund, which disclosed a $3.2 billion stake in AT&T, called the company "deeply undervalued" and hinted it would press for board seats, while proposing changes that could double the company's current share price. "Despite nearly 600 days passing between signing and closing (and more than a year passing since), AT&T has yet to articulate a clear strategic rationale for why AT&T needs to own Time Warner," Elliott said in a letter to the company's board of directors. The company bought Time Warner last year in a deal that gave it control of HBO and CNN and took more than two years to close, as it was heavily scrutinized by antitrust authorities and even questioned by President Donald Trump. In response to Elliott's letter, AT&T said it would engage with Elliott and review the shareholder's views. Elliott said a strategic review will help AT&T to rapidly pay down debt through divestment and increase its financial profile.

Dividend Payers

Nothing significant to report.

Economic Conditions

Canada's employment surged 81,000 in August according to the Labour Force Survey, significantly above the 20,000 increase expected by consensus. Despite this huge gain, the jobless rate remained unchanged at 5.7% as the participation rate increased to 65.8%. The gain was driven by the private sector (+94,000) while government (-2,000) and self-employed (-11,000) posted pullbacks. Employment in the goods sector rose 8,000 as gains in manufacturing (+8,000K) and agriculture (+3,000) more than offset declines in resources (-1,000), utilities (-1,000) and construction (-2,000). Services-producing industries employment jumped by 73,000 as gains in several sectors including trade, finance, educational services and healthcare more than offset losses in business services and transportations. Full time employment increased 24,000 while part-timers were up 57,000. Hourly earnings dropped to 3.8% year/year (vs. 4.5% in July). Private jobs in Canada now stand at a record high thanks to a strong rebound in August more than offsetting the plunge registered in July. So far in 2019, employment in Canada is up 304,000, the best performance since 2002 for the 8 first months of the year. No less than 230,000 were full-time positions and 237,000 are coming from the private sector (best tally since 2002 for both). While trade disputes remain a concern for global growth going forward, the booming labor market is far from indicating any need for monetary stimulus at this point in our view.

U.S. Nonfarm payrolls rose 130,000 in August, well below expectations, and that included 25,000 temporary Census 2020 positions. The prior two months were knocked down by 20,000, sending the monthly average this year down to 158,000 from 223,000 in 2018. Private payrolls rose just 96,000 after a downwardly-revised 131,000 advance in July, and both are below this year's average of 145,000. The weakness was widespread, including softness in the more resilient services sector, led by a seventh straight shedding of retail positions (that likely reflects the online sales revolution rather than any pullback in consumer spending). However, the jobless rate held at 3.7% despite a two-tenths upturn in the participation rate and the labour market remains tight, contributing to a 0.4% jump in average hourly earnings. Although the yearly wage rate edged down to 3.2% from an upwardly-revised figure, the trend has firmed in the past year.

The U.K. Report on Jobs for August shows the U.K. jobs market remains lackluster, as it has been for most of 2019, with many firms delaying hiring decisions. Within permanent staff appointments, the rate of decline was the quickest since July 2016 and fell for the sixth consecutive period. Temporary billings growth was again minimal in August, with the rate of growth impacted by low demand for staff and subdued increases in vacancies. Overall vacancies increased at the slowest rate since January 2012. The lingering market uncertainty means candidate availability also fell in August and, although quicker than the historical trend, the rate of fall was one of the slowest for almost three years. Although still high overall, due to continued candidate shortage and greater competition for staff, average salaries increased at the slowest rate since December 2016. Similarly, to July, the good news in our view is that, although the survey indicates a subdued market, it is not showing a further sharp deterioration.

Financial Conditions

Bank of Canada left the overnight rate unchanged at 1.75% last week. The BoC acknowledged Q2 2019 Canadian GDP growth was better than expected, but thought that some of the strength was temporary, e.g. rebound in energy output and exports. The central bank bemoaned weakness in business investment and consumption and expects economic activity to slow in the second half of the year. The central bank said that while the economy is operating close to potential and measures of core inflation remain around the 2% target, the "current degree of monetary policy stimulus remains appropriate" amid uncertainties with regards to the escalating trade war. The latter is "weighing more heavily on global economic momentum" than it had projected last July. The no-change decision was largely expected. The tone of the statement, however, was dovish, with the BoC downplaying the Q2 upside surprise on GDP growth and emphasizing instead the escalating trade war and potential negative impacts on the Canadian economy. The BoC's updated projections will be available next month but in light of today's message, one can expect a downgrade to the central bank's growth forecasts particularly for 2020. Developments on the trade front (i.e. U.S.-China negotiations) will be crucial in determining what the central bank does next given the impact they will have on global and hence Canadian growth. If there are positive developments on the trade front, the BoC needs to not alter its current policy stance in our view. Otherwise, the central bank may be forced to follow the Fed in easing policy significantly.

Bank of Japan Governor Haruhiko Kuroda, who made his mark pursuing aggressive monetary stimulus policies, is under fresh pressure by financial markets to return to the fight. Government bond yields are falling through the floor of the central bank's target range, the yen is hovering at the limit of companies' comfort zones and inflation is weakening again. Among the options are lowering the negative short-term interest rate, increasing asset purchases or widening the trading range around its long-term yield target. Japan's central bank has been reluctant to take further action out of growing concern that its yield curve-control program is squeezing profits at commercial banks and distorting markets. Feeble inflation by itself hasn't been enough of a factor for the central bank to add extra ammunition, even though the BOJ sets price growth as the main target of its easing program. (Source-Bloomberg).

The U.S. 2 year/10 year treasury spread is now 0.042% and the U.K.'s 2 year/10 year treasury spread is 0.14% - 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 2 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 3.49% (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 6.4 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 14.97 (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.

September 9, 2019

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 Fund
- 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) per unit 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.

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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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on common equity, 'ROTCE' return on tangible common equity.

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