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. October 7, 2019

Owner Operated Companies

Nothing significant to report.

Energy Sector

Nothing significant to report.

Financial Sector

DNB ASA, Nordea Bank Abp - Both banks last week announced that they had closed the sale of stakes in their Baltic banking joint venture (Luminor Bank AS) to Blackstone; the transaction was first announced around a year ago, indicating completion has been a lengthy process.

DNB guided to around a 30bps uplift to its CET1 ratio from this, to be booked in Q3 2019 results - consistent with previous guidance on the quantum (albeit timing had been uncertain between Q3 and Q4 2019. Nordea guided to a 10bps CET1 ratio uplift at Q3 2019 having already recognized an increase of 10bps in Q2 2019. Note, there will be an additional increase of 20bps at some point in the future (probably by fiscal year 2020/2021 when the rest of Nordea's stake is expected to be sold), which is broadly consistent with what they'd said when the deal was first announced around 12 months ago. DNB (and Nordea too, for now) will each retain 20% of the shares of Luminor after this transaction.

HSBC Bank plc - The Financial Times wrote that HSBC's interim CEO Noel Quinn may be preparing a meaningful new (and incremental) headcount reduction plan, in an effort to cut costs. Mr. Quinn is reportedly working closely with CFO Ewen Stevenson to deliver on a new program (in addition to the 4,700 headcount reduction announced in August 2019), which could be announced with Q3 2019 results. It is said to target senior bankers across all of the main operating divisions of the bank, but, from the geographical perspective, fall mainly outside Asia (a region where HSBC will continue to hire revenue generators). The article indicates that Mr. Quinn is willing to take the tough decisions here that as predecessor John Flint was not. The potential sale of HSBC's French retail banking operations could also deliver a substantial drop in headcount for the group (analysts estimate there's around 3,500 employees in French retail at HSBC), although there is little update on how this is progressing. In terms of quantifying the impacts, it is roughly estimated that 10,000 high paid roles (around 4% of workforce) could cost around $1.5 billion-$2.0 billion in restructuring charges (-0.2% off CET1 capital ratio). Against that, assuming $1.5 billion per annum of savings, there could be a theoretical 7% increase to consensus profit before tax. However, it's not clear how much of this is in response to revenue weakness (analysts suspect a good element). It's also unclear how much of the potential headcount reduction would be included in business disposals – e.g. France.

TD Ameritrade matches Schwab by eliminating commissions: TD Ameritrade (AMTD) announced that it will introduce US$0 commissions for online stock, ETF, and option trades on both U.S. and Canadian exchanges (from the current US$6.95) effective October 3, 2019 (option trades will maintain a fee of US$0.65 per contract). The move comes in response to Charles Schwab's similar announcement earlier in the day. Based on AMTD's press release, management expects the impact of the changes to reduce revenue by US$220 million to US$240 million per quarter. That equates to roughly 16% of total net revenue and 33% of earnings in the most recent 12-month period.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Nestlé S.A. announced a Nestlé Skin Health (NSH) skin care strategic review on September 20, 2018. Last May, the deal with EQT Partners and the Abu Dhabi Investment Authority was announced at a price tag of CHF 10.2 billion (EV/Sales 3.6x, EV/EBITDA >20x) and now the deal is done, the NSH deal closes a relative painful chapter for Nestlé. Under the leadership of Mark Schneider, we believe Nestlé is being propelled to a higher level of growth and returns. The changes are tangible and reshaping Nestlé's profile in Nutrition, Health & Wellness with a stronger focus and as such we believe Nestlé is on track to complete its CHF 20 billion buyback by year-end (more than CHF 17 billion YTD). In the absence of larger M&A opportunities, we expect Nestlé to announce a new buyback in the coming months.

Economic Conditions

Canada's real GDP was flat in July disappointing consensus which had expected a 0.1% increase. Goods sector output fell 0.7% due to declines in all sectors except utilities, causing industrial production to drop 0.8%. But that was exactly offset by 0.3% increase in services-producing industries. The latter was boosted by most sectors including wholesale, real estate, and professional services which dwarfed declines in arts/recreation, info/culture, and transportation.

A moderation was always in the cards after Q2's massive and unsustainable growth print. While July's flat GDP was lower than expected, special factors contributed such as the shutdown of some offshore oil production in Newfoundland and Labrador because of maintenance issues. Also dragging down activity in July was arts/recreation and info/culture which softened after earlier outsized gains due to the run of the Raptors in the NBA playoffs. There were also cyclical forces at play in July, such as the manufacturing slump which mimicked the situation worldwide. But factory woes are being offset by a resilient services sector which expanded for a fifth consecutive month.

U.S. non-farm payrolls rose 136,000 in September, slightly lower than the 145,000 print expected by consensus. But there were upward revisions to prior months which added 45,000 to payrolls. In September, the private sector added 114,000 jobs, with gains in the goods sector (with an increase of 5,000 thanks to construction which offset declines in manufacturing). Services-producing industries in the private sector added 109,000 net new jobs thanks to gains in professional and business services (including temporary help), education/health, finance, transportation and leisure/hospitality which more than offset declines in retailing and utilities. Government added 22,000 jobs, but not at the federal level. Average hourly earnings were flat in the month, causing the year-on-year print to drop to 2.9%, the lowest since July last year. Hours worked rose 0.1%, on top of the prior month's 0.4% increase. Considering upward revisions to prior months, the September payrolls were better than expected. Those concerned about an imminent U.S. recession will be encouraged by those healthy job gains (which are enough to absorb new entrants in the labour market) but also by further increases in construction and temporary employment (a decent leading indicator). While there were declines in manufacturing, that can't be surprising amid well-documented factory woes. The household survey was also encouraging with another massive month (almost a million jobs created in just the last two months according to that survey) causing the jobless rate to fall to the lowest in 50 years. One blemish from the employment reports, however, was the decline in wage inflation, something Federal Open Markets Committee doves could emphasize to justify another interest rate cut before year end. But overall, September's employment reports were largely positive, and consistent with a still-expanding U.S. economy.

U.S. manufacturing ISM contracted for the second month in a row, landing below the key 50 mark again. The headline dropped to a decade-low 47.8 in September from the 3½-year low of 49.1 in August. Also note that the index has declined for six consecutive months, a streak not seen since 2015. Of the five equally-weighted components, new orders rose but just 0.1% and it is still sub-50 (or 47.8, lowest since April 2009). Production was down for the third straight month (-2.2% to 47.3, also lowest since April 2009). Payrolls were trimmed for the third consecutive month, down 1.1% to 46.3, lowest since January 2016. In our view the trade war is clearly the biggest issue facing manufacturers (and others), with the trade talks moving forward but tariffs still in place and rising. It was the start of September that the 15% tariff on $125 billion of China's imports kicked in. And, more are coming on October 15 (then again on December 15) unless, of course, there's some breakthrough during those high-level talks next week. And it is not just China, as the U.S. was cleared to impose tariffs on the EU, thanks to the WTO's ruling (Airbus/Boeing). On the plus side, a mini-trade agreement was worked out with Japan.

U.K. house price growth "almost ground to a halt" in September, with property prices 0.2% higher than a year ago, the Nationwide Building Society has said. The building society also said that prices fell by 0.2% compared with August, according to figures based on its own mortgage data. It said activity in the housing market had been slow, but stable, for two years. The average home was now valued at £215,352, it said. Brexit uncertainty had widely been associated with the relatively static U.K. housing market, but some commentators have said this has led to pent-up demand. "When the extension of Brexit was announced there was a spike in activity in the market, which again reiterates the fact that it is uncertainty holding buyers back rather than a lack of interest," said Iain McKenzie, chief executive of The Guild of Property Professionals.

Financial Conditions

Reserve Bank of Australia (RBA) cuts rates 25bps, in line with analyst sentiment, taking the benchmark rate to 0.75%. The Australian central bank cited that it needed to support income growth and employment. The hope is that another cut would provide greater confidence in order for inflation to be consistent with the medium-term target. The RBA also said that an extended period of low interest rates will be needed to reach full employment and the inflation target. The RBA says it is prepared to ease monetary policy further if necessary to achieve its targets.

The U.S. 2 year/10 year treasury spread is now 0.12% and the U.K.'s 2 year/10 year treasury spread is 0.10% - 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 3.65% (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

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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 currently at 18.00, and has averaged 17.28 over the last year. This compares to a post-recession low of 9.14 achieved in early November 2017. While we expect the VIX to remain volatile, given its characteristics, we believe a VIX level below 25 bodes well for quality equities.

And Finally - A random market indicator which has worked amazingly well is the Super Bowl Indicator that says that the stock market's performance in a given year can be predicted based on the outcome of the Super Bowl of that year. It was "discovered" by Leonard Koppett in the '70s when he realized that it had never been wrong, until that point. This pseudo-macroeconomic concept states that if a team from the American Football Conference (AFC) wins, then it will be a bear market (or down market), but if a team from the National Football Conference (NFC) or a team that was in the NFL before the NFL/AFL merger wins, it will be a bull market (up market). As of January 2017, the indicator has been correct 40 out of 50 times, as measured by the S&P 500 Index – a success rate of 80%.... likely due to the random odds of there being so many data points that the odds favor an indicator which works despite no correlation...

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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