News Highlights

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Email: info@portlandic.com

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Our views on economic and other events and their expected impact on investments. January 17, 2020

Owner Operated Companies

Nothing significant to report.

Energy Sector

Nothing significant to report.

Financial Sector

Bank of America Corporation reported Q4 2019 EPS of $0.74. Consensus was $0.69. Results were positively impacted by a $0.3 billion benefit from the resolution of certain tax matters as well as an $18 million loan loss reserve release. It also booked a net Debt Value Adjusted (DVA) loss of $86 million. Net, these added $0.03 to EPS. In addition, other income included $0.2 billion of higher partnership losses compared to Q3 2019, associated with an increase in tax-advantaged solar and wind investments in its leasing business. Relative to consensus, the modest beat was driven by higher than anticipated fee income (both Trading and Investment Banking above guidance) as well as a lower than forecasted loan loss provision. Operating revenues slipped 1% year/year and declined 2% linked quarter to $22.6 billion. Tangible book value increased 0.8% to $19.41 (trading at 1.8x). It posted an 11.00% ROE, and 15.43% ROTCE. Its CET-1 ratio was 11.2% (-25bps). It repurchased $7.7 billion of common shares, up from $7.6 billion in Q3 2019 (at 50% of $30.9 billion allowance). Average diluted shares declined by 2.9%. Net interest income slipped 0.6% as lower asset yields were partially offset by lower funding costs as well as benefits of loan and deposit growth. Average earning assets rose 2.3%. Its net interest margin contracted 6bps to 2.35%. Excluding Global Markets Net Interest Income, it decreased a greater 12bps to 2.77%. Its yield on average earning assets fell 27bps to 3.25% while its cost of interest-bearing liabilities decreased 27bps to 1.24%. Still, the impact of noninterest-bearing sources fell from 40bps to 34bps. Fee income fell 3% reflecting increases in brokerage (+$84 million) and card income (+46 million) more than offset by declines in trading (-$280 million), other (-$113 million), investment banking (-$59 million) and service charges (-$18 million). Excluding net DVA, total sales & trading revenue increased 13% year/year to $2.9 billion (guided to up 7-8%). FICC increased 25%, driven by an improvement in most products, particularly mortgages, while equities decreased 4% reflecting lower levels of client activity in derivatives. Investment banking fees increased 9% year/year (guided to up 5%) but declined 4% from Q3 2019. Expenses rose 1% year/year as investments across the franchise including in client-facing associates, employee compensation programs, technology, and real estate were partially offset by efficiency savings. Its cost efficiency ratio was 59%. Its effective tax rate of 14.4% (down from 15.8% last quarter) was positively impacted by a $0.3 billion benefit from the resolution of certain tax matters, as well as higher levels of credits related to tax-advantaged investments. Its reserve/loan ratio declined 1bp to 0.97%.

Citigroup Inc. reported Q4 2019 EPS of $2.15. Results included a net benefit of $0.25 related to discrete tax items, recorded in Corporate/Other. Excluding this impact, EPS was $1.90. Consensus was $1.83. Realized gains on investments were $515 million, up from $361 million last quarter. Results included a $253 million ($0.09) credit reserve build, up from a $158 million build last quarter. Net interest income/margin (though driven by markets) and Fixed Income Currencies & Commodities (FICC) trading (rates and spread products) were better than expected while higher than forecasted expenses restrained further improvement. Revenues increased 7% year/year but slipped 1% linked quarter to $18.4 billion. Tangible book value rose 2.0% to $70.39 (trading at 1.1x). In Q4 2019, it posted a 12.4% ROTCE. Its CET-1 ratio was 11.7% (+10bps due to a $21 billion or 2% reduction in Risk Weighted Assets). It repurchased 69 million shares, down from 76 million shares last quarter. Average diluted shares declined by 3.1%. Global Consumer Banking (GCB) revenues increased 5% year/year (+4% constant dollar) and rose 2% linked quarter to $8.5 billion. Institutional Clients Group (ICG) revenues rose 10% year/year but declined 5% linked quarter to $9.4 billion. Trading revenues increased 31% year/year (guided to 'high-teens' growth). FICC jumped 49% year/year (recovery from the prior-year period in addition to strong performance, particularly in rates and spread products), while equities fell 23% (cited a more challenging environment in derivatives). Investment banking fees rose 6% year/year (guided to stable to slightly lower) and rose 10% sequentially. Net interest income increased 3%. Average earning assets were little changed. Period-end loans increased 1% (constant dollar unchanged). GCB rose 5% with card (+6%) and retail banking (+3%) higher. ICG declined 1% with private bank (+4%) higher but corporate lending lower (-3%). Its net interest margin expanded 7bps to 2.63%. Its yield on average earning assets declined 14bps to 4.07%. Its cost efficiency ratio was 56.9%. Its effective tax rate was 12%. Its reserve/loan ratio was 1.84%, up 2bps.

The Goldman Sachs Group, Inc. reported Q4 2019 EPS of $4.69. Consensus was $5.49. Goldman Sachs Group reported a bigger-than-expected fall in quarterly profit as the Wall Street bank set aside more money to cover legal costs for the 1Malaysia Development Berhad corruption scandal, overshadowing a rebound in its trading business. The bank set aside US$1.09 billion ($1.6 billion) in Q4 2019 ahead of an expected settlement that could touch US$2 billion or more. Goldman's full-year earnings took a hit of US$3.16 per share from

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Web: www.portlandic.com
Email: info@portlandic.com

the provision. Net provisions for litigation and regulatory proceedings were $1.1 billion (has booked $2 billion over the past 7 quarters). It also recorded a $140 million charitable contribution to Goldman Sachs Gives (this is typical for Q4; was $132 million last Q4). Its tax rate was also lower than anticipated. Revenues were above expectations, driven by Fixed Income, Currencies, and Commodities (FICC), investment banking fees and equity investments. But, both compensation and non-compensation expenses were also higher than projected and its 2019 compensation ratio increased slightly from 2018. Revenues increased 23% year/year and rose 20% linked quarter to $10.0 billion. Tangible book value slipped 0.2% to $205.15 (trading at 1.2x). In Q4 2019, it posted an 8.7% ROE and 9.2% ROTCE. Excluding legal expenses, its ROE and ROTCE for the full-year 2019 were 11.5% and 12.2%, respectively. Its CET- 1 ratio was 13.3% (-30bps). Total assets declined by $14 billion, while global core liquid assets averaged $237 billion, down $1 billion. In Q4 2019, it repurchased $2.16 billion of its shares (10.2 million shares). This is up from $673 million shares (3.1 million shares) in Q3 2019. Average diluted shares declined by 1.9%. Investment Banking – Revenues declined 6% year/year but increased 12% linked quarter to $2.1 billion. Relative to the prior quarter, financial advisory (+23%) as well as both debt (+14%) and equity underwriting (+3%) increased, while corporate lending (-9%) declined. Global Markets – Revenues rose 33% year/year and declined 2% from Q3 2019 to $3.5 billion. FICC rose 63% year/year and grew 5% sequentially. Compared with a weak Q4 2018, it benefited from higher revenues across most major businesses, including significant increases in interest rate products, commodities and mortgages. Asset Management – Revenues increased 52% year/year and rose 85% from Q3 2019. Relative to the prior quarter, management fees rose 1%. Equity investments generated $1.9 billion in revenues, compared to a challenged Q3 2019, which stood at $0.6 billion. Consumer & Wealth Management – Revenues increased 8% year/year and rose 7% quarter/quarter to $1.4 billion. Relative to Q3 2019, wealth management fees increased 7% with higher management fees (+10%) more than offsetting declines in incentive fees (-10%) and private banking & lending (-3%). Consumer banking revenues rose 5%. Excluding legal, expenses increased 34% year/year and rose 11% linked quarter. Compensation expenses increased 64% year/year, while non-compensation grew 14%. Its tax rate was 17.4%, down from 22.3% last quarter. It noted its 2020 effective tax rate is expected to be around 21% (was 20.0% in 2019).

JPMorgan Chase & Co. reported Q4 2019 EPS of $2.57. Consensus was $2.36. Relative to expectations, higher than expected trading revenues (Fixed Income, Currencies & Commodities (FICC) followed by equities), as well as Investment Bank fees (broad-based), and a lower than expected loan loss provision helped to fuel the beat. Results included $123 million of securities gains, up from $78 million in Q3 2018. Tangible book value rose 0.8% to $60.98 (2.2x). It posted a 14% ROE, 17% ROTCE. CET- 1 ratio was 12.4% (11-12% target), up 10bps. It repurchased $6.9 billion of its shares in Q4 2019, approximating the prior quarter. Average diluted shares declined by 1.8% Consumer & Community Banking (CCB) revenues rose 5% year/year and slipped 1% linked quarter to $4.2 billion. Relative to Q4 2018, Card, Merchant Services & Auto increased 9% (higher card net interest income on loan growth and margin expansion, as well as higher auto lease volumes), while Home Lending (-5%; lower net interest income on lower balances, and lower net servicing revenue, predominantly offset by higher net production revenue) and Consumer & Business Banking (-2%; impact of deposit margin compression, largely offset by growth in deposit balances, and fee income from higher client investment assets and account and transaction growth) declined. Corporate & Investment Banking (CIB) revenues rose 31% year/year and rose 1% linked quarter to $9.5 billion. Trading revenues jumped 56% year/year (guided to "up meaningfully") with FICC up 85% (favourable comparison against a weak prior year; reflected strength across businesses, notably in Securitized Products and Rates, driven by strong client activity and monetizing flows) and equities growing 15% (driven by higher revenue in Prime and Cash Equities). Total investment banking fees rose 5% year/year (guided to little change) but declined 4% from Q3 2019. Commercial Banking (CB) revenues declined 3% year/year (lower net interest income driven by lower deposit margin, largely offset by higher deposit balances, and higher fees from deposit fees and a gain on a strategic investment) but rose 1% from Q3 2019 to $2.2 billion. Asset & Wealth Management (AWM) revenues rose 8% year/year (driven by higher investment valuations and average market levels, as well as deposit and loan growth, partially offset by deposit margin compression) and grew 4% linked quarter to $3.7 billion. Net interest income declined 0.4% from Q3 2019. Average earning assets rose 1% with securities (+15%) and deposits with banks (+2%) higher; loans little changed (though core +1%). Average total loans declined 1% year/year, though increased closer 3% excluding the impact of loan sales in Home Lending. Its net interest margin declined 3bps to 2.38%. Its yield on average earning assets fell 21bps to 3.35% (loans -19bps, securities -27bps), while its cost of interest bearing liabilities decreased 25bps to 1.22%. Still, its net interest margin excluding CIB markets dropped 17bps to 3.6%. Expenses rose 4% year/year (driven by higher volume- and revenue-related expense, including compensation and auto lease depreciation) but declined 1% from Q3 2019. It posted a 19.4% effective tax rate (25.6% managed), down from 20.4% (25.1%) last quarter. Its reserve/loan ratio declined 1bp to 1.31%.

Morgan Stanley reported Q4 2019 EPS of $1.30. Morgan Stanley lifted its performance goals after beating analysts' estimates by a wide margin, the latest sign that chief executive James Gorman's strategic vision for the bank is bearing fruit. In a presentation, Morgan Stanley set the bar higher for expense controls, returns on equity and wealth management profits over the next two years and beyond. Results included an intermittent net discrete tax benefit of $158 million ($0.10 per share) and severance costs of $172 million ($0.08 per share) associated with a December 2019 employee action. Consensus was $1.02 EPS, though we understand it included the severance charge but not the tax benefit. Relative to expectations, Fixed Income, Currencies & Commodities (FICC), wealth management (transactional revenues) and investment management (investment gains tied to accrued carried interest related to an underlying investment's IPO within an Asia private equity fund managed on behalf of clients) drove a revenue beat. Higher compensation expense restrained further improvement. Revenues increased 27% year/year and rose 8% linked quarter to $10.9 billion. Tangible book expanded 8% to $40.01 (trading at 1.3x). It posted a 11.3% ROE and 13.0% ROTCE. Its CET- 1 ratio was 16.4% (+10bps).Assets declined by 1%, consolidated loans & commitments grew 2%, and deposits increased 5%. It repurchased $1.5 billion of its shares, matching Q3 2019 (now at 50% of its $6 billion ask). Average diluted shares declined by 1.5%. Institutional Securities – Revenues increased 32% year/year and rose 1% linked quarter to $5.1 billion. Investment banking fees increased 11% year/year and rose 3% linked quarter. Relative to Q3 2019, advisory (+19%) and equity underwriting (+5%) increased, while debt underwriting (-14%) declined. Sales & trading revenues rose 28% year/year and fell 8% sequentially. Relative to the prior year, FICC rebounded 126% due to improvement across all businesses, with particular strength in credit products. Wealth Management – Revenues increased 11% year/year and rose 5% sequentially to $4.6 billion. Relative to Q3 2019, transactional revenues jumped (+39% or $234 million), asset management (+1% or $16 million) and net interest income (-1%, -$10 million) were little changed, and other fell (-20% or $16 million). Excluding severance, its pre-tax margin was 26.1%, down from 28.4% last quarter. Wealth Management client liabilities increased 5% to $90 billion, while client assets expanded 5% to $2.7 trillion (fee-based up 7% to $1.3 trillion). Investment Management – Revenues jumped 98% year/year and gained 77% linked quarter to $1.4 billion. Asset management revenues increased 11% or $72 million to $736 million. Still, investments surged from $105 million to $670 million. It benefited from accrued carried interest related to an underlying investment's IPO (subject to sales restrictions), within an Asia private equity fund managed on behalf of clients. Other was a $50 million loss reflecting impairments on an equity method investment in a third party asset manager. Assets Under Management (AUM) increased 6% to $356 million, while net long-term flows increased $6.7 billion and liquidity flows increased by $22.4 billion. Expenses rose 19% year/year and increased 9% linked quarter. Compensation expenses rose 34% year/year and grew 14% sequentially. Non-compensation costs were little changed on both a year/year and quarter/quarter basis. The effective tax rate was 15.7% (included intermittent net discrete tax benefits of $158 million), compared to 18.2% ($89 million benefit) last quarter. Excluding the benefits, its tax rate was 21.4%, stable with Q3 2019.

State Street Corporation reported Q4 2019 EPS of $1.73. Excluding $110 million of repositioning costs the company put core EPS at $1.98. Results also benefited from a lower than expected tax rate (primarily due to foreign legal entity restructuring and the associated impact on its deferred tax position in Q4 2019). Consensus was $1.68 EPS. In addition to the lower tax rate, fee income (driven by market-related, servicing fees and management fees), as well as net interest income, were higher than expected, while expenses were unchanged linked quarter, matching expectations. Assets Under Custody/Administration increased 4% to $34.4 trillion reflecting higher equity levels, client flows, and net new business. Assets Under Management (AUM) rose 6% to $3.1 trillion due to market levels and net inflows from ETFs, partially offset by outflows from institutional and cash. Investment Management net outflows in Q4 2019 of $3 billion (saw $13 billion of inflows in Q3 2019). Operating revenues declined 1% year/year and rose 3% linked quarter. Excluding-notable items, its ROE was 13.3%. Its CET- 1 ratio was 11.9%, down 30bps (increased Risk Weighted Assets). It repurchased $500 million of stock, same as Q3 2019. Average diluted shares declined by 1.3%. Fee income rose 5% (guided to up 1-2%). Net interest income declined 1%, primarily due to the absence of episodic market-related benefits and lower market rates, partially offset by higher deposit balances. Its net interest margin declined 6bps to 1.36%. Its yield on average earning assets declined 27bps to 1.93%. Excluding notable items, expenses were flat to Q3 2019 (guided to stable). The effective tax rate in Q4 2019 was 9.5% compared to 19.2% in Q3 2019. The effective tax rate decreased primarily due to foreign legal entity restructuring and the associated impact on its deferred tax position in Q4 2019.

Wells Fargo & Company reported Q4 2019 EPS of $0.60. Results included $1.5 billion ($0.33 per share) of litigation accruals for a variety of matters, including retail sales practices matters (a majority of the litigation accruals was not tax deductible). It had a $362 million ($0.07 per share) gain from the sale of Eastdil Secured (other fees). It booked $166 million ($0.03 per share) of expenses related to the strategic reassessment of technology projects in Wealth & Investment Management (predominantly equipment expense). Other income included a $153 million ($0.03 per share) decrease in low-income housing tax credit (LIHTC) investment income reflecting a timing change of expected tax benefit recognition. It recorded a $134 million ($0.02 per share) gain on loan sales predominantly junior lien mortgage loans (other fees). It posted a net Mortgage Service Rights loss of $115 million ($0.02 per share), compared to $284 million loss in Q3 2019. It booked a $125 million ($0.02 per share) loan loss reserve release. Combined these cost account for $0.30 per share. Adjusting for these items, EPS was closer to $0.90 and consensus was $1.11. Lower than expected fee income (equity investments, other) followed by higher than anticipated expenses drove the shortfall. Results included $451 million of gains from equity securities (down from $956 million in Q3 2019), while it had losses on debt securities sales of $8 million ($3 million in gains in Q3 2019). Operating revenues declined 9% year/year and fell 8% linked quarter to $19.4 billion. Tangible book decreased 1.0% to $33.50 (trading at 1.6x). CET-1 was 11.1% (current target is 10%), down 50bps. It repurchased 141.1 million shares, down from 159.1 million shares last quarter. Average diluted shares declined by 3.5%. Net interest income declined 4% owing to balance sheet repricing driven by the impact of the lower interest rate environment, and unfavourable hedge ineffectiveness accounting results. Average earning assets rose 1.1% with loans up 0.7% and securities up 1.1%. Period-end loans increased 0.8%. Its net interest margin fell 13bps to 2.53% due to balance sheet repricing driven by the impact of the lower interest rate environment (-9bps) and unfavourable hedge ineffectiveness accounting results. Its yield on average earning assets declined 25bps to 3.51%. Operating expenses rose 2% year/year and quarter/quarter. Its effective income tax rate was 19.1% and its reserve/loan ratio declined by 3bps to 1.09%.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Mondelez International Inc. - It was in 2017 that The Kellogg Company initiated its exit from its direct store door delivery system (DSD) for its cookie and cracker business. At the time, from Kellogg's perspective, there was plenty of hand wringing over both the executional and strategic aspects of this plan given the potential distribution advantage it could give Mondelez's Nabisco brands. However, because this move coincided with Mondelez's North American supply chain challenges, which include a malware attack, it was difficult initially to get a true read of whether this potential distribution advantage would play out. With Kellogg's DSD transition far behind it (including its move to sell the biscuit part of its snacks portfolio to Ferrero) and much of the supply chain disruption now behind Mondelez, Barclays revisited whether Mondelez has in fact been able to leverage a DSD "advantage". Barclay's analysis highlights that Mondelez has been able to competitively leverage its DSD system to accelerate its trends, particularly in the cookie category (as Kellogg's Cheez-It brand is quite unique in the cracker space). Specifically, to assess the benefits of a DSD system in the marketplace, Barclays looked at the key metrics of market share, distribution, and display – as having "feet on the street" (relative to competitors), so to speak, should enable Mondelez to garner incremental shelf placements in the store. Specifically, across the cookie and cracker categories, in the past two years Barclays believes Mondelez has gained overall dollar market share and steadily improved its share of volume sold on display and distribution points on display – all key markers regarding the effectiveness of a DSD system. So too has its DSD system accelerated new product speed to market relative to a competitive warehouse system. Most important, we see this DSD advantage as having ongoing momentum and while Barclays believes Mondelez consistently assesses the return profile of its own DSD network, the data would suggest its model is proving to be a clear advantage for its broad-based snacking portfolio.

South32 Limited delivered a solid set of Q2 2019 production figures, with key contributors: manganese, alumina and coking coal first half of 2019 production tracking at around 50% of full year guidance. Fiscal Year 2020 guidance was maintained for all operations apart from South Africa energy coal, which was reduced to the bottom of the range with unit costs 10% above guidance in first half of 2019 due to wet weather and poor operational performance. The sale of the asset is tracking for completion by the end of Calendar Year 2020, around a 2-3 month delay reflecting slow regulatory progress. Other production highlights were not impacted from load-shedding on South Africa aluminum smelters, 10% lower South Africa manganese output quarter/quarter as South32 cut back on trucking volumes in weaker markets and inventory release at The Cannington Silver and Lead Mine in Australia following floods earlier in 2019. Realized prices were generally in line with expectations for first half of 2019. No net cash figure was provided but the release highlights $93 million legacy shareholding sale in the Samancor Manganese Joint Venture that was returned as part of a $160 million total dividend from Joint Ventures in the first half of 2019. The strategic review of manganese alloy smelters continues and an update will be provided in the March 2020 quarter.

Economic Conditions

The global economy remains sluggish, as advised by the United Nations (UN). The Globe & Mail reported the UN's statement that a decade after the 2008 financial crisis, the global economy remains sluggish, and trade and geopolitical tensions could further derail recovery. The world economy expanded by just 2.3% last year, its slowest pace in a decade, and could grow by 2.5% in 2020 if downside risks are kept at bay. People in a number of countries, mostly in Latin America and sub-Saharan Africa, will see their incomes stagnate or decline this year, the UN stated. "For this year there is a hope of a pick-up, but downside risks and vulnerabilities remain very significant," said Richard Kozul-Wright, head of globalization and development strategies at the UN Conference on Trade and Development and co-author of the report. "A lot of the pick-up that we see for this year hinges on the performance of large emerging economies," Kozul-Wright told a news briefing, naming Argentina, Mexico, Turkey and Russia. The UN expects growth to remain "anemic" in most advanced economies, including the United States. Japan may do better, because of the Olympics, Kozul-Wright said. "Quite a large number of countries will actually see stagnation or decline in per capita incomes this year, predominantly in Latin America and Sub-Saharan Africa," he said, flagging the burden of debt repayment and interest payments.

U.S. inflation despite the lengthy trade war and tariffs remains quite muted. Consumer prices rose a below-expected 0.2% in December 2019, the smallest increase in three months, as overall prices were held back by declines in cars, household utilities, and only modest gains in housing/shelter, new cars. There were areas that saw hotter gains - outside of gasoline (+2.8%), most of the pressure came from medical, specifically, medical care and prescription drugs. Apparel costs rose 0.4%, the most since July, possibly due to the U.S. - China trade war, but are still down from year-ago levels. Excluding food & energy, prices inched up just 0.1% (smallest gain since May), keeping the 12-month trend at 2.3% for the third consecutive month. On a

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6-month annualized basis, core CPI slowed to 2.4%, the lowest rate since July.

China's trade numbers rebounded strongly in December 2019 in signs that global trade weakness may have bottomed out amidst the trade truce between the U.S. and China. The recovery was also partly due to a low base effect. In U.S. dollar terms, exports rose 7.6% year/year in December, well above consensus forecast of 2.9% year/year (November: -1.3% year/year) and was the first expansion recorded in five months. Imports surged 16.3% year/year in December (November: +0.3% year/year) to top consensus forecast of 9.6% year/year. The trade surplus widened to US$46.79 billion in December from US$38.73 billion in November, highest in six months. Overall for 2019, China recorded export and import growth of +0.5% and -2.8% compared to +9.9% and +15.8% in 2018 respectively. The contraction in annual imports was the first since 2016, reflecting the slowdown in the economy. Total trade surplus rose to US$421.51 billion in 2019 from US$350.95 billion in 2018, the first annual increase after falling in the last three years. Meanwhile, China's trade surplus with the U.S. narrowed to US$295.43 billion in 2019 from US$324.45 billion in 2018, which could ease some concerns from the U.S. on the sustainability of the trade imbalances in analysts' views.

The U.K.'s economy grew by just 0.1% in the three months to November 2019, according to the Office for National Statistics (ONS). Growth was slightly stronger in September and October than previously thought, but fell 0.3% in November, dragging down the three-month figure. The ONS said growth in the economy year-on-year was at its lowest since the spring of 2012. Growth in construction was, offset by a weakening service sector, while manufacturing was "lacklustre". UK's trade deficit widened by £9.1 billion to £36 billion in the 12 months to November 2019, mainly because of the trade in goods deficit, which increased by £7.4 billion to £143.9 billion.

U.K.'s consumer price inflation (CPI) came in flat for December 2019 versus 0.2% month/month previously. Year/year, CPI softened to 1.3% year/year for December, down from 1.5% year/year in November. December's inflation rate was the lowest since November 2016. Core inflation also came in lower at 1.4% year/year versus forecasts for 1.7% year/year. In month-ago terms, CPI decelerated due to a sharp drop in prices of clothing and footwear (-1.8% month/month), the recreation category (-0.3% month/month) and restaurants and hotels (-0.5% month/month) as well as alcohol and tobacco prices (-1.4%). In year-ago terms, clothing and footwear prices (-0.8% year/year, 0% prior), restaurants and hotels (1.6%, 2.4% prior), food and beverages (1.7%, 2.1% prior) and alcohol and tobacco (1.5%, 1.9% prior) were the main culprits.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.27% and the U.K.'s 2 year/10 year treasury spread is 0.21% - 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 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 12.20 (compares to a post-recession low of 18.00 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.

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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 tangible equity, 'ROTCE' return on tangible common equity.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC20-005-E(01/20)