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. February 10, 2020

Owner Operated Companies

Brookfield Asset Management Inc. announced today the closing of its latest flagship global infrastructure fund, Brookfield Infrastructure Fund IV, with total equity commitments of $20 billion. Based on strong investor demand, BIF IV attracted total capital commitments exceeding the original $17 billion fundraising target. BIF IV's predecessor fund closed in 2016 with $14 billion of total capital commitments. Over the last 24 months, Brookfield has raised more than $50 billion across its flagship private fund strategies, including the close of its flagship real estate fund, Brookfield Strategic Real Estate Partners III, at $15 billion, and its flagship private equity fund, Brookfield Capital Partners V, at $9 billion, and co-investment capital across each fund. All three flagship funds surpassed their fundraising targets. Investors in BIF IV are a diverse group of 170 institutional investors from across the globe, including public and private pension plans, sovereign wealth funds, insurance companies, financial institutions, endowments and foundations, family offices, and private wealth investors. Approximately 75% of the third-party capital came from existing Brookfield investors, highlighting Brookfield's focus on building long-term relationships with its limited partners. Brookfield committed $5 billion to the Fund, underscoring its strong alignment of interests with its investors. Brookfield's commitment will be funded through Brookfield Infrastructure Partners L.P. and Brookfield Renewable Partners L.P. To date, the Fund has invested or committed approximately $8 billion, or 40% of its capital, to a diversified set of attractive infrastructure businesses, including the largest short-haul rail operator in North America, natural gas pipelines in North America, data infrastructure businesses in South America, New Zealand, India and the U.K., and a global portfolio of renewable power assets.

Fortive Corporation announced results for Q4 2019. For Q4 2019, net earnings from continuing operations attributable to common stockholders were $161.6 million. For the same period, adjusted net earnings from continuing operations were $367.8 million. Diluted net earnings per share from continuing operations for Q4 2019 were $0.48. For the same period, adjusted diluted net earnings per share from continuing operations were $1.03. For Q4 2019, revenues from continuing operations increased 13.9% year/year to $2.0 billion, with core revenue growth of 0.4%. James A. Lico, President and Chief Executive Officer, stated, "Our results for the fourth quarter of 2019 represented a strong conclusion to the year, with 13% earnings growth and strong adjusted operating margin performance. Our free cash flow was particularly notable as we generated over $450M in the quarter, a 17% year-over-year increase and a conversion ratio of more than 120% of adjusted net income. Our ability to generate such strong free cash flow in the face of the continued impact of slow demand dynamics across our short-cycle businesses is a testament to the quality of our portfolio, the dedication of our team, and the power of the Fortive Business System." For Q1 2020, Fortive anticipates diluted net earnings per share from continuing operations to be in the range of $0.24 to $0.28. Fortive anticipates adjusted diluted net earnings per share from continuing operations to be in the range of $0.70 to $0.74. For FY 2020, Fortive expects diluted net earnings per share from continuing operations to be in the range of $2.16 to $2.26. For FY 2020, Fortive expects adjusted diluted net earnings per share from continuing operations to be in the range of $3.68 to $3.78.

Energy Sector

Trans Mountain Expansion – Canada's Federal Court of Appeal dismissed a challenge regarding government approval of the Trans Mountain oil pipeline expansion (TMX), clearing some uncertainty from the project. The court said Prime Minister Justin Trudeau's government held "reasonable and meaningful" consultations with indigenous groups as required by law. Parties have 60 days to appeal to Canada's Supreme Court. At least one other legal challenge is underway. Congested pipelines have forced the Alberta provincial government to curtail production to reduce a glut that has pressured prices, leading to layoffs. In 2018, Canada bought the 67-year-old pipeline, which runs from Alberta to the British Columbia coast, to ensure expansion proceeded as planned. The project under construction would nearly triple capacity to 890,000 barrels per day by the third quarter of 2022. The duty for governments to consult indigenous people on resource projects does not amount to a veto, the panel said. "This is a victory for common sense and the rule of law," said Alberta Premier Jason Kenney. "TMX will result in billions of dollars of economic prosperity for Canadians." Trans Mountain is one of three projects, along with TC Energy's Keystone XL and Enbridge's Line 3, that have been stalled for years. Line 3 also cleared some regulatory hurdles recently. "We can move forward, but we expect opponents to find ways inside and outside the law to work against the projects," said Tim McMillan, chief executive of the Canadian Association of Petroleum Producers.

Financial Sector

DNB ASA continued its strong core revenue performance, growing net interest income by 4% quarter/quarter and fees by 13%. However, costs were higher than expected with the cost-income ratio rising to 56% vs. 54% in Q3 2019. The group's capital ratios remain strong. The CET-1 ratio improved by 0.3% to 18.6% and the dividend of NOK 9.0 per share grew 9% year/year and was 3% ahead of expectations.

ING Groep N.V. reported Q4 2019 profit was 23% below consensus. Q4 2019 was marked by a continuation of deteriorating core operating leverage with core revenues up 1.3% year/year and expenses up 3% year/year due to investments in the business. The bank delivered positive developments in terms of Net Interest Income (up 2.7% vs. consensus) and Fee & Commission (up 1% vs consensus); however, the cost of risk came out 50% higher than expected due to files in Wholesale Banking, including a provision for a suspected external fraud case (in Trade Finance with an undisclosed amount).

Activist Influenced Companies

Brookfield Business Partners L.P. announced financial results for FY 2019. "We delivered strong financial performance in 2019, generated over $1.0 billion from monetizations and distributions, and deployed over $2.5 billion into new businesses including Clarios, Genworth Canada and BrandSafway," said Cyrus Madon, CEO of Brookfield Business Partners. Brookfield Business Partners generated Company EBITDA of $1.21 billion for the year compared to $843 million in 2018, reflecting incremental contributions from recent acquisitions and improved performance at its existing businesses. 2019 Company Funds From Operations was $1.10 billion ($7.86 per unit) compared to $733 million ($5.67 per unit) in 2018. Net income attributable to unitholders for the year was $88 million ($0.62 per unit), compared to $422 million ($1.11 per unit) in 2018 which included the benefit of a non-cash gain. Results included improved performance for the year at the company's road fuels operations and its construction services business. Results also benefited from contributions by Healthscope, Ouro Verde and Genworth MI Canada Inc., which were acquired during the year. Results benefited from strong performance at North American Palladium Ltd. and the incremental contribution from Clarios, which was acquired in April 2019, partially offset by a lower contribution from GrafTech International Ltd., primarily due to a decreased ownership in the business. During Q4 2019 Brookfield Business Partners realized $135 million from the sale of GrafTech shares that reduced its ownership interest in the company to 25%. In December 2019, together with institutional partners, Brookfield Business Partners acquired a 57% controlling interest in Genworth Canada for $1.7 billion. Genworth Canada is the largest private residential mortgage insurer in Canada, providing mortgage default insurance to Canadian residential mortgage lenders, making homeownership more accessible to first-time homebuyers.

Dividend Payers

Compass Group PLC - Organic revenue in North America increased by 7.5%, with particularly strong growth in Business & Industry, Healthcare and Education. In Europe, as anticipated, organic revenue was flat year/year as it was impacted by the expected volume softness in Business & Industry and a less favourable Sports & Leisure calendar. These headwinds were offset by a good performance from Turkey and the Central and Eastern European region. Organic revenue in the Rest of the World increased by 4.7% supported by good levels of growth in Australia and Latin America. Compass Group has had an encouraging start to the year and its outlook for 2020 remains unchanged with organic growth around the mid-point of its 4-6% guidance range whilst maintaining its strong margin. In the longer-term, Compass Group remains excited about the significant structural growth opportunities globally, and the potential for further revenue and profit growth combined with further returns to shareholders.

Brookfield Property Partners L.P. – For Q4 2019, Brookfield Property Partners LP reported solid results, driven by healthy performance from the office portfolio and profits from the sale of condos in London, England. Retail fundamentals remain under pressure, and while Brookfield Property Partners LP achieved its goal of leasing more than 10 million square feet of retail space in 2019, same-property Net Operating Income dropped 3.8% in the retail portfolio. The units continue to trade at a large discount to Net Asset Value, and it is difficult to see a material catalyst in the near term, especially with the continued negative outlook towards retail properties. Management has been active with share buybacks, and we believe this is an attractive use of capital. Overall, Brookfield Property Partners LP owns an extremely high-quality portfolio of properties, and we believe that it is well positioned to create value over the long-term through the completion of its current active development and redevelopment projects.

Economic Conditions

U.S. – American companies kicked off the year in high style, cranking out 225,000 net new jobs in January 2020. This fits with a spate of other indicators (ISMs, auto sales, consumer confidence) that suggest resilience in the economy. Gains in the prior two months were revised modestly higher to 147,000 in December and 261,000 in November. The six-month average payrolls gain (205,500) is up materially from the prior half year (136,500), suggesting good momentum in hiring. Benchmark revisions cut the monthly average pace in the year to March 2019 to 169,000 from an initial tally of 210,000, but what matters is the stronger trend since then (190,400). While manufacturing continued to shed jobs (-12,000) in January, construction more than picked up the slack (+44,000), though likely, in part, due to warmer-than-usual weather. Governments added 19,000 workers, with likely support from temporary Census hiring. A drop in household employment (-89,000 after +267,000 in December) and a two tenths jump in the participation rate (great for incomes) nudged the unemployment rate up a tenth to 3.6% from a 50-year low, while the U6 "underemployment" rate bounced off a record low (back to 1994) to 6.9%. The increased margin of slack in labour markets is keeping a tight grip on wages, with average hourly earnings up 0.2% in the month and a moderate 3.1% in the past year.

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The state of the U.S. non-manufacturing sector may not necessarily be the best it has ever been, but it is starting 2020 off on a strong footing, which is good news. The non-manufacturing ISM rose an above-expected 0.6 pts in January to 55.5, the highest level since last August. After stumbling in the prior month, new orders regained some, but not all, of its footing, at 56.2. Business activity, a measure of current production, rose 3.9 pts to 60.9, the highest level in nearly a year (or, specifically, since February 2019). Both of these components, key indicators for current and future activity, are well in the expansionary zone, pointing to continued growth. Employment, however, eased for the second consecutive month, down 1.7 pts to 53.1, suggesting that hiring cooled in January. That could reflect ongoing complaints from businesses about tight labor markets, but the drop also contradicts the strong results from ADP's latest survey (+291,000 private sector jobs). Mull that over ahead of Friday's payroll report. One respondent said that the "dramatic workforce shortage continues" while another said "Filling open positions due to new orders."

U.K. - The U.K. Report on Jobs for January shows potential signs of improvement following a rather lacklustre performance for most of 2019. Permanent staff appointments recorded a second successive monthly rise, the quickest increase in 13 months and overall vacancies saw the quickest increase in ten months. Less positively, temporary billings fell for the first time since April 2013, possibly due to the upcoming IR35 legislation, candidate availability fell further in January and the rate of starting salary inflation was the softest since July 2016. Overall, there are some signs of a restart in hiring following the general election and Brexit. The degree to which this is a temporary release of pent-up demand or something more sustainable will be a theme throughout 2020. Permanent placements continued to rise. The January reading of 52.3 (where 50 signals expansion) is an improvement on the 51.9 in December (the first period of growth since December 2018). The rate of growth was the quickest recorded for just over a year, amid reports of improved business confidence following the general election. Demand for staff picked up at the start of the year. Demand for staff improved month/month in January, with the Vacancy index reaching 54.7 in the month following 52.5 in December and 51.7 in November, the quickest increase in vacancies for ten months. As in recent months, the absolute level remains above the neutral 50.0 value but was subdued compared to historical levels (61.2 average in 2018 and 63.0 average in 2017).

Australia – The Reserve Bank of Australia left its official cash rate unchanged at 0.75 per cent on February 4th, 2020, a decision that was widely expected by financial markets. Yet the case for monetary policy to do more remains compelling. The Reserve Bank of Australia presides over an extended undershoot of its inflation target and an unemployment rate above its own estimates of the "full employment" rate. The Reserve Bank of Australia continues to expect a "gradual" improvement in both these key indicators, but this gradualness is entirely of its own making. The Reserve Bank of Australia has wisely decided to keep its powder dry, holding off any further rate cuts until it gets a clearer view of the state of the economy. With a mixed picture on the state of the economy, signs of a pick-up in the established housing industry, an expected upturn in residential construction and the dollar already at a near record low, for recent times, there is no point in the Reserve Bank of Australia rushing towards the unknown territory of a zero interest rate regime and below. At 0.75 per cent, the official cash rate is still at a record low. And uncertainty about the monetary policy regime once the cash rate hits zero would be a negative in itself. The dollar and benchmark 10-year government bond yields bounced off four-month lows after the Reserve Bank of Australia sounded more confident about the economy and shares tracked a global rebound as China ramped up its financial response to the coronavirus outbreak. While acknowledging that recent bushfires in Australia and the outbreak in China would weigh on Australia's economic growth in the short-term, the central bank said it was "too early to determine how long-lasting the impact will be". It left rates unchanged at a ¬record low of 0.75 per cent, as widely expected.

Canada - The Financial Post reported that the chief executive of the Bank of Nova Scotia says Canada's housing market needs more supply, not a major change to the mortgage stress test. Scotiabank president and CEO Brian Porter says while the stress test is "something that you have to look at occasionally, for sure," the move by the Office of the Superintendent of Financial Institutions, a federal banking regulator, to bring in the measure at the start of 2018 was appropriate. "I don't think a lot of tinkering is necessary on the stress test," Porter told the Financial Post in an interview at the bank's investor day in Chile last month. "But we have to make sure that these housing markets are in balance. So, rather than look at the demand side of the equation, let's look at the supply side. Everybody wants to talk about the demand side without looking at the supply side." Porter said housing supply needs to be matched with Canada's growing population and success in attracting immigrants, which he called "the envy of the world." "But where are we going to house them?" he said. "There has been a lack of a long-term housing policy in this country." Porter and Scotiabank, Canada's third-largest lender, are forecasting a shortage of housing supply in Canada. During the bank's investor day, Scotiabank's chief economist Jean-François Perrault said a fast-growing population, strong employment levels, rising wages and low long-term interest rates have led to a rebound in the Canadian housing market. "And we think it's going to keep going," he added. "And it's going to keep going for a very simple reason: the housing market in Canada remains undersupplied."

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.18% and the U.K.'s 2 year/10 year treasury spread is 0.07% - 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 3.45% (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 15.98 (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.

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