News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments

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Energy Sector

Shell today provided an update on exploration activities in Alaska. The Burger J exploration well in the Chukchi Sea was drilled to a total depth of 6,800 feet this summer. Although the well found indications of hydrocarbons, Shell said these are not sufficient to encourage further exploration in the Burger prospect. As a result of this drilling result, 'high costs associated with this project' and 'challenging and unpredictable' regulatory environment, Shell decided to cease further exploration activities in offshore Alaska 'for the foreseeable future'.

Total SA – French oil and gas major put the protection of its dividend at the centre of its strategy as it set out reduced investment plans and increased cost cuts in preparation for an extended period of depressed oil prices. The cost cutting deepens previous steps taken by Total to withstand the oil price rout and is similar to measures taken by rivals. So far only Italy's Eni has cut its dividend among oil majors, most of whom see the payout to shareholders as the chief factor supporting their shares. "We cannot control the price of oil and gas but we can control our costs and allocation of capital," Chief Executive Officer Patrick Pouyanne told investors. Total said it would reduce capital expenditure to between $20 billion and $21 billion from 2016 and to $17-19 billion per year from 2017 onwards. That compares with $23-24 billion in 2015 and a peak of $28 billion in 2013. It also maintained its target of selling off $10 billion of assets in the coming two years. "We are preparing the group to face low oil prices for a longer time and if oil prices rise this would be good for us," Chief Financial Officer Patrick de la Chevardiere told reporters. He added that Total had decided to cut capital expenditure for next year so it can cover its dividend at $60 per barrel in 2017. De la Chevardiere envisaged further measures to protect the payout even if oil continues to weaken. "The break-even price is decreasing sharply. The objective is to by 2017 decrease the break-even price. To cover the existing dividend you need something like a $45/bl assumption by 2019," he added, noting a scrip (or share) dividend could help sustain the payout. "We will remove the scrip scheme when cashflow covers dividend," Pouyanne told investors. "It (the scheme) will be maintained next year. From 2017 with oil at about $60 per barrel, we will have cash flow to cover the dividend." Total also raised the target of operating expense reductions to $3 billion by 2017, from a previous target of $2 billion. It said its production would grow by 6% to 7% percent a year between 2014-2017 and by an average of 5% a year between 2014-2019, effectively reducing its 2017 production target to 2.6 million barrels per day from the previous 2.8 million.

Total plans to invest $500 million a year in renewable energy, a step by Europe's second-largest oil and gas company to expand in biofuels and solar. The French company said in a presentation to investors it wanted to take "advantage of fast growing renewable market" to build a profitable business. Total bought a majority stake in SunPower Corp., one of the largest manufacturers of solar panels in the U.S., for about $1.4 billion in 2011. The company earlier this year said it would invest €200 million to transform its unprofitable La Mede oil refinery into a biofuel plant. The $500 million commitment comes four months after Total Chief Executive Officer Patrick Pouyanne pledged to lift spending in renewable. Ambition is to modify Total's future energy mix and become part of the solution to climate change. Total and some of its European rivals, including Royal Dutch Shell Plc and BP Plc, have taken small steps into renewable energy, partly in response to shareholder concerns about climate change. Earlier this year, the heads of BP, Eni SpA, Shell, Statoil ASA, Total and BG Group Plc signed an unprecedented letter to call for governments to agree on carbon pricing at a United Nations climate summit culminating in December.

Total is trimming its exposure to Canada's oil sands amid a slump in crude prices. It announced it had sold a tenth of the Fort Hills oil sands project in northern Alberta to Canada's Suncor Energy. The stake in the planned 180,000 barrel-per-day project was sold to Suncor for around C$310 million. The sale, which is subject to regulatory approval and expected to close by the end of the year, will give Suncor a 50.8% stake in Fort Hills. Total will own a 29.2% in the project and a third partner, Teck Resources Ltd, owns 20%. The total C$15 billion cost of Fort Hills is estimated at a capital intensity of approximately $84,000 per flowing barrel of bitumen, according to Suncor. The project will start producing oil in the fourth quarter of 2017. Canada's oil sands are home to the world's third-largest crude reserves but carry some of the highest breakeven costs globally because of the scale of projects and energy-intensive production methods. A number of future projects scheduled to start up after 2018 have been deferred, but Fort Hills and other facilities under construction are expected to be completed because of capital already invested in them.

Financial Sector

HSBC plans to recruit another 4,000 staff in China, bolstering its operations in the country even as the giant bank cuts back its workforce elsewhere in the world. Its Asia-Pacific boss Peter Wong told the Hong Kong Economic Times that the staff would be employed in the Pearl River Delta – a unit that he hopes can generate earnings of $1bn (£643m) per year by 2020, up from $100m last year. The wider group plans to cut 25,000 jobs and is losing another 25,000 staff by selling operations in Brazil and Turkey. (Source:The Telegraph)

Volkswagen - preliminary analysis indicates that total bank sector exposure could amount to a minimum of €8bn. However, the risk of default at the moment still appears to be small given VW's Credit Default spread of 236bps. A review on Dealogic syndicated loans data for Volkswagen AG and its subsidiaries identified a large bank loan of EUR5bn. This loan is underwritten by a large number of EU and global banks; the EU book-runners exposed in this loan are: Commerzbank, Barclays, BBVA, BNP Paribas, Credit Agricole, HSBC, Lloyds, RBS, Santander, Standard Chartered, Unicredit, ING. Santander and BBVA have also underwritten a smaller loan of US$250m for VW's Mexican subsidiary.

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Activist Influenced Companies

Nothing to report this week.

Canadian Dividend Payers

Transalta Renewables announced that on September 24, 2015 it priced a $442 million bond offering for its indirect wholly-owned subsidiary, Melancthon Wolfe Wind LP. The bonds are amortizing and bear interest at a rate of 3.834%, payable semi-annually and mature on December 31, 2028. The bonds have a preliminary rating of BBB, with a Stable trend, by DBRS. Net proceeds of the financing will be used to, among other things, make advances to Canadian Hydro Developers, Inc. on a subordinated basis pursuant to an intercompany loan agreement, the proceeds of which will be used to finance certain facilities of the company's affiliates and for other general business purposes. The wind project consists of three facilities, Melancthon I, Melancthon II and Wolfe Island, all located in the Province of Ontario. The 199.5 MW Melancthon I and II facilities are located near Shelburne, ON and began commercial operations in March 2006 and November 2008, respectively. The 197.8 MW Wolfe Island facility is located near Kingston, ON and began commercial operations in June 2009. The projects are 100% contracted to the IESO for a term of 20 years from commercial operations and utilize proven turbine technology (GE and Siemens).

Global Dividend Payers

Compass Group PLC has announced that Andrew Martin, Chief Operating Officer for Europe and Japan, will step down from the Board on 1 December 2015 and that Dominic Blakemore, currently Group Finance Director, will become the Chief Operating Officer for Europe, including Turkey, from that date. On the same day Johnny Thomson, who is currently Regional Managing Director of the Group's Latin American business, will become Group Finance Director and will join the Board as an Executive Director.

Novartis AG's new heart failure drug Entresto is on track to be approved for use in Europe by the end of the year after it received the backing of EU regulators. Entresto, also known as LCZ696, is the first new drug in decades for helping patients whose lives are in danger because their hearts cannot pump blood efficiently. Analysts estimate it could have annual sales of some $4.4 billion by 2020. Entresto won approval in Switzerland last week and got a green light from the U.S. Food and Drug Administration in July. Pending final approval by the European Commission, Entresto will be available for the treatment of adult patients with symptomatic chronic reduced ejection fraction (HFrEF), the company said. In trials, Entresto showed that it reduced the risk of cardiovascular death and first-time hospitalisations due to heart failure by a fifth over a widely used generic medicine. Novartis is looking to Entresto to help revive its fortunes in heart medicine as the blood pressure pill Diovan - a major source of the company's profits in the past - faces competition from generics.

Roche today announced positive topline results for ocrelizumab in its third Phase 3 trial for multiple sclerosis (MS), another upside surprise from a drug that could rate as the most underestimated late-stage program in the Roche pipeline. In July 2015, Roche announced positive results for ocrelizumab in the OPERA pair of trials in more common relapsing/remitting form of MS. The reflex opinion has been that ocrelizumab will be positioned in 2L, as a 'better Tysabri' simply because it is administered as an intravenous infusion, in a MS world that is transitioning to potent oral therapies. However this could in our opinion be under-selling the opportunity. With two administrations a year, the drug can be worked into regular neurologist visits without added inconvenience to the patient. If the safety and efficacy is solid then it clearly will be a viable 1l competitor.

Economic Conditions

US – US durable goods orders turned 2% lower in for the month of August, as expected, dragged lower by a drop in defence, aircraft and auto vehicles orders. The core figure, which excludes the impact of defence and aircraft was only down by 0.2% in the month, marginally worse than expected. Machinery orders advanced 1.0% in the month, building on the strength recorded over the previous two months.

The revised reading of the US GDP for the second quarter, at 3.9% annualized, came ahead of the preliminary 3.7% figure, potentially signalling better momentum into the third quarter of 2015 for the US economy.

On the consumer front, the US personal income grew by 0.3% in August, just shy of the expected 0.4% advance and a deceleration from the 0.5% rate of improvement for July, providing some justification for Fed's wait and see attitude of late. The same could be said of the US consumer sentiment, as measured by the University of Michigan, which, at 87.2 for the month of September, was significantly lower than August's 91.9 index points read, with both the 'current conditions' and the 'expectations' component of this composite index retreating in the month. The core personal consumption expenditures (PCE) price index, the Fed's favourite inflation gage, inched up one notch, to 1.3% year on year, in line with the expectations.

The US housing sector presented a mixed picture for August, with a 5.7% advance in new home sales, to a 550,000 units annualized, being offset by a 1.4% drop in pending home sales.

Canada – Canadian retail sales for the month of July were in line with the expectations, improving by 0.5% in the month, driven by robust auto sales. The core reading, which excludes sales of vehicles and parts, was flat, falling short of the expectations. Sales of clothing and sporting goods were higher, while sales of food, furniture and electronics were weaker in the month.

Financial Conditions

US Federal Reserve policymakers remain determined to signal that although Quantitative Easing has stopped, the stimulus remains via keeping rates at present low until earliest September 2015. The US 2 year/10 year treasury spread is now 1.44 and the UK's 2 year/10 year treasury spread is 1.21% - 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 their costs of capital. It seems the top tier 6-9 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the withdrawal of quantitative easing, the US 30 year mortgage market rate has increased to 3.86% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing US housing inventory is at 5.0 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 26.05 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

In Closing

It seems that a cold drink doesn't have the cooling effect hot people expect, with research suggesting it is better to pour it over your head and drink a cup of tea. The problem is that the body compensates for the cold and keeps the core temperature constant, says University of Sydney researcher Dr Ollie Jay. "When exercising in the heat, a cold drink causes an immediate suppression of sweat, which stops the body from cooling. "The heat our body loses to warm up the cold drink is countered by the fact that the body decreases the amount of heat lost through the evaporation of sweat." A person might be better off pouring liquid over their head, as long as it evaporates, he says. "For hydration, people can drink any temperature drink. It does not have to be cold." A hot drink, such as a cup of tea at 50C, causes more sweat and is therefore more cooling than a cold drink, he says. (Source AAP)

Mutual Funds

Portland Investment Counsel Inc. currently offers 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency & Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

Sources: Thomson Reuters, Bloomberg, KBW,BMO, Bernstein, Credit-Suisse

Source: Thomson Reuters, Bloomberg, KBW,BMO, Credit Suisse, Macquarie, Barclays, TD, NBFinancial

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