cardinal UPDATE

DECEMBER 2016

DIVIDEND INCREASES

Canadian Natural Resources Ltd.	8.7%
Siemens AG	2.9%
Sun Life Financial Inc.	3.7%
TELUS Corp	4.3%
Becton Dickinson and Co.	10.6%

(During the period: November 1 – 30, 2016)

OPEC

On November 30, the members of the Organization of Petroleum Exporting Countries (OPEC) met and agreed on a production cut for the first time since 2008. It marks a 180 degree change from November 2014 when, faced with an oversupply, the cartel decided not to cut production. That 2014 meeting sealed the fate of the oil price recession as the Saudi's put the cartel before the horse, targeting market share, rather than the price.

OPEC member countries have agreed to reduce production by approximately 1.2mmbbl/d from October levels to 32.5mmbbl/d beginning in January 2017. The agreement is to last 6 months with an option of a 6 month extension. As expected, the Saudi's will bear the brunt of the cuts and Nigeria and Libya are exempt. Iran has agreed to freeze production just modestly higher than October levels and Iraq has also agreed to cut production. As well, several non-OPEC nations agreed to cut 0.6mmbbl/d of production, with Russia to account for half of this.

OPEC policy is driven by Saudi Arabia and we can only speculate about its motives. With that in mind, one must first understand why they didn't cut production in 2014 or subsequently. Geopolitically, the Saudi's are in a proxy war with Iran and believed that low oil prices would hurt Iran. In addition they felt that with low cost production and ample foreign reserves, they could outlast the competition (other OPEC, Russia, U.S. shale, other non-OPEC) as the freed market reduced supply and increased demand. The Saudis would then prevail when prices rose.

For a while, it worked. Oil prices fell below $40/bbl and with it, non-OPEC production led by U.S. shale declined over 1mmbbl/d. But the U.S. shale industry became more efficient and stayed solvent. Further, Iraq and Russia continued to increase production, joined by post-sanction Iran.

OPEC cut production for a number of reasons: low oil prices are putting a strain on local OPEC economies; a recovered Iran is more amenable to a production freeze, and the Saudis want more non-oil revenue and may IPO its crown jewel Aramco, which has more value at higher crude prices. Thus, OPEC blinked and production cuts agreed upon.

With production cuts coming in early 2017, excess inventories may draw down, putting the market into balance, which we believe should push prices closer to $60/bbl.

Questions remain as to compliance and whether the cuts will be extended. Further, there are concerns that the now more-efficient U.S. shale producers may increase production, offsetting any cuts. Historically OPEC cut regimes have had 70-80% adherence, and U.S. shale probably puts a medium term cap on prices in the $60/bbl range. Ultimately, we believe prices must rise beyond this to incentivize capital spending. Spending cuts of $1 Trillion were made for 2015-2020, and at some point this spending will be needed to offset conventional oil declines and meet future oil demand.

COMPANY FOCUS:

WELLS FARGO

Wells Fargo is the second largest U.S. bank as measured by deposits (over $1 trillion) and market capitalization ($294 billion). In September, Wells Fargo was in the headlines following a scandal where bank branch employees were opening unauthorized accounts on behalf of customers in order to meet their cross-selling targets. The fallout of this scandal included the dismissal of the CEO, a decline in market value (up to $32 billion at one point), and an increase in regulatory oversight. While the story made good headlines, the context is that it affected about 2% of total accounts and about 2% of total employees engaged in the fraudulent behaviour.

There has been a decline in customer account openings since the scandal, but the bank continues to see growth in both loans and deposits. The bank also has ample excess capital to absorb any possible litigation costs. Overall, the scandal shook investor confidence, but did not significantly disrupt the solid fundamentals of the business, and provided a discounted valuation for a short window of time (the stock has since recovered). Headlines may continue to pop up intermittently regarding the scandal, but should not dampen the business' prospects nor our long-term outlook for their shares.

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