Market Commentary

PORTLAND INVESTMENT COUNSEL™

March 22, 2010

News Highlights on Current Holdings

- **BMW** detailed their 2009 full year results and 2010 outlook during their Annual Accounts Press Conference in Munich last Wednesday. While the headline pre-tax profit number exceeded expectations by a large margin, most of the contribution came from its financial services segment as a result of profitable unwinding of derivative positions. Revenues declined moderately by 4.7% in a very challenging year for the leading global premium car maker. A series of successful product launches, including the new BMW X1 and the 5 Series Grand Turismo, helped contain the drop in sales. The company has also been successful in marketing its premium cars in the emerging markets with sales growing 37.5% in China, 118.8% in Brazil and 24.4% in India. Going forward the company targets a solid single digit revenue growth in 2010 and an improvement in profitability towards an earnings before interest and tax (EBIT) margin of 8-10% in 2012. The company intends to preserve its leading premium cars provider status and targets sales of over 1.3 million vehicles in between its three core brands, BMW, Mini and Rolls Royce. The new BMW 5 Series, to be launched in a few weeks is expected to account for roughly one fifth of the sales, while a brand and production extension is envisioned for Mini. An equity swap and cooperation in the small car segment with the Renault-Nissan group is also in the books. The company maintained its 0.30 EUR/share dividend for 2009.
- **Royal Dutch Shell PLC** said it was planning a return to robust growth in oil and gas production after seven years of decline and unveiled strong reserves additions that should underpin longer-term growth aims.
- **Maquarie** announced the acquisition of the Technology Services Division of Relational Technology Solutions, a US/Canadian leasing business comprising circa US$500m of assets leased to mid market and enterprise customers.
- **Hartford Financial** – In a "Heard on the Street" column, the Wall Street Journal last week reflected our own views, commenting that there may be upside to the company's book value. The article points out that the company is sitting on $5bn of unrealized securities losses, some of which could reverse as credit markets improve. In addition, even if Hartford continues to trade at a discount to its peer group, at 1.05x, the group's multiple is still well below its long-term average of 1.6x.
- **HSBC** has indicated that it will probably subscribe to the CNY42 billion (US$6.1bn) rights issue by its mainland China partner Bank of Communications Co. as part of its investment plans in the country. HSBC is also working towards being one of the first foreign-listed companies to tap into the country's huge liquidity and help raise its profile there, per Chief Executive, Michael Geoghegan. Last year it was suggested HSBC was planning to raise as much as $5bn from an IPO in Shanghai. Based on its 18.6% stake in the state-run Chinese lender, the UK lender may spend as much as $1.1bn to subscribe to the rights issue. Apart from the stake in Bank of Communications, HSBC's major strategic investments in China include its 16.78% stake in Ping An Insurance (Group) Co. of China Ltd., an 8% stake in mid-tier Bank of Shanghai Co., 50% of HSBC Life Insurance Co., 49% of HSBC Jintrust Fund Management Co., and 24.9% of Beijing HSBC Insurance Brokers Ltd. The market valuation of HSBC's Chinese investments at December 31st was US$25.4bn.
- **Barclays** – Financial Times reported again on Barclays Capital, last week, this time suggesting that BarCap wants to double its revenues from Asia by 2013. Asia has historically run at 8-13% contribution to BarCap total revenues, but the aim is to raise this to 20% over 5 years. BarCap expects their existing businesses (primarily Fixed Income, Currencies & Commodities related) to at least double revenues over 3 years, but recognizes that newer areas (such as equities and M&A "will take a while to really hit the ground"). Article also comments on how the acquisition of Lehman's US arm has massively helped BarCap's perception amongst Asian customers. We expect profit before tax at BarCap to almost double in 2010, mainly as writedowns are much lower going forward.
- **Lloyds** – Released an impromptu trading update last Friday:
- Expects to deliver "better impairment performance than previously guided." This is the main positive point… impairments trends at lower levels than anticipated, and note that past guidance was just a month ago.
- Pleased with each area vs recent guidance, and says year-to-date, the Group's trading performance has been strong.
- Banking net interest margin is trending in line with recent guidance and expects to be profitable on a combined businesses basis in 2010.

Economic Activity, Consumer and Business Conditions

- The macro-economic indicators released last week in Canada continued to strengthen the opinion that the economic recovery has gained a lot of traction and that the Bank of Canada (BoC) is likely to adjust upwards the interest rates rather sooner than later, with or without a similar move from the Feds. The consumer price index (CPI) reading was surprisingly strong in February, with the core (excluding the 8 most volatile price components, mainly food and gasoline) number exhibiting a 2.1% annual rate growth, marginally outside (on the plus side) BoC's comfort level. While exceptional factors (the winter Olympics) contributed to this inflationary reading, the high level is likely to keep the Bank of Canada on alert. The manufacturing sales, up 2.4% in January over the previous month, exceeded by a large margin the expectations of 0.5% growth, with most of the reporting industries contributing to the improvement. The labour productivity in Canada recorded a long due improvement, rising by a significant 5.5% annual rate in Q4, way better than the consensus of 3.2% growth. More productivity improvement is badly needed though, as Canadian productivity has been virtually flat for the last three years, trailing the US and other developed countries' productivity growth.

Financial Conditions

- Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.70% and the U.K.'s 2 year/10 year treasury spread is 2.71% - enabling financial services companies' assets booked at these levels, to be very profitable, so enabling them to accelerate the absorption of anticipated consumer credit losses.
- Our concerns are mostly focused around the later cycle issues facing financial services companies – particularly commercial real estate and unsecured consumer loans/credit card loans. However, commercial real estate exposure is more acutely held by US regional banks – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (37 to-date in 2010 and 140 in 2009) but their franchises are being acquired/absorbed as convergence of the financial services industry accelerates – favouring we believe the stronger, better managed banks. Typically banks acquiring collapsed bank franchises from the Federal Deposit Insurance Corporation (FDIC) are paying little or no premium for deposits, assets are purchased at a discount and are covered by loss sharing agreements – so that such deals can be expected to be Immediately accretive to earnings per share. For instance last Friday 7 banks failed with the FDIC announcing buyers for 6 of them – all with loss share agreements.
- A concern which remains is the extent to which loan modifications are an exercise in loss deferral but for the larger franchises the quantum of proactive provisioning continues to act as a differentiator of quality which we believe has still to be fully appreciated.
- The VIX (volatility index) is 17.2 substantially below the levels experienced last August/September (and well off the highs of 70-80 witnessed late September/October). While, by its characteristics, the VIX will remain volatile, it is we believe further evidence of markets reacclimatizing to risk – typically we believe a VIX level below 25 augurs well for quality equities.
- We believe the next few years will highlight the growing polarization between strong and weak institutions. Financial services companies that have capital strength will buy assets from those required to divest. Companies that have a strong presence in emerging markets will likely grow quicker than those that do not. Banks that have strong retail deposit franchises will take market share from those that rely on wholesale markets to fund loan growth at attractive margins. Financial services companies that have breached client trust will keep losing business to those reputations that have been enhanced by the crisis. We believe all the Funds are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

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Closed-End Funds

Spreads on the closed-end funds are narrowing but remain wide and so in our view are very attractively priced to purchase.

At the beginning of business on Mondays and at the end of each month we publish the Net Asset Values (NAV) of our funds onto our Portland website at http://www.portlandic.com/Funds/WeeklyPricing.aspx. The NAV for the AIC Global Financial Split Corp. can be found on the AIC/Manulife website at http://www.aic.com/EN/PricePerformance/AICClosedEndFunds/Pages/Price.aspx and the Copernican World Financial Infrastructure Trust, Copernican World Banks Split Inc. and the Copernican International Financial Split Corp. can be found on the Copernican website at http://www.copernicancapital.com/Funds/WeeklyPricing.aspx.

The details published last Friday are replicated here below from which you can see we also highlight whether the funds share prices are trading at a premium or discount to their respective Net Asset Value.

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