Market Commentary

PORTLAND INVESTMENT COUNSEL™

May 24, 2010

Recirculation of shares in European Premium Dividend Fund (EPD.UN):

- **The EPD.UN** fund is undergoing its annual redemption privilege. This creates an opportunity for those wishing to increase their stake in this fund via the resale of those units which have been tendered for redemption. As outlined in the prospectus we have entered into a recirculation agreement whereby CIBC as the recirculation agent uses commercially reasonable efforts to find purchasers at a price which is not less than the prescribed redemption price (including the deduction for the redemption fee of $.045) to be paid to the redeeming unitholders. In practice this means that for 1 or 2 days CIBC (broker code 79) will, on the fund's behalf, be offering to sell units. During this period there will therefore likely be considerably more liquidity in the shares enabling larger purchase orders to be filled…. which I understand is a challenge during other trading periods. We therefore wanted to bring to your attention that in early June this recirculation opportunity will be opened – however as soon as CIBC have physically traded a sale then the recirculation 'window' will close at latest the day after.
- **EUROPE:** Recent events have highlighted that Europe has significant long-term economic problems which need to be fixed over time. However, we believe Europe's reputation may have suffered more than is justified. Europe is largely a mature advanced economy. It cannot approach the per-capita GDP growth rates of several emerging markets and because of its inconsistent record of integrating immigrants it cannot match the population-driven rate of overall GDP growth of the U.S.
- However, sourced from Thomson Reuters, Europe's aggregate debt (consumers, corporate and government) at 220% of GDP is below that of the US (270%) and Japan (363%). The problem is the disproportionate amount concentrated in peripheral Europe. The actions and funding programme set up by the European leaders in May are precisely to redistribute that debt from peripheral Europe to core Europe. Hence, from an economic perspective core Europe is financing transfer payments to its periphery. In addition, much of Continental Europe's consumer sector is underleveraged compare to other countries with higher household savings ratios - so standing to benefit more as interest rates rise.
- We believe that the austerity measures now being adopted across Europe and mostly in its peripheral countries are necessary and overdue but not necessarily the precursor to a sustained period of very low growth. Of course, there remains considerable uncertainty for as long as unemployment rises but for now, we continue to believe the more immediate concerns are associated with disinflation and financial turmoil (the kind that hit the world after the collapse of Lehman Brothers). However, we believe that Europe's belated but proactive response to sovereign debt concerns finally led to a proportionate European Union and European Central Bank response with modest growth expectations intact.
- In our view, recent market behavior, sparked by uneven government actions (mostly political / German) have priced in the worst fears that fiscal correction in the Euro periphery could derail the European economic recovery and Europe has become abnormally cheap. The European Dividend Fund's bias to strong dividend paying companies presents an investment opportunity into a robust, focused collection of dominant and / or growing franchises.
- We believe the Euro currency is likely to remain weak compared to its trading partners. On a trade-weighted basis each 10% depreciation adds nearly 0.8% to European GDP and 0.7% to European inflation according to the OECD. Certainly, a weaker euro will help boost Europe's exports - with more than one third of European earnings coming from outside Europe. In shaping the Fund's portfolio we believe we have leant it into these growing revenue flows and have underweighted peripheral Europe and over-weighted with core European businesses with strong international franchises.
- As Europe slowly recovers we believe the European Premium Dividend's portfolio of businesses are well positioned to catch the wave of opportunities that should flow across their global franchises albeit with western societies adapting to more frugal lifestyles.
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News Highlights on Current Holdings

Financial Services Companies

- **ICAP** – headline adjusted PBT before exceptionals and goodwill of £333m. This is before the discontinued cash equities business that lost £25m pretax so result to compare with the range indicated by company in March of £295-£315m would seem to be £308m. Revenues were close to expectation and were down 6% YoY on an underlying basis. Management have commented on a good start to the new year and focusing on organic growth. We view ICAP as a good play on volatility and while there is regulatory risk the final stages of the US Financial reform bill suggest there will be some compromises that may mean it is less draconian than currently feared.
- HSBC – Press reports (Haberturk) are that HSBC is in final

talks to buy GE's 21% stake in Turkey's Garanti bank. This would equate to ~$4bn purchase price (2x book), or 2% of HSBC's market cap (4% of core tier 1 and 35bps RWAs). If purchased, the stake would be 50% deducted from Tier 1 and 100% deducted under Basel 3 as currently proposed. We believe the deal could easily be completed from internal resources and would be strategically compelling for HSBC.

- **US credit cards –** We note that April US credit card securitization data released last week showed that asset quality improved for the industry. Both the average charge-off rate (-30bps m/m to 9.62%) and the average delinquency rate (-21bps m/m to 5.18%) across the top card issuers decreased. We continue to believe the delinquency trends (in the 30-59 days bucket) seen over the past 6 months paint a constructive picture for charge-offs over the next several months.
- **Standard Chartered** has began it's Indian capital raise in order to raise $588mln in the country, the stock will take the form of rupee denominated IDRs and ends this Friday. The IDRs are priced at 104 Rupees and 10 IDR's will equal one ordinary share. According to Bloomberg $78.8mln of the deal has already been subscribed for.
- **Banco Santander SA –** the Financial Times reports Spain's largest bank, held talks with M&T Bank Corp. about combining its U.S. operations with the Buffalo, New York-based lender. Talks are said to have stalled following a disagreement over ultimate control of the company. The plan was for M&T to buy Santander's Sovereign U.S franchise, leaving San with a stake in M&T.
- **BNP –** has announced the purchase of Hill Street Capital LLC (an Investment Bank boutique formed in 2001) to boost their presence in the United States M&A space.
- **Dubai –** Dubai World's proposed restructuring of debt outlined last week (30% over 5 years / balance in 8 years - split $4.4bn / $10bn) has been accepted by the group's creditors, having now reduced the total debt down from the previous $23bn. Dubai World will pay 1% interest on loans on top of another 1% upon maturity. The proposed restructuring will require the accord of all of Dubai World's creditors.
- **BBVA –** to pay $100mn for Credit Agricole's Uruguayan retail banking unit. The deal requires regulatory approval, expected in <6 months. BBVA Uruguay would end up with 42.5bn pesos of assets ($2.2bn) and 665 employees across 45 branches.
- **SPANISH BANKS -** four Spanish "Cajas" plan to combine to form the nation's 5th largest financial group with more than E135bln in assets, a solvency ratio of 12.1% and Tier1 capital of 9.4%. Spanish regulators have pushed ailing lenders to merge with stronger partners. Caja de Ahorros del Mediterraneo, Caja de Ahorros de Santander y Cantabria, Grupo Cajastur and Caja de Ahorros y Monte de Piedad de Extremadura have submitted a proposal to the central bank in Spain to pool businesses.

Dividend Paying Companies

- **Vodafone –** reported full year 2009 results , with revenues at £44.5 billion and Earnings before interest, tax and depreciation of £14.7 billion which was 0.7% ahead of consensus. The dividend of 8.31p is 9% up on last year and management have committed to increase the dividend by 7% year on year for the next 3 years. All of the group's major European assets showed improving top-line trends with the UK showing the best turnaround since it started offering the iPhone late last year…. it seems clear that mobile data should support growth from here with Vodafone well placed compared to peers. Similarly, India continues to grow ahead of peers with margins slightly improving and Turkey continues to show improvement as well with top line growth over 30% in the last quarter. Nonetheless, Vodafone has cleared its balance sheet of the hefty price it paid for its Indian business, by writing down its value by more than 25%. It paid US$10.9 billion for a 66% stake in Hutchison Essar 3 years ago – and this mobile operator has since moved up from 4th to 2nd largest mobile operator by revenue albeit margins have reduced and regulatory action increased. Vodafone has therefore written down the book value from £8 bn to £5.7 bn (i.e. $11.5bn to $8.2 bn). This write-down draws a line under the pricey acquisitions undertaken by the previous CEO (Arun Sarin) and helps cement the new CEO's reputation (Vittorio Colao) for focusing on returns not size.
- **Vodafone Group Plc** is in talks to sell its 55 percent stake in Vodafone Egypt Telecommunications Co., a person familiar with the matter said. The stake is valued by analysts at about 3 billion pounds ($4.3 billion).
- **ABB** has announced its intention to raise its interest in its Indian subsidiary ABB Limited (India) to 75% from 52% as it is looking for opportunities in which to invest its sizeable cash position. The cost of the 23% stake is estimated at roughly one billion dollars, which represents a premium of about 34% relative to the previous closing price. ABB is willing to pay a roughly three times sales multiple to increase its exposure to what it perceives to be a secular growth market of strategic importance in its line of business.
- A consortium of ABB Limited (India) and Bharat Heavy Electricals is seen as the frontrunner in a power transmission

project commissioned by the state run Power Grid Corp of India, estimated to be worth 1.31 billion dollars. The project aims to connect the power rich north eastern region of India (also a significant potential source of hydro power) to mainland India and is likely the largest transmission project in the country.

- The week before ABB had spent another billion dollars on another acquisition of strategic importance, by taking over Ventyx, a power transmission and utility software company, aimed at strengthening the company's offering in the Power Systems division.
- **Shell –** China National Petroleum has agreed to acquire a 35% stake in Shell's oil and gas unit in Syria, a deal worth $1.5 billion.
- **Roche Holding AG –** according to Swissmedic , Roche is updating information on the Avastin cancer drug in Switzerland to indicate a higher incidence of sensitivity to the medicine after discussions with the country's regulator.
- **National Grid PLC –** the operator of the U.K.'s power and gas networks, plans to raise 3.2 billion pounds ($4.6 billion) through a rights issue to fund a five-year investment program while maintaining its credit ratings.
- **Visa:** Announced last Thursday that it was repurchasing $500 mill of class A shares. At current prices, it's about 6.8mill shares which is larger than earlier expectations.
- **Toyota:** Announced on 21 May that it will form a business alliance with and invest $50mn (around ¥4.5bn) in California electric vehicle (EV) venture firm Tesla Motors. This is likely to have only a minor impact on earnings for the time being, but we believe this is a key move for two reasons: 1) it could play a part in improving Toyota's corporate and brand image in California and the rest of the US; and 2) it could be effective in the medium term in terms of Electronic Vehicle-related joint development.

Economic Activity, Consumer and Business Conditions

- **US:** The inflation numbers coming out of US last week showed once again that the inflationary risk is skewed towards deflation, with the Consumer Price Index (CPI) down 0.1% in April, on expectations of marginal 0.1% increase, while the core CPI (less food and energy) was flat month on month for April. The yearly rate is currently 2.2% for CPI and 0.92% for the core CPI, the lowest since January of 1966. At the same time the Producer Price Index retreated 0.1% in the month of April as well, while the core PPI (less food and energy) moved up marginally by 0.2%. Given that the inflation trends seem to be running below Fed's expectations and given the Fed's all important price stabilization mandate, we see the chances of any move in the Fed's fund rate as very slim at the moment.
- The stabilization of the housing and construction markets in the US seems to be continuing, with a further increase in the number of house starts in April, bringing the total to 672,000 units, well above the recent lows of 477,000. On the other hand the number of building permits issued declined in the month to 606,000 units from the previous 685,000 figure, showing that the builders are still cautious about a full blown recovery in the sector. The NAHB Housing Market Index is consistent with the above, showing an improvement in the home builders' sentiment, with a reading of 22 for May, up from the previous month's 19, yet still at very depressed levels (a reading of 50 indicates a neutral stance). Supported by the last iteration of the home buyer's tax credit, the existing home sales in April moved higher by 7.6%. The growth rate in existing home sales is expected to slow down significantly past the expiration of the incentive program and the inventory of existing homes, at 8.4 months worth of sales at the current pace, is still a couple of months above the historical 'norm'. The S&P/ Case-Shiller price index for 20 US major metropolitan areas increased by 2.3%, less than the expected 2.5% movement upwards, for the month of March.
- The latest Initial Jobless Claims read in the US surprised negatively, moving higher to 471,000 from the revised 446,000 the week before and way off the expected 440,000, showing significant job losses are still taking place. As is with most recovery related indicators, this one is also pointing towards a gradual, slow paced process rather than a full blown economic recovery.
- **Canada:** In Canada, the retail sales jumped up significantly in the month of March, registering a 2.1% broadly based month on month growth, way over the expected 0.1% rate of improvement. Significantly milder than usual weather during the month is seen as a factor and building and outdoor supplies sales 6.6% increase comes in support of this theory. The core retail sales number (excluding motor vehicles and parts) was also up significantly, growing 1.7%, well over the expected 0.4%. The Canadian Consumer Price Index moved higher by 0.3% in April, pushing the yearly rate to 1.8% from 1.4%. At the same time, the core number (excluding the eight most volatile categories) moved up 0.3% taking the yearly rate from 1.7% to 1.9%. Thus, the Bank of Canada's case for an interest rate move at the next

meeting is finding further support, although external factors, such as instability in markets surrounding Canada might prove to be a significant factor too.

- **Greece:** has received the first EUR 20bn (14.5 from EU and 5.5 from IMF) in time to ensure repayments in May and June are covered.
- **Japan:** Japan's consumer sentiment index has risen to its highest level since Oct 2007 as the index climbed to 42 from 40.9 in March.
- Spanish 10yr Bond Auction: went well last Wednesday selling EUR3.52bn just higher than the top of the range expected. At 4.05% the rate was inline with expectations and the auction was twice covered.
- Spain: approved the first public wage cuts since returning to democracy in 1978 and reduced its economic growth forecast for next year as the government tries to tame the euro region's third-largest budget deficit.
- UK: the new coalition government has announced plans to save £6.2 billion in the current financial year – including a freeze on civil service recruitment and cuts in spending on IT, consultancies and non-government bodies – this follows the 5% pay cut for all elected ministers.

Financial Conditions

- **German/Financials –** the German regulator BaFin last Tuesday announced they would ban naked short-selling of any Credit Default Swaps on European government debt and also on the main financial stocks in Germany. We believe it's arguable whether short selling bans have helped calm markets or just prompted greater fear but it does demonstrate angst at the recent wave of panic selling with Berlin refering to the destabilizing speculation and resultant "exceptional volatility" in Eurozone bonds and the considerable widening of credit default swaps that could endanger the stability of the financial system. The ban is effective until March 2011. French Finance Minister Lagarde said on Wednesday that France was not considering a similar ban like Germany and that it regrets Germany's unilateral decision. Obviously discord of any type at this stage does not provide confidence to EU investors and fuels the very speculator acts Germany seeks to curb.
- Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.41% and the U.K.'s 2 year/10 year treasury spread is 2.62% - 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 (73 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. We understand however that the FDIC is changing the loss share arrangement on assisted deals from absorbing 95% of losses down to absorbing 80% although this is still attractive to acquiring banks it does probably lower the Internal Rate of Return.
- The U.S. **30 year mortgage market** has remained low and has now fallen back to 4.84% its lowest level since December 10,2009 as the Government and Fed continue to incentivize new home owners. U.S. housing inventory has reduced to 8.4 months supply of existing houses – but that is still higher than what we believe is a more normal range of 4-6 months. We believe it remains premature to consider a recovery in house prices but a measure of stability from which to build is welcomed….particularly for those financial services companies holding such assets in their portfolios.
- 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 38.32, which is below the levels experienced prior to the ECB bail out and substantially lower than last August/September. While, by its characteristics, the VIX will remain volatile, it is evident that increased tension in North & South Korea and Europe soverign debt concerns have increased risk aversion to the detriment of equities – 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. 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 the Funds we manage are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

Closed-End Funds

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

The Portland Investment Counsel Inc. 2009 Closed End Annual Reports are now available on the web site. Below you can find the link to access the closed end annual report. http://www.portlandic.com/Info.aspx?disp=Financial_Reports

At the close of business on Fridays 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.

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