Market Commentary

PORTLAND INVESTMENT COUNSEL™

July 26, 2010

European Bank Stress Tests

- The bank stress test has been released (Summary report attached) from which 7 of 91 banks failed -ending with an overall Tier 1 capital ratio below 6% as a result of the adverse scenario
- An additional 11 banks fall between 6-6.5%

In the stressed scenario a 'double dip' recession is assumed with the euro area seeing a decrease in GDP of -0.2% in 2010 and -0.6% in 2011. Over the 2 years, the adverse scenario assumes a 3% deviation of GDP for the EU compared to the benchmark scenario of 0.7% GDP growth in 2010 and 1.5% GDP growth in 2011. Over the same period equity markets were stressed to fall by 36%. Although the stress tests took into account bank losses only on government bonds they trade rather than those they hold to maturity (because no outright default assumption is considered after the approx $1 trillion stop-gap funding measures put in place earlier this year) the trading books assume a loss of 23.1% on Greek debt, 14 % of Portuguese bonds, 12.3% on Spanish debt, 10% on UK, 5.9% on French and 4.7% on German state debt. In our view these tests are sufficiently stressed – The post-stress minimum Tier 1 capital requirement of 6% was used in this exercise, from which all banks we follow, passed comfortably.

Tier 1 Capital Ratios	31-Dec-09	31-Dec-11	31-Dec-11	Tier 1 Capital to:	
	Actual	Benchmark scenario	Most stressed scenario	Peripheral Europe (includes Spain)	Central & Eastern Europe
Credit Agricole	9.7%	10.6%	9.0%		
Barclays	13.0%	15.8%	13.7%	12%	2%
BBVA	9.4%	10.6%	9.3%	151%	1%
BNP Paribas	10.1%	11.4%	9.6%	17%	7%
Deutsche Bank	12.6%	13.2%	9.7%	25%	16%
HSBC	10.8%	11.7%	10.2%	3%	1%
ING Bank	10.2%	11.2%	8.8%	17%	18%
Lloyds Bank	9.6%	10.8%	9.2%	0%	0%
Nordea	10.2%	11.3%	10.1%	1%	3%
Royal Bank of Scotland	14.4%	14.1%	11.2%	13%	1%
Santander	10.0%	11.0%	10.0%	93%	0%
Unicredit	8.6%	10.0%	7.8%	4%	29%

The stress tests have, in our opinion, achieved a sufficient level of rigour to be taken seriously. Not all banks passed, and although the aggregate capital shortfall was small (€.4bn), this largely reflects the amount of capital that has already been put into the European sector, circa Eu220bn (including retained earnings, risk weighted asset reductions and capital increases). Although the sovereign stress only stressed trading books, we find that the additional stress placed on the banking book in the "adverse" sovereign scenario compensates for this and in our view is a realistic approach to factoring in the loss that would be delivered in such an extreme scenario …. (i.e. " … a common upward shift in the yield curve was applied for each country in the EU … reaching 1.25% for 3 month rates and 0.75% for 10 year rates … and reflects an assumption of tensions in the interbank market – as was seen during the earlier financial turmoil episodes".)

On the table above we include the quantum of sovereign debt exposure banks have to 'peripheral' Europe (i.e. Portugal, Ireland, Greece and Spain) and by including Spain the banks with large retail operations in that country have relatively high commitments to their domestic base (notably BBVA and Santander) although as both these banks expand globally the % of exposure to Spain is falling – particularly Santander. The very strong capital levels across the UK banks reflects the earlier demands from the British Government to recapitalize and so now underscores, in our view, the value therein.

In our opinion, the important catalyst has not so much been the stress tests themselves as the transparency provided, which is impressive, in our opinion.

News Highlights on Current Holdings

Financial Services Companies

- **Goldman Sachs:** after enduring a protracted period of bad publicity culminating in the settlement with the Securities & Exchange Commission and as the firm seeks to re-emphasise it is client-driven, it is something akin to common sense for the firm to post a disappointing quarterly result. Net income for 2Q10 fell 82% to US$613mn from US$3.4bn in 2Q09. Revenue dropped to US$8.84bn, 31% below the 1Q10 and down 36% from the 2Q09. The biggest component, revenue from trading fixed- income, currencies and commodities, fell 40% to US$4.4bn from US$7.39bn in the 1Q10. Equity trading revenue declined 49% to US$1.21bn from US$2.35bn in 1Q10. Goldman's reported 2Q earnings per share were $2.75 after backing out UK bonus tax & SEC settlement charge ($ 600m and $550m) which compares to the consensus at $2.28. Investment banking revenues also fell (-23%) offset by principal transaction gains – mostly on ICBC (Industrial & Commercial Bank of China) & asset management/securities services (2%)... The compensation ratio was 43% (vs. 43.0% in 1Q which seems reasonable

& core non-comp ratio was 27% excluding the litigation increases (vs. 16.6% IN 1Q10)..The operating Return on equity was at 9.5% (7.9% with the charges) compared to approximately 25% over previous 4 quarters, while Book Value increased to $123.73 (from $122.52) and Tangible Book Value moved to $112.82 (from $111.41). In summary core results were marked by broad-based top-line revenue weakness, stable compensation accrual trends (still well below historical averages) and robust capital levels (15.2% Tier 1 ratio, 12.5% Tier 1 Common ratio). Notwithstanding the accusations from the Securities Exchange, we believe Goldman retains one of the best-in-class franchises with solid market positioning across myriad businesses and strong balance sheet. Ability to gain and sustain market shares across the franchise given long track record of performance and return should sustain premium-to-peer earnings/book value growth over the course of the cycle.

- **Morgan Stanley:** reported $.80 of EPS from Continuing Ops. Excluding a tax benefit of $.20 per share, EPS was $.60, versus consensus $.46. These figures all exclude a 1-time gain of $.40 from the sale of Van Kampen to Invesco. Included were costs of $.20 in a Tax Benefit and $.27 in Debt Value Adjustments (DVA = gains on MS' own debt as its spreads widened). The UK bonus tax was also included. Revenues were $7.95B, with trading revenues strong and Wealth Management a bit weaker than expected. The positive surprise was the Compensation /Revenue ratio in the Institutional business which was 34% excluding both DVA and the UK tax, much better than expected although non-personnel costs seem to have offset this. Return on equity from operations was 12% on a reported basis, excluding the UK bonus tax, the DVA, and the tax benefit, ROE was about 7%. Given the weak operating environment and fickle markets, we believe this is an acceptable outcome as the firm continues to transition away from a proprietary trading bias and more to being client driven with steadier growth. Book value per share made a significant improvement, to $29.65 from $27.65.
- **Wells Fargo** reported 1Q10 EPS of $0.55 beating consensus of $0.48. Its loan loss provision came in lower and results included $500 million ($0.06) of reserve release (and it expects future reductions). Its net interest margin increased 0.11% to 4.38% - an extremely encouraging trend in such a low interest rate environment. Average earning assets were relatively stable with loans down 3% but its mortgage application pipeline was $68 billion at 2Q10, up 15% from 1Q10 and growth in consumer and commercial checking and savings accounts offset the impact on income and margin from the decline in loans.
- Net Mortgage Servicing Rights hedge results were $626 million (-$363MM) and included a $2.7 billion decline in the fair value of MSR offset by a $3.3 billion increase in the value of the hedge including carry income (note our forecast included $600MM of gains). Results also included $506 million non accretable difference release due to loan resolutions (payoffs/sales) in the commercial PCI portfolio ($182MM in 1Q); $627 million of operating losses primarily due to additional litigation accruals; $498 million of merger expenses; $137 million of Wells Fargo Financial severance costs; a $382 million addition to its mortgage loan repurchase reserve ($402MM in 1Q10); and $30 million of securities gains. Net, these cost it $0.01.
- Operating revenues declined 7% y-o-y and declined 1% linked quarter. Excluding the impact of Mortgage Servicing Rights, revenues increased modestly from 1Q10. Its tier 1 common ratio was 7.5% (+40bps) and tier 1 capital was 10.4% (+50bps). Ratios were adversely impacted by the purchase of $540 million of WFC warrants auctioned by Treasury (5bp cost). It had net unrealized gains on AFS securities of $8.6 billion, compared with $7.4 billion at 1Q10. These robust and improving capital ratios are testimony to its powerful diversified earnings base and ability to ride out adverse periods of liquidity without having to sell assets at distressed prices.
- Its Non Performing Assets ratio rose 26bps to 4.28%. Dollar NPAs increased 5% or $1.4 billion. The increase occurred in its real estate portfolios (commercial & residential). It stated it is taking longer to dispose of nonaccruals due to modification programs. Nonaccruals in all other loan portfolios were essentially flat or down. New inflows to nonaccrual loans declined 18%. Loans 90 days or more past due and still accruing decreased 11%. Credit trends are improving with management lowering its reserve/loan ratio 1bp to 3.21%, while its reserve/NPLs was 84%, down from 88%. Its remaining purchased (from Wachovia) credit-impaired (PCI) portfolios continued to perform better than original expectations. Its remaining PCI non-accretable balance was $16.2 billion. In particular, the Pick-a-Pay portfolio improved, resulting in a $1.8 billion transfer from the non-accretable difference to the accretable yield. This increase in accretable yield is expected to be recognized as revenue over the remaining life of the loans (8 yrs) an ongoing boost to overall margins / yield.
- **Credit Suisse** reported a CHF1.6bn 2Q10 'headline' net profit, ahead of consensus CHF1.3bn, driven by larger own-debt gains and an unexpected tax gain (implying an

underlying miss). Investment Bank (pre-tax of CHF784mn) revenues met expectations although overall trends were mixed vs. US peers (debt in line, equities better - equity trading revenues fell just –3% vs. 1Q10 in dollar terms vs. US peer –42%), with the strength attributed to prime services and, in contrast to most US peers, a "solid revenue contribution from derivatives." Conversely, Wealth Management disappointed (pre-tax of CHF 633bn was down –6% vs. 1Q10). Net inflows of CHF11.9bn (1.3% of AUM) was encouraging but possibly at the expense of gross margin and costs overall disappointed. By region, inflows were driven by EMEA inflows, which more than doubled (2Q10 CHF5.6bn, 1Q10 CHF2.4bn), which may reassure given concerns over the German data theft. CS' 'equity' tier 1 ratio rose 0.1pp to 10.3% . NAV per share dropped 8% vs. 1H10 to CHF21.6, seemingly as a result of the dividend paid (and despite the own-debt gain). Management's outlook was non-specific: "We remain confident that our strategy is appropriate and resilient in the face of an uncertain and challenging economic and market environment."

- **State Street** reported 2Q10 operating EPS of $0.93, in-line with its pre-release. Results included $50 million ($3MM in gains, $53MM of Other Than Temporarily Impaired) of securities losses ($0.07). It confirmed its outlook for 2010, which is operating EPS slightly above $3.32.
- Assets under custody declined 0.4% linked quarter to $14.0 trillion, while Assets under management fell 8% to $1.8 billion. In 2Q10, it added $1.1 trillion in assets to be serviced, including $686 billion from the acquisitions of Intesa Sanpaolo's Securities Services business (mid-May) and Mourant (early April). Operating revenues increased 10% on both a y-o-y and linked quarter basis. While expenses increased 11% y-o-y, they declined 6% from 1Q10 despite recent acquisitions. Employee costs (lower incentive comp due to sec lending charge) and other led the decline. Its Tangible Capital Equity ratio declined 120bps to 6.30% amid acquisitions, while Tier 1 common was 13.20% (-2.7%). Its unrealized after-tax investment portfolio loss improved 31% from $1.44 billion to $994 million.
- Fee income rose 12% y-o-y and rose 10% from 1Q10. Relative to the prior quarter, servicing fees, FX, securities lending and brokerage all gained, while processing & other and management fees (-lower equity markets) declined. Core net interest income rose 4% y-o-y and increased 8% linked quarter. It benefited from favorable yields in its investment portfolio as well as the impact of the Intesa acquisition. Average earning assets rose 4% with loans up 7% and securities up 1%. Its core net interest margin rose 4bps to 1.66%, while its reported NIM declined 13bps to 2.21%. Its loan loss provision was $10 million, down $5 million.
- We view operating results as relatively high quality and recurring in nature, highlighted by the contribution of recent business wins (more to come here in the back half), solid expense control and strong capital levels. Higher margin fee businesses such as securities lending and FX trading contributions were higher than anticipated, though we would expect some of that to be seasonal.
- **Bank of New York r**eported 2Q10 EPS of $0.55. Consensus was $0.55, down from $0.57 one month ago. Results included $13 million ($0.01) in securities gains. Operating revenues rose 2% y-o-y and declined 1% from 2Q10. Cash operating expenses increased 4% y-o-y and rose 3% from 1Q10, resulting in negative operating leverage. The sequential cost increase reflects higher support agreement charges resulting from a quarterly change in the market value of Lehman securities, and the U.K. bonus tax. Assets under custody declined 2% linked quarter to $21.8 trillion and Assets under management fell 5% to $1.0 trillion (both reflecting lower market values). Long-term inflows were $12 billion in 2Q10, while short-term outflows totaled $17 billion (-$5B net).
- Its Tangible Common Equity ratio was 6.3% (+20bps), Tier 1 common was 11.8% (+20bps) and Tier 1 Capital Ratio was 13.5% (+20bps). The unrealized net of tax gain on its securities portfolio was $114 million. This compares to a loss of $191 million at 1Q10. It benefited from tightening credit spreads and a decline in rates.
- Fee income rose 2% y-o-y and was relatively stable linked quarter. Relative to the prior quarter all securities servicing fee lines increased including issuer services, securities lending, clearing and asset servicing. Restraining improvement were declines in FX and other trading, investment income and Asset & Wealth Management. Within FX and trading, while FX fees increased $49MM (increased volatility), fixed income swung from a $80 million gain to a $32 million loss.
- Net interest income rose 3% y-o-y and declined 6% linked quarter. Average earning assets rose 2% with loans up 7%, securities down 2% and trading assets up 33%. Its net interest margin compressed 15bps to 1.74%. Its Non Performing Assets ratio declined 26bps to 1.09%. Overall revenue and expenses were in line with our expectations but composition was a bit different. On a positive note, core servicing fees were better than we anticipated, new

business wins/flows were nicely positive and credit quality was improved. On a negative note, more material net interest margin compression, fixed income trading losses and a slightly lower than expected tax rate all weighed on earnings quality.

- **Northern Trust** - reported second quarter earnings per share of $0.82. Reported results included $13 million of litigation accrual reversals ($0.02 EPS), discounting this means approximate operating EPS at $0.78 - ahead of expectations ($0.74). Upside was top-line driven as the Northern benefited from the seasonal uplift of international dividend season and heightened FX volatility. Results also included the recovery of previously recorded unrealized asset valuation losses of $37 million in a marked-to-market investment fund used in securities lending activities ($38MM benefit in 1Q, $19MM left we believe), testimony to the ability of a strongly capitalized firm not to be forced into selling at a loss.

- Operating revenues declined 8% y-o-y and increased 7% linked quarter. Expenses rose 2% y-o-y and increased a modest 1% linked quarter. Its tier 1 common ratio was 13.1% (+30bps) and tier 1 capital ratio was an impressive 13.6% (+20bps). Assets under custody declined 4% to $3.55 trillion, while Assets under management fell 7% to $603 billion. Fee income fell 9% y-o-y and increased 10% linked quarter. Relative to the prior quarter, FX and securities lending were strong, while PFS, investment management, custody and commissions also increased. Net interest income fell 7% y-o-y and increased 1% linked quarter. Relative to 1Q10, average earning assets declined 2% with securities up 6%, money markets assets up 11% and loans relatively stable (period-end loans +1.6%). Its net interest margin rose 3bps linked quarter to 1.47% ….which is an encouraging sign that in this low interest rate environment the firm is now stabilizing this important revenue stream. Its Non performing assets ratio increased 7bps to 1.37% whereas its reserve/loan ratio was relatively stable at 1.15%. In all – an encouraging performance from which, as the economy recovers, this client driven business is favorably leveraged.
- **Nordea -** reported operating profit of €730mn – about 1% above consensus although the fair value result in the Group was affected by a non-recurring gain of approx €50mn in connection with the merger of the two payment companies Nordito and PBS. Net interest income was in line with expectations. Encouragingly, lending and deposit volumes were up but lending margins in Nordic Banking were slightly down to 1.43% (1.45% in Q1 10) and deposit margins continued down to 0.08% (0.11% in Q1 10). Preservation of earnings stability and managing of balance sheet risks still remain top of the agenda. Total loan losses were better / lower than expectations. Danish losses stood at 45bp (66bp in Q1), Finland 45bp (45bp in Q1), Sweden no losses at all (8bp in Q1) and Norway at 7bp (22bp in Q1). Q2 shipping loan losses stood at 30bp (57bp in Q1) and Baltic losses at 114bp (166bp in Q1).
- **Julius Baer -** reported a largely reassuring 1H10 result with net new money inflows, gross margin improving to 107bps vs Consensus 106bps with costs in line with their earlier guidance and consolidating ING Switzerland for the first time. The key point is that despite integrating ING's private banking business, Julius Baer continued to deliver good results. Net new money of CHF 3.3 bn was 20% ahead of consensus and company is guiding for second half gross margin of 105-110 bps. The improvement as the burden of the Italian tax amnesty & US exit recedes is somewhat offset by end period Assets Under Management coming in 2% below consensus numbers and importantly management comments that the 12% Tier1 target has been caveated for the first time by stating it is pending changes to regulatory capital requirements. This effectively takes the edge off the surplus capital/buyback/accretive deals story. Conversely, after stripping out excess capital, Baer trades on 9.5x 2011E earnings. By comparison Baer has historically traded on 14x forward earnings.
- **Janus** reported 2Q10 EPS of $0.17, ahead of consensus of $0.14. Higher than expected revenues ($0.01) and investment gains ($0.02) accounted for the beat.
- Revenue grew by 2.2% sequentially to $249.3mn, 2% ahead of consensus. Higher revenues were not due to performance fees, which were in line at $4.3m., but rather higher than forecast average AUM of $160.2bn. And Janus recorded investment gains of $3.9mn. Net outflows were -$1.3 bn. as INTECH outflows subsided to -$1.5bn from last quarter's -$4.3bn. Total outflows are equivalent to an annualized loss rate of 3.2%. AUM of $147.2bn – the slowing trend is encouraging.
- The only negative is that Growth/Blend had $1.9bn. in outflows, due to "one significant equity mandate loss totaling $1.8bn. during the quarter. Operating margin declined to 24.6% from 27.3% in the prior quarter, in line with expectations. Expenses were a little (2.2%) higher than expected, but offset by higher revenues.
- **Toronto Stock Exchange -** Alpha Group, the Toronto Stock Exchange's main rival, plans to launch a "dark liquidity" pool that enables buyers and sellers to match trades anonymously. Canada's biggest alternative trading system, which has captured 20% of the country's stock trading market since

its November 2008 launch, said it expects to implement the facility in the fourth quarter of this year. The plan is subject to regulatory approval.

- **UK Banks:** The government has hired a City banker, Jim O'Neil, Bank of America Merrill Lynch's corporate finance chief, to pilot its sales of the part-nationalised Royal Bank of Scotland and Lloyds Banking Group.

Dividend Paying Companies

Johnson Matthey – Johnson Matthey provided a trading update for the first quarter of the fiscal year. The revenues line registered a strong 32% year on year growth, albeit compared to a low base, while the underlying operating profit shot up by 47% on a year on year basis. The very important heavy duty diesel (HDD) autocatalyst market experienced significant improvement with sales nearly double on a yearly basis and the trend is expected to continue as new emissions regulation is phased in across the world.

Syngenta – Syngenta's first half results disappointed, with earnings per share (EPS) about 9% below the consensus expectations. The main culprit was a weak pricing environment in North America where an inventory overhang from the challenging 2009 caused some of the competitors to break ranks and discount heavily. The price weakness was lead by the glyphosate (total herbicide) market meltdown, to which Syngenta has a less than 2% of the group operating profit exposure. Syngenta, the number one crop protection business worldwide continued to make market share gains and benefited from a strong growth trend in Latin America, where it holds a leadership position. The company is also on track to meet its operating profit margin target of 15% by 2011 in its seeds business.

ABB – ABB's second quarter was a clear beat in regards to the underlying earnings before interest and taxes (EBIT) as the short cycle automation business continued its strong recovery while the longer cycle businesses showed signs of turning around. The EBIT margin bounced back up to 14.6%, closer to what ABB had been posting before the recession started. Group orders were up by 5% lead by base (other than large) orders. The earnings announcement was well received by the markets, showing a clear strengthening of the capital goods industry globally.
ABB received a record order worth US$ 700m from the German transmission grid operator Transpower to supply a power link from the offshore wind farms in the North Sea to the mainland grid.
BHP – BHP revealed the production numbers relating to the last quarter of the fiscal year and they showed continued volume growth across most minerals or at least the ones most important economically, which bodes well for the company's profitability in the year just ended. The management re-iterated their cautious outlook for the global economy in the short term. The announcement also emphasized the tightness of the global copper supply, with Escondida, the largest mine worldwide being forecasted to have a 5-10% lower production in the new fiscal year due to lower copper ore grades.

Fortum reported an adjusted Q1 Earnings Before Interest & Taxation of EUR 339m, 13% below consensus. Earnings shortfall is driven by Fortum's Power Generation unit, which reported an adjusted EBIT of EUR 271m, clearly below consensus estimates. Even if the EUR 11m in additional costs (nuclear provisions and Loviisa 3) flagged by Fortum are excluded, operating earnings in the unit were clearly below expectations as both the achieved power price (EUR 44.8 / MWh) and production volumes were below expectations. Nonetheless, one quarter's disappointing revenue is not material in our view and In Fortum's other units, performance was broadly in line with expectations. Russian operations did fail to deliver the small positive EBIT we had been anticipating, although we see this as a deferral of anticipated improvements. Fortum's disclosed hedges for 2010 (80% at EUR 44 per MWh) were in line with expectations while its 2011 hedges (60% at EUR 44 per MWh) are up clearly from Q1 (45% at EUR 43). This reduces uncertainty, but also upside potential, when it comes to 2011 earnings per share. Overall, Fortum's outlook comments regarding electricity consumption (2008 levels resumed by 2012-14), Russia (proceeding as planned) and capex (EUR 0.8-1.2bn per annum in the next 4-5 years) are unchanged. However, in terms of capex in 2010, Fortum is now guiding for 2010 capex of EUR 1.5bn (previously: 'above EUR 1.2bn'). In our view, this increased near-term capex intensity is driven by Russia, where authorities have recently published very favourable financial incentives for new power generation capacity. Also, as Fortum's net debt/EBITDA stood at 2.5 (vs. its target range of 3-3.5) at the end of Q2, we don't expect this year's high capex to put pressure on the company's dividend payout. Fortum's CEO Tapio Kuula said, "The overall Nordic and Russian power consumption figures continued to increase from last year during the first two quarters of 2010. Industrial activity is clearly picking up in Fortum's key market areas."

Iberdrola reported yesterday in line 1H results. At the EBITDA level the number showed a continuation of the trends seen in 1Q: solid performance in domestic generation thanks to above average hydro and nuclear production, growth in renewables, positive forex contribution in LatAm and UK wholesale and retail

business remaining very weak. In our opinion uncertainty on the ongoing electricity sector review continues to weigh on the name. Operating results: EBITDA came at Eu3,836m (+11.7% yoy) slightly ahead of Reuters consensus at Eu3,786m. Reported Net Income came at Eu1,467m (-2.6% yoy) vs Reuters consensus at Eu1,437m. The positive growth at the EBITDA level has been more than offset by lower non recurring items contribution (Eu84m vs. Eu223m last year), higher D&A and more importantly growing Net Interest expenses due to higher average debt in the period and negative forex impact. Net debt figure came at Eu30.7bn (Eu26.6bn ex tariff deficit). Weakening Euro and higher tariff deficit in the period explain most of the growth.

Despite the encouraging earnings momentum, we believe the solid operational performance could be overshadowed by the market concerns as regards domestic regulation. Even though these worries could be transferred to the balance sheet (and therefore the need of a right issue), we believe that the securitization of the deficit in the next months might be enough to reassure the market. In our view, the stock is definitively cheap (PE of below 10x) but clearly the risk profile could keep rising due to the regulatory doubts in Spain. Management have indicated there is no need for a capital increase despite ongoing delays in the securitization of the tariff deficit. They believe the current liquidity position and the potential to use other debt reduction measures (eg capex cuts and disposals) to contain Net Debt are sufficient to avoid the risk. We believe, for 2010 Iberdrola looks well on track to achieve a 9% EBITDA growth, at the top of the range guided by Iberdrola (5% to 9%).

Economic Activity, Consumer and Business Conditions

US – Most economic indicators released last week in US revolved around housing and were not all gloomy. The existing home sales for June, while, at 5,370 thousands units annual rate, weaker than May's 5,660 thousand units annual rate, exceeded the consensus expectations which were calling for 5,180 thousand units annual rate. With the number of listings climbing, the number of months of existing homes supply moved up to 8.9 at the existing sales pace. The new home sales improved from the historically low level of 300 thousand units annual rate to 330 thousand units annual rate, exceeding the expected 320 thousand units annual rate. Earlier in the week the housing starts number came disappointingly at a 549 thousand units from 578 thousand units compared to flattish expectations. The July National Association of Home Builders's (NAHB) Housing Market Index dropped another 2 points to 14, with both current and prospective selling environments worsening and the traffic of prospective new home buyers index dropping to 10 from 13. On a broader economic perspective, the Leading Economic Indicators (LEI) index for June decreased by – 0.2% compared to the expected -0.3% monthly reduction, indicating that the economic recovery process might slow down.

Canada – The inflation worries in Canada were toned down by the Consumer Price Index (CPI) reading which at the headline level retreated to 1.0% on a year on year level in June compared to 1.4% in May. The core (excluding food and fuel mainly) reading moved lower as well to 1.7% year on year change from the 1.8% year on year change in May. Some inflationary effect is expected from the introduction of the HST as of 1st of July.

The May retail sales in Canada were unexpectedly weak retreating by 0.2% compared to an expected 0.4% improvement. The main drags were the building materials sales, as sales volumes were pulled forward by the tax incentives, as well as the auto and gasoline sales. The retail sales excluding motor vehicles and parts were also down, by 0.1%, in the month of May.

The Net Foreign Investment report revealed significant inflows of 23.16 billion CAD in Canadian securities in May, a record level. The majority of the funds went into fixed income instruments, federal bonds in particular.

Australia export price index rose +16.1% in the June quarter, the biggest jump on record.

German business confidence spiked to its highest level in 3 years in July after exports boomed and economic growth accelerated. The IFO business climate index for July had the largest monthly gain since records started for a reunified Germany.

UK GDP rose 1.1% in the 3 months through June, almost twice as fast as the +0.6% gain predicted by economic forecasts.

Hong Kong inflation at 19 month high . Hong Kong's inflation accelerated to the fastest pace in 19 months as the costs of rents and meals climbed. The CPI rose 2.8%, up from the 2.5% seen in May and slightly above market forecasts.

Brazil's central bank raised interest rates 50bps last week, after two, punchy 75bp hikes so far this year. This was more cautious than the consensus and with powerful transmission from commodities to the domestic economy, well-considered policy is vital.

Financial Conditions

Funding stress appears to be improving on a daily basis as the market clearly is shifting away from funding issues to arguing the pace of recovery/double dip. Spain, Ireland, and Greece have all had recent successful bond auctions with very high levels of demand, Spain/German bond spreads which were once over 244 bps are now down to much more moderate levels of 153 bps, LIBOR/OIS spreads and FRA/OIS spreads are now back to early May levels, not perfect by any means…but improving nonetheless.

Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.40% and the U.K.'s 2 year/10 year treasury spread is 2.56% - enabling financial services companies' assets booked at these levels, to be very profitable.

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, Spanish and German regional banks – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (103 to-date in 2010) and we expect will exceed last year's 140 which was the highest annual tally since 1992. This supports our view that 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. The FDIC changed 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 4.56% - the rate marks another record low over the last 39-years. A year ago, rates for 30-year mortgages averaged 5.20%. Existing U.S. housing inventory has increased to 8.9 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 23.47, 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, 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.

Market Commentary

PORTLAND INVESTMENT COUNSEL™

July 26, 2010

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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The content of this document is for informational purposes only and, in no way, should be construed as financial advice. Please consult a professional advisor for advice related to your specific situation.

Certain statements included in this document constitute forward-looking statements, including those identified by the expressions “anticipate,” “believe,” “plan,” “estimate,” “expect,” “intend” and similar expressions to the extent they relate to the Fund. The forward-looking statements are not historical facts, but reflect the Portfolio Management team’s current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. The Portfolio Management team has no specific intention of updating any forward-looking statements whether as a result of new information, future events or otherwise.

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