Market Commentary

PORTLAND INVESTMENT COUNSEL™

August 3, 2010

News Highlights on Current Holdings

Financial Services Companies

- HSBC reported Profit Before Tax (ex Fair Value gains) of US$10bn in 1st Half 2010, versus consensus of US$8.6bn. Driving the beat was reduced bad debts, which were $ 7.5bn – about US$2bn lower than expected. Driving the beat were lower bad debts in the US (c.US$1bn), Europe (c.US$700mn) and Asia (c.US$400mn). In the US, HSBC saw a reduction in bad debt in each division with solid improvement in HSBC Finance. This was notable in cards; delinquencies fell to 5.6% (1Q10: 6.8%). Outside the US, bad debt fell sharply in Europe, with HSBC noting a significant improvement in commercial real estate and in Asia, as the economy rebounded. We expect trends to continue to improve and for bad debts to normalize further.
- Revenues fell by 11% on an underlying basis, reflecting tough Global Banking Markets compared to last year, a 30bp reduction in the Net Interest Margin (NIM) and a US$2.1bn swing in hedge ineffectiveness. The North American unit returned to profit for the first time in three years. Margins appear to be stabilizing and HSBC has rekindled risk appetite in Asia. Asia loan growth was 15% compared to 4% globally. NIMs fell to 2.04% from 1.81%, and the group has been cutting back on some loan portfolios, particularly in India, where impairment charges are high. Mainland China pretax-profits were up 70% to US$1.28bn, accounting for 23% of group profits up from 16% a year ago. “Mainland companies expanding overseas accounted for half of the new customer growth in commercial banking in HK” CEO Michael Geoghegan stated. 2010 should mark the trough for revenues in our view.
- With a core tier 1 of 9.9% HSBC is very well capitalized. Basel 3 impacts have been diluted; we think resumption of a more normal dividend is increasingly likely.
- BNP - reported a 2Q10 Net profit of €2.102 bn down 8% QoQ but 21% above consensus (included fair value gain on own debt of €235m in its corporate centre) with revenues of €11.174bn, 6% above consensus and provisions coming in lower by 19% QoQ, which was 29% better than consensus. Group wide provisions are at their lowest since Lehman’s failure. Loan loss numbers in BancWest and CIB, in particular, saw significant improvement. The pre provision profit was down 4% vs 1Q10, which was 13% above consensus. As expected Corporate & Investment Banking saw revenues decline 28% QoQ with pre tax €1278mn some 9% above consensus aided by relatively robust earnings from fixed income, currencies ad commodities and a provision reversal of €61mln. Retail revenues were 4% below 1Q10, yet 14% above consensus with beats on consensus divisionally leaving group Profit before tax €3676mln 33% above consensus numbers. French retail banking was stable and BancWest delivered a good result with a pick-up in revenues and lower provisions
- Visa (V) delivered another solid qtr, with F3Q revenue up 23% and EPS of $0.97 vs. Street at $0.93. EPS upside was driven by lower incentives, better cross-border trends, and a lower tax rate, which were partially offset by CyberSource transaction costs.
- While regulatory questions remain, we believe that the fundamentals of the model continue to speak loudly with Visa on track for FY10 revenue growth at the top end of 11%-15%, operating margin in the “mid to high” 50% range, EPS growth of 20%+, and FCF of $2 bn+. In addition, Visa remains on track for FY11 EPS growth of 20%+ and FCF of $2bn+.
- This quarter’s result were another reminder of the strong trends driving the Visa model as volume growth was bolstered by global spending, continued penetration of electronic payments, cross border, and the ramp of emerging payment channels; which have held up through the month July with payment volumes up 13%-14% yoy.

- Admittedly, there are still various moving parts to be resolved on the regulatory front; however, the impact of those developments is months away and is expected to be marginal, while the earnings results provide a reminder on what makes these models attractive investment vehicles—namely, the robust earnings growth and returns.
- Global Payments Network (GPN) reported fiscal 4Q EPS of $0.58 beating consensus of $0.57. Revenue in the quarter beat forecast due to strong U.S. growth; however, SG&A expenses were higher than expected. U.S. transaction growth accelerated to 19% in the fiscal 4Q, although this strong growth was largely driven by the lower-margin ISO business.

- Our positive view on GPN is based on the breadth of the company’s growth opportunities, the strength of the management team, the flexibility of its balance sheet, and its strong free cash flow generation. GPN continues to successfully use acquisitions to reinvent its growth prospects. With international operations now spanning Asia and Europe, we believe GPN is well positioned to benefit from higher payment processing growth rates outside the U.S. As an added bonus, GPN continues to drive surprisingly strong growth in its core U.S. merchant processing business by retaining and adding to its ISO clients. GPN is not immune to the weaker economic conditions, but we think its transaction-based, recurring revenue, and high free cash flow business model stands tall in challenging environments.

- AFLAC (AFL) reported Operating EPS of $1.35 vs. consensus of $1.33. The beat versus was entirely in the U.S. segment where premiums were higher and the benefit ratio a bit better than expected. BVPS was $21.30, up 11% QoQ. Risk Based Capital (RBC) ended June >560%, up from 539% at March, implying cushion above 400% of about $2b. 2010 EPS guidance assuming 90 Yen/Dollar for the remainder of the year is $5.44. 2011 guidance unchanged at 8-12% growth assuming constant currency.
- We view AFL's second quarter results positively given the upside in EPS, robust Japan sales, better than expected U.S. sales, and an increase in the RBC ratio. The potential for portfolio impairments remains a risk, but we believe that AFL has adequate capital to withstand losses without suffering a ratings downgrade or having to raise equity.
- INVESCO (IVZ) reported solid EPS of $0.27, better than the consensus of $0.26. Earnings positives include lower taxes, better Van Kampen revenue, and faster synergy realization. Negatives were a greater investment loss and higher INVESCO distribution costs.

- Analyst day emphasizes fast growing global footprint and benefit of Van Kampen deal. We feel very positive about the firm's competitive position amid secular industry changes, which was further strengthened by the recent completion of the Van Kampen/Morgan Stanley retail deal. Our key takeaways from investor day include: 1) consolidation of the US retail distribution channel creates a competitive advantage for IVZ to deliver a higher organic growth for the combined company; 2) Institutional demand for alternatives and passive (ETFs/structured) products globally bodes well for IVZ's diverse asset mix; 3) net operating margin could expand another 500-600bp from 2Q levels over the next two years.
- Franklin Resources (BEN) reported EPS of $1.58, $0.09 which was $0.10 ahead of the Street. Results included roughly $0.04 of net one-time benefits as a tax benefit ($0.07 positive) was partially offset by a sublease charge and non-recurring impairment totaling $0.03 after-tax. Results also included sizable performance fee and carried interest gains. The remainder of the upside is primarily explained by a higher average fee rate. Operating margin in the quarter was 34.0%, up 140bps sequentially.
- BEN generated extremely strong organic growth that materially outpaced its public peers. Net flows of $21.9 billion represent annualized organic growth of 14.9%. The majority of the upside is attributable to the Global Bond strategy where inflows were $16.1 billion.
- Thomson Reuters (TRI) reported Revenue of $3,216m vs. consensus of $3,218m, EBITDA was $839m Vs consensus of $857m, Operating Profit margin was 20.4%.Management affirmed its standing guidance of flat to slightly down full year revenue ex-currency and 100 bp operating Income margin decline (flat ex-investment). It added an expectation that 3Q will see organic revenue growth for the company after declining since 2H2009. The prior expectation had been for broader 2H revenue to grow.
- MetLife (MET) reported 2Q operating EPS of $1.23, versus consensus of $1.00. Per management, normalized EPS is estimated at $1.11. MET produced strong earnings across its franchise, with most businesses exceeding estimates on a normalized basis. MET reported net realized investment gains of $767 million (primarily due to derivative gains) versus $2 million last quarter. Relative to 1Q/10, book value per share including AOCI increased 10% to $45.51, while book value per share excluding AOCI increased 4% to $44.50.These result bodes well for future ROE improvement, particularly once the company closes its acquisition of ALICO scheduled for late 2010.

- MET's top line revenues (i.e., premiums, fees and other revenues) increased 4% from 2Q/09. Drivers included 34% growth in Retirement Products and 21% growth in International (or 13% on a constant currency basis). Offsetting these strong increases was 2% growth in Insurance, which tends to be slower growth, and a 17% decline in Corporate Benefit Funding, which tends to be lumpy due to the close out business. Variable annuity deposits were roughly $4.5 billion, or in line with the year ago quarter, suggesting MET is defending its VA market share. Net flows were $2.3 billion, down 15% from the year ago but up 28% from 1Q/10. Separately, investment spreads and underwriting margins were generally stable. Lastly, MET's balance sheet continues to improve.
- Ameriprise (AMP) delivered a 2Q10 EPS upside surprise of $1.10 versus consensus of $0.73, driven by two areas that have been a major focus for the firm – Advice & Wealth Management and Asset Management. Better top-line and bottom-line results came on the back of improved client activity, higher average account balances, well-managed expenses and inclusion of two months of Columbia's results.

As a result, asset gathering businesses comprised 43% of the firm's core pre-tax income (ex. corp and eliminations), up from mid-20% in 1Q, with a pre-tax margin of 15.4%, up 200bp qoq. Also, AMP repurchased 5.7 mn shares ($220 mn) during the quarter, with still over $1.5 bn of excess capital leaving the door open for additional buybacks.

- Santander: Profit of €2.5bn vs. consensus of €2.3bn, driven by lower than expected loan losses Net Interest Income increased 4% QoQ, partly driven by currency. Revenues in-line with consensus, better fees offset by weaker trading. The Non Performing Loans ratio spiked higher, as expected, with group coverage marginally decreasing to 73% albeit with Spanish book at 53%. In Continental Europe - deposits showed another strong quarter of growth, rising 13% QoQ. Loan growth came in at 3%. The division's loan/deposit ratio continued to fall, dropping to 138% in the quarter - however this is coming at the cost of pressuring the net interest margin. The two current main attractions, Brazil and UK, both showed flattish QoQ trends in local currency terms but profit before tax was pushed up higher by a reduction in loan losses and in Brazil, customer loan growth remains encouraging – up 5% compared to last quarter. Results from Mexico were strong, particularly credit expansion (which bodes well for BBVA's larger franchise in Mexico). Overall results were modestly better than expected as the group's operating trends are less volatile than other banks that are less retail-centric.
- UBS: Second quarter results, a pre-tax profit of CHF2,614m was 25% ahead of consensus with group revenues CHF 9.2 bn ahead of consensus CHF8.3 bn. Net new money outflows lost further pace: Wealth Management CHF-5.2bn (1Q: -8.0bn), Wealth Management Americas: CHF-2.6bn (1Q: -7.2bn), Global Asset Management: CHF+3.4bn (1Q: -2.6bn). At the same time, surprisingly favourable margin trend in Wealth Management, with gross margin up to 95 bps from 93 bps in 1Q (consensus: 89 bps). Investment banking strong on secondary market side: equity securities +9% q/q (best in peer group), Fixed Income, Currencies and Commodities -21% q/q (second-best in peer group). Special items: positive revenue impact from valuation of own credit +CHF595m, Debt Value Adjustments +CHF280m, UK bonus pool tax CHF-242m, restructuring charges CHF-119m. In all, UBS' restructuring is gaining pace and increasingly retaining clients and assets.
- Deutsche Bank: Second Quarter's results pre-tax profit of €1,524m, slightly below Reuters consensus of €1,571m. While capitalization has been less of a short-term catalyst (leverage ratio at 23x and core tier I of 7.5% unchanged – apparently, hedges), the investment bank's contribution (€779m pre-tax profit) was the drag (similar to other investment banks – Goldman Sachs in particular). Secondary market revenues in equity was down 32% q/q, Fixed Income, Currencies and Commodities -44%. Revenue-wise asset and wealth management and private & business clients stronger than assumed, but surprising €12bn net new money outflow in Asset Management in the quarter.
- Mediolanum : Net profits of €85m for first half of 2010 were a touch lighter than consensus. One important reason for the shortfall was an unexpected €4m tax provision taken in Q2. Adding this back, the result is broadly in line with expectations. Book value per share reduced from €1.46 per share at the end of Q1 to €1.37 per share at the end of Q2 (back to end 2009 levels). Looking at the main operational trends, net inflows of €2.6bn for first half were very respectable, in our view. Total assets under management closed Q2 at €43bn (+7% year to date, +30% Year on Year). Customer (+1%), advisor (-2%) and bank account (+1%) numbers did not move materially YoY. Overall, First half revenues were up 7% YoY. Total costs increased by 17% YoY, partly due to a disproportionate cost allocation to Q2 (marketing spend). This left pre-tax income 17% lower YoY, and a higher tax charge meant post-tax income declined 21% YoY. The tax provision may turn out to be prudent. The charge relates to a reduction in the tax deductibility of changes in life reserves in Italy. There is no guarantee that the law will be passed and even if it is, it is possible in our view that companies find a way around it. The €4.3m charge taken in H1 is based on 1.5% of the relevant reserve base (around €1.1bn) multiplied by the tax charge (27%). The results presentation provided a positive outlook for the second half of the year with there being a number of reasons to be more optimistic: the ongoing management fee base is building (+41%); expenses should level out in Q3 and Q4; the tax provision may turn out to be conservative; and performance fees and spread income are more likely to recover in H2 than get worse.
- Western Union : reported 2Q revenue and adj. earnings per share of $1.27B and $0.36. Operating margins across both C2C and Global Business Payments (GBP) held up at combined 27% and year-on-year C2C transaction growth of 9% was led by growth of 28% in the Americas business. By segment, C2C op. margin expanded to 29.1%, from 27.6% a year ago, while Global Business Payments declined to 18.9% from 26.8% (primarily reflecting the Custom House

acquisition).

- International grew 7%. WU raised its 2010 EPS outlook (ex-restructuring) to $1.31-$1.36 from $1.29-$1.34. The company raised its 2010 revenue outlook to -2% to +1% from -2% to -1% previously. On a constant currency basis revenue is expected to grow by 0 to +3%. On a negative note, transaction and revenue growth from India and China (~7% of total revenue) declined from 1Q and Gulf state transaction volume continues to decline.
- Deutsche Börse reported Q2 EPS of €0.87, ahead of consensus of €0.76. The strong performance was driven primarily by operating costs reductions and the company now expects to come in below its 2010 cost guidance of €1,210mn but has not specified a revised target. Q2 sales of €564.4mn was broadly in line with consensus (€561.5mn). The interest cover ratio stood at 20.2x in Q2, well ahead of the 16.0x targeted to support the AA credit rating. Headroom was supported by €90mn of bond buybacks in H1. Strong cost discipline and the option to repurchase more debt in H2 should help to allay lingering concerns about interest cover although given Q3 activity is currently slower, lower volume growth may largely mitigate strong cost discipline.
- Legg Mason reported June quarter earnings per share of $0.30, $0.01 below consensus. Excluding the $0.08 cost associated with a large closed-end fund sale and severance, we estimate normalized earnings of $0.38.
- Outflows of $23.1bn were probably as expected but $8.7bn long-term outflows were only slightly better than the March quarter. Fixed income outflows of $9.4bn. worsened, with Western (74% of LM's long-term AUM) losing mandates in its Core and Core Plus strategies (20% of its AUM), suggesting continued difficulties despite improved recent performance. Equity flows were positive at $0.7bn. due to a $1.1bn. closed-end fund. The successful launch of a large closed end fund added $17.6mn to operating expenses in the quarter, divided between distribution ($14.8mn) and compensation ($2.8mn). Underlying expenses appear stable however.
- Sarasin: 1st Half net profit of CHF51.2mln was disappointing versus consensus expectations of CHF 69mln. Extremely strong inflows - net new money of CHF 6.3bl were offset by poor trading revenues and fees leading gross margin to drop). Of course Management will view the poor trading results as a one off and in this regard we are inclined to the view the longer –term sustainability of this franchise as very attractive as evidenced by strength of inflows.
- Chinese Banks are facing serious default risks on more than 1/5th of the E879bn they have lent to local governments across the country, according to senior Chinese officials. The loans are mostly used to fund regional infrastructure projects – some of which are unlikely to be completed and now perceived as unlikely to be repaid in full. Standard & Poor's has estimated that if 30% of loans to local government become irrecoverable it would add 4-6% to overall non-performing loan ratios at the local chinese banks. China's banking system had a non-performing loan ratio of more than 50% a decade ago – whereas today the ratio is approximately 1.3% ... in our view it does seem likely that at least part of the price of China's fiscal stimulus is to be charged across its banks ... such command-economy tactics makes, in our view, an unattractive longer term investment environment in China's local banking sector.

Dividend Paying Companies

- Hong Kong Electric / Hutcheson Whampoa: A consortium led by Cheung Kong Infrastructure (85% owned by Hutcheson Whampoa) and Hong Kong Electric (Hong Kong-listed infrastructure and electric companies) announced on Friday they have won the auction (beating a consortium that included Macquarie Group and Canada Pension Plan) and are set to pay £5.775bn for EDF's UK electricity networks. This includes assets such as long-term contracts with businesses such as London Underground, Heathrow and Gatwick airports, and the Channel Tunnel. The Offer is subject to approval from shareholders of CKI and HEH, as well as being conditional on the European Commission deciding there is no merger control issue. We believe the deal highlights that infrastructure funds continue to see significant value in UK regulated businesses. These are long-duration, RPI index-linked assets remunerated in real terms; they have a very strong and proven regulatory structure; and are still in short-supply, in our view which is why we hold National Grid and Severn Trent (electricity transmission and water services, respectively).
- Pearson reported record first half adjusted EPS of 16.6p, as notable organic growth in each division and continued market share gain delivered impressive results across the board. As a result, management increased its full year 2010 guidance, indicating that it expects an adjusted EPS of 70.0p. We believe that a combination of market share gains in most if not all areas of activity, combined with accelerating university enrolment around the world, growth in emerging economies and a renewed emphasis on consumer-funded education services will drive the bulk of the growth. In addition, while there are risks associated with difficult government funding in most developed economies, some signals are encouraging and suggest that conditions in US school curriculum (which still represents 12% of Pearson's

revenues) may even improve in 2011. Pearson's growth has historically been driven by its Education division, which operates primarily in the highly defensive U.S. education segment and we expect North American Education (as well as International Education) to account for the bulk of growth going forward. We believe, however, that there will be more growth and market share gains to come with the steady shift to digital education programs, particularly at the time when Pearson's competitors are negatively affected by capital constraints.

- SK Telecom : For 2Q10, SK Telecom reported W3.1tn in revenue, W582bn in Operating profit and W364bn in net income. The lower-than-consensus results were driven by the following factors: (1) 40% YoY decline in sign-up fees due to decrease in new subscriber numbers and (2) 16% YoY decline in call charges due to adoption of 1-second billing plan. Mobile data revenue is up 6% YoY and 7% QoQ, respectively, but total ARPU (average revenue per user) declined 5% YoY and remained flat on QoQ basis. Marketing expense increased incrementally on a QoQ basis but decreased on a YoY basis which indicates that marketing expense cap is having an incremental effect. SKT has already captured 1.7mn smartphone subscribers (1.22mn smartphone subs as of 2Q10) and has raised its target smartphone subscriber number to 3mn. Current smartphone subscribers are generating W55k in ARPU which excludes sign-up and interconnection fees. Management indicated it will roll out 10k Wi-Fi hotspots by the end of September and has increased its capex guidance by W100bn (+5.7%) to W1.85tn. We believe that the absolute downside risk to the share price is modest as SKT share price is trading at its 5-year low range and SKT is expected to pay W8,400/share in dividend at year-end providing dividend yield of 5%. In addition, we believe that the announced share buyback will also provide support in the near term.
- Syngenta – The European Commission approved the import of six genetically modified varieties of corn, two of which were developed and are being marketed by Syngenta. The approvals are varied for 10 years and cover imports for food and animal feed, but not for cultivation. The European Commission is thus trying to prevent last year's animal feed blockade caused by finding trace amounts of unapproved GM corn traits in imports coming from the United States. In regards to cultivation, a regulatory package proposed last month, would leave the decision with individual country members.
- Wesfarmers – Wesfarmers provided a fourth quarter retail sales up-date last week, showing good results across most of its retail lines, in particular in its all important grocery business Coles. Coles reported 4.2% comparative sales growth in the last quarter of the fiscal year, against a very strong fourth quarter of the 2009, which was significantly boosted by last year's Australian stimulus package. The success in the grocery division was assured by a well executed price repositioning strategy as well as by a revamping of the fresh category led by a Curtis Stone promotion. Similarly, the group's leading home improvement retail business, Bunnings, registered a 2.3% growth compared to the fourth quarter of the previous year, which had grown 14.7% on the back of the same stimulus package.
- Wesfarmers-owned Coles has launched its own brand of car insurance, making for the fifth new entrant in the $6.2bn Australian car insurance market in the last two years.
- Bayer – Bayer announced their earnings result for the second quarter of 2010, with weakness in the Crop Science and Health Care divisions being offset by a better than expected result in the Materials Science division. The group underlying earnings before taxes, interest, depreciation and amortization (EBITDA) at 1,917 million USD were mildly below the consensus expectations at 1,990 million USD. A weak soft commodity environment and an inventory over-hang in North America, which lead to pricing weakness in the crop protection industry were the main culprits for the miss in the Crop Protection Division. The Health Care division suffered from weaker than expected sales in its pharma business, with the YAZ (women health) franchise being affected by the early introduction of a competitive generic, while the consumer health business was actually strong. The Materials Science division (polyurethane and polycarbonates) recovered strongly with volumes returning to pre-crisis level and pricing improving in Asia/Pacific and Europe. The management of the company remains optimistic in regards to a continued recovery through the rest of the year and committed further resources to the development programs with the stated target of maintaining the status of the leading research based pharmaceutical and chemical company in Germany.
- Siemens – Siemens reported a strong beat for the third quarter of the fiscal year with earnings per share more roughly 18% higher than the consensus expectations. A strong recovery in orders, driven by the short cycle businesses of automation and drive technologies lead to a record breaking order backlog of 89 billion EUR. The sector (core businesses of Siemens) profit was 2.3 billion EUR, an all time high. The company announce its intention to divest its below the line Electronics Assembly Systems (EAS) business, a perennial underperformer, to ASM Pacific Technology, headquartered in Hong Kong. The management maintained its previous full

year guidance, which has become extremely conservative given recent outperformance.

- GEA – GEA group of Germany, the engineering company leading the heat exchange, mechanical separation and farm technologies, reported results for the first half of the year which were broadly in line with consensus expectations. Order intake, up 7% year on year on an organic basis exceeded the consensus expectations of 3% growth. Orders growth was particularly strong in Asia Pacific, while 44% of the group sales is being generated in the emerging markets. Group's operating margin improved in the second quarter to 6.7% or 30 bps higher. GEA targets a margin improvement to the 12% level, to be driven by divisional and legal reorganization.
- Shell's 2Q10 adjusted net income of US$4.2bn came in 5% above consensus, its steady operational improvement reflects the progress made in restructuring the company. The star of the quarter was the Downstream segment (US$1.16bn) driven by an improvement in margins and a solid contribution from Chemicals. The Upstream segment was a touch lighter than anticipated - despite Exploration & Production volumes of 3.1mmboe/d, showing an impressive 5.5% growth YoY - due to the growing contribution from low-value barrels in Nigeria and lower natural gas realisations during the quarter…. Attention does seem to be turning to optimizing the group's existing portfolio of assets. Dividend per share of 0.42/sh was in-line. Importantly, cashflow generation (cash from ops before capex) was stronger than anticipated at US$8.1bn.

Economic Activity, Consumer and Business Conditions

- US – The important GDP report issued last week revealed, through its final revision, that the American economy grew at a 3.7% pace in the first quarter of 2010, far exceeding the previous estimate of 2.7%. Only partially offsetting the good news, the second quarter GDP growth clocked in at 2.4%, marginally below the consensus expectations of 2.5%, in its advanced reading. Key contributors to economic growth in the second quarter were non-residential investment, consumer spending and investment in private inventories. The only factor detracting from the economic growth was the change in net exports which removed 2.8% from the headline number, as imports expanded rapidly during the second quarter, faster than the exports growth.
- In the manufacturing sector, the good news were supplied by the Chicago purchasing managers index (PMI) which unexpectedly rose to 62.3 from 59.1, while the consensus was expecting a drop to 56.5. While a narrower indicator compared to the national based Institute for Supply Management (ISM) PMI, it is a reasonable estimator of the later and of the manufacturing activity. On the flip side, the actual goods orders reported for the month of June disappointed on the downside, with the core reading down 1% on expectations of a 1% increase, while the core number, excluding transportation orders was also down by 0.6% on expectations of a 0.3% increase.

- The consumer confidence surveys are showing a decrease in confidence with the University of Michigan's Consumer sentiment final reading for July moving lower to 67.8 from 76.0, albeit higher than the expected 67.0 reading, while the Consumer Confidence reading by the Conference Board earlier in the week resulted in a drop to 50.4 from 54.3, with the consensus expectations calling for 51.0. On the housing front, the search for a bottom in new housing sales continues, with sales moving higher to 330 thousand units annual rate from a revised historical low of 267 thousand units annual rate. Not surprisingly housing starts have retreated to 549 thousand units annual rate in June from 578 thousand in the month of May. Luckily the housing pricing seems to be holding the line with the S&P/Case-Shiller latest reading improving by 4.6% year on year.

- Canada – Canadian real GDP grew 0.1% in May, as expected, on top of a flat reading the month prior. The growth was lead by the goods producing industries, in particular oil and gas and agriculture. The average weekly earnings continued to grow in May at a 3.7% year on year pace, surpassing the 3.3% year on year growth in April. Inflationary pressures are not being felt anywhere else, with the Industrial Product Price Index actually contracting by 0.9% in June on a month on month basis, while the raw materials price index contracted by 0.3% over the same time period.
- UK house prices fell in July for the first time in 15 months as the government's budget squeeze curbed demand and more people tried to sell their properties, Hometrack stated last week.
- UK July's UK CBI distributive trades survey suggests that high street spending is recovering strongly. The reported sales balance leapt from -5 to +33, its highest level in 3 years. The survey covered the period from 23rd June to 14th July and so would have captured some of the boost to sales in June from the World Cup and warm weather. Nonetheless, retailers are optimistic about August, with the expected sales balance even higher at +45.
- India : The Reserve Bank of India (RBI) increased its two key policy rates last Tuesday – the repo rate was lifted 25bp to

5.75% and the reverse repo rate 50bp to 4.5%. This should be no surprise given that industrial production has been climbing at a double-digit pace since the end of 2009. The economic upswing looks set to stay strong and high inflation has now developed into a big political problem as well as a major policy challenge. Rates are likely to be move up a further 100-125bp over the next 12 months and the next hike will probably happen in mid-September.

- New Zealand : The Reserve Bank (RBNZ) lifted its cash rate by 25bp to 3.0% last week, as expected. Exports should remain a bright spot but domestic indicators have been softer than anticipated by the RBNZ and will probably continue to disappoint. The tightening cycle has only just begun and, although it is a close call, it is expected there will be another 25bp hike at the next meeting in September. The RBNZ is then likely to stay on hold into 2011.

Financial Conditions

- UK Financial Regulation – Last week the U.K Government published details to consolidate and enhance its financial regulatory structure by transferring more powers to the Bank of England. The new supervisory system includes:
  - Tripartite system to be dropped
  - Bank of England to play senior role in future crises
  - Financial Services Authority to be dismantled
  - New Financial Policy Committee at Bank to set macro-prudential policy
  - FSA's supervision unit to be the kernel of new Bank offshoot, the Prudential Regulation Authority
  - FSA's markets and enforcement units to be put into new Consumer Protection & Markets Authority
  - CPMA to take consumer credit responsibility from the Office of Fair Trading; and
- Clearing houses should be brought under the direct supervision of the Bank of England, the UK Treasury proposed, in the strongest statement by any European government that such financial institutions should be more tightly regulated.

- ECB funding - The European Central Bank last Wednesday announced big increases to the discounts it will impose on low-rated and illiquid bonds when it accepts them as collateral for its lending operations. The new discounts, or haircuts, which will come into force Jan. 1, 2011, will make it harder for banks to borrow from the ECB using low-quality bonds. The ECB had greatly expanded the range and quality of paper it would accept as collateral in the wake of the financial crisis, to ensure that banks retained access to funding as the wholesale money markets seized up. This is further evidence of the ECB weaning the financial system off funding sources that were not available in normal markets.
- Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.39% and the U.K.'s 2 year/10 year treasury spread is 2.51% - 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 (108 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 4.54% - the rate marks another record low over the last 39-years, the lowest since Federal Reserve began tracking rates in 1971. The last time home loan rates were lower was during the 1950s, when most mortgages lasted just 20 or 25 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 22.01, 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.

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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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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