News Highlights on Current Holdings

Financial Services Companies

- ING reported very strong results. Net underlying profit came in at €1.2bn, versus consensus of €731m. Similar to other European banks, first half results are particularly strong in banking at €1.6bn versus consensus of €1.1bn. Insurance was weaker than expected at a loss of €115m versus consensus of €22m loss. On a divisional basis, the strong performance of the bank is largely driven by commercial banking with earnings of €564m, compared with consensus of €355m. The strong performance is driven by financial markets and structured finance which both reported much stronger revenues albeit the interest margin is down slightly, at 136bps (-6bps). Loan loss provisioning (LLP) continues to trend down and the company guides LLP for H2 to be around the same level of H1, which is an improvement in guidance of €300m. The core tier 1 ratio came in at 8.6%, up from 8.4% in Q1. The weakness in insurance earnings is largely driven by the US with losses of €472m, versus €263m loss estimated. The higher than anticipated losses seem to be due to higher than expected DAC unlocking. Although Central and Eastern Europe was weaker than expected largely due to some realized losses on the exposure to Southern European sovereigns, results were largely in line in the other main regions. The company guides separation costs of the bank and insurance operations to be around €110-150m for 2010, of which €30m has already been taken in H1. No additional details have been provided in these latest results and we continue to believe the eventual divestment (probably by 2013) will be done at a timing and level more beneficial to shareholders than originally feared when the European Commission ruled on the need for the divestment.
- National Australia Bank 3Q trading update: showed that the underlying business continues to show reasonable growth although this has been eroded by mark to mark in the special assets group. Bad debts continue to trend down, while flat margins is a positive surprise (quantified on the conference call at 2.27% 3Q10, up 1bp on 1H10) with revenue growth of 1.5% a bit lower than best expectations but still signaling in our view that NAB looks capable of returning to revenue growth in most of its core divisions. NAB stated that the Australian business credit pipeline remains strong (reaffirming their +6.5% Australian system business credit growth projection), but that system-wide recovery was now more likely in 2011 given residual global uncertainties and the pending Federal election. Nevertheless, NAB stated that Business Banking 3Q10 lending volumes improved sequentially, although competition for loans and deposits remained intense.; New Zealand Banking demand for both business and consumer credit was relatively low.; UK Banking deposit growth remained strong. NAB stated that cost growth was moderate. (quantified on the conference call at 3%) and that the Aviva Australia integration was progressing well, with cost synergies ahead of expectations. It stated that the 3Q10 bad debt charge was $510mn (equivalent to an estimated 46bp), a decrease on the 1H10 average, with NAB stating that the year-to-date charge was 51bp, but that they expected a lengthy timeframe over which bad debts were expected to normalise.
- National Australia Bank concessions to win regulatory approval to buy Axa Asia Pacific were referred to rivals for comment according to the Financial Times last week. NAB offered to sell Axa Asia Pacific's North investment platform to IOOF Holdings. Australian Competition Commission asked for responses from industry to the proposal by Aug. 23 and plans to make a decision by Sept. 9, it said on its website. The decision to seek feedback on the plan, rather than reject it, is a positive move and brings the deal closer according to the Financial Times' article.
- Lloyds Banking Group and Scottish entrepreneur Tom Hunter are near to finalizing a £150m ($240m) sale of retail properties to Legal & General Group Plc.
- Prudential plc: press reporting an expected rise in dividend to try and placate investors still smarting following the failed bid for AIA (the Asian franchise of AIG).
- US financial regulation: New whistle-blowing incentives within the Dodd-Frank financial reform act, that could net informants 10% - 30% of any sanction imposed over $1m, are, according to the Financial Times, expected to generate a surge in allegations against US listed companies and Wall Street banks given the prospects of multimillion payouts.

Dividend Paying Companies

- Nestle – Nestle reported, as we have grown accustomed to, solid results in an overall difficult end-user environment in the first half of 2010. The top line grew at a 6.1% organic growth rate, with the core food and beverage businesses growing at 5.7%, exceeding the company's perennial 5% organic revenue growth goal. Growth was supported broadly by all the geographic regions, led by Latin America and Asia, as well as by all the product groups led by Powdered and Liquid Beverages, including the top selling brand Nespresso. The management raised its revenue target to a 5% organic growth, up from the previous guidance of better than 2009's 3.9% organic growth, pointing out though that the second half of the year is expected to be more challenging with increased cost pressures and forecasting 2-3% raw materials inflation for the full year. The company accelerated its investment in consumer facing marketing up 14% versus the first half of 2009, which supported its sales even in tougher conditions and is expected to sustain sales going forward as well. The company enjoyed improved profitability with the earnings before interest and tax (EBIT) margin up 80 bps to 15.1%, while the earnings per share were 13.5% higher at 1.60 CHF/share. The company announced it will continue its share buy-back program with 5 billion CHF earmarked for the second half of the year.

- Schindler Holdings – Schindler Holdings' subsidiary ALSO, a major publicly listed European IT and consumer electronics distribution company, will be merging with Actebis, a subsidiary of Droege International, to form Europe's third largest IT distributor with revenues of about 9.5 billion USD. Schindler's stake of 64% prior to the merger forced the company to consolidate the subsidiary on its books. Past the merger, Schindler's interest in the combined entity will reduce to about 33%, thus being classified as a financial investment. Markets reacted positively to the news and some of the conglomerate discount previously associated with Schindler's diversified interests got removed as, going forward, the company will be a concentrated elevators and escalators business.
- Bayer, Syngenta – The United States Department of Agriculture (USDA) revealed its view of future global soft commodities production and inventory levels trends for the month of August with the grain situation stealing the headline. In the context of difficult weather conditions in key wheat producing countries such as Russia, Canada and China, the production and inventory levels where significantly downgraded. The stock to use ratio for grain inventories is forecasted to be at 19.8% for the 2010/2011 growing season, with the wheat ratio moving lower to 26.3%, the corn ratio lower to 16.7%, rice ratio stable at 21.4% while the soybeans ratio moved lower to 25.8%. Earlier in the week Russia had announced a ban on wheat exports till the end of the year, while the neighboring Ukraine was considering capping its wheat export. A result of these developments, the price for weak spiked by more than 50% over the last month and is sitting at the highest level in two years. As the shortage of wheat is expected to be filled up by other commodities, the corn and soybeans prices moved higher in sympathy. A food crisis similar to the one in 2007/2008 is unlikely says USDA, given the relatively high level of inventories and record corn and soybeans harvests in US. Nevertheless, the higher soft commodity prices are poised to significantly improve the farm economics, which bodes well for agricultural input providers, including Syngenta, the largest global agribusiness and Bayer, an innovation leader in crop protection.
- Bayer – The company revealed results from the Einstein-DVT (Deep Vein Thrombosis) study on its key pipeline drug Xarelto (rivaroxaban), which showed an overall risk reduction compared to the current standard therapy. While in itself good news, the study also increases the likelihood of a good safety profile for the stroke prevention in atrial fibrillation (SPAF) indication, which is the subject of the Rocket AF study, results being due later this year. Industry analysts estimate the sales potential for the DVT indication at about 1 billion EUR, while the sales for the SPAF indication could reach as much as 15 billion EUR.
- BHP – Showing commitment to its Saskatchewan potash projects, including Jansen, an 8 million tones project accounting for roughly 12% of the current global capacity, BHP Billiton reached a preliminary agreement with Port of Vancouver USA, regarding the location of a potash export facility. The company is reportedly in talks to Canadian Pacific Railway and BNSF Railway for the transport of potash to the West coast once the product becomes available.
- Novartis, Nestle – The European regulators approved last week the purchase of Alcon's controlling stake by Novartis from Nestle. Novartis is paying roughly 28 billion USD for 52% of Alcon, the leading global ophthalmology business, to add to its existing 25% stake. The addition of Alcon to its existing portfolio of consumer healthcare businesses is further diversifying Novartis' earnings base, increasing its attractiveness as a strong cash flow generating investment. Novartis is required to divest some of the existing products in the ophthalmological and consumer vision care sectors in the EU, as a result of the regulator's anti-trust concerns.
- Carnival – Carnival Corporation announced it had ordered a new cruise ship to be part of its AIDA cruises brand, targeted exclusively to the German speaking clientele. The ship will be able to carry 2,192 passengers and it will enter in service in the spring of 2013. The cost per lower berth is reported to be approximately 150,000 USD. Together with other sister ships due to be launched in April of 2011 and June of 2012, it will bring the total of cruise ships under the AIDA banner to 10. The company management declared that growth in the region outpaces growth in other areas of the world. The German clientele is particularly attracted by a host of onboard innovations unique to the brand.

Economic Activity, Consumer and Business Conditions

- US – The retail sales numbers for July, the closest watched gage of the consumer sector, although mildly positive on month on month terms, at 0.4%, were below the expected 0.5% monthly growth rate and were supported largely by sales of gasoline, up 2.3%, and motor vehicles and parts, up 1.6%. Most other components actually declined in the month. The year on year change is sitting at 5.5%, versus a weak July 2009, while retail sales excluding motor vehicles and parts (about 25% of the retail sales) were up 4.9% year on year. Earlier in the week the US trade balance report spooked the markets as the trade deficit opened wider than expected at 49.9 billion USD in June, the largest since October of 2009. The exports declined by 1.3% in the month while the imports grew by 3% over the same period. Coupled with a weak July retail performance, it follows that we should see a significant up-tick in the wholesale trade inventories in the months to follow, hence weaker internal growth in the quarter.
- On the marginally positive news side, the consumer price index (CPI) inched higher by 0.3% in July, versus the expected 0.2% change, which moves the yearly rate to 1.2% from 1.1% the month prior, helping to alleviate the deflation fears. The core CPI (excluding food and energy) crawled higher by 0.1%, as expected, being at the 0.9% year on year rate for the fourth month in a row now. The University of Michigan's preliminary reading on the Consumer Sentiment was better than expected at 69.6 versus 69.3 and higher than the revised July number at 67.8, yet still at very depressed levels by the historical norm.
- The US Productivity report for the second quarter showed a -1.1% annual rate retreat in productivity, putting an end to a streak of five quarters of very strong productivity gains, a sign the businesses can only extract this much from the much leaner structures they kept throughout the recession and they would have to start hiring to sustain any growth going forward. The labor costs stopped their slide and inched higher in the quarter, which might again support at least a tentative up-tick in hiring.
- The Federal Reserve has noted that the pace of recovery in the economy and employment has "slowed in recent months", and that the recovery "is likely to be more modest in the near term than had been anticipated." Accordingly, and as expected, the Fed has taken measures to prevent a de facto tightening in policy, saying it will reinvest the proceeds of maturing agency debt and Mortgage Backed Securities in longer-term Treasuries, and will roll over its holdings of Treasuries as they mature. This will prevent its balance sheet from shrinking upon maturity of these assets. Although it did not undertake any major steps towards quantitative easing this action likely signals that the Fed is prepared to take further steps should its economic outlook deteriorate further.
- Canada – Housing reports point to a moderate weakening of the housing markets at the end of what some feared to be a housing bubble. The housing starts retreated to 189,200 units in July, better than the expected value of 186,500, driven by a reduction in single-units construction, as the multi-unit construction continued to increase in the month. The new houses prices rose only 0.1% in June on expectations of a 0.2% improvement, which leads to 3.3% year on year price growth, higher than the 2.9% year on year rate in May, as the effect of the HST introduction is yet to be fully reflected.
- The Canadian visible (merchandise) trade balance was a negative 1.13 billion CAD in June, as exports of industrial materials, energy and vehicles were lower. The expected deficit was 300 million CAD, while May's balance was a revised negative 695 million CAD. The results point to the fact that despite a better economic performance than most of its developed peers, Canada in not isolated from the recent slowdown in economic activity in US and overseas.
- German imports surged last month to a record Eur72.4bn, up a seasonally adjusted 1.9% month on month, lifting hopes of a solid economic recovery in Europe. Exports grew by 3.8 per cent but, over the past 12 months, the rate of import growth has outpaced exports.
- UK house prices dropped for the first time in a year in July, a monthly report from the Royal Institution of Chartered Surveyors showed. The number of houses being put on the market rose to a three-year high and RICS said that viewings of houses were falling.
- Russia has imposed an export ban on grains until the end of this year, causing wheat prices in particular to rise sharply. Russia has blamed the ban on droughts and fires that have ravaged some of its wheat growing districts. The embargo comes against the backdrop of a tight commodities market although grain inventories are higher now and so better able to cope compared to 2 years ago when grain prices escalated. If this winter's harvests in Argentina and Australia hold up then supplies should be adequate to meet demand but the problem now will be whether Russia's announcement causes traders to hoard supplies. The crisis of 2008 was

the first such upheaval for 30 years and the danger of a repetition should act as a wake-up call for countries to invest more in irrigation and to make more use of hardy GM crops – which ultimately presents additional opportunities for growth for Syngenta – the world's largest global agri business and third largest in seed sales.

- India is planning to open the country's equity markets to foreign retail investors, especially wealthy Indian nationals living abroad. Foreign Investment Income flows reached nearly $11bn in the first 7mths of the year

Financial Conditions

- Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.11% and the U.K.'s 2 year/10 year treasury spread is 2.37% - 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 (as identified in the European stress tests) – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (110 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 4.44% - the lowest rate since the Federal Reserve began tracking rates in 1971, as the Federal Reserve effectively continues to seek to incentivise home ownership. 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 26.24, 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™

August 16, 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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