Market Commentary

PORTLAND INVESTMENT COUNSEL™

January 25, 2010

Forthcoming Recirculation

We will early next month be looking to re-circulate some shares of Copernican British Banks (CBB) and on behalf of Manulife, some shares of Copernican World Financial Infrastructure (CIW).

Regulatory Reform

- Further to the already announced US bank responsibility fee, the US Govt. has now proposed to limit the scope and size of US banking entities, in particular to outlaw banks from proprietary trading and investment in or ownership of hedge funds or private equity funds.
- Unfortunately the limited details available introduce a layer of uncertainty to the outlook for large financial services companies that understandably has investors concerned.
- We believe the goal of the proposal, to reduce systemic risk is reasonable but complex to implement in practice.
- Ultimately, we assume that a bank's 'proprietary trading operations unrelated to serving customers for its own profit' will be defined as standalone trading desks designed to trade the banks own money for profit. If this is the case then we believe such separate trading desks contribute about 10% of earnings at Goldman Sachs but less than 2% at JPMorgan, Credit Suisse and Deutsche Bank and less than 1% at Wells Fargo, BNP Paribas, HSBC, and Credit Agricole …and Barclays in a written letter to staff today (attached) reminded that it closed its proprietary trading business in 1998 and "such activity of this sort remaining in investment banking represents less than 3% of total revenue."
- In terms of investments in private equity funds we assume that the qualifier of funds which are 'unrelated to serving customers' should restrict the impact to 2-3% of bank earnings and we assume that strategic investments (like Barclays' and Bank of America's in BlackRock) will not be impacted.
- With regard to the restriction on investments in hedge funds we again focus on the wording that the activities are those which are: " unrelated to serving customers for its own profit" …. For instance JPMorgan owns a large hedge fund called Highbridge Capital which invests the money that its clients give to it, not the deposits of JP Morgan's customers. Hereagain, we believe that once the details become clearer the impact on JP Morgan's earnings will be about 2% and less for Wells Fargo. Alternative asset management activities are viewed as a core competency by European investment banks – Deutsche Bank, Credit Suisse and UBS and notwithstanding our doubts that Germany or Switzerland would adopt such constraints we recognize the impact on their earnings could be a more sizeable 3%-6%.
- The President also announced a new proposal to limit further consolidation of the US financial sector – but we are overall less concerned by this imposition as we don't believe JP Morgan or Wells Fargo are looking to grow significantly from further M&A at this time…. rather they are still absorbing the huge franchises they bought during the crisis (Washington Mutual and Wachovia respectively). In fact this imposition is more likely to consolidate their large domestic footprints and obstruct other banks seeking to bulk up in size … such as US Bancorp.
- We doubt the proposed activities to be outlawed would have any material impact on the more retail-centric banks – particularly the Spanish banks (Santander and BBVA) the Italian banks (Unicredit) and the globally diverse HSBC and Standard Chartered.
- Everything points in the same direction: banks must reduce balance sheet risk, have more and better capital and better funding….with investment banking operations being targeted most. Goldman Sachs' earnings could be impacted by as much as 20% but this would probably prompt them to revert to being a 'pure' investment bank rather than remain regulated as a bank holding company. Perhaps other investment banks would follow – like Morgan Stanley - thereby technically moving outside the 'too large to fail' criteria which is vexing Governments in their 'headline' determination to ensure such banks pay for the support they received during the crisis. Bank of America will likely have less options to be nimble enough to retain fully their Merrill Lynch franchise earnings' power and so we believe, like Citigroup, are likely to experience a slower path to full recovery. Of course, the withdrawal by some banks creates opportunities for others so that unless a global wide approach is adopted, regulatory arbitrage will pertain.
- The primary aim in regulatory policy should be to make it possible for banks to fail without endangering the rest of the banking system- and society. Last week's proposals do not address this aim and we still believe government's key policy lever should be to make sure that institutions hold enough capital to reflect the risks that they run. Therefore, as regards last week's regulatory reform, we believe the initial bark will likely be much more damaging than the ultimate bite. The proposals on the limits on the size and activities of

the nation's largest banks will be debated for at least several months. The exposure to proprietary trading, hedge funds, and equity investments is a very small percentage of the revenue streams of these large banks, and restrictions on growth will likely apply only to acquisitions (and not to organic growth). There is a very high probability that "tax rates" will increase for financial institutions, much like they will for every American and West European worker and employee.

- Ultimately, it will be recognized that banks play a critical role in the economy and that the financial crisis polarized the best from the rest. JP Morgan, Wells Fargo, Barclays, BNP Paribas and Santander provided substantial and ongoing credit each quarter during the economic downturn and rescued some of the largest (and crippled) financial institutions.
- Obviously, we have entered a period of intense regulatory oversight – which broadly we welcome but acknowledge that the associated uncertainty/ headline risk creates volatility – and we expect this volatility to persist. We do however believe that even in the context of these changes there is very good long term value in a selective group of large-cap, mostly retail-centric banks with most of them now within a few quarter's grasp of meaningful credit leverage and improved profitability…. which we believe will comfortably exceed the expected impact of the recent regulatory impositions.

News Highlights on Current Holdings

- South China Morning Post writes last week that HSBC is competing with Korea Development Bank and Thailand's Thanachart Bank for a 47.6% stake in Thailand's Siam City Bank. Article says that the stake could be worth ~$900mn (roughly 1.5x Book Value). Final bids are due by the end of the month, according to the central bank.
- Chinese energy company Sinopec has indicated it is negotiating an agreement on shale gas exploration and development with BP, according to the Financial Times. If a deal is concluded, BP would assist China in utilizing foreign technology to develop its shale gas reserves more quickly.
- South Korea's POSCO stated last Tuesday that US investor Warren Buffet, whose investment vehicle owns 4.5% of the world's No. 4 steelmaker, had indicated he wanted to buy more POSCO stocks.
- Standard Chartered's China banking unit has won regulatory approval to act as a market maker in China's interbank bond market, as have Citigroup and JPMorgan Chase. This is clearly positive news.
- JPMorgan is reportedly in exclusive talks to buy the Royal Bank of Scotland's Sempra joint venture (Commodity trading). Deutsche Bank and Macquarie are also said to have submitted offers worth nearly $4B for the unit but are currently behind JPMorgan.
- According to a Bloomberg article, Deutsche Bank is revising its compensation structure, with a higher emphasis on base salaries (as a proportion of total compensation) vs bonuses. The expectation is that it is raising base salaries +30% or more, across the globe, depending on the position, and reducing bonuses, to keep the total compensation pool flat.

Economic Activity, Consumer and Business Conditions

The Bank of Canada held its key interest rate unchanged on Tuesday, as expected, and revised slightly downward its growth outlook for this year, saying the weak US economy and strong Canadian dollar remained a threat to recovery. The central bank maintained its overnight lending rate at 0.25% and repeated its conditional commitment to hold them at that level until the end of the second quarter. Its view of the Canadian economic recovery remains largely the same as in the October Monetary Policy Report. However, it now expects 2010 growth of 2.9% compared with 3.0% previously and 2011 growth of 3.5% compared with 3.3%. It believes the economy contracted 2.5% in 2009 versus its previous forecast of a 2.4% decline. The bank sees the economy returning to its full capacity and inflation returning to the 2% target in the third quarter of 2011. In December, it had said this would occur in the second half of that year. The economy ran at 3½% below its production capacity in the fourth quarter, it said, saying "considerable excess supply remains." The bank made no explicit mention of an eventual exit strategy from a period of record low rates but it did continue to adjust its term purchase and resale agreements to shorten maturities to the end of the second quarter, in line with its low rate commitment.

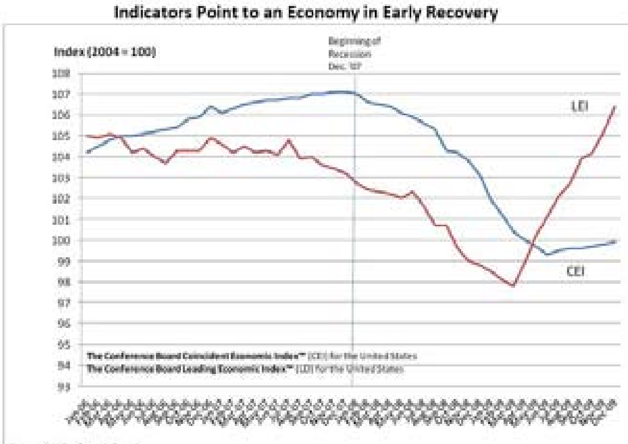
Signs of economic recovery continue despite tremendous hurdles. The US Leading Economic Indicator Index, published by the Conference Board, has recorded the ninth consecutive monthly improvement in December. The index grew an impressive 1.1% over the previous month, significantly better than the expected 0.7% monthly growth. Moreover, eight of the ten component indexes indicated growth, with only a couple (manufacturing workweek and consumer goods indices) posting flat readings. The Coincident Economic Index posted a growth number as well, at 0.3% over the previous month (see chart below).

Stateside, the good news was offset last week by disappointing numbers around (1) the employment situation, with the initial unemployment claims posting a negative surprise of 482,000 – being 42,000 higher than expected and (2) the housing market, with housing starts down 4% month on month.

Earlier today, the reading on US Existing Home Sales, down by 16.7% for the month of December, was largely in line with our expectations re the previous Pending Home Sales number (released January 5th) which has been negative 16% growth. Clearly, challenges in the housing market remain.

In Canada, despite a negative retail sales performance, down by 0.3% for the month of November, the news was mainly positive for the week, with the Leading Indicator up 1.5% for the month of December and improvement of the Manufacturing New Orders of 3.2% for November and the Wholesale Trade up by 2.5% for the same month.

Indicators Point to an Economy in Early Recovery



Financial Conditions

Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.82% and the U.K.'s 2 year/10 year treasury spread is 2.67% - enabling financial services companies' assets booked at these levels, to be very profitable, so enabling them to accelerate the absorption of anticipated consumer credit losses.

Our concerns are mostly focused around the later cycle issues facing financial services companies – particularly commercial real estate and unsecured consumer loans/credit card loans. However, commercial real estate exposure is more acutely held by US regional banks – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (9 to-date in 2010 and 140 in 2009) but their franchises are being acquired/absorbed as convergence of the financial services industry accelerates – favouring we believe the stronger, better managed banks. Typically banks acquiring collapsed bank franchises from the Federal Deposit Insurance Corporation (FDIC) are paying little or no premium for deposits, assets are purchased at a discount and are covered by loss sharing agreements – so that such deals can be expected to be Immediately accretive to earnings per share.

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) jumped last week to 27.3 on news of President Obama's regulatory reform and concerns that the reform will dampen economic recovery. The VIX has now lowered slightly to 25.4 which remains substantially below the levels experienced last August/September (and well off the highs of 70-80 witnessed late September/October). While, by its characteristics, the VIX will remain volatile, it is we believe further evidence of markets reacclimatizing to risk – typically we believe a VIX level below 25 augurs well for quality equities. And credit default swaps across most leading financial companies are trading in a gradually improving range of 1%-2% (compared to 5%-7% late September/early October).

Cash on Sidelines – we understand that US money market funds as % of market cap are currently 25% versus 18% long-term average.

As often repeated and borne out by last week's news, we believe the largest impediment to a sustainable rally remains government intervention, not the global economy.

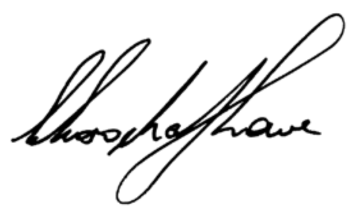
We believe the next few years will highlight the growing polarization between strong and weak institutions. Financial services companies that have capital strength will buy assets from those required to divest. Companies that have a strong presence in emerging markets will likely grow quicker than those that do not. Banks that have strong retail deposit franchises will take market share from those that rely on wholesale markets to fund loan growth at attractive margins. Financial services companies that have breached client trust will keep losing business to those reputations that have been enhanced by the crisis. We believe all the Funds are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

Closed-End Funds

Spreads on the closed-end funds are narrowing but remain wide and so in our view are very attractively priced to purchase. We will early next month be looking to re-circulate some shares of Copernican British Banks (CBB) and on behalf of Manulife, some shares of Copernican World Financial Infrastructure (CIW).

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.

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



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