



## News Highlights on Current Holdings

### Financial Services Companies

TD Bank agrees to buy Chrysler financial corp from Cerberus for \$6.3bn, the transaction will all be in cash and its estimated will add \$100m to 2012 profits with TD stating the IRR should be in about 3-4 years "well above 20%". The value that TD brings is access to capital and/or funding, which could allow Chrysler Financial to renew making new loans, with an attractive cost base under the TD ownership; and a brand, which is important as Chrysler Financial is no longer affiliated with Chrysler and TD will seek to start making loans again, under the TD brand. The acquisition will give TD all of Chrysler Financial's processes and technology as well as its existing portfolio of retail assets ( US\$ 7.5 billion) on both sides of the border. Following this transaction, the business - combined with TD's current platforms in Canada and the United States - will be positioned as a top 5 bank-owned auto lender in North America. Tier 1 Capital impact is expected to be 55-60 bps. The assets being acquired have a 50% risk-weighting.

"This transaction represents a unique opportunity to purchase a great organic growth platform at an attractive price," said Ed Clark, Group President and CEO, TD. "Chrysler Financial is a well-run business with the capacity for significantly higher returns over the next several years. This acquisition will allow us to leverage our lending expertise and financial strength to expand our presence in a large North American market with tremendous potential upside." Clark continued: "Because we're well-capitalized and a leading deposit franchise, we've been looking for opportunities to accelerate the growth of our loan book. This acquisition gives us that opportunity and also diversifies our lending portfolio."

Credit Agricole: Taking a EUR1.25bn hit to earnings in 2010 as it writes down its stake in Intesa San Paulo. It is moving its 4.8% stake from equity to available for sale and hence marking it to market. This will reduce core-tier 1 by 38bps and reduce Book Value Per Share by 2% to EUR20.4bn. The French bank said it would not sell the stake immediately as the share price does not reflect the asset's fundamental value. Credit Agricole, by deciding to Mark to Market its Intesa stake, gives evidence of a more proactive management of its international stakes. In this respect, we would not exclude that it adopts a similar approach on its 24% stakes in Bankinter and BES (24% inc. indirect stake) and then recognises, at least partly, respective unrealised capital losses of €0.7bn and €0.4bn. While there is no plan yet to dispose these stakes, we believe Credit Agricole could be willing to regain strategic flexibility on these issues.

Deutsche Bank agreed last Tuesday to pay \$553.6 million and admitted criminal wrongdoing to settle a long-running probe over fraudulent tax shelters that allowed clients to avoid paying billions of dollars in U.S. taxes. The \$553.6 million payment represents the total fees that the bank collected during the period, the taxes and the interest the IRS was unable to collect during the period, and a civil penalty of more than \$149 million.

JPMorgan buys former Lehman's offices in Canary Wharf for \$769m to use as EU headquarters.

Unicredit has agreed to sell its Mediocredito Central unit to Poste Italiane for Eur136mln.

Royal Bank of Scotland have finally completed the sale of the Grosvenor House Hotel to Indian conglomerate, Sahara, for £470m. The sum is considerably less than the £600m plus figures talked about some 12mths ago although there will be some comfort that the sale has been completed.

Bank of America has announced it will take a \$2 billion impairment charge on home loans and insurance and a \$3 billion provision for repurchase obligations to government sponsored entities Freddie Mac and Fannie Mae to resolve repurchase representations and warranties claims involving certain residential mortgage loans sold to them by Countrywide for \$2.8 billion. We believe this addresses one of the uncertainties surrounding the shares of Bank of America at a cost that appears to be less than the market anticipated. We also believe it supports our view the industry's mortgage repurchase headwind is an earnings issue, not a capital one. Results in 4Q10 will include a \$3 billion (\$0.20, 14bps of Risk Weighted Assets) rep & warranty provision related to its GSE exposure. This includes the settlement, as well as adjustments not covered by these agreements. Through this provision, Bank of America believes that it has addressed all of its GSE mortgage repurchase obligations.

BBVA: Plans to sell 3-year covered bonds may yield about 225bp over mid-swaps, according to Bloomberg. This would be more than the 195bp spread BBVA paid on 3-year covered bonds it issued in July, in the wake of the last round of the sovereign risk crisis. By comparison BNP Paribas is selling 10yr covered bonds at 65bps above mid-swap highlighting the different funding issues of the French vs Spanish banks.  
Financial Infrastructure

BME, the Spanish Stock Exchange, said yesterday that equity trading volumes rose 16 percent in 2010 compared with the



previous year.

Deutsche Boerse announced transactions on its Xetra platform increased by 39% in December to 14.6m. They also announced that cash market turnover increased to EUR 1.32tn in 2010 up by 16% on 2009.

## Dividend Paying Companies

ABB – ABB is reported to have won a \$580mm order to supply a power link between Sweden and Lithuania, the second major interconnection between the Nordic and Baltic energy markets. ABB also built the Finland to Estonia Estlink in 2006. The company will design and supply two 700 MW converter stations as well as to 300 KV 400 Km long underwater cables. The project will be supported by EU funding and is expected to be completed by 2015.

Carrefour – Carrefour will open its first cash-and-carry store in India together with Parsvnath Developers at one of the Indian realtor's malls in New Delhi. The second largest global retailer is showing its commitment to the promising Indian market. India's retail sector is estimated to be \$450bn large, yet the vast majority of it is un-organized. The multi-brand retail is closed to foreign entities, with the exception of the wholesale operations.

Carnival – Carnival Corp reported fourth quarter and full year results in Miami at the end of last month, exceeding the consensus expectations as its underlying earnings per share hit \$0.38 compared to \$0.31. Some of the beat was due to better than expected net revenue yields, while the negative currency impact was smaller as estimated. Full year results netted at \$2.47 and the company guided for a significant improvement in 2011, targeting earnings per share of \$2.90 to \$3.10. The growth is to be driven by a 3% to 4% increase in net revenue yields as well as by a continuing reduction in cruise costs. The company comments also revealed improving booking trends for both the company's North American and European brands, in particular for the incoming summer season.

It should also be remembered that higher fuel costs are expected to cost CCL 17 cents in EPS in the year, with favourable FX offsetting this by 4 cents. The company confirmed that it expects to generate significant free cash from 2011, giving it 'ample opportunities to return additional cash to shareholders over time'. It also confirmed it intends to increase its ordinary dividend and will give an update in mid-January. Management reiterate the

2011 outlook, reflects a gradual improvement in the consumer. Booking trends, perhaps helped by frigid weather, are good in both Europe and North America for the summer season. Fleet capacity will increase by 5%, ranging from 3% in North America to 9% in Europe. Four new ships will be delivered over the course of the year. Advance bookings of about 50% of next year are in line with last year. Close-in pricing has been stronger than expected with little 2010 inventory left to sell. On board spend is picking up from 2% growth in 2010 to an expected 2.5% growth in 2011. New offerings are expected to contribute to this result. Pricing is above 2010, not yet at 2008. The Splendor is leaving no legacy. While the fiasco that cut power and crippled the ship received a lot of notoriety, the company saw no negative impact on booking trends.

Hutcheson Whampoa: announced on Monday the acquisition from China Resources (Holdings) of minority interests in certain port and property assets in HK/China that it already controls for HK\$5.7bn. We believe the price paid as fair since we understand the attributable NAV estimate for these assets bought is HK\$6bn. Although the financial implications of the acquisition are not large, we think the strategic importance is more significant, as it represents another sign that Hutcheson Whampoa is comfortable with its cash flow profile to make investments in its businesses other than 3G. This acquisition came after Cheung Kong's recent large acquisition (HK\$28bn share) of UK electricity grid assets. In turn, these acquisitions suggest, in our view, that the turnaround of Hutcheson's 3G business is still on track. The two largest pieces of the acquisition are ports assets in Hong Kong and Yantian: Hutcheson's interest in HIT (HK) will rise from 66.5% to 76.5%, COSCO-HIT (HK) from 33.25% to 38.25%, and Yantian by 5% to 48%-53%. The acquisition also includes a 12% interest in a logistics centre in Kwai Chung, HK, and a 36% stake in a small office building in Kwun Tong, HK.

GEA – GEA Group announced two medium sized acquisitions recently, showing that the company is ready to continue to grow in key areas as the restructuring process is getting closer to an end. The larger acquisition saw the addition of Convenience Food Systems (CFS), a Dutch significant supplier of secondary food processing and packaging machinery (meat, fish, cheese) with roughly €400mm worth of sales, for a €432mm consideration. The subject of the second acquisition was Brock Kaltemaschinen, a German supplier of components for low and medium refrigeration applications, fetched an estimated €65mm for about €70mm worth of sales and will be integrated in the company's Refrigeration division. The acquisitions clearly show the company's commitment for its core food processing business



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and, we believe, are positioning the group for profitable growth in the future. The group management sees the market segment of the animal proteins (CFS core business) as one of the fastest growing in the entire food industry, driven by demand from Asia. GEA used existing credit facilities to finance the two deals, preserving its financial flexibility. Fitch re-affirmed its BBB- credit rating for the company.

Tesco, Carrefour – Tesco emerged as the winner in the bid for the Czech Zabka convenience stores, paying roughly \$52mm. Both Tesco and Carrefour are still in the race for Zabka's Polish stores, expected to bring in some \$300mm for the current owner, the Czech private equity firm Penta Investment. Both global retailers are allocating significant resources to Eastern Europe as the area is emerging from recession and holds the promise of a quicker recovery compared to other European nations.

Economic Activity, Consumer and Business Conditions

US – Good news continued to come out of the US manufacturing, with the durable goods orders excluding transportation up 2.4% in November, compared to expectations of a 1.6% increase, lead by the computer, electronics and communication orders. The headline figure was down 1.3% in the month, as the bulky aircraft business dropped in November. The forward looking Institute for Supply Management (ISM) Purchasing Managers Index (PMI) posted an increase in December, at 57 indicating a sustained expansion in the goods producing sectors.

Personal income stateside registered a 4.1% annualized improvement in November, better than expected, however much of the personal income in the US comes from government social assistance, recently extended. In an environment of protracted unemployment the consumer confidence retreated in December, as indicated by both the Consumer Confidence Index by the Conference Board, down to 52.5 compared to expectation of an improvement to 56, as well as the Consumer Sentiment by the University of Michigan, which missed the expectations of an 86 level and stopped at 85.3.

The housing sector is showing signs of life with the new home sales up 5.5% in November to 290,000 units, still stuck close to historical lows though, while the existing home sales progressed 5.6% in November as well to 4.7 million units. The housing pricing though is soft to say the least as the S&P Case-Shiller Index (the 20 city composite) retreated for the fourth month in a row in October to 143.5.

Worrisome numbers on the pricing front with the core personal consumption expenditures (PCE) down to a year on year level of

0.8%, the lowest since at least 1960. Just a reminder, the core PCE is Fed's preferred inflation gage.

U.S. initial unemployment claims dropped by 3k in the week of December 18. The resulting 420k level was the second lowest reading for first-time filers since July 2008, surpassed only by a 410k level in mid-November. Continuing claims (those who stay on state-paid U.I.) also improved in the latest period, falling 103k to 4,064k in the week of December 11, the lowest level since November 2008.

Canada – The consumer price index (CPI) showed benign inflation in November as the year on year rate of change retreated to 2% compared to the 2.4% a month earlier. The core figure is similarly tame, at 1.4% year on year rate of change. Some of the key categories that helped reduce to inflationary threat were clothing, cars and electricity. The average weekly earnings however continue to register sustained rate of growth, posting a 4.4% year on year improvement in October. The Canadian retail sales grew strongly in October, up 0.8%, lead mainly by an increase of the gasoline sales as prices continue to trend higher. Excluding fuel, sales were rather modest for the month.

UK house prices unexpectedly rose in December according to the Nationwide house price survey. Expectations were for a -0.2% fall and prices rose 0.4%. This is the first price rise in 6 months but it is unlikely to be taken as a reversal of the trend.

## Financial Conditions

In support of our view that consolidation within financials is ongoing, the Financial Times reports that regulatory changes from new global liquidity rules are going to drive up the cost to banks of processing cash payments and are likely to hasten industry consolidation by forcing smaller players out of some basic banking services. Big global banks such as JPMorgan Chase, HSBC and Citigroup are most likely to benefit because they can afford to invest in cost-cutting technology and process many payments internally.

China has indicated it will take further 'concerted action' to support European financial stabilization, including continuing to buy the bonds of 'peripheral' countries according to senior European officials.

Policymakers continue to accommodate a recovery in bank profits, albeit less than 6 months ago. The U.S. 2 year/10 year treasury spread is 2.74% and the U.K.'s 2 year/10 year treasury



spread is 2.31% - enabling financial services companies' assets booked at these levels, to be 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 (157 in 2010) exceeding 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 at 4.86% - (the lowest rate since the Federal Reserve began tracking rates in 1971 was 4.17% on Nov. 11, 2010), as the Federal Reserve effectively continues to seek to incentivise home ownership. Existing U.S. housing inventory has increased to 10.7 months supply of existing houses – much 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 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 mortgage foreclosures have been properly documented, thereby enabling mortgages to be “put back” to the originating bank. However, from recent bank investor relations presentations it does seem the rate of “put backs” are now expected to decline, suggesting current levels of provisions should suffice. 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 17.61 and 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. 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.



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## 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](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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# Market Commentary



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