Market Commentary

PORTLAND INVESTMENT COUNSEL™

March 7, 2011

News Highlights on Current Holdings

Financial Services Companies

Aviva: operating earnings came in at £2,550m (+26% YoY) versus consensus of £2,542m and announced that it had eliminated the vast majority of its pension deficit. On a per share basis, IFRS operating EPS was 50.4p. Cash generation of £1.7bn is better than the Group's previously stated targets of £1.5bn representing a 13% free cash flow yield. Dividend per share was in line at 25.5p, up 6.3% YoY and giving c.6% yield. Solid operational performances across major divisions. Life up 23% and P&C up 10% with combined ratio of 96.8%, despite winter storms. No news on disposals (eg possible disposal of some more of the Delta Lloyd stake) or portfolio restructuring yet. Capital was strong with a solvency surplus of £3.8bn. Headline IFRS book value came in at 454p per share (+21% YoY) versus consensus 441p with an ROE of 14.8% and EEV was 621p. Turning to the embedded value results, EV operating profits came in at £3,760m (+5% YoY) versus consensus of £4,097m forecast. The embedded value itself came in at 425p per share (+22% YoY) adjusted to strip out goodwill.

HSBC: PBT ex. Fair Value on own debt of $19.3bn against consensus $19.7bn. Both provisions and costs were higher than consensus. Capital moderately weaker but still relatively very strong with a Core Tier 1 ratio of 10.5% against expectation 10.6%. They have reduced their ROE target to 12-15% from 15-19% through the cycle. In our view the change to the ROE target reflects higher capital requirements under Basel III rather than lower earnings. But Return on Equity target assumes no increase in interest rates which looks very conservative - a 25bps increase in rates was highlighted as adding $882m to NII (+c5% to profits). CEO Stuart Gulliver seems pretty bullish on getting the costs down. He describes the current Cost/Income ratio as completely unacceptable and that he will outline in May what they will do about it. Dividend payout ratio forecast at 40-60%. This compares with previous objective of aiming to deliver "dividend growth". Current payout ratio c50%.

Credit Agricole: EUR328m net loss was better than the consensus (EUR393m) with a cost/income ratio of 70% and loan loss charges of 70bp, a decrease on 92bp recorded in 3Q10. Core Tier 1 -including the two new special treatments which provide a capital relief of EUR14bn - was 8.4%. These technical solutions significantly reduces the capital overhang on the stock and hence leaves the valuation looking attractive, in our view. French retail performed in line with stable revenues and stable cost of credit. The regional banks' contribution was flat. International retail saw a decrease in the cost of credit at its Greek subsidiary, Emporiki (cEUR60m). The cost of credit decreased moderately but remains high at 216bp, in line with the other French banks.

RBS: Published Group PBT FY10 of £1,913m excluding Fair Value of own credit this was in line with consensus. PBT FY10 of the Core business excluding FV of own credit was £7,418m. This is c2% ahead of £7.3bn consensus. Revenue and costs both came in marginally better than expected. Provisions were higher driven (on the face of it) by Ireland. RBS has £15.6bn of Commercial Real Estate exposure to Ireland. Irish provision cover of 44% compares with Lloyds Republic of Ireland coverage that went to 54% when they took the one-off hit in Dec. For RBS to achieve the same coverage would need a £1.4bn provision. Amongst the divisions UK Retail was the strongest, coming in at £780m and +20% Q4 against Q3 (driven by better margins). Core Tier 1 ratio at 10.7% was slightly better. Tangible NAV has fallen to 51.1p (52.9p 3Q) which is disappointing. Chief Executive Stephen Hester expects the U.K. government to gradually sell its stake in the bank to private investors, though he says this won't happen before the state-appointed Independent Commission on Banking releases its report on competition in the sector in September. In an interview with financial daily Il Sole 24 Ore, Hester says the bank itself isn't in talks with investors over the possible sale of a stake. He adds that the bank's insurance operations could be sold in the second half of 2012.

Lloyds Banking Group ; António Horta-Osório, the new CEO of Lloyds Banking Group PLC, said the U.K. lender will accelerate the sale of a 600-branch network that was slated for disposal by 2013. Mr. Horta-Osorio said the sale, and a strategic review of the overall business that he will complete by June, "mark the start of the next phase of Lloyds Banking Group's development." Advisers are to be appointed to handle the sale within the next few weeks, which means it should put the sale on track for completion in late 2011 or early 2012.

National Australia Bank's "beak up" marketing campaign appears to be winning over home loan customers with internal figures showing the promotion has attracted 11 times more online visits that the bank's previous most successful campaign. NAB's figures reveal a 79% increase in NAB home loan inquires in the week following the launch of its advertising campaign.

RBC reported Q1 2011 cash EPS of $1.26, versus $1.03 in Q1 f2010 and $0.84 in Q4 f2010. Earnings beat consensus estimate of $1.01 but it did not increase its dividend. Cash Return on Equity improved to 20.7% from 14.2% last quarter and 18.0% one year ago. Reported group net interest margin was 1.51%, down from 1.52% last quarter. Average earnings assets grew 4.2% q/q and 12.7% y/y. The efficiency ratio was 53%, in-line with last quarter. The Tier 1 ratio of 13.2% was up from 13.0% last quarter and 12.7% one year ago. Book value per share increased to $24.75 from $23.99 last quarter. Canadian Banking net income was $882 million, up from $765 million last quarter and $777 million one year ago. Loan growth was modest at 1.4% q/q. Wealth Management net income was $221 million, up from $175 million last quarter and $219 million one year ago. Strong revenue growth in Canadian Wealth Management and Global Asset Management, combined with better efficiency drove the beat. Overall, revenue grew 11% y/y and efficiency improved to 73.8% from 75.8% one year ago. The Insurance segment reported net income of $145 million, up 23% y/y. Lower reinsurance and disability claims costs and favourable life insurance policyholder experience drove the improvement. Premiums and fee income were relatively flat y/y. Capital markets net income was $613 million up from $373 million last quarter and $571 million one year ago, largely due to better trading revenues. International Banking posted a gain of Cdn$24 million versus a loss of Cdn$57 million one year ago. Provisions for credit losses dropped substantially to Cdn$131 million, from Cdn$191 million last quarter and Cdn$175 million in Q1 2010. Trading Revenue was strong. The bank indicated that it benefited from $135 million in gains on legacy assets (i.e., those assets impacted by the financial crisis of 2008-2009): $102 million from its exposure to MBIA and a $33 million gain on its Bank owned life insurance and other exposures.

Standard Chartered Plc posted its seventh successive year of record profit while warning that the biggest threat to future earnings is uncoordinated regulatory change. It highlighted the “superequivalent” rules applied by UK regulators, which go beyond those agreed under the Basel III rule book. StanChart’s 2010 Profit before tax came in at US$6,122mn (up +19% YoY), broadly in line with consensus estimates. Performance was broad-based, while the substantial fall in group credit costs (down -54% YoY) was a highlight. Although the Wholesale Bank remains the largest contributor to group PBT, the pick up at the Consumer Bank was encouraging. The group will possibly struggle to improve its RoE materially from current levels but possesses very attractive leverage to many of the fastest growing banking markets in the world, strong capital and liquidity position, and solid EPS growth outlook.

St James’s Place reported solid FY results and announced a higher than expected dividend. The updated disclosure on the book of business that is not yet generating cash supports a view of strong cash generation. The new dividend guidance implies a payout ratio of 33% for 2012E, but still a lower-than average dividend yield. The Management is ‘very confident’ in the longer-term 15-20% APE growth target.

TD reported net income was $1,541 million, compared with $1,297 million (first quarter 2010). Operating earnings increased 9% to $1.74 per share, due to record results from Canadian Personal & Commercial and very strong results from Wealth Management and U.S. P&C. TD increased the annual dividend 8% to $2.64 per share from $2.44 per share. Reported cash earnings were $1.82 per share. Operating Return on Equity was 16.0% Canadian retail earnings increased 26% to $905 million from $720 million a year earlier. Retail net interest margin was down 9 bps sequentially and 11 bps from a year earlier to 2.82% due mainly to the transfer of the U.S. credit card business to U.S. Personal & Commercial. Average loan and acceptances growth was 7% y/y. Revenue growth was 4.9% with expense growth of 1.5% for positive operating leverage. U.S. P&C earnings increased 47% YOY to $333 million from $227 million a year earlier and 18% from $283 million the previous quarter. Average loan and acceptances growth was 13% y/y. Wholesale banking earnings were $237 million, down 36% from $372 million a year earlier, although up 10% from $216 million in the previous quarter. Trading revenue declined to $364 million versus $383 million in the previous quarter and a very strong $549 million a year earlier. Wealth Management earnings, including the bank’s equity share of TD Ameritrade, were $181 million, an increase of 26% YOY. TD Ameritrade earnings contribution increased 12% y/y and 45% q/q to $48 million or $0.05 per share representing 3% of TD earnings. Overall Net Interest Margin was down 0.01% y/y but up 0.08% sequentially to 2.48%. Revenue growth was 8% YOY with expense growth of 7% for positive operating leverage of 1%. Specific loan loss provisions increased slightly to $414 million or 0.60% of loans from $404 million or 0.58% of loans in the previous quarter.

Dividend Paying Companies

Carrefour – Besides its full year results announcement, which revealed in-line with expectations results and provided a cautious outlook, Carrefour took the center stage by announcing the spin-off of its hard discount business as well as of a portion of its property business. The company’s hard discount division, Dia, with main operations in Spain and France as well as a number of developing countries, including Turkey, will be listed on the Madrid exchange and is estimated to be worth about €4bn. The company considers Dia to have very few synergies with Carrefour’s main operations. Carrefour is also set to restructure its French, Italian and Spanish real estate assets and list them into a separate entity, with 25% of the business being floated. The property assets are being valued at around €11bn. The market reaction was mixed following the announcement as some of the divestitures' benefits had already been priced in. At the same time, and rightfully so in our view, most analysts are concerned with the dynamic of the business fundamentals, most importantly, the restructuring of the hypermarkets business.

Pearson : results were marginally ahead of expectations with EPS at 77.5p, up over 20% YoY. Cash performance was strong helped by low cash tax: FCF was >£900m, leaving net debt at just £430m, 0.4x EBITDA with dividend per share +9% to 38.7p in line with historical trends. Guidance for positive 2011 earnings growth despite an FX headwind implies underlying high single digit EPS growth. Within the divisional mix, US Education falls a little (given a much lower revenue base but far higher margin than expected in 2010) and International Education moves higher (Emerging markets growth ahead of expectations). The message from the results was that the ongoing transition from print to digital and from developed to developing markets remains a positive one, driving growth and improved financial dynamics.

Power Assets Holdings (Formerly Hong Kong Electric) posted 2010 net profit of HK$7.19 billion up 7%. The results were slightly above market estimates. The focus on M&A activity going forward is, we believe, on regulated power assets and with a view to keeping its current debt ratings intact. The group's overseas earnings reached 36% of total earnings in 2010 and are expected to grow to 43% in 2011. We believe investors regard Hong Kong utilities as bond-like instruments with dividend 'certainty'. We believe risks for the Hong Kong utilities sector stem from inflation (and medium-term interest rate cycle) and the sector's (PAH included) yield spread to MSCI Hong Kong (which is already close to thirteen-year lows, ex. crisis periods). That said, in our view Power Assets' strengths are: 1) secured M&A earnings growth in 2011E, 2) optionality for future M&A (i.e., if its war chest is fully utilised), and 3) cheap valuation.

Economic Activity, Consumer and Business Conditions

ECB : Head of the ECB, Trichet surprised the market last week with his "strong vigilance" comment. Inflation and GDP growth forecasts were raised and the ECB looks to be taking a pre-emptive move against inflation before high oil prices really work their way through. In the past, "strong vigilance" was code word for an immediate rate hike at the next meeting and many economists have changed their forecasts to incorporate this.

US – The Institute for Supply Management's (ISM) both manufacturing (PMI) and non-manufacturing (NMI) surprised on the upside for March, indicating an improvement in business conditions in manufacturing as well as in services. The PMI came in at 61.4 relative to the expected 61.0 and the February's 60.8 value, while the NMI beat the expectations of 59.5 with a 59.7 reading, ahead of the 59.4 reading for February.

Positive evolution on the employment front, although short of some expectations, with a drop of 30,000 initial jobless claims for a total value of 368,000 for the week ended February 25, while the unemployment rate retreated to 8.9% from 9.0% rate for January and the Nonfarm Payroll Employment increased by 192,000 jobs. Some other indicators of the employment report were less rosy, with the average weekly hours virtually flat at 33.5, versus expectations of an improvement to 34.3, while the average hourly earnings were unchanged in February, versus expectations of a 0.2% monthly increase.

Financial Conditions

Portugal : Standard & Poor's says it expects Portugal's economy to shrink 2% this year and is reviewing its debt ratings. The rating agency expects to make a decision about any downgrade in the next three months. Portugal has 383 tons of gold worth ~Eur 13bn at current levels which we believe would reduce public debt by >9% vs. 2010e ~85% debt/GDP. So a debt buyback and sale of gold reserves could leave Portugal at a very manageable ~70-72% debt/GDP. But the structural problems would remain given the bloated public service sector and anemic economic growth.

UK house prices: Halifax house index; "There has been little change in house prices over the first two months of 2011 as a whole. February's monthly decline of 0.9% offset January's 0.8% gain."

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 2.83% and the U.K.'s 2 year/10 year treasury spread is 2.27% - 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 (24 in 2011) compared to 157 in 2010 which was the highest annual tally since 1992 (140 in 2009). 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 4.87% - (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 7.6 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 19.06 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

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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Sources: Thomson Reuters; Macquarie Securities - Global Financials Daily (ECB, UCG, ZFS, SAN, MAP, ING, ARL, JYSKE, NZ quake, ALPHA, NBG, RBS, DB1, UBS, ICE, WIBC, PMI, H&R, Indian Banks, CGF, SUN, BKK, SIAM, China) – email dated February 22, 2011

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PIC11-0032-E(03/11)