Market Commentary

PORTLAND INVESTMENT COUNSEL™

August 15, 2011

News Highlights on Current Holdings

EUROPE

France, Spain, Italy and Belgium are imposing short-selling bans from last Friday in an effort to stabilize markets. The European Securities and Markets Authority said in a statement that the ban will prevent "benefits that can be achieved from spreading false rumors.

Earlier last week financial services companies in UK, Italy and then France came under intense selling pressure due to multiple rumours related to France losing its AAA credit rating; Societe Generale selling gold; Groupama, Societe Generale's main shareholder selling down its stake, etc. Besides the rumours, the bank's exposure to peripheral Eurozone sovereign debt, although limited, has continued to fuel concerns.

In a more recent development, leaders of Germany and France ruled out the issuance of Eurobonds as a solution to the current eurozone debt crisis, ahead of a meeting tomorrow. It has been pointed out by the French officials that such Eurobond issuance 'would require a much more determined integration of the budgetary policies'

Financial Services Companies

Bank of America – is preparing to exit its credit card businesses in UK, Ireland and Canada in an effort to streamline the bank's activities around the US retail banking, commercial borrowers and investment banking and increase its capital cushion. Earlier this year, the company shed an insurance unit and mortgage servicing rights. The Canadian credit card agreement, struck with TD Bank, covers an $8.6bn portfolio spread over 1.8mm active accounts. The monetary consideration for the deal has not been disclosed, TD Bank acknowledging it paid a small premium for the credit card receivables. Bank of America sold its card business in Spain to Apollo Capital Management a couple of weeks ago.

Lloyds: As much as €1bn (£877m) of distressed Irish properties backed by debt from Lloyds Banking Group could be transferred to a new venture with one of Ireland's best-known property groups, the FT says. The aim is to help recover the properties' values, rather than book significant losses for the bank through a quick fire sale. Dublin-based Green Property will manage the properties on behalf of the receivers appointed by Lloyds, although receivers will have the option of not choosing to use the group. The agreement is open-ended, but one source said that Green could assume control of property backed by more than €1bn of the bank's debt. Green will aim to maximize the recovery of Lloyds' debt through rents and pushing up values for a sale rather than selling into the market at a heavy loss.

National Australia Bank's direct asset manager, nabInvest, has acquired Aviva Investors Australia, securing its funds management and executive teams and about $5.5bn in funds under management.

Dividend Paying Companies

BHP – announced the acquisition of HWE mining, a mining services company belonging to Leighton Holdings, for A$705mm in an attempt to improve its cost position. HWE mining is a key supplier of mining equipment and staff to BHP in the Western Australian iron ore rich region of Pilbara. The skilled labour shortage is also being cited as a key reason for the acquisition, with HWE's 2,500 staff being highly sought after.

Nestle –had to change its second quarter press conference venue from London, due to rioting, to the home town of Vevey, announced an impressive set of results, given the challenging economic environment, and cautiously upgraded the outlook for the full year, pointing out political and economical instability, natural disasters, rising material prices and a strong Swiss franc. Sales of Nestle brands, driven by the success of Nescafe and Maggi in emerging markets, surged by 7.5% in the second half, on underlying bases. Organic growth registered an 8.5% rate, driven by real internal growth (volume) of 4.7% and price increases amounting to 3.8%. Operating profit margin retreated by only 20bps, despite the raw materials and currency pressures and benefiting from about 40bps of lower restructuring expenses. The company decided not to launch a new share buy-back programme as it plans to invest in the business, both organically and through bolt-on acquisition and as it plans to increase its dividend. Unfavourable trends in the first half of the year are seen to be easing, mostly the rise in raw materials pricing and the strengthening of the Swiss franc.

Economic Activity, Consumer and Business Conditions

US – In a week of unprecedented volatility in the equity markets, investors clung to every bit of macro-economic news and fortunately, for the past week, it has been mostly positive news, even though only mildly so. Most notably, the Fed's historical decision to pin the monetary policy expectations two years out, committing to exceptionally low interest rates until at least through mid-2013, gave a new meaning to the 'Bernanke put'. Further, the Fed is committed to looking for other ways to provide economic stimulus, the ones mentioned prior being to initiate more securities purchases, to increase the average maturity of the current holdings or decrease the interest rate it pays the banks on their reserves.

The US retail sales numbers for July were encouraging with the headline advancing 0.5%, as expected and an improvement from June's 0.3% rate of growth, while the retail sales excluding sales of vehicles improved by 0.5% as well, way ahead of the 0.2% improvement expectations. Consumer credit has seen a steady improvement recently. Unfortunately, the turmoil in the markets could not go unobserved by the American consumer and as a result, the consumer sentiment as measured by the University of Michigan dropped dramatically in August, from 63.7 to 54.9, below the expected 63.0 reading, with both current conditions and future expectations components of the index being affected.

An otherwise barely noticeable downward move of 5,000 initial jobless claims, to the 395,000 level, provided support for an impressive stock market rally in Thursday, as the investors were fearing the worst. The US foreign trade deficit opened up in June, to over $53bn, as exports fell 2.3%, despite a more competitive dollar, while imports only retreated by 0.8% in the month. It looks increasingly unlikely that the foreign trade would add much to economic growth in the third quarter.

Earlier in the week, the Non-manufacturing index (NMI) as measured by the Institute for Supply Management (ISM), gave little reason for optimism, as it fell to 52.7 for July, from 53.3 for June, indicating growth, but slower still for this important area of the economic activity.

The second quarter preliminary productivity numbers show a reduction of 0.3%, on top of the first quarter revised number, indicating a 0.6% reduction, signalling an end to the proverbial productivity boost at the end of recessions, as the marginal effect of 'sweating' existing employees wore off. For the US economic growth to continue, a solution needs to be found to bring the large mass of unemployed back into work.

Canada – Canada's foreign trade continued on its existing trend of disappointing results, with the visible merchandise trade deficit widening to $1.56bn in June, on top of a lower revised $1.04bn deficit in May. The Canadian export competitiveness is undoubtedly high on the watch of the Bank of Canada, a move which would further strengthen the dollar, also given Fed's recent stance, becoming increasingly unlikely.

Housing and construction related releases continue to depict a Canadian housing market in rude health, with a new houses price increase of 0.3% in June, as expected, while the housing starts moved higher, to an annualized figure of 205,100, ahead of expectations.

Financial Conditions

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 2.07 % and the U.K.'s 2 year/10 year treasury spread is 1.87 % - enabling financial services companies' assets booked at these levels, to be profitable.

Later cycle issues continue to challenge 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, albeit at a more moderate pace (64 in 2011) compared to 157 in 2010 which was the highest annual tally since 1992 (140 in 2009). 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 U.S. 30 year mortgage market has remained low at 4.32 % - (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 9.5 months supply of existing houses – a 7 month high and much higher than what we believe is a more normal range of 4-7 months. We believe it remains premature to consider a recovery in house prices but a measure of stability would be 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 36.44 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

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: KBW - EuroAsian Daily, TD: Morning FX Outlook ,Thomson Reuters, Global Financials Daily (JPM, SEB, Asian banks, VR, Italy, STB, UBS, CS, ASHM, PAY, TNN, RBS, HIG, SIFI, Mortgage, DBS, RHB, Mizuho, JGBs), Credit Suisse - MONEY NEVER SLEEPS, Eight Banks Fail Stress Test With $3.5 Billion Capital Shortfall, CNBC.com – article dated August 5 "United States of American Long-Term Rating Lowered to 'AA+' Due to Political Risks, Rising Debt Burden; Outlook Negative"