



News Highlights on Current Holdings

Financial Services Companies

AMP reported an underlying profit of \$455mn for the half year to 30 June 2011, which includes a A\$61m contribution from AXA for the second quarter of 2011, following the merger of the two businesses on 30 March 2011. On a like for like basis, AMP's underlying profit for 1H 11 was up 3% on 1H 10. The interim dividend has been set at 15 cents per share, the same level as 1H 10 and will be 30% franked. The dividend represents a payout ratio of 81% of underlying profit.

AMP chief executive Craig Dunn will shield the wealth management giant's planning and adviser workforce from job cuts to capitalise on the wave of retail superannuation contributions expected as markets recover.

Australian Stock Exchange reported a 2011 normalised net profit after tax of A\$357mn, up 7% on the previous comparative period. A fully franked final dividend of 93cps was declared, up 11% on pcp, and in line with the group's 90% target payout ratio. Management indicated that the Board selection process for the next MD and CEO is expected to be completed prior to the AGM on 22 September.

Hong Kong Exchanges & Clearing Ltd. is closer to trading with investors in the world's busiest equity markets after starting joint venture talks with China's bourses as the country plans for more cross-border investment. Hong Kong Exchanges may develop indexes and derivatives with the Shanghai and Shenzhen bourses, it said in a statement last week.

Dividend Paying Companies

BHP – announced its tender offer to acquire Petrohawk Energy Corporation had been completed. The offer consisted of \$38.75 per share in cash for all outstanding shares of common stock of Petrohawk Energy Corporation or an enterprise value of about \$15.1bn including the assumption of roughly \$3bn of debt. Petrohawk's assets include about 1 million acres in Texas and Louisiana, with proven shale gas reserves of 3.4Tn cu ft of natural gas equivalent spread over the highly prospective and liquids rich basins of Eagle Ford, which is known to be delivering the best project return in US domestic on-shore exploration and production, as well as Haynesville and Permian. Together with the earlier acquisition of Fayetteville assets from Chesapeake, the recent additions would in fact triple BHP's oil and gas risked resources. At the same time, the recent

foray of BHP in the energy sector, requires significant capital expenditure additions, to be able to bring production to higher levels and improve the economics of the deal. BHP has had a successful history of acquiring Tier 1 assets (large reserves, low costs) and the recent US shale gas additions are in line with the company's history of leveraging its operational excellence.

Expansion of the Cerrejon, La Guajira, Colombia, thermal coal mine received board approval, with construction set to start in 2011 and completion in 2013. The mine is the largest coal producer in Colombia and the fourth largest exporter of thermal coal worldwide. The mine is controlled by a joint venture comprising BHP Billiton, Xstrata and Anglo American. The cost of the expansion is estimated at \$1.3bn, with BHP Billiton's share at \$437mm. The expansion would bring the mine's current production of about 32mm tonnes per annum to about 40mm tonnes per annum when the ramp-up of the production will be completed, in 2015.

Schindler Holding – managed to deliver good results in challenging conditions, announcing earnings before interest and taxes (EBIT) of CHF455mm for the second quarter, ahead of consensus. The EBIT margin reached 12%, roughly level with the previous comparative period. The company faced significant currency headwinds, as the Swiss franc soared following the recent flight to safety, with currency effects subtracting roughly CHF58mm from the EBIT. Profitability is expected to increase in the second part of the year, as some of the currency effects are, arguably, likely to reverse. Longer term investments in the efficiency of the service/maintenance business should also start to bear fruit.

Wesfarmers – reported a 23% increase in its full year earnings, from A\$1.565bn to A\$1.922bn, as strong operational performance at Coles and Bunnings retailers, as well as exceptionally high coal prices offset the effects of a weaker macro-economic environment, floods and earthquake. Progress in turning Coles around continued, with improved wastage metrics and lower distribution costs, while the sales momentum was reported to continue beyond June. The coal mining operations suffered a one million tonnes set-back earlier in the year, under the impact of severe floods, but it recovered and the management is guiding for metallurgical coal sales of 6.8mm to 7.2mm tonnes from Curragh in its fiscal year 2012. No specific guidance has been provided at the group level for the coming fiscal year, other than capital expenditure plans, which would total A\$3.2bn in 2012, mostly on store improvements and expansion at Curragh and Bengalla coal operations. The Premier Coal thermal coal operation, coveted by a number of buyers, has been classified as an asset available for sale. The outlook for the



next year is mainly positive, pending a global economy able to grow through recent set-backs.

Economic Activity, Consumer and Business Conditions

US – The increased volatility of the markets recently has been accentuated by a number of economic releases, with the more negative ones seemingly having a more pronounced impact on the mood of the investors.

A rather narrow indicator of manufacturing activity in US, the Philly Fed business index took pre-eminence in last week's trading, as its 30.7% drop came in stark contrast with the expectations of a 3.7% improvement for the month of August. The better than expected growth in the US Leading Economic Indicators (LEI), released at the same time, did nothing to calm the markets. LEI moved higher by 0.5% for July, ahead of the expectations for a 0.2% improvement, a relative high. However, the LEI, a diffusion index, grew chiefly due to an increase in the M2 and an improvement in the yield curve, offsetting a worsening in the business related components. Earlier in the week, the industrial production for July turned out better than expected, up 0.9% compared to 0.5%, while the capacity utilization improved as well, reaching 77.5% compared to expectations for a flat performance.

The inflation numbers worried the markets as well as an increase in the headline inflation to 3.6% in July and a core inflation reaching 1.8%, up from 1.6%, restrict the Fed's freedom of movement and increase the chances of stagflation. The US consumer saw a further decrease of its real earnings, by 0.2% in July, as a result, while a higher initial jobless claims number, to 408,000 from 399,000 a week before, provided little reason for confidence as well.

On the housing front, the existing home sales provided the biggest disappointment, as July's annualised rate dropped to 4.67mm from 4.84mm, way short of the expected 4.9mm. The disappointment was that much bigger, as two consecutive monthly increases in the pending home sales, a leading indicator of the existing home sales, amounted to little, with reports of numerous pending contracts getting cancelled as a result of the worsening in the economic outlook.

Canada – Inflation numbers on this side of the border were much tamer as the headline consumer price index (CPI) actually retreated in July, to 2.7% from 3.1% and below expectations for

a 2.8% rate, while the core moved higher, to 1.6%, yet still well within Bank of Canada's targets.

Financial Conditions

US mortgage rates have plunged to a 50-year low, sparking a surge in refinancing that is helping growing numbers of homeowners reduce their borrowing costs. Freddie Mac, the quasi-government entity that buys and insures mortgages, said on last week that an average US 30-year fixed-rate mortgage had dropped to 4.15%.

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 1.92 % and the U.K.'s 2 year/10 year treasury spread is 1.81 % - 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 (68 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 4.15 % - (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 43.05 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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Market Commentary



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