Market Commentary

PORTLAND INVESTMENT COUNSEL™

August 29, 2011

News Highlights on Current Holdings

Financial Services Companies

Australia New Zealand Bank Limited reported 3Q2011 unaudited underlying Profit of circa $1.4bn, including sequential revenue growth "slightly positive", pre-provision profit "broadly flat", a bad debt charge of $328mn, lending growth of 2.2%, a flat Group headline net interest margin and a Tier 1 ratio of 10.6%.

Bank of America announced last Thursday it had reached an agreement to sell 50,000 shares of Cumulative Perpetual Preferred Stock with a liquidation value of $100,000 per share to Berkshire Hathaway in a private offering, for $5bn. The preferred stock has a dividend of 6% per annum ($300mn), payable in equal quarterly installments, and is redeemable by the company at any time at a 5% premium. Berkshire will also receive warrants to purchase 700,000,000 shares of BAC common stock at an exercise price of $7.142857 (another $5bn). The warrants may be exercised during the 10-year period following the closing date of the transaction. Of note, we understand Warren Buffet approached Bank of America. Bank of America's valuation remains discounted (two-third of tangible book) and the aggregate purchase price to be received by Bank of America for the preferred stock and warrants is $5bn in cash. We expect no immediate impact to Tier 1 common. If/when the warrants are excised, Bank of America would get the capital benefit at that time ($5bn=0.35% of current risk weighted assets = circa ,0.25% of Basel 3 risk weighted assets).

Credit Agricole - France's third-largest bank by market capitalization, reported an 11% drop in second-quarter net profit, hit by its exposure to Greece. Crédit Agricole booked write-downs related to holdings in Greece and the bailout plan for that country. Along with a €146 million charge on its Greek government bonds, Crédit Agricole was hit by a €359 million write-down in the value of its stake in Greek bank Emporiki, in line with its previous disclosure. Nonetheless, Q2 Revenue at €5531m was 7% ahead of consensus. The beat was driven by the corporate centre where revenues were €43m versus expectations of - €301m. This was largely down to some clever asset & liability management of inflation link bonds, which we recognize can't be easily repeated. Greek bond impairments of €202m were higher than estimates of €150m and this sees provisions (-€1125 vs consensus -€990m) missing consensus by 19%. Overall loss at its Greek Subsidiary, Emporiki of -€777m is slightly below the earlier guidance of -€850m. Expenses are a small miss and divisions ex Corporate & Investment Banking are all below expectations. In terms of capital they report a core Tier 1 under its own calculations of 8.9%, which is up 20bps on 1Q11. They also say 86% of 2011 funding plan completed at competitive spreads, having raised €23.3 bn of long-term funding with an average maturity of 6.5 years and an average spread of 79 bps over the 6-month swap. With $36 bn of US money market related funding, Credit Agricole is exposed to current difficult market conditions. However, the bank highlights that it has €120 bn of liquidity reserves (~$175 bn), of which €86 bn can be mobilized in 48 hours. Management pointed to recent covered bond issuance as a sign things are improving, referenced below.

HSBC is in talks (sourced from Reuters) on the possible sale of its Canadian wealth management unit as part of the bank's worldwide restructuring. The Canadian retail brokerage, is said to manage around C$16 billion in investors' money.

ING last Wednesday sold the first covered bond in Europe for over two months. The company sold €1.75bn 10yr covered bonds at some 15bps premium to yields on their existing bonds. The transaction is being held up as showing all is not lost in funding markets and bankers close to the deal suggest that others were closely watching and considering following suit.

Royal Bank of Canada reported cash EPS of $1.06, which missed consensus of $1.08. However, EPS was reported on a continuing operations basis, by adding in the operating loss from RBC's U.S. retail bank, core cash was closer to $1.00, moreover, a low tax rate added approximately $0.05 to this quarter's EPS. The earnings miss is attributable to fairly broad-based weakness across most operating divisions. While International Banking came in slightly ahead of expectations, Canadian Banking, Wealth Management, Insurance and Capital Markets were all light. $405 million of core trading revenues was in-line with estimates, but down 42% QoQ and 7% YoY. The Canadian Banking net interest margin declined 0.04% sequentially to 2.74% with guidance disappointingly towards further pressure, albeit the bank is targeting tighter expense controls in 2012. Capital trends were in line with expectations. The Tier 1 common ratio was unchanged at 10.3% and the Tier 1 ratio declined to 13.2% from 13.6% largely given the $1.6bn writedown associated with the U.S. divestiture. Risk-weighted assets declined to $253.2bn from $256.0bn in Q2/11. Credit losses of $275mn were better than expected however, this was likely due to the U.S. banking operations being transferred to discontinued operations.

Dividend Paying Companies

BHP – put out a very strong set of full year results, as expected, when it presented to investors and analysts in London and Sidney, last week. Its full year underlying profit soared 74% to over $21bn, as exceptionally high prices in iron ore and energy more than offset set-backs in base materials and metallurgical coal, impacted by decreasing ore grades and the spring deluge in Queensland. Earnings per share were up by 76%, to $3.94, as the company conducted a $10bn buy-back program during the fiscal year. The final dividend was raised by 22%, to $0.55 per share or a full year dividend of $1.01, yielding roughly 2.86% for the PLC (UK listed) common share. The management emphasised the major US shale gas acquisitions, the Fayetteville, from Chesapeake, and Petrohawk, as transformational for its energy business, adding top quality assets, expertise and diversification. The company is committed to its investment though the cycle approach and is flagging in excess of $80bn of capital expenditure through 2015, used to initiate a ramp up production as well as to provide much needed infrastructure. Key projects include expansion at the Olympic Dam (copper, uranium), Escondida (copper), Petrohawk (shale gas and liquids), port infrastructure at Port Hedland, Western Australia (iron ore) as well as rail infrastructure in Bowen Basin, Queensland (metallurgical coal) and access shafts and equipment at Jansen, Canada (potash). The company is seeing continued tight supply in key minerals, supporting pricing, as expansion projects are being delayed by a shortage of resources, mostly skilled labour and equipment.

Toyota Motor – launched its 2012 model Camry in US last week, aiming to regain its sales momentum in its most important market. Toyota Camry is still the bestselling car in US and held the distinction for 13 of the last 14 years. Around 15 million Camrys have been sold globally since the launch of the model in 1983, with more than half sold in US, helping the company build a reputation for worry-free reliability. The company estimates that more than 6.8 million Camrys are still on the road in US today. Toyota aims to sell 360,000 of the Camry model next year, an improvement over last year, yet well short of the 2007 record, when it sold 473,108 units. The new model is expected to hit the US showrooms in early October and sports a roomier rear sit and a bigger trunk, improved ride and handling as well as best in class fuel consumption at 41mpg. In a more competitive landscape, with manufacturers such as Kia, Hyundai, General Motors and Ford asserting themselves, in addition to the perennial rivals Honda and Nissan, the company decided to cut pricing, with five of the six new Camry versions having lower pricing compared to the 2011 versions. Toyota is set to release numerous new models in the short term, as many as 20 until 2013, including a number of Prius models, Yaris, Scion minicar and sportscar, modified Tacoma truck, new Lexus GS and an electric RAV4.

Toyota and Ford are in initial discussions about collaboration on product development for future rear-wheel drive gasoline-electric trucks and SUVs. The companies do not plan to co-produce trucks, but rather to take advantage of Toyota's expertise in hybrids and Ford's expertise in trucks in order more efficiently to bring to market vehicles that are compliant to the more stringent US standards.

Economic Activity, Consumer and Business Conditions

US – A number of better than expected US macro-economic indicator readings pre-empted the markets from slipping further, maintaining hopes that the US might avert a double-dip recession. Fed's Chairman's remarks in Jackson Hole, Wyoming, at the end of last week depicted a similarly benign macro-economic picture, if only as a trade-off for a sub-par economic growth.

US durable goods orders unexpectedly improved by 4.0% in July, double the expected rate of growth, driven by an exceptionally strong aircraft orders month, yet, even when excluding transportation, the orders grew by 0.7%, ahead of an 0.5% expected retreat. US personal consumption grew by 0.8% in July, ahead of the expectations for a 0.5% improvement, backed by a 0.3% increase in personal income for the same month, in line with the expectations. Importantly, the core personal consumption expenditures (PCE) price index moved 1.6% year on year, from 1.4% in June, entering the 1.5% to 2.0% Fed's comfort zone, yet potentially precluding further monetary easing South of the border.

The US consumer is still suffering from the recent market rout, with the sentiment indicator, as measured by the University of Michigan, dropping further to 55.7, from a revised 63.7, below the expected 56.0 level. Both the current conditions and the expectations components of this diffusion index retreated, yet the expectations retreated less than expected. The preliminary Q2 GDP numbers came a tad weaker than expected at 1.0%, versus 1.1%, and compared to the advance reading of 1.3%.

A couple other economic readings in the week were rather disappointing, with the initial jobless claims moving higher to 417,000, from an upwardly revised reading of 412,000 for the prior week. The new home sales dropped below the 300,000 units threshold once more, reaching 298,000 in July, below expectations for a 310,000 units annual rate number and a far cry from a more 'normal' level of about 750,000 units yearly.

Canada – Canadian retail numbers, released last week, posted an in-line increase in sales for June, up 0.7%, driven chiefly by auto sales, which benefited from significant promotions in the month. Excluding sales of motor vehicles, the Canadian retail lost 0.1% worth of revenue in the month, less than the expected 0.2% improvement, with many of the retail categories retreating.

Source: Thomson Reuters, Bloomberg, Company reports

Financial Conditions

Short selling bans - the French, Italian and Spanish regulators have extended their temporary bans on short selling of financial services companies. Spain and Italy have extended their bans until Sept. 30th, France have said that their ban could last until Nov. 11.

Policymakers continue to accommodate a recovery in bank profits, albeit less than 12 months ago. The U.S. 2 year/10 year treasury spread is 2.06 % and the U.K.'s 2 year/10 year treasury spread is 1.89 % - 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 (71 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 4.22 % - (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 33.14 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

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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, Bloomberg, Company reports

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