Market Commentary

PORTLAND INVESTMENT COUNSEL™

October 10, 2011

News Highlights on Current Holdings

Financial Services Companies

Bank of America is to charge a $5 monthly fee for debit

JPMorgan reported net income of $4.3 bn and EPS of $1.02 vs consensus of 92c with a return on equity of approx 9%. However this included 29c ($1.9bn) benefit from fair value gains on own debt value adjustment (DVA) offsetting this was a $691m loss (11c) on counterparty credit value adjustment (CVA)….consequently suggests core EPS at $84c and there was also $1bn of mortgage litigation losses (15c) and a $542m loss on private equity (9c). We believe it is presumptive to view the extra litigation reserves as a one-off although from conference call it seems coverage levels are expected to be high and as the private equity book has mostly been marked to market with next quarter no material loss expected … which suggests all-in core eps of at least 93c. Total revenues came in at $22.5bn (ex DVA) in line with consensus, albeit consensus has been marked down over recent weeks. In the Investment Bank revenues were at $6.3bn down from $7.3bn in 2Q ; Fixed Income fell to $3.3bn from $4.3bn 2Q and $5.2bn 1Q… but equities were better at $1.4bn compared to 2Q $1.2bn and 1Q $1.4bn. Netting out the DVA gains the Investment Banking profit was just $430m albeit some of the CVA mark downs would suggest the investment bank platform performed better than expected. The DVA gains and CVA losses reflect widening of credit spreads which could reverse in future periods and do not relate to the underlying operations of the company. Elsewhere both Retail Financial Services and Card services were slightly ahead driven by better revenues with strong retail mortgage origination volumes from prior quarter, loan and deposit growth…the firm's total deposits increased to $1.1 trillion – up 21% compared to the previous year…but loss reserve releases were muted pending more evident stability in economy …with group's loan loss coverage ratio remaining very strong at 3.74% of total loans. Stock repurchases of $4.4bn in 3rd quarter has completed the current permitted amount of buybacks and future buybacks should not be expected until regulatory requirements are clearer as to whether stronger capital is needed by 2019 as currently required or earlier … say 2013. If the latter is the case then we should expect JPM to buy short term high yielding assets from mostly European banks that are currently in deleveraging mode – rather than do more buy-backs… confirming the bank's ability to exploit its strengths… Capital ratios still strong, Basel I at 9.9% and Basel III at 7.7% (up from 7.6% 2Q). Finally, total firm wide net exposure to the euro 5 of Greece, Ireland, Portugal, Italy and Spain is confirmed at $15.1 bn of which 85% is Italy and Spain. Thanks to the share buyback, common shares at period end had declined by 112 million – approximately 2.9% of shares outstanding. Reported book value per share has risen to $45.93.

Wells Fargo : Excluding Wachovia -related merger charges and securities gains, Wells Fargo reported quarterly net income of $4.1 bn and diluted $0.72 earnings per share – in line with consensus expectations. Lending revenues of $10.7bn fell short of estimates as the lending margin was squeezed down from 4.01% to 3.84% of which 70% of the change is attributed to the exceptional 'flight to quality' deposit growth of $42 billion. Non-interest bearing deposits are now up 20% since last December. Average total deposits were up 4% QoQ and so deposit growth is outstripping loan growth although on the conference call, management emphasized that with the integration of Wachovia now nearing successful completion, the group's loan growth of 1% this quarter came through late in the quarter and expectations now are higher than at any time since the merger…. with broad loan growth expected across its retail and commercial lines (i.e. core commercial loan growth was up 9% annualized QoQ.) and 'opportunistic' purchases of US $ loans from European banks . Nonetheless, the increased deposits, pending deployment, were invested in low yield short-term assets, so accounting for 12bp of the 17 bp drop in net interest margin…with management therefore understandably highlighting this drop should be recovered as the deposits are redeployed into supporting loans. Total pre-tax net revenue of $7.95bn actually slightly beat expectations – all due to strong expense control ($11.3bn vs. $12bn est.). However, management reiterated its $11bn quarterly expense goal for 4Q12 and noted that its expense line will likely fluctuate from here. Losses improved 9bp QoQ with non performing assets down 4% and allowance coverage to loans still high at 2.68%.. Also, management continue to call its expensive preferred shares… buying back $5.8bn of trust preferred securities with an average coupon of 8.45% … and while such purchases tempered its enthusiasm to repurchases own stock – these repurchases did continue with 22 million shares repurchased and a further 6 million being repurchased through a repurchase transaction to be reflected in the 4th quarter (equates to 0.5% of shares outstanding) ….all with capital strength continuing to improve ..current Tier 1 capital is now at 9.35% up from 9.15% in June and up from 8.01% Sept 2010… and with estimated Basel III Tier 1 now at 7.41% …. With return on equity above 11%, management also re-iterated a wish to increase dividends… as part of its overall capital management from here on. Management re-iterate its confidence, post integration of Wachovioa, of hitting a cost base of no more than $11bn by 4th Q 2012 and that its loan pipeline is strengthening (i.e. its mortgage pipleline at September-end was $84 bn compared with $51 bn at June) such that it is confident of experiencing positive earnings leverage through 2012. Finally, its Book Value per share also increased to $24.13.

AMP has appointed Colin Storrie as Chief Financial Officer, effective 1 January 2012. Mr Storrie will replace current Chief Financial Officer Paul Leaming, who will retire at the end of the year after almost 14 years with the company. Mr Storrie joined AMP earlier this year as Deputy Chief Financial Officer and Group Treasurer. Prior to AMP, Mr Storrie was Chief Financial Officer for Qantas and served on its board.

Barclays - CEO Bob Diamond made a non-binding preliminary offer for Caja de Ahorros del Meditteraneo earlier this month, according to the Financial Times. Separately, the Sunday Telegraph reports Barclays is also in the early stages of looking at a further three cajas, including Novacaixagalicia. Separately, Barclays is providing $11.5bn of financing for Kinder Morgan's $21.1bn takeover offer for El Paso.

BNP: S&P downgraded its Long-Term rating on BNP from AA to AA- on Friday.

Spanish banks including Banco Santander and Banco Bilbao Vizcaya Argentaria (BBVA) had their ratings cut by Standard & Poor's, which cited "dimming" growth prospects and "heightened" market turbulence. The banks had their long- term credit ratings cut to AA- from AA with a negative outlook.

HSBC or ING : Dexia – Four European banks have applied to Ernst & Young to acquire Dexia's Turkish unit Denizbank, according to local paper, Haberturk. The potential buyers include Russia's OAO Sberbank and 2 banks with no presence in Turkey. The fourth bank has 300-500 branches in Turkey and wants to increase its market share, meaning it must be either HSBC or ING, the newspaper said. Separately. Dexia Bank Belgium's acquisition by the Belgian State should be concluded by October 17th 2011.

HSBC : has warned it could leave London or reduce business or investment in the UK if planned regulatory reforms prove too harsh on the industry. "It clearly poses a structural and a cost issue for banks' headquarters ... and therefore it will certainly have an impact on the considerations as to the relative benefits of that structure," said Douglas Flint, chairman of HSBC, in reference to both the ICB proposals and a tax on bank balance sheets. (Reuters)

Royal Bank of Scotland - Sunday Times says RBS looking to cut 5000 jobs. Global Banking Markets likely to be cut back to the core British and American operations. The European outposts of its corporate lending business would be cut back, along with higher risk parts of its trading and investment operations.

TD : S&P announced last week it has revised the outlooks on Royal Bank of Canada and Toronto-Dominion Bank to stable from positive. At the same time, the rating agency affirmed its AA- credit ratings.

Fitch Banks Downgrades - Fitch downgraded UBS's Long term rating to A from A+, outlook stable on diminishing government support. RBS & Lloyds had their credit ratings cut by Fitch also, which said the UK is less likely to provide support in future. Both banks Long term ratings were lowered 2 notches to A from AA-. Fitch lowered its support rating floors, which measure the likelihood of government support for systemically important banks, to A from AA- at Lloyds and from A+ at RBS. Further, Fitch Places 7 Global Trading & Universal Banks on Watch Negative: Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, Goldman & Morgan Stanley.

Dividend Paying Companies

BHP – is reported to be ready to launch a $3.2bn bid for Ferrous Resources, a Brazilian iron ore mine. A controlling stake in Ferrous is cited as another possibility. The world leading mineral resource company, BHP has been known to be looking for top tier assets (large reserves, low operating costs) to strengthen its core competencies.

Carrefour – announced third quarter sales of €22.8bn, in line with the consensus expectations of €22.74bn, as poor revenues in France and core European markets were offset by continued strength in Latin America. The group though issued a new profit warning, estimating that the operating profit for the full fiscal 2011 will be 15% to 20% lower than for 2011, adjusted for the divestiture of the Dia discount chain. This compares negatively to the previous guidance of a 15% retreat in operating profit for the full year. The like for like sales in the group's French hypermarkets were down 4.6% as the consumer are subject to continued economic pressures. Some of the decrease is justified, the company explained, by a move towards an everyday low prices business model and away from promotions. The company estimates that it reduced its price gap with the lowest price competitor, Leclerc, by about 1 percentage point. The group was also impacted by a drop in discretionary spending in China, as new price labelling regulations impacted retailers in the country. Latin America on the bright side, registered a 10.2% rise in sales, at constant exchange rate, while Belgium continued its strong momentum.

Syngenta – reported third quarter sales of $2.7bn, significantly higher than the $2.48 called by the consensus estimate, as the strong sales momentum in Latin America continued, with sales higher by 27% and good uptake of the new Viptera corn seeds line. Sales registered double digit rates of growth across all the regions. A particularly welcome development was a 3% price increase for the quarter, the first such increase since the second quarter of 2009, as the strong pricing trend for the soft commodities continued. The company expects to deliver mid-single digit price increases in the next year, as well as margin improvements in both crop protection and seeds businesses and a significant boost to the free cash flow for 2011.

Economic Activity, Consumer and Business Conditions

United States – Economic news out of US last week helped alleviate worries for a renewed recession, as two key contributors of economic growth continued to show signs of life. The 'star' announcement last week was the September retail sales numbers, higher by 1.1% in the month, compared to Augusts 0.3% growth and the expected 0.7% advance. The improvement was driven mainly by auto sales, but even excluding sales of motor vehicles, retail advanced in US in the month by 0.5%. The results are even more impressive considering that consumer confidence, as measured by the University of Michigan, recorded a drop in October to 57.5 from 59.4, short of the expectations for an improvement to 60.2. Both the current conditions and the expectations sub-indexes dragged the composite lower. The US trade deficit held steady in August, at $45.61bn, compared to the revised $45.63bn for July and expectations for a worsening to $45.80bn.

Announced earlier today, the US industrial production recorded a 0.2% advance in September, as expected and ahead of August's flat performance, with most sectors contributing to the improvement, lead by manufacturing. The US capacity utilization inched higher to 77.4% from 77.3%.

Canada –the visible merchandise trade balance continued to be negative on this side of the border, with August's deficit standing at $620mm, a widening compared to July's negative $540mm, yet significantly better than the expectations for a $1.0bn deficit. With the Canadian dollar still close to parity and the US economy troubled, the days of the 'normal' $4bn visible goods trade surplus seem to be nowhere in sight.

Meanwhile, the housing sector in Canada is showing signs of rude health, with starts moving higher to a 205,900 units annualized in September, compared to Augusts 191,900 units annualized and the consensus expectations of a decrease to a 188,000 units annualized level. The new housing price index inched higher by 0.1% in August, as expected.

Eurozone - The Sunday Times reports that China have made a secret commitment to prop up the eurozone in exchange for sweeping budget reforms and further public sector cuts. At the G20 meeting in Paris, China are said to have been willing to pump tens of billions into the eurozone by buying infrastructure assets from debt riddled states. Chinese banks would also increase their purchases of sovereign debt. Yesterday, it emerged that a Chinese Group, HNA, is favourite to take over the Athens airport. Chinese assistance could be channeled through the IMF, though Britain and America have blocked plans to use IMF cash to support struggling eurozone nations. Separately, according to the Financial Times, the G20 told the Eurozone that by the European summit next Sunday it should agree on the losses the private sector should take on Greek debt; arrange a credible plan for the recapitalisation of Europe's banks; and install a firewall to protect other countries from Greece's woes. Details of the package are not expected to emerge before the full troika report on Greece is delivered on Wednesday night, reportedly. This report will spell out the financing gap that has emerged in the Athens budget since a €109bn second rescue package was agreed in July. German finance minister Wolfgang Schäuble, said the package must contain a "lasting solution" to Greece's debt problem, with an increased contribution from private creditors. But Paris and the European Cental Bank insist that any Greek debt restructuring must still be voluntary, something which becomes more difficult the greater the suggested haircuts. The article goes on to say that the European Banking Authority is finalising new stress tests and plans for the recapitalisation of banks, constrained by the need for the stress scenarios to be sufficiently tough to be credible at the same time as demonstrating that the capital requirements are achievable without deepening the squeeze on credit. Banks are said to need 9% capital to pass a stress' test with banks unable, given until June 30th 2012 to raise the money allowing time for asset diposals. Details of the bank recap plan are not expected until next weekend but the Qatar Invt Authority, the Kuwait Inv't Authority, Temasek and Norwegian sovereign wealth fund, Norges are said to be in talks with several European banks to provide capital. Sources say there will be another midweek meeting of Angela Merkel and Nicolas Sarkozy and euro officials continue to work on the bank recap plan. Separately, Bild reports that Germany may veto requests from countries seeking funds from the European Financial Stability Facility that have not tried to help their banks first, citing an interview with lawmaker Rainer Bruederle.

Greece - The EC/ECB/IMF announced last week that they have concluded the weeks long review of the country's finances and that Greece will likely receive the €8bn tranche in early November. The Eurogroup and the IMF's Executive Board need to approve the conclusions of the fifth review before the money is paid.

Spain : S&P downgraded Spain last week one notch to AA- from AA with the outlook remaining negative. This is the country's third cut in 3 years. S&P said the cut was needed to reflect "heightened risks to Spain's growth prospects" due to higher unemployment, tighter financial conditions, a high level of debt and a broader eurozone slowdown. The rating agency did highlight a few positives that the Spanish economy has remained resilient this year and that Spain's 70% debt to GDP ratio is better than the the other troubled nations like Greece and Italy. Spain has been able to cut its deficit to GDP from 11% in 2009 down to 9% for the first half of this year but will likely still miss its deficit target of 6% this year and 4.4% next year.

Italy : Italian Premier Berlusconi won the key confidence vote. Calls for resignations should simmer down a bit from here.

Financial Conditions

European Banks: Manuel Baroso, President of the EC, outlined yesterday the basis of the Euro banks recapitalisaion plan. This was for a fully coordinated approach to strengthen Europe's banks - this should be based on a reassessment by the supervising authorities using a temporary significantly higher capital ratio of highest quality capital after accounting for exposure. Banks should first use private sources of capital, with national governments providing support if necessary. If this support is not available, recapitalisation should be funded via a loan from the European Financial Stability Facility. Pending this recapitalisation, these banks would be prevented by national supervisors from distributing dividends or bonuses. Bank CEOs are pushing back against plans to forcibly recapitalise the European banking sector. The FT says banks would rather deleverage than raise expensive capital at this point in the cycle with bank valuations where they are. This highlights the challenge the EU will have in putting together and executing a plan which will have credibility and the desired impact. France has said it is happy to put capital into its banks if necessary, rather than rely on the EFSF.

French banks – Bloomberg report the eight largest US money market funds reduced their lending to French banks by 44% last month. Holdings in BNP, Societe Generale, Natixis & Credit Agricola dropped to $23.2bn end September from $41.5bn the previous month. The largest falls were Natixis at 74% & Credit Agricole at 64%.

The European Union's top banking regulator, the European Banking Authority, has asked lenders for more information on sovereign debt holdings as part of its review of financial industry capital levels. European Commission President Jose Barroso is proposing measures to recapitalize banks gripped by the region's sovereign-debt crisis. Heads of state are scheduled to meet in Brussels later this month to discuss the proposals.

The president of the European Council has said that a summit of EU leaders to discuss the Eurozone debt crisis has been delayed by a week. Herman Van Rompuy said more time was needed to finalise a plan to give money to Greece and bolster debt-laden banks. The summit, originally planned for this Monday and Tuesday, will now start on 23 October. (BBC News)

French Finance Minister Francois Baroin said that he did not think any more banks would need to be rescued by governments after Belgian-French bank Dexia. Baroin told French television iTele that the rescue should not endanger France's prized AAA credit rating because France was participating by granting guarantees. (Reuters).

USA

Wall Street trading appears to be headed for an inhibited new era after the US government, last Tuesday, outlined rules limiting banks' ability to make 'proprietory' bets with their own capital. Regulators released a 298-page proposal (Volcker rule), that would restrict how big financial firms can trade securities and invest in hedge funds for their own benefit.

US regulators will scrutinize asset size, leverage and debt levels of non-bank financial firms to determine which ones need extra supervision because they pose a potential threat to the economy. The Financial Stability Oversight Council voted to evaluate companies that have more than US$50bn in assets and meet any of five other criteria, including a 15-to-1 leverage ratio, US$3.5bn in derivatives liabilities or US$20bn of outstanding loans borrowed and bonds issued.

The advent of the US 'twist' means policymakers are no longer accommodating a recovery in bank profits (gained via them trading on a steep yield curve) . The U.S. 2 year/10 year treasury spread has been falling and is now 1.95 and the U.K.'s 2 year/10 year treasury spread is 1.93% - meaning investment banks will need to seek operational efficiencies, including job cuts, to maintain acceptable levels of profit – above their costs of capital.

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As concerns have swung from commercial real estate and unsecured consumer loans/credit card loans to European sovereign debts the number of small U.S. banks failing continues to grow, albeit at a more moderate pace with (83 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.

Influenced by the US 'twist', the U.S. 30 year mortgage market at 4.12% - (3.94 is the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing U.S. housing inventory has increased to 9.4 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. While we still believe it remains premature to consider a recovery in house prices prospects of a measure of stability are likely to increases as a result of the Fed actions – which 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 and whether bank's have mis-represented the quality of those assets sold to Freddie Mac and Fannie Mae. Such legal debates are likely to drag on for years but from recent bank investor relations presentations it does seem the rate of "put backs" are now expected to decline and that litigation reserves have been increased suggesting overall current levels of total provisions should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 2 years by when we expect more normalized earnings power to have returned. 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 30.32 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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Credit Suisse - MONEY NEVER SLEEPS
Global Financials Daily (US Banks Preview, DEXB, Italy, CBK, Hungary, DB1, AMBR, BK, NYX, CME, SGX, SMFG, RHB, Fortegra, CF, GMP, Krung Thai
TD: Morning FX Outlook, 5 October 2011
Senators Plan To Introduce Repatriation Tax Break Bill
Credit Suisse - MONEY NEVER SLEEPS
BMO Capital Markets A.M. Notes --- October 6, 2011
Credit Suisse - MONEY NEVER SLEEPS
Economics Newsflash: ECB Holds Rates Steady, Increases Liquidity Provisions

Thomson Reuters, Bloomberg, Company reports

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