



News Highlights on Current Holdings

Financial Services Companies

AMP chief executive Craig Dunn insists the growing financial stresses in Europe over the past year have not diminished the attractiveness of last year's \$14.6bn joint move on rival Axa Asia Pacific. "By bringing the two Australian wealth managers together, this will create a more efficient business, while revenue growth will come over time, regardless of uncertain markets", Mr Dunn said.

AXA : underlying earnings were €9.9bn (+2% YoY) slightly above consensus. Within the detail, the P&C combined ratio was 97.9%, slightly better than forecast and price rises are continuing around the same pace with an average 3.8%. US Variable Annuity losses are in line with those previously communicated, and margins are improving as planned due to the mix of business. AXA has seen €100m of bond impairments (mainly Greece which has been written down to 22% of original value) and €100m on equities. Adding disposal gains and other one offs brings up the headline net earnings number to €1.3bn (+49% YoY) although this was well below forecast due to the €1.2bn goodwill write down, mainly concerning its US life business. This relates to a block of business purchased back in 2000 and has no impact on AXA's solvency. Free cash flow is improving as planned - operating FCF +14% to €1.2bn. This supports an estimated 11% free cash flow yield calculation. AXA has declared a €0.69 per share dividend for 2011, flat versus last year. This represents a payout of 49%, at the top end of AXA's 40-50% range.

Solvency ratios are holding up well and in line with expectations (Solvency 1 188%, economic 148% & 'above 150%' at end Jan), gearing ratio is down 2pts to 26%.

IFRS book value per share was €8.6bn (-2% YoY) or €0.8 per share with the current share price therefore trading at circa 0.6x book value. The group's embedded value came in at €3.5 per share

BNP Paribas, France's largest bank by assets announced its 4Q11 net profit reached €65m beating market expectations of €100m (€1,051m before Greek net charge of €51m, thereby writing down Greek sovereign exposure by 75%). Adjusted 4Q11 Return on tangible equity is 9% compared to a cost of equity of 10+%. The bank signaled it is one-third of the way through its €80 bn deleveraging plan and increased its

estimates of synergies from the 2009 acquisition of Fortis, the Belgium Bank. This news assuaged disappointment that the year's operating businesses were disappointing with a modest miss on expectations for Investment Solutions and Corporate & Investment Banking. Retail Banking accounted for 61% of pre-tax profit of €9.7bn. Total adjusted cash assets amounted to €65bn and were reduced by 53bn quarter on quarter or 5% (-12% yoy). Risk Weighted Asset change (€14bn) is also positive, being 2% below market expectations of €29bn. Core Tier 1 ratio was therefore strengthened and reached 9.6% in Dec 2011. Importantly, the 9% European Banking Authority hurdle is already met at end of December, so diminishing the market's lingering concerns of the need to raise more capital and management confirmed it is halving the bonuses awarded for last year, compared to the previous year.

Swedbank Published net profit of SEK965m approximately 2% ahead of SEK944m consensus expectations. Net Interest Income beat consensus by 3% or SEK 160m, but included SEK 206m of one-off revenues related to Swedbank's old Lehman Brothers exposure. Adjusted for this the NII was 1% short of expectations. Commission income was weak and trading income was strong and driven by a wider EURSEK basis swap spread (just like seen in previous quarters). Figures impacted by a number of one-offs (expected) including SEK1.9bn goodwill write-down for Latvia. Pre-impairment Q4 SEK3,709m, about 7% ahead of consensus expectations. Basel II Core tier 1 capital strong at 13.9% (Basel III; 12.9%) . Retail banking was a little disappointing (rising impairments in Q4) as was Baltics (due to costs); whereas Russia & Ukraine were better (impairment write-backs). Loan losses remain low in Sweden Management outlook was "uncertain" and so they aim to decrease costs 2012 v 2011 by SEK1bn (c6%) ex. variable staff costs. The dividend per share of SEK 5.3 is in line with the dividend policy of 50% of EPS. Although no official new capital target is given, the management believes that a Core Tier 1 ratio of 13.5-14.5% will be required long term (compared to old target of 10% long term and at least 13% until 2013). The Core Tier 1 ratio according to Basel 3 metrics was 14.7% in Q4 2012, and its estimated this ratio will strengthen to 15.1% by end 2014.

UBS is poised to issue at least \$1bn using a contingent debt instrument that could provide a benchmark for other European banks that are looking to boost their capital strength. The bank is marketing so-called tier two subordinated notes to Asian and European investors as it looks to meet tough Swiss bank rules that require the country's lenders to have a 19% total capital ratio, a measure of balance sheet strength, by 2019



Moody's announced a review of 17 banks with large capital markets operations. The agency's criteria suggest as much as three-notch downgrade for Morgan Stanley, two-notch downgrade for Citibank, JPMorgan, and Goldman Sachs. The market had anticipated potential rating actions from Moody's for some time, so the announcement should not come as a surprise. Compared to expectations, Moody's rating guidance appears "in line" for JPMorgan and Goldman Sachs; slightly worse for Citibank and Morgan Stanley. Other institutions affected include Royal Bank of Canada, Macquarie, Barclays, BNP Paribas, Commerzbank, Crédit Agricole, Deutsche Bank, HSBC, ING Groep, Royal Bank of Scotland, Santander and Société Générale.

Financial Infrastructure

Deutsche Börse reported Q411 adjusted EPS of €0.91 (+11% YoY), 4% below consensus (€0.95). However, the "miss" was attributable to a €7mn non-cash impairment charge (€0.07 per share) relating to a 5% stake in the Bombay Stock Exchange, acquired prior to the financial crisis. Adding back this item "underlying" adjusted Q4 EPS of €0.98 was 3% ahead, driven by strong sales revenue. The company confirmed an ordinary dividend per share of €0.30, matching our €0.30 estimate and announced a special dividend of €0.00 per share. The total dividend per share of €0.30 equates to a prospective yield of 7%. In addition, the company will resume a €00mn share buyback in second half 2012, equating to 2% of shares outstanding at the current price. We see scope for similar distributions in 2013 & 2014. Q411 sales of €577mn came in 2% ahead of estimate driven by a 4% beat at Clearstream, which benefited from strong demand for its growing liquidity and collateral management services. 2011 costs of €1,134mn came in 3% below the midpoint of original guidance of €1,160-1,180mn.

Lender Processing Services reported strong 4Q11 results relative to expectations, with adjusted EPS of \$0.72 (excluding one-time accruals/charges) well above consensus of \$0.58. The beat reflected scale benefits from refi volumes and a drop in corporate expense. However, 1Q guidance of \$0.50-0.55 EPS and \$470-490 million revenue came in below estimates, with management taking a more cautious stance on origination market volumes over the next couple of months. For the first time, LPS took an accrual representing management's best estimate of future costs to resolve all legal issues the company is currently facing (\$78 million - subject to re-evaluation, but signals greater clarity).

Dividend Paying Companies

ABB – reported fourth quarter and full year 2011 results in Zurich last week, with robust top line growth and strong new order inflow outside of Europe. Fourth quarter orders rose by 16% driven by demand in China and the United States. However, competition on prices and a less profitable backlog of orders impacted the company's profitability, with the adjusted earnings margin before interest and tax kept down by margin contraction in all divisions except Power Systems. Outlook for the beginning of the 2012 is tough, with projected margin the same or worse compared to the previous year. ABB estimates the trend will revert in the second part of the year, yet overall an estimated impact of about \$1bn could come from price pressures during the year. ABB has answered the competitive pressures by cutting costs, achieving \$1.1bn in savings in 2011 and targeting a further \$1bn in cost savings in 2012. The company's net cash position provides ample room for further acquisitions, in line with the estimated \$18bn for acquisitions over five years from 2011, of which about half has already been deployed. The focus, however would be on integrating the newly acquired companies, most notably Baldor and Thomas & Betts. ABB announced an increase in its annual dividend to CHF0.65 a share.

BHP – The company's Board approved a \$2.6bn investment in two projects that will expand production at Escondida, Chile, the world's largest copper mine. The first project, the Organic Growth Project 1 (OGP1) will replace the Los Colorados concentrator with a new 152,000 tonnes/day plant which would also allow access to higher grade ore located under the existing facilities. The project is anticipated to be commissioned in the first half of 2012 and will cost \$3.8bn with \$2.2bn being BHP's share. The company also approved the Oxide Leach Area Project (OLAP), which will maintain oxide leaching capacity at current levels following the exhaustion of the existing heap leach in 2014. This second project will cost \$721mm, with BHP's share at \$414mm and will be commissioned in the middle of 2014. BHP also announced a 17% increase in Mineral Resources and a 25% increase in Ore Reserves at Escondida. The company believes that, given the success of its brownfield exploration program, there are sufficient resources at Escondida to sustain production at current levels for more than a century.

In a separate announcement, BHP revealed the restart of its copper and molybdenum operation at Pinto Valley in Arizona. The project is expected to lead to production resumption at the end of 2012, and will create about 650 new jobs while producing some 60,000 tonnes of copper concentrate a year.



Nestle – reported fourth quarter organic sales growth of 8.4%, of which real internal growth was 3.3%, while pricing added 5.1%. The strong result was driven by innovation and sustained capital deployment in the emerging markets. The company maintained an upbeat outlook for the current year, confirming guidance of 5%-6% growth and operating margin improvement. The company expects low single digit raw materials inflation during the year, while a further CHF1.5bn of costs savings are targeted. The company guided for an increase in the net debt position by the end of 2013, amid speculation of the company's interest in Pfizer's nutrition business.

Schindler Holdings – a leading global elevators and escalator business, surprised positively earlier today when it reported a 20 basis points improvement in its operating margin, during an industry wide challenging year. While order intake growth was moderated at the group level, at a 4.8% pace year on year, emerging markets stood out, led by China, India and Latin America. The company's capital expenditure commitment in China and India has increased as a result and is estimated to reach a total of CHF330mm group-wide. The order backlog improved to over CHF6.4bn. For 2012 the outlook is upbeat, looking for revenue growth of more than 5% in local currencies, and significantly higher net profit, as an ambitious earnings margin target before tax and interest is set at 13%. The company maintained its annual dividend at CHF2 per share.

Siemens – is reported to have won a €1.1bn order in a consortium with Prysmian, a leading cable producer, to build an underwater cable connection between the power grids of England and Scotland. The cable link is expected to be about 400km long and will be built by late 2015. Siemens share of the contract is estimated at about €00mm.

Wesfarmers – The company results for the first half of its fiscal year were relatively flat, with a 0.3% improvement in its net profit, to AUD1.8bn, as a price war with its grocery retail rival Woolworths led to a subdued result at Coles. The other retail divisions completed a mixed picture, with Bunning, the group's home improvement star performer improving its earnings by 6.1%, while Target, the group's department store business came short of last year's performance by 9.7%. The discount stores chain Kmart increased its earnings by 12.6%. The resources division (mostly coal) reported a flat result, as higher coal pricing was offset by higher AUD. For the second half of the year, the company anticipates continued improvement in the retail divisions, increased export coal volumes and a better result in its insurance division.

Economic Activity, Consumer and Business Conditions

US – Retails sales in the US for January had a disappointing headline reading, growing by only 0.4%, on top of a flat performance in December, yet it was rather strong when removing the vehicle sales, growing by 0.7% in the month, with good performance in electronics, general merchandise and sporting goods.

On the business activity side, the US industrial production was flat in January, short of expectations for a 0.7% improvement as well as December's 1.0% advance, with results impacted mostly by a weaker utilities contribution, due to milder weather, as well as sub-par growth in mining. The US capacity utilization remained flat at 78.6%, in line with the expectations.

The US housing sector continues to signal improvements, with the National Association of Home Builders (NAHB) housing index advancing another 4 index points in February, to 29, clearly ahead of expectations for 26 index points. While the index has moved off the low readings of the past couple of years, it still indicates a rather depressed sentiment on the home builders' side. Meanwhile, the US housing starts improved to a 699,000 annual rate level, while the buildings permits moved higher too, to 676,000 units annualized, just shy of expectations.

On the inflation front, the January readings were encouraging, with a year on year rate for the consumer price index (CPI) of 'only' 2.9% as an increase in gasoline pricing was more than offset by tamer levels in other categories, notably autos. The core reading indicated a 2.3% year on year rate, roughly in line with December's as well as with the expectations.

Canada – inflation in Canada moved higher in January, reaching 2.5% year on year in headline terms, helped by gasoline pricing, but also by the removal of seasonal discounts for some discretionary spending categories. The headline reading moved higher as well, to 2.1% year on year, ahead of the expectations for a 1.9% reading as well as ahead of December's 1.9% level.

Core retail sales in Canada (excluding autos) were surprisingly flat in December, even lower than expectations for a modest 0.1% improvement as many retail categories were impacted by reduced pricing. The headline reading was down by 0.2%, as expected.

Sovereign downgrades - Moody's has placed the AAA ratings of the UK, France and Austria on watch negative as well as downgrading Italy, Spain, Portugal, Malta, Slovenia and Slovakia. Moody's said it was concerned about Europe's ability to undertake the kind of reforms needed to address the crisis



and the amount of funds available to fight it. It also said the region's weak economy could undermine austerity drives.

Economies in recession: Two of the eurozone's biggest economies have fallen into recession, according to the latest economic figures. Italy and the Netherlands both saw their economies shrink by 0.7% in 4Q, the second consecutive quarter of economic contraction.

Greek debt - Eurozone finance minister approve 130 Billion EUR bailout package for Greece. Under the new plan, private sector holders will take a 53.5% haircut on Greek debt (70% on Net Present Value terms) with maturities of 11 to 30 years and 15% will be in short dated securities issued by the European Financial Stability Fund. The debt swap bonds will have a 2% coupon until 2014 which will rise to 3% for the years 2015-2020 and then rise to 4.3%.and the ECB and other national central banks will pass profits on the bonds they held under the Securities Markets Portfolio. All parties though have agreed to lower coupon payments. Greek debt/GDP is expected to fall to 120.5% by 2020 from the 164% presently. Separately the Financial Times says that the new bailout package will come with "unprecedented controls on Athens' ability to spend money". The plan is likely to include a requirement for an escrow account that must always hold enough money to pay Greece's debt for 9 to 12 months. Should the cash in the account fall below that level, money designated for the running of the Greek government will be used to fund the debt. Also, the agreement will impose a permanent team of international monitors to keep close track of the Greek government's spending decisions.

Financial Conditions

Short selling : The Spanish Regulator has followed the France and Belgium ones and lifted the short restrictions on Spanish banks.

Federal Reserve policymakers appear determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels' of interest rates "at least through late 2014". which is still an "exceptionally low level" in the grand scheme of things. Fed Reserve Chairman Ben Bernanke has indicated 1% or less would be considered exceptionally low. The advent of the US 'twist' (whereby the Federal Reserve is selling 3 year and less maturities to buy 6 years and longer) means all parts of the yield curve will benefit from a near-zero anchor for essentially the next 3 years. The U.S. 2 year/10 year treasury spread has been falling and is now 1.74% and the U.K.'s 2 year/10 year treasury spread is 1.77% - meaning investment banks can no longer profit from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above their costs of capital. It seems the top tier 8-10 investment banks will continue to command their market and possibly increase their

share – as barriers to entry for newcomers have in our view been raised.

Influenced by the US 'twist', the U.S. 30 year mortgage market remains very low at 3.87% - (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 fallen / improved to 6.2 months supply of existing houses. So the combined effects of record low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in 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 increase as a result of the Fed actions – which 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 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 beginning 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.

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 9 in 2012 (compared to 95 in 2011 and 157 in 2010 which was the highest annual tally since 1992). 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 VIX (volatility index) is 17.78 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

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Market Commentary



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