



News Highlights on Current Holdings

Financial Services Companies

Ameriprise AMP's 1Q12 earnings of \$1.45 ex unusual items were lower than anticipated driven by weaker-than-expected Asset Management earnings. Asset management net outflows improved vs 4Q11 although its expected net outflows will persist. AMP's 1Q12 operating ROE (ex Any Other Comprehensive Income) was strong at 16% and is on track to meet its 2012 guidance of 15% adjusting for the DAC (deferred acquisition costs) accounting change. Asset Management net outflows improved to \$4.6bn (includes \$2.3bn of previously disclosed parent net outflows) from \$10bn of normalized net outflows in 4Q11. Notably, AMP anticipates another \$7bn of parent and other related outflows in its Asset Management business later in 2012. The Advice & Wealth margin improved to 9.9% from 9.2% in 4Q11, and AMP expects to reach 12% by YE12 due in part to expense savings. AMP has over \$2bn of excess capital that its anticipated may be deployed in share buybacks. AMP's ROE profile is likely to improve as it transitions to become more of an asset manager than a life insurer, although results could be negatively impacted until net outflows cease.

Australia & New Zealand Bank reported cash earnings of \$2,976mn (up 5% on \$2,832mn 1H 2011) and interim Dividend Per Share of \$0.66 (up 3% on \$0.64 1H11). While the headline result was in line with consensus, compositionally there was a Group sequential net interest margin decline of 6bp higher than expected and a slightly low bad debt charge including a sizeable reduction in collective provision coverage; with consensus earnings being reached

through a sizeable recovery in Global Markets trading & balance sheet income. Guidance statements included little change on Net interest margin, but with cost growth being substantially lower than the 3% 1H12 reported, although there is to be a further \$60mn of restructuring charges that would be booked within 2H12E cash earnings. ANZ also reiterated its expectation for a 2012 bad debt charge similar to 2011, noting that this implied a 2H12E sequential increase. S&P said that its AA-credit rating on ANZ was unchanged following the result stating that, while ANZ's Australia division results were negatively impacted by squeezed interest margins in an environment of subdued credit growth, the bank nonetheless improved profitability overall, compared to its previous half. "Our stable outlook on ANZ reflects our view that our ratings on ANZ are likely to remain unchanged over the next one to two years," said S&P credit analyst Gavin Gunning.

BBVA and Santander: S&P has downgraded the ratings of the top Spanish banks after slashing the country's credit standing because of worsening deficit and growth problems. The banks affected include Santander and its subsidiary Banesto, BBVA, Banco Sabadell, Ibercaja, Kutxabank, Bankinter and the local unit of Barclays. S&P on Monday downgraded Banco Santander by two notches to A- from A+, with BBVA cut to BBB+ from A. Santander has therefore managed to maintain a higher rating vs. the Spanish sovereign (Santander A- vs. Spain BBB+).

BNP Paribas: its 1Q results show its core tier 1 capital ratio of 10.4% came in above expectations (10.1%) and even beat the top of range consensus forecast (10.3%). The beat is driven by lower than expected Risk weighted assets. BNP Paribas states that its fully phased in Basel III common equity tier 1 ratio stands at 8.6% at the end March 2012, pro-forma for the sale of Klepierre and the reserve base lending portfolio. To put that in context - the same figure at JP Morgan is 8.4% and JP Morgan is talking about capital return. BNP Paribas also states that it is on track to meet its targeted Basel III core tier 1 of 9.0% by January 2013.

As of the end of March BNP Paribas had a liquid asset reserve of €201 bn, up from €160 billion at the end of the 2011 and ~100% of its short-term wholesale funding. As of mid-April BNP Paribas had completed three-quarters of its 2012 medium and long term funding plan, leaving it well positioned on both short and long term funding. Stripping out exceptionals from Q1 figures, its estimate BNP Paribas reported a clean pre-tax profit of €3,155 million - 1% ahead of a clean consensus. On a divisional basis, the quality of results looks good with both retail and CIB beating expectations.

BNP Paribas Investment Partners is buying emerging-market debt because of a "virtuous cycle" of strong economic growth and improved national finances, while hedging against a worsening of Europe's debt crisis. (Source : Bloomberg)

Goldman Sachs and Wells Fargo last week took advantage of low cost of funds and sold bonds as yields on highly rated corporate debt fell to record lows. Goldman Sachs, the fifth-biggest U.S. bank by assets, issued US\$2bn of 3.3%, three-year notes, while San Francisco-based Wells Fargo issued US\$1.5bn of 2.1%, five-year securities. (Source : Bloomberg)

Lloyds reported Profit before tax on a Combined basis (before volatility) of £868mn ahead of consensus. The fair value unwind was £355mn. Profit before volatile accounting items and fair value (clean representation of earnings power) was £513mn compared to £299mn in 1Q11 and a loss of £9mn in 4Q11. Combined PBT was £628mn, reflecting the non-cash volatile



items. Overall the group reported statutory profit of £288mn, including a £375mn additional PPI provision (extra cash to cover claims from customers wrongly sold payment-protection insurance...but see comment below). Income net of claims cleaned up for volatility was £4.7bn. Group Net interest margin was 1.95% and compares with 1.97% in Q4 2011 giving Net interest income of £2.6bn reflecting a lower balance sheet due to faster non-core run-off. NIM guidance remains the same. Other income was £2.1bn compared to 4Q11 of £2.3bn. Costs were £2.6bn. Bad debts were had £2bn, a fall from £2.4bn in 4Q11. International drove the improvement: £705mn vs. £1,321mn in 4Q11. UK bad debts were slightly lower in Retail, but down 14% in Corporate vs. 4Q11. Guidance for FY12 is unchanged. Core Tier 1 capital was strong at 11.0% (FY11: 10.8%) and the loan to deposit was 130% (FY11: 135%). Tangible /Net asset value per share was 58.3p (FY11: 58.6p). Core Net Asset Value is 40.8p. Non Core run-off has been increased to £30bn in 2012 and is now expected to be completed by 2013, one year early. The wholesale funding plan for 2012 has already been completed at the end of 1Q12. And the bank is looking to repaying the remaining £10.6bn UK Government Credit Guarantee Scheme in 2012. Its target return on equity is 12.5-14.5% to be achieved within 3-4 years.

Lloyds Banking Group said that one in four of the payment protection insurance (PPI) claims made against it were fraudulent. A quarter of the claims "are on behalf of customers who do not even have a PPI policy with us", its chief executive Antonio Horta-Osorio said as he revealed that the bank had set aside a further £375m to deal with the mis-selling scandal. That takes the total for Lloyds above £3.5bn.

Manulife reported Q1/12 earnings of \$1.18bn, or \$0.66/share, versus earnings of \$967mn, or \$0.54/share, in the year-ago quarter. On a reported basis, EPS beat consensus and was attributable in large part to favourable tracking error, reserve releases within the variable annuity business, and a net tax recovery in the quarter. On a normalized basis, it's estimated that earnings came in at approximately \$0.30/share versus \$0.32/share in Q1/2011. Manulife stock has proven resilient of late despite a 10-yr U.S. Treasury below 2% due in part to the market anticipating that core earnings have troughed. MCCSR ended the quarter at 225%, up from 216% in Q3/11 due to the headline beat and preferred share and subordinated debt issues in the quarter. Equity markets and interest rates positively impacted earnings by +75mn. Steve Roder will join Manulife as CFO in June 2012, replacing Michael Bell. Steve has more than 20 years of experience in Asia's insurance and financial services sector and was most recently CFO of AIA Group Ltd. until 2010.

National Australia Bank announced that it will restructure its loss making business in the UK after it contributed to a 15.6% previous comparable period (pcp) fall in the group's first half profit. The group's overall net profit in 1H12 was about \$2.05bn. NAB's UK business posted a £25mn 1H 2012 loss, down from a £77million profit in the previous comparable period. NAB's first-half result, which is yet to be finalised and will be announced on May 10, will include a \$1.13bn charge on bad debts, up 14.4% from the pcp. The bank's interim dividend will be lifted, though, to \$0.90 per share, fully franked. Its cash earnings in the first half of fiscal 2012 were \$2.82bn, up 5.7% from the pcp. NAB had been reviewing its UK business, and has opted for a restructure instead of a complete sale. The bank announced plans to significantly scale back its UK operations, renewing its focus on retail and small business lending and cutting around 1,400 jobs over the next three years. The bank's management said a deteriorating UK economy combined with the higher cost of wholesale funding caused by a series of ratings downgrades at its British business had sparked the retreat. "In the last half year there has been a significant downgrade in the growth prospects of the UK economy, in part reflecting the drag on its recovery from heightened weakness in the euro zone," said NAB CEO Cameron Clyne. "In addition, the commercial property market, which had previously seen signs of recovery, has recently experienced a 'double dip' as the recovery stalls."

Royal Bank of Scotland : Operating profit came in at £1.2bn, versus consensus £0.9bn. Income net of claims was £6.5bn (consensus £6.2bn). Costs came in at £4.0bn (consensus £3.9bn). Bad debts were £1.3bn - consensus expected £1.5bn. Statutory loss was £1.4bn after a £2.5bn own credit reversal and a £125mn PPI loss. Group Net Interest Margin was improved at 1.89% and outlook for NIM is stable on 1Q12. Core Tier 1 capital was up 20bp v 4Q11. Loan to deposit ratio was 106% (4Q11: 108%). Tangible/NAV per share 48.8p (4Q11: 50.1p) reflecting the reversal on own debt. RBS' Chief Executive Stephen Hester described the results as a "rock solid" performance within much of its core business in the quarter and at the same time he announced that, as of next week, RBS will have finally paid back its UK central bank support - an important milestone in its efforts to restore the fortunes of the bank.

Standard Chartered published its Interim Management Statement for 1Q12. The key points to focus on are i) high single digit income growth vs double digit target, ii) positive cost-income jaws (flat headcounts), iii) "good single digit income growth" in Consumer Banking and "high single digit client income growth" in Wholesale Banking. Only single digit income growth in client Wholesale Banking looks slightly disappointing because at the full year results Standard Chartered indicated



that Consumer banking had a good start into 2012 and Wholesale Banking had a strong start to the year. Single digit income growth targeted for India in 2012 (which is disappointing after a 33% decline in pre-tax profit in India in 2011), loan growth only marginally up in 1Q12, increasing competition from US banks in Asia (JPM and Citi). Company targets reconfirmed - which are double digit income and earnings growth and neutral cost income.

UBS - Q1 results. Clean pre-tax CHF2.04bn, 12% ahead of consensus. Good performance especially in Investment Banking - clean pre-tax CHF846m c.40% ahead of consensus. Wealth Management result solid - pre-tax CHF578m, in line with consensus. Both gross margin and net money inflows as expected. Good news on capital with tier 1 significantly ahead of expectations, 18.7% vs consensus 16.7% as risk weighted assets were -12% vs Q4. On capital position management won't commit to JPM-style buybacks but confirmed they are accruing a dividend for FY12 (wouldn't say at what level). Although Risk Weighted Asset reduction is clearly ahead of plan, deleveraging targets not being changed at this point. Management also suggested on the conference call their Wealth Management gross margin in March was within the 95-105bps target range (Q1 93bps).

Wells Fargo, already the largest US home lender, won the biggest market share ever recorded as competitors led by Bank of America pulled back after suffering more than US\$65bn in combined mortgage losses. Wells Fargo made 33.9% of the US\$385bn of mortgages originated in 1Q, up from 30.1% in the preceding 3 months, more than triple the share of the closest competitor, JPMorgan (Source : Bloomberg).

Financial Infrastructure

Mastercard : delivered solid 1Q12 earnings, with earnings per share of \$5.36 ahead of consensus estimate of \$5.29. Revenue was \$1.76bn (up 17% Y/Y; 19% constant currency) and 1Q12 operating margin was 56.9% in what remains an industry of strong secular growth. Management provided an updated on the U.S. debit market, indicating that the company continues to execute well against its primary post-Durbin strategy of maximizing Mastercard's presence on U.S.-issued debit cards. In particular, Mastercard is now enabled on roughly half of U.S.-issued debit cards (vs. ~25% a year ago), including 3 of the largest portfolios in the market. Additionally, the company's share of PIN debit transactions exceeded 20% in April (vs. the high single-digits in 2011). During 1Q12 global purchase volume growth was up 16.8% Y/Y (vs. 15.2% Y/Y in 4Q11), transactions processed growth was 29.2% Y/Y (vs. 23.2%

in 4Q11 and 26% year-to-date through the end of February, normalized for the extra day), and cross-border volume growth was 18.4% Y/Y (vs. 17.5% in 4Q11 and 17% year-to-date through the end of February, normalized for the extra day), all on a constant currency basis.

Total U.S. processed volumes were up ~10% Y/Y (vs. ~15% in 1Q12), a modest deceleration driven by the extra day during 1Q12, along with tax refund programs during 1Q12 and the lapping of new business wins. Total processed volumes outside the U.S. were up ~16% Y/Y (vs. ~19% in 1Q12), primarily due to the extra day during 1Q12, with Europe processed volume growth only showing a modest deceleration of a couple percentage points. Finally, processed transaction growth accelerated to 32% Y/Y (vs. 29.2% in 1Q12), with the acceleration in the growth rate driven by incremental U.S. PIN debit transactions (resulting from Durbin) and the continued roll-on of domestic transactions in the Netherlands.

Visa : delivered adjusted EPS of \$1.60 beating consensus estimate of \$1.50. Net revenue was up 14.8% y/y, with the beat driven by stronger-than-expected Card Service Fees (likely due to a modest benefit from pricing) and lower incentives. Operating margin for the quarter was 62.3% though marketing spend should rise meaningfully over the remainder of fiscal 2012 as we near the Summer Olympics. While there remains ongoing headline risk from regulatory/litigation matters, and probably slower growth in PIN debit transactions (as a result of Durbin) management have raised the EPS outlook for FY 2012 to the high-teens to low-twenties versus high-teens prior. During the quarter, payments volume growth was 11% Y/Y (vs. 11% Y/Y in fiscal 1Q12), transactions processed growth was 8% Y/Y (vs. 8% in fiscal 1Q12), and cross-border volume growth was 16% Y/Y (vs. 13% in fiscal 1Q12), all on a constant currency basis.

Dividend Paying Companies

Carnival – Cruise operator Cost Crociere, a subsidiary of Carnival Corp, took delivery of a new flagship liner on Saturday, the 114,500-tonne Costa Fascinosa, built by Fincantieri in Italy. The vessel has room for 3,500 passengers and an even bigger ship, with 5,000 berths, is scheduled for delivery in 2014. The cruise operator advised that bookings have recovered from the crisis, which should put the subsidiary on its way to recover its profitability.

Novartis – said on Wednesday it has agreed to buy Fougera Pharmaceuticals, a maker of generic dermatology products for \$1.53Bn in cash. The deal is expected to close in the second half of 2012 and the newly acquired unit will be incorporated



into the generics unit Sandoz. Fougera has valuable technical capabilities in the area of topical dermatological products, particularly in the development and manufacturing of semi-solid forms such as creams and ointments, and had sales of \$429mm in 2011.

Toyota – reported a 68% increase in sales of its vehicles in China to 81,700 units, justified mostly by a very weak comparative period, immediately after the March 2011 earthquake, yet it emphasised the strong momentum and maintained its sales goal of selling one million cars in the country this year. Sales for the first four months of the year are up by 14.3%. Toyota would need a 13% sales growth this year to meet its sales goal; sales for 2011 totalled 883,400 vehicles.

Chemring confirmed the award of the key \$569m contract to supply the US Army with bomb detection kit and a further £21m+ order to supply flares to the Ministry of Defence. That completes all five of the major orders the group was aiming to win in 2012. The business retains leading edge anti- Improvised Explosive Device (IED) technologies, a rapidly growing non-NATO franchise and good order books across the group. Chemring appears set to deliver top line growth of 10%, EBIT growth of 21% and EPS growth of 7% this year, with circa 5% growth the following year and a current dividend yield of almost 4.7%. Debt should be just 1x EBITDA by the end of next year, leaving the group well placed to make bolt-on acquisitions to take it further into the electronic warfare arena and reduce dependence on energetics (bombs, bullets and flares).

Vodafone to Vivendi : Michel Combes (CEO, Europe) is to leave Vodafone Group at the end of July, whereupon he will join SFR/Vivendi. His new responsibilities at SFR (single country operation, c21.5mn subs) will be of much smaller scope than at Vodafone Europe (vast footprint, c150mn subs). Mr Combes was a well-paid (c£1.8mn cash - salary/bonus/cash in lieu of pension) member of Vodafone's Board (for the past two years) and Vodafone's 20-F highlights Mr Combes ownership of c10mn Vodafone shares. Mr Combes' initial performance was hindered by a lack of iPhone. However, since 2010, Vodafone Europe has gained considerable share in the UK and the NL. Vodafone also out-performed peers in Germany (and more notably) in Italy. However, Mr Combes may be drawn back to his native France, where SFR is struggling against new entrant, Iliad/Free and his experience as CFO of France Telecom (rights issue, implementation of difficult Top / Next plans) will be very valuable commodities for Vivendi/SFR.

Economic Activity, Consumer and Business Conditions

Canada – The Canadian economic output took a tumble in February as a slowdown in manufacturing, utilities and mining

caused the GDP to contract by 0.2%, which compares to a 0.1% improvement in January and the consensus expectations calling for a 0.1% improvement. Some of this poor performance has been explained by temporary factors, such as the unusually warm weather (in the case of utilities) or shutdowns in mining, yet it becomes clearer that the risks for the first quarter's Canadian GDP reading are weighing on the downside.

USA: the U.S. manufacturing ISM unexpectedly rose in April, climbing 1.4% to 54.8, the highest since June 2011. For the nation as a whole, this marks the 33rd consecutive month of expansion, and it was broadly based across 16 of the 18 industries that reported. Of the 5 components that make up the index (20% weighting per component), the details were encouraging. New orders, production, and employment (to a 10-month high....good news for factory payrolls) climbed. There was less delay in supplier deliveries (which weighs on the index), while inventories contracted. So all in, it looks like manufacturing is still expanding at a decent rate, thanks to exports (the new export orders component hit a 2-month high).

U.S. jobs : Nonfarm payrolls rose 115,000 in April, below expectations and slowing from a revised 154,000 gain in March and an average 252,000 advance the prior three months. However upward revisions totaling 53,000 in the previous two months remove some of the sting from the weak April. Business services, retail and manufacturing added a moderate number of jobs, while construction was down slightly for the third straight month. The unemployment rate unexpectedly slipped to 8.1%, a more than three-year low. The labour force continued to shrink, with the participation rate hitting fresh three-decade lows of 63.6%. The "effective" unemployment rate, which adjusts for discouraged workers and part-time workers who want full-time work, stayed at 14.5%, more than two-percentage points below its cycle high but still elevated. The average duration of unemployment eased further from near-record highs to 39.1 weeks, but the number of people working part-time for economic reasons rose.

Australia's central bank reduced its cash-rate target by 50bp to 3.75% last Tuesday, as a closely-watched measure showed inflation remained soft last month and the housing industry says new home sales have hit a 10-year low. The latest TD Securities-Melbourne Institute inflation gauge rose 0.3% in April after a rise of 0.5% rise in March, bringing the annual inflation rate to 1.9%- just below the RBA's target range of 2 to 3%. The size of the cut by the Reserve Bank



of Australia surprised financial markets and was the first easing since December. Economists had been expecting a 25bp cut. It was the biggest single move in interest rates since February 2009 when the RBA was still managing the collapse in global confidence following the demise of Lehman Brothers.

France : Françoise Hollande achieved a narrow victory in the French presidential election, taking 51.7% of the vote. Mr. Hollande will become the first Socialist in power for 17 years, as the French voters appear to have voted as much to remove Nicolas Sarkozy as a push against austerity measures.

Greece: the indecisive results from Greek elections means the largest party Pasok with just 19% of the vote will try and form a coalition but with such a strong level of support for anti-austerity groups it seems there is the possibility of further elections needing to take place.

Financial Conditions

The ECB held rates steady at 1.0% last week for the fifth consecutive meeting, as expected. The ECB continues to see inflation holding above 2% this year, before falling below target in early 2013. Risks to the inflation outlook are now balanced, a downgrade from last month's near-term upside risk. Underlying inflation pressures are "limited". While inflation has been sticky above 2%, the ECB appears less concerned about price pressures as commodity prices have levelled off (energy prices in particular). With respect to growth, the economic outlook remains subject to downside risks and has become more uncertain over the past month. According to Draghi, "available indicators for the first quarter remain consistent with a stabilisation in economic activity at a low level", while recent survey data show "uncertainty prevailing." He also said that the ECB will have more data next month to assess the outlook, suggesting possible action if the data continue to deteriorate. A gradual recovery later this year is still expected, though increased tensions in sovereign debt markets, high unemployment, and balance sheet adjustments could derail anticipated growth. As he did during his testimony to European Parliament, Draghi highlighted the need for a "growth compact" to go along with the "fiscal compact". He favours economic reforms and increased EU infrastructure to boost growth. However, countries must persevere in fiscal consolidation. It was noted that Spain is making a "very significant effort" on fiscal issues.

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 is now 1.61% and the U.K.'s 2 year/10 year treasury spread is 1.59% - 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 3.84% - (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 improved to 6.4 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 misrepresented 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 24 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 19.16 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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