



News Highlights on Current Holdings

Financial Services Companies

Australia & New Zealand announced plans to invest a further RMB 2bn (A\$300mn) in its locally incorporated subsidiary in China, ANZ China, to support ANZ's continued growth in China. The additional capital is the first since an initial investment of RMB 2.5bn (A\$395mn) bringing its registered capital to RMB 4.5bn (A\$695mn). ANZ China has six outlets in Beijing, Shanghai, Chongqing and Guangzhou, and plans to increase its network to 20 outlets in the next five to 10 years subject to regulatory approval. ANZ also has 20% stakes in Shanghai Rural Commercial Bank and Bank of Tianjin, and a fully-owned rural bank in Liangping county, the Chongqing Liangping ANZ Rural Bank.

Barclays announced that it intends to dispose of its ownership of BlackRock stock via a secondary offering. Barclays currently owns a 19.6% (\$6.1 billion) economic interest in BlackRock, consisting of common stock and Series B convertible preferred shares. Upon the sale, the shares will convert into common stock. Assuming Barclays is able to complete the full extent of the offering (excluding the 10% underwriters' option), BlackRock will repurchase the remaining \$1 billion of stock from Barclays at the price per share offered to the public, less the underwriting discount. The offering process is expected to start Wednesday evening and close in the middle of next week. BlackRock intends to fund the purchase with \$500 million of cash and \$500 million of commercial paper. The stake would have hurt Barclays under Basel III capital rules. Barclays is carrying the Blackrock stake as an AFS investment and assuming a steady state environment, the implications are that a decline in Blackrock shares QTD (\$172/share vs. \$192/share Q1 close) looks to lower Barclays Net Asset Value by an estimated -5p/share. Also, the ongoing regulatory requirements of Basel 2 and Basel 3 core Tier 1 capital mean the gain on sale translates as a £ 3.8bn valuation gain, so increasing Basel 3 core Tier 1 capital by +0.20% (+10bps capital and +10bps from removal of RWAs). Barclays is therefore seeking to lock in the gain to capital ratios now albeit the loss of this sizeable stake in this globally large wealth manager will be felt more when markets normalize.

Credit Suisse have announced the number of new shares to be issued following their announcement on 27th April at their AGM to offer shareholders an option to receive a scrip dividend or cash for the 2011 financial year. 48% of shareholders opted to receive a scrip dividend resulting in 24,195,537 new Credit Suisse shares, representing 1.9% of the share capital of Credit Suisse Group currently issued. The delivery and listing of new shares is expected to occur on May 23, 2012.

ING's sale of its Asian investment management business has attracted bids from Nikko Asset Management, Macquarie and others, in an auction that could value the operations at around US\$500mn. ING is also selling its larger Asian insurance operations, which could be valued at up to US\$6bn, to comply with the European Commission's order that it sell its global insurance arm in return for the state aid received during the 2008 financial crisis. ING's Asia unit had US\$54bn under management as at the end of Dec. 2011. It has a presence in China, Hong Kong, Taiwan, Japan, Korea, Singapore, Malaysia, Thailand and India. Reuters reports that MetLife and Prudential of the US and Manulife bid for all of ING's \$6bn Asian insurance operations in the first round as they believe that certainty of sale will prove most attractive to the Dutch group. AIA is only likely to have bid for the entire business if it is certain it can get a partner to take the Japanese units where it currently has no presence. The Japanese unit has a good life insurance company but an opaque and potentially loss-ridden variable annuity division that writes long-term income guarantees to policyholders. Of the eight to 10 companies that sent offers, a shortlist is expected to emerge by the end of May. Its reported that five bidders expressed interest for the whole Asia division while the rest sought parts of the business. Asian insurer AIA Group Ltd and Korea's KB Financial Group submitted first round bids plus Korea Life Insurance Co, Canada's Sun Life Financial Inc, and Switzerland's Zurich Insurance Group.

Separately – Capital One filed a shelf prospectus on behalf of ING Group N.V., registering its 54 million shares of common stock in accordance with the shareholders agreement Capital One entered into on February 17, 2012, at the close of the ING Direct deal. ING Group is able to sell all of its shares as of last week, however, the probability of a sale of its entire stake should be relatively low given ING Group recently took a seat on Capital One's board of directors but ING Group is able to sell up to 33% of its stake before losing its board seat.

JP Morgan : The Office of Comptroller of the Currency (OCC) said last week that it is examining JPMorgan's activities and evaluating their transactions following a US\$2bn loss that shook up bank leadership. The regulator, which oversees national banks, also is evaluating risk management strategies and practices at other large banks to validate their understanding of risk levels and controls. The OCC said JPMorgan's losses affect its earnings while not presenting a threat to the safety and soundness of the bank. (Source : Bloomberg). The bank suspended its \$15bn share buyback programme to preserve capital following the \$2bn trading loss. Jamie Dimon, chief executive, said: "Obviously, we're not going to make as much money." But he said the suspension of its share buyback



programme did not imply that the bank was suffering worse losses than already stated.”

Lloyds Bank - CEO Antonio Horta Osorio bought 85,000 of the bank's ADR's last week at \$1.85.

Santander, the biggest eurozone bank by market capitalisation, said it would have to set aside an additional €2.7bn to meet new Spanish government reforms on risky property assets. The new provisions come on top of the €2.3bn which the bank was required to set aside in order to comply with reforms announced in February. A total of €5bn would therefore have to be provisioned, and the sum accounted for in 2012 results, the bank said in a statement.

Financial Infrastructure

Euromoney delivered H1 profits ahead of its detailed April 17th trading update. As previously flagged, revenues grew by 17% to £189m, representing a 5% like for like uplift. There was strong underlying growth in subscriptions (+7%) and Events (delegate revenues +19%) more than off-setting weak advertising (-9%), while the Ned Davis acquisition delivered a maiden first half profit of £5.2m, suggesting upside to full year assumptions. Pre-tax profits came in at £48.6m/29.7p with a lower than expected tax charge. This represented 16% EPS growth. The dividend was increased by 12%, a positive signal. And net debt was down to £88.5m, supporting the expectation that year end Debt/Ebitda will be down to just 0.6x.

ICAP : 2012 results are in line with reduced guidance: the profit (from continuing operations and before acquisition and disposal costs and exceptional items) was £354m (guidance was towards the top of the £336m to £358m range). The 10% increase in the dividend to 22p a share (given basic EPS down 26% to 21p and adjusted EPS up 1% to 40p) is justified by the Board's confidence in ICAP's medium-term prospects. Management's outlook statement is realistically downbeat: “activity in April and early May was slow with the ongoing Euro crisis and regulatory uncertainty depressing volumes” so ICAP is “embarking on a structure that will result in [£50m] savings over the next two years” The dividend appears underpinned by strong cash generation. We maintain our HOLD recommendation. At some point over the next few months the US regulator may provide further guidance on the capital requirements under which ICAP and others intend to operate.

Dividend Paying Companies

ABB – announced the completion of the acquisition of Thomas&Betts, the US electrical components maker, within a

week from the clearance by the EU regulators. Thus, the US becomes ABB's largest market with roughly \$6.6Bn in annual revenue. The deal, announced initially in January, is worth \$3.9Bn. The US regulators approved the deal on April 30. Thomas&Betts shares have ceased trading on the New York Stock Exchange.

BHP – in a clear sign of prudent capital management, BHP's management signalled a re-thinking of its expansion plans and said the company won't spend the previously outlined \$80Bn over five years. The group's chairman, Jacques Nasser, declared during an industry conference last week that the company expects commodity markets to deteriorate further. The company's intent is to continue to finance its capital expenditure projects through its cash flows, which are expected to weaken following a drop in commodities' prices. Three projects likely to be postponed (yet unlikely to be cancelled) are the Outer Harbour development at Port Hedland in Western Australia, the expansion of the Olympic Dam copper and uranium mine in South Australia and the Jansen potash project in Canada.

SP Ausnet – announced full fiscal 2012 year results, which were substantially better than expected driven by better operating costs and a lower tax rate, while announcing an A\$434 capital raise to finance its front end loaded capital expenditure requirements. The company's earnings before interest, tax, depreciation and amortization (EBITDA) was 1.4% higher than the consensus expectations, while the net operating profit after tax (NPAT) was 9.6% ahead of expectations. The net debt to regulated asset base (RAB), a key solvency ratio for the industry, was reported at 73% and it will move to 66% post the capital issuance, better than the industry averages. Capital expenditure needs, including the regulatory determinations, the transmission-terminal station rebuilds, the smart metering roll-out, the bushfire mitigation measures and the Victorian desalination high-voltage transmission line, are expected to reach \$3.4Bn over the 2013-2016 period, or an average of \$850mm a year. The company maintained its guidance of an 8% per annum growth in the regulated asset base (RAB), the key revenue driver, through fiscal year 2016. For the current fiscal year, 2013, the company forecasts a distribution of 8.2 cents per share (a 2.5% increase and a yield of 7.8%), set to increase to 8.35 cents per share the following year.

Syngenta – plans to invest \$500mm in Africa, as it is building a business expected to generate roughly \$1Bn in sales over the next 10 years. The company believes the continent has the capacity to become a major world food exporter. The capital will be used to recruit and train over 700 new staff, develop distribution channels, logistics and local production facilities.



The company's business in Africa will attempt to increase access to technology for smallholders and large-scale farms. The company targets over 5 million farmers and expects to enable productivity gains of 50% or more.

Vivendi – reported first quarter results in Paris last week, beating expectations in terms of operating profit. The company's earnings before interest tax and amortization (EBITA) reached €1.62Bn, ahead of the consensus expectations for a €1.46Bn figure. Revenues retreated in the quarter by 0.9%, to €7.1Bn, impacted by heightened competition in the French telecom business, where SFR, the wholly-owned subsidiary, lost 3% of its contract and prepaid consumer base. Revenues for the division fell by 7% in the quarter. An overhaul of the division includes: the replacement of the CEO with Michel Combs, former boss of Vodafone Europe and CFO of France Telecom; a cost-cutting plan and changes in its commercial offerings and strategy. Higher sales at Universal Music and at the GVT Brazilian telecom unit helped offset the weakness at SFR. The group maintained its goal of posting an adjusted net income above €2.5Bn this year and of paying 45%-55% of it in dividends to shareholders.

National Grid : Adjusted EPS of 51.3p for FY11/12 (+1%) was 4% higher than consensus. Adjusted profit before tax of £2585m was 5% ahead of consensus. EBIT was in-line, and the beat was mainly due to lower than expected interest costs, offset by a higher tax charge. The full year dividend of 39.28p (+8%) is in line with the company's prior commitment. An internal process designed to better assess the capital employed in the US business has confirmed there are \$1.9bn of regulatory assets which are not currently reflected in the published rate base. This represents items such as deferred costs and capex in progress, and mechanically increases the estimated intrinsic value of the company.

Pearson : The acquisition of Certiport is Pearson's first deal in 2012, utilizing a relatively small portion of the £1bn+ of acquisition resources management has indicated is at its disposal. It looks highly complementary and nudges up EPS c1% from 2013. Certiport is in the professional testing space, focused at the high volume, lower value end of the market. Customers are mainly employees looking to gain accreditation or certification (eg for IT programming). By contrast, Pearson's existing business in this space (Vue) is more focused at the high value, lower volume end of the market, suggesting it should be a good fit. Certiport's model suits emerging markets suggesting good scope to leverage into Pearson's EM network, albeit Certiport has already made good inroads in places like S

Korea. Certiport reported \$48m revenue in 2011 but has been growing well over 20% per year and we assume this continues.

Economic Activity, Consumer and Business Conditions

US – US consumer's appetite slowed down more than expected, as retail sales for April grew a meagre 0.1%, short of expectations for a 0.2% improvement and just a fraction of March's 0.7% advance. Even after stripping out the more volatile auto sales, the result was similarly disappointing. Despite the weather, sales of building materials and gardening supplies weakened in the month, offset by stronger sales of furniture and electronics and appliances. The US consumer prices, a key indicator of inflation trends, was virtually unchanged in April as it maintained, at the core level, the previous month's year on year 2.3% rate. The headline CPI (consumer price index) year on year rate was 2.3% in April, slowing down from March's 2.7%, as the energy related costs dropped in the month.

A relatively rosier picture has starting to take shape in the housing sector, as the National Association of Home Builders (NAHB) Housing Market Index, unexpectedly jumped 5 index points in May, to 29 from 24. While still in the pessimistic territory, it is a clear departure from the last four-five years level of about 13. All the subcomponents of the index improved, in particular the traffic of prospective home buyers. It should be pointed out though that part of the improvement is the reversal of a 4 index points drop in April. The housing starts improved in April in the US, while the building permits actually retreated in the month, more than expected. Lastly, earlier today, the existing home sales figure for April revealed a slightly better than expected 4.62mm units annual rate of sales of existing homes, an improvement from March's 4.47mm units annual rate.

Less conclusive were the economic indicators related to business activity, as both the Philly Index and the Leading Economic Indicators (LEI) disappointed last week. The LEI retreated by 0.1% in April, unexpectedly, reversing some of the 0.3% improvement in March. The actual US industrial production, however, improved in April by a higher than expected 1.0%, while the capacity utilization reached 79.2% in the same month. The good result was helped by a strong bounce-back in the utilities sector, as well as by good performance in mining, motor vehicles and parts and business equipment.

Canada – Inflation trends on our side of the border were less forgiving in April as the headline Canadian consumer price



index (CPI) reached a 2.0% year on year rate, ahead of March's 1.9% and the expectations for a similar rate. The core CPI (which excludes eight most volatile series, including food and energy) reached a 2.1% year on year rate in the same month, ahead of the expectations. While higher than many people hoped, the current inflation rates are within manageable levels and we do not perceive them to pose an immediate threat to BoC's monetary policy.

Bank of England's Quarterly Inflation Report suggested higher inflation and lower growth are in the cards. Governor Mervyn King said inflation was not falling as quickly as had been expected and does not see inflation below the 2% target until Q3 2013. Growth remains a concern and the central bank reduced its GDP forecasts accordingly. This opens the door for fresh stimulus for the country's struggling economy. However, more encouraging is the number of Britons claiming jobless benefits in April dropped by the sharpest amount in almost two years with the overall unemployment rate also falling.

Spain - The Financial Times reports that the Spanish Government will attempt to give credibility to efforts to stem fears over potential loan losses and will announce Blackrock and Oliver Wyman as independent valuers of real estate loans. The process will be in two stages, a top down assessment between book value of loans, value on a mark to market basis and value under a more stressed scenario. A 2nd 3 month exercise will begin in a month's time, will involve a bottom up examination on a bank by bank basis of all loans, the Financial Times reports. The Bank of Spain had in April already contacted Blackrock and Oliver Wyman to make proposals for a "bad bank" structure for Spain's lenders. As part of the provisioning process announced last week, each bank will be forced to create a bad bank into which it will put physical property assets at marked-down valuations in preparation for potential sales to outside investors.

Greece : European leaders appear to be trying to turn Greece's repeat national election next month into a referendum on the country's membership of the euro. Meantime Greece took the incredible decision last week to pay in full the remaining holders of a bond that matured on May 15, avoiding 'default' on the first issue to expire after the biggest sovereign debt swap in its history. Greece completed a huge debt restructuring in early March, swapping a nominal amount of 177 billion euros (\$227.23 billion) of government paper held by private creditors for new securities as part of its second rescue package. A few investors held out, however, rejecting the swap offer accepted by 96.9% of bondholders who suffered a real loss of 75%. The remaining amount of E 430 million of the May 15 Hellenic Republic note was serviced, paying a coupon based on 3-month Euribor +8 basis points. The government did not comment on why it had decided

to repay the bond or what Greece would do for remaining holdouts on other bonds.

Greek Deposits – Since Dec '09 the Greek banks have seen deposits fall by over 2bn a month to the current 140bn. Unsurprisingly reports are that this has accelerated over the past few days as the political situation deteriorates further and reports surface that banks would have to close for at least 3 months in the event of a departure from the Euro. Fresh elections are forecast on June 16, the question is whether the financial markets will allow them this long to make a decision.

Greece/Greek banks - The ECB said last week that it will temporarily stop lending to some Greek banks to limit its risk as ECB head, Draghi signaled they won't compromise on key principles to keep Greece in the euro. The ECB said it will push the responsibility for lending to some Greek financial institutions onto the Greek central bank until they have sufficiently boosted their capital. "Once the recapitalisation process is finalised, and we expect this to be finalised soon, the banks will regain access to standard Eurosystem refinancing operations," the ECB said. However, the Financial Times article this morning highlighting 'secret aid' propping up the Greek banks through ELA (Emergency Liquidity Assistance). ELA basically allows individual central banks to provide liquidity on looser terms than allowed under the ECB's standard monetary policy operations. The key checks are that ELA is subject to approval from the ECB and are done so at the national bank's own risk (i.e. not shared across eurozone central banks like ordinary MPOs).

Financial Conditions

Bank Capital - Finance ministers last week appear to have broadly agreed the Basel 3 rules. The UK is allowed to impose additional capital requirements if required through an additional systemic buffer of up to 3%. The Financial Times suggests that some "wiggle room" has been included in the text to allow some hybrid capital to be included in core tier 1.... The release makes no mention of the French and German push to side-step higher capital rules on Bank assurance, although the Financial Times suggests this has also been agreed.

French banks have already provisioned most of their exposure to Greece and none of them would be placed in difficulty by an "extreme scenario" of the debt-laden country leaving the euro, Bank of France Governor Christian Noyer said last Monday. Noyer told a news conference that



French banks had made provisions for 75% of the value of their holdings of Greek sovereign debt, and would have no difficulty in covering the remaining 25%. (Source : Reuters)

Italian Banks : IMF statement last week urging Italian banks to raise capital: “The Bank of Italy (BoI) should continue to encourage large banks under the European Banking Authority (EBA) to meet their capital needs by raising equity or disposing of noncore assets, rather than cutting loans. To further enhance transparency, the BoI should consider extending its stress tests to a larger set of institutions, including mid-sized banks, and publish the results in its regular Financial Stability Reports. This would help market participants assess banks’ capacity to withstand a slowdown and funding distress and anchor market discipline. Encouraging banks to improve their capacity to post eligible collateral at the BoI would facilitate access to Eurosystem liquidity facilities”

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 1.49% and the U.K.’s 2 year/10 year treasury spread is 1.56% - 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 3.79% - (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 6.6 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 25 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 22.01 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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