Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Barclays - Former Legal & General chief Tim Breedon is to join Barclays as non executive director, having stepped down from L&G in June. He is known for his strong views on excessive pay and follows Sir David Walker, who takes over as Chairman next month and was vice-chairman at L&G.

Barclays issued a statement stating it had experienced higher than previously anticipated levels of payment protection insurance claims (PPI) since the end of the first half and so has determined to provide a further £700 million as at 30th September – in addition to provisions of £1bn in 2011 and £300 million in first quarter 2012. The bank expects its Group adjusted profit before tax which excludes the impact of own credit (i.e. a Debt Value Adjustment expected to be £1.1bn as its own credit improves) and the provision for PPI, for the 3 months to end September to be broadly in line with the current market consensus of £1.7 billion

Bank of America reported 3Q12 GAAP EPS of $0.00 and core EPS of $0.28, excluding a number of unusual gains and losses beating consensus expectations of a loss of $(0.07) driven by lower-than-expected expenses and provision for loan losses. The quarter was highlighted by strong commercial loan growth, capital ratio building, 7% lower noninterest expense, and margin expansion. Total commercial loans increased 4% linked-quarter driven by strength in commercial and industrial (C&I) and commercial real estate (CRE). Investment banking fees showed a 17% LQ increase to $1.3 billion in 3Q12Core expense (excluding one-time items) decreased in 3Q12, as the company realized benefits from its 'New BAC' initiative. It continued to grow its Tier 1 common ratio, and the estimated Basel III Tier 1 common ratio was 8.97% which ranks the company among the top of its peer group. Net interest income and the net interest margin (NIM) both showed LQ improvement. Net charge-offs (NCOs) increased LQ due to regulatory guidance for the industry (as commented last week for JP Morgan, Wells Fargo and Citi) , and excluding incremental NCOs, total loan losses were down LQ.with a 3% LQ decline in total nonperforming assets (NPAs). Bank of America trades at about 85% of 2013E tangible book value of $14.24 per share (compared to its three-year average of 92%). This compares to recent industry average (for the nation's 40-largest banks) of 138%.

Citi: the day after it posted a better-than-expected quarter, C announced last Tuesday its CEO Vikram Pandit (age 55) and President & COO John Havens (55) have resigned. In April Michael O'Neill replaced Richard Parsons as Chairman of the Board which could have facilitated this move. Pandit said given the progress the company has made in the last few years, he concluded that now is the right time for someone else to take the helm at Citi. Havens said that he had already been planning retirement from Citi at year-end but decided, in light of Pandit's resignation, to leave at this time. Both joined Citi from hedge fund Old Lane (and both were at Morgan Stanley together before that) five years ago.

The Board named Michael Corbat as CEO and a director (52). Corbat previously served as Citi's CEO of EMEA (Europe, Middle East and Africa) since the start of the year and is a 29-year veteran. Corbat has managed numerous institutional businesses, including sales and trading, capital markets, corporate and commercial banking, and such consumer businesses as wealth management, mortgages and credit cards. He was also the initial head of Citi Holdings. One of Corbat's initial orders of business will be to focus on the 2013 budget; update its three-year strategic plan; and engage in the CCAR(capital stress test) 2013 process. There could also be more of a focus on Citi's efficiency ratio and overall expense levels with more accountability at the business unit level around operating performance, balance sheet/ capital usage, and risk/returns.

Goldman Sachs reported profit that beat consensus estimates on higher underwriting fees and a jump in the value of the firm's own investments. The firm also set aside almost $11 billion to pay employees in the first nine months of the year, up 10% from the same period in 2011 as revenue climbed.

ING: announced the sale of its HK and Thai insurance units for $2.14bn to Richard Li, leaving the Dutch group with just its Korean and Japanese operations to sell in Asia. The deal, sees the majority owner of Hong Kong media and telecoms group PCCW move back into an industry he left with the 2007 sale of Pacific Century Life, a Hong Kong-based life assurance company that he sold to Belgo-Dutch group Fortis. The transaction multiples are 1.9x 2012 estimated book of €865m and 24.3x 2012 estimated earnings. Disposal price looks – as expected – good and the transaction is a positive. With the most attractive assets in Asia now disposed, the next positive share price catalyst probably has to await the 3Q results (07 November).

Morgan Stanley reported continuing EPS of -$0.55. Excluding Debt Value Adjustment & Global Wealth Management-related charge), its estimated core EPS closer to $0.34, well ahead of consensus estimates and so a quarter that represented a nice recovery for Morgan Stanley and affirmation that the weak 2Q results were more the anomaly than the norm. With that said, return on tangible equity remains in the 4-7% range and still reflective of a challenging environment and limited capital management since the crisis. It trades at 0.7x Tangible Book Value.

Royal Bank of Scotland: last week RBS suspended its head of rates trading in Europe and Asia Pacific, the most senior staff member so far, as part of its ongoing investigation into the Libor scandal. Separately, RBS have announced the agreement with the UK government and regulators to exit the state backed Asset Protection Scheme (APS) effective 18th October, which is the first step to pave the way for the government to begin selling its 82% stake presumably such re-privatization will be before the 2015 general election. The exit from this loan insurance arrangement comes at the earliest date consistent with the minimum contractual APS fee. RBS will have paid £2.5bn for its participation in the APS, without having made a claim, in addition to around £1.5bn it paid to HM Treasury for liquidity support received during the financial crisis. The capital benefit (0.8%) will therefore disappear, but in principal this is good news. RBS continues to discuss with the Financial Services Authority its capital plans and actions for ensuring a balanced transition to Basel III. Core Tier 1 will therefore set fall about 0.7-0.8% due to the withdrawal of the capital benefit and RBS have been negotiating with the government and regulators whether there needs to be any remedial action to offset that.

Santander/BBVA - ratings cut by S&P along with nine other banks. Santander's long term counterparty credit rating cut to BBB from A- with a negative outlook. Short term ratings have been cut on four banks and placed the ratings for 6 banks on credit-watch negative. It plans to conclude a review of the sovereign downgrade's implications next month. S&P last week cut its sovereign ratings on Spain to BBB-/A-3.

Wells Fargo is restructuring sales and trading operations to form a new markets division at its investment bank. The division will be one of five main units under the Wells Fargo Securities brand and include equity and fixed-income sales and trading, commodities, prime services and futures clearing (Source: Bloomberg).

Financial Infrastructure

Willis announced that long-time CEO, Joe Plumeri will step down at the beginning of next year, but remain as Chairman of Board. Taking over as CEO will be Dominic Casserley, a senior partner at McKinsey & Company. This move was about six months earlier than expected. Steve Hearn, currently head of Willis Global, will serve as Deputy CEO of the company. In our view, Mr. Plumeri did a good job in changing the culture at Willis, transforming it into a sales driven organization with coordination across regions and products, not an easy task. The company has had challenges over the past several years, many of them related to the 2008 acquisition of Hilb, Rogal and Hobbs. It appears that company has been addressing these issues, but it may be an appropriate time for a new leader to take over the helm.

Dividend Payers

BHP – provided a production update for the first quarter of its fiscal year, which showed significant volume increases in most of its key commodities. As demand in China has been slowing down, well flagged by the company over the past several months, the low cost mining giants such as BHP, Rio Tinto and Vale, have been gaining market share at the expense of smaller competitors. BHP and Rio Tinto boast some of the world's lowest production costs of around $20 - $30 per tonne, a far cry from about 100 million tonnes of low-quality Chinese production, running at costs as high as $100 per tonne and which is likely to be shut down, making room for more imported ore. The global iron ore market is expected to grow by 650mm tonnes in this next decade, below last decade's $800mm tonnes growth in demand. Also, record prices experienced over the past decade, driven by the 'demand shock' will likely not be there to support returns. As such, BHP outlined plans to boost output by 5% by the end of June 2013, the end of its 2013 fiscal year, to make up for the impact of lower selling prices. In the quarter, BHP's iron ore production was steady at 39.8mm tonnes.

The company's well diversified portfolio of commodities showed increases in copper production, up by 24% in the quarter, driven by improvements at the majority-owned Escondida mine in Chile, the largest in the world, which targets a 20% increase in fiscal 2013; coal output rose by 20% during the September 2012 quarter.

Nestle – reported its sales for the first nine months of the year, which were marginally lower than expected, equivalent to a rate of organic growth of 6.1%, relative to expectations for a 6.3% rate. Demand in the emerging markets, which has been driving growth at the world's largest food company, cooled off. Growth in Asia, Oceania and Africa, which accounted for about one fifth of sales, retreated to 9.4% from 11.6%. The management pointed out that the company's third-quarter sales were impacted by one-off events such as typhoons in Philippines, social unrest in Egypt and business disruptions due to sanctions on Iran. Debt crisis stricken Europe delivered a 1.9% rate of organic growth, down from 2.4%, while the Americas region grew steadily at a 5.5% rate. The company re-iterated its 5%-6% underlying sales growth outlook for the year.

Roche – Strong demand for the company's established cancer treatments helped it beat the consensus forecasts in its third quarter. Sales rose 15% to CHF11.27Bn, ahead of the expected CHF11.12Bn, also helped by a weakening Swiss franc. The company is indicating that a new generation of breast cancer medicines will be driving sales growth in the near future. Perjeta, a treatment of women with a particularly aggressive form of breast cancer which was approved by the US regulators in June has met good adoption by practitioners as a follow on to its third biggest seller Herceptin. Roche is also hoping to gain European and US approval for a new chemotherapy-carrying antibody called T-DM1, a drug for advanced breast cancer. Its pharmaceutical division has been developing follow-on drugs, which can be used in combination with its existing medicines, helping to extend the longevity of its brand name drugs.

The company's top three cancer medicines, MabThera, Avastin and Herceptin reported solid growth during the quarter, while its rheumatoid arthritis medicine Acterma advanced by 27%. In turn, sales of its eye drug Lucentis suffered due to competition from Regeneron's drug Eylea. The company maintained its guidance for sales growth by a low-to-mid single digit percentage at constant exchange rates, with core earnings up in the high single-digits.

Syngenta – The largest agribusiness company in the world has appointed ABB's finance chief, Michel Demare, as its new chairman, to replace Martin Taylor, an ex-CEO of Barclays, who is retiring. The change is set to take place on April 23, 2013, the date of the firm's next annual general meeting. Michel Demare had previously worked for medical products maker Baxter International and for Dow Chemical. In a separate statement, ABB said that Demare was stepping down to concentrate on his board mandates and said a successor would be announced in due course.

Vivendi – The French corporate activist investor Vincent Bollore will join Vivendi's board after raising his stake in the company to over 5%, or 66 million shares. He is known for his shrewd investments in turn-around companies such as ad agency Havas and industrial tube-maker Vallourec and is expected to play a key role in reviewing Vivendi's portfolio of business as the company is trying to boost its stock price. Jean-Rene Fourtou, Vivendi's Chairman said the group would now propose the Bollore join the supervisory board.

Economic Activity, Consumer and Business Conditions

US – Encouraging numbers were released in the US over the past week, in particular relating to business activity and the housing sector. Tuesday, the US industrial production report, revealed a better than expected 0.4% monthly rate of growth for the industrial production in September, reverting some of the 1.4% drop the month before, as mining and utilities production recovered and manufacturing continued to grow, albeit at a muted 0.2% pace. The capacity utilization over the same month improved to 78.3%, right in line with the expectations. Thursday, the leading economic indicator (LEI) up by 0.6% in September, beat the consensus expectations handily, helped in part by a jump in building permits, which in September moved to a 894,000 units annualized level, ahead of the consensus calling for a more modest improvement to a 810,000 units annualized level. The other positive development in the US housing sector was an improvement in the home builders sentiment, as measured by the National Association of Home Builder (NAHB) Housing Market Index, which continued to move higher, to a 41 index level in October. The existing home sales, released later in the week, failed to generate the same amount of excitement, as the in-line with expectations reading of 4.75 million units annualized implied in fact a pull back in the month from August's relatively elevated level of 4.83 million units annualized.

On the inflation front, things are relatively smooth, much to the liking of the monetary policy-makers, as the headline consumer price index (CPI) recorded a 2.0% year on year rate driven mostly by a continued rise in energy prices. The core CPI, which excludes the effect of energy and food prices, was in-line with the expectations, at a 2.0% year on year rate, as reduction in car prices and household furnishings were offset by increases in rent and health care costs. The US real weekly earnings, part of the same report, remained disappointingly flat in September, short of the expectations for a 0.2% improvement and on top of a 0.6% August revised retreat.

Canada – Inflation turned out to be tamer than expected in September, increasing chances of a more dovish stance in Bank of Canada's next monetary policy meeting. While the headline CPI, came in at 1.2% year on year rate, the core reading, which excludes the effect of eight most volatile series, including fuel and food, recorded a 1.3% year on year rate of growth, as, aside from gasoline prices, which were up 2%, most other categories retreated in the month.

Italy: successfully raised E 18 billion through the issue of a 4 year inflation-linked bond primarily aimed at retail investors…the treasury fixed a minimum coupon of 2.55% linked to inflation…and it was the largest amount ever sold in a single debt offering in Europe.

Portugal: the government has unveiled an uncompromisingly tough budget for 2013 involving the big direct tax increases as the country tries to keep within its E78 billion bailout programme. The average tax rate is set to rise from 9.8% of earnings to 13.2% but the Finance Minister has stated Portugal would balance its current account deficit in 2013 due to an increases in exports over the past 2 years.

Spain: Moody's has confirmed the Baa3 rating, with negative outlook. However, the market had expected Moody's to downgrade Spain below investment grade whereas it has left the country at investment grade for now – citing as positives;

- the risk of losing market access is materially reduced by ECB's willingness to activate its unlimited (conditional) bond buy-back program;

- the continued commitment by Spanish government to implement fiscal/structural reform; and

- the external monitoring accompanying an European Stability Mechanism precautionary credit line is a positive factor.

Financial Conditions

EU Summit - Following the 22nd EU summit since 2010 EU leaders have agreed the legal framework for the EU banking regulator to be in place by the end of the year and it will be implemented over the course of 2013. The rapid pace of implementation may surprise some and will mark a victory for a French-led group that had pushed for this first step to be taken quickly. However, leaders failed to agree on the second key step in the process: when the eurozone's €500bn ESM rescue fund will be able to start injecting cash directly into failing European banks, giving in to German resistance.

US – UK: US Federal Reserve policymakers remain determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels of interest rates through 2015 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 extension 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 until mid to late 2014. 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 1.64% - 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 3.37% - (3.36% early October 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 is at 6.1 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 increases 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 18 – 24 months 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 46 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..

The VIX (volatility index) is 17.06 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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