Market Commentary

PORTLAND INVESTMENT COUNSEL™

November 12, 2012

News Highlights on Current Holdings

Financial Services Companies

BNP Paribas net profit of EUR 1,324M is 34% above consensus, adjusted for own credit losses (EUR 774M) and gains on Fortis assets (EUR 427M), the beat is closer to 10%. Retail performed the best with a +15% beat and a respectable 9% YoY. Asset gathering is down 6% quarter on quarter with weak asset management (limited adjusted inflows of EUR 1bn) despite strong insurance (growth outside France). Corporate & Investment Banking was closer to consensus (+3%), Fixed Income, Currency and Commodities is up 35% quarter on quarter at EUR 1.13bn and Equity delivers a good performance, offsetting the fade of financing due to lower volumes (deleveraging total cost of EUR 250M). Despite headwinds in Europe BNP Paribas was able to deliver a 1.1% positive 'jaws' in retail (revenues +1.3%, cost +0.2%). Italy, Belgium and the Mediterranean countries were very positive, with a limited negative in France (-0.4% with -1.7% in cost). On 9 months, French retail shows a -0.8% in revenues and -1.4% in cost.. Funding balance improved in all countries with deposits growing (~5% in Euro countries) in front of stable loans except in US and Turkey. With Risk Weighted Assets down to EUR 565bn (-13bn in Q3), Core Tier 1 equity on Basel 3 fully fledged is at 9.5% and liquidity buffers at 114% of short term wholesale funding, all targets fixed during summer 2011 are achieved.

ING will axe nearly 2,400 employees over the next two years in a new round of restructuring moves – even as the bank completes the divestments and demergers forced on it as part of its bailout during the financial crisis. The bancassurer said the layoffs would hit its insurance and banking arms, which are soon to split up as part of the 2009 deal agreed with the European Commission in exchange for approving the Dutch state's injection of €10bn of capital into the bank.

JP Morgan - JPM's disclosure last Thursday that the Federal Reserve did not object to the firm's resubmitted capital plan to buy back up to $3bn in shares in 1Q13 can be seen , we believe, as a "stamp of approval" by the regulators on the firm's risk-management practices, post May's CIO loss announcement. $3bill in share repurchases in 1Q 2013 will be in line with their quarterly run rate under the original 2012 CCAR program.

Lloyds Banking Group is considering selling its 60% stake in wealth manager St James's Place in a bid to raise around £1bn, according to a report in Britain's Sunday Times. The report said the bank's stake in Britain's biggest chain of financial advisers could be placed with investors in the market before the year-end.

Maquarie has won its bid to acquire a portfolio of about $350mn in reverse mortgages from Royal Bank of Scotland. CGF was the underbidder on the deal. The mortgage book, which was sold at a discount to face value, had been on the market for almost two years, with an average mortgage size of about $100k.

Insurance: The Financial Times reported that Insurers have complained that they face billions of dollars of extra losses after US authorities declared superstorm Sandy a post-tropical cyclone rather than a hurricane. The lower classification of the storm, which ravaged parts of New York, New Jersey and the US north-eastern seaboard last month, will benefit homeowners at the cost of their insurers. Had the storm been declared a hurricane, householders would have had to bear a greater proportion of their rebuilding costs.

Dividend Payers

BHP – announced it had initiated a search process for a new CEO to replace Marius Kloppers, a process which is expected to take one to two years. Jac Nasser, the BHP's Board Chairman, who is leading the search said succession planning was ongoing and a key task for the board. Marius Kloppers tenure as the head of BHP so far has seen mixed reviews, with some praising his ability to steer the company through the global financial crisis, when BHP boasted the strongest balance sheet among the biggest global miners, as well as for leading the group through its most profitable times, spurred by the commodity boom led by China's fast growth. Others point out to his failures in mergers and acquisitions, with three deals falling through, mostly due to regulatory concerns. Earlier in the year BHP replaced its chief financial officer, Alex Vanelow.

Chemring – Much as anticipated by the investment community, following a profit warning and the replacement of Chemring's chief executive, the US private equity group Carlyle walked away from a deal to acquire the UK defence company. The announcement came a couple of days prior to a UK regulatory deadline.

Siemens – reported fourth quarter and full 2012 fiscal year results which were ahead of the expectations, as the fourth quarter's net profit from continuing operations was, at over €1.48Bn, more than the consensus expectations of €1.34Bn, as the results were helped by higher profits in the healthcare business in Asia and the Americas. Net profit was down 2% in year on year terms, dragged down by overall weakness in the global economy and two material write-downs in the energy business. The energy business' annual operating margin dropped to 7.8% from 17.2% due to delays in the connection of German offshore wind farms to power grids and trade sanctions on Iran that hit its oil and gas business. The company's top management stated that it certainly sees a 'slowing global economy and more headwinds'. While still maintaining its longer term goal to increase annual sales to €100Bn, it actually expects for the revenues to pull back in the current fiscal year, before resuming growth in 2014. In its efforts to stay competitive, the company aims to save €6Bn over the next two years, which involves, within other measures, cutting some of the group's 410,000 jobs. The group has set a goal to improve its operating profit margin from its four core businesses to at least 12% from 9.5% last year, in order to get more in-line with industry peers, most notably GE and ABB. Beside the above-mentioned savings programme, the company will be using a series of acquisitions and divestiture to improve its portfolio's profitability. Siemens announced plans to sell its solar units and its water businesses, which are responsible for about €1Bn in revenues. At the same time the company announced the acquisition of LMS International, a Belgian industry software maker for about €680 mm, in a move mirroring ABB's acquisition of Ventyx a couple of years ago.

SP Ausnet – The Australian utility responsible for electricity transmission as well as for electricity and gas distribution in the state of Victoria released its half year results last week which met its prior guidance and the consensus expectations. Profit after tax for the half year was $169mm, while the half distribution was confirmed at $0.041 per share, which represents a yield of roughly 7.7%.

Vivendi – Reuters reports that Vivendi has been shopping GVT, its Brazilian alternative provider of fixed telephone, broadband and TV services, in a sign that the company is looking to scale back its presence in telecommunications to focus more on its media assets. Vivendi is reported to seek to raise at least €7Bn from the sale, which has attracted expressions of interest from at least four bidders, including Brazil's Grupo Oi SA, Mexico's America Movil SAB, DirecTv and Telecom Italia SpA. Vivendi paid about €3Bn for GVT in late 2009 and has spent heavily to build its high-speed fiber broadband network. Vivendi has also been seeking a buyer for its controlling stake in Maroc Telecom.

Economic Activity, Consumer and Business Conditions

US – After the 'hurricane' of political and economic news releases in the run-up to the US Presidential elections, the past week was rather light in macro economic data point releases. Of note was an unexpected drop in the US goods and services trade deficit, to $41.5Bn in September, contrary to an expected increase to $45Bn from August's $43.8Bn. The reduction in the trade deficit was driven by a rise in exports, helped by a weakening of the US dollar relative to a basket of major currencies, partly offset by a rise in imports. The consumer credit for September rose by $11Bn, broadly in-line with the expectations, albeit less than previous month's $18.39Bn increase, in a sign that the all-important consumer sector might be able to continue to support the otherwise weak US economic growth. The improvement in the consumer sentiment might also help in this respect. University of Michigan's consumer sentiment index reading for November exceeded expectations, as it reached an 84.9 index level, the best reading in over 5 years, with both the 'expectations' and the 'current conditions' sub-indices contributing to the improvement.

Canada – Canada's balance of merchandise trade also improved unexpectedly in September, helped by a jump in exports, mostly energy and mostly outside the US. The Canadian housing continues to show signs of weakness, as the housing starts for October dropped 8.9% to 204,100 units annualized, lower than the expected level of 214,000 units annualized and September's 224,000 units annualized. Both single and multi-unit sectors cooled off in the month. The September reading of the New Housing Price Index, up 0.2% as expected, and matching August's reading, shows that price corrections are yet to happen.

Reserve Bank of Australia left rates unchanged at 3.25% last night.

The Bank of England left rates unchanged and did not expand its Quantitative Easing program beyond £ 375 Billion….as 3rd quarter growth was better than expected.

European Central Bank left rates unchanged at 0.75%, as expected. This was the fourth consecutive month that rates were left on hold and last Thursday's press conference did not hint at a December rate cut. ECB President Draghi hinted that the risks to growth are tilted to the downside, but importantly, he also indicated that inflation risks 'continue to be broadly balanced'. If the ECB was contemplating an imminent rate cut, we believe a reference to 'downside inflation risks' would most likely have been embraced.

Greece passed the 2013 austerity budget as expected. Focus now is on the €5bn debt repayment due this week. The country's debt management office plans to cover the shortfall through an auction tomorrow, although press speculation suggests that the Greek banks only have sufficient collateral to raise €3.5bn through ECB. In the meantime, Eurozone finance ministers meet this morning to try and finalise an overhaul of the total €174bn bailout, although speculation suggests agreement unlikely at this stage.

Financial Conditions

Global Regulators considering easing liquidity rules: The Financial Times last week reported that global regulators are considering expanding the definition of high-quality liquid assets for calculating the Liquidity Coverage Ratio (LCR). The article indicates that regulators are considering including single-A corporate bonds of non-financial institutions and some equities as Level II assets. Under the current draft, banks are limited to sovereign debt qualifying for a 20% risk weight under the Basel II approach, as well as corporate bonds and covered bonds rated at least AA- as Level II assets. The LCR is designed to ensure that banks have enough high-quality liquid assets to meet a 30-day stress scenario that incorporates both idiosyncratic and systemic shocks, and is expected to be implemented in 2015.

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 1.35% and the U.K.'s 2 year/10 year treasury spread is 1.48% - 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 3.40% - (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 5.9 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 is easing 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 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 49 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 17.73 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.

Chris Wain-Lowe
Executive Vice President
Portland Investment Counsel Inc.
Phone: 905-331-4250 Ext. 4232
Fax: 905-331-4368
www.portlandic.com

Source: Thomson Reuters, Bloomberg, Company reports

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC12-0146-E(11/12)