Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Bank of America CEO Brian T. Moynihan said the firm has plenty of capital and he's confident it will pass the next US stress tests. We're not going to fail this," Moynihan said. "It's pretty clear we've got the capital we need," and now the question is how much to return to shareholders, he said last week (Source : Bloomberg)

Bank of Montreal : reported cash earnings of $1.62 per share, including a $35 million after-tax or $0.05 per share gain related to benefit of credit-related items with respect to acquired M&I loan portfolio, $95 million after-tax or $0.15 per share charge relating to M&I integration costs, $67 million after-tax or $0.10 per share related to gains in run-off structured credit activities, $53 million after-tax or $0.08 per share restructuring charge, and $27 million after-tax or $0.04 per share benefit on decrease in collective allowance. The earnings were above expectations and BMO also announced its intention to repurchase up to 15 million of its common shares or 2.3% of outstanding. Operating ROE: 16.3%, Return on Risk Weighted Assets: 2.10%, Core Equity Tier 1 ratio: 8.7%

Barclays – Confirmation of August announcement that ABSA will acquire the African business of Barclays (ex Egypt & Zimbabwe) for $2.1bn in exchange for an increased stake from 55.5% to 62.3%. Limited impact on financials with smaller minority interest of a larger business.

Citigroup : US banking giant Citigroup's new chief executive on Wednesday announced a cut of 4% of its global workforce, less than two months after a shock board move forced out CEO Vikram Pandit. Michael Corbat, who took the lead of the mega-bank on October 16, said it would slice more than 11,000 jobs, mostly in its global consumer banking division, and take a $US1bn charge in the 2012 fourth quarter and another $100mn in the first half of next year.

Deutsche Bank - The Financial Times reports that three former employees have alleged that Deutsche have failed to recognize up to $12bn of paper losses during the financial crisis helping them to avoid a government bailout albeit the article does go in to say that it could be "only" $4bn. The three complaints, made to regulators including the US Securities and Exchange Commission, claim that Deutsche mis-valued a giant position in derivatives structures known as leveraged super senior trades. But Deutsche claim this is an old claim that was refuted over 2 years ago and so the article appears somewhat sensationalist.

HSBC - HSBC is to sell its 15.6% stake in Ping An, China's second largest insurer, to Thailand's richest man, billionaire Dhanin Chearavanont, for ~$9.4bn equivalent to HK$59 per Ping An share. HSBC said it will make a $2.6bn post-tax profit on the deal with Mr Chearavanont's CP Group, which will boost core tier-1 capital ratio by 0.5% slightly higher than had been expected.

National Australia Bank : NAB has priced a $1bn residential mortgage-backed security (RMBS) at lower margins than recent deals, reflecting a sharp rally in credit spreads. The $800mn of AAA rated Class A-1 notes, which carry a 3.22-year weighted average life, paid a margin of 110 basis points over the bank rate.

National Bank reported Q4/12 adjusted cash earnings of $1.93 per share, which was in line with consensus. As expected, National Bank increased its dividend 5.1% to $0.83 and bought back 1 million common shares under its NCIB program. Earnings in the quarter were positively impacted by solid growth in Financial Markets partially offset by slightly weaker-than-expected earnings from Personal and Commercial Banking. Despite good volume growth, P&C earnings fell to $168 million, down 11% sequentially. The underperformance was due to higher costs on loyalty programs and lower margins. NIM fell 3 bps to 2.12% due to product mix and lower margin on loans. Financial markets had a solid quarter with earnings of $124 million. The better-than-expected performance was due primarily to solid trading revenues of $145 million, particularly in fixed income and interest rate derivatives. Asset quality was good in the quarter with specific provisions of $46 million. Tier 1 capital ratio of 12.0% and the Basel III Core Equity Tier 1 ratio was

7.3%, which is at the low end of its peer group.

Scotia : Bank of Nova Scotia reported cash operating EPS of $1.21, which was slightly better than expectations of $1.19. Trading revenue, at $389 million versus expectations for $275 million, drove earnings growth. International Banking, Global Wealth, and Canadian banking were largely in line with expectations, at $401 million, $294 million and $481 million, respectively. International banking did enjoy a $20 million (pre-tax) credit mark gain from the Colpatria acquisition. Credit losses were $321 million, in line with consensus expectations of $305 million, and Basel 3 Core Equity Tier 1 ratio is estimated at 7.6% (includes full IFRS phase-in and ING acquisition but not Guangzhou acquisition) up from guidance of 7%-7.5% last quarter. The bank maintained its financial objectives of 5–10% EPS growth and 15–18% ROE for 2013 but the outlook for efficiency ratio improved.

Standard Chartered – trading statement issued last week. At the group level, revenues are guided up by a high single digit after a 2-3% currency headwind, with the Net Interest Margin flat Year on Year. Africa, Americas/US/Europe, Malaysia, China and Indonesia are all growing income 10+%. Costs are growing at a slower pace (including the U$340m New York DFS settlement), with 'jaws' therefore positive. Pre-impairment profit is also growing high single digit, with PBT expected to grow mid single digit and double digit ex the DFS settlement (KBWe +10%). There has been some slowdown in Wholesale income growth in 4Q (FX/commodities), which is offset by a better performance in Consumer. Core tier 1 has slipped slightly from 1H12 (11.6%), with Risk Weighted Assets growing double-digit. While not concluded, the group flags a likely charge of around U$330m to settle with the other US agencies, which at least removes some uncertainty. Management remains comfortable with FY 2012 consensus of U$7.4bn (ex DFS settlement). For 2013 we see an opportunity for Standard Chartered to improve cost efficiency after a period of heavy investment.

TD reported Q4 2012 core cash EPS (excluding IFRS dilution) of $1.84, versus $1.76 in Q4 2011 and $1.91 in Q3 2012. Earnings beat the consensus estimate of $1.81. Strength in the U.S. P&C Banking and Wholesale banking segments offset weaker-than-expect results in the Canadian P&C Banking and Wealth & Insurance segments. The beat came largely from the Corporate segment, which benefited from more favourable treasury activities than the bank anticipated. TD's U.S. P&C Banking segment delivered another strong quarter reporting net income of Cdn$353 million For the tenth straight quarter TD generated sequential loan growth in excess of 2%, reporting actual loan growth of 4.0% q/q (in US$). This was underpinned by residential mortgage (excluding HELOC) and indirect auto loans, which both exceeded 7% growth q/q (in US$). Net interest margin (NIM) declined 11 bps q/q to 3.48%, but TD managed to offset this compression with higher fee revenue.

TD also announced the acquisition of the U.S. asset manager Epoch Investment Partners (Epoch) this quarter. The purchase price is US$668 million, a 28% premium to yesterday's market close, for an asset manager with US$24 billion in assets under management. TD's expects the deal to reduce its Basel III Core Equity Tier 1 ratio, which is 8.2% presently, by a modest 0.24%. While this helps TD achieve manufacturing scale in the U.S., the transaction was in our view, expensive. The purchase price values Epoch at 12.4x Trailing Twelve Months Economic Value /EBITDA versus a trading range of 9.6x to 10.2x over the past couple months. By comparison, CI Financial, the Canadian asset manager, trades at about 10.5x TTM EV/EBITDA, which is high compared to its historical trading range of 9.0x-9.5x.

UK Banks – Early days in Funding for Lending scheme but initial indications are that impact has not been as substantive as policymakers might have hoped. 35 banks subscribed to the scheme, but only six banks have tapped the scheme so far taking a total £4.4bn driving a £496m total increase in lending. Barclays, Lloyds and Santander each drew down £1bn. RBS £750m. However, amongst the big banks only Barclays saw a material increase in Net lending which is required to fully benefit from the low costs.

Dividend Payers

ABB – Reuters reports ABB won a $255mm solar power order as South Africa is boosting its renewable power program.

Syngenta – released a set of results from expanded US field trials, which in 2012 confirmed that corn hybrids with its Agrisure Artesian native trait outperform comparable hybrids. An average yield advantage of around 17% was observed across severe and extreme drought conditions. Agrisure Artesian is a native trait developed using proprietary technology and containing multiple genes that have been identified and selected from the corn genome itself. The genes work in complex ways to help plants use water more efficiently at every growth stage to provide season-long defense against drought. Syngenta is a pioneer in the field of drought resistant traits and we expect the product to be met with good market acceptance, especially in the light of this past year's severe US drought.

Tesco – provided a trading update for the third quarter of its fiscal year, in London last week, while at the same time revealed it is reviewing its US loss-making unit, Fresh & Easy, with the most likely outcome being the closure of the 200 store chain, which currently employs 5,000. Phil Clarke, the group CEO, said that the chain's 'journey to sustainable returns was going to take too long', while in Los Angeles, on its 10th trip to the US business since taking over the top job. Tesco added that Tim Mason, Fresh & Easy's CEO and deputy group CEO, is leaving after 30 years with the firm. The group also disclosed it had received a number of approaches from parties interested in acquiring all or part of Fresh & Easy or in partnering with the firm. Fresh & Easy, Tesco's attempt at breaking into the huge US market, absorbed nearly £1Bn of capital since its 2007 launch and has become one of many failed attempts by European retailers in establishing a meaningful presence across the ocean. We welcome the company's decision to review its US business, as this would, in our opinion, allow Tesco more flexibility and fire power in the key UK and emerging markets businesses.

Tesco's sales at UK stores (that have been open for over a year) were down 0.6% in the 13 weeks ending Nov 24, which was in the middle of the range of expected results. Like for like sales in food, which is the main focus of the recovery programme in the UK stores, were up by 1.2%, ahead of the market overall, yet the non-food categories more than offset the positive momentum. In South Korea, the group's biggest overseas market, underlying sales retreated by 5.1% as sales were affected by new legislation allowing local governments to impose shorter trading hours. In Eastern Europe, Tesco's other area of focus, underlying sales retreated by 3.6% as the region struggles with the effects of the Eurozone instability.

Toyota – Japanese media, quoted by Reuters, said Toyota expects Japan vehicle sales to fall by a fifth next year, in part due to the end of government tax incentives for fuel-efficient automobiles. The company decided to set its 2013 domestic sales target for Toyota-brand cars to 1.36mm vehicles, down from its 1.67mm target for this year. The difference is also explained by a large back-log of orders following supply-chain disruptions from last year's earthquake and tsunami, which had inflated sales this year.

TOTAL announced last week that it had made a significant oil discovery in the Gulf of Mexico. The North Platte prospect was drilled in Garden Banks Block 959 in the deepwater Gulf of Mexico. TOTAL holds 40% in the prospect which is operated by Cobalt, with 60%. The result was described as being in line with Cobalt's pre-drill estimates for 400-850Mboe of resources, assuming 350 feet of net pay. Cobalt has highlighted 2Bn Boe of gross resource potential across related structures in the Gulf of Mexico. This result is the first from TOTAL's Gulf of Mexico alliance with Cobalt, formed in 2009. TOTAL has increased exploration focus in recent years and has a 2013-14 program targeting a range of key frontier areas.

Economic Activity, Consumer and Business Conditions

US – US labour productivity improved by 2.9% in the third quarter, ahead of the expected 2.7% rate and building on a second quarter advance of 1.9%. The US economy continues to post decent productivity improvements as businesses have been delaying hiring plans, preferring to continue to 'sweat' the existing workforce. As discussed before, such an approach is not sustainable in the long run and, were the economic growth to continue, hirings pace would have to pick up. A consequence of the above productivity improvement is a 1.9% reduction in labour costs in the quarter, ahead of the expected 0.9% reduction, which is likely to keep a lid on inflationary pressures.

November's employment report revealed a better than expected 146,000 non-farm payroll additions, versus the consensus calling for a 93,000 improvement. All of the growth came from the private sector, with 147,000 new private payrolls. The unemployment rate unexpectedly retreated to 7.7%, as the consensus was pencilling in a flat 7.9% rate reading, mostly due to a drop in the labour force participation rate. The average weekly earnings improved by 0.2% in the month, as expected. 53,000 jobs were created in retail, a seasonal improvement.

Last week, the non-manufacturing purchasing managers index (NMI) reading, issued by the Institute for Supply Management (ISM), showed a better than expected 54.7 index points reading for November, ahead of October's 54.2. The advance in the index was due to a jump in the 'current business activity' component, but was also helped by the 'new orders' component. The 'employment' component of this diffusion index actually retreated in the month, to a 50.3 index points reading, compared to October's 54.9 level. Indicators of consumer sentiment took a tumble in December, with the University of Michigan's consumer sentiment index retreating to 74.5 in the month, from November's 82.7 level, significantly below the expected 'flattish' reading of 82.4, dragged down chiefly by the 'expectations' component of the index. The consumer credit report, issued with some lag, revealed a $14.16Bn increase in consumer credit in October, on top of September's $12.19Bn and ahead of the expectations for a $10Bn improvement.

Canada – The Canadian economy added 59,300 new jobs in November, a big increase on October's 1,900 job additions, including 55,200 full-time jobs and 48,200 jobs additions in the private sector. The growth was driven by strong job additions in the service sector, including accommodation and food services, retail and wholesale trade and professional and technical services, offset by a pull-back in manufacturing and construction. The Canadian rate of unemployment retreated to 7.2% from 7.4%, matching its previous low level during the current economic cycle. Labour productivity continued to deteriorate, down by 0.5% in November, following a 0.6% pull-back in October.

The building permits reports for October showed a 15.0% advance in the month, ahead of the expected 2.6% improvement, though basically a retracement of the 12.7% drop for the month of September. The Canadian housing starts report, released earlier today, showed a larger than expected retreat, to a 196,100 units annualized for November, from October's 203,500 units annualized level. Both multi-unit and single-unit starts dipped in the month.

Canada: the Bank of Canada kept the overnight lending rate at 1%. According to the BoC's statement, "over time, some modest withdrawal of monetary policy stimulus will likely be required, consistent with achieving the 2 percent inflation target." This maintains the tightening bias that the central bank introduced back in October. While the BoC acknowledged Canada's disappointing third-quarter economic growth of 0.6%, annualized, it said the slowdown was partly due to temporary disruptions in the energy sector. Further, "although underlying momentum appears slightly softer than previously anticipated, the pace of economic growth is expected to pick up through 2013.' Most market economists don't expect an interest rate hike until the fourth quarter of 2013.

Australia : Reserve Bank of Australia cuts rates 0.25% to a record low 3% as markets had expected in efforts to foster stronger growth in the non-mining sectors of the economy. Eyes now switch to the major Australian banks to see how much of the rate cut they pass along.

Australia's economy was reported to have grown at a slightly weaker-than-expected pace in Q3, advancing 0.5%—that's the coolest quarterly growth rate since the one-quarter contraction in 1st Q 2011, and leaves output up 3.1% y/y versus 3.8% y/y in the prior quarter. Household consumption grew just 0.3% q/q while government spending contracted 0.4%, but machinery and equipment investment rebounded 6.2% after three straight quarterly declines.

The ECB held rates steady at 0.75% last week and announced no new policy measures, as expected. In his opening statement, ECB President Draghi noted that inflation is projected to fall below 2% in 2013, though risks to the outlook are broadly balanced. He remains downbeat on the growth outlook with activity expected to be weak into next year. Economic risks remain on the downside, which shouldn't surprise anyone. The ECB is expecting the economy to recover gradually "later in 2013" due to easy monetary policy, improved confidence and stronger foreign demand.

Italy : Prime Minister Monti after holding talks with President Napolitano, made the surprise move of indicating his intention to resign once the 2013 budget law has been approved and is expected to lead to general elections in February. He said that "the words of PDL secretary Alfano clearly represent a no-confidence vote for the government and his policies". Napolitano has considerable discretion in setting out the course for the conclusion of the legislature and will not make his roadmap public for another 8 days. The date of elections remains uncertain, though a February vote looks increasingly likely. Parliament must be dissolved 45-70 days before elections. Monti has left blame squarely on the shoulders of Silvio Berlusconi and his party, the centre right People of Liberty party PDL who walked out of a Senate confidence vote on a package of economic measures last week and abstained in a separate confidence vote in the lower house. Berlusconi confirmed his intention to run for prime minister on Saturday. People of Liberty (PDL) party currently has 13.8% support and trails center-left Democratic Party (led by Pier Luigi Bersani) by a wide margin (30% support). Given that the market was already suffering last week by the uncertainty caused by Berlusconi's decision to run for Prime Minister once more and his party's abstention from reform votes in Parliament, bringing forward the inevitable at least implies the uncertainty may be removed sooner rather than later. Nevertheless, politics continues to be one of the key risks in Italy and election results remain far from clear. The market may take some comfort that Monti does not appear to have ruled himself out from returning to serve post elections.

Spain - Eurozone finance ministers approved €39.5bn in aid to Spanish banks last week, largely expected given €100bn was set aside in June. The Financial Times reports yields on Spain's benchmark 10-year bonds dropped to 5.25 per cent last Monday after Madrid announced the request for bank aid, the lowest borrowing costs in eight months. Funds are to be available for distribution next week. Despite analyst claims that the Spanish banks require 2-3 times that amount, Spain's Finance Minister Luis de Guindos said the conditions attached are advantageous and help heal the banking system. The bailout loans would carry a 12 and a half year maturity with a 10-year grace period and an interest rate in the first year of less than 1%.

EU regulators gave the green light to €37bn in euro-zone funding for Spain's stricken banking sector, setting in motion a long-term cleanup. In exchange, four nationalised banks agreed to make sharp cuts in their balance sheets and payrolls—a retrenchment that carries the risk of intensifying Spain's credit crunch in the midst of a deep recession. (Source : Bloomberg)

Financial Conditions

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 1.37% and the U.K.'s 2 year/10 year treasury spread is 1.49% - 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 3.34% - (3.31%, end of November 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 5.4 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 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 48 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 15.90 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

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

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