Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Aegon and Santander are to form a long-term strategic partnership to distribute both protection and general insurance products through Santander's branches. Under the terms of the agreement, Aegon will acquire a 51% stake in both a life insurance company as well as in a non-life insurance company for a consideration of €220mn. Depending on the performance of the partnership, Aegon may pay an additional amount after five years. Furthermore, Aegon Spain will provide the back-office services to the joint venture companies. The transaction is expected to close in the first half of 2013 subject to regulatory approval and will be financed from existing resources.

AXA: S&P lowered the counterparty credit and insurer financial strength rating on the core operating entities of AXA to A+ from AA- yesterday. The credit rating agency reduced credit ratings on the parent, its US holding company, AXA Bank Europe and its unsecured and subordinated debt. The basis of the downgrade was (1) earnings growth impacted by unfavourable investment market conditions and weak economic prospects (2) despite improved capital adequacy during 2012, sensitivity to market conditions remains relevant for its capital position.

Aviva - Aviva last week reached settlement with Bankia for €608 million regarding their Spanish JV Aseval. As a result, Aviva will transfer its entire holding in Aseval to Bankia. The transaction will increase Aviva's economic capital surplus by approximately £0.5 billion. The deal will also add a decent boost to both tangible IFRS of £0.4bn and tangible MCEV of £0.33bn.

Last Friday, Aviva announced the disposal of its US life subsidiary to Athene, an insurance vehicle led by Apollo. The headline price is £1.1bn, or £1.0bn after repayment of an external loan. This compares to an IFRS book value of £3.2bn, split £2.45bn equity, £0.75bn debt (internal loan). Unsurprisingly, therefore, there will be a significant hit to headline IFRS book value. Aviva has stated that its end-Sept IFRS book value falls from 397p to 318p (-79p per share). The book value hit is larger than the expected estimate of 50-70p. Aviva's US life business posted £197m of pre-tax operating profits in 2011 and is on track to repeat broadly the same level of earnings in 2012, in our view. Therefore, we estimate the dilution effect to be in the region of 4-5p per share. The good news for Aviva is that its economic capital position has improved significantly; this is a key strategic objective for the company. Aviva has stated that its economic capital surplus, including both the US and Spanish sales, has increased by 17pts (or £1.1bn), to 165%. This is now within the company's target range of 160-175%. Going forward, Aviva's sensitivity to credit spreads will reduce by around 30%.

Banco Santander is to absorb its subsidiary Banesto into its main domestic bank in a deal that will close 700 branches as Spain's largest lender by assets cuts costs. The board of Santander met on Monday to approve the merger of its domestic bank with Banesto, which currently operates as a standalone lender with its own management structure and stock market listing.

BBVA has agreed to sell its pension fund management unit in Colombia to a local competitor for $530mn and will book a gain of €265mn net of tax in 1st Half 2013 at closing of the deal. BBVA is still in the process of selling its pension business in Peru and Chile, where it owns 52% of listed Provida (currently valued at €0.9bn). The bank has already agreed to sell the Mexican pension company to Banorte for $1,730mn and a net gain of €800mn. Overall its expected BBVA pension business in Latam (including Mexico) to be sold for €2.7-3.3bn and generate capital gains of €1.4-1.8bn. The bank intends to use the profits to strengthen Core Tier 1 capital by 0.6%-0.7%

BNP - BNP Paribas has agreed to sell their Egyptian unit for $500mn (top end of estimated range) to Dubai's largest bank, Emirates NBD. The deal values BNP Egypt at 1.6x book value. The transaction is expected to close by the end of 1Q 2013 and Emirates NBD will offer to acquire the remaining 4.8% of BNP Paribas Egypt form its minority shareholders at the same price

UBS: announced last week a CHF1.4bn ($1.5bn) settlement on Libor, in line with recent press reports. UBS Japan to plead guilty to wire fraud while the company has entered a non-prosecution agreement with US authorities (essentially a conditional amnesty). Both elements are also per recent press reports. 4Q guidance for a net loss of CHF2-2.5bn. This compares to our pre-Libor estimate of CHF(88)m, the difference largely being accounted for by guidance for total litigation charges of CHF2.1bn, including mortgage claims "and other matters". Basel 3 Core Tier 1 guidance is for 4Q to be "roughly in line" with 3Q 9.3%. The 4Q guidance suggests Fixed Income Currency and Commodities exit losses are not a substantial factor, which will come as a relief to the market, as will guidance for "good" money flows into Wealth Management, suggesting Libor hasn't (yet) impacted client confidence. Additionally there will be relief there appears to be no implication of senior management involvement. Key issue going forward remains the extent to which Civil actions follow regulatory settlement.

Dividend Payers

Carnival: 4Q Results Better Than Expected: Carnival reported adjusted EPS of $0.13 compared to consensus of $0.11. Constant currency net yields decreased 4.5% in the quarter, better than estimates of down about 5.5%-6%.Carnival provided 2013 guidance below consensus on net yields and EPS. Net yield guidance of up 1% to 2% compares to consensus +3.7% (according to Consensus Metrix). FY2013 EPS guidance is also slightly disappointing at $2.20-$2.40 versus consensus of $2.46. The company noted that a deteriorating economic environment in Europe continues to be a drag on the overall outlook for next year. In the past, management has typically been conservative in setting guidance ahead of the key Jan-Mar booking period. Overall, yield recovery seems to be on track, but not as quickly as had been hoped. Carnival remains a well-run company with strong operating metrics versus the industry and a commitment to returning capital.

Roche : L'Agefi (Swiss press) reports that Roche have tentatively reached agreementl to buy Illumina for US$66 per share (agreement not finalised yet, but reports that the purchase may be announced in January). USD$66 would represent a 21% premium to last Wednesday's close before the press comment. In January, Roche bid US$ 44.50 and increased later to US$ 51. There has been much press speculation that they might raise their bid north of US$ 60.

Economic Activity, Consumer and Business Conditions

US GDP : The final reading on U.S. Q3 real GDP growth was revised up to 3.1% - stronger than expected and up from the 2.7% reported in the 2nd release—most areas of the economy saw an upward revision, with the exception of residential construction, which was cut to a still-strong 13.5% pace from 14.2%. While strong on the surface, the core of the third quarter still looks much softer than the headline—a 12.9% surge in defense spending (unrevised) and a jump in inventories (little revised) boosted headline growth. That said, final sales (GDP ex-inventories) were revised up to 2.4% up from 1.9%, and stripping out government spending as well would leave growth at around 2% (previously about 1.5%). In other words, underlying growth in Q3 was much weaker than the headline print, but not quite as weak as previously thought.

US : The current account deficit narrowed less than expected to $107.5 billion in 2012 Q3 (or $430 billion annualized) from $118.1 billion in Q2. This was the smallest deficit in nearly two years, and, as a percentage of GDP, the smallest in three years at 2.7% (down from a record-high 6.5% in late 2005). Imports of goods and services fell on lower oil prices and weak domestic demand. While exports continued to rise, growth has slowed meaningfully in the face of the Eurozone recession and a slower-growing China. The U.S. continues to run a sizeable income surplus (courtesy of higher interest rates on its holdings of foreign assets), though it declined modestly to $50.8 billion in Q3. Next year, faster growth in emerging markets should support exports, extending the improvement in the trade balance. A gradually shrinking current account deficit means the U.S. is becoming less dependent on foreign funding, which should be a long-term positive for the US$.

US Housing : With one month to go in the year, housing starts are on pace to average about 775,000 units in 2012, up 27% from 612,000 last year. And, with household formation running above 1 million per year again, there is we believe more upside in 2013. U.S. housing starts slipped 3% to a weaker-than-expected 861,000 annualized units in November, after revisions pulled October's tally down to 888,000 from 894,000 initially. Given growth in housing starts was extremely strong in the prior 3 months (a 160,000 annualized increase), some giveback is not a concern at this point, especially given what permits did in November. Building permits topped expectations, rising 3.6% to 899,000 annualized units, the highest level since July 2008—this points to continued upward momentum ahead for homebuilding.

U.S. existing home sales rose 5.9% in November to 5.04 million annualized units, better than expected and the first reading above 5 mlllion since the tax credit-induced days of late 2009. October's tally was revised down slightly to 4.76 mln from 4.79 mln previously, but that doesn't detract from this solid report which added that home sales would have been "modestly higher" if not for Superstorm Sandy. November's gain leaves sales up a solid 14.6% from the same month last year and more than 30% above the lows set in mid-2010.

Developed Nations' Economic Growth : IMF chief Christine Lagarde has upwardly revised the fund's estimate of economic growth among developed nations. Ms Lagarde said in an interview that growth in developed nations was now expected to increase by 1.6% next year, up from an earlier estimate of 1.5%.

Greece: Standard & Poor's Ratings Services last week raised its long-term foreign and local currency sovereign credit ratings on the Hellenic Republic (Greece) to 'B-' from 'SD' (selective default). It also raised its short-term foreign and local currency sovereign credit ratings on Greece to 'B' from 'SD'. As a result, S&P has raised the ratings on all the outstanding issues, including those guaranteed by Greece, to 'B-/B'. The outlook is stable. The rating action reflects the completion on Dec. 17, 2012, of Greece's distressed debt buyback in tandem with approval by the Eurogroup (the finance ministers of EU member states belonging to the eurozone) of a loan disbursement to Greece under the second economic adjustment program. S&P view the eurozone member states' decision to provide material cash flow relief to Greece as indicative of their determination to restore stability to Greek finances, and to preserve Greece's eurozone membership.

Ireland : Two years after Ireland's banking crisis forced the country into an international bailout, signs are emerging of stabilisation, with lenders raising funds on bond markets, deposits growing and reliance on central bank funding being reduced.

Financial Conditions

Bank of England : The BoE's credit- boosting plan is showing "early signs" of helping to lower bank funding costs, which may spur a gradual pickup in mortgage approvals and aid the economy, the central bank said. "Easier access to credit" through the so-called Funding for Lending Scheme "should boost consumption and investment by households and businesses," it said in an article in its Quarterly Bulletin. "In turn, increased economic activity should raise incomes." (Source: Bloomberg).

Bank of Japan : The BoJ maintained their 1% inflation target in spite of Prime Minister elect Abe's request to have it doubled, and added Yen 10trn to their asset purchase program (5trn in bills/5trn in JGB's). Interest rate remained unchanged at 0.10%. But the Central Bank did give a nod to Abe in stating that they would "discuss" the inflation target at their next meeting. Longer-term, the new PM can reshape the BoJ as he sees fit, with Gov Shirikawa and his two deputies' terms expiring early in the new year.

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 until the unemployment rate falls below 6.5% (November 7.7%) which is likely to be through 2014. Fed Reserve Chairman, Ben Bernanke has indicated 1% or less would be considered exceptionally low. In September 2012, the

Fed announced it would buy $40 bn per month of agency mortgage-backed securities and in December 2012 that it would also buy $45 bn per month of treasuries (4 year maturity and above) which means all parts of the yield curve will benefit from a near-zero anchor until late 2014. The U.S. 2 year/10 year treasury spread is now 1.51% and the U.K.'s 2 year/10 year treasury spread is 1.55% - 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% - (3.31%, 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. A recovery in house prices appears increasingly sustainable 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 17.84 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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