Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Allianz - fourth-quarter net income more than doubled after profit from property and casualty insurance unexpectedly rose and year-earlier write-downs weren't repeated. Allianz benefited from higher prices for some of their products last year after earnings in 2011 were hurt by record losses from natural catastrophes. A recovery in financial markets also helped bring an increase in investment income, outweighing the impact of lower interest rates. 4Q 2012 operating profit was EUR2,275m - consensus EUR2.1bn - beat primarily in P&C and Asset Management partly offset by miss in Life. 4Q 2012 Combined Ratio of 95.4% - much better than consensus 99.1% - due to higher than expected reserve releases and lower catastrophe claims but underlying loss ratio of 67.8% versus expectation of 69.5% so very positive. Asset Management inflows in 4Q of EUR40bn - very strong. Operating profit for 2013 guided to EUR9.2bn. Dividend of EUR4.5 in line with expectations.

AXA 2012 Underlying Profit Before Tax Eur 4251 versus 4260 consensus, also at the adjusted level realised gains higher and impairments lower than expected but net income lower as a result of higher Mark To Market un-realised movements. Dividend increase in line at 4% to 72c. Divisional results: Life & Savings margin, new business value and sales ahead, P&C weaker than expected, asset management better than expected - some recovery here with net flows –Eur 1bn for full year.. Economic capital ratio 206% +0.23% is a positive. P&C combined ratio improved 1pp in mature markets and c5pp in direct business (near to breakeven on technical profit) but high growth markets deteriorated impacted by bodily injury claims in Turkey. In mature markets, rating improvements in Germany and France evidenced. One-off reserve strengthening in P&C in Turkey.

Separately, Deputy CEO Denis Duverne said in a Bloomberg Television interview in Paris that the insurer resumed buying Italy and Ireland sovereign bonds in recent months and is looking carefully at the Spanish situation.

Credit Suisse said last Wednesday it would redeem $1.5bn in Tier 1 Capital notes next month as part of measures to manage its capital to comply with tougher regulation. The bank said in a statement it had decided to redeem $1.525bn 7.9% Tier 1 Capital Notes on March 28. It said it would pay a redemption price per note of $25, plus $0.07132 per note in interest.

HSBC as announced the sale of HSBC Panama (sold for $2.1bn cash, 3x Price/Book and 14% ROE) which boosts HSBC's core tier 1 capital ratio by +0.10-0.15%

Santander has reduced the pay of its top executives by more than a third as the bank's earnings fell sharply and its share price remained below half its pre-crisis high. (Source: Financial Times)

Dividend Payers

BHP's – half year results presentation was overshadowed by the announcement of the replacement of its CEO, Marius Kloppers, by Andrew Mackenzie, an oil and gas and minerals industry veteran. While the departure of Marius Kloppers was well flagged, expectations were for his departure later in the year or even in 2014. The switch is set to happen in the month of May of this year. Andrew Mackenzie is a prize-winning scientist (geologist and organic geochemist) who worked for the oil and gas giant BP for 22 years prior to moving to Rio Tinto in 2004, were he acted as the CEO of the Industrials Minerals Division. Mackenzie joined BHP Billiton in 2008 as the CEO of the Non Ferrous (base metals) division. He is known for his strong operational credentials and focus on capital discipline. His deep experience in oil and gas was a decisive factor in his nomination, as BHP Billiton has recently become a major oil and gas player, with the addition of its shale assets in the US, on top of its existing deep sea operations in the Gulf of Mexico and gas assets around the shores of Australia. In our view, Marius Kloppers ends a six year career as the CEO of BHP Billiton and has been credited with leading the company through the global financial crisis in better shape than its peers as well as with overhauling the global iron ore market to market-based pricing rather than pricing setting based on annual talks. On the flip side, Kloppers led three failed major mergers and acquisitions during his tenure.

BHP Billiton is the fourth global miner to change its top executive this year, following changes at Glencore, Anglo American and Rio Tinto.

BHP reported first half operating profit of $5.68Bn, a 43% reduction, as commodities markets suffered from pricing weakness throughout the second half of the calendar 2012. Its net profit fell to $4.2Bn affected by about $3Bn worth of write-downs in its aluminum and nickel businesses, much as expected, and helped by sales of assets such as its stake in the Richards Bay minerals, its stake in the Browse gas projects, its diamond business and Yeelirie uranium deposit. The company raised its interim dividend by 3.6% to $0.57 per share, in line with the expectations. The group expects global commodity prices to remain under pressure as new low-cost supplies come into production, even though demand is expected to improve over the next 12 months.

World trade in iron ore is preparing for major disruption as the key producing area of Pilbara in Western Australia is bracing for cyclone Rusty. The storm is currently rated a category 2, but could strengthen to a category 4. A weaker category 4 system which passed the area in January forced shutdown of all three major export terminals (Port Hedland, Dampier and Cape Lambert), contributing to a 9% drop in exports in the month and a 5.2% rise in iron ore spot prices. Port Hedland has been closed and all vessels sent out to sea in preparation for the storm, as well as Cape Lambert, while Dampier port is expected to be fully closed by sunset on Monday. The cyclone is expected to cross the coast by Wednesday with winds reaching up to 280km/h.

Shindler Holding – one of the leading elevator and escalators companies worldwide, reported its fiscal year 2012 results last week, which were broadly in line with the expectations. The company reported strong order intake over the year, up 8.7%, and ended the period with a high order back-log of CHF7.1Bn, mainly in Asia (36%), while Europe and Americas each accounted for 32%. Earnings before interest and tax (EBIT) was 24.8% higher in 2012, while the EBIT margin improved to 12% from 10.1% in 2011. However, the company had to suspend a mid-term EBIT margin target of 14%, as it decided to focus on top line growth and generating a higher EBIT in absolute terms. The strong order growth lead to a change in the sales mix in favour of new installations, which is a lower margin business compared to service jobs. In our view, new installations growth reduces margins but increases the base for future higher margin service business. Net profit for the group was 21.5% higher, at CHF730mm. The company proposed a CHF2.20 per share for 2012, a 10% increase.

Siemens – has reportedly won a €300mm order for a gas-fired power plant in Turkey.

Vivendi – After revealing it is talking with a number of banks about a syndicated loan of up to $8Bn, Etisalat, the United Arab Emirates biggest telecom, revealed it had lined up advisers for its bid for Vivendi's 53% stake in Maroc Telecom. BNP Paribas and Morocco's Attijariwafa Bank will advise on the deal. Other bidders for the stake include Qatar Telecom and South Korea's KT Corp.

Maroc Telecom, 53% controlled by Vivendi, posted 2012 results last week, including a 17% drop in net profit attributable to shareholders to 6.7mm dirhams ($794mm), as its bottom line was affected by restructuring charges and a non-recurring contribution to the government. Sales retreated 3.2% affected by a 7.4% drop in revenues in its main market, Morocco, while the customer base continued to grow, up by 13.5% to 33 million customers. Mobile price cuts and reduced termination rates in Morocco were partially offset by a 17% increase in international revenue. Revenues at Maroc Telecom's subsidiaries grew 23% in Gabon, 19.3% in Mali, 14.3% in Burkina Faso and 14.1% in Mauritania. The company said it would pay a 100% of its 2012 earnings, representing a yield of about 7.0% to shareholders.

Economic Activity, Consumer and Business Conditions

US – Inflation continued to hover just under 2.0% in year on year terms for the core reading. In January, the core consumer price index (CPI) rate of change, which excludes food and energy prices, was 1.9%, in line with December's reading and slightly ahead of the expectations, which were calling for a 1.8% rate. Strong price appreciation in the apparel category was offset by weaker prices in household furnishings and medical care. At the headline level, the CPI year on year change was 1.6%, as expected, and a tenth below December's read of 1.7%, as energy prices tumbled 1.7% in the month, while food and beverage prices were unchanged.

On the housing front, a 4.92 million annualized rate of existing home sales for January was stronger than expected, given a significant drop in the pending home sales in the month prior. For the same month, housing starts retreated, unexpectedly, to a 890,000 units annualized, while building permits actually exceeded expectations reaching a 925,000 units on annualized basis. Overall, a mixed picture with a slight positive bias, showing that the US housing sector is slowly continuing its recovery.

Canada – Inflation in Canada continues to underwhelm, as the CPI reading was up only 0.5% year on year, short of the expectations for a 0.7% reading and a drop from December's 0.8% rate. Unlike US, clothing prices tumbled in the month, which makes it likely that prices for this category in both countries will revert somewhat to the average in the months ahead. Other categories such as home finance and food were also weak in the period. The core reading, which excludes eight most volatile series, including food and gasoline, was 1.0%, a tenth below the expectations and December's read.

Retail sales in December were substantially worse than expected and expectations of a 0.3% retreat at the headline level, and a 0.1% improvement at the core level, were anything but demanding. The headline retail sales in Canada were down 2.1% in December, dragged by a 6.4% drop in sales of autos and parts. The core retail sales were down by 0.9% in the month, as other categories, such as electronics and home appliances, as well as home furnishings and department store sales retreated in the month.

Britain has suffered its first ever sovereign ratings downgrade from a major agency with Moody's stripping the country of its coveted top-notch triple-A rating. And the U.K. government named Bank of England veteran Andrew Bailey as its new banking supervisor.

European Commission cut its Euro-area 2013 GDP forecasts to -0.3% from +0.1%. Looking at the deficit trends, it's just France and Spain that are projected to have larger deficits next year. Everyone else is looking better, and Eurozone as a whole is expected to have deficit fall slightly. Forecasts now call for the Euro-area deficit to come in at 2.8% in 2013 and 2.7% in 2014.

Italian Election Day: Initial indications are due out at some point after c3pm. Consensus view remains that Bersani wins (centre left coalition) but will need help to form a government (potentially with Monti). With numerous parties all vying for a piece of the action, stage looks set for a volatile couple of days in Italy as we wait for formal appointment of a government.

Financial Conditions

The LTRO repayments came in much lower than economist predicted. Euro 61.1 billion was returned to the ECB, much lower than the medium forecast of 138 Billion. Spanish banks who were big takers of the second LTRO appears to have kept their cash. 356 banks repaid monies but only 9 banks from the first LTRO repaid an additional 1.7 Billion.

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% (January 7.9%) 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 1.74% and the U.K.'s 2 year/10 year treasury spread is 1.88% - 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 3.56% - (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 4.4 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 3 in 2013 (compared to 49 in 2012, 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 14.17 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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