



News Highlights on Current Holdings

Financial Services Companies

Lloyds Banking - announced an intention to sell an anticipated minimum 102mn shares at 510p, in St James's Place, a 20% stake, which would leave them with 37%. The sale would generate a gain on sale of about £350-400mn though the gain includes the write up on the 37% residual, so the actual gain on the 20% is £130mn. Core Tier1 capital is raised by about £600mn or 0.2% on current rules, or £500mn and 0.15% on Basel 3. The placing has a 365 day lock up on completion.

National Australia Bank - will shut its financial advice division in the UK as it scales down its loss-making British business. The move will lead to 130 job cuts from the advice arms of its Clydesdale and Yorkshire banks in England and Scotland.

Royal Bank Scotland – Reuters reports that RBS is sounding out some of Britain's biggest investment firms on their appetite for a stock market listing of the bank's small business lending arm, investor sources close to the talks said. The new business, which would revive the British banking brand of Williams & Glyn's, will be composed of 315 branches. European competition authorities have ordered RBS to sell these branches as a consequence of a £45.5bn bailout by the British government during the 2008 financial crisis. The talks are effectively a pre-sale dialogue between prospective shareholders and RBS. Note, A plan to sell these branches to Santander fell through in October.

Royal Bank of Scotland has announced it will dilute its stake in its direct insurance business by placing 229.4m shares/15.3% (ex over allotment which is further 22.9m). Accelerated bookbuild starts immediately. Goldman Sachs/Morgan Stanley/UBS are joint bookrunners. Assuming no over allotment, this takes RBS's stake to 49.99% and therefore fulfils its obligation under the EC restructuring for 2013 (<50% by end-2013/0% by end-2014). If the over-allotment is exercised, then the remaining stake would be 48.5%. There is now a 180 day lock-up on the remaining shares. This looks entirely sensible. Direct Line is marked at 216p in the

RBS accounts, so depending on the placing price, it will generate a small loss but frankly insignificant. Neutral for RBS.

JP Morgan – In the second phase of the Fed's annual stress tests, also known as the Comprehensive Capital Analysis and Review (CCAR), JP Morgan was allowed to move forward with its plans to buy back \$6Bn of stock over the next 12 months and raise its quarterly dividend in the second quarter to \$0.38 a share from \$0.30 a share, but was requested to submit new plans the Fed at the end of the third quarter; a requirement which also applied to Goldman Sachs Group Inc.

The same day, a US Senate report incriminated the bank for its role in a number of derivative bets, known as the 'London whale' bets, which ended up costing more than \$6.2Bn. Senior JP Morgan executives appeared before a Senate sub-committee, but not the Chief Executive James Dimon. Dimon is known for publicly criticizing lawmakers for creating onerous new rules for banks after the crisis.

US banks stress tests – The Comprehensive Capital Analysis and Review (CCAR), which stress tested 18 largest US banks, resulted in the unconditional approval of 14 firms' capital plans, while JP Morgan and Goldman Sachs were allowed to go ahead with their plans with the condition to submit new plans by the end of the third quarter, on qualitative, not quantitative, grounds. The Fed rejected the capital plans of BB&T and Ally Financial. The annual testing has become a key tool for regulators to ensure that banks are not using too much of their capital cushions by examining how banks would weather a hypothetical major stock market shock. The Fed test assumed a spike in unemployment to 12.1% and a 50% drop in share prices. Overall, the Fed said the stress tests showed that the 18 banks have substantially increased their capital bases since the regulator's first exams in 2009. From the end of 2008 through the end of 2012, their total Tier 1 common equity increased to \$792Bn from \$393Bn.

A number of major US financial firms announced increased dividend payments and share buy-backs as part of their capital plans examined by the Fed. Of note:



JP Morgan and Wells Fargo increased their dividends by 27% and 20% respectively, a clear sign of confidence.

Bank of America said it would buy back \$5Bn in common stock and redeem \$5.5Bn in preferred shares. JP Morgan, Wells Fargo and Citibank also announced share buy-back equivalent to about 3.1%, 2.1% and 0.8% of their outstanding shares, respectively.

Dividend Payers

BHP – is being investigated by the US Department of Justice and the Australian Federal Police (AFP) for allegations that it provided inducements, hospitality and gifts to Chinese and other foreign officials during the 2008 Olympic Games. BHP's involvement at the 2008 Beijing Olympics was targeted mostly at its close circle of Chinese buyers and employees. BHP was not one of the 12 sponsors in the International Olympic Committee's elite 'TOP' programme, but a local sponsor, paying Beijing organizers an undisclosed amount of money and providing materials for the 6,000 or so medals required for the Olympics and Paralympics. Maria McCarthy, the head of BHP's Olympic sponsorship team, said that BHP spent almost nothing on media buys and advertising and chose to focus on community leveraging, stakeholder leveraging that involves governments, customers and staff. One event hosted by BHP during the Olympic Games was a roundtable for its iron ore clients, where they discussed outlook for the steel industry. At the time, BHP was championing market pricing for iron ore instead of annual contracts, which materialized shortly after, a move which was applauded as it was perceived to increase the market transparency and improve the economics for smaller operators.

Carnival Corp – reported results for the first quarter of its fiscal year, which included a return to profitability, yet the forecast for the remainder of the year had to be adjusted downwards, in the light of recent cruise incidents. The company now expects net revenue yields to be flat this year, versus an earlier forecast that they would rise 1% to 2%. Net yields are expected to be impacted by weak demand in Europe, increased price promotions for its flagship brand and weaker than expected on-board revenues. Carnival now forecasts full-year earnings of

\$1.80 to \$2.10 per share, down from its earlier forecast of \$2.20 to \$2.40, impacted chiefly by the Triumph incident and lost bookings. The group reported net income of \$37mm, or \$0.05 per share, on revenue of \$3.59Bn for its first quarter. Net revenue yields were 2.3% lower for the period. Compared to a year ago, when demand for cruises plunged after Carnival's Costa Concordia ran aground off the Italian coast, bookings had been increasing. However, while demand is improving in Europe, the tough economy is preventing a quicker recovery in pricing.

Novartis – announced its eye care unit Alcon got approval from the European Commission for Jetrea, a drug that treats vitreomacular traction (VMT). VMT is associated with macular hole that can cause progressive sight-threatening symptoms and irreversible vision loss. Novartis estimates that the condition affects 250,000 to 300,000 people in Europe alone. Novartis has acquired the rights to sell Jetrea outside the United States from ThromboGenics NV. Jetrea allows eye care professionals to treat the disease early with a one-time injection instead of using surgery.

Tesco – acquired family restaurant group Giraffe for £48.6mm, extending the reach of Britain's largest retailer into cafes and dining. The acquisition follows the move to free up space in some of its larger stores, as its general merchandise moves online. Giraffe restaurants could be opened near Tesco stores, as the company tries to increase the amount of time consumers spend at the shop. Tesco already owns a 49% stake in artisan cafe Harris + Hoole.

Veolia – In an effort to reduce its indebtedness, the company divested Transdev, its Eastern European bus services for €52mm to Deutsche Bahn. The deal also involves Deutsche Bahn assumption of €30mm in Veolia Transport Central Europe's (VTCE) debt. Through this acquisition Deutsche Bahn becomes Eastern Europe's biggest private passenger transport company as it now controls routes in Croatia, Poland, Serbia, the Czech Republic, Slovakia and Slovenia.

Vivendi – announced it had put the sales of its Brazilian alternative broadband operator GVT on hold. DirecTV, the



largest US satellite TV provider, pulled out of the bidding for GVT on Thursday. DirecTV offered roughly €6Bn in shares and cash, while Vivendi had wanted at least €7Bn. Vivendi believes GVT is a good asset and will continue to develop it. The GVT auction was hampered by the fact that the logical strategic buyers both present in Brazil, Spain's Telefonica and Telecom Italia, were saddled with high debts, reeling from recession in Europe and unable to bid. Next on Vivendi's disposal agenda is its 53% stake in Maroc Telecom, which has a current market capitalization of nearly €1mm. This process appears to have better chances of success as there are currently three bidders for Vivendi's stake: Qatar Telecom, the United Arab Emirates' Etisalat and South Korea's KT Corp.

Economic Activity, Consumer and Business Conditions

US – The all important US consumer sector had a very strong showing in February, as the retail sales jumped 1.1% in the month, led by strong auto and gasoline sales. The core retail sales, which exclude auto related sales, also exceeded expectations, with robust rates of growth across the board, led by furniture and building materials categories. Somewhat surprising then, the University of Michigan's US consumer sentiment showed drop to a 71.8 index points level, well short of an expected improvement to a 78.0 index points level. The drag on the sentiment was the 'expectations' components, which might indicate consumers' worries related to the effects of the payroll tax increases and the automatic budget cuts. Consumer price inflation appears to be well behaved as the headline rate, at 2.0%, was just a tenth above the expectations, driven chiefly by a rebound in gasoline pricing, while the core rate inched higher to 2.0%, as expected.

On the US business activity side, the industrial production expanded a better than expected 0.7% in February, compared to a flat result in January, led by automotive products, business equipment and construction supplies. The capacity utilization, at 79.6%, was also ahead of the expectations, for a 79.3% level, and an improvement compared to January's 79.2%.

Less up-beat news than we've come to expect were issued by the National Association of Home Builders (NAHB), whose housing market index posted a 2 point retreat for March, a move in the opposite direction of the 1 point improvement factored in by the consensus expectations.

Canada – Canadian capacity utilization retreated in the fourth quarter of the last year to an 80.7% level, as expected.

The new housing price index continued to advance in January, albeit, at 0.1% improvement, a deceleration from December's 0.2% advance, in a sign that a soft landing of the Canadian housing market is not only possible, but it is likely happening.

Europe – Cypriot ministers were trying to revise a plan to seize money from bank deposits before a parliamentary vote on Tuesday that will secure the island's financial rescue or could lead to its default, with reverberations across the euro zone.

A weekend announcement that Cyprus would impose a tax on bank accounts as part of a €10Bn bailout by the European Union broke with previous practice that depositors' savings were sacrosanct. The euro and stock markets fell on concern the euro zone crisis was returning.

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 until the unemployment rate falls below 6.5% (February 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 1.68% and the U.K.'s 2 year/10 year treasury spread is 1.69% - meaning investment



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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 3.63% - (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 5

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 12.91 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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Market Commentary



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