



## News Highlights on Current Holdings

### Financial Services Companies

Allianz - Bloomberg report Allianz is close to buying Unicredit's Yapi Kredi Bankasi's insurance unit and pension business stake for almost €1bn. Yapi and KOC Holding may complete the sale in coming weeks.

BNP (Fortis) - announced they will close 150 branches in Belgium in the next 2 years and eliminate 1800 jobs, as part of a €300mn cost reduction plan, in a sign they are delivering on their cost reduction plan (€bn),

Berkshire Hathaway agrees to convert Goldman Sachs warrants to stock. On September 24, 2008, nine days post Lehman Brothers; Berkshire Hathaway invested \$5.0 billion in Goldman Sachs preferred stock with a 10% coupon. As part of the package Berkshire received warrants to buy 43.5 million shares of stock. The strike price on the warrants was \$115 with the Goldman Sachs shares trading at \$133 and the term was five years. Now Berkshire Hathaway has agreed to convert the warrants to common stock. The deal will be effective October 1. At the current \$146 stock price the intrinsic value of the warrants is \$1.3 billion which would convert to 9.2 million shares, or 2% of Goldman Sachs outstanding shares. The preferred was previously called in 2011 at a 10% premium. It's estimated the annual IRR of the preferred alone was 13%, but with the warrants it moves the annual return up to 18%.

Citigroup : The Federal Reserve has ordered Citigroup to better police for the risk of money laundering, part of a broad US regulatory crackdown on the potential for illicit money flows. The Fed told Citigroup's board to submit a plan within 60 days to improve its oversight of company-wide anti-money laundering compliance, according to a consent order dated March 21, but only made public on Tuesday.

UK Banks - The Financial Policy Committee of the Bank Of England yesterday announced that UK banks overstated their capital by £ 52bn but reduced to a level, below investors had feared, of £25bn taking existing capital buffers into consideration. The gap is

to be bridged by the end of 2013, though the £25bn is expected to be half that after related income, provisions and Risk Weighted Asset reduction plans. The Financial Times reports that after this RBS will need £6bn, Lloyds £3bn and Barclays below £2bn. Sir Mervyn King said it was not an immediate threat to the banking system. The UK's chief banking regulator, the Prudential Regulation Authority will now take several more weeks to identify individual capital positions, where the preliminary estimates could be changed substantially.

### Dividend Payers

Novartis – today lost the ruling to be able to patent its cancer drug, Glivec. Novartis believe this outcome will have repercussions for multinational drug companies' future activities in the country.

Monsanto – the maker of genetically engineered seeds and agricultural products, is aiming for a very strong second quarter as reported in today's Financial Times... which would bode well for Syngenta.

Toyota has published a progress report for its Toyota New Global Architecture (TNGA). TNGA is the basic architecture for making vehicles in a manner that reconciles improved product appeal with reduced costs towards the "Making Ever-Better Cars" drive due to take shape under the leadership of CEO Akio Toyoda. Alongside organizational reforms, Toyota also unveiled its Powertrain Development and Production Engineering Building (which will serve as the site for next-generation powertrain development), and its Aerodynamics Laboratory. Toyota is widely expected to change its mainstay front-mounted engine/front-wheel drive platforms, namely the K (Camry class), MC, (Corolla class), and NBC (Vitz class) platforms. This time Toyota announced plans to start adopting TNGA in new models from 2015. It is to change vehicles from the framework upwards, creating cars meant to appeal to customers' senses through a low center-of-gravity and attractive proportions. TNGA will build up an optimized overall architecture, allowing Toyota to (1) enhance basic functions, (2) use more common parts through grouped development, and (3) build a benign cycle of accelerating cost-reductions in collaboration with suppliers. We think



this will power an improvement in Toyota's international competitive strength.

## Economic Activity, Consumer and Business Conditions

The Euro's challenge to the international status of the US dollar has been set back as new deal data shows developing countries selling their official reserves, The Financial Times reports that Central Banks in developing countries sold Euro 45bn in 2012, according to data compiled by IMF, cutting their holdings by 8%.

Cyprus : as feared uninsured depositors at Bank of Cyprus may potentially end up with little current expectations are that their uninsured depositors may face 62.5% haircut with the remaining 37.5% deposits to be converted into new illiquid Bank of Cyprus equity. The massive flight of Russian and wealthy Cypriot deposits (despite official capital controls) automatically meant bigger losses than initial suggestions of -30-40% haircut on those without/unable to use back channel connections.

The U.S. manufacturing sector slipped from its highest level in 21 months in March. The 2.9% decline was more than expected and left the headline ISM at 51.3, the lowest level since December. New orders and production (i.e. future activity and current activity, respectively) took a sizeable drop to three- and six-month lows. However, ahead of the payroll report was some good news. Employment popped up to a 9-month high, fully erasing February's decline. And new export orders jumped for the second consecutive month. Overall, though, a greater sense of caution has probably permeated business investment owing to fiscal policy uncertainty along with the economic uncertainty posed by actual tax hikes and spending cuts. And this move is in-line with some of the other March PMIs seen around the world. Japan popped over the 50 mark for the first time since May, China's was at an 11-month high (the official measure), South Korea was at a 12-month high, and Brazil and India slowed but were still over 50. Then there were the preliminary estimates for Europe and the U.K. and they were still stuck below 50.

U.S. personal income and spending : the US consumer

steadied him/herself and boosted spending a solid 0.7% in February, better than expected and supported by a sizeable 1.1% jump in incomes. In real-terms, spending grew a larger-than-expected 0.3%, matching the prior month's gain and although we still have one month left to go in Q1, suggests that consumer spending grew over 3% annualized in the first quarter, which would be the largest increase in three years. Consumers were a little more watchful of what they spent, lifting their savings rate from 2.6% from 2.2% in January, still down from last year's average of 3.9%

## Financial Conditions

Canada : Last week, OSFI released an advisory that details its framework for dealing with Domestic Systemically Important Banks (D-SIBs). In line with expectations, all the big six Canadian banks, including National Bank, will be subject to a 1% increase in the Core Equity Tier 1 requirement (CET 1) to 8% from 7%. This is not a surprise given this is the lowest threshold for global systemically important banks (G-SIBs) and no Canadian bank was included in the current list of G-SIBs. In terms of implementation, OSFI stated the Canadian banks will have until January 1, 2016, to adhere to this requirement. However, this should not pose any difficulties for the Canadian banks given their CET 1 capital ratios already exceed 8%. National Bank is slightly below 8%; however, it's expect to hit the 8% target later this 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% (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 1.63% and the U.K.'s 2 year/10 year treasury spread is 1.56 % - 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 3.57% - (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 4.7 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 misrepresented 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 4 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 12.70 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](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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