Market Commentary

April 22, 2013

News Highlights on Current Holdings

Financial Services Companies

Axa - are cutting around 450 jobs in Axa UK, as it announced ceasing offering face to face financial planning advice in branches of its UK banking partners, the Co-Op, Clydesdale & Yorkshire banks.

Bank of America : reported Q1/2013 EPS of $0.20 compared to $0.03 last quarter and $0.03 a year ago. Earnings were slightly below consensus estimate of $0.22. Items of note in the quarter included litigation fees $812 million ($0.05/share), largely offset by reserve releases of $804 million ($0.05/share and DVA losses of $50 million (or $0.005/share). Adjusting for the above noted items core operating EPS was $0.21 per share.

Results driven by improved credit quality and stronger global wealth earnings, and solid capital markets, offset by weaker consumer & business banking and consumer real estate services income.

Sales and Trading revenue was $4.5 billion (excl. DVA), up 78% from the previous quarter but down 14% from a year earlier (drag coming from lower fixed income, down 20% YOY). Total investment banking fees were strong at $1.5 billion, up 19.8% from $1.3 billion last quarter and 58% from $1.0 billion a year earlier.

Reported net interest margin was 2.43%, up 0.08% QoQ and down 0.08% YoY. The Net Interest Margin benefitted from positive impacts from market-related premium amortization expense and the reduction in average long-term debt and deposit rates paid. Average total loans increased 1.5% QoQ to $906 billion and were down 0.8% from a year earlier. Average total deposits during the quarter were $1.08 trillion, down 0.3% QOQ and up 4.4% YoY. Expenses declined 4% y-o-y and increased 8% from 4Q12 (-5% ex. personal expense). As expected, results included $893mn of expense associated with retirement-eligible stock compensation costs. Excluding litigation costs, expenses in Legacy Assets & Servicing was $2.6bn, down from $3.1bn in the prior quarter. Bank of America expects total cost savings from Project New BAC to reach $8.0bn per year, or $2.0bn per quarter, by mid-2015. It expects to achieve $1.5bn in cost savings, per quarter, by 4Q13 (75% of quarterly target). Its effective tax rate was 28%, up from 22% in 4Q12.

Net charge-offs were $2.5 billion or 1.14% of loans compared to $3.1 billion or 1.40% of loans in the previous quarter and $4.1 billion or 1.80% of loans a year earlier. Reserve releases declined to $804 million from $900 million in the previous quarter and $1.6 billion a year ago.

Profitability in the quarter improved. Reported ROE was 4.2% compared to 0.7% in the previous quarter and 0.6% a year ago. Core Equity Tier 1 Capital Ratio under Basel III was up to 9.42% compared to 9.25% at the end of the previous quarter, well above the Basel II minimum requirement of 8.5%. Risk-weighted assets under Basel III at $1.39 trillion, down 0.2% QOQ.

Barclays has drawn a line under the former CEO Bob Diamond era, ejecting the last two senior executives from his period in charge, with the departures of Rich Ricci, head of investment banking, and Tom Kalaris, who ran wealth management. (Source Financial Times)

Citigroup: Reported Adjusted EPS of $1.29, up 15.9% YOY – ahead of expectations. Earnings Driven By Strong Results From Global Consumer Banking (Return On Equity: 29%) and Securities & Banking ROE: 22%). Strong Capital Markets Revenue, Lower Credit Costs and Expenses, and a lower drag from Citi Holdings contributed to earnings Improvement. Citicorp Earnings Up 7% YOY to $4.8B. Securities and Banking Earnings Up 17% YOY; North American Consumer Banking Earnings Up 17% YOY. Relative to 4Q12, results evidenced modest balance sheet contraction, a relatively stable Net Interest Margin (+1bp), a jump in fee income (driven by trading), lower core expenses (-1%), a lower loan loss provision (-$0.6bn to $2.3bn) as Non Performing Assets (-9%) and Non Conforming Obligations (-3%) both continued to improve, a higher tax rate, and a higher average share count (+1%).

Citi's Basel III Core Equity Tier 1 Ratio improved to 9.3%, Up From 8.7% in Q4/12. Its capital Position Continues to Benefit from Improving Earnings, Lower Risk Weighted

Assets, Citi Holdings wind down and part-utilization of DTA (deferred tax allowances) this quarter. Its estimated, full utilization of DTA would add 4.6% bps to Core Equity Tier 1, Citi Holdings wind down would add 2.8% – i.e. a potential boost of 7.4% to Core Equity Tier 1 to 16.7%. Return on Tangible Common Equity is: 9.8% .

This quarter evidenced the beginnings of two long awaited trends, including a reserve release related to North American mortgages ($375mn) and DTA utilization ($700mn), albeit both by modest amounts. Additionally, assets in Citi Holdings continued to decline (-$7bn), Citi Holdings losses narrowed ($0.8bn vs. $1.0bn in 4Q), core expenses declined (-1%, with further reductions expected) and capital was built faster than anticipated (Basel III Core Equity Tier 1 Capital +60bps to 9.3%). Tangible book approx $54.

ING - announced in a regulatory filing late yesterday the price range and size of the offering for the proposed IPO of its US insurance unit. The IPO will consist of both a primary component offered by ING US and a secondary component offered by ING Group, both at a currently estimated price range of $21.00 to $24.00 per share for 64.2mn shares. Based on this, the total offering would be $1.4-$1.5bn. ING will own 75% of ING US after the IPO. At the midpoint of the range, ING US's market value would be about $5.78bn, according to data compiled by Bloomberg. The IPO is expected to price on 1st May.

Lloyds Banking Group, the UK's biggest mortgage lender, is considering selling Scottish Widows Investment Partnership, the asset manager, in an effort to increase capital. This is the asset management business and not the life assurer, so it is not a game changer. As such, it should be divorced from the Danish Compromise debate, ie, it would only be the gain on sale which would flow through to capital. Profitability of this unit is no longer disclosed, it has a rough valuation of ~£600-800mn which, if sold, would generate ~0.20-0.25% of capital.

UBS - has poached one of the highest profile natural resources bankers in the City of London from Nomura, the Financial Times reported. He will start in June as head of corporate client solutions in EMEA (Europe, Middle East , Africa) . The move comes as UBS attempt to attract top talent whilst shrinking the fixed income unit.

Dividend Payers

Bayer – and Monsanto have signed a series of cross-licensing deals to share certain crop biotechnology for weed and pest control. Monsanto will provide Bayer CropScience, a subsidiary of Bayer AG, with a royalty-bearing license to herbicide-tolerant soybean technology known as Genuity Roundup Ready 2 Yield and Genuity Roundup Ready 2 Xtend technology in the United States and Canada. Bayer CropScience will also receive a royalty-bearing license to use Monsanto's Intacta RR2 PRO, an insect-protected soybean, in Brazil. Bayer CropScience will be able to stack the genetic traits with other traits in the crops it develops under certain conditions. In return, Bayer CropScience will grant Monsanto licenses to evaluate some of its own technologies for controlling corn rootworm pests and for making crops that are herbicide tolerant. Financial terms of the deals were not disclosed.

BHP Billiton – Andrew Mackenzie, the group's new CEO announced a number of changes in the structure and composition of the top management team, effectively removing executives earlier overlooked for his job and stripping a layer of top managers. The surprise departure was that of Michael Yeager, the head of the petroleum business, who is set to leave the company next month. Yeager will be replaced by Tim Cutt, who will also lead BHP's nascent potash business. Alberto Calderon, who was also seen as a candidate for the top job, will leave the group's management committee but will remain as an adviser to Mackenzie until 2014. Marcus Randolph, the head of BHP's ferrous (i.e. iron ore and manganese) and coal businesses, will leave the management committee on May 10. His role has been eliminated and Jimmy Wilson and Dean Dalla Valle, the heads of iron ore and coal divisions respectively, will report directly to the CEO. Chief financial officer Graham Kerr remains on the management committee, which is expected to ensure a good balance of existing and new team members.

In a separate announcement, BHP updated on production for the third quarter of its fiscal year, highlighting a 15% increase in oil and gas liquids production, to 5mm barrels, as its focus on US onshore oil drilling is starting to pay off.

The group said it will spend 80% of its $4Bn US onshore development budget on the Eagle Ford and Permian shale assets, its biggest liquids-producing holdings. BHP also stuck to its full-year production guidance for its major businesses, with an increase in its iron ore production of roughly 6%, to 40.2mm tonnes, in spite of the effects of the bad weather. Iron ore production rates were close to 200mm tonnes a year, with fiscal 2013 (ending June 2013) output target maintained at 183mm tonnes. Production of coking coal and thermal coal however suffered because of flooding. Meanwhile, production of copper concentrate at the BHP majority-owned Escondida, the largest copper mine in the world, rose by 61% in the nine months ending March 31 and is on track to increase by at least 20% during the 2013 fiscal year.

Carnival Corp – Carnival Cruise Lines plans to spend $300mm to improve emergency power and fire safety mechanisms following a series of mishaps that curtailed cruises in the recent months. The cruise operator, owned by Carnival Corp, said the upgrades would improve back-up systems across its 24-ship fleet.

GEA Group – the German engineering group focused on food and farm technologies, reported a roughly 6% reduction in the order intake, when it announced first quarter results in Frankfurt last week. The prior year figure was boosted by a major order. The 2013 outlook is for moderate revenue growth relative to the high levels of 2012. The group targets €700mm in earnings before interest, tax, depreciation and amortization (EBITDA) for the fiscal 2013, a €100mm improvement on 2012 EBITDA level.

Nestle - first quarter sales growth was 4.3%, lower than expected, after some retailers in Asia cut inventories back to match poor demand, and the destruction of a key Middle East factory in Syria slowed supplies. Sales at the world's largest food company rose 4.3 percent to CHF21.9Bn, below the average estimate of CHF22.6Bn. In Europe, a cold spring hit consumption of bottled water and ice-cream, while a horse meat scandal and pizza and chocolate egg recalls in the region turned off consumers already affected by living in austere conditions. Sales growth in Asia, Oceania (Australia and New Zealand) and Africa (AOA) slowed to 4.4% overall, from 8.4% in full-year 2012. They were slowed further by shortages in Nido milk powder, Maggi bouillons and Crelac infant cereals after a mortar shell destroyed a major production plant in Syria. India and Philippines had a slow start to the year, while China slowed as well, yet still growing at a double-digit pace. The company said consumer sentiment remained subdued in Europe, where volume growth was partly offset by falling prices. Sales in the region grew 1.5% to €3.7Bn francs. Business in North America is improving as the pizza category returned to growth and soluble coffee brand Nescafe performed well, the group said. Overall sales in the Americas increased 5.3% to €6.6Bn francs. The group CFO confirmed Nestle aimes to increase its dividend each year.

In a separate announcement, Mexico's Federal Competition Commission, which in November of last year rejected Nestle's acquisition of Pfizer's baby food assets on the basis it would give Nestle too much power in the baby foods market, said the Swiss company must sell the assets of Pfizer's baby food business in Mexico. Nestle acquired the global baby food business of Pfizer of $11.85Bn last year. Nestle hired Rothschild in January to help the company sell Latin American assets valued at over $1Bn, as part of its drive to win regulatory approval for its purchase of the Pfizer unit.

Schindler Holding – one of the world's leading elevator and escalator companies, reported robust results for the first quarter of its fiscal year and showed high confidence in the future order growth during its results announcement last week. Orders grew by 7.5% in local currencies in the first quarter, a pace which the company expects to be able to maintain going forward. Growth has been driven by orders in China, in particular top range elevators and escalators, with the benefits of the company's acquisition of a key local player in the affordable housing space expected to play out later on. The company's order backlog increased by 7.9%, while sales improved by 4.2% in local currencies. The company re-iterated its target sales growth of 6% and net profit of CHF740mm to CHF790mm for the full year.

Syngenta – reported first quarter sales in Zurich last week and said it expects farmers to continue to invest in products to boost agricultural output, despite a recent pull-back in commodity prices. The Swiss company, the world's largest agricultural inputs providers, including crop protection products and high productivity seeds, reported a 6% increase in sales in the first quarter, to $4.57Bn, on the back of a strong end to the Latin American planting season. Mike Mack, the company CEO, said he was confident the company remained on track to achieve its long-term sales growth target of 8% a year, despite cold weather across Europe and North America delaying the start of the planting season this year. The company also said it expected the impact of currencies and raw materials to be neutral this year.

Tesco reported full-year earnings, missing Consensus Trading Profit expectations by 2%, almost entirely due to a miss in Europe, while UK was a touch ahead and Asia in line. Tesco's new Capex plan with a target of 3.5% to 4.0% of Sales implies capex for 2013/14 between £2.4bn and £2.7bn, a cut from the 2012/13 level of £3bn. UK Trading profit was £2,272mn, in line with expectation and a touch ahead of Consensus at £2,256mn. Trading profit margin was 5.2%, a touch ahead of Consensus. Furthermore, Tesco said this is a sustainable level of margin for the foreseeable future. Europe at £329mn, was a big miss versus consensus of £406mn. Tesco refers to particularly poor trading in Turkey and losses there as the primary reason for the miss in the trading profit in Europe. Tesco points to a year-over-year positive impact coming in the current year of £30mn from the lack of Hungarian crisis tax. A material cut in planned square footage in Europe -- 0.4mn sqft in 13/14 vs 1.8mn sqft in 12/13 -- points that not much recovery is likely in Europe in the near term. Asian trading profits of £661mn was in line with consensus at £658mn. Korean impact was broadly in line with £100mn guided. In the USA a trading loss of £169mn was worse than expectations of £134mn and an exit at £1bn in terms of write-down of assets.

Tesco wrote down £804mn UK property pipeline as they have identified more than 100 sites on which they no longer plan to build. Tesco is now guiding for 3.5% to 4.0% capex on an ongoing basis, which puts Capex at £2.4bn to £2.7bn this year vs last year's level of £3bn. This capex discipline and focus on cash flows should mean a 5% to 10% head room on balance sheet to buy back stock next year. Tesco is guiding for a mid-single-digit trading profit growth - which seems to be in line with Consensus trading profit growth expectations of 5%-7% over the next couple of years. Tesco expects to deliver ROCE of now 12% - 15% as they target generating positive free cash flows.

Toyota – has reportedly been offered $146.5mm worth of tax breaks from the state of Kentucky to add production capacity at its Georgetown plant where the Lexus ES will be built starting in 2015. Besides the pecuniary benefit, such a move would also improve Toyota's manufacturing footprint, still heavily overweight towards Japan.

Wesfarmers – presented a retail trading update last week, with the key Coles supermarkets posting improved quarterly results, driven by strong volume and competitive grocery prices. Comparable food and liquor sales at Coles, representing some 50% of the company's revenues, rose 5.3% in the fiscal third quarter compared to a year earlier. The result exceeded a 3.8% increase at the rival Woolworths. Coles opened four new supermarkets and closed three supermarkets during the quarter, talking the total number of supermarkets to 754. Comparable sales at Bunnings, the group's home improvement business, were up 4.0%, while sales at Target, Wesfarmers' department store business, grew by 1.9%. Kmart sales were up 3.0%.

Economic Activity, Consumer and Business Conditions

The IMF has cut its world growth forecast for 2013 as the eurozone recession continues to drag, but predicts growth overall will pick up in the second half of the year. In its newest assessment of the global economy, the International Monetary Fund said world output would expand by 3.3 % this year, compared to the 3.5% it predicted in January but kept the 2014 forecast at 4%.

Canada – Consumer price inflation for March slowed down to a 1.0% year on year rate, from February's 1.2% rate, dragged down by food prices, as well as a reduction in auto related prices. The reading was marginally lower than the expected 1.1% annualized rate. The core reading of inflation, which removes the effects of eight most volatile price series, fell in-line with the expectations and the prior month's reading, at a 1.4% year on year rate of change. Numbers such as this, coupled with tepid economic growth provide, we believe, little ammunition for the interest rate hawks.

U.S. housing starts exceeded expectations in March, surging 7.0% in the month to 1,036k units. (Gains were across the country except in the Northeast….possibly due to snowstorms in the region at the beginning and the end of the month) This is the first time starts broke the 1 million unit mark since 2008 and comes on the back of a big upward revision to February. (February's starts were revised up over 5½% to 968,000 units, all due to single starts, originally reported at 618k, now showing up as 650k.) In March, single starts gave back all of the prior month's gains (-4.8% to 619k) but multi-unit construction carried the day with a 31.1% jump to 417k, the highest since 2006. Conversely, building permits, which are future starts (need a permit before one can break ground), fell 3.9% to 902k units annualized and, along with the three monthly declines in homebuilder sentiment, suggest that we should see some easing in activity in the near term.

US Industrial production : The coldest March in seven years helped give a larger-than-expected boost to U.S. output. U.S. industrial production jumped 0.4% (there was also an upward revision to February), with the upside surprise coming from the 5.3% spike in utilities, which is always a wildcard. But it wasn't just utilities that lifted output. Another surprise came from manufacturing, which only slipped 0.1% despite a sizeable decline in hours worked in that sector during the same month. Consumer goods—durable and non-durable climbed 1.1%, the 2nd straight month of gains. And business equipment edged up 0.1%, also the 2nd increase in a row, although this was centered on transportation equipment. For all of Q1, total industrial production as well as manufacturing are both up over 5% annualized, the best reading in over a year.

UK : Britain's unemployment rate rose in February and pay excluding bonuses posted the smallest increase on record, suggesting that cracks are starting to show in the so far surprisingly resilient labor market. The Office for National Statistics said that the main jobless rate rose to 7.9% in the three months ending in February - the highest rate since the three months to August 2012, when it was also 7.9%. (Source : Reuters)

UK : credit rating cut to AA+ from AAA by Fitch, with a stable outlook, this matches Moody's downgrade back on Feb 22. Standard & Poor's is still at AAA.

Greece - Reuters reported last week that Greece received a clean bill of health from the Troika (ECB/IMF/EC) yesterday and is on track to receive its next aid tranche of at least €2.8bn which should be approved soon. "Greece has identified some 15,000 public-sector workers to be let go over two years as part of a tentative agreement sealed Monday with its international lenders to unlock the next payments from its €173bn bailout." Finance minister Yannis Stournaras said Greece may ask for more debt relief.

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% (March 7.6%) 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 1.47% and the U.K.'s 2 year/10 year treasury spread is 1.43 % - 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 3.41% - (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 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 14 – 20 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 8 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 15.07and 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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