Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

BBVA said it would lose €35mn in net profit in June, after a court forced it and other banks to change some mortgage structures which protected them against interest rate drops. BBVA said the impact of the changes beyond June, when they come into effect, would depend on the movements of Euribor.

BNP – last week, BNP Paribas Bank Polska announced plans to sell as many as 8.58mn shares "in the middle of 2013". This to meet the financial regulator's requirement to increase its freefloat on the Warsaw Stock Exchange to 15%

ING announced after the close on Friday that it has reached an agreement to sell its Mexican mortgage business, ING Hipotecaria, to Santander for 643mn Pesos. The transaction is small and is not share price sensitive. Expected to close in 2nd Half 2013.

JPMorgan Chase's Chief Risk Officer, John Hogan, is being replaced by his deputy, Ashley Bacon, a British executive who was drafted in to clean up after the London Whale trading debacle.

Legal and General - Legal & General has appointed Mark Gregory as CFO with effect from July 1. He is currently CEO of Savings business.

Lloyds Bank / Royal Bank of Canada: : The Wall Street Journal reported last week that Royal Bank of Canada has emerged as a potential bidder for Scottish Widows Investment Partnership (SWIP) , the asset management arm of insurance group Scottish Widows, owned by Lloyds Banking Group, according to three sources familiar to the situation. It is unclear how far the acquisition process has progressed. SWIP manages a range of assets including equities, bonds and property. The future ownership of SWIP, which primarily manages money on behalf of Scottish Widows, has been the subject of speculation for some time. Deutsche Bank has been advising Lloyds Banking Group since 2009 on the future of the asset management business. Recently, media speculation over the future of SWIP stepped up a gear, tipping as a possible bidder, Ameriprise Financial, owner of U.K. asset manager Threadneedle Investments, according to a report in The Times. Both Aberdeen Asset Management and L&G have ruled themselves out of bidding for SWIP.

Nordea announced after market close last Wednesday that in order to meet its financial targets the bank has decided to divest its Polish banking, financing and life insurance operations to PKO for €694mn. The transaction is expected to lead to a minor capital gain and profit and loss effect. In addition, it has a positive impact on the Core Tier 1 capital ratio of approximately 0.5%, of which approximately half is expected to be realised immediately on closing of the transaction, according to the company statement.

Royal Bank of Scotland - A company statement last night announced CEO Stephen Hester is stepping down. "The Board believes that an orderly succession process will give a new CEO time to prepare the privatisation process and to lead the bank in the years that follow. Stephen was unable to make that open-ended commitment following five years in the job already". It was always the expectation that Stephen Hester would leave after the 5 year restructuring, so in principal not a huge surprise but a bit earlier than expected. He will leave in December 2013, so again nothing untoward. Given some speculation of a good bank/bad bank recommendation from the Parliamentary Commission on Banking Standards report (due Friday), there could be some speculation that he has been given a heads up, but this seems a fairly straight forward announcement. Nevertheless, he is well liked and it will be hard to find a replacement that could have handled the government involvement he endured. The Financial Times reports further cut backs in the investment bank are due this week, with up to 2,000 of the 11,300 investment banking jobs to go. They conclude that there may also be a further attempt to sell more non performing businesses, particularly Ulster Bank. The Financial Times says Standard Chartered Finance Director Richard Meddings is among those being approached with Nathan Bostock, newly appointed finance director, Rory Cullinan, currently heading winding down the bank's non-core portfolio, or retail boss Ross McEwan seen as the most likely internal candidates.

Santander - CFO Jose Antonio Alvarez says he sees provisions normalising over the next 24 months after its real-estate provisioning effort completed in Spain. Santander is to work over next 3 years to normalize profitability, Alvarez says. His comments were in a presentation at Goldman Sachs conference and posted on the bank's website last Thursday.

Dividend Payers

ABB – has named one of its top managers as its new chief executive, following the surprise resignation of CEO Joe Hogan last month. Ulrich Spiesshofer will take the helm at the world's biggest supplier of industrial motors and power grids on Sept. 15.

Spiesshofer had already been reported to be the favoured internal candidate to lead ABB, which operates in about 100 countries and has 145,000 employees. Kasper Rorsted, CEO of German consumer goods company Henkel, was also seen as a strong contender. Hogan, who spent nearly five years as CEO and said he was resigning for personal reasons, will continue as a senior adviser to the board for some months, ABB said. Spiesshofer currently heads ABB's discrete automation and motion (DAM) arm, which makes motors, generators and robotics, and this year boosted its presence in renewable energy with the $1 billion purchase of U.S. company Power-One Inc. German national Spiesshofer has led DAM since 2009 and is credited with doubling the division's revenues through organic sales growth and acquisitions, and with improved performance and profitability at its robotics unit. He also managed the integration of Baldor Electronic, the biggest acquisition in ABB's history - bought for $4.2 billion in 2010 as the company sought to boost its presence in the United States.

BHP Billiton – Global miner BHP Billiton has received approval to build a $400 million gas-fired power plant in northern Chile, a local media report said on Saturday. BHP Billiton, which owns Escondida, the world's largest copper mine, had in November submitted a revised proposal for the plant, which originally would have burned coal. Pablo Toloza of the regional government of Antofagasta told La Tercera newspaper the new project would have lower emissions and be more environmentally friendly. The project in Chile, which needs to ramp up energy output for its fast-growing economy even as many proposed projects face tougher reviews, would have generation capacity of up to 540 megawatts.

Barrick Gold – says it will take until December of next year to build the water infrastructure needed to meet Chilean environmental requirements for the miner to restart its $8.5 billion Pascua-Lama gold project, high in the Andes Mountains. These estimates are subject to review by Chilean regulatory authorities.

Mondelez International, the world's second-biggest coffee maker, is going head to head with larger rival Nestle by launching capsules compatible with its Nespresso system. The capsules will be sold under the Jacobs and Carte Noire brands in Germany, France, Austria and Switzerland in the second half of the year - the biggest challenge yet for the $4.4 billion Nespresso brand that has sued many copycats.

Nespresso has been Nestle's fastest-growing brand in recent years, with its recipe for success based on relatively cheap machines and costly coffee capsules, available only online or in exclusive boutiques, prompting rivals to launch cheaper copycat pods through traditional retailers. Nestle has sued rivals including D.E. Master Blenders, Ethical Coffee Co and Swiss supermarket chains Migros and Denner, but so far it has failed to obtain a definite sales ban on their products. It nevertheless confirmed Nespresso was aiming to grow sales by around half a billion francs in 2013. The snacks powerhouse, carved out of Kraft Foods Inc last year, makes Cadbury's chocolate and Oreo cookies, but 17 percent of its turnover comes from coffee and powdered drinks. Mondelez' Tassimo machine competes with Nestle's Dolce Gusto drinks maker, D.E. Master Blenders' Senseo and the Keurig brewer made by Green Mountain Coffee Roasters Inc. The company does not see economic weakness throughout Europe as an obstacle to success, saying that it has pushed people to drink more coffee at home.

Nippon Telegraph and Telephone (NTT) – one the world's largest global IT and telecommunications services company, and Solutionary, a leading pure-play Managed Security Services Provider, today announced the two companies have entered into a definitive agreement for NTT to acquire Solutionary, a privately held company based in Omaha, Nebraska, in an all-cash transaction. The acquisition is subject to regulatory approvals and other customary closing conditions and is expected to close in the third quarter of 2013.

NTT continues its global expansion with revenues exceeding $107 billion and operating with 227,150 employees across 69 countries. With a strategic focus on cloud services, NTT is providing its clients solutions spanning a variety of cloud service and delivery models through group companies Dimension Data, NTT Communications and NTT DATA. NTT continues to aggressively expand its security capabilities to become one of the world's largest security integrators. NTT is currently providing services to over 50 countries through its cutting-edge R&D, world-class communications carrier Computer Security Incident Response Team.

Solutionary, incorporated in 2000, is the leading pure-play Managed Security Services Provider in North America. With a focus on managed security services and security consulting service, Solutionary protects traditional and virtual IT infrastructures, applications, networks, cloud and mobile environments. Built on the patented, cloud-based ActiveGuard(R) services platform, global threat intelligence, certified information security experts and the Security Engineering Research Team (SERT), Solutionary services are delivered 24/7 through multiple state-of-the-art Security Operations Centers (SOCs). Solutionary offers its services to over 600 clients in a wide range of industries such as financial services and healthcare.

Rio Tinto - Japanese trading house Marubeni Corp is reportedly bidding for a 29% stake in Anglo-Australian miner Rio Tinto's Coal & Allied unit, valued at an estimated $2 billion. It will be up against China's state-owned Shenhua Group Corp Ltd, India's Aditya Birla Group and Coal India, which are also eying bids for the stake in Coal & Allied and the Clermont mine that Rio has put up for sale.

Barry Callebaut AG announced last Thursday the successful pricing of USD 400 million 5.5% senior notes due 2023 (the "Notes") with estimated gross proceeds totalling USD 392.5 million. The remaining amount will be financed through the partial funding of an existing bridge loan. The proceeds of the offering will be used to fund a portion of the consideration in respect of the previously announced acquisition of the Cocoa Ingredients Division of Petra Foods for USD 950 million (subject to customary closing adjustments).In light of the volatility in the debt markets and the pricing of the bonds at a coupon higher than expected, the Company decided to reduce the amount from USD 600 million to USD 400 million. The Notes are unsecured and rank pari passu with the existing revolving credit facility and the existing notes.

Barry Callebaut, also successfully priced its offering of new shares last week at CHF 875 per share. Barry Callebaut placed the new shares via an accelerated book-build procedure by way of a private placement in Switzerland and outside of Switzerland in accordance with applicable securities laws. Barry Callebaut will issue 318,858 new registered shares resulting in gross proceeds for the Company of CHF 279 million. Barry Callebaut's nominal share capital is expected to be increased by 6.2% to CHF 102,092,758.80. The proceeds from the share placement are intended to partly finance the acquisition of the Cocoa Ingredients Division from Petra Foods, Singapore as announced on December 12, 2012. Jacobs Holding AG, the majority shareholder of Barry Callebaut AG, has purchased 159,790 new shares at the book-building price of the share offering and has agreed to a lock-up period starting today and ending 180 days following the settlement date. Credit Suisse acted as Sole Bookrunner and Joint Lead Manager.

Economic Activity, Consumer and Business Conditions

United States –US retail sales were more robust than expected for the month of May, up 0.6% relative to the consensus call for a 0.4% advance. The improvement was driven by strong auto sales, up 1.9% in the month. Retail sales excluding autos were up by 0.3%, as expected. Building and garden equipment, as well as grocery sales led the non-auto categories advance, while sales of furniture, electronics and clothing actually retreated in the month. The consumer sentiment, as measured by the University of Michigan, surprisingly dropped in June, to 82.7 index points, dragged lower by the 'current conditions' component sub-index, while the 'future expectations' component actually surprised on the upside.

Key report of the US business activity, the industrial production report was underwhelming for the month of May, recording a flat reading against the expected 0.2% improvement. The culprit was the utilities sector, while most other, including mining and manufacturing improved slightly. The flat result though comes on the back of a poor showing for April, when US industrial production retreated by 0.4%. US capacity utilization moved one notch lower to 77.6%, which compares unfavourably with the expected 77.9% level.

Canada – The New Housing Price Index surprised on the upside in April, with a 0.2% advance, which, together with earlier very strong housing starts and building permits reports does little in the way of underlying a much desired cooling off of the Canadian housing market.

On the Canadian business activity front, the April manufacturing sales dropped an unexpected -2.4% (expectations had been for a 0.3% improvement). Sales of autos and petroleum products were to blame for the retreat. Canadian capacity utilization improved to 81.1% for the first quarter of the year, from 80.5% in the last quarter of 2012, albeit short of the expected 81.5% level.

Financial Conditions

The Bank of Japan kept the policy rate unchanged in last week's meeting. Many were disappointed as the BOJ refrained from adding any new measures to stimulate growth or ease market volatility. The BOJ upgraded its assessment of the economy saying Japan's GDP grew at a 4.1% annualized pace and said it will keep its monetary base at 60-70 Trillion JPY (60-70 Billion USD). No mention though of helping the volatile Japanese Yen bond markets either.

ECB deposits – The Financial Times reports last Friday that the drop in ECB overnight deposits (to €72bn vs €103bn) is seen as positive, as the facility fell to its lowest point since November 2011, shrinking the ECB balance sheet, despite the recession grinding on. The last sharp fall in the use of the deposit facility came last July when the ECB cut its overnight deposit interest rate to zero from 0.25%. That led to a drop in the amount kept on deposit from more than €800bn to €324bn.

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% (May 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 1.87% and the U.K.'s 2 year/10 year treasury spread is 1.67 % - 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 3.98% - (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 16 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 17.15 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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