Market Commentary

PORTLAND INVESTMENT COUNSEL™

June 6, 2010

Recirculation of shares in European Premium Dividend Fund (EPD.UN):

- **The EPD.UN** fund is undergoing its annual redemption privilege. This creates an opportunity for those wishing to increase their stake in this fund via the resale of those units which have been tendered for redemption. As outlined in the prospectus we have entered into a recirculation agreement whereby CIBC as the recirculation agent uses commercially reasonable efforts to find purchasers at a price which is not less than the prescribed redemption price (including the deduction for the redemption fee of $0.45) to be paid to the redeeming unitholders. In practice this means that for 1 or 2 days CIBC (broker code 79) will, on the fund's behalf, be offering to sell units. During this period there will therefore likely be considerably more liquidity in the shares enabling larger purchase orders to be filled…. which I understand is a challenge during other trading periods. We intend to commence this recirculation opportunity next week – however as soon as CIBC have physically traded a sale then the recirculation 'window' will close at latest the day after.
- If you are interested in purchasing shares over this period we have attached the most recent client friendly fund brief.

News Highlights on Current Holdings

Financial Services Companies

- **Prudential:** Confirms that the deal to buy AIA is to be terminated. Costs related to the attempted transaction are stated to be about £450mln (3% mkt. cap), including £152.6m break-up fee, after the net costs of the currency hedge. The cost of the currency hedge is surprising given the £ has fallen 2% since the deal was announced and reflects the transaction costs on this hedge. CEO and Chairman remain committed to the company but in our view their position looks awkward, particularly given the costs of the aborted deal represent about one third of 2009's operating profit. Investment case now reverts to the possibilities of a break up scenario (with values of £7-£9.50 mentioned by analysts) and should AIA successfully IPO later this year, early next then it remains possible that AIA in turn will bid for all or parts of Prudential. In our view the unintended consequence of Prudential's bid is that it underscores the premium investors are willing to pay for Asian lifeco franchises – with integration risks and a high price being the combined hurdle Prudential were not able to overcome.
- **Banco Santander** (according to the local press – Expansion) is considering selling its insurance business, which it valued at €4bn ($4.9 billion) in 2008. The bank could either sell the unit or seek a strategic partnership, and a formal sale process has not yet started, the newspaper said.
- **Santander:** Press reports are that National Australia Bank has dropped out of the running for Royal Bank of Scotland's 318 UK branch network sale and Santander is now the lead bidder. The sale is expected to garner GBP 2bn for RBS. The deal involves about £18bn Risk Weighted Assets and £1.5bn book value so goodwill would be £200-500mn…. capital requirement for Santander about 0.35% from current capital ratios of 8.75% core T1 and 10.2% T1.
- In fact the deal could be financed from internal resources given capital ratios and dividend flexibility. Santander's shareholder base is >1/3 retail and Santander offered shareholders the option to take shares in lieu of cash for one interim dividend in 2009. Given the tax advantages of taking shares, retail takeup was >80% (74mm shares issued which equated to 600mm capital raise). For 2010, Santander offering shareholders stock in lieu of cash for two interim dividends (implies 1.2bn capital raise assuming similar takeup).
- **AXA CEO De Castries** said there's no reason to be worried about the solvency of European states despite company exposure of government bond exposure of EUR5.2 billion for Italy, €3.8bn for Spain, €800mn for Portugal and €500mn for Greece. In addition, he is looking at PRU- AIA deal failure with a lot of prudence.
- **Barclays** - Cash offer for all shares in Tricorona AB, a Stockholm listed carbon-credits trader developer, "specialising in the sourcing, development and trading of Certified Emission Reductions from greenhouse gas reduction projects in developing countries". Total consideration £98mn (SEK 1,130mn), and is equivalent to a 40% premium to the listed close price. Transaction due to close in Q3. Expected to be earnings accretive within a year. No material impact to core capital
- **Barclays** is selling a 50% in its French life unit Barclays Vie, daily La Tribune reported, citing unidentified people. Axa SA and CNP Assurances SA are favorites to buy the stake, which may be worth about €65m, according to the newspaper.
- **Barclays**: Reuters report over last weekend that Barclays has announced to sell HomEq Servicing (its US mortgage servicing business) to Ocwen Loan Servicing (a subsidiary of Ocwen Financial)for approximately USD 1.3bn. This will be paid in cash along with an agreed USD 1.0bn in secured financing (subject to special conditions) and expected to occur in 3Q10.
- **National Australia Bank/AXA:** Axa Asia Pacific Holdings has given National Australia Bank 6 more weeks (until 15th July) on its exclusivitiy arrangement as NAB tries to acquire

AAPH's Australian wealth-management and life-insurance operations. The Australian Competition and Consumer Commission blocked the deal on April 19th over concerns regarding the ownership of retail distribution platforms. NAB continues to try to seek a resolution with the regulator.

- **RBS/Lloyds** - Telegraph newspaper reported last week early sale of Govt's holdings in RBS (84%) & Lloyds (43%) could help Britain retain AAA rating. Cost of funding these they say is £3.2bn a year so & selling would stave off downgrade. Also would remove Govt implicit guarantee and therefore lift the sovereign borrowing cost. They argue the stakes cost around 8% of UK entire budget interest expense of around £40bn - currently points to a breaching of the 10% threshold required for a AAA rating by 2013. Selling stakes would lower the estimated ratio this year from 7.7% to 7.1% and delay a possible breach of 10% until at least 2014. Separately. RBS has announced plans for up to 500 more job losses. The cuts will be within its wealth management division and will affect back-office functions across the UK.
- **Spanish Banks:** In a tumultuous seven days, 12 of Spain's 45 savings banks have begun merger talks and a 13th has been rescued by the central bank.
- **Spain:** Fitch downgraded sovereign credit rating from AAA to AA+. At the same time it revised down the floor rating at BBVA and Santander from A+ to A.
- UK bank Northern Rock's existing mortgage portfolio that was separated from the core business at the start of this year is back in profit after declining loan impairments and lower costs have boosted its performance….in our view this bodes well for other UK banks.
- European Banks: ECB latest financial stability review outlines 2 years of steep loan losses for the banks sector (e.g. savings banks in Germany & Spain) and that they may face a further €195bn in write-offs, while also saying the sector's prospects are clouded with uncertainty.
- **Irish Banks:** there was further media speculation last week regarding Allied Irish Bank's (AIB) disposal of BZWBK, its polish subsidiary. According to a Polish media report in the "Gazeta Wyborcza", AIB gave the former head of Bank Pekao two weeks to form a consortium to purchase its stake. It suggests that the consortium of local Polish institutions may not necessarily outbid competing offers, however the group is likely to benefit from preferential regulatory treatment. Separately, the French newspaper "La Tribune" today reports that Societe Generale is still interested in AIB's stake, but that the bank may require a capital increase to support a potential purchase. It notes that BNP Paribas is among the favourites interested in bidding for BZWBK, with Banco Santander, BBVA, Intesa Sanpaolo and HSBC also mentioned as potential acquirers
- **ING Groep:** The largest Dutch financial- services company stated last week it bought back 2.08mn shares for an average of 6.33 euros apiece on June 1 and June 2 to cover stock options for employees
- **JPMorgan Chase London** unit was fined a record £33.3mn by Britain's financial regulator for not properly separating client money from the firm's accounts. The bank discovered the issue in July 2009 and received a discount for early settlement…. The Financial Securities Association's head of securities, David Pinto, commented that "while the error is regrettable, I am proud of the manner in which the firm has conducted itself since discovering it".
- **ASX Limited** has almost halved its main trade execution fees from 0.28 basis points to 0.15, in a clear show of force against potential new stock market entrant Chi-X.
- **BNP Paribas:** announced on June 3 that it will merge its two Turkish banking operations, TEB and Fortis Bank Turkey. The operation is expected to be concluded at the beginning of 2011. No details of the transactions were provided as two companies quoted on the local exchange are involved and the operation is subject to regulatory approval. We see the merger as a positive move.
- **HSBC Holdings PLC** said it will likely sell its private-equity fund-management businesses in Hong Kong, the U.K., the U.S., Canada and the Middle East to the respective management teams. The move to sell some of its fund-management business comes as banks around the world face regulatory changes that could include limits in ownership of hedge and private-equity funds or an increase in costs for holding such assets. The five private-equity businesses being bought out have about $8.8 billion in funds under management. About 20% are HSBC's own money. No financial terms of the deals were disclosed.
- **HSBC** also said Friday that it promoted its deputy CEO for China, Helen Wong, to chief executive of the bank's operations in the country. She succeeds Richard Yorke, whose next role will be announced in due course, the U.K. lender said in a statement, adding the appointment is subject to regulatory approval. Ms. Wong has more than 25 years of commercial and investment banking experience in Greater China and joined HSBC in 1992. She was appointed deputy chief executive for China in September and has led projects and new businesses that have supported the expansion of HSBC's capital markets franchise in Asia, the bank said. "China is a key focus of our emerging markets strategy and the growth engine of the global economy," HSBC Asia-

Pacific Chief Executive Peter Wong said in the statement. The banking giant's business in China has undergone a rapid expansion since Mr. Yorke's appointment as China chief executive in 2005. It now has 99 outlets across 23 cities in mainland China compared with fewer than 30 in mid-2006, a year before China fully opened its banking industry to overseas competition. The U.K. lender plans to add around 20 outlets in China this year.

- The bank is also working toward being one of mainland China's first foreign-listed companies to tap into the country's ample liquidity and help raise its profile there. We understand HSBC is planning to raise as much as US$5 billion via an initial public offering on the Shanghai Stock Exchange's international board when it is launched.
- Speaking before the US Congress's Financial Crisis Inquiry Commission Warren Buffett – the largest shareholder of Moody's – last week defended credit rating agencies for failing to spot the US mortgage bubble that sparked the financial crisis, stating: "The entire American public was caught up in a belief that housing prices could not fall dramatically."

Dividend Paying Companies

- **Johnson Matthey –** The company announced full year results slightly beating the expectations last week and presented an up-beat outlook for the current fiscal year. The company earned an underlying profit of 254.1 million GBP for the year ended March 31 2010, which was 5% lower than the one for the year ending March 31 2009, but higher than the £252 million consensus. Johnson Matthey has seen good sales momentum in the catalytic converters business for lighter vehicles as sales of such vehicles rebounded strongly all over the world and in particular in China. Sales of heavy duty vehicles, which constitute the core of the company's converter business, lagged, but are expected to pick up gradually.
- The outlook for the 2010/2011 year looks promising, with good sales momentum in the first half. The company expects underlying pretax profit to be significantly higher for the current half compared to the year earlier period. Johnson Matthey raised its dividend by 5% to 39 pence per share, which currently yields 2.6%.
- **NOVARTIS** announced last week that a Phase III study of Afinitor (everolimus) tablets plus best supportive care met its primary endpoint, showing the drug significantly extended progression-free survival, or time without tumor growth, in patients with advanced pancreatic neuroendocrine
- **Novartis**: According to latest data Novartis' Tasigna medicine is more effective at treating newly diagnosed leukemia than the company's best-selling cancer drug Gleevec. With Gleevec due to lose patent protection in 2015 the data is important for driving a switch of Novartis's leukemia treating franchise from Gleevec to Tasigna.
- A group of US experts is due to vote next week on whether Novartis' new oral multiple sclerosis drug, Gilenia, should be recommended for approval by the FDA. The drug has outperformed the alternative injectable medicines in trials, yet a number of side effects are likely to raise the panel's level of concern. Multiple sclerosis drugs are prone to showing side effects as their desired effect is in fact a weakening of the immune system. Novartis is hopeful that the experts would favorably assess the risk-reward profile of the innovative drug.
- **Dealogic** has provided a trading update saying that "despite a degree of uncertainty as to the outlook due to continued volatility in financial markets, trading for the current year remains in line with market expectations." It has also announced its intention to return up to £38.8m to shareholders via a tender offer at a price of 220p per share. To complete the tender offer, the company intends to use up to £19.4m in cash to purchase 8.8m shares (13.2% of Ordinary Shares) and the remainder via bank debt, provided it can be obtained (an announcement will be made on 14th June in this regard). If bank debt is obtained, the tender offer maximum is increased to 17.6m shares, or 26.4% of Ordinary Shares. This could put the company into a net debt position of around $10m. That is Net debt / EBITDA ratio of c.0.3x, very reasonable in our view, given the company's strong cash generation. Depending on the interest rates paid for their proposed facility, the full tender offer could be 20-25% accretive.
- **Siemens** – The European Commission is set to investigate a non-compete agreement between Siemens and Areva that prevents either of the two parties to compete in a number of nuclear power areas following the dissolution of their joint venture. Areva took control of the joint venture in which Siemens still has a 35% holding.
- **Siemens** would like to exit the joint venture and set up a new partnership with Rosatom, the Russian state nuclear company. Siemens' original proposal for exiting the joint venture was swapping its stake for an equity stake in the state owned Areva, which the French government opposed. Siemens would now like the European Commission to nullify the non-compete clause on the grounds of anticompetitive

behavior. As per Siemens estimates, each completed nuclear power could bring €1 billion of revenues to the German group.
- **Syngenta, Bayer –** The European Union announced that its Executive Commission would be given greater freedom to approve genetically modified (GM) varieties under a proposed set of legislation changes due to be adopted in July. In return, individual EU governments would have the freedom to decide whether or not to grow the varieties approved at the EU Commission level. Such a change would likely see an increase in the GM cultivated acreage in Europe, currently at only 100,000 hectares, compared to a total of 134 million hectares globally. The biotech industry, which is the producer of the GM seeds would see a boost in sales in important European markets. However, companies involved, including Monsanto, DuPont, Dow, Syngenta, Bayer and BASF are criticizing the proposals because of the legal uncertainty that would be introduced into the individual countries' approval process and because of the lack of scientific groundwork in making such decisions. Certain countries including Spain, Czech Republic, the Netherlands and Sweden are supportive of GM introduction, while others such as Italy, Hungary and Austria, oppose vehemently. The proposed set of changes would theoretically allow countries which are currently open to GM cultivation to change their mind and introduce a ban with no scientific justification, increasing the riskiness of business environment for the biotech industry across the continent.
- BHP Billiton, Wesfarmers – The negotiations between the mining industry and the Australian government are likely to be protracted and are unlikely to finalize ahead of the 2010 elections as per Kevin Rudd, the Australian prime minister. In a recent development, Xstrata announced the shelving of about US $600 million worth of expansion projects and threatened to scrap US $5.4 billion projects in coal and copper mining in Kevin Rudd's home state of Queensland.
- Deutsche Bank announced it forecasts thermal coal contract prices of roughly 120 USD per ton or 26% higher by 2012.

Economic Activity, Consumer and Business Conditions

- Hungarian Forint came under pressure last Friday due to the comments by new government spokesman Peter Szijjarto, "It's clear that the economy is in a very grave situation" "I don't think it's an exaggeration at all to talk about a default". Lajos Kosa, a deputy chairman of the first political Hungarian party, also indicated: "Hungary has a slim chance to avoid the Greek situation and the cabinet's primary objective is to avoid a default".
- The government comments look to be aimed at introducing a tighter fiscal policy rather than expressing a real concern regarding the possibility of a default. Hungary is expected to have a 2010 fiscal deficit of -5%, well below Greece. Also, its Debt/GDP is 79%, higher than other CEE countries but much lower than Greece.
- Last week's, comments (as above) from government officials comparing Hungary's debt problems with that of Greece stoked fears that the European debt problems were spreading. Now, it looks more like a new government fumbling on its communication rather than a new front of the debt crisis. Hungary this morning stated that it will keep to its 3.8% deficit target by cutting spending of 1.0-1.5% of GDP. EU officials following the G20 finance meetings in Korea called the possibility of sovereign default by Hungary as "wildly exaggerated". Hungary will publish its economic program in the next couple of days.
- Germany – German unemployment fell more than twice as much as economists forecast in May as exports from Europe's biggest economy surged, bolstering the recovery.
- Spain – The country's joblessness fell at its fastest pace in five years in May, with the number of unemployment benefit claimants at 4.06 million, down by 76,223 or 1.8% from April. On the flip side, the consumer confidence fell to 65.1 in May from 78.2 in April, as Spain is struggling with the prolonged effects of the worst recession in decades.
- US – US unemployment rate decreased one notch to 9.7% from 9.9% in May, not as the result of the job growth but rather as a result of a drop in the labour force. The non-farm payroll employment disappointed at 431,000 jobs added as 411,000 of them were temporary positions boosted by the US Census hiring. The private sector jobs grew only by 41,000 compared to the adjusted April number of 218,000. The job growth was supported by the manufacturing sector and held back by the construction and financial services sectors. The average duration of unemployment grew further at 34.4 weeks, while the average weekly hours grew marginally to 33.5 versus the expected 34.1. The average hourly rate growth was 0.2% month on month, but only 1.9% annual rate, significantly below the 2.9% growth a year ago. All in all a poor employment report which justifies the worries expressed earlier in the week by the Fed's Chairman and points towards a prolonged period of accommodating monetary policy.
- The Institute of Supply Management's (ISM) surveys issued

at the beginning of each month, showed continued strength in the manufacturing sector as the Purchasing Managers Index (PMI) reading at 59.7 is still close to historical highs and exceeded the expected 59.0 reading, while the non-manufacturing index remained flat at 55.4. Growth in the manufacturing sector remains broad based, with 16 of the 18 industries surveyed being net contributors.

- The US Pending Home Sales moved higher by 6% in April, largely as a result of the expiring tax credits. With the removal of the US home buying tax credits at the end of April, housing sales are expected to slow down. With the last few readings of the housing indicators showing significant improvement it remains to be seen whether the government intervention helped form a bottom in the market and the next few months should be relevant in this respect.
- Canada – The Ivey Purchasing Managers Index, the Canadian equivalent of the US manufacturing index issued by the Institute of Supply Management, moved higher for the month of May to 62.7, indicating that the robust recovery pace in the Canadian manufacturing is likely to continue. A significant surprise was the strong 5.4% monthly growth in Canadian building permits issued in April, as the consensus was calling for a 2% reduction following the 12.2% jump in March.

Financial Conditions

- Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.47% and the U.K.'s 2 year/10 year treasury spread is 2.68% - these spreads are narrowing and the US spread is at its slimmest since August 2009 but they are still historically wide - and are enabling financial services companies' assets booked at these levels, to be very profitable, so enabling them to accelerate the absorption of anticipated consumer credit losses.
- Our concerns are mostly focused around the later cycle issues facing financial services companies – particularly commercial real estate and unsecured consumer loans/credit card loans. However, commercial real estate exposure is more acutely held by US regional banks – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (81 to-date in 2010 and 140 in 2009) but their franchises are being acquired/absorbed as convergence of the financial services industry accelerates – favouring we believe the stronger, better managed banks. Typically banks acquiring collapsed bank franchises from the Federal Deposit Insurance Corporation (FDIC) are paying little or no premium for deposits, assets are purchased at a discount and are covered by loss sharing agreements – so that such deals can be expected to be immediately accretive to earnings per share. The FDIC changed the loss share arrangement on assisted deals from absorbing 95% of losses down to absorbing 80% although this is still attractive to acquiring banks it does probably lower the Internal Rate of Return.
- The U.S. 30 year mortgage market has remained low and has now fallen back to 4.79% % - the record low is 4.71% - as the Government and Fed continue to incentivize new home owners. U.S. housing inventory has reduced to 8.4 months supply of existing houses – but that is still higher than what we believe is a more normal range of 4-6 months. We believe it remains premature to consider a recovery in house prices but a measure of stability from which to build is welcomed…. particularly for those financial services companies holding such assets in their portfolios.
- A concern which remains is the extent to which loan modifications are an exercise in loss deferral but 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.
- The VIX (volatility index) is 34.85, which is below the levels experienced prior to the ECB bail out and substantially lower than last August/September. While, by its characteristics, the VIX will remain volatile, it is evident that increased tension in North & South Korea and Europe soverign debt concerns have increased risk aversion to the detriment of equities – we believe a VIX level below 25 augurs well for quality equities.
- We believe the next few years will highlight the growing polarization between strong and weak institutions. Companies that have capital strength will buy assets from those required to divest. Companies that have a strong presence in emerging markets will likely grow quicker than those that do not. Banks that have strong retail deposit franchises will take market share from those that rely on wholesale markets to fund loan growth at attractive margins. Financial services companies that have breached client trust will keep losing business to those reputations that have been enhanced by the crisis. We believe the Funds we manage are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

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PORTLAND INVESTMENT COUNSEL™

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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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