Market Commentary

PORTLAND INVESTMENT COUNSEL™

March 19, 2012

News Highlights on Current Holdings

Financial Services Companies

HSBC: Financial Times reports that HSBC may exit Asian retail banking businesses in Bangladesh, Brunei, Macau, New Zealand, Pakistan, the Philippines and Sri Lanka. All these are markets where HSBC is sub-scale (10-20 branches). Financial Times also mentions HSBC's Korea business which has been widely reported to be up for sale. In our opinion to exit low margin retail banking does not impair the value of HSBC's Commercial Banking franchise and would accelerate the restructuring potential to improve its cost structure."

Invesco reported February-ending Assets Under Management of \$667.6bn, up 3% month on month, and long-term Assets Under Management of \$592bn, up 3% month on month. The company announced that long-term flows were modestly positive in the quarter, and it is estimated that they may have been around +\$2bn, with most of the inflow from their active products, similar to January where +\$2-\$3bn of long-term inflow is estimated, with about +\$2bn of that coming from long-term active products.

Schroders experienced net inflows in institutional and intermediary business in early 2012 which is a more upbeat outlook than peers. We see the outlook balance the risks from lower operating margins in the short term, particularly as earnings risk may be more to the upside if confidence returns following the decision on Greece.

Dividend Paying Companies

Bayer – is reported to have made a non-binding offer for the animal health business of Pfizer, though Pfizer's management believes that, at this stage, a spin-off of the unit is the most likely course of action. No details have been provided at this early stage, yet previous reports indicated the value of the business to be in between \$15Bn and \$20Bn.

BHP – Operation at Port Hedland, the Western Australia Pilbara's main iron ore shipping hub, was suspended temporarily due to tropical cyclone Lua, which crossed the coast some 100km north in a sparsely populated area on Saturday afternoon. Anchorage was closed for 66 hours, while the port was closed for a total of 52 hours, curtailing the shipments of iron ore to the Asian markets. The shortage led to an increase in iron ore prices to the highest level in nearly four months. BHP said it would monitor the situation closely and report any material impact on production in its quarterly statement.

A new 30% tax on iron ore and coal mine profits was passed in the Australian parliament earlier today, at the end of a process which lasted almost 2 years and involved tough negotiations round with leading mining groups, including BHP, Rio Tinto and Xstrata. The tax is designed to spread the benefits of Australia's resources boom to other sections of the economy by funding a cut in the corporate tax rate, higher payments into pension funds and A\$6Bn of infrastructure spending. Smaller miners vehemently expressed their opposition to the new tax as it is perceived to unfairly treat emerging miners. The official opposition announced its intention to repeal the tax if/when it gets into power, with elections scheduled for late 2013.

Novartis – licensed the eye disease treatment ocriplasmin from the Belgian biotech company ThromboGenics, through its eye care unit Alcon, in a deal which is reported to see €75mm as an initial transfer payment to ThromboGenics. Alcon is acquiring the rights to commercialize the new therapy outside the United States and is preparing to launch in some 40 countries. The drug has completed phase III trials and is under review by the European Medicines Agency (EMA) to treat vitreomacular adhesion (VMA). VMA is a condition which could lead to distorted vision and the formation of a macular hole, a small break in the macula, located in the center of the retina; currently the only option is surgical treatment. Alcon estimates some 300,000 patients could benefit from the new treatment in Europe alone.

Britain's National Institute for Health and Clinical Excellence (NICE) recommended Gilenya, Novartis' multiple sclerosis oral pill, for use in Britain's state health service. Initially NICE said it was unclear whether the new drug was any better than existing treatments, yet further data provided by the company, showing the benefits of using Gilenya in a subgroup of adults with highly active disease, led the regulatory agency to conclude that it was clear that Gilenya was a cost-effective option in such cases.

Tesco – Philip Clarke, the group CEO, announced it would take over the company's UK operations, following the departure of Richard Brasher, who stepped down from the company's board and will leave the firm in July. The departure of Richard Brasher follows Clarke's decision to have a more active role in the UK business. Brasher is also said to have been responsible for the "Big Price Drop" campaign last year which failed to deliver at Christmas. Clarke said that the change would ensure rapid implementation of Tesco UK's turn-around plan, which involves investing hundreds of millions of pounds into the business and take on 20,000 new staff, though, it also said, in the long term it was in the best interest of the group to have a dedicated UK team and its own boss.

Economic Activity, Consumer and Business Conditions

US – Macro-economic data released in US over the last week is likely to temper the recent optimism related to the state of the US economy, as many data points failed to meet expectations.

Industrial output for February was flat, significantly below the expected 0.4% improvement and the 0.4% advance recorded in January, as the growth rates in the auto sector and mining cooled off. The capacity utilization rate inched lower to 78.7% from January's 78.8% value.

The US consumer sentiment, as measured by the University of Michigan dipped in March, to a 74.3 index points level, down from February's 75.3 and short of expectations for an improvement to a 76.0 index points level. The retreat was chiefly driven by the consumer "expectations" component of the index as the consumers' views of "current conditions" actually improved in the month. The worsening in sentiment could be the result of persistently high pricing for items such as gasoline and food and expectations for continued inflation. For the month of February, the headline consumer price index (CPI) maintained its relatively high pace at 2.9% year on year rate of change, while the core reading of the CPI (which excludes the above-mentioned categories of food and energy) showed a moderate retreat, to a 2.2% year on year rate of change. Earlier in the week, the US retail sales maintained a healthy 0.9% month on month rate of growth for the month of February, helped by strong sales of auto vehicles, gasoline, clothing and building materials. The core retail sales showed strength as well, moving higher by 1.1% in the month, ahead of the expectations and almost double the pace compared to January.

On the housing front, the National Association of Home Builders' (NAHB) housing market index revealed a flat reading for March, remaining at the depressed level of 28 index points, against expectations for continued improvement following a string of encouraging reports.

Canada – Capacity utilization for the fourth quarter in Canada fell short of expectations, at an 80.5% level compared to 81.5%, yet still managed to inch higher compared to the revised 80.0% level recorded for the previous quarter.

Financial Conditions

Federal Reserve policymakers appear determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels' of interest rates "at least through late 2014". which is still an "exceptionally low level" in the grand scheme of things. Fed Reserve Chairman Ben Bernanke has indicated 1% or less would be considered exceptionally low. The advent of the US 'twist' (whereby the Federal Reserve is selling 3 year and less maturities to buy 6 years and longer) means all parts of the yield curve will benefit from a near-zero anchor for essentially the next 3 years. The U.S. 2 year/10 year treasury spread has been falling and is now 1.94% and the U.K.'s 2 year/10 year treasury spread is 1.95% - 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 3.92% - (3.87% is 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 fallen / improved to 6.1 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. While we still believe it remains premature to consider a recovery in house prices prospects of a measure of stability are likely to increases 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 remains 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 have been increased suggesting overall current levels of total provisions should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 2 years 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 14 in 2012 (compared to 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. 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 VIX (volatility index) is 14.86 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

US Stress Tests (Comprehensive Capital Analysis review)

The Federal Reserve last week reported that 15 of 19 banks would be able to maintain capital levels above a regulatory minimum of 5% in an “extremely adverse” economic scenario, even while continuing to pay dividends and repurchasing stock. Citigroup, SunTrust, MetLife and Ally Financial failed the tests. The ones that passed will be able to return capital to shareholders.

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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