



## News Highlights on Current Holdings

### Financial Services Companies

Bank of America : Freddie Mac forced Bank of America to buy back US\$330mn of mortgages originated over the past 2 years after the government-controlled mortgage-finance company challenged the lender over technical issues with how the loans were manufactured. ( Source : Wall Street Journal)

Barclays has said that it has sold about 26.2 million Blackrock shares to money managers for \$160 each and expects to book a £200m profit on its \$5.5 billion/£3.5 billion sale, a deal which will then deflect the impending regulatory requirement to have this asset 250% covered by capital ( i.e. \$13.75m of capital would have been needed to support this \$5.5 billion asset once Basel III is implemented. Barclays is also looking to sell its Italian branch network comprising of ~200 branches and ~200 financial shops (jointly owned by Barclays and agents). Barclays opened its first Italian branches in 2006 and total exposure now stands at £~25bn of which £21bn is loans of which reports are Barclays is looking to sell Eur 4bn loans and Eur 4bn deposits and that 3 bidders have emerged (2 Italian).

Citigroup is planning to expand its Indian consumer-banking operations by ramping up its credit-card business and adding 1mn new customers from the urban middle class over the next two to three years. ( Source Wall Street Journal)

Santander has hired UBS and Deutsche Bank as advisors for the sale of their Mexican unit. This is fully expected. The estimated value is \$3-3.5bln for 25% stake using Banorte as a proxy. Banorte is up 40% YTD (San Brazil +10%) so the sale is probably timely and helps with the Santander's domestic real estate clean up. The 25% sale should generate 30-40bps of tier 1 capital.

Swedbank and Nordea : Moody's cut their ratings on Nordea, Svenska Handelsbanken and DNB by one level to Aa3, while affirming the credit grades of SEB and Swedbank. All the ratings carry stable outlooks. Moody's said the actions follow the "comparatively high reliance on wholesale funding, which Moody's regards as less reliable

under a severe stress scenario, but acknowledges the relatively good capital markets access for most Swedish banks despite difficult market conditions".

### Financial Infrastructure

CME Group has been dropped from the shortlist of prospective buyers for the London Metal Exchange, leaving just Intercontinental Exchange and Hong Kong Exchanges and Clearing.

(Source Wall Street Journal).

### Dividend Paying Companies

Bayer – An FDA advisory panel voted against expanding the use of Xarelto, Bayer's new blood thinner, for reducing the risk of new heart attack and strokes in people with acute coronary syndrome (ACS). The vote followed the presentation of results for a trial in which Xarelto was tested as an addition to aspirin and other clot preventers. In the trial, people who took a 2.5mg dose of Xarelto in addition to anti-platelet medication had a 15% lower risk of having a stroke or dying from a heart attack than people just taking the anti-platelet medicine. However, patients taking Xarelto had an increased risk for a major fatal bleeding, albeit being overall low at about 0.1% of the patients, as well as an increased risk for non-major bleeding. Some people dropped out of the 15,500 patients study, leaving the trial missing some clinical data, which had an impact on the panel's decision. The company said it will address the questions raised with the FDA as it continues to pursue registration. Xarelto has already been approved to reduce blood clots in the legs and lungs of people who have had knee or hip replacement surgery, as well as for the important indication of stroke prevention in atrial fibrillation. The recent set-back, while material, should not impede Xarelto from becoming a blockbuster franchise.

Siemens – received a \$73mm contract from the city of Portland, Oregon, to build 18 of its S70 light rails vehicles. The vehicles are to be manufactured entirely at Siemens' rail vehicle manufacturing plant in Sacramento, a facility powered almost entirely by 2MW of solar energy, and



will bring the total number of S70 manufactured by the company for TriMet, the Portland transit operator, to 40.

Syngenta – settled an 8 year old legal dispute with several communities in the US Midwest which had been affected by an above limit seepage of the company's atrazine herbicide into the water systems. The product is already highly regulated under the US Environmental Protection Agency's stipulations and the settlement is not expected to change the safety evaluation of the product. The company said the charge was partly covered by provisions and that it would take a \$0.50 per share hit against its 2012 earnings, which are estimated at \$21.71.

Toyota – announced plans to roll out eight compact car models until 2015, in an attempt to recover the lost terrain to Volkswagen and GM in the fast growing emerging markets such as China, India and Brazil, and pre-empt heavier competition in Southeast Asia, where the company has a leading position. The new vehicles are expected to be priced around \$12,500 and Toyota will try to source 100% of the cars' components locally to keep costs lower. Toyota's cheapest model is Etios, which retails for about \$9,000 in India. The company denied rumours about entering the \$6,000 category, although it said its subsidiary Daihatsu might have an interest.

Vodafone delivered re-assuring full year results. The UK-listed Telcom beat consensus estimates at the top-line (+0.3%) and Operating Profit (+0.7%) levels. Slight EBITDA weakness (-0.3%) was caused by Italy, Spain and re-structuring costs (Germany). Group service revenue growth rates improved considerably (Q2: +1.3%, Q3: +0.9%, Q4: +2.3%) in Q4 11/12, driven by the leap year (extra day: +100bps. Low cash taxes is encouraging (-24% YoY in FY 11/12), a manageable cost of debt (c5.0% in FY 11/12 and FY 12/13E), and low indebtedness (proportionate Net Debt / EBITDA of c1.25x, including Verizon Wireless). Vodafone presented a strategic vision for 2015 - focusing on Best Network, ARPU accretion and lower acquisition / retention costs. We believe Vodafone's two next catalysts will be positive, namely Verizon Wireless Q2 results and a likely US dividend announcement (possibly announced in late calendar Q3 2012).

Economic Activity, Consumer and Business Conditions

US – the US durable goods orders, an important indicator of manufacturing and business activity in general, posted a lower than expected performance for the month of April. The headline figure showed a 0.2% improvement, below the expectations for a 0.5% advance, following a 3.7% drop in the previous month. The core reading however, which excludes the effect of the orders intake in the notoriously volatile aviation industry, fell by 0.6%, well below the expected 0.9% growth. Communications equipment, capital goods, computers and general machinery led the slide.

Adding to the recent good news in the US housing sector, the new home sales for April reached 343,000 units annualized, higher than March's 332,000 units annualized and ahead of the expectations for a 335,000 units annualized figure. The US consumer also is showing signs of improved morale, as the most recent reading of the Consumer Sentiment, measured by the University of Michigan, improved to 79.3 index points from April's 76.4 level, ahead of the expectations for a flat reading and driven by the 'expectations' component, meaning that the average US consumer expects for the outlook to improve.

Canada – Canadians spent more than expected in March as the headline retail sales advanced by 0.4% in the month, more than reverting February's 0.2% drop, driven chiefly by a 1.2% increase in motor vehicles and parts. The core retail sales number, which excludes sales of gasoline and auto vehicles, were however less encouraging, higher by only 0.1%, well short of the expectations for a 0.5% improvement.

## Financial Conditions

Spain is considering directly injecting its own government debt into Bankia to help fund the stricken lender's €9bn nationalisation, in an attempt to sidestep borrowing money directly from the bond markets. The plan, involves Madrid issuing Spanish government guaranteed debt to Bankia in return for equity, with the bank then able to deposit the bonds with European Central Bank as collateral for cash. (Source : Financial Times)



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 until mid to late 2014. The U.S. 2 year/10 year treasury spread is now 1.45% and the U.K.'s 2 year/10 year treasury spread is 1.52% - 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 3.78% - (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 improved to 6.6 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 increase 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 25 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 21.76 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>.



Chris Wain-Lowe  
Executive Vice President  
Portland Investment Counsel Inc.  
Phone: 905-331-4250 Ext. 4232  
Fax: 905-331-4368  
[www.portlandic.com](http://www.portlandic.com)

# Market Commentary



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Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • [www.portlandic.com](http://www.portlandic.com) • [info@portlandic.com](mailto:info@portlandic.com)

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