Market Commentary

August 27, 2012

News Highlights on Current Holdings

Financial Services Companies

Barclays, Britain's second- biggest lender by assets, and South Africa's Absa Group said they're in talks to combine their African units and complete a plan started seven years ago. There's no certainty the talks will lead to any deal, which wouldn't be completed until 2013, the banks said in a statement. The combination would affect assets in Kenya, Botswana, Zambia, Tanzania and Ghana. Barclays, based in London, bought 54% of Absa in 2005 for US$4.5bn to expand in emerging markets. Bloomberg

Bank of America said it has stopped selling to credit-card customers products that suspend borrowers' minimum monthly payments in the event of a job loss or other hardship as regulatory scrutiny of these offerings grows. (Source Wall Street Journal)

Citigroup's CEO has knocked back the idea of big banks being split up after calls from people such as his predecessor Sandy Weill. Vikram Pandit said Citi, formed in Mr Weill's time with mergers such as the acquisition of Travelers in 1998, had already gone back to the basics of banking, and aside from some global markets businesses had sold most of the units from that deal.

Also, Citigroup became the first Western bank to issue credit cards in China without co-branding from a local financial institution as the government relaxes restrictions in the world's second-largest economy. (Source :Bloomberg). In addition , Citigroup, plans to increase the headcount for its European credit sales and trading team by as much as 5% to seize market share from rivals cutting back in the region.

ING : The Financial Times reported last Wednesday that ING Japan's corporate business is being eyed by Manulife as a possible acquisition target. According to the report's sources, Manulife is interested in acquiring the corporate business, while ING Japan's annuities business is also been considered. The article also notes that Manulife is unlikely to move on the variable annuities business, as it would significantly alter its portfolio business. The report also highlights that funds Apollo Global Management and J.C. Flowers were interested in ING Japan, however, that it might be difficult for either to gain approval from the Japanese financial authorities, as the two firms will likely exit in a few years time. Some industry observers believe that private equity firms could encounter an uphill regulatory battle for approval, as PE firms are not known to be in for the long haul. Further, for a strong strategic buyer such as Manulife, regulators may act more positively regarding an acquisition, compared with competing bids from lesser known firms or private equity funds.

Lloyds Banking Group continues to make progress in the task it set itself three years ago to sell £200bn of unwanted loans and investments after it agreed a clutch of deals in the traditionally quiet summer months. In the past week alone the bank, which is 42% owned by the UK government, has offloaded more than £2bn of assets, exceeding its target of shedding about £1.5bn a month until the end of 2014. (Source Financial Times)

Royal Bank of Canada : The Globe & Mail reported today that Canada's insurance brokers are asking regulators to look into the possibility that Royal Bank of Canada is sharing customer data with its insurance arm. The complaint stems from a marketing letter, which appears to be a form letter, that RBC Insurance sent to an individual in Alberta. "As an RBC Royal Bank credit card client, you already have a relationship with RBC Royal Bank," the letter states. "Now you can trust RBC Insurance for your insurance needs." The letter goes on to note that "if you use your RBC Rewards credit card to pay for your insurance premiums you can earn RBC Reward points." As it turned out, this particular customer was a member of the Insurance Brokers Association of Canada. Ottawa has rules that are designed to stop banks from marketing or selling insurance in their sizable branch networks (and more recently on bank websites) and that place other barriers between banks and the insurance companies they are allowed to own. The rules were created partly out of concern that banks would have too much power over potential customers if they were able to tie the granting of credit or loans to buying insurance. The rules include restrictions on the flow of information between banks and

their insurance arms. A spokesperson for the bank said "RBC operates on the fundamental principle of regulatory compliance, which includes designing our work flows and processes to respect the Bank Act and privacy legislation, while at the same time delivering a superior client experience."

Santander - Reuters reports that Santander is looking to list its Mexican unit in Mexico and New York on Sept 25th. The bank plans to list about 25% of the unit, which is Mexico's third-largest bank by assets, with just over 6% being sold in Mexico and 18.7% abroad. It's calculated 100% of Mexico would be worth between $11-18bn and therefore a secondary placing of 25% of the unit could generate $2.8-4.4bn or 40-64bps of Basel III capital.

Santander raised €2bn from the first sale of senior unsecured bonds by a Spanish bank in more than five months. Spain's biggest lender tapped debt investors as the nation's government prepares to hash out terms for the €100bn bailout of its financial system.

Santander has also announced a further offer to buy back institutional euro & sterling preferred shares and subordinated debt amounting to €7.2bn and £3.4bn. The final price will be determined at the Tender offer. Santander will announce on 31 August, 2012 the final amount of the Tender Offers accepted from each series and as of right now, the date of settlement of the Tender Offers will be 4 September, 2012. Assuming a premium of ~5/10% to current market prices and a 20/30% take up its calculated the buyback could generate €0.3-0.5bn pre-tax capital gains expected to be allocated to balance sheet clean-up in 3Q12. As a reminder, Santander will book in 3Q12 ~€1.3bn of additional pre-tax capital gains (~€0.8bn from debt buybacks in UK and €0.5bn from the reinsurance deal in Spain & Portugal) entirely aimed at reinforcing the group's balance sheet.

Wells Fargo, the largest US home lender, said competition in the mortgage market is "essential" and that its control of 1 in 3 US mortgages is the result of doing a better job than rivals. (Source : Bloomberg).

Financial Infrastructure

CME confirmed on Monday that it would file an application for a London-based derivatives bourse, its first outside the US. It also named Bob Ray, a veteran Chicago exchange expert formerly with the Chicago Board of Trade, as chief executive of CME Europe, which is expected to open in mid-2013. (Source : Financial Times)

Dividend Paying Companies

BHP – Beside a set of results, which was much in line with the expectations, the largest global miner also made a number of highly anticipated announcements regarding its pipeline of key development projects. On Wednesday it announced that no major capital investment decisions will be taken prior to June 2013, including the expansion of the Olympic Dam mine in South Australia, the expansion of facilities at Port Hedland in Western Australia and the potash mine at Jansen, Saskatchewan. Pleasingly, the company showed restraint in deploying additional capital as demand slowdown, primarily from China, coupled with a tight labour market, a tight supplier market, a high exchange rate and high diesel prices changed the feasibility of some of the project. The Olympic Dam expansion, which would've seen the copper output triple at the mine, seems to be postponed as BHP wrote off the study cost of the project altogether. Short term capital commitments, which include $22.8mm for the next fiscal year, are set to be deployed as planned. Expansions under way should still boost BHP's production output substantially by the end of 2015, including a 50% increase in coking (metallurgical) coal volumes. Earlier today, the company issued an announcement regarding another Australian based expansion project, maintaining its commitment for the $20mm outer harbor expansion of the Port Hedland outer harbor as a key part of the long-term strategy, yet choosing instead to focus on squeezing as much as possible out of the existing inner harbour iron ore port. The group announced it had received the right to develop two additional berths in Port Hedland's inner harbour. Meanwhile, the company is reported to be making plans to double the first phase of production on its proposed Saskatchewan potash mine to 4 million tonnes, even though decision to proceed with the project

has been delayed. Some 400 people are on site digging two mine shafts and building two surface facilities.

Full year profit, which was impacted by a number of pre-announced write-downs, was $17.1Bn, a drop from last year's $21.7Bn, impacted by a significant price reduction of its key commodities and the abovementioned supply side pressures. BHP raised its final dividend by 2 cents to 57 cents. The 11% increase in the total 2012 financial year dividend takes the compound annual growth rate of BHP's progressive dividend to 26% over the last 10 years.

Tesco – announced the closing of a property sale and leaseback deal in South Korea, which provides the group with about £300mm of much needed liquidity to help it advance its turn-around plans at its domestic operations. The deal comprised a portfolio of 4 Homeplus stores and mall space and it was undertook by a consortium of investors led by Ignis Asset Management.

Vivendi – announced the appointment of Jean-Yves Charlier as the head of group's telecom businesses and of Bertrand Meheut as the head of its media and content activities, as it is trying to assess its strategic options in the wake of Jean-Bernard Levy's, its former CEO, departure. Jean-Yves Charlier is a current member of Vivendi's supervisory board and the head of interactive learning company Promethean. Bertrand Meheut is the current chairman Canal+, Vivendi's pay-TV business.

Economic Activity, Consumer and Business Conditions

US – US manufacturing recorded a significant drop in capital goods orders in July, the largest in eight months, as durable goods orders excluding transportation and defence retreated 3.4% in the month. The headline figure, which includes the notoriously volatile transportation orders, were actually up by 4.2% over the same time period. Domestic uncertainty related to the outcome of the elections and the tax environment, as well as global uncertainty related to European debt crisis and China's economic deceleration are seen as main culprits for the weak demand. Demand for machinery and communications equipment was the most affected, down 3.6% for the first and 4% for the later. Although a net contributor in the month, airplane orders took a hit earlier this week when Qantas Airways scrapped a contract to purchase 35 Dreamliners from Boeing.

Thankfully, the housing sector continued to reveal encouraging numbers, such as the existing home sales for July, which reached 4.47 million units, annualized. An improvement from June's 4.37 million units annualized, albeit short of expectations. Yesterday's US new home sales report surprised on the upside for the month of July, reaching 370,000 units annualized, ahead of the expected 365,000 units and an improvement compared to June.

Canada – Continued economic challenges south of the border and global uncertainty seemed to have finally caught up with the Canadian consumer, as a 0.4% drop in Canadian retail sales for June more than reversed May's 0.2% advance and fell way short of the 0.1% expected improvement. Even when accounting for the volatile auto sales, the core numbers showed a similarly weak -0.4% rate of growth in the month. The weakness was broad-based across the retail sectors, led by building materials stores and general merchandisers, with many observers pointing out that the new duty-free stores might have stimulated the cross-border shopping.

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 "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 extension 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 1.39% and the U.K.'s 2 year/10 year treasury spread is 1.40% - 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 3.66% - (3.49% end of July was 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 6.5 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 40 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 15.96 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.

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

Source: Thomson Reuters, Bloomberg, Company reports

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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 • info@portlandic.com

PIC12-0086-E(08/12)