Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Aviva : Reuters reported last week that Aviva plc and Malaysian bank CIMB Group Bhd have set an October 29 deadline for shortlisted suitors to place binding bids to buy their Malaysian insurance joint venture, in a deal worth probably at least $500 million. Prudential Plc, Manulife Financial Corp and Sun Life Financial Inc are reported to be the remaining suitors for the venture after AIA Group Ltd dropped out of the race as it is believed to be likely to win the bid to acquire ING's insurance unit in Malaysia. The Malaysian joint venture sale has generated interest from global insurers keen to tap growth prospects in Southeast Asia. Malaysia is the third-biggest economy in the 10-member Association of Southeast Asian Nations grouping.

Bank of America Merrill Lynch is set to announce a wave of job cuts at its Asia markets division, as the bank reduces staff globally. The job cuts in Asia will total up to 40 people, or less than 4% of the markets unit. (Source : Wall Street Journal)

Deutsche Bank investors are divided over how Germany's biggest bank should raise capital, with some shareholders favouring its plans to avoid a share sale, said co-CEO Anshu Jain. "I'm getting two responses," Jain said at the Bank of America / Merrill Lynch conference. Jain said he met with investors since unveiling the firm's strategy on Sept. 11 and that those who "have been with us" told Deutsche Bank "without exception that they applaud management's commitment to grow this capital organically."

Hartford agreed to sell its Individual Life insurance business to Prudential. The sale is structured as a reinsurance transaction and Hartford estimates that the deal will provide a net statutory capital benefit of $1.5 billion, much better than the market's expectation of about $1 bn. The life sale completes the planned divestiture program and the $2.2 billion of capital generated is toward the upper end of original estimates. Hartford will unveil how it plans to use the $2.2 billion early next year. Clearly, share buybacks would be materially accretive to book value per share given where HIG's stock is trading, although to maintain leverage ratios, the company will also likely pay down debt. In addition, management has discussed exploring ways of more permanently reducing risk in its run-off annuity business.

HSBC - leads group of creditors taking control of Biffa, from Montagu, Global Infrastructure Partners and private equity arm of HBOS following inability to pay back more than £1bn ($1.6b) in loans, Sunday Times reports. Biffa were taken private in 2008 by a consortium of investment firms in £1.7bn takeover.

Invesco is acquiring a toehold in the India asset management market, similar to other large public managers, by agreeing to purchase a 49% interest in India's Religare Asset Management (RAMC), an affiliate of financial conglomerate Religare Enterprises. Religare manages equity, fixed income, liquidity and alternative strategies, with total AUM of $2.6bn. At $1.4bn of mutual fund AUM according to Simfund Global, RAMC ranks 13th among India's largest asset managers, with a 1.2% market share. This investment should provide Invesco entry to a market which is seen as promising given its projected growth rate and demographics. Recently India fund managers have seen outflows at a roughly 15% annualized rate, but Religare funds have held up better, with inflows to equity and bond funds offset by outflows from liquidity. Invesco is likely to use Religare as a distribution platform for India and source of India-focused investment products. Invesco did not disclose deal terms, but press reports suggest $88mn for the 49% stake, which would value RAMC at roughly 6.7% of AUM. This would be in line with estimates of Fidelity's recent sale of its India unit and Nippon Life's investment in Reliance Capital (4.3%). Invesco may be able to buy a majority later.

Morgan Stanley has officially dropped the 'Smith Barney" name from its wealth management business, making the former Citigroup brokerage the latest in a string of well known financial brands to have disappeared since the financial crisis.

Prudential is to acquire life business from Hartford —The purchase price will be $615 million. We see this deal as positive for PRU as it effectively lets the company deploy some of the excess capital within its life insurance subsidiary.

Royal Bank of Scotland : Britain's biggest government-owned lender, said it will cut 300 more jobs at its investment banking unit and is "on track" with its plan to exit businesses. RBS will eliminate 3,800 jobs at the division by 4Q next year, compared with an earlier target of 3,500, according a presentation delivered by John Hourican, chief of markets and international banking. About 3,000 of the cuts will have been completed this year, RBS said. (Source Bloomberg).

Stephen Hester, chief executive of RBS, said he expects the turnaround of the state-backed lender to be largely completed by the end of next year, paving the way for it to resume paying a dividend. Mr Hester stated that RBS was "well on the way to being a good bank" and that the lender was on track to meet the aims of a five-year plan put in place when he joined as chief executive in October 2008. (Source : The Telegraph).

Santander - the dual US & Mexican listing of the 24.9% stake in Santander Mexico raised $4.13bn, with the shares ending up 6%. It became the largest debut to take place on the Mexican market. Proceeds were to be used to bolster the parent group's capital position, with analysts estimating a boost of 0.5% to core capital.

Australia's four largest banks are dominating the ranks of covered bond issuers, filling a gap left in the 300-year-old market as European issuers fund themselves with central bank cash. Commonwealth Bank, Wespac , Australia & New Zealand Bank and National Australia Bank led €29.6bn of sales of the notes this year from the nation, data compiled by Bloomberg show. The four banks, including units, are among the top 10 sellers worldwide. Australia passed laws last year letting its lenders sell the debt, which has collateral that stays on the seller's balance sheet, unlike the mortgage-backed bonds that triggered a global credit freeze in 2008

Spanish Banks : Stress Test Results released last Friday, no real surprises.

Company	Adverse Stress Test (bn)
BFA/Bakia	-24.7
Catalunyabank	-10.8
NCG	-7.2
Banco Valencia	-3.5
Banco Popular	-3.22
BMN	-2.2
ICL	-2.1
Stress Test Deficit	-53.7 bn
Santander	25.3
BBVA	11.2
Caixabank	5.7

Stress tests on 14 institutions (90% of country banking assets) approved by the Big 4, 6 independent appraisal firms, Wyman, Bank of Spain, European Commission, ECB, EBA and IMF. Aggregate Results. (E53.7bn) capital shortfall, or (E59.3bn) excluding mergers with up to E100bn available and compares favorably to the (E62bn) initial government estimate. Banks with deficits have to submit capital raising plan to Bank of Spain within two weeks and will be classified under two groups (ie. those who can and cannot raise private capital). As can be seen from above analysis Santander and BBVA are Spain's two best capitalized banks with 'excess' capital to meet stressful situations.

Financial Infrastructure

Global Payments : reported fiscal 1Q 2013 cash EPS of $0.87 (in-line with consensus estimate of $0.87) and GAAP EPS of $0.59 (including a $0.20 adverse impact from an $24mn pre-tax charge related to the completion of the company's data intrusion investigation). Excluding the impact of a higher tax rate, it would have beaten consensus by roughly $0.05-$0.06 (including a ~$0.01 benefit from a lower F1Q13 share count).

Global Payments delivered solid top-line growth of 9%

Y/Y, primarily driven by U.S. revenue up 20% Y/Y. That said, Canada continued to show weakness (down 11% Y/Y) as a result of ongoing spread compression. International revenues were flat Y/Y primarily driven by weaker-than-expected top-line growth in Europe (down 1% Y/Y). Management maintained FY 2013 guidance, which calls for revenues of $2,360mn to $2,400mn and EPS of $3.59 - $3.66, including $0.07 accretion from the HSBC acquisition. Additionally, the company noted that on a partial year basis, the acquisition of Accelerated Payment Technologies (expected to close in October 2012) will positively impact total company cash operating margins by ~50bps.

Dividend Payers

Bayer – US Food and Drug Administration (FDA) approved a new Bayer drug, regorafenib, brand name Stivarga, for advanced colon cancer, a month ahead of the agency's expected action date for a decision. The drug is meant to treat colon cancer that has progressed after prior treatment. The speedy approval fits an FDA pattern of expedited approval for drugs for high unmet needs diseases. The company is currently awaiting a colon cancer approval decision for the drug in Europe and is also seeking US approval of regorafenib as a treatment for gastrointestinal stromal tumors. Bayer and Onyx, a company which worked with Bayer in developing Nexavar, a closely related medicine, will jointly promote Stivarga in the US. Onyx is entitled to a 20% royalty. Unofficial estimates place the peak sales potential of the drug to $1Bn by 2020.

BHP – announced it is seeking to obtain an extension for the December deadline from the South Australia's government for the company to approve an expansion of its Olympic Dam cooper and uranium mine. In August, BHP cancelled its plans for a more than $20Bn expansion of the Olympic Dam mine in favour of looking for a less capital intensive solution to production increase. The company said the extension is needed for it to complete studies on new processing technology and a less capital-intensive design for the open-pit expansion. The requested deadline, of October 2016 would align with the federal government's environmental approval deadline for the project.

Carnival Corp – reported stronger than expected quarterly earnings for its third quarter as booking trends started to recovered from the effects of the Costa Concordia disaster at the beginning of the year. The company said that booking excluding the Costa line had risen 9% from a year earlier while pricing held steady. Earnings excluding unrealized gains on fuel derivatives were $1.53 per share, ahead of the consensus expectations calling for $1.43 per share, on revenues of $4.68Bn, which retreated from last year's $5.06Bn. Net revenue yield, which is the revenue each cabin generates, fell 5.3%, less than the company's previous guidance for a 6% to 7% retreat. The company also narrowed its full-year underlying profit forecast to $1.83 to $1.87 per share from the previous $1.80 to $1.90 target range.

A couple of days later the crew of Costa Concordia, a Carnival Corp cruise ship operated by Costa Cruises, won the Lloyd's List "Seafarer of the Year" award for 2012. The citation for the award said the crew provided "true examples of courage and professionalism" during the dangerous night evacuation of the ship after it was capsized off the Tuscan coast.

Roche Holdings – Results for two different studies into Roche's breast cancer drug Herceptin published earlier today showed showed that the current standard of treatment of taking the drug for a year provides the best outcome for patients. Herceptin, active ingredient trastuzumab, was first approved in 1998 and had 2011 sales of roughly $5.5Bn and is used as a treatment for around a quarter of breast cancer patients who have tumors that generate a protein called HER2, which tends to make the disease more aggressive. Roche conducted a study that investigated the benefit of using Herceptin for two years rather than one, while an opposing French study looked at whether the patients got the same benefit from a shorter treatment period of just six months. While the Roche study found no difference in the rate at which patients' cancer recurred or in how long patients lived, the French study's results were inconclusive. A spokesperson for the French study said the results showed a "trend in favour of the 12 months treatment" rather than six months. These findings removed a downside risk for Roche that could have cost the Swiss company up to $1.5Bn in sales if the trials had shown that a shorter treatment of six months would be just as effective.

Toyota – Last week in Beijing, a Toyota company official revealed plans for the company to reduce the production rate in China in the coming weeks in order to deal with a potential slowdown linked to anti-Japan sentiment in China.

Economic Activity, Consumer and Business Conditions

US – Indicators of business activity and economic output released last week were underwhelming, as the US durable goods orders dropped by 13.2% in August, a lot lower than the expected 5.0% retreat and a significant departure from July's 3.3% advance. The main culprit for the poor performance is the notoriously volatile transportation component (i.e. Boeing orders). However, even after stripping off the transportation orders, the durable goods orders still fell short of expectations, down 1.6% relative to an expected 0.3% improvement and adding to July's negative 1.3% number. Machinery orders lagged in the month and so did orders for computer equipment, in a sign that corporate America is re-trenching in the face of economic and political uncertainty. The revised GDP output number for the second quarter surprisingly fell to 1.3%, from the previous 1.7% reading, a clear slowdown from and already unexciting 2.0% level in the first quarter. On the bright side, the Institute for Supply Management's (ISM) Purchasing Managers Index (PMI) a leading indicator of the manufacturing activity, announced earlier today, rose to a 51.5 index level for September, from a 49.6 index level in August, ahead of expectations (of a modest improvement to a 49.7 level). Eleven of the eighteen industries included in this diffusion index indicated expansion, albeit at a very muted pace.

The US housing sector was rich in data over the last week, with the improvement in the Case-Shiller price index for 20 metropolitan areas stealing the headlines, up 1.2% year on year, ahead of the expected 1.0%, showing that the housing market continues to strengthen. Other housing indicators were less exciting in the week, as the new home sales were virtually flat, at a 373,000 units annualized level in August, mildly below expectations, while the pending home sales, a leading indicator of existing home sales, retreated 2.6% in August, surprisingly.

On the US consumer front the sentiment indicators have taken a turn for the better with the Consumer Confidence, measure by the Conference Board, increasing to 70.3 in September from August's 61.3 and ahead of the expected 63.0, while the Consumer Sentiment, as measured by the University of Michigan, also moved higher, to 78.3, short of expectations though, led by an improvement in the 'expectations' component of the index. All the while, the personal income report revealed a meagre 0.1% improvement in the US personal income in August, short of the expected 0.2% advance. Part of the same report, the Fed watched indicator of pricing, the core personal consumption expenditures (PCE) price index, remained at a depressed 1.6% level, providing more credence to Fed's recent expansionary moves.

Canada – Retail sales in Canada were stronger than expected in July, improving by 0.7% over June's level, well ahead of expectations, driven by good auto sales. Even when discounting sales of vehicles and motor parts, the core retail number, up by 0.4% exceeded the expectations, as gains in department stores, furniture and building materials offset weaker retail categories such as clothing and electronics. The strong retail sales performance likely contributed to a higher than expected economic output in July, up by 0.2%, ahead of the expected 0.1% improvement.

Spain - The Spanish government last week announced its fifth round of budget cuts and tax increases. Its understood the programme was part of a carefully-calibrated strategy between the EU and the government to meet conditions likely to be demanded by Europe, if Prime Minister Rajoy requests a bailout. The Spanish stressed it was going beyond the structural reforms recommended by the EC earlier this year. The budget minister reiterated the -6.3% deficit target for 2012 and -4.5% for 2013 and said the YTD revenue collection is in line with plans. Alongside key budget items listed below, Spain have announced plans for a new independent fiscal commission to oversight budget execution at central and regional level. Spending is to be cut 9% and they will raise €4.4bn in tax changes. In the Q&A session the budget minister said that they are still analyzing the convenience and implications of asking for financial assistance for the sovereign and there is still no final decision taken. GDP forecast is unchanged at -1.5% (2012) and -0.5% (2013) versus current consensus of -1.6% (2012) and -1.25% (2013) so still based on "optimistic" macro outlook for 2013, however its likely to be pre-orchestrated with EC approval, paving the way to ease conditionality for a request of a precautionary credit line from the European Stability Mechanism.

The improvement in the budget deficit is 58% based on expenditure measures and 42% based on higher taxes. On the expenditure side the only two items that grow are the interest of the public debt and the pensions (approved 1% increase, below inflation). Average expenditure of ministries to fall by ~9%. They confirmed the freeze in civil servants salaries for a 3rd year in a row (also affects regions and municipalities) and the replacement of only 10% of those that retire or leave. To reduce investments in civil works from ~0.9% of GDP in 2013 from 1.3% in 2013. On the revenue side the Government has cancelled the 1% reduction for 2013 in social security contributions approved in the summer and expect to raise €4.4bn from tax changes including: €0.8bn from 20% tax on lottery prices (above €2,500), €2.3bn from lower corporate tax credits, €0.7bn from renewing another year the wealth tax, and other small items. This is on top of a bigger contribution from tax measures introduced in the middle of 2012 that will have bigger impact in 2013 (VAT increase from 1st Sep, personal income tax increase, lower tax credits for corporates).

Financial Conditions

Basel III: The IMF have raised concerns that the Basel III rules will exacerbate the "Too-to-Big-to-Fail" problem. In particular the IMF highlights that the big banking groups have the size to absorb the costs of regulations and will therefore become even more prominent in certain markets." Big banking groups with advantages of scale may be better able to absorb the costs of the regulations ; as a result, they may become even more prominent in certain markets, making these markets more concentrated" the IMF wrote in its latest Global Financial Stability Report.

USA : S&P/Case-Shiller data shows rise: The report shows the 20-city composite index rising 1.6% month-over-month in July and increasing 1.2% year-over-year. Importantly, all 20 cities in the Index posted increases.

Britain said it would allocate £1bn towards a new state-backed business bank designed to expand lending to smaller firms currently starved of loans from Britain's main lenders. The government hopes its backing will be matched by a similar amount from private capital and could support up to £10bn of new and additional lending, Business Secretary Vince Cable said. (Source : Reuters)

The British Bankers' Association (BBA) council has formally voted in favour of ceding responsibility for establishing the interbank borrowing rate Libor in a move that comes in the wake of a fixing scandal that erupted three months ago. At a BBA council meeting last week, a motion was passed in favour of the BBA relinquishing its role — held since the 1980s — in the Libor administration process, which will force regulators to create a new structure to monitor and establish the benchmark rate.

Funding for Lending: Bank of England highlighted last week that Banks had applied for £60bn of the available £80bn under the Funding for Lending scheme, suggesting that funding pressures across the sector are clearly not as tight as one might have expected.

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 1.54% - 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 3.40% - (end of September 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 6.1 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 43 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 15.73 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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