



News Highlights on Current Holdings

Financial Services Companies

Bank of America is disposing of its Japanese private banking joint venture with Mitsubishi UFJ, becoming the latest in a string of foreign banks to pull out of high net-worth retail banking in Japan.

Barclays - The Wall Street Journal reports that Barclays plans to cut as much as 9% of its investment bank headcount, mostly in Asia and Europe starting early next year. Senior executives plan to recommend a reduction of 1,000 to 2,000 jobs from investment banking while protecting the bank's U.S. and U.K. operations from much of the cuts, the newspaper stated.

Credit Suisse – Wall Street Journal reports that Credit Suisse have closed their FX trading desk in Tokyo as part of their cost-cutting plans.

Deutsche Bank – last week company provided a 4Q outlook (as part of a scheduled conference call to discuss establishment of a non-core unit as announced in Sept.) Commentary was more downbeat than expected “4Q characterised by a continued difficult macro environment with low volatility and by the usual seasonal slowdown”. Expect non-operating charges (restructuring, asset impairments, de-risking) to have “a significant negative impact on 4Q earnings”. Conference call was to outline establishment of non-core unit: its main topic was 4Q guidance and specifically why the guidance on non-core exit losses appears to have changed from “no material impact” as per management comments in Sept to “significant negative impact” as per last week’s press release. However, CFO stated loss experience “less than budgeted for” and Basel III Core Tier 1 guidance was unchanged. This suggests 4Q losses could be mostly goodwill. Nonetheless, confusion is unhelpful.

HSBC - Moody's the credit rating agency, says HSBC's sale of Ping An stake is credit positive. It raises HSBC's Tier 1 ratio, which was 11.7% at end Sept., by approx. 0.5% and total capital ratio, which was 15.6%, by around 1%, Moody's says. Comments are taken from Moody's latest credit outlook report.

HSBC US fines - HSBC announced last Tuesday that they have settled the US money laundering case for \$1.92bn and entered a deferred-prosecution agreement to settle accusations that it allowed itself to be used by money launderers in Mexico and terrorist financiers in the Middle East. This is a good result IF this is full settlement for all issues, and dependent on whether there are any further business restrictions involved. They have provisioned \$1.5bn already so an extra \$400mn is only c5bps of capital.

Standard Chartered agreed to pay \$327 million of fines, in line with the bank's forecast, after regulators alleged it violated U.S. sanctions with Iran. After paying a \$340 million settlement in August to New York's Department of Financial Services, the company told investors on Dec. 6 it expected to pay about \$330 million to resolve other investigations. (Source : Bloomberg)

UBS - Fiera Capital Corp is acquiring the Canadian fixed income, Canadian equity and balanced account business of UBS global asset management (Canada) for a cash consideration of \$52 million. Fiera says transaction will immediately be accretive to earnings

Canadian Banks : S&P downgraded the credit rating of Bank of Nova Scotia, National Bank and Laurentian Bank by one notch, due to their expectations of intensifying competition for loans and deposits in the Canadian banking industry exacerbated by a slowing economy. However, S&P stated their view that Canada remains positioned favourably relative to most of its global peers. Bank of Nova Scotia's rating was downgraded to A+ from AA-, National Bank was downgraded to A- from A, and Laurentian Bank was downgraded to BBB from BBB+. The Outlook for all three banks was changed to Stable from Negative. TD (AA-) and RBC (AA-) had their ratings affirmed and their outlook changed to Stable from Negative. BMO (A+) and CIBC (A+) had their ratings and outlook (Stable) affirmed. The downgrades are a continuation of a trend by credit rating agencies in targeting the global banking sector. However, Canadian banks remain amongst the highest rated banks globally.

Dividend Payers



ABB – won a \$133mm high-voltage direct-current (HVDC) order for a subsea power transmission link to Finland. The HVDC transmission system will be capable of transmitting 100MW (megawatts) of electricity with minimum losses across a distance of 158 kilometers, between the Finish mainland and the Aland archipelago. The link is scheduled to become operational in 2015. ABB pioneered HVDC transmission technology almost 60 years ago and has extensive experience in both new installations and refurbishments. ABB remains the world leader in this highly-efficient technology, with over 70 HVDC projects around the world, providing a total transmission capacity of more than 60,000MW.

ABB announced Friday that, following its strategic review of the Power Systems division it is repositioning the business to secure higher and more consistent profitability. The division is shifting its focus to higher-margin products, systems, services and software activities and is closing low value-added EPC (engineering, procurement and construction) operations in more than 10 countries where project returns do not reflect the executions risk involved. Countries targeted include Czech Republic, Lithuania and Nigeria. These actions are expected to reduce earnings before interest and tax (EBIT) reported by Power Systems and ABB in the fourth quarter by approximately \$350mm. Of this, about \$100mm is related to restructuring-related expenses and other non-operational write-offs and is not included in the operational EBITDA. EPC projects had low ABB product content, of less than 30%, reducing their attractiveness to the company. The charge will also include a \$60mm-\$80mm of charges related to offshore wind projects. Part of the review, ABB has raised the division's margin target on EBITDA to 9%-12% and expects the business to reach the new target by the fourth quarter of next year.

BHP – sold its interest in the Australia's Browse liquefied natural gas (LNG) project to PetroChina International Investment for \$1.63Bn. The Browse LNG project met with significant controversy over its location at James Price Point and had been opposed by some of the project partners, environmentalists and Aboriginal landowners. Prior to BHP's exit from the \$30Bn project, Chevron had agreed on an asset swap deal in August, which increased

Royal Dutch Shell's stake. The other partners in the project are Woodside Petroleum (majority shareholder and operator), Mitsui and Mitsubishi Corp. Woodside is scheduled to make a decision on whether to go forward with the James Price Point location by mid-2013. Australia, with more than \$170Bn in LNG export projects under construction, is expected to surpass Qatar by 2020.

BHP's exit from the Browse project comes as the company is committing \$520mm to the Longford Gas Conditioning Plant project, a key extension to its Bass Strait infrastructure, meant to enable valuable hydrocarbon liquids and gas production. Following a number of smaller divestments of non-core businesses, we appreciate the company's continued emphasis on reducing the number of operations and increasingly focusing on its core, large and cost competitive projects.

Hutchison Whampoa : Hutchison has received approval from the EU to acquire Orange Austria under the condition of allowing its spectrum to be open to other MVNO operators. We believe it is a positive step for Hutch's 3G operations. We believe Hutchison continues to look at other consolidation opportunities in markets in which they operate in. In Italy, we believe some form of network sharing deal is likely to help 3 Italy to achieve better cost efficiency. While Hutchison's '3' operation is expected to be doing better in 2H12 than in 1H12 in Europe, we believe the market still under-appreciates the positive earnings delta that this division is bringing to overall earnings growth for Hutchison.

Novartis – released trial results for its blood cancer drug Tasisna, which show it being superior at treating a type of chronic myeloid leukemia than Gleevec, an older generation Novartis drug which is set to lose its patent exclusivity in 2015. The latest data, which is presented at the American Society of Hematology's (ASH) annual meeting, showed patients who still had evidence of residual disease after long-term treatment with Gleevec achieved undetectable levels of the disease after switching to Tasisna. More than twice as many patients treated with Tasisna continued to show undetectable levels of the disease compared to Gleevec. The company said the results were statistically significant. Four-year



data from the ENESTnd trial showed more than three times as many patients being treated with Tasigna as a frontline therapy experienced a reduction in the level of the disease versus Gleevec. The company's next big challenge in supporting its blood oncology franchise is to convince doctors to switch patients to Tasigna to shield its sales once Gleevec loses patent protection.

Roche Holdings – European health regulator recommended the Roche's breast cancer drug Perjeta for approval. The company is hoping that combining Perjeta with its older drug Herceptin will become the standard treatment for women with a form of cancer known as HER2-positive, which makes up about a quarter of all breast cancers and has no known cure. Recommendations from the European Medicines Agency are normally endorsed by the European Commission within a couple of months. US health regulators already granted the drug approval in June.

Vivendi – Vincent Bollore, a French industrialist and tycoon, will join the board of Vivendi, a move which had been largely expected and is likely to be approved by the shareholders. Mr. Bollore is also one of Vivendi's largest shareholders. He is expected to back the company's drive to reduce debt and streamline its conglomerate structure by reducing its exposure to capital-intensive telecom business, while focusing on media. As reported before in our newsletter, Vivendi has been working on selling assets, including telecom units in Brazil and Morocco. Pascal Cagni, the former general manager of Apple in Europe, Middle East, India and Africa, was appointed as an attending director of Vivendi's board.

France's two biggest mobile telecommunications groups have been fined a total of €83mm for distorting competition and harming smaller rival Bouygues by offering deals which included free unlimited calls between subscribers to the same operator. Orange owner France Telecom was fined €17mm, while Vivendi owned SFR must pay €6mm. France Telecom said the Bouygues had long benefited from regulatory measures, including getting higher call termination fees, as a result of its smaller size and status as the newest operator at the time; France Telecom said Orange will exercise its

right to appeal in the courts, while SFR said it too would appeal the decision. The fine imposed by the French regulator is highlighting the increased regulatory risk from the part of governments strapped for cash. We are mindful of such risk and have been given it increased weighting in our analysis

Economic Activity, Consumer and Business Conditions

US – US retail sales for the month of November were muted, with the headline figure up 0.3%, short of the expected 0.5% and not quite reversing the 0.3% drop in October caused by hurricane Sandy. The core retail sales, which excludes sales of vehicles and parts, were flat, as expected. Electronics and appliances sales bounced back a robust 2.5% and on-line sales also jumped 3.0%, with other retail categories chipping in more modestly. A drop in gasoline prices caused sales of fuel to drop 4.0% in the month, while general merchandise and food sales were also a drag in November.

The US trade deficit expanded by almost \$2Bn in October to \$42.2Bn, as imports retreated by 2.1%, but exports retreated even further, by 3.6%. Both imports and exports are likely to have been affected by hurricane Sandy, active on the East Coast in October.

Inflationary trends in the US, as measured by the consumer price indices (CPI) continue to provide little hindrance to Fed's just expanded easing measures, as the headline CPI rate, at 1.8%, fell short of the expected 1.9% rate for November, while the core reading, which excludes the effect of food and energy prices, was also lower than expected at 1.9%.

On the manufacturing front, November turned out to be a better month than expected, with industrial production moving higher by 1.1% in the month, more than reverting October's 0.7% retreat (adjusted lower from the initial 0.4% reading). The auto sector was a big contributor to the performance in the month, while the capacity utilization increased more than expected, to 78.4% from October's 77.7% level.

Canada – The balance of Canadian merchandise (visible goods) trade for October was a surprisingly low



\$170mm deficit, well below the expected deficit of \$1.2Bn, a level which has been the norm for most of the past year. Canadian exports improved by 1% in the month, while imports retreated by 1.2%. Key exports contributors were energy and agricultural commodities.

The capacity utilization level in Canada remained steady at 80.9% in the third quarter of the year, which was better than the consensus expectations, calling for a retreat to a 80.5% level.

Canadian housing is seeing continued pricing appreciation of 0.2% for October, which matched September's 0.2% advance and was ahead of the expectations for a 0.1% improvement.

Greece: will hopefully receive its next €4.4bn aid tranche despite falling short in its bond buyback target. Reports are that Greece has received offers to tender €2bn of bonds, but the purchase price will be 33.5c, above the originally envisaged 30c. That would leave a c.1.5% of GDP shortfall. The IMF was clear it would wait to see the results of the buyback before agreeing to pay the next tranche of aid – the hopes are that the shortfall is small enough that they still acquiesce.

Italy – Prime Minister Monti is in talks with centrist groups to run again as PM in elections next year, the Financial Times reports. Amidst concerns Italy could forsake its recent reforms, Centrist politicians were urging Mr Monti to stand as a candidate. He was said to be in discussions with Luca Cordero di Montezemolo, the head of Ferrari who launched a political movement last month, and Pier Ferdinando Casini, leader of the centrist Catholic UDC party. Italy's influential Catholic establishment weighed in last Monday, with Archbishop Angelo Bagnasco of Genoa delivering thinly veiled criticism of Silvio Berlusconi for triggering Monti's resignation after withdrawing his party's support. The political drama continued to reveal more twists when Silvio Berlusconi said he would step back if Mario Monti agreed to enter the election campaign as part of the coalition of "moderates". Berlusconi's remarks though came after his coalition partner, the Northern League, said they wouldn't support his latest candidacy. In a poll released yesterday, Berlusconi's party had less than 20% support.

And so the debate on the Italian budget begins today in Parliament - expected to be passed later this week, which will see Monti's government subsequently resign and pave the way for elections in mid-February. Outcome of the election remains far from certain – but the fact that it looks increasingly likely that Monti will run, and that Berlusconi has once more stepped back from his ambition to win power is likely to calm markets.

Financial Conditions

Banking Union - European leaders took a big step towards banking union with agreement that the ECB will have direct responsibility for banks with assets of more than €30bn. This covers 150-200 French banks with most of Germany's retail banking sector and savings banks still under the control of the national authorities. However, the ECB retains the power to intervene in any bank and deliver instructions to national supervisors. Berlin won concessions on the timing of implementation, so that no fixed deadline is included in the text for the ECB to take direct oversight of the biggest banks, though a series of specified goals will mean the system could be up and running by March 2014 whilst non-eurozone members like UK and Sweden will have specific safeguards to maintain their influence over standards for all EU banks. Wolfgang Schaeuble, German Finance Minister, made clear that one of the key purposes of the reform, to allow common resources in the eurozone's €500bn rescue fund to be injected directly into ailing banks – was out of the question until well into 2014.

UK authorities are prepared to "trust" their US counterparts the next time a big American financial company with large London operations runs into financial trouble and will refrain from seizing local assets and capital, said Paul Tucker, the deputy governor of the Bank of England. The promise, which could herald a significant breakthrough in efforts to deal with the problem of banks that are too big and too international to fail, is contingent on the US and the UK doing further work on a joint plan to deal



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with failing cross-border institutions. (Source : Financial Times)

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 until the unemployment rate falls below 6.5% (November 7.7%) which is likely to be through 2014. Fed Reserve Chairman, Ben Bernanke has indicated 1% or less would be considered exceptionally low. In September 2012, the Fed announced it would buy \$40 bn per month of agency mortgage-backed securities and in December 2012 that it would also buy \$45 bn per month of treasuries (4 year maturity and above) which means all parts of the yield curve will benefit from a near-zero anchor until late 2014. The U.S. 2 year/10 year treasury spread is now 1.48% 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 3.32% - (3.31%, end of November 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 5.4 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. A recovery in house prices appears increasingly sustainable 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 is easing 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 should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 18 – 24 months 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 49 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..

The VIX (volatility index) is 16.80 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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Market Commentary



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