Market Commentary

PORTLAND INVESTMENT COUNSEL™

February 4, 2013

News Highlights on Current Holdings

Financial Services Companies

Allianz and HSBC signed a 10-year distribution agreement that will see HSBC selling Allianz life and pension products in Turkey and possibly other European countries, Allianz said, adding it will pay HSBC €23mn to be the exclusive provider of the products in Turkey.

Barclays CFO Chris Lucas and head of investment banking Rich Ricci have been named in a damages claims against the lender relating to the alleged manipulation of the Libor rate. The men were among the list of 104 of the bank's current and former employees, including former directors Bob Diamond, John Varley and Jerry del Missier, mentioned in the first claim of its kind relating to Libor in the UK. Barclays has revealed - finance director Chris Lucas is to announce his resignation today, continuing the clear-out of top executives since the Libor interest rate manipulation scandal broke last summer. This was always a risk after the apparent widening of scope of the Qatar enquiry, but it appears that the he will stay on until the end of the year giving some time for a replacement to be appointed. This was anticipated and we don't think it a bad thing as he was always going to be viewed as being slightly tainted by association with the old regime and his health probably warrants he withdraw from this demanding role. General counsel Mark Harding is also leaving the bank.

BBVA has issued a press release confirming the sale of its pension business in Chile to MetLife. Total consideration for the 64.3% stake is $1521mn and net capital gains of €500mn. BBVA already agreed to sell its Pension fund management in Colombia to a local competitor for $530mn and will book a gain of €265mn net of tax and to sell the Mexican pension company to Banorte for $1,730mn and a net gain of €800mn. Both deals and the Chilean one will be booked in 1H13. The bank intends to use the profits to strength Core Tier 1 Capital by 60-70bps.

Canadian Banks : Moody's has downgraded, as expected, the senior debt ratings of 6 Canadian Banks by one notch with their outlooks all now stable: Bank of Montreal downgraded to Aa3 from Aa2; Bank of Nova Scotia downgraded to Aa2 from Aa1; Desjardins downgraded to Aa2 from Aa1; CIBC downgraded to Aa3 from Aa2: National Bank of Canada downgraded to Aa3 from Aa2; TD downgraded to Aa1 from Aaa. Royal Bank of Canada's ratings remained unchanged, given the earlier downgrade in June 2012.

Deutsche Bank reported a €2.6bn pre-tax loss in 4Q12, or €1.2bn underlying pre-tax profit (adjusting for €1.9bn goodwill and intangible charges, €354mn restructuring charges, €1.2bn in litigation provisions and €372mn of other items including Own Debt Value Adjustments, IT write-downs in AWM, equity stake sales and write-downs). A messy quarter for the P&L , but a significant positive for the risk-adjusted capital ratios, with Deutsche achieving the 8.0% Core Equity Tier 1 ratio target a quarter early and raising the March 2013 target to 8.5%, significantly catching up with the peer group. Operationally, cost control was good, especially in Corporate Banking, although the revenue performance in FICC (Fixed Income, Currency and Commodities) was disappointing. Core Equity Tier 1 capital came in well ahead of expectations at 8.0%, from a much quicker reduction in Risk Weighted Assets. Basel 2 RWA fell 9% in the quarter, with Basel 3 RWA equivalent down €55bn, or -12%, to €401bn. Half of the RWA came from reducing the non-core portfolio (€13bn) and €15bn from portfolio optimization. The other half came from a lower VaR (value at risk) multiplier (€11bn) and only €8bn from 'model improvements' (which is the bit we believe the market will distrust).

Goldman Sachs is seeking to reduce its exposure to China's controversial banking sector by selling more of its shares in ICBC. The investment bank was offering $1bn worth of ICBC stock for HK$5.77 per share which represents a 3% discount to ICBC's closing price in Hong Kong on Monday of HK$5.95. It is also the fifth time that Goldman Sachs has unloaded part of its ICBC stake in recent years. (Source Financial Times)

HSBC - The $7.4bn sale of its stake in Ping An Insurance (Group) Co. to Thai billionaire Dhanin Chearavanont was cleared by regulators. Dhanin's Charoen Pokphand

Group Co. and HSBC said payment was made in cash after the China Insurance Regulatory Commission approved the sale of 976.1mn Hong Kong-traded shares in the nation's second-largest insurer, ending six weeks of speculation over the deal's fate. HSBC said in a statement that it expects to complete the transfer on Feb. 6. The transaction will generate a $2.6bn profit for HSBC, bolstering Chief Executive Officer Stuart Gulliver's efforts to improve profitability hurt by U.S. probes of money laundering and compensation claims from U.K. clients.

National Australia Bank has topped its big four rivals in the home loan market as the sector suffered its worst year on record amid global economic uncertainty. New figures released on Thursday showed NAB grew its mortgage book by 7.8% in 2012, the most of the big four banks. The total home loan market increased by a weak 4.5% over the year according to the Reserve Bank of Australia – the worst result since records began in 1976. (Source Australian Financial Review).

Nordea published its 4Q12 results, with 4Q PBT of € 1,059m, 8% higher than consensus of €985m. Outperformance was driven by better Revenue, with net fees and commissions from Asset management delivering the beat. Divisionally, both Retail and Wholesale banking were disappointing whilst Asset management delivered a robust results, with PBT nearly double from last quarter, thanks to the positive investment performance and higher net inflow. Nordea lifts the DPS for 2012 to €0.34, beat consensus at €0.30. Core Tier 1 capital ratio at 13.1% (ex. transition) better than 12.3% forecast due to Risk Weighted Assets €215bn down 4% on Q3.

Royal Bank of Scotland is winding down its M&A business after failing to secure a buyer for the division, which pulled in US$436mn in annual fees at its zenith six years ago. The bank made most of its 40 M&A bankers redundant at the end of last year, after attempts to spin off the unit failed amid one of the worst markets for dealmaking in decades. (Financial Times).

Santander : 4Q12 results. Core earnings, capital and asset quality all look weaker than expected. (i) Net profit of €401m significantly weaker than consensus (€916m) and our estimate (€832m). Higher provisions were a key driver but NII (-3% vs est) and fees (-2% vs est) were also significantly weaker than expected and offered only a partial offset to better than expected cost control. (ii) Looking through the division headlines, the disappointment seems widespread. Both Spain and UK missed already weak expectations, whilst Mexico also saw a large QoQ drop in net profits. Profits in Brazil fell 3% QoQ, but wre slightly stronger than we expected. (iii) At 10.3% the core Tier 1 ratio fell QoQ (from 10.4%) and weaker than expected (our est 10.5%). Meanwhile asset quality trends continued to deteriorate - Group NPL ratio rose to 4.5% (up from 4.3%) driven by ongoing deterioration in Spain (6.7% vs 6.4%). The higher provisions booked did at least result in an improvement in coverage levels but given the continued rise in NPLs the 2013 outlook remains tough in our view.

Santander's British arm is gearing up for a stock market flotation next year or in 2015, once it has improved its balance sheet and expanded corporate lending, a senior executive said on Thursday. Spanish parent Santander has separated and listed operations in some countries, including Mexico last year, and has said it will do the same for its UK arm when the conditions are right. (Source : Reuters)

Swedbank reported 2012 with SEK4.3bn profit (19% ahead of consensus) beating essentially on all line items. Furthermore, the bank raised its dividend payout permanently to 75% for a 7.3% yield. While helped by several one-offs (Net interest income and tax), this was a very strong result with good core revenue momentum, ongoing cost control and no major signs of credit deterioration. Revenues of SEK9.5bn were 5-6% ahead of consensus with Net interest income growing 4% QoQ, fees up 5% QoQ (beating consensus by 4%) and slightly better other revenues. NII benefitted from a strong treasury result. Costs saw the seasonal increase expected, but remained 1.4% below consensus. Swedbank exceeded its FY12 cost target of SEK1bn (ex variable comp) and in fact cut by SEK1.4bn. Swedbank cited no tangible impact on Asset Quality from Swedish slowdown. Stronger Baltic reversals

(SEK329m) offset higher large cap charges (mainly shipping). Non Performing Loans fell further to 1.1% and Swedbank reduced coverage by 3% to 62%.

Basel II Core Tier 1 increased to 17.4% (despite higher dividend though helped by lower-than-expected Risk weighted assets at -1%Q) and 15.4% Basel 3 Core Tier 1 - management updated its target Basel 3 Core Tier 1 ratio range to 13-15%. Swedbank permanently raised dividend pay-out to 75% (from 50%)

The resulting Dividend Per Share of SEK9.9 provides for 7.3% yield. Swedbank noted that this payout will still see them building capital though at slower pace

Banks' Debt Product Skirt Liquidity Rules – The Financial Times reported last week that US banks led by JPMorgan Chase are offering a new type of debt product that will help them to skirt new rules requiring them to hold war chests of liquid assets. The new product is known as "callable commercial paper" and is sold by banks on behalf of US municipalities which use it as a type of financing. The callable version is being openly marketed by at least two big banks as a way for them to bypass new liquidity rules, making it cheaper for them to sell the paper on behalf of munis. Banks often backstop short-term debt sold by US municipal issuers. When the financial crisis struck, many munis found traditional buyers for their short-term debt disappeared, meaning banks had to step in and buy the paper instead. To mitigate that risk, the Basel Committee of Banking Supervisors has proposed new rules that require banks to hold a portfolio of liquid assets against such short-term credit commitments. Banks have to hold high-quality assets to cover any credit commitments which could be tapped within 30 days. The banks say that would make it more expensive to provide the backstops. To mitigate the expense, banks have created "callable" paper for muni issuers which sell floating-rate debt – currently a $260bn market. Callable CP comes with a longer maturity of up to 200 days but would be redeemed by the issuer before 30 days. That will allow banks to avoid the liquidity rules, since the paper has a term of 30 days or more, and still make it palatable to money market funds which buy the short-term debt.

Dividend Payers

BHP – Worker's at Escondida, the world's largest copper mine, located in Chile, voted to approve a new contract proposal, helping remove fears of work stoppages and delays in production. The mine is majority owned by BHP Billiton, who said last month the mine was on track to increase its copper output by 20% in the 2013 financial year.

Johnson Matthey – The leading global catalytic converter and platinum processor and trader reported third quarter results which were broadly in-line with the expectations. Group sales, excluding precious metal sales, were down by 2% to £635mm, while the underlying pretax profit was down 19% to £84.3mm, mainly because of a change in the mix of its catalysts business and lower sales in its precious metals unit. The company saw lower sales of catalysts for vehicle exhaust systems in the high-value diesel category in Europe and weaker demand in Japan. In term of outlook, Johnson Matthey said it saw no upturn in Europe and Japan for its catalytic converter business in the new calendar year, but emphasized more promising prospects in North America. In its precious metals trading and processing unit, a small increase in realized platinum group metals (PGM) prices was outweighed by volume declines, impacted by work stoppages at Anglo Platinum.

Nestle – Germany's federal competition agency fined 11 chocolate and confectionary companies, including Kraft, Nestle and Alfred Ritter, with €60mm for agreeing anti-competitive price increases. The fine relates to searches of company offices made in February 2008 with the help of a subsidiary of Mars, which will not be fined as a result. Both Ritter and Nestle said that they intend to challenge their fines, on the grounds that the allegations were unjustified and questioning the 'methods and manner with which the agency has interpreted the competition law'.

Posco – reported fourth quarter results which missed the expectations as slower demand and lower prices offset better raw materials costs helped by a stronger Korean won. Operating profit for the quarter reached KRW379Bn, roughly half last year's level. Fourth quarter sales retreated 20% to KRW8.07Tn. POSCO, however, managed to maintain higher margins than its bigger peers, supported by its dominant position in the domestic market and its cost efficiency. POSCO, which counts Warren Buffett as a major investor, said the 'global race for survival will be fiercer than ever this year' and guided for a 10% drop in its top line, to KRW32Tn. It also guided for an 11% increase in its investment, to KRW4Tn, in order to remain competitive. The stronger Korean won has been helping the steelmaker as it imports more raw material than it exports finished steel products, however, the stronger won could hurt steel demand from automakers and other exporters in the long run.

In a separate piece of news, it was revealed that the Indian state of Odisha, formerly known as Orissa, resumed acquiring land for POSCO's planned $12Bn steel mill, India's biggest single foreign direct investment.

Roche – Clearly standing out in the crowd of big pharma companies reporting recently, Roche forecast a rise in sales and profits for this year, helped by its expanding oncology franchise. Sales for 2012, reported last week, rose 7% to CHF45.5Bn and the group said it expects sales for the current year would grow at a similar pace. Roche also said it was aiming for core earnings, up 11% in 2012, to increase ahead of sales. The company proposed a dividend of CHF7.35 per share, compared to CHF6.80 per share a year ago, and maintained its commitment to increased payouts to shareholders. Sales of Perjeta, a follow-on to Roche's current second-biggest seller Herceptin, a treatment for women with a particularly aggressive form of breast cancer, reached CHF56mm, up from CHF26 in the third quarter. The company's strategy is to develop new drugs to extend the longevity of its best-selling brands. US regulators are expected to decide on February 26 whether to approve another new breast cancer drug called T-DM1, which Roche hopes will be used in combination with Perjeta. Later in the week Roche reported that GA101, a follow-on to its leading MabThera/Rituxan franchise, met primary end-points in first late-stage study. The study revealed that GA101 significantly improved progression-free survival in people with chronic lymphocytic leukemia (CLL). A second set of data, specifically comparing GA101 to MabThera/Rituxan, is due later this year.

Toyota – reported US sales which were up almost 27%, beating the expectations and well ahead of the market growth of 14%. The annualized level of US vehicles sales was 15.3mm for January. Toyota's Chinese sales, including sales of Toyota and its Chinese joint venture's vehicles, rose 23.5% in January compared with a year earlier, to 72,500 cars. Toyota, which operates car ventures in China with FAW Group and Guangzhou Automobile Group Co, aims to sell 900,000 cars in the country this calendar year, up 7.1% from a year earlier.

Toyota is recalling nearly 1.3mm vehicles worldwide for two separate defects, including Corolla and Corolla Matrix to fix airbags that could deploy inadvertently. Toyota will add an electrical signal filter to the airbag control module to the recalled vehicles, with repairs expected to take an hour to an hour and a half. TRW Automotive Holding Corp has manufactured the airbag control unit. The financial impact of this recall is likely to be limited and Toyota may ask suppliers to compensate. Separately, Toyota is recalling a number of Lexus IS series over wiper problems, the fix of which involves exchanging a nut and should take about 30 minutes.

Wesfarmers – provided a trading update for the second quarter of its fiscal year, a key quarter for its retail division. The company's grocery retail operations, under the name of Coles, delivered a 5% headline food and liquor rate of growth, to $7.7Bn. Overall sales at Coles, which also includes gas stations, were $9.9Bn, up 5.2%, while same store sales were up 3.9% in the quarter, just shy of analysts' forecast of 4.0% growth. The group reported a 0.9% price deflation in its food and liquor business, which makes the reported results that much more impressive. A long-running price war, involving mostly its arch-rival Woolworths, enticed cost-conscious shoppers and boosted sales volumes. Sales at its 'star' home improvement division, Bunnings, were up 6.6%, to $2.2Bn. On the flip-side, Wesfarmers had to cut its full-year coal sales forecast, because of flooding in its production basins and weak demand in Asia.

Economic Activity, Consumer and Business Conditions

US – Last week's announcement of the fourth quarter US GDP growth, a negative 0.1%, was a significant negative surprise compared to expectations for a 1.1% increase, and it has been blamed on the effects of hurricane Sandy as well as an unexpected drop in inventory levels and a significant pull-back in government spending (i.e relates to the third quarter pre-election boost in defence spending). Given that some of the contributors to GDP growth have been artificially inflated in the prior quarter, with the revised third quarter GDP up 3.1%, typical of an election year, it is probably best to look at the two quarters in tandem and tally some 1.5% of economic growth for each of them, more in line with the economists view of the state of the US economy.

The January employment report was more in-line with the expectations, albeit missing on the downside for both the headline non-farm payroll additions, at 157,000 versus 160,000, and the unemployment rate, up one tenth to 7.9% versus 7.8%. However, the previous three months payroll additions were revised upwards by 150,000 and private payrolls were once more a net contributor, with 166,000 positions added in the quarter, while jobs in manufacturing, at 4,000, fell short of the expected 10,000 positions. Average weekly earnings and hours were roughly in-line with the expectations.

Sentiment indices offered a mixed consumer picture for January, with the University of Michigan's Consumer Sentiment index recovering in January, driven by better 'expectations', while the Consumer Confidence index, as measured by the Conference Board, pointed to a continued worsening of the consumers' mood, down to 58.6 from 66.7. The personal consumption and income reports seemed to offer something for both views, as personal income unexpectedly jumped 2.6% in December, ahead of the expectations for a 0.8% improvement, while the more circumspect consumer seems to be reflected in a deceleration of the US personal consumption in December, up only 0.2% compared to November's 0.4% increase and expectations for a 0.3% read. Part of the same report, the core personal consumption expenditures (PCE) price index, Fed's favourite inflation gage, showed and even tamer inflation, at a 1.4% year on year rate, from 1.5% rate for November.

Canada – The GDP growth in Canada was 0.3% in November, better than expected and an acceleration compared to the month prior, driven by manufacturing, utilities and the mining sector, with the hospitality and entertainment industries at the other end of the spectrum. Construction was largely flat in the month, a hopeful sign of a soft landing for the Canadian housing sector.

Spanish Prime Minister Rajoy is facing corruption allegations which may lead to his departure.

French Finance Minister commented that the Euro may be too high.

Former Italian premier Silvio Berlusconi is growing in popularity with calls for Italian tax cuts. Berlusconi announced his "last great electoral and political battle" on Sunday with a sweeping promise to cut taxes and the cost of government if his centre-right wins elections this month.

Japan's public pension fund, the world's biggest manager of retirement savings, is considering the first changes to its asset structure in seven years as a new government pursues policies that could erode the value of $747 billion in local bonds. Managers of the Government Pension Investment Fund, which oversees about 108 trillion yen ($1.16 trillion) in assets, will begin talks in April about whether to reduce its 67% target allocation to domestic bonds, Takahiro Mitani, who has been president since 2010, said in a Feb. 1 interview in Tokyo. The fund may increase holdings in emerging market stocks and is evaluating alternative assets.The GPIF, as the fund created in 2006 is known, didn't alter the structure of its holdings during the worst global financial crisis in 80 years or in response to the 2011 earthquake and nuclear disaster. Talks to shift its positions come as Prime Minister Shinzo Abe and the Bank of Japan pledge to restore economic growth and spur inflation, which will mean higher interest rates, Mitani said. "If we think about the future and if interest rates go up, then 67 5 in bonds does look harsh," Mitani, who was an executive director at the Bank of Japan when it bought shares from banks in 2002, said. "We will review this soon. We will begin discussions for this in April-to-May. Any changes to our portfolio could begin at the end of the next fiscal year."

GPIF, one of the biggest buyers of Japanese government bonds, held 69.3 trillion yen, or 64% of total assets, in domestic bonds at the end of September, according to its latest quarterly financial statement. That compares with 12 trillion yen, or 11%, in Japanese stocks. The asset manager had 9.6 trillion yen, or 9% of its portfolio, in foreign bonds.

Financial Conditions

UK Banks: George Osborne, UK Chancellor of the Exchequer, gave a speech today confirming that he will take Parliamentary Select Committee recommendations on "electrifying" the ring-fence between Investment and Retail banking operations - more specifically will give the regulator powers to break up banks that breach the rules. Osborne expects the legislation being introduced today to become law within one year. Under Mark Carney, the Bank of England is set to gain new powers of supervising banks.

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% (January 7.9%) 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 1.74% and the U.K.'s 2 year/10 year treasury spread is 1.77% - 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 3.53% - (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 4.4 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 2 in 2013 (compared to 49 in 2012, 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 13.97 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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