



Recirculation of shares in European Premium Dividend Fund (EPD.UN):

- **The EPD.UN** fund is undergoing its annual redemption privilege. This creates an opportunity for those wishing to increase their stake in this fund via the resale of those units which have been tendered for redemption. As outlined in the prospectus we have entered into a recirculation agreement whereby CIBC as the recirculation agent uses commercially reasonable efforts to find purchasers at a price which is not less than the prescribed redemption price (including the deduction for the redemption fee of \$.045) to be paid to the redeeming unitholders. In practice this means that for 1 or 2 days CIBC (broker code 79) will, on the fund's behalf, be offering to sell units. During this period there will therefore likely be considerably more liquidity in the shares enabling larger purchase orders to be filled.... which I understand is a challenge during other trading periods. We therefore wanted to bring to your attention that in early June this recirculation opportunity will be opened – however as soon as CIBC have physically traded a sale then the recirculation 'window' will close at latest the day after.
- If you are interested in purchasing shares over this period we have attached the most recent client friendly fund brief.
- **Given the significant adverse volatility in share prices in May, CDS (Clearing and Depository Services) have been informed that unitholders who tendered the annual redemption privilege for European Premium Dividend Fund may withdraw their tender by notifying CDS by latest June 4th 2010 (7.00pm Toronto time)**

News Highlights on Current Holdings

Financial Services Companies

- **Royal Bank of Canada** cash operating earnings declined 1% YOY to \$0.96 per share, below consensus expectations of \$1.10. After previously strong quarterly performances this quarter was therefore relatively weaker -earnings were negatively impacted by weaker trading revenue and wholesale earnings. Operating Return on Equity was 17.3%. Much like TD, earnings were driven by strong Canadian Banking results (up 27%) with net interest margin improving 4 basis points and solid year-over-year growth from Wealth Management. Wholesale Banking earnings were weak, declining 10% from a year earlier due to large declines in trading revenue. Insurance earnings declined slightly year over year while International Banking remained in a modest loss position due to continued high levels of loan loss provisions, although moderating. Generally, loan loss provisions of \$504 million

were better than most expected strengthening the belief that credit is under control. And so in all, capital ratios remain strong – with Tier 1 at 13.4%.

- **TD** reported cash operating EPS of \$1.36 versus consensus of \$1.40 with return on equity of 13.7%. Declining loan loss provisions helped drive operating EPS growth, offset by a more modest contribution from its wholesale franchise - TD Securities. The quarter's results did highlight the ongoing retail earnings power at TD Canada Trust (albeit a sequential 1 basis point decline in net interest margin) and the earnings potential of its Canadian P&C insurance (earnings up 29%) and wealth management (up 33%) franchises. Mutual fund assets under management increased 20.6% to \$62.6 billion. Similar to RBC, credit trends are now moving in the right direction albeit given the larger US book , challenges still remain. Nonetheless, capital cover is strong with Tier 1 ratio at 12% although post the latest US acquisition (South Financial) the ratio will fall to 11.5%.
- **Lloyds / RBS - Standard & Poor** raised the “stand-alone” credit profile of the banks' core businesses - a measure that reflects their existing government support - from BBB to BBB+. S&P said both banks had signaled improving margins and cost efficiency and looked to be making headway in scaling down their reliance on wholesale funding. The actual credit ratings of the banks - which factor in the possibility of future government assistance - were unchanged at A+/A-
- **Deutsche Boerse AG**, Europe's largest exchange, is reported as indicating that a proposed dividend for 2009 of 2.10 euros per share is “reasonable.”
- **Standard Chartered**, the U.K. lender that makes at least three quarters of its profit in Asia, raised about 24.9 billion rupees (US\$540 million) from a sale of shares in India, albeit in difficult markets this was at the lower end of the proposed offering.
- **Regulatory Reform** : The Wall Street Journal reported last week that House Financial Services Committee Chairman Barney Frank said the White House's proposal to stop banks from certain risky trading practices would “very likely” be in the final financial overhaul, but said that a separate provision to force banks to spin off their derivatives businesses “goes too far.”

Dividend Paying Companies

- **Severn Trent** reported strong full year March 2010 numbers. They beat consensus by c5% at Underlying EBIT and c4% at PBT, driven by stronger than expected performance in the water division.
- **Regulated water:** At their January Interim Management Statement, Severn Trent noted that despite allowed price



increases of 5.3% for 2010, falling consumption had stabilised but was still forecast to impact revenues by £5-10m for 2010. However, actual revenue growth came in at 4.6% as lower consumption only resulted in a fall of c£3.5m. EBIT was 19% higher at £541m. This reflects strong increase in efficiencies, particularly reductions in pension costs and contracted services. The group invested £36.2m in efficiency programs versus expectations of c£20m, which they believe will create c£13m additional cost savings of which 50% will come in 2010/11. We view this clarity and clear progress as a positive. Infrastructure renewals declined c£25.6m, in-line with guidance. Bad debts increased marginally to 2.5% from 2.3% in FY Mar 09A. They are guiding to commercial consumption declining 2% on an ongoing basis.

- **Unregulated:** The Water Services division at Severn Trent is not a big contributor to Group profits. EBIT fell c6% to £29m.
- **BHP Billiton, Wesfarmers** – ‘The Australian’ reported last week that the Australian regulators are already reconsidering key elements of the recently proposed mining resources super-profits tax, following vehement opposition from mining companies and industry groups in Australia and abroad.
- A consultation panel which involved over 80 companies is the regulator’s main negotiation arena with the industry. One of the main critiques brought against the proposed reform was that the country’s competitiveness would be seriously affected, investments would be significantly reduced and job creation and economic growth would be jeopardized. BHP Billiton’s chief executive, Marius Kloppers, said that the tax “goes against the core offering that Australia has, which is being a stable place for investment.” In addition, many fear that the implementation of such a reform would likely cause other resource rich nations to follow suit. Such a move would impact investment in the sector globally which would result in tight supplies, increased commodities cost and slow down of the economic growth.
- The regulators are likely to consider lifting the super-profits threshold to about 12% from the initially proposed 6% figure. To offset the budgetary loss, the regulators are likely to withdraw the 40% support for mining projects that fail, which was part of the original design of the tax reform. The miners’ reaction to the expected alteration of the reform was dismissive - the action being seen as ‘tinkering at the margins’ in our view such a reaction was hardly surprising and given how quick the government was in adjusting its initial proposal, many industry analysts are expecting the reform to be watered down even further.
- **Siemens** – The Russian state rail company signed a contract for the purchase of 221 locomotives worth 1.36 billion USD.

The German engineering group and the local manufacturer Sinara Group have created a joint venture which will supply the locomotives between 2011 and 2016.

- **Bayer AG’s Nexavar** for liver cancer failed to win the recommendation of a U.K. agency that advises the state-run National Health Service on cost-effective treatments.
- **Novartis AG’s** experimental medicine EPO906 failed to help extend the lives of patients with advanced ovarian cancer, a late-stage study found.
- **Syngenta** said it agreed to buy the Maribo Seed sugar beet business from Nordic Sugar for 43 million euros plus 5 million euros in contingent payments.
- **Siemens** – the German engineering group has announced it is investing about E3 billion (US\$3.7bn) in India, China, Russia and Brazil over the next 3 years in a drive to produce technology especially adapted for a quick roll-out in emerging markets.... Including technology for traffic management, solar-powered X-ray machines, wind-power generators and a ‘smart’ camera.

Economic Activity, Consumer and Business Conditions

- **US:** The US personal income number grew by 0.4% in the month of April, the highest growth in recent months, yet slightly below the expected 0.5% appreciation. At the same time the personal consumption expenditures remained flat on a month on month basis as the personal savings rate grew to 3.6%, temporarily reversing a trend that saw the personal savings rate dropping to 3.1% last month from as much as 6.4% in May of last year. Part of the same report, the core personal consumption expenditure (PCE) price index yearly change moved to 1.16%, very close to its all time low of 1.1%. This low reading for the core PCE, the Fed’s preferred inflation gage, is in our view, clearly indicating that a change in the monetary policy is unlikely to happen any time soon.
- The **manufacturing** activity is continuing its recovery with the durable goods orders moving higher by 2.9% in the month of April, helped largely by an influx of orders in the bulky business of aircraft manufacturing. Orders excluding transportation were down 1% in the month. The shipments grew by 1.4% in the month of April, following March’s 2.1% increase, led by the computers and electronic products. The inventories growth of 0.7% indicates a healthy inventory to shipments ratio now back down to 1.24, very close to the historical trend.
- Strongly supported by the expiring home buyer tax credit programme, the new home sales in US grew by 14.8% in April, to 504,000 units, on top of the 29.9% increase in



March, while the inventory of new homes was reduced to 5 months at the current sales pace, very close to the historical normal level. While such a strong growth pace is not sustainable, and the next sales months are likely to be weaker, as there is no longer a tax incentive in place, we hope the last two months helped form a bottom in the new home sales.

- **Canada:** The Canadian GDP grew at an impressive 6.9% annual rate in Q1 of 2010, following a 4.9% growth in the last quarter of the 2009. Inventories rebuilding and consumer expenditures lead the economic growth in the quarter. The GDP by industry report for the month of March indicates a 0.6% month on month improvement, with most major industrial sectors being net contributors, notably the manufacturing, mining and oil and gas extraction, wholesale and retail trade, as well as the residential construction. Such a strong pace of the economic recovery leaves, we believe, little room questioning whether the Bank of Canada will opt for higher interest rates during its key policy interest rate announcement tomorrow. Inflationary pressures are also being visible throughout the economic chain, with the raw materials price index up 1.7% in the month of April, while the industrial product price index moved higher by 0.3% during the same month. Last week, the average weekly earnings report revealed a 2.9% yearly increase in the Canadian workers' income.
- **Global Growth:** The OECD provided a rosier last week outlook saying world GDP will hit 4.6% for 2010, up from its 3.4% forecast in November.

European Austerity measures:

1) Greece (2014 target to meet 3% deficit)

- Austerity measures totaling 30bn (~13% GDP) through 2013:
 - Freeze on public-sector wages and elimination of "13th" and "14th" month bonuses (+1.5bn)
 - Reduction in pension payments (+1.85bn)
 - Increase in retirement ages for some public-sector workers and early retirement age to 60 yrs
 - Increase in excise taxes (fuel, alcohol and cigarettes) (+250mm)
 - Increase in VAT from 21% to 23% (+800mm in 2010)
 - Ad hoc tax on "highly profitable businesses"
 - Significant cut in military spending
- Greek Government estimating 2010/11e GDP -4% / -2.6%; January unemployment 11.3%

- 3% deficit target deadline now pushed back to 2014 (vs. 2012)
- Greece indicating debt/GDP to peak at ~140% in 2014 vs. 115% in 2009
- Reuters estimates 86bn Greek debt due through May 2013

(2) Ireland (2014 target to meet 3% deficit)

- Eur 1bn reductions across public service pay at the following rates:
 - 5-8% on a sliding scale for those below 125k salaries
 - 8% for those earning €125k-€165k
 - 12% for those earning €165k to €200k
 - 15% for those earning €200k+
- A new pension scheme is to be introduced for all new entrants to the civil service based on career average salaries, rather than final salaries, while the minimum pension age is to be raised from 65 to 66.
 - 760mm reduction in welfare benefits
- Net Impact to Irish Budget Deficit
 - 2010 deficit estimated to be -12% vs. -20% pre-fiscal action
 - 2011 deficit estimated to be -10%
 - 2014 compliance with EU guidelines <3% budget deficit

(3) Portugal (2013 target to meet 3% deficit)

- VAT +100bps (6% for necessities, 13% for restaurants, 21% for most other goods and services)
- Income tax rates:
 - 500bps higher for corporates with income >2mm (250bps apiece for government and local administrations);
 - 100bps higher for individuals earning <18,000
 - 150bps higher for individuals earning >18000
 - New 45% marginal rate for individuals earning >150000
- Lowering subsidies for state-owned companies and delaying investments in railway projects (1bn projected savings)
- Salaries -5% for senior government officials and executives at state-owned companies
- Unemployment benefits maintained at 65% gross salary but now subject to a cap of 75% of salary aftertax
- Announced measures are to remain in force through the end of 2011 and are projected to reduce government deficit from -9.4% in 2009 to -7.3% / -4.6% in 2010/1 vs. previous projections of -8.3% / -5.1% for 2010/1. Market projections are the cumulative reductions equate to 3% GDP. Portugal to meet -3% target for 2013.



(4) Spain (2013 target to meet 3% deficit)

- Additional 15bn budget cuts announced last week (65bn total)
- Public sector wages -5% for 2010 and wage freeze for 2011 (15bn projected savings)
- Pensions to be frozen in 2011
- Permanent elimination of “baby check” (2500 for each newborn) beginning in 2011
- 6bn cut in public investments for 2010-11

The new cuts are projected to reduce government deficit from -11.2% in 2009 to -9.3% / -6.0% in 2010/1 vs. initial projections of -9.8% / -7.5% for 2010/1. Spain to meet -3% target for 2013.

(5) Italy. (2012 target to meet 3% deficit)

- Spending cuts of -10% for municipalities (13bn savings)
- Extending eligible age for pensions (5.2bn savings)
- Three-year salary freeze for Government employees (5.3bn savings)
- More real estate sales (1bn proceeds)
- Improved tax collection

The austerity measures look to total 24.5bn (1.6% GDP) which will be realized between 2011-12. Italy targeting reaching <3% deficit in 2012 (vs. Portugal/Spain 2013 and Greece 2014).

Italy Deficit (Govt Estimates)

2009 -5.3%
2010 -5.0%
2011 -3.9%
2012 -2.7%

Financial Conditions

- **Germany** – according to a report from the BBC last week, Germany is considering widening their ban on naked short selling on certain financial stocks to cover all German listed stocks. The proposals are expected to be discussed by the German cabinet this week.
- **Policymakers** continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.52% and the U.K.'s 2 year/10 year treasury spread is 2.70% - these spreads are narrowing and the US spread is at its slimmest since August 2009 but they are still historically wide - and are enabling financial services companies' assets booked at these levels, to be very profitable, so enabling

them to accelerate the absorption of anticipated consumer credit losses.

- Our concerns are mostly focused around the later cycle issues facing financial services companies – particularly commercial real estate and unsecured consumer loans/credit card loans. However, commercial real estate exposure is more acutely held by US regional banks – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (78 to-date in 2010 and 140 in 2009) but their 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. We understand however that the FDIC is changing the loss share arrangement on assisted deals from absorbing 95% of losses down to absorbing 80% although this is still attractive to acquiring banks it does probably lower the Internal Rate of Return.
- **The U.S. 30 year mortgage market** has remained low and has now fallen back to 4.78% - the record low is 4.71% - as the Government and Fed continue to incentivize new home owners. U.S. housing inventory has reduced to 8.4 months supply of existing houses – but that is still higher than what we believe is a more normal range of 4-6 months. We believe it remains premature to consider a recovery in house prices but a measure of stability from which to build is welcomed.... particularly for those financial services companies holding such assets in their portfolios.
- A concern which remains is the extent to which loan modifications are an exercise in loss deferral but 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.
- **The VIX** (volatility index) is 32.07, which is below the levels experienced prior to the ECB bail out and substantially lower than last August/September. While, by its characteristics, the VIX will remain volatile, it is evident that increased tension in North & South Korea and Europe sovereign debt concerns have increased risk aversion to the detriment of equities – we believe a VIX level below 25 augurs well for quality equities.
- We believe the next few years will highlight the growing polarization between strong and weak institutions. Companies

Market Commentary



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that have capital strength will buy assets from those required to divest. Companies that have a strong presence in emerging markets will likely grow quicker than those that do not. Banks that have strong retail deposit franchises will take market share from those that rely on wholesale markets to fund loan growth at attractive margins. Financial services companies that have breached client trust will keep losing business to those reputations that have been enhanced by the crisis. We believe the Funds we manage are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

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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