Market Commentary

PORTLAND INVESTMENT COUNSEL™

January 4, 2010

News Highlights on Current Holdings

- Barclays – WSJ reports Barclays has pipped Deutsche Bank to the title of top European bookrunner of the decade having lead arranged more international and domestic bond sales for issuers in the region than any other bank.
- UK Banks – Sunday Times wrote that the largest bank in Brazil, Itau Unibanco, may be interested in buying a stake in either Lloyds Banking Group or Royal Bank of Scotland when the Government starts to divest their holdings in each, but is in no hurry to do so.
- This morning Nestle has announced that it is exercising its option to put its remaining 52% stake in Alcon to Novartis for an average consideration of $180/share, realizing $28bn of cash proceeds – the maximum possible achievable price for Nestle under the agreement with Novartis.
- Today's announced disposal brings the total sales proceeds achieved from the Alcon divestment to ~$40bn against the $280m acquisition price paid by Nestle in 1977. The $28bn disposal proceeds announced today are cash and are tax free. The deal is expected to complete mid-2010 subject to the necessary regulatory filings.
- Simultaneously, Nestle has announced a new CHF10bn buyback program to be completed over the next two years, which comes on top of the remaining CHF5bn of the three year $25bn buyback program announced in August 2007.
- Nestle has only accounted for the use of ~$10bn of the expected $28bn proceeds, leaving the market to speculate as to the likely uses of the remaining $18bn. While a bump in the dividend payout ratio is possible, we believe a special dividend is unlikely due to Swiss tax considerations. With the company recently restating its commitment to maintain its AA credit rating, we believe today's announcement may lead to speculation that Nestle emerge as a contender for Cadbury.
- Novartis has offered a below-market price of $153 for the 23% of Alcon that is publicly traded. This is because it appears that Novartis has the upper hand due to unique circumstances related to Swiss merger law. Both Novartis and Alcon are Swiss companies, but Alcon is listed on the NYSE.
- Novartis already owns a 25% stake in Alcon that it purchased from Nestle back in April 2009, and the company announced today that it will acquire another 52% of Alcon from Nestle in 2010. Once this 52% stake goes through, Novartis will have a majority of the board seats at Alcon, and it will own 77% of total Alcon shares outstanding. Swiss merger law, according to Novartis management, says that a simple majority of Alcon board votes are needed and that 2/3rds of Alcon shareholders need to support the deal. Novartis also says the law allows for it to vote its stake in favour of the transaction.
- In other words, once it owns 77% of Alcon, it appears that Novartis can "force" through the rest of the transaction, leaving non-Novartis minority shareholders in Alcon without much power. This implies that the $153 below-market price Novartis is offering is likely to stand.
- The above is contingent on the 52% Nestle stake being transferred successfully, but this is likely to happen per the call/put arrangement that Nestle and Novartis agreed to back in April 2009. Nestle will be a disinterested party as it relates to what may ultimately happen to the publicly-traded minority interest Alcon stake.

Financial Conditions

Worldwide, the improvements in financial conditions are providing support for a rebound in the economic activity and an upgrade in the business conditions.

Policymakers continue to accommodate a recovery in bank profits. The U.S. 2 year/10 year treasury spread is 2.71% and the U.K.'s 2 year/10 year treasury spread is 2.66% - 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 (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. 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 amended Federal Reserve Stats for large domestically chartered commercial banks in the US shows that the quantum of net unrealized losses on available for sale securities peaked in December at -$87.4 billion …improving to -$21.7 billion by end September and as at December 23 was reported as -$6.0 billion (see chart below). The pricing of these securities will in our view become increasingly volatile as liquidity now drives more

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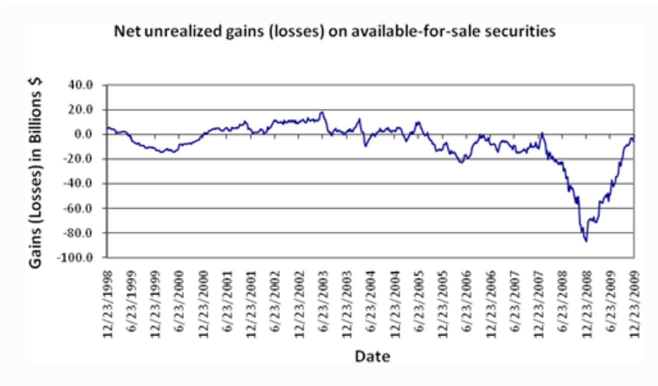
normalized prices but the positive trend is much welcomed. The writing back up of these assets feeds through to the book value and endorses the strategy of many large financial services companies to hold rather than trade such assets.



The VIX (volatility index) is 21.0, below the levels experienced last August/September (and well off the highs of 70-80 witnessed late September/October). While, by its characteristics, the VIX will remain volatile, it is we believe further evidence of markets reacclimatizing to risk – typically we believe a VIX level below 25 augurs well for quality equities. And credit default swaps across most leading financial companies are trading in a gradually improving range of 1%-2% (compared to 5%-7% late September/ early October).

We believe the largest impediment to a sustainable rally remains government intervention, not the global economy.

We believe the next few years will highlight the growing polarization between strong and weak institutions. Financial services companies 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 all the Funds are extremely well positioned to benefit from the strength of their portfolios of strong, dominant, attractively priced financial services companies.

Spreads on the closed-end funds are narrowing but remain wide and so in our view are very attractively priced to purchase. We will this week be looking to re-circulate some shares of Copernican World Financial Infrastructure Trust (CIW) on behalf of Manulife.

At the close of business on Fridays and at the end of each month we publish the Net Asset Values of our funds onto our Portland website at http://www.portlandic.com/Funds/WeeklyPricing.aspx

The details published last Friday are replicated here below from which you can see we also highlight whether the funds share prices are trading at a premium or discount to their respective Net Asset Value.

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