



## News Highlights on Current Holdings

### Financial Services Companies

Credit Suisse beat Goldman Sachs in the rankings of top bankers to private-equity firms last year, logging in a 9.3% market share of fees according to the Wall Street Journal. CS had \$944mln vs \$942mln at GS.

Investment Banks: Dealogic data for the Investment Banks in 4th Quarter suggests trends have been reasonably robust across many business lines, seemingly in-line with or better than the first 9 Months of the year. This data only relates to Debt Capital Markets, Equity Capital Markets, M&A & syndicated lending activities, thus excluding the big swing factor of trading. As such it provides a limited read but shows core Investment Banking businesses showing signs of a pick-up.

Barclays won the dismissal of a lawsuit from a group of investors who accused the bank of not disclosing that the bank held large amounts of Mortgage Backed Securities. The US investors were seeking to recover losses from Barclays due to their alleged failure to disclose and properly account for its real estate exposure. The Judge said there was an "absence of ample allegations that Barclays did not truly believe" how it valued its subprime and other real estate assets, and offered "substantial risk disclosures" regarding its valuations to investors who bought its securities.

Barclays said disputes over an \$11 billion profit it is alleged to have made buying bankrupt Lehmans may not all be resolved in a current trial and may need "further adjudication."

UK banks issue covered bonds; Lloyds plans to sell EUR 750m of bonds due 2023. These are expected to yield 150bps over mid-swap. RBS is selling EUR1bn of 7yr bonds these will be priced to yield 125bps over mid swaps. Net net cheaper than the Spanish (c. 220bps) but more expensive than French covered bonds (c.90bps).

Julius Baer has announced that it is significantly expanding its services for wealthy clients in Germany. Heiko Schlag has assumed the role of head of private banking at the Swiss Bank. Financial Infrastructure

Deutsche Borse has held talks with rival clearing houses about joint clearing in cash equities according to the Financial Times.

Global Payments reported better than expected 2Q11 revenue

and earnings per share, boosting confidence that trends will start to turn more positive in 2011. Normalized earnings per share was \$0.70 on revenue of \$443.5 million. Better than expected results primarily reflected strong performance out of Asia. North American EBIT/margins remain challenged but seem on track to stabilize going into 2011 and 2012

Reflecting stronger performance and some benefit from F/X, the company increased guidance for 2011 organic revenue and EPS. This upside will be offset by \$0.02-\$0.04 per share GAAP dilution from the recent la Caixa acquisition in Spain (on cash basis, acquisition is accretive by \$0.02-\$0.04).

Reflecting Canada slowdown and IT investment drag in US, technical conversion delays and costly service center launch in Manila, the past year has been challenging for the company but we believe momentum is turning and ultimately see the company as a likely beneficiary of Debit Interchange Reform in the US.

### Dividend Paying Companies

Novartis – gained approval from the European Commission for a new indication for Lucentis (ranibizumab) to treat patients with visual impairment from diabetic macular oedema (DME), which leads to blindness. Lucentis was shown to significantly improve vision in patients affected by DME, which compares favourably with the current standard of laser therapy, which only provides stabilization of the vision. The approval increases the spectrum of applications for Lucentis, also approved for the treatment of age-related macular degeneration (AMD).

Loyal to its strategy of extending its presence in key emerging markets, Novartis signed a memorandum of understanding with the City of St. Petersburg, Russia, which commits \$500mm of investment over the course of the next 5 years. The investments would also include a full-scale state-of-art pharmaceutical manufacturing facility.

Seven&i – the leading Japanese retailer (the country's #1 convenience store chain Seven-Eleven) reported its fiscal third quarter (Sep-Nov) results which were 7.4% better in terms of operating profit, driven mainly by its core convenience store business. Its supermarkets business however is still struggling and the company is under pressure to restructure it, with many analysts expecting as much of half of the stores to be closed. Cost cuts rolled out since the beginning of the recession have significantly improved the overall profitability of the business and they are expected to continue. The company re-iterated its



previous profit guidance for the full 2010/2011 fiscal year.  
Economic Activity, Consumer and Business Conditions

US – Economic news over the past week were dominated by the employment situation. The US employment report for December was largely disappointing, despite a reduction of the headline unemployment rate from 9.8% to 9.4%, the biggest in more than a decade. The US nonfarm payrolls rose by 103,000 in the month, significantly lower than the expected 150,000 jobs additions. The jobs additions were helped by an uptick in manufacturing hiring, offset by downsizing in the construction and state/local government. The sharp drop in unemployment was chiefly due to a drop in the labour force, as discouraged workers stopped looking for jobs. The average duration of the unemployment, at 34.2 weeks is still very close to its historical high. On the same disappointing note, the average weekly hours worked came in well below consensus, at 33.6 versus 34.3, while the average hourly earnings were flat month on month compared to expectations of a 0.2% improvement.

Encouragingly, the non-manufacturing Institute for Supply Management's monthly index expanded in December, reaching 57.1, compared to 55.0 in November, lead by the business activity, new orders and the price index components. 14 of the 18 industries surveyed reported growth in the month. The employment component was a key laggard in the index, at 50.5 still signalling expansion, but only barely so.

Canada – Canadian economy added 22,000 jobs in December, driven by improvement in full-time jobs, up by 38,000, and hiring in the private sector, up by 52,500 jobs, with manufacturing up 65,700 jobs. The gains were offset by job losses in construction, health-care and retail. Geographically, the growth was more pronounced in Ontario and Quebec.

## Financial Conditions

Eurozone Bonds: The EU sold EUR 5bn in five-year debt last Tuesday, the first part of some €50bn in bonds to help the Irish bail-out over the next two years. Bankers noted strong demand for the bonds from European, Asian and Middle Eastern investors. The issuance was 3x oversubscribed and sold within one hour giving the commission confidence that future sales will go well. Portugal - Spanish Finance Minister Elena Salgado said today Portugal won't need a bailout even as the cost of insuring Portuguese debt against default surged to a record. "The Spanish government is confident that the fulfillment of its commitments

will be recognized and Portugal won't need any external help," Salgado said in an interview with Cadena Ser radio today. Germany's Finance Ministry said on Jan. 9 it wasn't pressing Portugal to tap the euro area's rescue facility after Hamburg-based Der Spiegel magazine reported that Germany and France plan to put pressure on the nation to accept aid. Borrowing costs for Portugal, which plans to sell bonds on Jan. 12 (€1.25bn 10 year bonds), surged today and the cost of insuring its debt against default rose to a record, according to data provider CMA. Germany may be softening its opposition to expanding the 750 billion-euro (\$966 billion) rescue facility for indebted euro nations as investors question Portugal's ability to avoid tapping the fund. Chancellor Angela Merkel's chief spokesman, Steffen Seibert, declined to repeat German objections to restocking the fund after the Handelsblatt newspaper reported European Union leaders may discuss the matter in February. Merkel has up to now opposed expanding government-funded help for debt-plagued euro nations, saying as recently as Dec. 6 that she sees no need for additional aid. However, as mentioned above with Portugal due to sell debt on Jan. 12 and Spain on Jan. 13, attention is shifting back to whether Europe is doing enough to stem the crisis.

Policymakers continue to accommodate a recovery in bank profits, albeit less than 6 months ago. The U.S. 2 year/10 year treasury spread is 2.71% and the U.K.'s 2 year/10 year treasury spread is 2.26% - enabling financial services companies' assets booked at these levels, to be profitable.

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, Spanish and German regional banks (as identified in the European stress tests) – rather than larger more diversified global financial services companies. The number of small U.S. banks failing continues to grow (8 in 2011) compared to 157 in 2010 which was the highest annual tally since 1992. This supports our view that 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 FDIC changed 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 at 4.77% - (the lowest rate since the Federal Reserve began tracking rates in 1971 was 4.17% on Nov. 11, 2010), as the Federal Reserve effectively continues to seek to incentivise home ownership. Existing U.S. housing inventory has increased to 9.5 months supply of existing houses – much 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 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 mortgage foreclosures have been properly documented, thereby enabling mortgages to be “put back” to the originating bank. However, from recent bank investor relations presentations it does seem the rate of “put backs” are now expected to decline, suggesting current levels of provisions should suffice. 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 18.58 and while, by its characteristics, the VIX will remain volatile, 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 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. 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](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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