



News Highlights on Current Holdings

Financial Services Companies

Bank of America : reported 3Q \$6.2 billion / \$0.56 earnings per diluted share... higher than consensus but supported by gains of \$4.5bn on revaluing its own debt – which has no impact on operations. The results were also flattered by the gain of \$3.6bn on partial sale of its stake (now 5%) in China Construction Bank but this usefully offset losses of \$2.2 bn re equity investments, \$500m in expenses tied to mortgage litigation, \$300m loss on its international card divestiture and \$800m after-tax loss on the UK tax rate change. The group's revenue lines were weak, as the group continues to wrestle away legacy assets and litigations wrought by the mistakes of its now ex-CEO Ken Lewis in particular vis-à-vis the value destruction purchase of Countrywide and culturally demanding acquisition of Merrill Lynch.... the latter purchase – while far too expensive – is at least now generating returns akin to the size of its franchise capabilities in this difficult market... it remains global #2 in net investment banking fees and has experienced 9th consecutive quarter of increased client facing associates bring total Financial Advisors to 16,700. The group's credit releases were also muted – the same tend as already seen by its peers – whereas its reductions in operating expenses were surprisingly strong .. at least ahead of expected delivery .. with more to come. Book value per share modestly declined \$0.37 to \$20.80 whereas tangible book value per share moved up #0.31 to \$13.22 Over the next few quarter's management guide us to expect fewer extra-ordinary / exceptional items ... in particular the group equity investment exposure is now at \$26.9bn compared to \$44.1bn last quarter but while attention should, therefore, return to the fundamentals of the business (which are improving) the residual concerns around mortgage put backs and litigation risks will most likely hamper enthusiasm for the stock price to climb too close to its tangible book. Nevertheless, the listed Repts & Warranties o/s of \$16.2 bn are down from 2Q's \$17.8bn and outstanding claims have steadied at \$11.7bn compared to the 'peak' of \$13.6bn in 1Q11.... suggesting the 'known knowns' are now being managed down. Net interest income did decline by 18bps to 2.32% but as this was more due to ineffective hedging costs, management asserted the margin will have recovered 2Q levels in 4Q – assuming stable rates. Also, the group's total deposits have increased 6.5% year on year but only 0.3% quarter on quarter ... and with the 'threat' of enforcing the \$5 debit card charge and magnitude of litigation issues it is not really surprising that the 'flight to quality' has, to date, favored Wells Fargo more than BoA.

Bank of New York Mellon reported 3Q EPS of \$0.53. Reported results included a few one-time items (merger charges, discontinued operations, severance charges, reserve release) all of which netted to less than a penny. Adjusting for all this, earnings at \$0.53, were slightly ahead of consensus. Similar to State Street's results yesterday, BNY Mellon's results benefited from robust deposit-driven balance sheet growth amidst a flight to quality (which also weighed on Net interest margin – as it did for Wells Fargo). Fee revenues retrenched from seasonally stronger 2Q levels; the impact of market depreciation and \$40 million of fixed income/Counterparty value adjustment losses also weighed on results. The company repurchased a bit more stock than was anticipated.

Goldman Sachs reported a 3Q11 net loss of \$428m. The loss of 84cps compared with earnings of \$2.98ps in the 3Q last year. Revenues plunged from US\$8.9bn to US\$3.6bn, with the bank's debt holdings falling in value. Investment banking net revenues fell 33% year-on-year to US\$781m and were down 46% compared to the 2Q. The fall was due to a 61% plunge in underwriting revenues. Goldman's principal investment arm and its stake in ICBC, reported negative net revenues of US\$2.5bn, including a US\$1bn loss from the decline in value of its investment in ICBC and \$1.9bn of mark-to-market losses from equity and debt investments. Operating expenses fell sharply, down 29%. It cut its compensation accrual sharply, by 59% year-on-year, but said the ratio of compensation to net revenues was at 44%, in line with expectations. Given the probable back-log of debt and equity capital raisings pending less volatile markets, prospects for a rebound in Goldman's underwriting and takeovers businesses are more highly leveraged than its more diversified peers.

Morgan Stanley reported profit that beat analysts' estimates on a US\$3.4 billion accounting gain and higher revenue from stock trading. Net income was US\$2.2 billion, or \$1.15 a share, ahead of the \$0.30 consensus estimate. Morgan Stanley's 20% gain in YoY equities-trading revenue was the biggest among the largest U.S. banks, excluding the accounting benefit. Fixed-income fell 17%.The main variance was Debt Valuation Adjustment gains on the firm's own debt instruments, which added \$1.12 (\$3.4 billion). Adjusted for this, Operating EPS was \$0.02/ share, vs. consensus of (\$0.02) loss. Overall, Institutional revenue was slightly better than forecast, GWM and Asset Management weaker, and strong expense management (tighter comp accruals) largely made up the difference. The firm de-leveraged further, with assets declining 4% and equity growing by that percentage due to the retention of the \$2.2 billion of reported earnings. As a result, Book Value Per Share grew to \$31.29 from \$30.17.



Aviva plans to cut 950 jobs in Ireland as it merges its business there with its UK division. The cuts will almost halve Aviva's Irish workforce of about 2,000 according to the Financial Times.

Lloyds Bank is in talks with the UK listing authority regarding a spinoff of their Project Verde retail banking unit after bids for the unit didn't meet their demands, according to the Wall Street Journal and the Telegraph. It appears is unwilling to sell its portfolio of branches for the £1.5bn offered by the new banking venture. NBNK, the new banking venture, is understood to be under pressure to raise its bid for the portfolio of branches being sold by Lloyds Banking Group even though it is the only prospective buyer to have made a formal approach for the business. (Financial Times)

National Australia Bank : plans to gauge investor appetite in the US and Europe for an issue of covered bonds, with investor discussions beginning end October. The local debt market is widely expected to be bypassed in the early stages of covered bonds in Australia, with much of the issuance expected to be in foreign currency. Local investors say they can already buy senior unsecured notes from the banks, effectively the same risk, for a wider spread than covered bonds. (sourced from Dow Jones). All the major Australian banks are moving swiftly to act on their new-found ability to issue covered bonds to international investors, planning deals worth up to \$3bn that will diversify their funding bases.

Northern Trust reported EPS of \$0.70. Reported results included a penny of merger/restructuring/integration charges and results were ahead of expectations (CS \$0.64, consensus \$0.70) driven by better than expected fee (C&IS a highlight) and spread revenues. Spread revenues were stronger as the net interest margin recovered during the quarter. Expenses in line with expectations. Credit quality ticked up a bit as trends remain lumpy. Northern's capital position remains among the best within the U.S. banks but the company didn't buy back stock as aggressively as some (lesser capitalized) peers.

Royal Bank of Scotland - Bloomberg reports that China investment Corp and Blackstone Group will each invest £50mln to acquire part of the £1.4bln real-estate related non-performing loans package being sold by RBS

Santander has agreed to sell 35% stake in Santander Consumer USA (auto finance) for \$1.15bn, of which:

- 25% is to Sponsor Auto Finance Holding (owned by Warburg Pincus, KKR, Centerbridge Capital) for \$1bn; and the remaining

- 10% to Dundon DFS LLC (controlled by Santander Consumer USA CEO Dundon)

The business has \$16bn assets, 2800 employees, >2mm customers, and posted \$455mm net income in 2010 and has purchased portfolios from HSBC, Citigroup, and Toyota

Importantly the sale values unit at \$4bn (~9x 2010 P/E) and Santander is posting \$1bn capital gain (+15bps capital) which will be used to boost its capital strength to comply with latest regulatory requirements calling for Core Tier 1 capital of 9% by mid 2012.

Spanish Banks - following the downgrade of Spain to A1 from Aa2 on Wednesday, Moody's were obliged to downgrade Santander issuer rating to Aa3 from Aa2; and reduce cut BBVA to Aa3 as typically no retail bank can rank higher than the sovereign in which it is headquartered.

European insurers can withstand more losses on their Greek sovereign debt, as well as potential defaults by Ireland and Portugal, credit rating agency Moody's said last Thursday. Most European insurers have low exposure to the economies and sovereign debt of the eurozone's indebted peripheral nations, and would suffer only a "minimal impact" if their creditworthiness deteriorated further, Moody's said in the report.

Financial Infrastructure

Deutsche Boerse's planned \$9 billion takeover of NYSE Euronext faces growing opposition, from its largest clients who fear the merger will lead to increased trading costs, a concern the exchanges reject. (sourced from Reuters). Ahead of the full report due next week, Deutsche Borse pre-released strong 3Q11 key earnings data. It reports 3Q11 net profit of €14mn (or an EPS of €1.69) 20- 30% ahead of analyst's estimates. Sales revenues of €05mn were particularly strong although the results do include an exceptional gain of €4mn on the mark-to-market valuation of liabilities relating to the buyout of SIX's minority stake in Eurex and merger related costs of €5mn. Stripping this out, the result is still strong. The shares trade at sub 7x next years' earnings on a standalone basis which we believe to be very attractive.

Dividend Paying Companies

Fortum – announced its third quarter earnings, with earnings before interest and taxes (EBIT) at €97mm, barely missing the consensus expectations which called for a €05mm figure. The earnings also fell a modest 2% relative to the previous comparable period, as pricing in the Nordic region softened due to an increase in the reservoir levels, which increased the



supply of cheaper hydro power. The company expects that the high water levels and the Euro zone uncertainty could cause the pricing to deteriorate further, although, on the flip side, it also recorded an improvement in demand in Russia and the Nordic countries in the quarter. For the quarter the pricing level averaged €4.3 per MWh, compared to the same period of the prior year, when the pricing stood at €6.9 per MWh. The company revealed it had added to its 2012 hedging, now at about 55% of its volumes for €7 per MWh, while for 2013 hedging stands at 25% of volumes for €6 per MWh. In terms of nuclear power, Fortum has added a comment, where it highlights that an increase in Swedish waste handling fees and guarantees is expected from 2012 onwards. On a more positive note, Fortum reiterated its comment that it expects earnings for its Power Generation unit to be more H2-focused this year vs. 2010.

In a separate announcement Fortum revealed it had signed a contract to divest its 24.5% ownership in the Ishavskraft AS Northern Norwegian power company, as the company is striving to focus on its own retail business. The sales gains is expected to be booked in the fourth quarter of the current fiscal year and is not likely to have a significant impact.

Nestle – reported first nine months of the year sales which were 7.3% higher in constant currency, ahead of the consensus expectations for a 7.1% improvement, yet lower than the first half's result of a 7.5% increase. The group pointed out that the weakening consumer sentiment in the developed countries could impact the company's ability to keep increasing margins, according to its famed model of 5% top line growth and continuous margin improvement. The results were helped by price increases and strong demand in emerging markets. The 7.3% underlying result advance is due to a 4.1% volume growth and a 3.2% hike in prices over the first nine months. The group's parting CFO, James Singh, emphasised the company's commitment in investing in its business and bolt on acquisitions and downplayed the possibility of share buy-backs.

POSCO – operating profit for the third quarter reached KRW1.09tn, slightly missing the KRW1.15tn consensus estimate. On a previous comparable period basis, the result was actually ahead by 6%, with both volumes and prices contributing to the improvement. The company expects for the steel pricing to be weighed down by the weakness in developed economies as well as by the tightening in credit conditions in China. With this view, the group decided to cut its capital expenditures for the year by 18% to KRW6tn. The important domestic market is also being affected, with supply of steel outpacing the demand, South Korea becoming a net steel

exporter. A recent retreat in raw materials cost, iron ore and coking coal, is expected to be offset by a drop in currency.

Wesfarmers – reported robust retail sales results for the first quarter of its fiscal 2012, yet cautioned for the quarters ahead. Same store sales at the group's grocery retailing unit, Coles, grew by 5.2% in the quarter, while its department store business continued to see tough trading conditions in September and through October, as the consumer confidence continued to weaken. Bunnings, the group's star home improvement retail unit delivered 6.3% of same store growth in the quarter, while Kmart, the hard discount store chain only inched higher by 0.5%.

Economic Activity, Consumer and Business Conditions

EU Summit - as expected there was little in the way of announcements at the week-end summit with no major decisions expected until Wednesday. Tapping the ECB's balance sheet to boost the EFSF was ruled out but “progress was made” on a Greek firewall. The Financial Times reports one plan under consideration would set up a special fund to attract global investors that would buy Eurozone bonds. The other, which could run in parallel, would guarantee against losses by bondholders. The French President Sarkozy did concede to the Germans on his plan to use unlimited ECB funds to fight the crisis. Instead, the eurozone may turn to China and Brazil for help in underpinning the bond market (perhaps providing credit guarantees !). The Wall Street Journal says European leaders are also nearing agreement on recapitalising the region's banks, with an amount of about €100bn now being discussed to enable banks to reach a 9% Core Tier 1 ratio. After the summit Sarkozy said “Work is going well on the banks, and on the fund and the possibilities of using the fund, the options are converging. On the question of Greece, things are moving along. We're not there yet.” EC President Jose Barroso said. “We have discussed options for increasing the firepower of the European Financial Stability Facility, I'm sure that progress can be confirmed on Wednesday.” German Chancellor Angela Merkel made clear that Italy cannot count on unrestricted European support saying “Confidence won't result merely from a firewall, Italy has great economic strength, but Italy does also have a very high level of debt and that has to be reduced in a credible way in the years ahead.” EU President Herman Van Rompuy said “We have taken major steps to overcome the crisis, See you on Wednesday.”



While this newsflow may not appeal to all of the market's hopes of a fast solution the progress looks realistic given the involvement of EU-27 countries, regulators, politicians, and ECB. China and others have already been actively buying European sovereign debt. Presumably also Asian sovereign wealth funds and European insurers will be buyers of European sovereign debt under the new structure to be announced (which will come with some type of credit enhancement). It appears that the haircut on Greek debt will be within the 40%-60% range which will be a real struggle for Greek banks – but should only represent up to 3-4 months profits for international banks with the heaviest Greek exposure. And so the capital need to achieve core Tier 1 ratios of 9% by June 2012 is estimated to be Eur 100-110 bn of which about a half will be directly needed by the local Greek, Portuguese and Irish banks ... with the rest most likely being achieved through deleveraging and retained earnings rather than additional capital being raised..albeit failing which governments would inject capital, failing which (i.e. in the case of Greece) then EFSF will inject capital.

US quashed proposals to double the size of the International Monetary Fund in response to the eurozone crisis, leaving Europe to deal with the turmoil. Some policymakers were said to have supported pumping about US\$350bn into the IMF. But the US, along with other big IMF shareholders such as China, Japan and Germany, argued that the fund's existing US\$380bn firepower was enough.

US – September's industrial production report state-side revealed that the country's manufacturing business has not taken a turn for the worse, as it showed a 0.2% rate of growth, much as expected, on top of an August flat performance. The growth was driven by an improvement in business equipment production, with many other sectors contributing a well, including the durable goods and motor vehicles and parts production. Capacity utilization inched higher in the month to a 77.4% value, from August's revised 77.3% utilization rate. The US leading economic indicator rose by 0.2% in September as well, short of 0.3% expectations, yet for five months in a row, which should help confidence in economic growth, albeit slow.

Inflation numbers for September did not provide add to worries as the headline value kept relatively steady at 3.9% year on year rate of change, while the core consumer price index (CPI), which excludes food and energy, matched August's 2.0% rate, just shy of an expected 2.1% year on year rate of growth. On the producer side, the more pronounced headline producer price index inflation (PPI) for September, at 6.9% year on year, was not reflected by its core reading which held steady at 2.5%.

Mixed signals came from the US housing sector last week, with the marked improvement in the National Association of Home Builders'

(NAHB) housing market index, to an 18 reading in October, relative to September's 14 level, stirring up a lot of attention, even though it only signifies that the home builder, while still very pessimistic have shifted their expectations from some extreme levels. All the components of this diffusion index contributed to the improvement, most notably the view for the state of the new home market 6 months hence. Meanwhile, the all important existing home sales value, at a 4.91 million units annual rate, came short of both August's reading of 5.06 million as well as of the consensus, which was calling for a 4.93 million annualized rate. New home starts in September surprised vigorously on the upside, reaching a 658,000 units annual rate level, well above August's 572,000 units level and ahead of the expectations for a 590,000 units level.

Canada – the Canadian lead economic indicator continued its deceleration, with a negative 0.1% reading in September, from a flat performance in August, short of the consensus expectations, which were calling for a 0.1% improvement.

Inflation readings for September in Canada made for a tighter manoeuvring space for the Central Bank, as the headline rate reached a 3.2% level, driven by clothing and vehicles pricing, while the core reading (which excludes the eight most volatile series, including food and energy) jumped to a 2.2% rate of growth from August's 1.9% value and expectations calling for the same.

Financial Conditions

The improvement in US mortgage delinquencies has flattened or reversed, the Financial Times reports, referring to quarterly earnings from three of the four biggest US lenders, sparking fresh fears over the resilience of the American consumer. Record low mortgage rates and government loan modification programmes have failed to help struggling mortgage borrowers, the data from Wells Fargo, Citigroup and JPMorgan Chase show.

The advent of the US 'twist' means policymakers are no longer accommodating a recovery in bank profits (gained via them trading on a steep yield curve) . The U.S. 2 year/10 year treasury spread has been falling and is now 1.95 and the U.K.'s 2 year/10 year treasury spread is 1.95% - meaning investment banks will need to seek operational efficiencies, including job cuts, to maintain acceptable levels of profit – above their costs of capital.

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 (87 in 2011) compared to 157 in 2010 which was the highest annual tally since 1992 (140 in 2009). 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.

Influenced by the US ‘twist’, the U.S. 30 year mortgage market at 4.11% - (3.94 is 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 has steadied at 8.5 months supply of existing houses – below its recent 9.4 months high but still higher than what we believe is a more normal range of 4-7 months. While we still believe it remains premature to consider a recovery in house prices prospects of a measure of stability are likely to increase as a result of the Fed actions – which would be 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 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 expected to decline and that litigation reserves have been increased suggesting overall current levels of total provisions should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 2 years 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.

The VIX (volatility index) is 30.23 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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October 21, 2011

From: Bailey, David
Sent: Monday, October 17, 2011 4:33 PM
Subject: Credit Suisse - MONEY NEVER SLEEPS

From: Cordukes, James On Behalf Of Ellis, James
Sent: Wednesday, October 19, 2011 4:28 PM
Subject: Credit Suisse - MONEY NEVER SLEEPS

From: Lee, Jennifer H. [
Sent: Thursday, October 20, 2011 10:31 AM
Subject: Economics Newsflash: U.S. Existing Home Sales (Sep.), Philly Fed Index (Oct.), Leading Index (Sep.)

From: Adams, Andrew [
Sent: Thursday, October 20, 2011 4:32 PM
Subject: Credit Suisse - MONEY NEVER SLEEPS

From: Wong, Walter

Sent: Thursday, October 20, 2011 7:22 AM
Subject: KBW - EuroAsian Daily

From: Wong, Walter
Sent: Monday, October 24, 2011 7:50 AM
Subject: KBW - EuroAsian Daily

From: JAMIE SCANLON, KEEFE, BRUYETTE & W
Sent: Monday, October 24, 2011
Subject: KBW European Financial Morning News Monday 24th October

From: Wong, Walter
Sent: Monday, October 24, 2011 8:57 AM
Subject: Santander - \$1bn Gain on Partial Sale of US Auto Finance

Thomson Reuters and Bloomberg

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