Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Bank of America, which has been divesting assets in recent months, agreed to sell its stake in the largest Pizza Hut Franchisee to private-equity firm Olympus Partners in a deal worth around US$755mn. (referenced in Wall Street Journal)

Credit Agricole: 3Q11 net profit includes €637m impairments (after tax) on Greek Gvt bonds (bringing the coverage ratio to 60%) as well as €286m after tax of Debt Value Adjustments. Excluding exceptional items, 3Q net profit was €609m (adjusted for Greek write down and debt value adjustments). Retail operations net profit was in line with expectations except in Greece with Emporiki contributing -€397m. Corp & Investment Banking proved slightly more resilient than French peers as Fixed Income, Currencies and Commodities revenues were down 31% quarter-on-quarter and Equity down 11% qoq but losses on discontinued operations were high (€164m). The Asset Mgt, Insurance and Private Banking business line was impacted by the above mentioned high cost on Greece. Total banking exposure on peripheral sovereign bonds decreased from €11.8bn at end of June to €9.3bn at end of Sept, of which €6.7bn in Italy. As for insurance, Credit Agricole discloses €2.7bn for Greece, €1.5bn for Ireland and €2.2bn for Portugal but makes no disclosure as for Italy and Spain.

Goldman Sachs is paring its stake in Industrial & Commercial Bank of China, hoping to raise about $1.5bn by selling more than 2bn shares in the lender. Goldman is trimming its investment in order to book profits now as volatility continues to rock ICBC shares. Goldman, wrote down its ICBC holdings by $1bn last quarter.

HSBC reported 3Q11 PBT (before gain on own debt and adverse FX movements) of US$2.9bn vs. consensus of US$ 5.1bn. Driving the miss versus expectations was a US$ 800mn higher bad debt charge as Bad loan provisions increased to $3.89 billion (mainly in the US and Corporate/ Investment Banking re a U$0.9bn Quarter on Quarter increase in loan impairment charges in the run-off portfolio) and an US$1.3bn non-qualifying hedges charge. On a positive note, costs were US$600mn better than expected as HSBC started to feel the initial benefits from its restructuring program announced in May-2011. Core tier 1 was -0.2% QoQ to 10.6%, which HSBC attributes to a U$4.5bn exchange rate-related decline in absolute core tier 1. The outlook statement points to some improvement in trading conditions in October (but still difficult) and possible continuing turbulence in global markets resulting in further downside risk.

Intesa San Paolo reported a net profit of €527mn beating varying estimates of €81mn - €320mn, due mainly to the higher net contribution of positive one-offs (unexpected positive one-off on taxes of €0.9bn, partly offset mainly by higher charges on Greek bonds, €0.6bn). In our view core earnings were better and net interest income was 5% higher than consensus, with fees 1% better. Total revenues were, however, in line due to a higher trading loss. Costs were 3% better and Loan Loss Cover (74bp) were 7% lower than consensus. ISP reported a Basel II Core Tier 1 ratio of 10.2%, in line with expectations. The expected impact from Basel III is seen at 1.5% (vs. 1.2% previously), hence Basel III CT1 ratio pro-forma is 8.7%. Loans were stronger than expected, up 1.7% QoQ, while total deposits (including securities) declined €20bn QoQ (according to ISP mostly due to short-term funding from institutional clients. Italian Government Debt is 63.4bn vs. 64bn Q2 (3.3x current marketcap, >1x stated equity, ~10% assets) which for now, overwhelms the earnings fundamentals.

Invesco: reported October-ending Assets Under Management of $635.7bn, up 6.2% month over month and long-term active AUM increased 6.4% to $465.3bn. The company announced that it had positive net flows into its passive, active, and money market categories.

Lloyds: - reported 3Q11 Profit Before Tax on a combined businesses basis (after fair value, pre-exceptionals) of £547m (versus estimates of £268m), with a reported loss before tax of £607m. Net Interest Income of £3149m is flat with NIM at -4bps QoQ. Impairment charges are better (£1956m vs estimates of £2409m), although the group remains comfortable with £9.9bn consensus impairment charges for FY11 (prior estimate £10.2bn). The balance sheet looks good, with the Loans / Deposits ratio down 4% (to 140%), loans -£30bn and non-core assets -£11bn QoQ. Core tier 1 improved 0.2% to 10.3%. Wholesale funding is down 5% since 1st Half and Lloyds has completed its funding for the year. Non core assets have fallen to £151bn (were £162bn at the half year). Tangible NAV stands at 58.3p. Lloyds is reassessing its revenue assumptions in the light of lower GDP and base rate expectations. This means that the medium term revenue targets may be pushed back beyond 2014, tantamount to a profits warning. This is in line with what was communicated at the recent Merrill Lynch conference and should not be too much of a surprise. Bad debt trends are improving but management are understandably still cautious on the outlook. With the shares on 0.5x T/NAV we believe the shares remain attractively priced.

Prudential PLC : 9M 2011 new business profit of £1,535mn was up 9% y/y, representing a 1% beat versus consensus. The US and Asia were the areas of outperformance versus consensus. Growth in the key Asian subsidiary was driven by a dramatic recovery in single premiums, management aggressively growing agent numbers and new bancassurance deals coming on line. From these results, the evidence is however that maintaining productivity growth is becoming more challenging. In terms of the bancassurance pipeline, management stated that they are having conversations in a number of sub-markets, but they conceded that bidding for deals here is competitive. The IGD surplus at £3.9bn (£4.1bn 1H11) was ahead of expectations of £3.6bn, which is pleasing given market movements during the period – this also ignores £2.0bn of UK default provisions and £1.9bn of net unrealised gains in the US. A negative factor is that this result represents a significant slowdown in the top-line value of new business growth, especially since Prudential is usually viewed as high growth, with the y/y growth rate progression of 26% FY11, 20% 1H11 and 3% 3Q11.

Royal Bank of Scotland / Macquarie : According to the Australian Financial Review a Macquarie led consortium will face stiff competition including Japanese bank Sumitomo in the final round of bidding for RBS's US$6bn aircraft leasing unit.

Santander / BBVA is moving on with their intentions to clean up a balance sheet sitting on c €3bn real estate assets, which it has now put up for sale at a 60% discount. Despite the impact on earnings, we believe this is the needed step for investors to recover confidence. BBVA has also made some steps on this front. Today BBVA has announced it has created a real estate unit with €30bn of foreclosed property, developer loans and stakes in real-estate companies.

Global Systemically Important Financial Institutions (GSiFis) Citigroup, JPMorgan, BNP Paribas, RBS and HSBC may face top capital surcharges of 2.5%, according to a provisional list prepared by global regulators and obtained by Bloomberg News.

Dividend Paying Companies

Bayer – in a surprise move, the Food and Drug Administration (FDA), the US health regulator, approved Bayer's stroke preventer Xarelto for people with a common heart rhythm disorder known as atrial fibrillation, without requiring any additional study, as some analysts expected. Xarelto, clinically known as rivaroxaban, is already approved in Europe for stroke prevention in atrial fibrillation (SPAF) and had been approved in the US for anti-clotting after knee and hip surgery. Xarelto, a once daily pill is now competing with a number of other new drugs to replace the standard of treatment, warfarin, in a market estimated to be worth more than $10bn.

Bayer presented clinical study data for Xarelto in acute coronary syndrome (ACS) at a scientific meeting of the American Heart Association in Orlando last week. According to the study, the new Xarelto pill reduced the risk of death by more than 30% in patients who have had an ACS episode. Xarelto patients however, incurred a significantly higher risk of major haemorrhages, although there was no increase in fatal bleeds. The ACS indication would account for about 15% of the Xarleto's market potential. Other drugs, including apixaban/Eliquis by BMS and Pfizer failed to meet the main goal of separate, unrelated studies.

Siemens – announced fourth quarter and full fiscal year results in Munich last week, while delivering a cautious growth outlook for 2012. The last quarter's operating profit reached €2.17bn, short of the expected €2.39bn as the company had to book a €231mm impairment on its loss-making solar energy business. The fourth quarter new orders at €21.57bn exceeded expectations of €20.37bn, as the economic environment in Germany remained robust, albeit losing some speed, while growth continued in the key emerging markets. The company raised its dividend to €3/share from €2.7/share and estimated that the 2011/2012 income from continuing operations would match the current year €7.0bn, which excludes the €1bn positive effect related to the Areva transaction. Longer term, the company expects to continue to grow faster than the global economy as a whole.

SP Ausnet – released its first half of the fiscal 2012 results, which were broadly in line with the expectations, as the company's revenues reached A$830.5mm, 5.7% higher year on year, while its earnings before interest, tax, depreciation and amortization grew 6.5% to A$493.0mm. The company's net profit after tax for the first half of the year reached A$146.2mm, 11.9% higher year on year. The half year distribution was maintained at A$0.04/share. Revenues in the gas distribution business were affected by lower gas volumes, due to milder than usual winter in the Melbourne area. The company also updated on the outcome of the two legacy tax audits, including arrears payments, while maintaining that it would continue to attempt recovery of some of the amounts disputed. A key new development is the negotiation rounds with the Victorian government to operate and maintain an electricity distribution line supplying a desalination plant. Preliminary costs of A$230-A$250mm would secure a 27 year license, which would provide unregulated contract revenue beginning with 2013.

Toyota – withdrew its full year profit guidance as uncertainty around its earnings grew due to operational interruptions stricken by floods in Thailand and the effects of the Japanese spring natural disasters, as well as due to continued strength of the yen. The second quarter of its fiscal 2012 recorded a ¥75.4bn profit, short of the consensus calling for ¥101.3bn in operating profit. Three vehicle plants in Thailand, its Southeast Asian export hub, were forced to stop work in October, as a result of the floods, with the shortage of parts forcing the company to cut output in nine other countries, including Japan. Toyota estimates the Thai calamity would force it to keep its Japanese production reduced at least until November 18.

Vivendi – announced the acquisition of EMI Group's recorded music business from Citigroup for £1.2bn ($1.9bn). The company said it would finance the transaction from its existing credit lines, while about €500mm would be generated by selling non-core assets of Universal Music, its wholly owned subsidiary. The deal is not expected to endanger the group's BBB credit rating. Through this transaction, Universal Music Group's leading position as global provider of music content would be strengthened, subject to regulatory clearance.

In a separate announcement, Vivendi revealed that Activision Blizzard's latest Call of Duty release, the 8th of the series, Modern Warfare 3, set an all-time record for the biggest entertainment launch with more than $400 in revenues in North America and United Kingdom alone. The popular game sold 6.5mm copies in a single day, ahead of the last year's launch which brought in sales of 5.6mm units. Vivendi controls roughly two thirds of the Nasdaq listed Activision Blizzard.

Hutcheson Whampoa : disclosed that its group EBITDA advanced 31% YoY in Q3 (37% YTD) excluding HPH Trust and related gains and suggests that Hutch is on track to deliver encouraging full year results with upside in property offset by possible downside in telecom. Its current and estimated 2012 Net Asset Value is HK$103 and HK$108 respectively, with it currently trading nearly 50% below that level. Increased confidence in Hutch's ability to execute through a downturn would be key to narrowing its NAV discount, and the continued improvement in disclosure this year also helps.

Vodafone delivered reassuring H1 results. The UK-listed Telco beat consensus estimates at the top-line (+0.5%), EBITDA (+1.3%) and Op. Profit (+3.4%) levels. Group service revenue growth rates slowed only slightly (Q1: +1.5%, Q2: +1.3%), as price rises triggered better top-line trends in the UK (Q1: +1.7%, Q2: +2.5%), India (Q1: +16.8%, Q2: +20.1%) and the Netherlands (Q1: +0.5%, Q2: +4.2%). Vodafone Italy (Q1: -1.5%, Q2: -3.0%) & Spain (Q1: -9.9%, Q2: -9.3%) remain challenged. Vodafone's businesses are winning share in 16 of 19 markets (including the US). Its estimated that Vodafone's underlying Group EBITDA remains in positive YoY growth territory (H2 10/11: +1.6%, H1 11/12: +0.5%). Vodafone Germany returned to EBITDA growth in H1 (+1% YoY), while Vodafone Italy has just limited EBITDA leakage (-3.7% YoY). There are also better EBITDA trends at Vodafone UK (+5.6%), Nrtherlands (+3.5%), Greece (+2.0%) and Portugal (+3.2%). Vodafone raised the mid-point of its 2011/2012E Adjusted Operating Profit guidance by c1.75%, from £11.4bn to £11.6bn - a positive signal as its quality network – following heavier investment than rivals – gains traction.

Economic Conditions

Telefonica produced another, dismal set of results this quarter, albeit beating consensus revenue by 1% but missing EBITDA by 5%. The company "reiterated their 2011 guidance and confirmed their shareholder remuneration policy". But this set of results, and in

particular a much weaker LatAm performance may be sufficient to goad the Company into more meaningful change. In our view, the most obvious and rational way to help Telefonica is to cut the dividend and rationalization of an arguably overextended portfolio would also be wise but ongoing cheap debt could convince the company to avoid action. Spanish decline accelerated from -6.6% to -8.8% (now just 40% of Group FCF, down from 43% a year ago and 49% in 2009). The UK continued to slow at the top line as the customers locked in before the iPhone exclusivity ended. Germany grew well (+1.8% in Q3 vs 0% last Q) whereas LatAm slowed - almost certainly the result of rapid fixed-mobile substitution as Telefonica loses high margin wireline minutes but also probably some 'kitchen sinking' by the new Head of Latin America. Nonetheless, we believe the overall group business profile will get a little better in 2012, as pricing stabilizes and despite weakened margins in LatAm, growth continues to accelerate in the majority of wireless businesses (Telefonica's LatAm division is two thirds mobile, one third wireline).

Economic Activity, Consumer and Business Conditions

United States – The US trade deficit continued to narrow in September, to $43.1bn, better than the expectations for a $46bn deficit, as exports moved higher by 1.4%, while imports saw a more muted 0.3% rate of growth. The feat is noteworthy, given that the export pricing retreated 2.1% in the month, while the import pricing only pulled back by 0.6% over the same period.

Better news on the consumer front as well, South of the border, as the consumer sentiment, as measured by the University of Michigan, improved markedly in November, to 64.2, ahead of the expectations for a 61.5 level, driven by both the current conditions and the expectations sub-indexes. The US consumer credit continued to grow in September, adding $7.39bn ahead of expectations for a $5bn increase.

Canada – The foreign trade report surprised positively with a $1.2bn surplus. Although short of the 'normalized' $3bn to $4bn level it interrupted a long series of consecutive visible goods trade deficits. The result was driven by a robust increase in exports, up 4.2%, led by energy and auto vehicles, while the imports actually retreated in the month, by 0.3%.

The Canadian housing starts virtually stagnated at 207,600 units annualized in October, compared to September's 208,800 units annualized, yet ahead of the expectations of a 195,000 units annual rate. The new housing price index continued to improve, by 0.2% in September, as expected, an acceleration from August's 0.1% rate of growth.

Italy - Silvio Berlusconi has left office after the 2012 budget bill was approved. Mario Monti is the new PM and the bond markets are relatively kind to him this morning as Italy issues EUR3bn of 5yr bonds at 6.29%, a month ago this was 5.32% but a lot has happened in the month which saw yields spike over 7%.

Clearinghouses last week unsurprisingly imposed slightly higher margin requirements on Italian Sovereign Debt. Market estimates are the Italian banks own E200bn government debt so E200bn x 5% is 10bn is not a huge number but the obvious danger is eventually the market forces the clearinghouses to impose much higher requirements (eg. margin requirements are currently 80% for Portugal and 45% for Ireland)…..with the clearinghouses sounding the warning, this may force the ECB's hand in adapting Quantitative Easing.

Japan : Japan's economy made a big comeback in the third quarter. Real GDP grew 1.5% in Q3, or 6.0% annualized, taking its level above that prevailing before the March disasters and not only snapping three consecutive quarters of declines, but it was also the strongest quarter since 2010Q1, boosted by private sector demand while total government outlays were down (the prior two quarters were also revised higher). Exports have rebounded impressively. But into next year a much weaker global economy will hurt industrial output and exports. Domestic-demand led growth will depend heavily on reconstruction activity, due to be kick-started shortly in a ¥12trn supplementary budget.

Financial Conditions

The European Union plans to tighten the screws on rating agencies in a raft of new proposals including judicial action, issued amid concern over Standard and Poor's erroneous downgrade of France.

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 1.84% and the U.K.'s 2 year/10 year treasury spread is 1.71% - meaning investment banks will need to seek operational efficiencies, including job cuts, to maintain acceptable levels of profit, i.e. 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 (91 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 remains very low at 3.99% - albeit off its early October low of 3.94%(this 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 increases 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 31.58 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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