Market Commentary

PORTLAND INVESTMENT COUNSEL™

November 28, 2011

News Highlights on Current Holdings

Financial Services Companies

Australia New Zealand Bank: has committed to buy the 50% it does not already own in boutique institutional firm Linwar Securities through its E*Trade online business.

Bank Sarasin - Safra Group have agreed to acquire Rabobank's controlling stake in Sarasin for over CHF1bn. Safra will acquire a majority shareholding in Bank Sarasin (46.07% equity interest and 68.63% voting rights) at a price of CHF 7.20 per A registered share and CHF 36.00 per B registered share, to be paid in cash.

BBVA announced that it will issue €3.48bn in mandatory convertible bonds (MCB) and offer them to holders of preferred stocks (domestic retail investors). BBVA expects to call 50% of the MCB by June next year and the remaining 50% by June 2013. The MCB will yield a 6.5% to be paid quarterly from March 2012. Current BBVA shareholders don't have preferred subscription rights. Assuming that all holders of pref. shares agree with the swap, at the current BBVA share price its estimated a dilution of 7%-8% earnings per share for 2012 and approaching 9% for 2013 while it should be relatively neutral on Net Asset Value /share. The MCB should reinforce Core Tier 1 capital by 1.07%, which has two immediate effects: (1) it improves the capital structure of the bank in favour of Core capital, and (2) it halves the capital shortfall to get to 9% Core Tier 1 under European Banking Authority criteria (proforma CT1 EBA 8.2% implying €2.8bn gap to 9%).

BNP – Financial Times says BNP planning to sell more than $700m of private equity portfolio investments. The bank may dispose more than 50 private equity fund interests to capitalize on rising demand for such portfolios according to the Financial Times. FT noted that the private equity portfolio is facing regulatory pressure, as the forthcoming Basel III reform package will impose tough liquidity and capital constraints on banks' such interests.

HSBC - last week Sky news reported that HSBC has tabled a formal bid of £3bln for Dexia's DenizBank

JP Morgan : is to buy MF Global's stake in the London Metal Exchange, making the US bank the largest shareholder with a 10.9% stake with Goldman Sachs owning 9.5%.

Lloyds - following Lloyds announcement last week that there are two bidders for the sale of its 632 branches, the Financial Timees reports the two, the Co-op & NNBK have two weeks to finalise their bids, with Co-Op the frontrunner. Separately, Lloyds has sold £1bn of distressed property loans in Australasia to Goldman Sachs and Morgan Stanley, as part of their plan to unwind £24bln of these distressed property loans that they hold on their books.

Royal Bank of Scotland: plans to double its Asian private banking assets to $30bln within five years, Nick Cringle the bank's co-head of global wealth management investing said. He went on to say "From a profitability perspective, 60% of our profits come from the U.K. and 40% from international businesses. Part of our five-year strategic plan is to reverse that."

Santander : announced a planned secondary offering of Santander Chile shares, representing a 7.8% stake. The 7.8% stake sale would reduce Santander's holding in its Chilean business from 75% to 67%. At current prices the stake sale could be worth c.EUR750m. The capital gain could be worth 0.06%-0.09% of core capital for Santander. Meanwhile the sale would reduce 2012e net profit by c.0.6%. With Santander Chile currently trading at 3x book value and 13.7x consensus earnings, the sale should generate a handsome capital gain with the proceeds able to be used to strengthen the balance sheet. Santander had limited take-up of the debt swap offer announced last week. Of the total EUR6.6bn, only EUR1.5bn was tendered for exchange. (i) The gross capital gain amounts to c.EUR170m so the total impact on core capital of only 0.02% - the implication from the offer was that if debt-holders did not accept this offer now, Santander would fail to buy-back the bonds when they became callable in 2012-2014. Santander will issue €1.34bn of new debt, which consists of €1.12bn of 3.381% debt maturing Dec 1st 2015 & €189.8mn of 3.16% debt maturing the same date.

UBS executives are considering cutting the group's bonus pool in an effort to recoup some of the US$2.3bn it lost in the alleged trading scandal (as reported in the Financial Times). UBS last month opted not to eat into bonus accruals when it reported its third-quarter earnings. The approach, which meant that 90% of the investment bank's CHF1.35bn of third-quarter revenues was set aside for pay and bonuses, was widely criticised.

Dividend Paying Companies

Johnson Matthey – the world's largest supplier of catalytic converters reported £203mm in underlying operating profit before tax, ahead of expectations for £194.1mm and 24% higher than a year ago, as an increased proportion of diesel cars sold in Europe and a significant raise in the price of precious metals (in particular platinum and palladium) contributed substantially to improved profitability. Strong sales of trucks in North America also contributed to a robust performance as well as improved utilization rates in its European plants. The company sees resilient demand and saw 'no evidence of any stockbuilding' among its customers. Johnson Matthey forecasts second half results 'slightly ahead' of the first six months of the year. The group raised its dividend by 20%, to 15 pence per share, while committing to its long-term target of a 2.5 times dividend cover.

Economic Activity, Consumer and Business Conditions

United States – the US housing market, while still struggling, continues to show signs of modest improvement, with existing home sales moving higher in October, to 4.96 million units annualized, from September's 4.9 million units annualized level and ahead of the expectations for a 4.80 million units annual rate level. Meanwhile, this morning, the new home sales reading also showed a bit of improvement, inching higher to 307,000 units in October, albeit from the lower revised September figure of 303,000 units annualized and short of the consensus expectations for a 315,000 thousand units annual rate.

The economy as a whole grew by only 2.0% annualized in the third quarter, as the GDP preliminary reading revealed, down from the advance rate of 2.5%, as inventories took a serious haircut in the quarter, as did non-residential investment and consumer spending.

The consumer income and spending report for October, however, showed a rebound in consumer activity with personal consumption moving higher in the month by 1.0%, ahead of the expectations for a 0.4% improvement. The personal consumption expenditures (PCE) core price index, Fed's favourite inflation gage, inched higher in year on year terms, to 1.7% from September's 1.6% revised value, yet it is presently residing in a 'sweet spot' within the Fed's comfort range of 1.5% to 2.0%.

Canada – The Canadian consumer is also showing resilience, as the headline retail numbers for September advanced by 1.0%, ahead of the consensus expectations for a 0.5% improvement, while the core sales, excluding the sales of motor vehicles advanced by 0.5%, ahead of the expectations for a 0.4% advance, as sales in clothing and sporting goods categories offset the softness in furniture sales.

France and Germany are preparing contingency plans to accelerate fiscal governance should treaty change prove too difficult. Paris hopes fiscal discipline will allow the ECB confidence to intervene in sovereign debt markets more aggressively. Hopes for more detail on a eurozone fiscal union could emerge within days as finance ministers gather Tuesday. The risk however is of a breakaway group of fiscal hawks led by France and Germany for an intergovernmental pact between willing eurozone countries.

Financial Conditions

The International Monetary Fund said last Tuesday it approved two new lending tools that can better help countries cope with economic crisis. The new Precautionary and Liquidity Line can be used in broad circumstances, "including as insurance against future shocks and as a short-term liquidity window" between six months to two years. A country can now borrow up to ten times its contributions to the IMF to help pay its bills.

Portugal - Portugal's credit rating was downgraded by Fitch, one notch to BB+. Fitch blamed Portugal's "large fiscal imbalances, high indebtedness across all sectors, and adverse macroeconomic outlook" for its decision.

Spanish Banks: Prime Minister-elect Mariano Rajoy told yesterday Bankia Chairman (and former Finance Minister) Rodrigo Rato that his Government will create a bad bank. The bad bank would be financed by the State and deposit-guarantee funds in equal measure. Of course, due to the financial amounts involved (at least €109bn or 10% of GDP are needed to get to acquire the problematic assets at 50% discount and recap the banks, assuming these would not increase further), it will be a very challenging task to finance this vehicle.

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 1.79% and the U.K.'s 2 year/10 year treasury spread is 1.90% - 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 93 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 3.98% - 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 34.47 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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