Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Aviva is planning a potential sale of its 26 Irish branches, according to sources on Bloomberg. The Insurer is considering closing between half and all of the branches, according to the article. The move is part of Aviva's plan to cut almost half its Irish workforce.

Bank of America may reduce annual costs by as much as an additional $3bn in the next stage of Chief CEO Brian T. Moynihan's efficiency plan. The lender, which already targeted $5bn in expense cuts from retail and back-office operations, may reach total savings of $6bn to $8bn a year, as sourced from Bloomberg

BNP Paribas is planning to sell $11bn of loans to oil and gas companies, according to the Financial Times report last Friday with at least 3 interested buyers. Targeted reduction in $ funding requirement is $20bn in Q4 and another $20bn during 2012. The company said in Q3 it was ahead of schedule. These are, in our view, tangible signs of deleveraging at an acceptable cost.

Credit Suisse – the Financial Times reports that part of the group's variable compensation will be paid in derivative notes linked to underlying credit positions held by the company. Few details on the size of the asset pool but likely to have some small positive effect on the Basel 3 ratio by taking the assets off balance sheet.

Deustche Bank - Josef Ackermann said in a Bloomberg TV interview last Thursday night that Deutsche Bank is "Not expecting a capital raise this year", DB Management have not been that explicit for some time on their capital plans.

HSBC is selling its Costa Rica, El Salvador and Honduras businesses to banking group Banco Davivienda for $801mn.

Invesco reported adjusted 4Q earnings of $0.42, ahead of consensus of $0.40. Base fees were lighter than expected but performance fees and real estate and transaction fees offset, leaving revenues flat vs. 3Q. A one-time $45m. legal benefit contributed to GAAP EPS of $0.44. Net flows of $5.4bn. to long-term products were ahead of forecasts, with positive flows to all asset classes, and particularly strong to ETFs, as expected. Management said demand for real estate has been strong, with "billions" to be invested, and demand for equity is growing.

Lloyds Bank issued a EUR1.5B 5-Year unsecured Bond last Thursday. This is a clear positive for it and the market with this funding avenue starting to open up. The pricing at Swaps +3.05% remains elevated but at least it now shows the banks have several windows from which to access liquidity.

Nordea : Q4 results showed profit before tax of €1,029m 16% ahead of €885m consensus. The revenue strength was largely due to trading income, mainly due to positive effects in equity and interest rate positions and recovering Life insurance. Net interest income in 4Q was up, mainly due increased lending margins and good volume growth. Lending margins in Retail Banking were up to 1.37% (1.32% in Q3 2011) and deposit margins were down to 0.63% (0.69% in Q3 2011), mainly driven by lower rates in Denmark and Finland. In Wholesale Banking, Q4 lending margins were unchanged at 1.56% versus Q3 2011. Lending volumes were up 1% from Q3 2011 and deposit volumes were up 3% q-o-q. Funding costs were largely unchanged in the quarter. Retail banking profit was €449m, lower than expected as shipping and retail banking in Denmark provisions were higher than expected. The group's 0.36% loan loss ratio in Q4 comprises 0.40% for new individual provisions (0.24% in Q3 2011) and 0.04% in reversals of net collective provisions (0.08% in Q3 2011). On a geographical basis, Danish loan losses were 0.82% (0.57% in Q3), Finland 0.13% (0.11% in Q3), Sweden had loan losses of 0.13% (0.06% in Q3) and Norway at 0.22%. Q4 2011 shipping loan losses remained high and increased to 2.09% (0.76% in Q3) and Baltic net loan losses were 0.58% (0.03% in Q3 2011). Impaired loans were up 5% in the quarter. The proposed dividend of 26c slightly light of consensus of 28c but in line with a 'normal' 40% payout ratio. But still targeting 15% ROE although management highlight that this is based on 11% Core Tier 1 whereas the Swedish regulator is still requiring 12%. The full Q4 2011 Basel 2 core tier 1 ratio was up to 11.2% compared to 10.9% and management say they will reach a Basel 3 12% Core Tier 1 ratio in 2015.

Financial Infrastructure

NYSE Euronext and Deutsche Boerse are unlikely to garner enough support from EU commissioners to overturn a looming veto over their plan to create the world's largest exchange, according to four people familiar with the situation, reports Bloomberg.

Dividend Paying Companies

ABB – announced the acquisition of Thomas & Betts (TNB on NYSE), a US electrical components maker, such as cable connectors, heating and ventilation products and steel masts, ranking in the top three in its industry together with Cooper and Hubbell. The deal allows ABB to grow its highest margin business, low voltage technology, by opening up an addressable market of $24bn through TNB's network of more than 6,000 distributor locations and wholesalers in North America.

ABB is offering $72 per share in cash, a 24% premium over TNB's closing price on Friday, for a total of $3.9bn, which would be financed through a mix of cash and debt. The deal would bring the total of ABB's M&A transactions in the US to $9bn since Joe Hogan, the current CEO, took over in 2008. The company is estimated a total of $200mm a year in synergies to be reached by 2016, with some being derived from increased revenues, while others through cost cutting (mostly purchasing) programs. The cost of realizing the synergies is expected to be roughly $80mm over the next five years. The deal, which has TNB board approval, still requires shareholder approval, and is expected to close by mid 2012.

Novartis – reported Q4 and full year 2011 results which were broadly in line with the expectations, while providing a cautious outlook for 2012. The company is preparing for increased generic competition on some of its branded drugs, whose patents are due to expire this year, most notably Diovan, the top-selling blood pressure drug. The core operating earnings per share rose by 8% in the last quarter of the year, to $1.23, just shy of expectations for a $1.28 figure, while the reported earnings were impacted by purchasing accounting effects related to the acquisition of Alcon, as well as extraordinary charges related to the scaling back of the Tekturna franchise. Productivity measures and margin improvement on products launched since 2007 (i.e. new products) were important contributors to profitability and are expected to offset to a large extent the loss of profitability from generic competition going forward.

For 2012, Novartis is aiming for sales in line with the recently concluded 2011, at $58.6bn. The group is aiming to save between $1.5bn and $2.5bn in 2012, adding to the $2.6bn in savings realized in the last fiscal year. Novartis had announced earlier that it would reduce its US workforce by 2,000 in preparation for the loss of patent by Diovan. On the bright side, sales of new products, such as the eye drug Lucentis, recently approved in China, and the multiple sclerosis pill Gylenia, grew by 30% in the fourth quarter, reaching 25% of the group sales. The company has also invested substantially in expanding its business in growth emerging markets and we believe will benefit from the increased healthcare focus in key emerging markets, as well as from having a well diversified business portfolio, which encompasses, next to pharmaceuticals, generic drugs, eye-care products, consumer and animal health products, as well as vaccines and diagnostics.

Siemens – The largest European engineering group recorded an expected lower operating profit in the first quarter of its 2012 fiscal year, as the European debt crisis and ensuing austerity measures impacted the renewable energy business. The first quarter operating profit reached €1.60bn, a 23% decline on the previous comparative period, as margins were squeezed by increased competition on a shrinking number of projects, with the uncertainties of the ongoing debt crisis continuing to impact the real economy. New orders retreated by 5% in the quarter, yet the book to bill ratio continues to be strong at 1.11x, while the order backlog is at its highest level at €102bn. The group was forced to book €203mm in charges for delays on a landmark project for connecting wind farms in the North Sea, as issues arose around project specifications. The troubles in the energy sector had a trickle-down effect on the industry sector as well with some impact on the group's power drives business. The shorter cycle business, centered around industry automation, continued to perform well in the quarter, with order and revenue growth across the regions. The management sees a challenging 2012 fiscal year, yet it stuck to its previous guidance of moderate organic revenue growth and an operating profit target of €6.0bn.

Toyota – announced it would raise output of its new hybrid vehicle, Aqua, launched last month, on the back of stronger than expected orders. Orders for Aqua, purportedly the most fuel-efficient mass manufactured car, with a consumption of roughly 2.82 litres per km, are likely to exceed 110,000 units for its first month. As such, the company is planning to boost the production to 320,000 units from the earlier target of 240,000 units. Toyota will also expand sales of Prius as it attempts to reach sales of 8.58 million vehicles in 2012, 22% higher than in disaster filled 2011. On a separate piece of news it was disclosed that Nippon Steel Corp and Toyota agreed on a 4% reduction in the price of steel sheet.

Economic Activity, Consumer and Business Conditions

US – The highlight of the US macro-economic news last week was the fourth quarter advanced reading of the GDP growth, which, unfortunately, disappointed by falling short of consensus, at 2.8% versus the expected 3.0% annualized rate of growth. The main culprits were a drop in government expenditures, detracting almost 1% from the rate of growth, as well as a weaker than expected contribution from the consumer expenditures. The final domestic sales were up only 0.8% in the quarter. Of note, the contribution of the increase in private inventories was almost 2.0%, which will likely act as drag on performance in the quarters ahead.

On the consumer front, the consumer sentiment, as measured by the University of Michigan, advanced in January to 75.0 index points, ahead of the expected 74.1 level, as consumers have a rosier view of the current conditions as well as an improved outlook. The personal income grew by 0.5% in December, ahead of the expectations for a 0.4% improvement, while, part of the same report, the year on year increase of the core personal consumption expenditures (PCE) price index, the Fed's favoured inflation gage, moved higher to 1.85%, closer to the now clearly stated inflation target of 2%.

After a number of encouraging reports, the housing sector delivered a couple of rather weak readings last week, as the new home sales rate retreated to 307,000 units annualized in December, short of expectations for an improvement to 320,000 units annualized. The pending home sales retreated by 3.5% in December, partially reverting a strong improvement in November.

Canada – Retail sales in Canada, although stronger than expected, advancing 0.3% in November, were below the previous month's performance of 0.9%, and possibly signal a tempering in the Canadian consumer's appetite for credit, now that the household leveraging has reached nose-bleeding levels in excess of 152%. The retail sales excluding sales of autos were no different, up 0.3% in the month.

Ireland - has returned to the bond market for the first time since 2010, swapping E 3.52bn in government bonds as sentiment has improved with bond yield falling below 6% compared with 8% earlier in the month and 18% last July. The new bond offered a yield of 5.15% and matures in February 2015.

Greek Debt Swap - a deal is expected to be reached this week as the IIF released a statement on Saturday saying that the two sides are "close" to completing a voluntary exchange within a framework outlined by Jean-Claude Juncker. Creditors are prepared to accept an average coupon of as low as 3.6% new 30-year bonds, according to an unnamed source on Bloomberg. Separately Bloomberg also says that European leaders are considering direct intervention in Greek budgetary decisions, having the power to implement austerity measures agreed under the bailout agreements. The Greek PM Venizelos has rejected the proposal saying it would improperly force his country to choose between "financial assistance" and "national dignity", he went on to say the plan, "ignores some key historical lessons" and that the EU already had sufficient monitoring safeguards in place in its bail-out programme. German Finance Minister Wolfgang Schauble responded, warning a fresh bail-out may be refused and that Europe is "prepared to support Greece but unless Greece implements the necessary decisions and doesn't just announce them, there's no amount of money that can solve the problem." Germany reportedly wants Greece to accept a Eurozone 'budget commissioner' to oversee tax and spending in return for securing a second Eu130bn bailout. The commissioner, appointed by other Eurozone finance ministers, would have the power to veto budget decisions taken by the Greek government.

Financial Conditions

France / Transactions / Tobin Tax - France may raise €1bln annually from a proposed transaction tax, the 0.1% tax would also cover derivatives, while bonds and transactions on capital instruments would not be taxed, according to Le Figaro. Assuming no volume impact, its estimated the effect of €1bn financial transaction tax is between 3-5% of 2012 earnings for the listed French banks. €1bn is way below the €12bn tax estimated to be raised per year for French banks under the original EU Tobin tax proposal. Sarkozy confirmed these figures in a TV interview last night. He also said the euro-region's financial crisis is stabilizing thanks to measures taken by European leaders.

Federal Reserve policymakers appear determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels' of interest rates "at least through late 2014". which is still an "exceptionally low level" in the grand scheme of things. Fed Reserve Chairman Ben Bernanke has indicated 1% or less would be considered exceptionally low. The advent of the US 'twist' (whereby the Federal Reserve is selling 3 year and less maturities to buy 6 years and longer) means all parts of the yield curve will benefit from a near-zero anchor for essentially the next 3 years. The U.S. 2 year/10 year treasury spread has been falling and is now 1.62% and the U.K.'s 2 year/10 year treasury spread is 1.63% - meaning investment banks can no longer profit from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above their costs of capital. It seems the top tier 8-10 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the US 'twist', the U.S. 30 year mortgage market remains very low at 3.98% - (3.88%, achieved mid-January 2012, 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 fallen / improved to 6.2 months supply of existing houses. So the combined effects of record low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in 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 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 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 beginning 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.

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 7 in 2012 (compared to 95 in 2011 and 157 in 2010 which was the highest annual tally since 1992). 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 VIX (volatility index) is 18.53 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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