



News Highlights on Current Holdings

Financial Services Companies

Australia & New Zealand Bank does not need to build a large branch network in Asia to succeed in the region, its chief executive for Asia, Gilles Plante, has declared. ANZ is aiming to become a top four international bank in Asia and has tripled its branch network over the past four years to 98. Its branches are spread across Singapore, Indonesia, China, Vietnam, India and Malaysia.

Barclays – Financial Times last week reported on a US court decision that Barclays can keep more than a billion dollars in the dispute related to Lehman Brothers bankruptcy, reversing a previous decision and disappointing the trustee collecting customer assets. Lawyers are set to appeal. In 2010 Barclays fought off the Lehman estate's claim that it negotiated an unfair discount of \$13bn when it bought the bank's broker-dealer assets for \$1.8bn during the turbulent week of its bankruptcy in September 2008. The UK bank's victory was incomplete, as it did lose claim to some assets it believed it had acquired as part of the purchase, including some \$2bn held in margin accounts backing Lehman Brothers' proprietary trading in stock options. However, judge Katherine Forrest, of the southern district of New York, ruled on Tuesday that Barclays was entitled to the margin. The Financial Times reported last Friday that Barclays' asset disposal plans are being hampered by Eurozone woes and uncertainty over financial regulation in the UK. Citing analyst estimates they say Barclays are about 1/3 of the way through their plan to eliminate or improve its least profitable units by 2013, having closed or shrunk its sub-scale operations in Russia, India, Indonesia and Pakistan and embarked on restructuring its Spanish business. Having taken rapid action to deal with these smaller overseas retail businesses, the bank's efforts been slowed as the eurozone crisis has derailed plans to exit its larger Italian, Portuguese and French operations. Barclays management reiterate that overall, good progress is being made.

BNY Mellon: has named Edward Watson as executive vice president and chief operations officer. In this newly-created position, he will be a member of the company's

global Operating Committee and report to Kurt D. Woetzel, BNY Mellon's head of global operations and technology and chief administrative officer. Watson, 51, most recently was executive vice president for operations, technology and general services for Fannie Mae

Morgan Stanley disclosed in an 8-K filing that it is exercising the right to purchase a 14% stake in Morgan Stanley Smith Barney ("MSSB") from Citigroup. From June 1st, Notice Date, the parties will have up to 90 days to determine a final purchase price. After the Fed's Comprehensive Capital Analysis Review "stress test" in March, MS announced that it received regulatory approval to exercise this option.

Dividend Paying Companies

Chemring – announced the divesting of its marine business, involved in the manufacture of marine distress signals the leisure and commercial markets, as it no longer considers it core to its mostly defence market focused activities. The acquirer, Drew Marine, will pay £32mm, which Chemring plans on using to reduce its net debt, buy back shares and fund pension liabilities. We welcome the move as it provides additional financial flexibility to the firm while freeing up time for the executive team to focus on the core activities.

Johnson Matthey – a leading global manufacturer of catalytic converters, announced full fiscal year results which exceeded expectations, at £426mm underlying profit after tax versus the consensus of £411mm, as most divisions contributed to the 23% year on year increase. Key to the positive results were the sales of catalysts, which outpaced the pace of growth in global car and truck production. For the first time in its history the company recommended a special dividend of 100 pence per share, in addition to its regular full-year dividend of 55 pence, which was upped by 20%. The two dividends represent about 7% of the company's value the day before the announcement. Despite the increased dividend and the special payment, the company maintains sufficient flexibility to increase its research and development as well as its capital expenditures in an effort to take advantage of the positive market trends as well as to better position the company for any potential slowdown. The catalysts



sales were driven by a substantial increase in demand in North America, where the heavy duty diesel segment saw a pick-up in activity following underinvestment caused by the economic crisis. Globally, sales of heavy duty diesel catalysts jumped by almost 50%, while the environmental technologies division, which also includes sales of catalysts for cars and heavy industry, saw operating profit rising by 29%. The precious metal products unit, involved in trading and refining of platinum, palladium and gold on a commission basis saw a 16% increase in operating profit, yet the group cautioned that sales might shrink if the low precious metals prices persist. The short and mid term outlook for the group remains cautiously optimistic, as the group is a major beneficiary of the regulation roll-out meant to tighten car and truck emissions around the globe.

Syngenta – is divesting its growing media business, branded as Farfard, which is part of its Lawn and Garden business, a relatively small portion of its business. Sun Gro is the purchaser of the unit and the consideration remained undisclosed. The Farfard unit was responsible for \$88mm of Syngenta's \$13.3Bn revenues.

Tesco – updated on trading for the first quarter of its fiscal year, which includes March to May, with results broadly in line with the consensus expectations. Total UK sales were down 0.3%, relatively better than the market, which shrunk by 1.3% over the same period. The blame falls on a reduction of UK consumers' disposable income as fuel prices have failed to come down, while confidence remains at depressed levels, affected by persistent economic worries. The roll-out of the over £1Bn program focused on improving stores and the online shopping experience for the home market is in full swing. The company announced the addition of staff in 700 of its stores, specialist training being provided to 145,000 staff, over 100 stores refreshed, the updating of its own-label ranges and the re-launch of its Everyday Value range. The group also indicated it saw its biggest ever week for sales outside a Christmas period in the week before the four days Queen's Diamond Jubilee, with over £1Bn in sales, to be booked in the second quarter. Globally, Tesco's 6,000 stores in over 14 countries saw total sales higher by 2.2%, including fuel. The management estimates

market share gains in 11 international markets, as sales at constant exchange rates moved higher by 9.1% in Asia and by 6.0% in Europe ex-UK.

Vodafone : is planning to pool its basic network assets with Telefonica in the UK while maintaining separate and competitive brands. The deal will see the companies contribute assets such as towers and masts into a 50/50 joint venture, resulting in one network of 18,500 masts – with duplicates being decommissioned... so that both companies will enjoy about a 40% increase in sites...with this single grid providing 98% indoor population coverage for 2G and 3G services by 2015. Also, provision of nationwide 4G services should be quicker – up to 2 years ahead of the expected regulatory requirement according to both companies.

Economic Activity, Consumer and Business Conditions

US – Institute for Supply Management's (ISM) Non-Manufacturing Purchasing Managers Index (NMI) contrasted with its manufacturing counterpart (the PMI) as it posted a 53.7 index reading in May, an improvement from April's 53.5 level and higher than the expected flat reading. The growth of this diffusion index was less broad based than in recent months as fewer industries were net contributors.

The productivity and costs report from the Bureau of Labor Statistics (Department of Labor) posted a higher than expected drop in productivity for the first quarter, down 0.9%, more than the expected 0.7% retreat and reversing some of the gains for the previous quarter (revised to a 1.2% growth). Such a dynamic is to be expected as most of the productivity gains have been extracted, in our opinion, in the first few quarters during the latest recession and the marginal benefit of job cuts has decreased and is turning negative. The labour costs as a result have moved higher, by 1.3%, in the same quarter, yet fell short of the expected 2.2% advance, further indication of poor bargaining power on the side of the US labour, as real incomes continue to slip. With real disposable income decreasing, the consumer sector is resorting to increased credit with consumer credit adding



a further \$8.57Bn in April, albeit short of expectations for an \$11Bn add.

The US goods and services trade deficit narrowed in April to \$50.1Bn from \$52.6Bn in March, just shy of an expected \$49.5Bn level as both imports and exports fell, with imports falling faster than exports in the month. Given the fall in imports and the precarious consumer condition, we wouldn't be surprised to see a poor retail sales performance in the short term.

Canada – the visible goods trade balance did not have the positive tilt it had for US as the tiny \$0.15Bn surplus for March turned into a \$0.37Bn deficit in April, continuing the series of sub-par net-export showings since the beginning of the last recession. The Canadian exports fell by 1.2%, dragged by shipping of industrial goods, machinery and energy products, while imports were virtually flat at 0.1% for the month.

The Canadian employment for the month of May added 7,700 jobs added, shy of expectations for 10,000. Worryingly, the private sector shed 22,500 jobs in the month, with the construction sector being a significant drag. Analysts are quick to point out that a slow-down was to be expected following a couple of months of strong job gains. The unemployment rate held steady at 7.3% for the month. Labour productivity in Canada barely rose in the first quarter, by 0.1%, on top of an anaemic 0.7% rate of growth in the prior quarter, and short of the expected 0.3% improvement.

Australia : the Reserve Bank of Australia decided to lower the cash rate by 25bps to 3.5%. It said growth in the world economy picked up in the early months of 2012, having slowed in the second half of 2011. But more recent indicators suggest further weakening in Europe and some further moderation in growth in China. Conditions in other parts of Asia have largely recovered from the effects of last year's natural disasters, but the ongoing trend is unclear and could be dampened by slower Chinese growth. The U.S. continues to grow at a moderate pace.

China has cut its key interest rates for the first time since 2008, in an attempt to boost its slowing growth.

The benchmark one-year loan rate was cut by 25bps to 6.31% while deposit rates were cut from 3.5% to 3.25%.

The Bank of England has once again left UK interest rates unchanged at 0.5% and announced no expansion to its quantitative easing (QE) programme.

The ECB held rates steady at 1.0% for the sixth consecutive meeting, as expected. The decision was taken by consensus, as "a few" members called for a rate cut. ECB President Draghi characterized economic growth as "weak", with heightened uncertainty weighing on confidence and sentiment. Most importantly, he said that there are "increased downside risks" to the economic outlook and that the ECB was cognizant of the recent weak data. When addressing the latter, Draghi noted that Q2 indicators point to weakening growth and that the ECB is watching developments closely and stands ready to act. Even so, the Bank continues to anticipate a gradual recovery, though a timeline on the recovery was omitted. Despite the downside economic risks, the ECB's inflation outlook was little changed, expected to remain above 2% this year, before falling below target in early 2013. Risks to the inflation outlook are balanced, and given modest growth expectations, "underlying price pressures should remain subdued." Weaker-than-expected economic growth was highlighted as the main downside risk to inflation. Draghi announced that the ECB will continue to provide unlimited liquidity in normal and three-month refinancing operations through year end. This was expected, as the last three-month operation was scheduled for June, and clearly the banking sector needs ongoing ECB support. Draghi left the door open for another 3-year LTRO, but questioned whether it would have much impact.

Europe; Josef Ackermann, the former Deutsche Bank CEO, said joint debt sales would force Germany to assume the funding burden and would take pressure off other euro-area nations to implement changes as they battle a worsening crisis. "I'm against euro bonds," Ackermann said. "If we do it right now, it allows maybe the funding with Germany guaranteeing up to 27%," and "that would mean that maybe the pressure from other



countries to do the necessary reforms would be taken away and that would be wrong.” (Source :Bloomberg)

Greece - S&P said that “we believe there is at least a one-in-three chance of Greece exiting the eurozone in the coming months, following national elections on June 17.” “This could be brought about by Greece rejecting the reforms demanded by the troika and a consequent suspension of external financial support,” S&P said in a statement last Tuesday. In addition the S&P said it doesn't see a Greek exit triggering automatic sovereign cuts.

Separately, Moody's lowered Greece's ceiling to Caa2. The highest rating on any Greek security is currently B1.

Spain's credit rating has been downgraded as estimates on the size of the bailout it needs begin to mount up. Fitch cut its rating on Spanish government debt by three notches to “BBB”, a sign it thinks Spain's ability to honour its debts has weakened. Spanish banks will recognise loan losses of €80-112bn by the end of 2013 as the country's double-dip recession drives up defaults, S&P said. (Source : Bloomberg)

Portugal has passed its fourth bailout review and will receive its next tranche of rescue loans from the EU and IMF, Finance Minister Vitor Gaspar said. “According to the evaluation made by international institutions, we are respecting our recovery program,” Gaspar said.

Financial Conditions

European Finance ministers announced over the weekend they would be providing “up to €100bn” to bailout the Spanish Bank sector. It would appear that the money will be provided from some combination of the EFSF / ESM and lent to the Spanish govt. bank bailout vehicle, the FROB. Injection of up to EUR100bn would cover estimated scenario of EUR70-85bn capital shortfalls for the Spanish system. The amount is about 2.7 times the funds deemed necessary to plug the financing gap for Spanish banks estimated by the International Monetary Fund (IMF) in an 8 June report (which said that Spain's banking system needed at least EUR 37bn to withstand a weakening economy). Spain's ability to bring its underlying deficit under control and Greece's position in the eurozone remain key trigger points.

Canada ; Office of Superintendent of Financial Institutions released a brief description of its decisions on key issues raised by federally-regulated financial institutions in response to OSFI's recently published “Draft Guideline B-20” on Residential Mortgage Underwriting Practices and Procedures. The two positives are 1) re-qualification at renewal will be in line with past practice and not subject to full re-qualification and 2) Home Equity Lines Of Credit below 65% Loan-to-value will not have to be amortized. Also OSFI is upholding its position that the HELOC component of mortgages be restricted to a maximum LTV of 65% which is positive longer term from a systemic basis but likely to slow loan growth modestly in the near to medium term. There is no mention of transition provisions for HELOCs that are outstanding and above 65% LTV.

Lenders reporting to the Bank for International Settlements, the record-keeper of the world's central banks, shrank their cross-border assets by US\$799bn, or 2.5%, in the three months ended Dec. 31. The decline was the sharpest since the 4Q 2008, when interbank lending markets froze worldwide following the collapse of Lehman Brothers. (Source : Bloomberg)

The US Treasury Department last Tuesday said it would sell stakes it holds in 7 banks that received bailout funds at the height of the financial crisis, continuing the slow process of winding down the TARP (Troubled Asset Relief Program)

Bank Recapitalisation - Dow Jones reports that ECB Executive Board member Benoit Coeure said in a speech on Friday but published yesterday, that “Banks that need recapitalisation must also be allowed to directly access the European Financial Stability Facility and, when it is in place, the European Stability Mechanism.” The possibility of banks tapping the bailout funds “should be accompanied by strong, centralised supervision of systemically important” banks, Mr. Coeure said. In addition to the Europe-wide banking authority, the euro zone also needs a



single bank-resolution fund, and a unified bank-deposit-guarantee mechanism, Coeure said, echoing the makeup of the “banking union” ECB President Mario Draghi was calling for in the European Parliament last week.

Angela Merkel said systemic banks may need supervision at the European level as the European Union weighs possible steps toward “political union”. “The fiscal pact is one step, but it’s not sufficient yet,” Merkel told reporters in Berlin yesterday before talks with European Commission head Jose Barroso . “So we will also talk about to what degree one has to bring the systemic banks under specific European supervision to keep national interests from playing too large a role.”

Swiss banking Regulations: The Swiss Federal Council has adopted a new package on Swiss bank regulation. The Basel 3 regulatory framework will be written into Swiss law. Implementation starts 1 January 2013 for all Swiss banks and has to be fully implemented by latest end 2018. This means the minimum requirement under Basel 3 for mid-sized Swiss banks will be a 10.5% total capital ratio of which 7% will need to be in core Tier 1 capital. For systemically important Swiss banks (UBS and Credit Suisse) the requirement remains: 10% core Tier 1 capital + 3% higher trigger COCO’s or core Tier 1 capital. For the additional 6% lower trigger COCO’s FINMA will decide on a potential “capital discount” after having received the “living wills” of the banks and evaluated the decrease in their risk profile over the last year (its expected FINMA to communicate a “capital discount” at the end of 2012 for UBS and Credit Suisse). Also with immediate effect there is to be (1) a countercyclical buffer. Swiss banks can be required to hold a higher amount of capital of up to 2.5% of Risk Weighted Assets in order to boost their resilience in the event of excessively strong credit growth or to counter excess credit growth; and (2) more capital underpinning some residential mortgage loans where the borrower has provided 10% or less of equity and does not repay the mortgage principal in an appropriate manner (i.e. 1/3 of the mortgage debt on a residential property has not been repaid after the first 20 years).

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 until mid to late 2014. The U.S. 2 year/10 year treasury spread is now 1.36% and the U.K.’s 2 year/10 year treasury spread is 1.41% - 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 3.67% - (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 improved to 6.6 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 increase 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 29 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 21.43 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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