



## News Highlights on Current Holdings

### Financial Services Companies

Bank of Nova Scotia adjusted for four items (Scotia Plaza and leasing business gains, charges on reserve build and CIX-related tax increase) operating earnings per share (EPS) for BNS are estimated at \$1.22 in 3Q, up 11% year on year and ahead of consensus (\$1.19). The EPS 'beat' came from a lower tax rate (21.6%) and a rare QoQ decline in the diluted average share count. As with BMO (see below), Scotia benefited from a surprisingly resilient level of trading revenue (at \$439m, the combination of trading & securities gains), but net income in the key International segment was lighter than expected (\$392m).

Barclays announced that Antony Jenkins has been appointed as a Director and as Group Chief Executive of Barclays with immediate effect. Mr Jenkins currently leads Barclays Retail and Business Banking (RBB) business. He has been a member of the Group Executive Committee of Barclays since 2009. His role as CEO for RBB includes responsibility for retail banking in Barclays Africa and Absa and he also represents Barclays as a non-executive Director on the Board of Absa Group Limited and Absa Bank Limited. New CEO interviewed in the Financial Times abandoned Barclays 13-15% ROE target and said that achieving cost of equity was a more appropriate goal and stated that that was c11-11.5%. In our view this shows the more realistic nature of the new man. The UK Serious Fraud Office has begun a probe into Barclays over payments made during its crisis busting Middle Eastern capital raising.

BBVA may begin a due diligence process in October for the sale of its 51.6% stake in Provida, the top Chilean pension fund administrator, Diario Financiero reported. The unsourced article said that MetLife and Principal are the main potential bidders for Provida. According to the daily, BBVA expects to raise some USD1.2bn for the deal. No other details on the matter were provided.

BMO Financial Posted diluted EPS of \$1.49 in 3Q12, up 11% YoY and comfortably ahead of consensus (\$1.38). The EPS 'beat' in 3Q resulted from lower core provisions for credit losses (\$116m) and a lower tax rate (21.2%).

BMO continues to prove itself adept at finding earnings levers to pull while awaiting the expected 2013 benefits from M&I (more specifically, expense synergies and loan growth acceleration). However, with Net Interest Margin pressure not abating, the ability of the bank to continue to find these offsets is increasingly important,

Citigroup - Confirmed that they have agreed to pay \$590m to settle a shareholder lawsuit accusing the bank of failing to fully disclose its exposure to toxic mortgage products during the crisis. This would seem to be a relatively good result given the potential losses that could have been involved.

Deutsche Bank - Deutsche Bank has become the first global bank to introduce rules whereby it can claw back bonuses staff had earned at a previous employer, enabling it to take back unvested shares that newly hired staff received in exchange for stock earned at a previous bank. Global banks have previously clawed back bonuses in regard to scandals such as Libor, anti money laundering failures and PPI but this new rule is said to be unique in efforts to tighten bonus rules.

ING - The Standard newspaper in Hong Kong reported ING is exploring a separate sale of its ~US\$1bn Hong Kong insurance business, a move that could further complicate the auction of its Asian operations. The Dutch insurer is selling its Asia divisions to repay a 2008 government bailout. To date it has been unable to secure a single buyer for the entire Asian group, valued at about US\$7 billion (HK\$54.6 billion). While selling Hong Kong separately may extend the auction process for the Asia business, it could allow ING to extract better value from a buyer focused just on that specific market. A successful Hong Kong sale may also allow ING the flexibility to accept lower offers for South Korea and Japan, which have received lukewarm response so far in the bidding. Pan-Asian life insurer AIA Group Ltd and Canadian insurer Manulife Financial Corp are believed to be the leading contenders to buy ING's Southeast Asia operations. Li's bidding group has also expressed interest in the Southeast Asia units.

ING - ING have announced the sale of ING Direct Canada to Scotiabank for CAD\$3.1b (€1.5bn) in cash. This comes



less than a month after ING announced the decision to review the position of ING Canada and UK and should provide some welcome good news on a somewhat lumbering restructuring process. The price of €2.5bn should be taken well given it represents 23x 2011 pre-tax profits (€109m) and is above basic estimates of €1.6bn. The disposal is worth 66c per ING share and €1.4bn of capital is released resulting in positive impact on core Tier 1 ratio of c 47bps. We were surprised ING were reviewing ING Direct Canada as it was the jewel in the ING Direct crown, however, the price achieved should mitigate any concerns that this business is being sold because the other disposal plans are not going well. ING Direct UK is still under review but given it is loss making (-€6m in 2011) expectations are not high.

M&T Bank agreed to buy Hudson City Bancorp for about US\$3.7bn in the banking industry's biggest takeover this year as it seeks to expand in New Jersey.

National Australia Bank has outpaced rivals in the home loan market as lenders battle to overcome record low demand for mortgages. NAB increased home lending by 0.5% in July, growing at a faster pace than the other major banks and the broader market. In a worrying sign for the mortgage sector, official Reserve Bank of Australia statistics released on Friday showed the overall home loan market increased by a subdued 0.3% in July. Over the 12 months to July, the market has grown by just 4.9%, the slowest rate since the RBA began keeping records in August 1977.

Royal Bank of Canada : Royal Bank adjusted EPS of \$1.31 (consensus \$1.18). Canadian Banking, Capital Markets and Corporate services drove the beat, partially offset by Wealth Management, which came in below expectations due to lower activity levels in the U.S. Capital Markets was buoyed by strong trading revenues: \$740mn: fixed income trading remained robust, however there was some softness experienced in equity trading. In Canadian Banking, the cost / income efficiency ratio declined to 43% versus 45.3%, better than expected. Capital Markets displayed its resilience and expense performance was excellent in the Canadian bank.

Royal Bank of Scotland - has ended talks with private equity groups about the sale of its Direct Line Group insurance unit according to the Sunday Telegraph. RBS held talks with Blackstone, Bain Capital and KKR but will now pursue an IPO of the division - in-line with previous plans.

Standard Life has unveiled plans to quadruple the size of its Asia and emerging markets division as it seeks to diversify its core UK and Canadian life and pensions business. The five-year plan is to be spearheaded by Nathan Parnaby, who took on the newly-created role of chief executive of Asia in a recent shake up of senior personnel by chief executive David Nish.

TD reported cash EPS of \$1.91, which beat consensus of \$1.84. A low tax rate added about \$0.06. Canadian retail results were good, with 5% QoQ loan growth and 2% adjusted operating leverage; U.S. loan growth was very strong yet again at 5% quarter on quarter, though profit growth was weaker due to regulatory impact and weak margins; the dividend was raised 7%, which was expected, and TD increases its payout range to 40-50% from 35-45%.

## Financial Infrastructure

Deutsche Boerse provided its regular volume data for Eurex and Xetra after the close yesterday. Average daily volumes for August 2012 for Eurex were 45% lower than August 2011 reflecting the very strong volumes in 2011 due to Eurozone turbulence at this stage last year. In order to put this one month impact in context, Eurex trading volumes are 16% lower year to date. The biggest impact year to date is on interest rate derivatives which were 28% lower. Total order book turnover on Xetra was €3.8bn, 54% lower than August 2011, off a transaction base which was 55% lower year on year. Based on data collected for the year to date, turnover is approximately 26% behind that for the same period in 2011 for Xetra. For reference, Eurex provided 46% of net revenues for Deutsche Boerse in 1H12 and Xetra 11%. We would expect these low volumes to have a knock on impact on settlement volumes i.e. revenues in its other main division Clearstream (33% of revenues) although modest organic growth is expected for Market Data & Analytics in 2nd



Half 2012.

## Dividend Paying Companies

Novartis : The US Food and Drug Administration has approved a higher dose of Exelon® Patch (rivastigmine transdermal system) for the treatment of people with mild to moderate Alzheimer's disease. The new 13.3 mg/24 h dosage strength of Exelon Patch provides physicians with a new treatment option for patients who are experiencing a decline in overall function and cognition. Alzheimer's disease (AD) is the most common form of dementia in older adults with about 4 million Americans living with mild to moderate AD<sup>1,2</sup>

Siemens : On August 14, press newswires reported that Siemens CFO Joe Kaeser gave guidance regarding new pension accounting rules for FY September 13 - i.e. that these would burden earnings by Eur650m to Eur700m. The stock did not respond much to this news, probably because Siemens' Eur3bn share buy-back has been foremost in the market's mind .

## Economic Activity, Consumer and Business Conditions

USA : Onshore insured losses from Hurricane Isaac along the Gulf coast are expected to be in the range of \$500mn to \$1.5bn, according to modelling firm Egecat. The onshore estimate reflects the impact of property losses and business interruption, including the halting of energy production as the storm slowly moves across the region. ( Source : Insurance insider)

## Financial Conditions

US: US banks with more than \$US10bn in assets may get more time to institute internal stress testing required by the Dodd-Frank Act, US banking regulators have indicated. The regulators proposed rules in December and January to require the big banks -- holding companies under the Federal Reserve and national banks under the Office of the Comptroller of the Currency -- to start self-testing their portfolios against adverse scenarios annually. The proposals, which initially called for banks to conduct tests this year, may be revised with a September 2013 deadline, the regulators said in

coordinated statements.

Mitt Romney has pledged to repeal the Dodd-Frank Act which in our view seems unlikely. Instead, Romney may give the financial industry something it wants more: a revamped Dodd-Frank that would accommodate some of the most profitable and riskiest activities while preserving a patina of protection for investors and consumers.

Basel III – the Financial Times reported on Monday that global regulators may allow banks to count more variety of assets towards liquidity buffers to soften Basel rules. The Basel Committee on Banking Supervision has been promising for more than a year to take another look at the LCR, liquidity coverage ratio, which is due to take effect in 2015. Industry groups say the current version, which limits the buffer to cash, sovereigns and top quality corporate bonds, will hamper lending and some central bankers fear it will hinder efforts to stimulate the economy. It is understood that, a growing group of regulators want to expand the buffer to include large-cap, nonfinancial equities because they are easy to sell. To guard against price swings, banks would be required to hold twice as many of them as other assets. The group may also lower the minimum credit rating on eligible corporate bonds from AA to A, or possibly triple B, though this is less likely. The Basel group is also looking at two key changes to how banks calculate the size of their required buffers which would lower the overall amount. They would reduce the pool banks have to hold against their retail deposits from 5 per cent to 3 per cent, and cut the buffer for untapped corporate lines of credit below the current 100 per cent.

The French government rushed to bail out a small, liquidity-starved lender, putting the country's capacity to support its financial sector to the test. Over the weekend, France's Finance Ministry said it would guarantee the debt of Caisse Centrale du Crédit Immobilier de France, or CCCIF, after the bank, which specializes in loans to housing programs, sought emergency assistance.

Spain : Similar to the events surrounding the USA sovereign downgrade from last summer, the rating agencies look to be giving forbearance (albeit perhaps only temporary) to Spain this year. Whereas Moody's



threatened Spain with a downgrade to non-investment grade in June (should a full sovereign bailout occur), S&P now indicating a full sovereign bailout would likely NOT prompt a rating downgrade, and Fitch now non-committal/vague at this stage by saying European Financial Stability Fund/ESM purchases of Spanish sovereign debt would not prompt a downgrade (but no comments of what would happen in the event of a full sovereign bailout). Although the medium term risks of a downgrade to noninvestment grade remain high, the shorter term outlook has improved given the prospects of a split rating at worst (which means index funds should not, in our view, be forced to sell at least for now).

US – UK: US Federal Reserve policymakers remain 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 extension 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 1.35% and the U.K.’s 2 year/10 year treasury spread is 1.56% - 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 3.59% - (3.49% end of July was 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 is at 6.5 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 41 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 18.39 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](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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