Market Commentary

PORTLAND INVESTMENT COUNSEL™

February 11, 2013

News Highlights on Current Holdings

Financial Services Companies

Barclays has increased the provisions to cover two mis-selling scandals by another £1bn. It relates to the mis-selling of interest rate hedging products sold to small firms, and payment protection insurance (PPI) schemes. Following a review, the bank said total provisions for the scandal involving interest rate swaps were now £850mn, and £2.6bn for the PPI schemes.

Citigroup last Monday began the process of repaying the last portion of the debt it owes the US Treasury, by announcing an US$894mn 9.5-year fixed-rate subordinated bond issue. The Citigroup subordinated notes, which carry a 4.05% coupon and are currently held by the Treasury, were sold in the bond market LAST Tuesday. Although Citigroup still owes the Federal Deposit Insurance Corp about US$2.225bn, it will sell the subordinated notes to general investors on behalf of the US Treasury and give the latter the proceeds. (Source : Reuters).

Credit Suisse - clean pre-tax CHF1.14bn, 3% light versus consensus CHF1.17bn. Disappointing misses in both Wealth Mgt (clean pre-tax CHF455m versus consensus CHF524m as well as weak net new money (CHF2.9bn versus cons.CHF5.1bn).) and Investment Bank (clean pre-tax CHF298m versus consensus CHF445m) compensated for by beats in Asset Management (CHF236mn underlying versus consensus of CHF60mn – boosted by performance fees) and Corporate Centre. On the positive side, Wealth Management gross margin is stable at 1.09% vs 1.07% 3Q, unlike UBS. Cost reduction programme has been boosted again - now targeting CHF4.4bn total save by 2015 from previously CHF4bn and capital ratios on track (8.4% Basel 3 Core Tier 1). Outlook also upbeat "2013 consistent with good starts of prior years".

National Australia bank : 1Q 2013 cash earnings of ~$1.45bn were 3% largely in-line with consensus expectations. Revenues were 3% up, driven by wholesale and higher customer margins. The stable asset quality numbers will also be a relief to holders. Divisional commentary was generally positive. The growth in customer margins and improvement in impaireds were reassuring, albeit largely expected. However, NAB's cost growth trajectory highlights that Australian banks still face some reinvestment headwinds.

Royal Bank of Scotland : The investigations found that 21 employees of RBS had attempted and in some cases succeeded in manipulating predominantly Yen and Swiss Libor rates between 2006 and 2010. The findings highlighted serious control issues, but did not conclude that RBS as a firm had engaged in any deliberate misconduct or that senior management had instructed the suppression of Libor rates. RBS will pay penalties of £87.5mn, $325mn and $150mn to the FSA, CFTC and DOJ, respectively, and has entered into a Deferred Prosecution Agreement with the DOJ. RBS commented that all the individuals involved have left the bank. RBS will reduce employee pay by c. £300mn with the individuals involved seeing claw-back of any outstanding bonus awards. Whilst the regulatory fines and reputational damage are clearly not positive, a main continuing concern of investors may rest with potential civil liability. To date the plaintiffs have not focused on individual trader manipulation in their class actions, instead arguing that banks "systematically lowered" Libor to benefit reputation and profit. Both the RBS and recent UBS findings to date suggest that this may not have been the case, in our view. RBS's agreement to settle with US, UK over Libor manipulation may be a credit positive, by spurring a strategic shift away from more capital intensive and riskier activities, Moody's said in their credit outlook. The fine imposed on RBS is "immaterial to its operating profit," Moody's says. Moody's highlighted that RBS still face probes in Europe and Asia that may lead to additional fines and damage to the bank's reputation.

Dividend Payers

GEA Group AG –leading German engineering heat exchange and food and beverage processing equipment manufacturer, reported its fourth quarter and full year 2012 results in Frankfurt last week. Revenues grew by 5.6% to €5.72Bn last year while the order intake rose 5.2% percent to €5.9Bn. Sales in western Europe were

1% lower in 2012, while increasing 22% in North America and 11% in the Asia-Pacific. Earnings before interest, tax, depreciation and amortization (EBITDA) declined 2% to €598mm last year, while the core operating profit increased by 7.1% to €562mm. The reported operating profit was lower, affected by on-going charges related to the company's newest acquisition, the Food Solutions division. Despite headwinds, the company is committed to raising the proportion of revenues from the food and beverage end markets to around 75% from 55% in 2012. For 2013 the company predicts EBITDA to rise to about €700mm, on the back of moderate revenue growth. The group's net debt position was reduced by €62mm to €326mm. GEA proposed a dividend to shareholders of €0.55 per share, on par with 2012's level.

Siemens – announced it has won an order worth €700mm to deliver 80 wind turbines to an offshore wind power plant in the North Sea. The order includes a service contract for a period of 10 years. The total cost to set up the wind park with a capacity of 288MW in the German North Sea is estimated at €1.4Bn. The construction is set to begin in 2014, while the operational start-up is scheduled for 2015. A group of 12 banks will provide loans totalling €937mm.

Syngenta – The largest global provider of agricultural inputs, such as crop protection products and high productivity seeds, reported a net profit for the full 2012 fiscal year of $1.84Bn, 17% higher than the year prior and ahead of the consensus expectations. Earnings were boosted by a lower than expected tax rate, which is likely to reverse in the near future. The company boosted its dividend by 19%, to CHF9.50 per share. Sales for the year rose 7% to $14.2Bn, slightly below the analysts' expectations, but the company pointed out strong trading trends for its largest markets at the end of the 2012 fiscal year, which the company expects will carry on in the current year.

Toyota – unveiled a redesigned Tundra pick-up truck on Thursday at the Chicago Auto Show. The truck is fitted with a back-up camera, easier to use controls and other features designed to take advantage of the lucrative US truck market's anticipated growth. This is Tundra's first overhaul since 2007, when the company's attempt to step-up its sales was ill-timed as the launch coincided with a slowdown in US home construction. As in 2007, the company relied heavily on focus groups in re-designing the truck. The Tundra accounted for 6% of the full-size US truck market last year, while the F-Series from Ford led the market with 38.5%. Last year, US industry sales of full-size trucks rose 9% to almost 1.64mm vehicles. Toyota's Tundra sales last year rose 22.6% to 101,261 vehicles. The 2014 Tundra is expected to arrive at dealerships in September.

Vivendi – Activision Blizzard, one of the largest video game companies in the world, majority owned by Vivendi, reported fourth quarter results which exceeded consensus expectations by a wide margin. Activision Blizzard's stock, quoted on NASDAQ, rose as much as 15.6% at one point on Friday as a result of the news. The strong earnings were driven by robust sales of its holiday hits 'Call of Duty: Black Ops II' and 'Skylanders: Giants'. The company also forecasted first-quarter profit of $0.10 per share, ahead of the expectations. Its outlook for 2013 was more muted however, as the industry is struggling due to customers delaying purchases as they wait for the deployment of updated hardware from Sony and Microsoft, as well as due to customers migrating from console gaming to mobile offerings on tablets and smartphones.

In a separate piece of news, Vivendi announced it had agreed to sell one of EMI's most prized assets, the Parlophone Label Group, to Warner Music, for £487mm in cash. The company had to sell Parlophone to satisfy EU regulators' concerns about its $1.9Bn purchase of EMI's recorded music business. The Parlophone deal is expected to close mid-2013.

GlaxoSmithKline reported 4Q core EPS of 32.6p, beating consensus estimate of 30.9p. Revenues of £6,802B were marginally below consensus. Total expenses were essentially in-line. Glaxo is providing specific revenue and EPS growth targets (usually this is not given). Total revenues are expected to grow at about 1% in constant currency (CER) (or flat if including Fx. Core EPS are expected to grow at 3-4% in CER after adjustment for IAS19 pension rule (which reduces EPS in 2013 by

~2%; this implies an EPS figure of 115.3p CER or 113.1p including Fx. Glaxo expects core 2013 tax rate of 24% and guides for share repurchases of £1.0B to £2.0B during 2013. The company has a comparatively robust long-term revenue and EPS profile but had execution issues in 2012 in terms of lower-than-expected financial performance, which impacted investor confidence. Re R&D – its pipeline progress is finally being made (dolutegravir, trametinib, dabrafenib, etc) and 2013 should see the approval/launch of several new medicines. One of the reasons for the comparative earnings stability at GSK is its diversification into areas like Consumer Health and vaccines and a lighter load of patent expiries ahead of it. One major controversy persists which is when exactly Glaxo's lead drug, Advair/Seretide, might face generic competition. We believe that at some point, fully substitutable Advair generics are likely to enter the market probably beginning in 2016 in the US. European quasi-generics could begin to get approved in EU potentially in 2014. Ahead of any potential generic threat, there is likely to be at least some stepped-up level of competition to this franchise from the introduction of other brands into the category, but GSK will likely remain the category leader partly because it will have its own expanded offerings in this area.

Suncor reported Q4 cash flow of $2.235bn or $1.46/sh, falling short of consensus of $1.59. Operating earnings were $0.65/sh, also lower than consensus of $0.76. The miss comes from a 19 mbpd difference between oil sands production and sales as the company expanded infrastructure (line pack and inventory) as well as higher oil sands opex and lower refining offset by lower cash tax and interest. Production of 557 mboe/d (million barrels of oil per day) was in line with consensus on the back of better Buzzard and Libyan production. Firebag averaged 123 mbpd for the quarter with minimal contribution from Stage 4 with total production expected to peak at 180 mbpd in approximately 12 months. Oil sands opex came in at $38.00/bbl, which was much higher than the $33.35/bbl in Q3 on similar volumes. The company recognized a $1.5bn after-tax impairment on the carrying value of its Voyageur Upgrader project – an indication it will be shelved in our view. Suncor also revealed a potential tax liability ($1.2bn) that it disputes and dates back to Buzzard hedges in 2007. Suncor repurchased and cancelled 12.5mn shares during Q4 at an average price of $32.70/share ($408mn).

Vodafone : After reporting a strong outlook for 2013E earnings at Verizon Wireless (40% owned by Vodafone), Vodafone has announced Q3 results that were broadly in-line with expectations. Group service revenue growth continues to slow (Q1: +0.6%, Q2: -1.4%, Q3: -2.6%) but was in-line with expectations. Q4 will see a further deterioration of top-line trends, driven by the leap year effect (unwinding of last year's +75bps benefit) and the full impact of German MTR cuts. Vodafone Italy has seen further slow-down (Q2: -12.8%, Q3: -13.8%), which is a concern, in light of the subsidiary's high margin (Italy: >40%, Group: c30%). Vodafone Germany has also slowed (Q2: +1.8%, Q3: -0.2%), again a high margin business. Vodafone continues to feel a top-line pinch in the UK (Q2: -3.2%, Q3: -5.2%), but Vodafone Turkey growth remains strong (Q2: +18.0%, Q3: +18.4%).

Economic Activity, Consumer and Business Conditions

US – The US services sector is likely to expand at a steady, albeit slow pace, as the US non-manufacturing PMI (purchasing managers' index), measured by the Institute for Supply Management (ISM), seems to attest. The index recorded a 55.2 index points level in January, right-on with the consensus expectations and mildly below the December's reading of 55.7 index points. The US fourth quarter productivity measurement retreated a larger than expected 2.0% as the US GDP growth failed to keep up with a somewhat recovering job market. Usually the mirror image of the productivity reading, the US labour costs grew a larger than expected 4.5% in the same quarter, ahead of the expected 3.0% growth. Should this become a trend it would, in effect, put more pressure on the profitability of US corporations.

The US consumer continues to see a relatively steady inflow of credit into its wallet, to the tune of $14.59Bn in December, which is slightly above the expectations and slightly lower than November's $15.91Bn consumer credit increase.

Meanwhile, the US trade deficit shrunk significantly in December, to $38.5Bn, as exports rose while imports retreated. A surprising contributor were record petroleum exports which helped reduce the US fuel gap.

The US government wants S&P to pay more than US$5bn—roughly what its parent company has earned in the past seven years—for giving its seal of approval to bundles of subprime mortgages that eventually crumbled, costing investors billions and helping sink the economy. The lawsuit represents the Justice Department's most aggressive move yet to try to hold accountable companies that were at the centre of the financial meltdown. (Source : Wall Street Journal)

Canada – A string of strong Canadian employment reports was finally interrupted last week, when the January employment report revealed that 21,900 jobs were shed in the month, affected by a pull-back in education jobs as well as a drop in manufacturing jobs, only partly offset by gains in construction. Full time employment retreated by 20,600 jobs, while the private sector cut 18,800 positions in the month. Contrary to the expectations, the unemployment rate inched lower, to 7.0%, mainly due to a fall in the size of the labour force.

As it has become the norm since the on-set of the financial crisis and on the back of a stronger Canadian dollar, the Canadian international visible goods trade balance recorded another deficit in December, at negative $900mm, marginally better than the expected negative $1.36Bn and November's revised $1.67Bn level. The country saw a decline in automotive and energy products, which was exceeded by a drop in imports which was relatively broad based.

Housing starts in Canada recorded a steep drop in January, to a 160,600 units annualized level, from 197,100 units annualized in December and below the expected, relatively flat, 195,000 units annualized level. The Canadian building permits report for December, released the day before, at 11.2% lower, foreshadowed the actual housing starts report. Meanwhile, the New Housing Price Index continued to inch higher in December, up 0.2%, albeit at a tempered pace.

Financial Conditions

MADRID—Spain is set to nationalize struggling regional lender Banco CEISS after an external valuation of the bank showed it had a negative value of €288 million ($385.9 million). Spain's bank bailout fund, the FROB, said Friday that the valuation will serve as the basis for a planned recapitalization of CEISS, the result of a merger of two small savings banks—Caja España and Caja Duero. Spain had already said it would inject €604 million into CEISS, a move that will wipe out existing shareholders. The retail bank had 910 branches at the end of 2011, most of which are based in its home region of Castilla y Leon in the northwest of Spain, and just over €30 billion in outstanding loans. CEISS, which had been struggling for years to digest billions of euros in loan losses, held merger talks last year with healthier rival Unicaja last year, but the parties broke off talks in December pending the valuation exercise and injection of state funds. At the time, the banks said they may resume merger talks later on. Spain already controls three lenders, including Bankia BKIA.MC +6.30%SA. A deep economic slump and a housing bust have wreaked havoc on bank balance sheets in Spain in recent years, leading the government to have to step in and bail out several loss-making lenders. Spain last year asked the European Union for a loan of almost €39 billion to help pay for the cleanup of the banking sector. The FROB said three other banks also receiving state aid were found to have positive values. Liberbank is worth €1.11 billion, while smaller Banco Grupo Caja 3 and BMN are worth €370 million and €569 million, respectively. The FROB will own large stakes in these three banks after injecting a total of €1.26 billion. Banco Gallego, a fifth lender that has been put up for sale, was found to have a negative value of €150 million. The FROB hired three investment banks to carry out the valuation process, which was needed to calculate what stake the state would get in exchange for pumping money into the lenders.

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 until the unemployment rate falls below 6.5% (January 7.9%) which is likely to be through 2014. Fed Reserve Chairman, Ben Bernanke has indicated 1% or less would be considered exceptionally low. In September 2012, the Fed announced it would buy $40 bn per month of agency mortgage-backed securities and in December 2012 that it would also buy $45 bn per month of treasuries (4 year maturity and above) which means all parts of the yield curve will benefit from a near-zero anchor until late 2014. The U.S. 2 year/10 year treasury spread is now 1.71% and the U.K.'s 2 year/10 year treasury spread is 1.79% - 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 3.53% - (3.31%, end of November 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 4.4 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. A recovery in house prices appears increasingly sustainable 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 is easing 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 should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 18 – 24 months 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 2 in 2013 (compared to 49 in 2012, 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..

The VIX (volatility index) is 13.02 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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Source: Thomson Reuters, Bloomberg, Company reports

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PIC13-010-E(02/13)