Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Aviva: Aviva announces sale of Aviva Russia to a non state pension fund, Balagosostoyanie, for €35m receivable in cash and creates a small realised gain. The deal requires regulatory approval but is expected to complete in 1H13.

BNP - the 2012 deleveraging effort is over, and BNP can now fully focus on shareholder value creation. Going back to its roots, BNP will focus on organic growth and has now disclosed two initial elements of its 2014-16 Business Development Plan (efficiency drive, plus Asia Pacific development). From a top-down point of view, we estimate the value creation of the full plan at ~€5bn, equivalent to 9% of the current market capitalization.

HSBC : Clean Profit Before Tax of US$24.2bn v US$24.8bn consensus. Clean adjusts for Fair Value on Own Debt, Disposal Gains, Restructuring, AML, Principle Protection Insurance /Swaps provisions, Ping An derivative loss and Net Debt Value Adjustments/ Counterparty Value Adjustment. The Dividend Per Share was US$0.45 compared to consensus of US$0.43. HSBC announced a quarterly dividend of US$0.10 per share for 1Q13-3Q13 compared to US$0.09 in 2012. Total clean income of US$66.8bn v consensus of US$67.0bn. HSBC booked US$7.0bn of disposal gains for Ping AN, US cards and branch sale, which combined with other disposals gives total gains of US$8.0bn. Within the mix, net interest income was in line at US$37.7bn (consensus US$37.6bn). Global Bank and Markets revenues were US$18.3bn and GBM 4Q results included a net US$400mn loss from CVA/DVA model changes. Total clean costs of US$37.8bn v consensus of US37.4$bn. HSBC booked US$700mn of cost savings in 4Q12, taking the total for the year to US$2.0bn, an annualized pace of US$3.6bn. Despite the higher cost reductions, clean costs (ex notable items) were worse than expected implying US$9.5bn of clean costs in 4Q12 although there was a US$0.2bn write-off within this number. Bad debts of US$8.3bn v consensus of US$8.6bn. Balance Sheet strong at 12.3% Core Tier 1. Risk Weighted Assets were US$1,124bn versus our forecast of US$1,175bn. Fully loaded Basel 3 Core Tier 1 was 9.8%.

JPMorgan Chase will eliminate as many as 19,000 jobs in mortgages and community banking through 2014 as Chief Executive Officer Jamie Dimon trims expenses. The bank will cut 13,000 to 15,000 jobs in its mortgage unit and 3,000 to 4,000 in community banking excluding home lending through the end of next year.

Lloyds – Financial Times reports the Co-op faces a £1bn capital hole, half its capital, which is further undermining the purchase of Lloyds 600 branches. This is the first capital gap emerging from regulator's analysis after the Bank of England's Financial Policy Committee suggested a shortfall across the sector. The Co-op is planning to sell its non-life insurance business, possibly its pharmacies business and may be able to release more capital through selling some of the bank's loan or mortgage book to address the deficit. The Co-op is close to completing a sale of ifs life business to Royal London for £200mn .

Lloyds posted annual losses of £1.43bn, hit by huge insurance mis-selling compensation, while it awarded its boss a bonus linked to an eventual sale of the government's stake. The loss after tax, equivalent to $US2.16bn, was almost half the £2.79bn shortfall it suffered in 2011. We believe the 4Q12 results illustrated good progress as the shift towards core profitability continues. 2013 guidance of (1) Net interest Margin of c1.98%, (2) costs of c£9.8bn, (3) a 'substantial' reduction in the impairment charge, and (4) a £20bn reduction in non-core assets was largely in line with prior expectations. That said, a better capital position (12.0% CT1 / 8.1% B3 fully loaded at end-2012) resulting from a £3.2bn gain on gilts detracts somewhat (2bps) from the previous NIM estimate. PPI provisions of £3.6bn were the most substantial part of the £5.4bn legacy/restructuring costs, but should reduce markedly in 2013 as the group now looks conservatively placed.

Royal Bank of Scotland Group CEO Stephen Hester is being pressed by the U.K. government to sell more assets and bolster capital as the Treasury tries to recoup some of its £45.5bn investment in the bailed-out lender. RBS is to sell a 25% stake in Citizens Financial Group and shrink assets at its investment-bank by as much as £30bn. Chief Executive Stephen Hester confirmed that it would list around 25% of the U.S.-based RBS Citizens bank in the next two years 'to highlight the valuable nature of the business. Full year Group PBT -£5,165m against -£3,400m consensus expectations, but driven by raft of below line one-offs including £650m for basis swap mis-selling and £450m for further Principal Protection Insurance. Core business £6,341m, looks c+2% against £6,200m consensus. Non-core losses -£2,879m against -£2,700m consensus but Risk Weighted Assets come in well below expectations. Hence capital better than expected at 10.8% Core Tier 1 against 10.3% forecast.

Standard Chartered - Bloomberg reports, that Standard Chartered is in talks to buy Morgan Stanley's Indian wealth management unit. According to the article, Standard Chartered, which re-entered the private banking business in 2006, is planning to expand in India while Morgan Stanley is narrowing its focus on investment banking and asset management in the South Asian nation. Both companies declined to comment.

Dividend Payers

Bayer- reported results for the last quarter of the fiscal 2012 which were in line with the expectations, with earnings before interest, tax and depreciation (EBITDA) moving 18.4% higher. Markets reacted positively taking the stock price to an all-time high, as the group's forecasted sales of more than €2.5Bn from its five key new drugs by 2015. Further, Bayer also confirmed that its five most important new products, including the stroke prevention pill Xarelto, should deliver longer-term peak annual sales of more than €5.5Bn. Bayer's pipeline of new treatments, which includes the eye drug Eylea against the leading cause of blindness among the elderly, is a rare bright spot in a struggling industry. However, the group is confronted with increased competition, including Pfizer's newly approved drug Eliquis, a rival of Xarelto's, and declining sales in its Yasmin/YAZ women's health franchise amid alleged side effects and generics competition. Bayer was, as a result, conservative in its 2013 underlying earnings forecast for 2013, targeting a mid single-digit percent gain in its 2013 adjusted EBITDA. Results in the quarter were also solid in Bayer's other two divisions, with CropScience sales up 9% and good short term prospects, while sale at the MaterialScience division were up by 5%, driven by polyurethanes, somewhat offset by sales of polycarbonates.

BHP – Port Hedland, used by BHP Billiton for its iron ore exports, reopened Thursday as the worst of the cyclone Rusty passed it without major damages. The port of Dampier, used mostly by Rio Tinto, re-opened late Wednesday, while Cape Lambert, a third smaller port near Dampier was also set to re-open. However, concerns remain of widespread flooding, as weather warnings stretch 500km inland to the mining area of Pilbara in Western Australia.

Chemring – Military equipment maker Chemring reported a 2.8% rise in revenue in the first quarter and said it remained focused on restructuring its operations. Revenue for the first quarter of the financial year rose to £136.1mm from £132.4mm a year earlier, while the order book was at £756.7mm, down marginally from £761mm a year ago.

Novartis – EU granted Novartis approval for Illaris in patients suffering acute gouty arthritis attacks who could not tolerate other treatment options. Ilaris is already sold for treating cryopyrin-associated periodic syndromes, a rare inflammatory disorder.

Toyota – reported US sales for February of 166,377 units, a 4.3% improvement, and said it is encouraged by very positive consumer reaction to its new Avalon and Rav4 models.

Veolia – Veolia Environnement, the world's leading water and waste group, plans to step up efforts to reduce debt left over from an acquisition spree and focus on growing organically in emerging markets. CEO Antoine Frerot said during the company's results presentation that major takeovers were a thing of the past. Veolia already earns about a third of its turnover in high-growth markets, a share that should grow to 50% in five years. The company, whose debt peaked at €16.5Bn in 2008, plans to reduce leverage further from €11.3Bn at the end of December to €8Bn-€9Bn. Veolia is the world's largest private supplier of drinking water, providing water for 100mm people worldwide and treating waste water for 71mm people. For 2012 the group reported a net attributable profit of €394mm, reversing a €490mm loss in 2011. The dividend remained unchanged at €0.70 per share. Revenue rose 3% to €29.4Bn and the company expects organic growth to be about the same amount in 2013.

Vivendi – reported €28.99Bn in revenue for 2012, slightly ahead of the expectations, mostly on the back of stronger than forecasted results at Activision Blizzard, the majority controlled global gaming franchise. The adjusted net income, at €2.86Bn was also ahead of its internal target of €2.7Bn. The group, which reported its results in Paris on Tuesday, said it could give no full-year group outlook until it had more clarity on key asset sales. The French newspaper Les Echos reported that Vivendi had failed to obtain offers close enough to its preferred price of €7Bn for GVT, the Brazilian independent broadband business. SFR, the group's French mobile operations, saw its EBITDA retreat 10.6%, marginally better than group's guidance for a 12% drop and it said its postpaid mobile customer base was stable at the end of last year compared to 2011. Guidance for 2013 include an EBITDA level of €2.9Bn at SFR, while Activision Blizzard, despite a forecasted challenging year, it still targets above €1Bn in EBITDA.

Pearson reported 2012 operating profit of £936m (+1%) and EPS of 84.2p (-3%), in line with its guidance at the January trading update. Pearson expects 2013 operating profit & adjusted EPS broadly level with 2012, rebased for the adoption of IAS 19 (at £932m & 82.6p) and excluding restructuring costs associated with its transformation program, announced last week. The program includes £200m of restructuring charges over two years (£150m costs in 2013, £50m in 2014), relating to: [1] the acceleration of the transition from print to digital, and from developed to emerging markets; & [2] the separation of Penguin (assumed merger of Penguin Random House in H2) . Pearson expects this investment to yield £100m of annual cost savings, and to contribute to faster organic growth, improving margins and improved cash flow & capital intensity from 2015. It also plans £100m of reinvestment in digital, services and Emerging Markets split between 2014/15. The net impact equates to an additional £100m of costs in 2013, with approximately a two year pay-back.

Economic Activity, Consumer and Business Conditions

US – Business activity in the US seems to be progressing, albeit slowly. The durable goods orders report surprised on the downside for January, dropping more than 5% in the month. However, most of the retreat was due to a slump in aircraft orders, a notoriously volatile business. When excluding the transportation orders, the durable goods orders advanced 1.9% in January, ahead of the expectations and adding to the 1% increase in December. General machinery and electrical goods led the charge. The Institute for Supply Management's Purchasing Managers Index (PMI) reading for February, at 54.2 index points, ahead of January's 53.1 read and ahead of the expectations for a pull-back, indicates continued improvement in goods producing industries. The US fourth quarter GDP's revised reading, although, at 0.1%, a couple of notches higher than the advanced negative 0.1% reading, was still worryingly low and short of the expected 0.5% improvement.

Consumer confidence improved in February and, for once, the two confidence measures, the Consumer Sentiment by the University of Michigan and the Consumer Confidence by the Conference Board seem to agree. The improvement though, was, in our opinion, largely due to advances in the asset prices, namely housing and the stock market, as the economic growth and outlook are rather subdued. The personal income report, released last week, reveals that the US personal income dropped by 3.6% in February, overshooting expectations for a 2.2% retreat. Part of the same report, the core personal consumption expenditures (PCE) price index, rose 1.2% providing ample room for the central money regulators to continue their unprecedented monetary easing.

Canada – Much like US and the developed world, Canada reported tepid growth in the fourth quarter of the 2012, managing to squeeze only 0.6% of economic advance, as expected. The weak results follows a 0.7%

increase in the third quarter of the year. A reduction in inventories was the main culprit for the weak result, while the business investment and the consumer spending had more decent rates of 4.4% and 2.7% respectively.

Ireland will start to withdraw its bank guarantee scheme for troubled lenders from March 28, in a major sign the banking system is emerging from crisis, finance minister Michael Noonan said Tuesday.

Italian voters blew a resounding raspberry to austerity against a backdrop of declining wages and rising unemployment. In particular, former comedian and anti-austerity Grillo polled far better than expected, whilst centre left Bersani was much worse. Lower house; Bersani 29.5%, Berlusconi 29.2%, Grillo 25.6% and Monti 10.6%. Senate seats; Bersani 36%, Berlusconi 37%, Grillo 17% and Monti 6%. Result calls into question the accepted European consensus solution that Germany will underwrite everyone's Sovereign losses and recover the money by imposing interminable austerity on the respective populations.

Financial Conditions

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 1.62% and the U.K.'s 2 year/10 year treasury spread is 1.66% - 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 3.51% - (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 3 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 15.36 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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