Market Commentary

PORTLAND INVESTMENT COUNSEL™

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News Highlights on Current Holdings

Financial Services Companies

Allianz: Headline numbers (operating profit EUR2.8bn, net profit EUR1.7bn) had already been reported but improved disclosure followed: reported combined ratio of 94.3% which given natural catastrophes were higher than expected and reserve releases lower - suggests underlying quality very strong – presumably the benefit of price increases coming through (German motor and property, and also Australia) . Also, very strong net inflows in Alternative Asset Management of EUR42.6bn (primarily PIMCO), but as expected, performance fees were also very strong at EUR276m. Cost income ratio lower at 52.9%. Also, Economic solvency improved from 199% to 208% QoQ - increase in available capital. Finally, Life result boosted by strong growth in unit linked products and also benefitting from lower admin expenses.

Barclays won dismissal of a US lawsuit by holders of American Depository Receipts who claimed that they had lost money because of the banks activities manipulating LIBOR.

BNP Paribas told shareholders it expects a "significant" drop in staffing levels in its home market as it moves to offset the shrinking economy. The bank is in the early stages of a plan to cut €2bn in annual costs over the next three years and is set to launch a new Europe-wide online bank. (Source : Reuters)

Citibank : Citi Brazil has entered into a definitive agreement with Banco Itaú Unibanco to sell Credicard, its non-banking credit card and consumer finance business in Brazil, for approximately US$1.37 billion generating an after-tax gain of US$300 million or $0.10/share. The sale is subject to approval by Brazilian regulatory authorities and is expected to close in Q2/13. In our view this is in line with Citi's strategic initiatives to prune its portfolio of non-core assets and to focus its resources on targeting the upper income consumer in the world's largest cities. Included in the transaction are 96 Credicard stores, Credicard-branded credit cards with a 4.8 million customer base and US$3.26B of consumer loans representing 0.5% of C's total loan book. The transaction does not however include Corporate cards, the Citi and Diners branded portfolios, and the Credicard Platinum portfolio or Credicard American Airlines cards, which will be migrated to the Citi brand and will continue to be managed by Citi. The transaction also does not impact Citi's retail branch network in Brazil with 200 branches and a 5-10% market share in the Brazilian consumer market, ranked # 7-10.

HSBC said that the bank would target an additional US$2-3bn in cost savings between 2014 and 2016, as the bank reduces jobs and sells non-core businesses with less than a year left in the first phase of its restructuring plan. HSBC also re-affirmed a target range for return on equity of 12%-15%and said it was on track with its cost-savings plan, having cut US$80bn in risk-weighted assets from the bank's balance sheet through disposals of 52 businesses worldwide and announced 46,000 job cuts to eliminate $4bn of annual costs since CEO Stuart Gulliver took up the role in 2011.

ING announced last week that it has agreed to sell part of its direct stake in Sul América S.A. to International Finance Corporation (IFC). ING has agreed to sell approximately 26.5mn units of SulAmérica, representing approximately 7.9% of SulAmérica's outstanding shares, for a total consideration of 400mn Brazilian Reais (roughly $200mn or €155mn at current exchange rates).

Lloyds Banking Group made two moves last week signalling its strengthening balance sheet. In the biggest move, it said it had paid back all the £11.4bn of cheap loans it took from the European Central Bank last year. This is almost two years before they were due for repayment. It has also sold a loss-making property loan portfolio to the private equity group Cerberus for £325mn. Similar to RBS, the UK Treasury are expected to begin privatisation pre the 2015 elections. The 61p (the price the Governement paid for its stake) was mentioned in March linking the price to executive compensation, where we learned that the price was the minimum the government could sell at to allow CEO Horta Ossorio his 2012 bonus, which is deferred to 2018.

Royal Bank of Scotland is to spend an additional £450mn to repair its ailing IT systems, as the part-nationalised

UK lender attempts to draw a line under recent failures. Sir Philip Hampton, chairman, told shareholders at the bank's annual meeting in Edinburgh on Tuesday afternoon that the extra money would be spent "improving our systems", though he gave no details. (Source : Financial Times). Further, he said he was "comfortable" with the bank's capital position, adding that he expected the business to be in a position whereby the government will be able to begin selling down the state's holding by the end of next year at the latest. (Source : The Telegraph). The bank is also to shed 1,400 jobs in the next two years as the lender slims down its UK retail head office to focus resources on its branches. The bank announced in March it would invest £700m in its UK retail arm over three years but acknowledged that this outlay would only be possible by trimming some of its administration.

David Cameron has indicated that RBS could be re-privatised through a sale of the shares to millions of ordinary investors at an initial loss to the taxpayer. George Osborne, the Chancellor, is said to be in favour of a public sell-off because it would give the British people a direct stake in any future recovery of RBS, giving him room for manoeuvre if he decides to sell the bank stake at a price below that paid by the Labour government in 2008. (source : The Telegraph)

Dividend Payers

Bayer – signed an agreement last week to acquire 100% of the shares of Steigerwald Arzeinmittelwerk GmbH, Darmstadt, Germany, a privately held pharmaceutical company specializing in pharmacy-only herbal medicines. Steigerwald's product portfolio includes Iberogast for the treatment of functional gastro-intestinal disorders and Laif for the treatment of mild to moderate depression. Steigerwald generated sales of €61.3 million in 2012. The company employs approximately 180 people and has its headquarters and manufacturing site in Darmstad. Financial terms of the takeover have not been disclosed.

Roche Holding AG – is reported to be exploring the sale of its blood glucose meters business, as the industry is struggling with increased competition and reimbursement pressure. The discussions about a potential sale of Roche unit are still in their early stages and a deal may not materialize. Last year, Bayer attempted to sell its blood glucose meter business for around $1.5 billion, but cancelled its efforts due to lack of interest.

SP Ausnet – State Grid Corp of China (SGCC), the world's largest state utility, has agreed to buy large stakes in Australian power companies from a unit of Singapore's Temasek, Singapore Power, in a deal that could be worth over A$5 billion ($4.93 billion), as it searches overseas for higher-yielding assets.

State Grid will buy 19.9% of the Victorian utility SP Ausnet for A$824 million, and 60% of energy infrastructure company SPI Assets Pty Ltd (SPIAA), known under the trading name of Jemena, for an undisclosed amount. Singaporean government-linked firms have spent billions of dollars over the past decade on Australian telecoms, energy and real estate assets. The retreat from Australia may signal a shift in their investment strategy away from relatively staid markets in favour of higher-growth economies, leaving room for the acquisitive State Grid. State Grid, ranked seventh on the Fortune Global 500 list in 2012 with revenue of approximately US$300 billion, has already established a presence in Australia, the Philippines, Brazil and Portugal. Credit Suisse Group AG and Lazard Ltd advised Singapore Power while Goldman Sachs Group Inc and Macquarie Group Ltd advised the Chinese group.

SP AusNet, listed in Australia and Singapore, owns and operates electricity and gas distribution assets in Australia's southeastern Victoria state, including the state-wide electricity transmission network. Singapore Power said it would continue to hold a 31.1% stake in SP AusNet, which would remain publicly listed. Both transactions announced on Friday are subject to approvals from Australia's Foreign Investment Review Board (FIRB), the Australian Competition and Consumer Commission, and China's National Development and Reform Commission.

Earlier in the week, SP Ausnet reported its fiscal year 2013 results, which were broadly in-line with the expectations. Earnings before tax, interest, depreciation and amortization (EBITDA) grew by 7.5%, mostly driven by higher regulated tariffs and higher gas volumes.

Net profit after tax, at $279 million, was 9.5% higher. Operating cashflow improved to $568 million due to slightly lower tax paid and better working capital management. As expected, a $0.082 per share dividend was declared, yielding about 7.2%, while dividend guidance for the fiscal 2014 was at $0.0836 per share.

Syngenta – announced a technology licensing set of agreements with DuPont, which will broaden each company's crop protection portfolio and enable both to bring new products to market more efficiently. Syngenta has obtained a global license from DuPont to develop products containing DuPont's fungicide oxathiapiprolin, a new class of fungicides offering a significant improvement for growers in the control of diseases in potatoes, grapes, vegetables and other specialty crops. The agreement gives DuPont exclusive access to Syngenta's Solatenol for mixture with DuPont's picoxystrobin fungicide on soybean and other crops in Brazil. Solatenol is a fungicide with a new mode of action with no cross-resistance to existing fungicides and it offers outstanding and long-lasting control of Asian rust in soybean. The transaction is subject to approvals from applicable regulatory authorities. Financial terms of the agreement were not disclosed. Such licensing agreements have become common place in the industry and help improve the economics of developing ground-breaking crop protection products.

Vivendi – reported first quarter revenues of €7.05 billion, in line with previous guidance, yet down 1% on a year on year basis, dragged by tough trading environment at its SFR French mobile division. Earnings before interest and tax retreated 17% to €1.34 billion, a 16% fall at constant exchange rates, also affected chiefly by performance at SFR. The company said business in the quarter, against the backdrop of a "very challenging economic environment" was in line with its outlook and confirmed its full-year guidance for all its divisions. SFR is still expecting a 12.5% drop in its earnings before interest, tax and amortisation (EBITA) this year to €2.9 billion, but it hopes investment in its 4G mobile network will help it claw back pricing power and retain customers starting next year. Management emphasized that new offers have maintained the commercial momentum initiated in the last quarter of 2012, with 257,000 new mobile subscribers and 56,000 new fixed line subscribers. The company also said that recent cost reduction actions would have their effects in the following three quarters of the year. Results were more robust in group's media divisions, with EBITA guidance for ActivisionBlizzard raised to $1.15 billion from more than $1 billion previously.

In a separate announcement, Warner Music won EU approval to buy Parlophone Label Group from Vivendi's Universal Music Group for £487 million. The world's largest recorded music company, Universal, is selling Parlophone, whose artists include Coldplay and Daft Punk, to fulfill a promise to the European Commission for clearing its $1.9 billion purchase of EMI's recorded music business.

National Grid has reported a solid set of results for FY12/13, including in-line underlying profits, a c3% EPS beat vs consensus due to tax, and an achieved ROE in the US above the 9% milestone. EBIT of £3644m (+4%) and adjusted Pre-tax profit of £2742m (+6%) are broadly in line with consensus. The tax rate came in lower than expected due to one-off prior year adjustments, boosting EPS to 56.1p (+12%), which is 3% higher than consensus. The full year dividend is 40.85p, consistent with the previously announced +4% policy for the year. The achieved ROE in the US is now 9.2% and we believe National Grid can make further progress towards the average allowed return of 9.8%. Capex in the US is now set to run c20% higher than previously anticipated, helping to drive growth in the rate base by c5% pa.

Economic Activity, Consumer and Business Conditions

United States – The US leading economic indicators (LEI) reading for April released last week, posted a 0.6% advance, significantly ahead of the 0.2% expected change, suggesting that the US economy might have continued growth ahead, despite readings earlier in the week suggesting otherwise. The US industrial production retreated 0.5% in April, more than the expected 0.2% pull-back and more than reversing the 0.3%

improvement in March. The weakness was broadly based, led by a 3.7% reduction in utilities output and a 1.3% reduction in production of motor vehicles and parts. The US capacity utilization retreated to a 77.8% level in April from a 78.3% reading in March. A 32,000 jump in the initial jobless claims also seemed to indicate a slow-down in activity.

Unexpected good news was the consumer sentiment read, by the University of Michigan, which for the month of May jumped to an 83.7 index points in aggregate from a 76.4 index points reading in April, as both the 'current conditions' component and the 'expectations' sub-index advanced more than forecasted. The expectations had been for a mostly flat reading.

The US inflation data, as measured by the changes in the consumer price indices (CPI), indicated a more muted rate of inflation than expected for April. The headline rate was 1.1%, two tenths lower than the expected rate and a four tenths drop from March's reading. An 8.1% drop in gasoline pricing explained most of the drop. However, even when removing the effect of food and energy price changes, the core CPI reading, at 1.7%, was lower than expected and two tenths lower than March's 1.9%. Tamer inflation rates will, allow more room for Fed's continued experiments with monetary easing.

Mixed news for the US housing sector, with US housing starts unexpectedly dropping 16.5% in April, while the building permits actually jumped 14.3% in the month, to a 1,107,000 annualized level. However, an encouraging piece of housing data is the National Association of Home Builders' Housing Index, which for May popped higher to a 44 index points reading, still in the 'less than confident' territory, but a clear improvement from the 41 index points reading in April. A leading indicator, the 'traffic of prospective homebuyers' improved 3 index points to a 33 reading.

Canada – Canadian manufacturing sales re-treated by 0.3% in March, after a strong 2.8% advance in February, affected mostly by a reduction in sales of energy products and chemicals (fertilizers).

Much as in the United States, although from an already lower base, the Canadian inflation proved to be tamer than expected, with a headline year on year rate reading of only 0.4%, dragged lower by weak energy prices. Even when excluding the eight most volatile price series, such as food and energy, the core rate sat at 1.1% in April, far away from the Bank of Canada's 2% target. Prices were weaker in clothing, transportation, health-care and recreation.

The Bank of England has forecast that the British economy will grow faster than expected in the coming months, but stresses the weak nature of the recovery. Growth in GDP was expected to strengthen to about 0.5% in the second quarter of 2013, but the recovery would be uneven, the central bank said in its latest quarterly report.

France fell into recession in the first three months of this year, official figures showed Wednesday. The national statistics agency INSEE said that the economy shrunk by 0.2% between January and March, after contracting by the same amount in the last quarter of 2012.

Financial Conditions

Italy managed to extend the average lifespan of its debt last Wednesday by issuing its first 30-year bond since 2009. The treasury sold €6bn of the new bond maturing Sept. 1, 2044 through a syndicated deal. The bond was issued at a price equal to a yield of 4.985%.

Spain - The Bank of Spain reports the March's non-performing loans for the country's lenders, which said bad loans dropped to 10.39% of their outstanding portfolios in February. Separately, the Spanish government yesterday reported 1Q13 estimates for the fiscal deficit at -1.42% before including municipalities that could add a few basis points. This seems to be on track for the revised 2013 budget pointing to -6.3% announced in April and current consensus of -6.0%.

Cyprus - The Central Bank of Cyprus reported its balance sheet as of 30th April and ELA funding to Cypriot banks was basically flat month-on-month at ~€11.4bn. This is much lower than what has been speculated and probably shows that the capital controls have been effective preventing significant deposit outflows from the Cypriot banks.

Turkey's credit rating was raised to investment grade by Moody's Investors Services Inc. for the first time in two decades as the government reduced its debt and current-account deficits. Moody's said in a statement last week that it lifted Turkey's government bond ratings by one step to Baa3, the lowest investment grade, from Ba1. The move puts Turkey's credit rating at the same level as Spain, Colombia and India. The outlook was set at stable.

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% (April 7.5%) 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 1.73% and the U.K.'s 2 year/10 year treasury spread is 1.57 % - 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 4.7 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 14 – 20 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 13 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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