IceCap
Asset Management Ltd.

Our view on global investment markets:

May 2018 – "Face Ripping Rally"

Keith Dicker, CFA
President & Chief Investment Officer
keithdicker@IceCapAssetManagement.com
www.IceCapAssetManagement.com
Twitter: @IceCapGlobal
Tel: 902-492-8495

The Facelift

It's all a show

Hollywood has made a living ripping people's faces right off their skull.

By many accounts, Tom Cruise has positioned himself as a professional face ripper. Whether he's ripping and flipping his face off in Vanilla Sky, or doing his best imitation of hiding behind different faces in Mission Impossible – Tom Cruise's film earnings have proved that a face ripping strategy can be very profitable.

Yet, the most famous face ripper is undoubtedly Hannibal Lecter. While his creepy movements, and his creepy speech was more than enough to give you the creeps, Lecter's real power was revealed the moment he escaped using another (unfortunate) person's face as a disguise.

Whereas Tom Cruise enjoyed his face-ripping experience, Hannibal Lecter's victim certainly did not.

In both cases, the face-ripping actions proved to be both memorable and shocking.

Unknown to Hollywood, and unknown to most investors – the world is on the precipice of one of the biggest face-ripping market movements to be felt by the money world.

For many reasons, many people hate the USD. Debts, deficits, wars, Trump – you name it, the reasons for the USD to fall are too many to count.

Yet, despite all the moaning and groaning about the USD – it just won't go down.

And in the investment world, what won't go down – goes up.

In our view, IceCap expects the USD to rally hard. The potential for a surge will be so aggressive that it will rip the face off all investors who are bearish against the USD and positioned for it to fall.

This is the real risk that faces the market today.

It's Déjà Vu all over again

Well, we've been watching now for quite some time – and it still hasn't happened.

We've watched Canadian, British, Australian and even tolerated the big American ones too – yet most media outlet refuse, is prohibited, or simply doesn't understand it enough to report to the masses the happenings within the world's bond market.

Yet, every single evening when the majority return home from their jobs, they inevitably turn to the TV to see what happened while they toiled away their day, earning money to tuck away for their eventual retirement.

Sadly, the largest investment market on the planet rarely gets a mention, a like, or even a tweet.

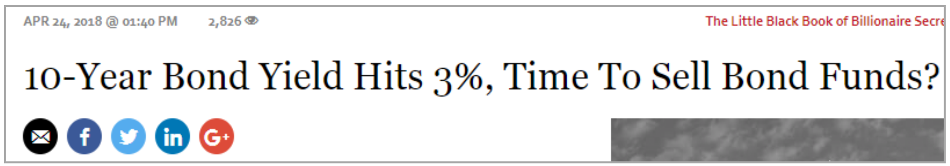
We're cool

But it should.

Readers of the very cool, **IceCap Global Outlook** are fully aware of our expectations for a crisis in the bond market. The crisis will likely originate, from a re-escalation of a crisis in the Euro-zone.

Cracks have started. Chills are beginning to be felt down spines.

And if you look close enough – you'll soon see the days of the big banks, big media, and big consultants avoiding this big discussion are coming to an end.


APR 24, 2018 @ 01:40 PM 2,826
The Little Black Book of Billionaire Secre

10-Year Bond Yield Hits 3%, Time To Sell Bond Funds?

The entire concept that there is a real person behind the investment account number has somehow disappeared over the years.

Instead, the investment industry has intensified its laser-like sharpness on miraculous products, lead by armies of glasses-wearing analysts scouring the world over in search of undiscovered opportunities.

Those that cannot see through this charade, will easily rationalise 100's of banks, 1000's of mutual funds, and 10,000's of analysts as something that's really cool and worthwhile paying 2% or more a year to experience.

Yet, others know that all these banks, mutual funds and analysts are all equipped with the same data, the same spreadsheets, the same software and the same bonus pool payout structure.

Which should lead you to ask – how is it possible to do better than the average?

The answer of course – it isn't.

Instead, the only way, and the easiest way, to truly protect your hard earned savings, grow your retirement funds, and ignore the headline news is actually rather simple.

Do the opposite of what everyone else is doing.

Being a contrarian in the investment world certainly isn't a new and novel idea. Yet, it's incredibly difficult to do for several reasons.

To start with – being a contrarian, means you will take active decisions within your investment portfolio which are quite different than what everyone else is doing.

Of course, being a contrarian doesn't mean you should be stupid either. It just means you need to be mindful of the truths, the untruths, and most importantly – be aware of your surroundings.

Achieving this starts with a rather novel concept – ignore the masses.

And there's no better way to ignore the masses, then to ignore the headline news regarding the stock market.

Asymmetrical

If the first four months of 2018 did anything to investors, it made them a little bit more honest with themselves.

In many ways, the volatility waves and the losses generated were unbearable for most.

For many, the first real losses in over a year can be hard to stomach. And despite acknowledging that stock markets can go down as well as up – the majority of investors react quite differently when this guaranteed event occurs.

By now, everyone should agree that all the euphoria experienced from gains, is dwarfed by the pain experienced from losses. In other words, the emotions earned from both gains and losses are not symmetrical.

Those that disagree, haven't truly experienced a loss.

Which of course brings us to the current stock market correction.

As of writing, US stock markets are now flat for the year 2018. Yet, you would never know it from the headlines of the big media outlets, or worse still – the twitter feeds from those who have been calling for stocks to crash to zero.

In many ways, one can be forgiven for falling for the hysteria. Between trade wars, tax wars, and real wars – everyone will admit that perhaps the world is just a bit off kilter.

Yet, if one stepped way back and objectively assessed the entire situation – one would discover this trifecta of events has not materialized into the face-ripping market movements that sells papers and clicks.

Granted, the world IS in a precarious state – IceCap has been writing and speaking about this in detail. But the challenge for investors remains – the majority continue to incorrectly assess the situation and therefore remain incorrect with their market expectations.

In other words – the majority are once again proving to be wrong.

IceCap's primary model for determining whether the stock market is about to turn into an abysmal collapse – has NOT flashed red.

Yes, the model signals have weakened over the last few months, but as of writing there isn't anything happening to suggest we should begin to stock up on bottled water, duct tape and (heaven forbid) 10-year US Treasuries.

From a technical perspective, our model tracks trend and momentum rate of change indicators covering sector/industry/sub-industry levels for multi-cap weighted indices.

From a layman's perspective, our model records how fast the price of stocks and industry groups are changing.

Be a robot

The important point to consider, and one that further reinforces how IceCap manages client portfolios – this model (and many others we employ) is devoid of subjective thinking.

The numbers are the numbers. And using the numbers and not using feelings, will usually help you avoid buying at market tops, and better still - selling at market bottoms.

Yes, you really should buy low and sell high.

We admit that the extreme market movements over the past four months have produced some uneasy feelings – but that's the main point.

Don't let your feelings hit your buy or sell button.

Of course, most people are not emotion free. And most people do not have access to some research models available to professional managers.

From our perspective, the real interesting result from recent market movements is the emotional reactions from other managers who have been very vocal about stocks crashing 50% or more, or the USD crashing by 50% or more, and of course gold sky-rocketing towards $10,000.

At present, IceCap disagrees with each of the above views.

What we can tell you is that these long-term views are based upon data, but the short-term hysteria is based purely upon emotions.

And, when you use emotions in the investment world – it will end in tears.

Don't follow the herd

When it comes to contrarian investing, the single biggest all-in trade in the world today is a bet of a collapsing US Dollar.

The reasons for a collapsing USD run a trillion miles long. They include:
- TRILLIONS in accumulated public and private debt
- TRILLIONS in accumulated public deficits
- TRILLIONS in unfunded public and private retirement benefits

It is fact that the above are all solid reasons to fear the eventual collapse of the USD.

But not today.

IceCap has commented before that in order for the USD to fail as the world's reserve currency, there needs to be a viable alternative.

And just to be clear – this viable alternative has to be the biggest borrower or issuer of debt on the planet.

At present, no other country is remotely close to being an alternative. It just isn't an option.

Objective > Subjective

However, there is another way for the USD to be dethroned as the world's most dominant currency – and this involves a complete overhaul of the current global monetary system.

In our view, one option leads to the other.

For now, let's focus more clearly on why the USD is not about to collapse. And why all of those investors positioned to benefit from a secular USD collapse, will see their investments collapse in value during a face ripping USD rally.

The biggest negative, USD falsehood making the rounds today is that America's trade wars will force China to unleash their very own financial weapon of mass destruction – the selling of its vast holdings of US Treasury Bonds.

This premise is based upon the incorrect belief and false hope that China will not only stop buying US Treasury Bonds, but it will also sell its holdings of US Treasury Bonds.

This story is gathering steam – and it's easy to see why.

To start with, China is the largest foreign holder of US Treasury Debt. China holds about $1.176 Trillion worth (less than 6% of total), and despite all the hoopla you're hearing these days – it is actually INCREASING its holdings, not decreasing:

China Holdings of U.S. Debt Rose in 2017 by Most in Seven Years

By Sarah McGregor and Katherine Greifeld
February 15, 2018, 5:00 PM AST *Updated on* February 15, 2018, 6:24 PM AST

It's fair to say, the vast majority of people outside of America do not support President Trump. And it's also fair to say the vast majority of big media inside and outside of America do not support President Trump.

This has evolved into a dangerous cocktail that is clouding the minds of many innocent investors.

Remember, as an investor it is absolutely critical to remove your subjectivity, emotions and biases when it comes to money.

Instead, become factual, objective and neutral – years from now, your retirement savings will thank you for it.

Everything Trump does is told in a negative light, and for many people – it creates a simmering rage which is clouding judgement, reality, and perhaps most important of all, just plain mathematics.

Investors also need to know that the majority of USD collapsing stories are being authored by groups that have become so emotionally invested in the story - that they spend every single waking hour desperately telling anyone who will listen why the USD will collapse.

Equilibrium

In fact, these groups have now become wound so tight – several have felt the need to voluntarily tell IceCap directly how right they are, and how wrong we are.

Talk about being frustrated.

When it comes to being right and wrong, it's best to stick to the facts.

It is true, the American government spends significantly more money than it collects in taxes. This difference between what they spend and what they collect in taxes is called the fiscal deficit.

In order for any government, or person to spend more than they collect in taxes or paid in salary, they have to borrow to make up the difference.

When an individual borrows money, they usually go to a bank.

When a country or government borrows money, they usually issue a bond and this bond is purchased by investors.

Investors may be a mutual fund, exchange traded fund, a pension fund, an individual, or even a foundation or trust.

This investor can also be another country , and in this case – China.

To truly understand how money moves around the world, know that it is all based upon a very simple concept – everything is in balance.

A Balancing Act

The world is a big place – but only if you are looking too closely.

In reality, global trade – the aggregate sum of all exports minus imports is always zero. It is impossible for it to be any other number.

It is true, that every country by itself either exports more, or imports more. But when every country is combined together – the net is zero.

This mathematical truth is called the balance of trade, and it is completely missing from the arguments presented by those who proclaim that China will begin to sell its USD holdings and unleash a financial hell upon the Americans and their trade war mongering President.

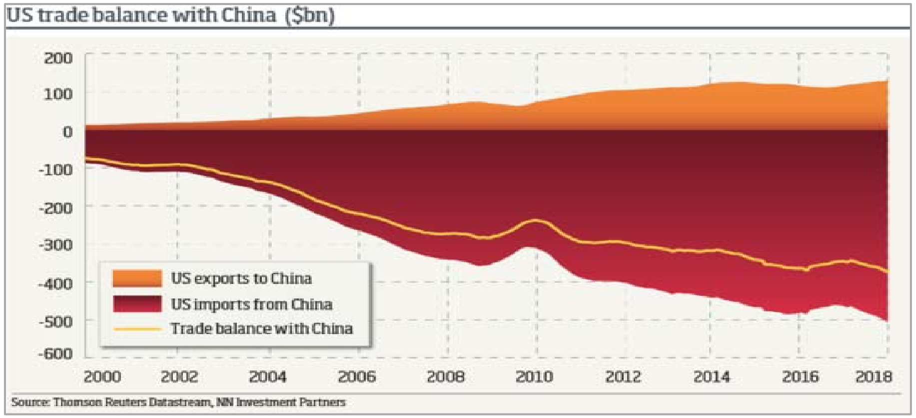
In addition to this mathematical truth, there is also a monetary policy truth that is also completely ignored by those USD doomsayers – China pegs its currency to a basket of currencies, lead by the USD.

To truly understand this little discussed, but enormously important topic, let's turn the world inside out and instead, look at it from a different perspective.

Instead of focussing exclusively on all the bad financial deeds committed by the Americans over the last 50 years, let's instead look inside China.

What you'll see, will help you realize China is not going to unleash a financial fury upon America, and that the head line grabbing USD

It’s a relationship business



collapsing stories are simply fantasy inspired fiction, written to defend bad investment calls.

To start, understand that China does indeed have an enormous trade surplus with America.

Currently on an annual basis, China is selling about $350 Billion more worth of stuff to the Americans, than what the Americans are selling to the Chinese.

Obviously, China also trades with other countries around the world. And what is rarely shown in the media and big bank research reports is that excluding the US, China actually runs a balanced trade account with the rest of the world.

In other words – the economic trade relationship between China and America is incredibly important.

And despite what you hear, read and see – this relationship is actually more important to China, rather than the USA.

Knowing this, you’ll better be able to understand why China is the one at risk – not America. In fact, China has an incredible incentive to keep USD hegemony alive for as long as possible.

Because, if the USD collapses – so too does the Chinese domestic economy.

Let us explain.

While everyone is seemingly an economic, and investment expert on USA – few know or even bother to find out anything about China.

This lack of knowledge and effort, is even further exacerbated when people use their American knowledge of markets and reflect this upon China.

There are some similarities, but there are even more differences – and it is these differences that are contributing to investors making up false stories about China being on the verge of collapsing the USD.

To begin with, most Western economies are highly driven by their domestic economies.

Not China.

It ain't pretty

China (as well as Japan, South Korea and Germany) is HIGHLY dependent upon exports to survive.

This isn't a new, startling revelation – most people are aware of the importance of exports for China.

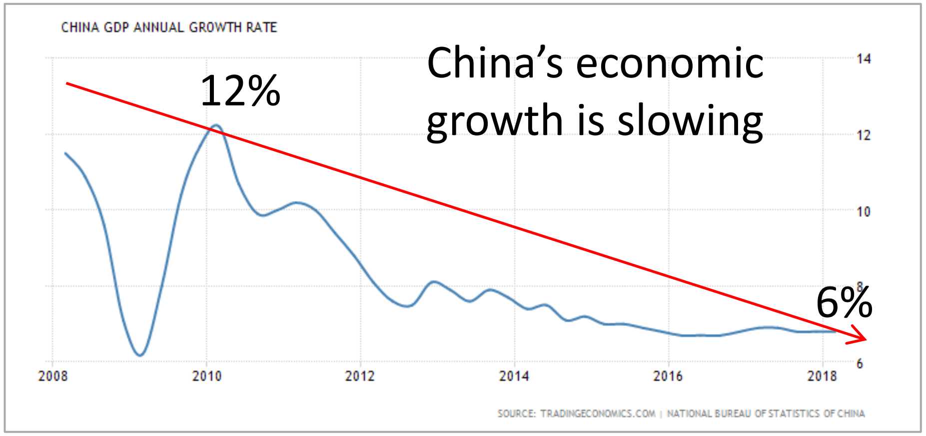
As well, most people are aware that the Chinese government is doing everything in their power to transition AWAY from relying so much upon exports, towards an economy humming along to the tune of domestic spending and investment.

Put another way, just as the American economy is unbalanced and hoping to shift more towards exports, the Chinese economy is also unbalanced but with hopes of shifting away from exports.

Over the years, financial markets have become quite accustomed to China's economy growing at 3-5 times that of the Western World.

Yet, what has been missed – and typical because the big bank analysts and big media rarely read beyond the headline number, is that the reason for this growth miracle is primarily due to:
1) American consumers
2) State sponsored (ie. forced) debt

In order for China's economy to maintain its legendary growth rates:
1) America needs to remain healthy,
2) and/or the Chinese government needs to force further debt upon its provinces and state sponsored enterprises.



Otherwise, China's economy slows considerably which will result in job losses, less employment gains and the real killer for Beijing – the potential for civil unrest.

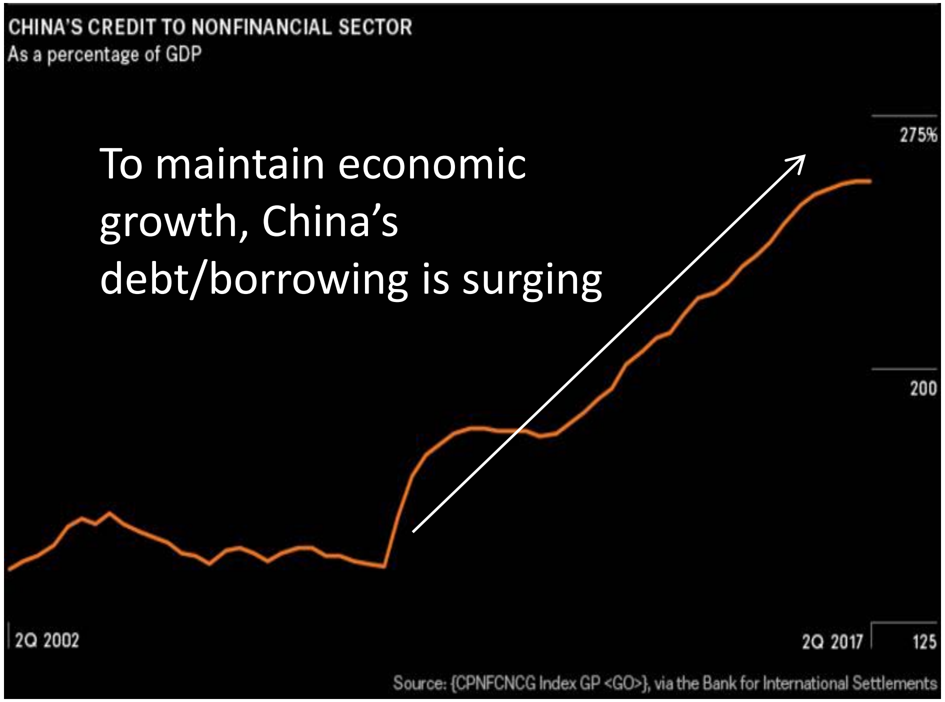
Chart above shows China's annual GDP growth rate over the past 10 years, and it ain't pretty.

Yes, growth has easily exceeded anything produced in the western world, but when China slows from 12% to 6%, it is the same as a recession anywhere else.

And moving past this headline number, informed investors will realize that during a period where China's economy has slowed from 12% annual growth to 6% annual growth – it's debt has surged.

Chart next page details this surge in borrowing by the Chinese.

Don't hurt yourself



When this rapid increase in borrowing is considered with a declining GDP growth rate – one MUST understand that China needs increasingly more debt to simply maintain a slowing economy.

Knowing this fact, helps you better understand the critical importance of China's exports to America – it is absolutely needed to maintain jobs and a certain level of happiness amongst its population.

Should the trade surplus with America decrease, China will be forced to increase its borrowing and debt even more to compensate for the decreased economic activity from America.

Deliberately harming the American economy, would in effect be deliberating harming its own economy.

What makes the entire Chinese-American trade relationship more clear is understanding the relationship between their currencies.

Another equally important aspect ignored by those predicting the collapse of the USD, is the fact that China's currency is not free floating.

Whereas most major currencies in the world are free floating – meaning the price of the currency is determined in the open market by investors; the Chinese Yuan is not.

The Chinese government determines what level it wants the Yuan to be priced at in USD, and then controls this price in the open market by selling Yuan.

For there to be any hope that the Chinese Yuan will dethrone the USD as the world's reserve currency, two things need to happen:

1) The Yuan needs to float in the open market
2) The Yuan bond market must be of significant size to absorb global capital flows.

Presently, neither condition #1 or condition #2 are even remotely close to being achieved.

Don't believe the hype

When it comes to the Yuan, Beijing knows they are boxed in.

If they were to let the Yuan float – it would likely increase in value. Any increase in value of the Yuan would reduce Chinese exports to America, which would result in slower domestic growth and job losses. This is not an option for Beijing.

If they were to devalue the Yuan, capital outflows from China would accelerate – meaning, Chinese nationals would transfer their money out of China faster than what they are currently doing.

If this were to happen, Chinese locals would further increase their savings and therefore decrease spending.

As this would harm the transition towards a stronger domestic economy, this too is an option that is not pleasing for Beijing.

To summarize:
- China is trying to shift its economy more towards domestic spending
- China's current economy is heavily dependent upon exports to America
- If China sold/reduced its holdings of US Treasury Debt, it would harm its exports to America, which would then harm its domestic economy through job losses and lower income
- If China devalued its currency, it would accelerate capital outflows from China which would harm its local economy via higher savings and less spending
- If China floated its currency (increase in value), Chinese exports to America would decrease, which would harm its local economy

Obviously, with respect to China (and the world's financial structure) there will be changes at the fringe.

And there is also little doubt that in the near future (10-30 years), China will replace America as the preeminent economy of the world.

But, we are not there yet.

And presently no matter which way you look at China, any attempts to harm their trade relationship with the Americans – all lead to harming their domestic economy.

In other words, those expecting the USD to collapse because of some sort of convoluted, international scheme to price oil in Yuan, or back a currency with oil, or value trade in Euro is a conspiracy, it's fantasy, and worst of all – it will rip the face right off your trading strategy.

Canadian Corner

It's happening. And for many it ain't fun, pretty, or even remotely okay.

Canadians suddenly find themselves in a bit of an uncomfortable investment tizzy.

Investing or speculating

For starters, the supposedly cheap, undervalued, and risk-free investment is turning into an expensive, overvalued, and anything but risk-free investment.

By this of course, we are referring to the Toronto/Vancouver housing markets.

About a year ago in several media interviews, IceCap was very clear that these housing markets will most certainly break, and the reason for them breaking will having nothing to do with the supply of new units, nothing to do with the demand from immigrants, and nothing to do with new government legislation.

Instead, we were crystal clear that the game changer for the entire housing market will be a sudden increase in long-term interest rates.

A year later, and borrowers are now faced with mortgage rates that are up to 1% higher than the year before.

Chart next column, shows the yield of the Government of Canada 5 Year Federal Bond. Note how the rate was 1% a year ago, and the rapid increase to over 2% today.

When you consider average properties are selling in excess of $1 million – a 1% increase in financing costs creates a significant increase in monthly mortgage payments.

For further proof, consider the following headline:

> **What it was like to get caught in Toronto's swift and brutal housing plunge**
>
> *Toronto homeowners collectively lost millions when prices fell 18% in just four months, a swifter decline than any experienced in the U.S. housing crash*
>
> Source: Financial Post

Of course, the recent rise in rates is really only hurting recent housing ~~speculators~~ investors.

The real meat and potatoes will be digested later in 2018 when about 47% (source: BMO) of all Canadian mortgages are to be renewed.

Interest rates are GLOBAL

From an investment perspective, this will have 2 effects:

1) Home owners will be paying out more in mortgage payments – which inevitably means less money left over to spend on hockey sticks, skis and curling brooms.

2) Canadian banks will inevitably have to increase provisioning for bad loans.

Both are clearly a concern for future economic growth in the Great White North.

As well - both will absolutely influence any further rate increases by the Bank of Canada.

Currently, most of Bay Street is expecting the predictably, unpredictable Bank of Canada to raise rates 2 more times in 2018.

This will be wrong – if anything, the Bank of Canada will be cutting interest rates.

Mind you, the Bank of Canada only controls over night interest rates – not long-term interest rates. Unfortunately, for investors and home owners – the long-term outlook for long-term interest rates is BRUTAL. They will go significantly HIGHER.

IceCap views this as great news.

Cracks 'Starting to Show' in Canadian Credit Quality, RBC Says

By **Chris Fournier**
April 9, 2018, 4:35 PM ADT

IceCap clients and other readers of this IceCap Global Outlook know very well that we fully expect bond markets to crater. This recent minor increase in long-term interest rates is simply a preview of what is to come.

The reason this is good news, is that here we have yet another data point to confirm that our view remains on track.

Even better news – the entire world runs off of the same interest rate curve.

What is happening is NOT exclusive to Canada. Investors across Asia, Americas, and Europe still have the perfect opportunity to reduce their risk from specific markets, and better still, if properly structured, to even benefit from the eventual bond market carnage.

Now, in addition to the housing story, Canada is also home to an eruption of the biggest trade war not to hit the media.

While the rest of the world is focused on America versus everyone, Canadian Provinces Alberta and British Columbia have their very own battle, and unfortunately for all Canadians, it's about to heat up.

Cowboys vs Aliens

Alberta produces an awful lot of oil, and needs a way to carry it to market.

British Columbia produces no oil, and wants nothing do to with Alberta's "dirty" money.

The challenge for Alberta is that they need to run a pipeline directly through British Columbia in order to deliver their oil.

British Columbia has flatly rejected every single attempt by Alberta (and Kinder Morgan) to complete the project.

And this is where it gets messy.

Many around the world are not aware that the 2015 oil crash ($100 to $30) has absolutely devastated Alberta.

Prior to the crash, Alberta (and Newfoundland) were flying higher than Oasis. The money flowing into the province was reaching never before seen levels.

Everyone had extra money, extra trucks and extra houses.

And then they didn't.

While crude prices have recovered on the international stage, the high cost Canadian oil sands prices have not.

People are struggling. Companies are struggling. And the government is struggling.

Simply put – Alberta desperately needs an economic win and morale booster, and the Trans Mountain Pipeline is seen as the answer.

British Columbia has a different view.

Long-time rivals – many in British Columbia view Alberta as being less sophisticated cowboys who squandered away their oil money on rodeos and country music.

The mere thought of tearing through British Columbia's pristine lakes, forests and mountains to help the oilman is a show stopper.

Top Corner!

And since everyone enjoys a good show – gather the popcorn because this one is about to grate the nerves across the entire Canadian political elite.

Alberta Premier Rachel Notley got the ball rolling by not only trolling British Columbia:

> Rachel Notley @RachelNotley Follow
>
> We will be bringing forward legislation giving our gov't the powers it needs to impose serious economic consequences on British Columbia if its government continues on its present course.
> Let me be absolutely clear, they cannot mess with Alberta.
> #ableg #abpoli #KeepCanadaWorking
>
> 8:24 PM - 8 Apr 2018

But also outright threatening British Columbia that Alberta will pass legislation to reduce the flow of oil to British Columbia, and thereby increasing the price of heating oil, gasoline and other products for everyone in the province.

Next, Canadian Prime Minister Trudeau will surely get involved and showcase to both Canadians and the world exactly why his popularity is in decline.

> CANADA March 2, 2018 6:00 pm Updated: March 2, 2018 6:09 pm
>
> **Justin Trudeau would lose if an election were held tomorrow, India trip a symptom of shift in mood: Ipsos poll**

While his youthful enthusiasm is seen as a hit on the world stage, within Canada, the Prime Minister's stock is dropping faster than a Guy Lafleur slap shot.

We share this with readers, not as a singular view and critique of Canadian politics and a struggling energy industry, but rather to demonstrate that as the global economy tightens further, regional economies and governments EVERYWHERE will begin to behave more aggressively.

This aggressive behaviour is completely a function of deteriorating economic conditions.

Declining prosperity is what caused failure of the Stay Campaign in the Brexit Referendum.

Declining prosperity is what caused failure for Clinton and the Democrats in the US Presidential Election.

And declining prosperity is what is causing the failure of the political establishments in France, Germany, Spain, and Italy.

When times are good and belly's are full, no one has the time nor inclination to protest in the village square.

When the good times are no longer rolling, out come the pitchforks, out come the Tweets, and out comes the reality that something else is happening beneath the surface.

This will be fun

The challenge with Canada and every other country today, is that the 10 year sugar high produced by over $15 trillion in various forms of global stimulus is coming to an end, at the exact moment in time when economies are on the verge of rolling over, and sharp political divides grow sharper.

The IceCap view of the world remains right on track.

The track will undoubtedly swerve and rumble making the ride fun for those who can see around the corner.

And not so much fun for others.

The joke is on you

There are jokes. There are riddles. There are conundrums. And there is the Euro-zone.

Sometimes when writing the IceCap Global Outlook, finding new investment themes can be tricky – but thankfully we have the Euro-zone, the European Union and everything else in between.

It's absolutely beyond us how anyone on planet Earth can say with a straight face that Europe is fixed and there is no risk of the European banking system and sovereign debt market imploding.

To be perfectly blunt:

- Most of the 19 countries in the Euro-zone haven't had to borrow from real investors in years
- The entire sovereign debt bond market has been completely supported by money printing by the ECB, which means all bank regulatory capital is fragile
- Every political establishment party has lost SIGNIFICANT votes to non-political establishment parties
- Total bad loans in the Italian banking industry exceeds total equity in the Italian banking industry

IceCap cannot emphasize enough, that the Euro-zone will absolutely return to a re-escalation of their sovereign debt crisis.

And once it begins, two things happen:

1) It snowballs VERY quickly
2) The negative effects on the bond market WILL spread around the world.

Yes, these are dire warnings. But the good news is that from a financial perspective, there are many ways to both protect your hard earned savings and even profit/grow your investment portfolios.

Of course, those in Brussels and Frankfurt will tell you a completely different tale.

Their stories begin with once upon a time, and weaves and bobs the readers to sleep with thoughts of financial integration and stability,

That's a lot of programs

safety and soundness of the banking system, and consistent supervision.

The European Central Bank and European Union websites are stuffed with beautiful and harmonious literary masterpieces.

Yet, as soon as you take your head out of the sand and objectively look around, you're hit with head shaking facts, figures and turns.

BUSINESS NEWS APRIL 23, 2018 / 9:51 AM / UPDATED 16 MINUTES AGO

ECB mulls shelving rules tackling euro zone's bad loans pile

Francesco Canepa, Balazs Koranyi 4 MIN READ

One of the worst kept secrets amongst those who care to look, is that the European banking system is absolutely stuffed to the gills with bad loans that banks absolutely refuse to write-off.

This is especially true in Italy, and the reason the banks have not written off these band loans is due to the need to replace these losses with new investment capital.

Nearly 10 years ago, the Americans faced the exact same dilemma and their imperfect solution was for the US Treasury to directly invest in the banks by way of the TARP bailout.

For better or worse, the Americans wrote-off (most) of the losses and forced the banking system to recapitalize.

In Europe, instead of writing off the bad loans and recapitalizing the banking system, they instead used the International Monetary Fund, World Bank, European Investment Bank, European Bank for Reconstruction and Development, Bilateral Loans, Loan Facilities, European Financial Stability Mechanism, European Financial Stability Facility, European Stability Mechanism, Longer Term Refinancing Operations I, Longer Term Refinancing Operations II, Zero Interest Rate Monetary Policies, Negative Interest Rate Monetary Policies and Quantitative Easing Monetary Policies to save the day.

The list is long. It's exhausting. And the only people who gauge these programs as a success are those in Brussels, Frankfurt and other centers of government who have all profited in one way or another.

Yes, this critique is harsh – and very un-European (or un-Canadian for that matter), but the truth sometimes hurts.

And the truth is, the ECB has tried extremely hard to right the ship. Yet, in addition to plain wrong and disastrous policies (ZIRP, NIRP, QE), other attempts to fix things have been completely rejected by various forms of governments.

The latest one of course is the ECB's plan for banks to write-off bad loans and raise new capital.

Loop to loop

When first announced, this was the newest plan to finally end the banking and debt crisis in Europe.

Months later, the plan is completely dead on arrival due to the rejections by the banks themselves.

European banks will tell you that there is no way possible for them to either write-off the loans, set aside capital to protect new loans, or attract new equity/regulatory capital from private investors.

Markets have noticed.

Over the last year, stocks of the biggest European banks have all declined significantly with the biggest, Deutsche Bank, having declined over -30%.

The problem with Europe is that the doom loop exists and there is no way to break it.

This doom loop involves the European Central Bank (ECB), the Italian Government, and Italian Banks.

The ECB prints money and sends it directly to the Italian Central Bank.

The Italian Government borrows money by selling bonds to Italian Banks.

To complete the loop, the Italian Central Bank buys these bonds from Italian Banks.

Wash, rinse, repeat.

This same exercise exists for all Euro-zone countries including France, Spain, and even Germany.

It's become a doom loop because in order to break the loop, private investors will have to step in to fill the gaps.

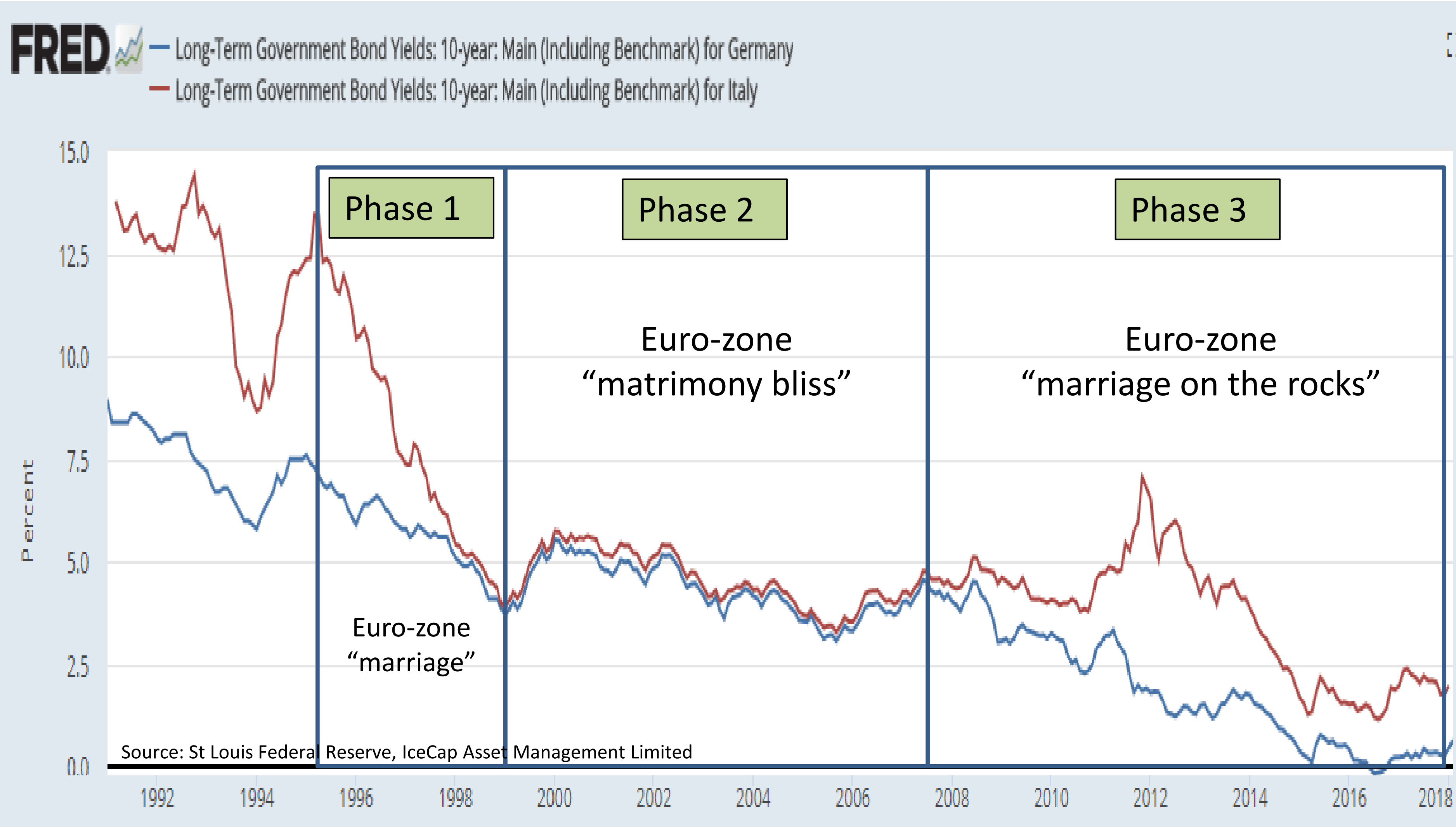
And private investors have a rather novel idea when it comes to investing – they either avoid risk, or of they do make a risky investment, they want to be paid appropriately for taking on this risk.

And with bond yields across the entire Euro-zone at all-time lows only because of the doom loop – why on earth would any rational private investor risk money by lending to Euro-zone sovereign states, or investing in Euro-zone banks?

For those still in disbelief, spend some time with our **chart on the next page**.

There you will see how interest rates in Italy and Germany converged entering the creation of the Euro-zone. Then how they become locked together, and now how they are moving away from each other.

Face Ripping Rally



Crisis will return

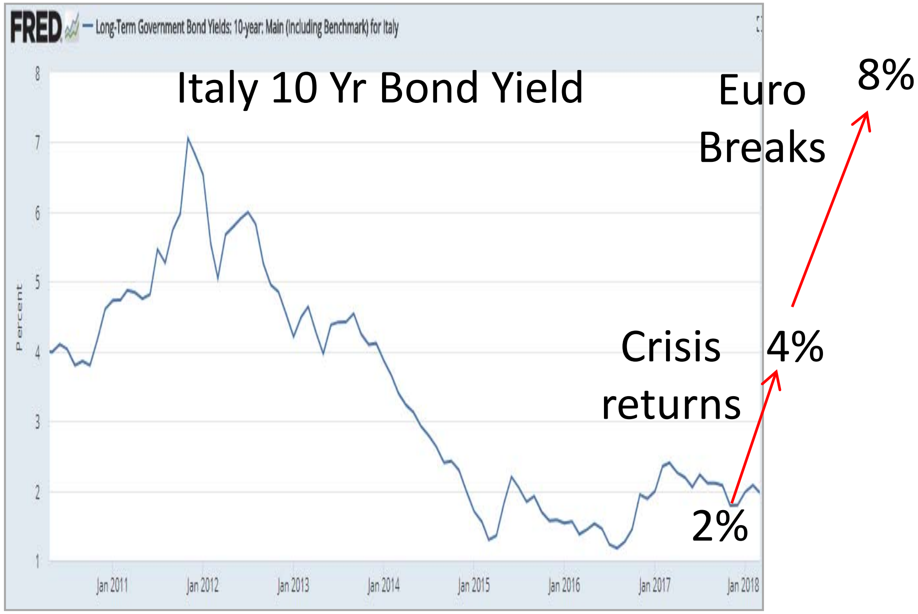
The only way to save the Euro-zone is to have these rates re-align.

And the only way for this to occur is for both of the following to occur:

1) Germany must agree to assume liabilities for all debt across the Euro-zone,
2) All countries must agree to forfeit complete control over government finances of spending and taxation to Germany.

And considering not one, let alone both of the above will never occur – the default option is for the crisis to return.

And once it returns, it will look like this:



Putting this altogether, one should be able to understand our expectation for many bond strategies/funds to perform poorly, and of equal importance – the USD to soak up foreign capital seeking safety from the bond market crisis and the resulting currency crisis.

Remember – all bond markets are connected. The crisis in Europe will not be isolated to Europe.

IceCap would love to see this view not occur – after all, it will not be fun for many people and investors.

Yet, as we travel further down this road the majority of the data points continue to lead us towards a serious bond crisis emerging.

Our Strategy

Bonds

Zero change to our strategy and outlook. In our last Global Outlook we indicated that we expect a dead-cat bounce to occur with the US 10-Year, and this is exactly what happened. This is further confirmation of our view of risk in duration. Duration, and especially emerging market debt is probably the scariest investments around.

Stocks

We've held our ground during the correction, and have not sold or reduced our equity positions. In fact, we are actually very close to adding further to our allocations in equities.

Contrary to the headline news and market doomsayers – our data is currently not indicating any massive sell-off in stocks.

Silver is on our radar

Currencies

Our network across the industry and around the world all agree that those bearish on the USD are very frightened about a potential face-ripping rally.

We remain positioned for a strengthening USD. However, the surge we expect will not occur until the sovereign debt crisis re-escalates in Europe. At present, the conditions for the debt crisis to return clearly exist, but it has yet to begin.

Until that time, we expect currencies to ebb and flow as if the global economy is headed towards a slowdown (which it is), which is positive for USD.

Commodities

No changes. We've consistently communicated our desire to build significant positions in gold, yet have been dissuaded due to weak technicals.

Interestingly, silver is also on our draft board and could provide significantly more upside relative to gold.

Just to be clear, we fully understand the fundamental reasons as to why gold should soar. Yet, until investors outside of the gold bug universe see and agree with these reasons, gold still isn't ready to launch into space.

New York Meetings

Keith Dicker, Chief Investment Officer and the author of the IceCap Global Outlook, will be in New York in late May/early June and is available for meetings.

If you are interested in discussing opportunities to partner with IceCap Asset Management, please contact Keith directly via email to request a meeting:
KeithDicker@IceCapAssetManagement.com

We're growing

As always, we'd be pleased to speak with anyone about our investment views. We also encourage our readers to share our global market outlook with those who they think may find it of interest.

Keith Dicker, CFA founded IceCap Asset Management Limited in 2010 and is the President and Chief Investment Officer. He has over 20 years of investment experience, covering multi asset class strategies including equities, fixed income, commodities & currencies.

Keith earned the Chartered Financial Analyst (CFA) designation in 1998 and is a member of the Chartered Financial Analysts Institute. He has been recognized by the CFA Institute, Reuters, Bloomberg, BNN and the Globe & Mail for his views on global macro investment strategies. He is a frequent speaker on the challenges and opportunities facing investors today, and is available to present to groups of any size.

Our Team:

Keith Dicker: keithdicker@IceCapAssetManagement.com

John Corney: johncorney@IceCapAssetManagement.com

Haakon Pedersen: haakonpedersen@IceCapAssetManagement.com

Andrew Feader: andrewfeader@IceCapAssetManagement.com

Conor Demone: ConorDemone@IceCapAssetManagement.com

We want Partners

Since 2010, IceCap Asset Management has consistently demonstrated a unique and correct understanding of the world's global macro environment.

Our ability to communicate this understanding in both our investment portfolios and through our highly successful **Global Market Outlook** is a feature we would love to leverage.

IceCap Asset Management is a growing firm, and we are completely open to discussing all opportunities, ideas and ventures with other firms, fiduciaries and individuals anywhere in the world.

Opportunities may include:

1. white labelling of funds
2. sub advisory of funds or managed platforms
3. speaking engagements for small or very large groups
4. joint ventures
5. other corporate opportunities

We want Partners

The Canadian investment industry is rapidly changing. If you are a licensed Advisor, or Portfolio Manager give us a call to see how you would benefit by joining our team.

Contact Keith Dicker 1-902-492-8495 or
KeithDicker@IceCapAssetManagement.com