



IceCap
Asset Management Ltd.



Local heritage,
Global experience.

Our view on global investment markets:

May 2012 – “Dodge”

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Gunsmoked

Dodge City, Kansas is a lovely place. The home to 26,101 people regularly enjoy old west casinos, old west rodeos and old west movies. Like we say – it is a lovely place.

Yet years ago when it was still cool to be a cowboy, cowboys of all types were getting' out of Dodge. And who could blame them – bullets flew around town on a regular basis.

As we look across the globe today, Dodge City's are popping up all over the place across America, Europe and Asia. However, within the World of financial markets, government sponsored economic policies are desperately trying to keep everyone *in* the 2012 financial version of Dodge.

Today's question of the century is which market is the equivalent of Dodge? One thing is for sure, financial bullets are flying fast and furious these days forcing every sane investor to keep their head down. For all other investors, be a good cowboy and be sure to have an exit plan – you never know when you'll need it.

Thin Ice

As Canadian hockey heroes begin their 10th week of playoff hockey, it's perfectly understandable to lose sight of the puck. After all, with 12 superstar players on the ice at any one time, it is pretty easy to become mesmerized with the talent.

Yet as the weather warms, the ice beneath them gradually becomes

sluggish and choppy which inevitably slows even the slickest of stick handlers.

The same is true in today's financial markets. **Unknown and ignored by many today, the "ice" of the global financial system has also become less supportive of the star players.** Yet, every self-proclaimed stock picker clings to the belief that great companies and great stocks will always rise to the "top."

While we certainly don't disagree with this belief, it's our duty to point out that this "top" to which these great stocks will climb may actually be a lot lower than what people are expecting.

Simply browsing the latest business section of most newspapers, all we read are stories of investors seeking growth. As global managers, we certainly appreciate this diligent effort by analysts and managers to uncover opportunities wherever they be.

Yet, we cannot help but to remind everyone with these starry eyed illusions they are living in the past. **The fact that the return expectations of these uber optimistic investors are anchored from the good old days of 1982 to 1999 continues to be lost on most people.** Using this period as your investment reference point is wrong in so many ways.

The conditions that supported this boon for the legendary stock picker is no where close to being present today. In fact, financial

The bigger problem is...

conditions today are anything but the same as what was experienced back then.

Instead of declining interest rates, rising PE ratios, rising debt, and rising government & consumer spending, today we have 0% interest rates, rising sovereign interest rates, declining PE ratios, declining debt, and austerity focused governments and consumers.

And let's not forget the grand daddy of them all – money printing by the forever respected and honorable central banks of the USA, Britain, Japan and Europe. **How any investor (or media outlet for that matter) could expect today's global financial environment to produce anything but the opposite outcome of the 1982-1999 period is beyond our comprehension.**

Today's global financial system is teetering once again. Who do we blame? The Greeks? The Germans? The Americans? It doesn't matter really. What really matters is how you can protect your hard earned money and not fall prey to the one-dimensional group think that dominates the financial services industry.

Are we better off today?

Thinking back to 2008, it was the collapse of the US housing market that triggered the Great Recession. Connecting the doomsday dots, you will notice that first Bear Sterns went under. Followed next by funding problems for Fannie Mae and Freddie Mac. If this wasn't enough, the moment Lehman was declared too small to save, the

entire system ground to a halt. It was a pretty scary time that's for sure.

The simple question every investor should be asking is whether the financial World is a better place today compared to 2008? Or better yet – which do you believe can be a bigger problem:

- 1) the collapse of the US housing market; or
- 2) the collapse of the European banking system?

While *almost* purely rhetorical at this point, we absolutely wish the World never gets the opportunity to experience the answer.

Nevertheless, any investment manager today worth a ½ grain of salt should most certainly be employing their duty to help preserve people's hard earned money. And of equal importance, providing a realistic and unbiased analysis of the real risks that captivates markets today.

Europe = Dodge City

IceCap has certainly not recently jumped on the anti-Europe/Greece bandwagon. If anything, we've been pulling the wagon since we first opened our doors in 2010.

Back then we had good fun hi-lighting the errors made by the majority of financial advisors, mutual fund sales reps and the big banks who confidently stated that Greece is less than 2% of Europe's economy – that *Greece does not matter*.

Lunatic Fringe

Well, by now everyone knows that Greece certainly does matter. To further clarify our view everyone must understand that GDP measures spending, yet the World is in the midst of a debt crisis.

The point being, anyone can max out their credit cards on nice holidays, cars and lattes. For the GDP counting folks out there, all this spending certainly does add to GDP – how can it not? However, eventually the day comes when you are unable to borrow and your spendthrift ways come to an end, and with that the fabled GDP indicator of economic growth declines as well.

Greece's GDP is valued at about EUR 200 billion, yet the unofficial total debt obligations of the country and financial institutions exceed EUR 1 trillion – over 5 times their GDP. Similar numbers also exist for Ireland, Portugal, Spain and Italy. This debt problem is very big and very real. Debt matters.

Greece's end should have occurred three years ago. If it was allowed to follow every other bankruptcy process, today Greece would have been well on its way to recovery. What should have cost a few billion is now certainly going to cost hundreds of billions and maybe even hitting trillions once all is said and done.

On June 17, 2012 Greeks will once again head to the polls. We have no idea of the outcome. All we know is that Greece has already lost everything it had – it can't lose much more. Rather, **the biggest losers will certainly be the rest of Europe and this is why you will see**

subtle, then not so subtle and then lunatic fringe campaigning by Brussels to ensure that Greeks vote to remain in the Euro-zone.

The talking heads will tell you that we'll have to wait until June 17 for this drama to unfold. IceCap is telling you the drama will happen before this pivotal day.

With Greece, we really only have two possible outcomes:

1 – Greece stays in the Euro-zone and continues to receive bailouts.

The problem with this is that practically all of the bailout money received is quickly paid back to bond investors who just so happen to be European financial institutions. The only thing the average Greek receives is the privilege to pay higher taxes from the salary they no longer receive. Brussels is effectively telling Greece, the bullying will stop as soon as the morale improves.

2 – Greece leaves the Euro-zone and defaults on its debt. Here, the institutions who lent money to Greece will lose money and justifiably so. Everyone else in the World (who isn't a bank), always takes losses when they make a bad investment, Greek bond holders including the IMF, ECB and EU should be no exception.

With outcome # 2, Greece will certainly enter a *recession* – yet, since they are currently in a *depression* it will actually be an upgrade from their current state.

Eye rolls and ear fumes

In this scenario, Greece would issue their own currency which would quickly be priced 40-60% less than the Euro or US Dollar. Chaos would undoubtedly ensue, yet the seeds will have been planted for the Greek economy to first stabilize, then recover followed by growth. For a real-time success story, see Iceland.

This process is not absurd in the least – in fact, it has been the IMF's only blue print to help financially challenged countries to get back on their feet. Naturally, even mentioning the IMF (International Monetary Authority) is surely inducing eye rolls and fumes of ear smoke as we write. After all, how can it be that the IMF, the great financial protector of impoverished economies is not doing so for Greece?

To answer the question with a question, it's better to ask "who" is the IMF trying to protect from a Greek bankruptcy? The answer of course is Europe. And for all you non-IMF groupies reading today, it may be a shock to learn that the Managing Director of the IMF is always a European. Considering that our World is in fact not the idyllic little place it should be, there is little wonder none of the global big guns are rushing to protect Greece. The only rushing taking place is the rush to protect the rest of Europe.

At this agonizing point in the Greek debt crisis, the only hope for a Greek recovery is to default on its debts, recreate the Drachma and begin again. Our concern is that all this hope, is really becoming hopeless.

U-S-A...U-S-A...

For most Americans, this self promotional chant evokes enormous pride in whichever event they are winning, or merely participating.

For most non-Americans, it signals that moment in time when you plug your ears and vow to beat them next time.

Well, in Spain these days the banks are clearly shopping for ear plugs. Leading up to the collapse of the US housing market, many US banks pulled a fast one and sold their mortgages to Wall Street who quickly pulled a faster one by bundling these mortgages together and selling them around the World. In short, the Americans sold many of their very-soon-to-be toxic mortgages to unsuspecting investors while quietly chanting – U-S-A...U-S-A...

Spanish banks however, were either not as cunning as their American counterparts or maybe they were just too nice to do the same. Nevertheless, today the Spanish banking system teeters on collapse.

Spanish banks hold about EUR 1 trillion in real estate loans. The colossal collapse of the real estate market will result in at least 20% of these loans not being repaid. This represents a EUR 200 billion hole in the Spanish banking system that has to be filled.

Since optimists believe this will not be a problem, let's examine where this EUR 200 billion may come from:

Intergalactic Investment

- 1) Private investors – no sane investor will put a single Euro cent in Spanish banks, count them out.
- 2) Spanish Government – After watching what happened in Greece, and Ireland, it would be political suicide for the Spanish to bail out their own banks. We forgot to mention one not so minor detail – Spain simply doesn't have EUR 200 billion to spend.
- 3) IMF, European Union and European Central Bank – on the surface, they will gladly provide the EUR 200 billion, in exchange for being allowed to appoint their choice for Spanish Prime Minister.
- 4) Intergalactic foreign investment – due to money printing by central banks, aliens from Mars, Uranus and Jupiter refuse to make any investments in Earth at this time.

Obviously options 1, 2 and 4 are a given. However, never underestimate the stubbornness prevailing from Brussels or Frankfurt. The likelihood of another concocted bailout European style actually has the same odds as the sun rising tomorrow.

The reason for the brash proclamation is two fold. First, although the installation of puppet-like regimes in other bailout receiving countries hasn't gone too well, sooner or later it should work. At least that's the thinking anyway.

Second, **bank deposits in all of the troubled European countries are**

plummeting. We've probably written before that a bank without deposits is like a burger without cheese – it just doesn't work.

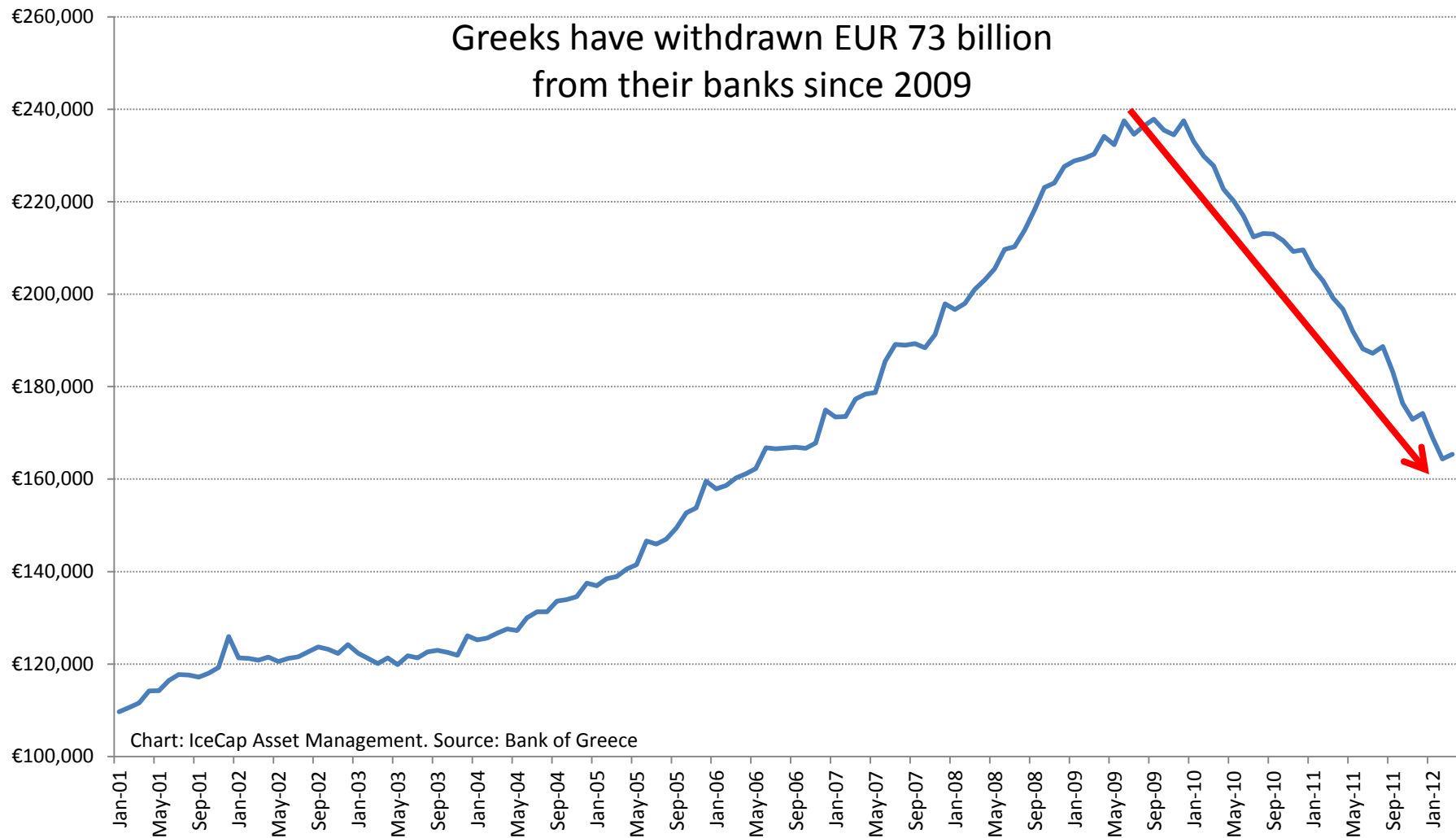
Without trying to sound too dramatic – **the situation in Europe is putting us on the cusp of witnessing the biggest bank run in the history of the World.** Unlike the old fashion bank run where a single bank fell into trouble, today in Europe we are witnessing both individuals and corporations withdrawing their savings from entire countries.

Chart 1 on the next page shows deposits in Greek banks. It's astonishing that the Greek banking system has lost over 30% of its deposits. Come to think of it, considering the circumstances it's even more astonishing that anyone has kept any of their money in any Greek bank at all.

Yet, the real reason for the stomach ulcer inducing epidemic in Europe is not the Greek banking system. Rather, **the worry is what happens to the banking systems in the other troubled countries should Greece completely unravel.** People in Spain, Ireland, Portugal and Italy are all experiencing bank deposit remorse and this is what the fuss is all about.

The fuss of course is due to the World's banks being structured as a "fractional reserve" banking system. This quite simply means all banks ever only have a "fraction" of peoples' money available to repay them. The thinking is that there is very little chance of EVERY bank client showing up at the SAME TIME demanding their money back.

Chart 1: Greek deposits and repos by corporations and households



This is nonsense

Well, in Europe these days that “very little chance” is potentially turning into a “very big chance.”

Yet, despite Spanish Prime Minister Mariano Rajoy asking the European Central Bank to print money to buy Spanish government bonds, and then quickly adding that “Spanish Banks are under no risk,” one would have to wonder how the average Spaniard isn’t thinking about giving their money a yank out of their bank.

The solution to this mess of course is to simply allow the free market economy to act as it should. Some money and jobs will be lost, yet the financial excess slate will be wiped clean and the next Secular BULL Market can start in earnest.

Instead, we are likely to see a plethora of new bailouts starting with guaranteed bank deposits, followed next by new money printing programs as well as the ultimate French financial product – Euro Bonds.

Any and all of the above will certainly create another mini-rally for stocks and risky assets as well as also providing the story-line for this very same conversation a year from now.

Perhaps there’s no need to worry. After all, the head of the Euro-zone Financial Ministers, Jean Claude Juncker did say “I don’t envisage, not even for one second, Greece leaving the euro area. This is nonsense. This is propaganda. We have to respect Greek democracy.”

Come to think of it, he also so infamously admitted “when it becomes serious, you have to lie.”

We think he just lied.

Deep Sea Fishing

Most people are familiar by now of all the sharks inhabiting Wall, Bay, Threadneedle and George Streets. These predatory creatures are forever known to have made significantly more money than their clients.

One up from the shark of course is the Vampire Squid a.k.a. Goldman Sachs. Ever since Matt Taibbi of Rolling Stone Magazine branded them with this blood seeking moniker, Goldman will forever be trying to convince anyone that they are in fact just a plain old Wall Street investment bank - not “a great vampire squid wrapped around the face of humanity, and relentlessly jamming its blood funnel into anything that smells like money.”

Naturally, when a bank becomes the biggest and self declared best you just know that a sea bucking name is not too far behind. Well, for JP Morgan the waiting is now over. Their top trader Bruno Iksil, or the “London Whale” as he will forever be known has spouted his blow hole and at last count will cost the American bank at least \$2 billion in trading losses.

Our only comment is that the ultimate losses will greatly exceed \$2 billion, but more importantly the underlying risk at these global

Just do it

banking behemoths is significantly beyond the comprehension of not only the manager at your local bank, but way beyond the talking heads in the media and especially way beyond your trusted mutual fund sales person and advisor.

The financial structure and investing activities of our big banks are extraordinarily complex. Here at IceCap, we certainly understand these intricacies and can even tell you a few balance sheet and level 3 asset jokes.

However, the point we make is that for JP Morgan to make a mid-quarter announcement of a mere \$2 billion hedging loss, one has to wonder exactly what else is swimming beneath the surface.

All of the super-sized banks will tell you that they are always hedged and net exposure is always at a minimal. When JP Morgan announces a \$2 billion loss on a hedge gone wrong and analysts dismiss this as a small 2% error that is easily absorbed – questions should be asked. For starters, JP Morgan's Level 3 Assets easily exceeds \$100 billion. **If that number doesn't induce glazed eyes, then perhaps knowing their total derivative exposure is \$70 trillion will do the trick.**

What would happen if something really went wrong? Such as a counter party being unable to pay? Or worse still, several counter parties being unable to pay.

Considering the state of Europe, this scenario is becoming much more

likely. If the mighty JP Morgan or any of the other big American banks run into trouble, will President Obama stick to his promise to never again bail out Wall Street? With the November election fast approaching, we're sure Obama and Romney are watching as well.

The Stock Market

Fans of IceCap know by now that we are concerned about the stock market. The reason for our concern is quite simple – **the prospect for severe loss of capital outweighs the prospect for average growth of capital.**

This asymmetrical risk-return relationship is likely quite similar to that faced by all cowboys travelling through Dodge City – one friendly yet unfortunate nod of your hat gave someone named "lefty" another opportunity to cut a notch in his belt.

There are many reasons for our concern, yet being our usual IceCap selves we'll repeat our oft repeated message. American Ben Bernanke is doing it. Britain's Mervyn King is doing it. Europe's Mario Draghi is also doing it. Japan's Masaaki Shirakawa is giving it his best as well. For the first time in the history of planet earth, the four largest central banks are all printing money at the same time.

Collectively, these guys completely influence trillions of Dollars, Pounds, Euros and Yen, and despite cutting interest rates to 0%, bailing out banks and printing bucket loads of money, their economies remain trapped in economic hell.

Mark Carney's # 1 Reason...

There's no question about – since the 2009 market lows, the America stock market has been nothing short of terrific. Meanwhile, other stock markets around the World have been rather un-terrific.

Chart 2 on the next page shows stock market returns over the last 5 years. The most notable take-a-way is that no major stock market has returned to their all-time high reached in 2007. In fact, many stock markets are actually closer to their 2009 market low than the 2007 market top.

Merely reading headline news and the commentary from your quarterly investment statement, one would think the good times are back again. Sorry for being the bearer of bad news.

The most significant observation from **chart 2** is found in the American stock market which clearly shows 3 major stints of stock market strength were all initiated by money printing.

Despite seeing trillions of newly printed Dollars, Euros, Pounds and Yen global growth is doing anything but accelerating. Currently we have slowing growth in China, Australia, Brazil and all of Europe and Britain.

The USA and Canada are growing between 1-2%, but if this is the best we can achieve by printing trillions in various currencies what happens once they stop the printing presses?

Even Mark Carney and his team at the Bank of Canada face a dilemma

of contradictory proportions. Although the housing market is clearly overvalued in many cities, the only response from Mr. Carney is a very stern warning to the banks that they should be more conservative when issuing mortgages.

This of course is hypocrisy of the worst kind. If Mr. Carney is truly worried about the Canadian housing market, and he should be, he cannot blame the Canadian banks for providing mortgages to new and repeat buyers.

By keeping short-term rates extremely low, it is Mr. Carney himself who is flaming the housing market. The Canadian banks are simply doing what every bank should do – lend money at a rate attractive enough to make a profit. If Mr. Carney raises interest rates, the banks will do the same and the housing market will certainly enter cool-down mode.

The real reason behind Mr. Carney's penchant for very low interest rates is because the housing market only ranks #2 on his concern list. **The # 1 reason of course is the state of the World's global economy and financial system.** While Mr. Carney has yet to join the money printing club, he is clearly playing ball with his central bank colleagues.

As we've said before, the good old business and credit cycles of the past are from the past. Whether you are aware of it or not, the new era of bailouts and money printing is dominating all economies and stock markets.

Chart 2: 5 year stock market charts



Hope is never a good strategy

Our Strategy

The fact that the financial World is completely dependent upon the fate of Greece and possible contagion spreading to other European countries makes us very worried. In addition, we haven't even touched upon the rapid decline of growth in India and China, nor the upcoming American fiscal cliff.

We fully expect The Troika (European Central Bank, European Union and International Monetary Fund) with the blessing of the US Federal Reserve to announce yet another save the day money printing scheme. We also fully expect markets to rally strongly on the news.

We only have two fears. One, The Troika et al do not make the widely expected announcement. It's our current view that the only reason markets remain at current levels is due to this very same expectation of another super-charged money injection scheme. Our other fear is that The Troika is actually too late with any new scheme and they are not able to self-arrest the snow-balling bank runs in Europe.

We speak often with investors and other managers on a regular basis and the high degree of complacency towards these very real problems continues to amaze us. Is this complacency due to a strong conviction of a positive outcome or is it simply due to the way the investment industry is structured to focus on profits and gathering assets? Sadly, we believe it is the latter.

While we will be amazed if the Greek and European situation is

sorted out, we will not be shocked if it isn't. A positive outcome will certainly provide a super boost to all aggressive investment strategies and we will be ready to make adjustments should this occur.

Our view is that this positive outcome is one based upon hope. Unfortunately, hope has never been a very good investment strategy. We'll remain conservative with client portfolios, emphasizing bonds, cash and gold, while remaining completely open to shifting allocations to stocks and commodities should the conditions change.

As always, we'd be pleased to speak with anyone about our investment management capabilities. As well, we encourage you to share our global market outlook with those who you think may find it of interest.

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Thank you for sharing your time with us.