



IceCap
Asset Management Ltd.



Local heritage,
Global experience.

Our view on global investment markets:

February 2015 – The Ice Bowl

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Brass Monkeys

GREEN BAY, Wisconsin (1967) “I just took a bite out of my coffee” chattered TV Commentator Frank Gifford. Yes, it was that cold. With temperatures hovering at -44 Celsius, everyone agreed that the biggest risk wasn’t football strategy - it was staying alive strategy.

With the clock seemingly frozen with 13 seconds remaining, no time outs left and a mere 1 yard from the end zone, the Green Bay Packers had time for one last passing play to win the game. There was little risk with this play – they catch the ball and they win. If they don’t catch the ball, they simply kick a field goal to tie the game and take their chances in overtime.

- Passing the ball was the low risk play.

The only other option was to run the ball, but if they didn’t score the clock would wind down to zero and Green Bay would lose.

- Running the ball was the high risk play.

Green Bay ran the ball, scored their touch down and their coach Vince Lombardi would go on to become the most famous coach in American football history.

Green Bay fans proclaim it was ingenious to run the ball. Everyone else counters that it was dumber than dirt. So dumb and high risk that even Tom Landry, the normally reserved coach of the Dallas Cowboys said it was “a dumb call” to run the ball.

Of course, hindsight is perfect but also irrelevant – the most important point of the famous last play from the Ice Bowl is that the risk involved with running the ball, was very obvious but since it didn’t happen, it wasn’t perceived to be risky at all.

Today’s investment climate is rather chilling and the major risk is so very clear. So clear in fact - it is crystal clear. Yet, most investors, advisors and managers continue to ignore this obvious risk because since it hasn’t happened - then the risk simply doesn’t exist.

What risk? Well, let’s just say Green Bay Packers fans everywhere are holding dearly onto government bonds, high yield bonds, their local currency and their beloved bank stocks. Dallas Cowboys fans meanwhile, are investing in non-bank stocks, US Dollars and avoiding everything else – especially anything from Europe.

So, the question to ask - are you a fan of Green Bay or Dallas? Be careful, as the wrong choice carries significant risk.

Unlike the sporting world, in the investment world, it’s perfectly acceptable to change your opinion and investment strategy. In other words, don’t be afraid to switch teams and cheer for the other side. After all, on the investment field – it isn’t always about winning, sometimes it’s about not losing.

And today, not losing means passing on the investment strategies that have become socially accepted as the low risk plays in the investment world.

Very nice indeed

Hold on to your hat

Since our last writing, global markets have been anything but boring. While US stocks are currently at the same trading levels as they were in early December, the intraday, the gap-day, the daily, and the weekly volatility has been enormous. In other words, 5% market swings have suddenly become the norm.

Yet, these up and down days were not solely relegated to stock markets. **Chart 1** (next page), shows a few rather unexpected market moves that caught not just a few investors off guard. The interesting point to understand is that prior to these very dramatic market moves, each of the underlying investments were perceived to have very little risk. Yet, as anyone who has met us, will confirm that we consistently tell investors that many people incorrectly perceive something as being risky only if the risk actually happens.

Think about that for a moment.

This is a key point to understand, and as we venture further into 2015 we believe many so-called low risk investments will in fact become high-risk investments. Unfortunately for some, this will only become obvious with hindsight.

In Canada meanwhile, the great hunt for yield has finally come crashing down. For our non-Canadian readers, understand that the worst investment idea in the Canadian stock market was to buy energy & energy related stocks to capture the 5%-8% dividend yield.

The reason for the “worst ever” label was due to the comparative return with the risk-free rate of return. In Canada, the central bank set the risk-free rate of return at 1%.

In other words, if an investor wanted (or needed) a return greater than 1%, they had no choice but to take on investment risk.

If you wanted a 2% return, in reality you wanted a return that was 2 times bigger than the risk-free rate of return of 1%. With energy stocks offering 8% dividend yields, investors were taking on a return that was 8 times bigger than the risk-free rate of return. Clearly, there is some risk with these investments.

Now, there’s nothing wrong with this – risk is risk, and this is what makes markets. But, to say (as many investment advisors did) that these energy stocks and their 8% dividends were very low risk was clearly not true.

Prior to the crash in oil prices, investors were told that these companies were managed by smart folks, with huge cash flows and a strong economic recovery to support their really nice dividends.

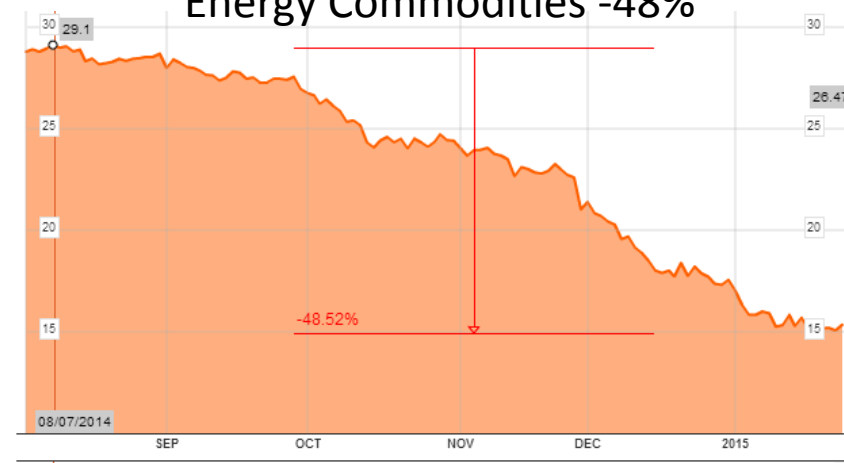
In fact, investing in high dividend paying energy stocks was considered so easy, that we were recently schooled by an investor about how ignorant we were of these energy stocks, that we didn’t understand markets and all of our talk about risk was just plain wrong.

Chart 1: Risk that no one worried about until it was too late

Greek Bank stocks -58%



Energy Commodities -48%

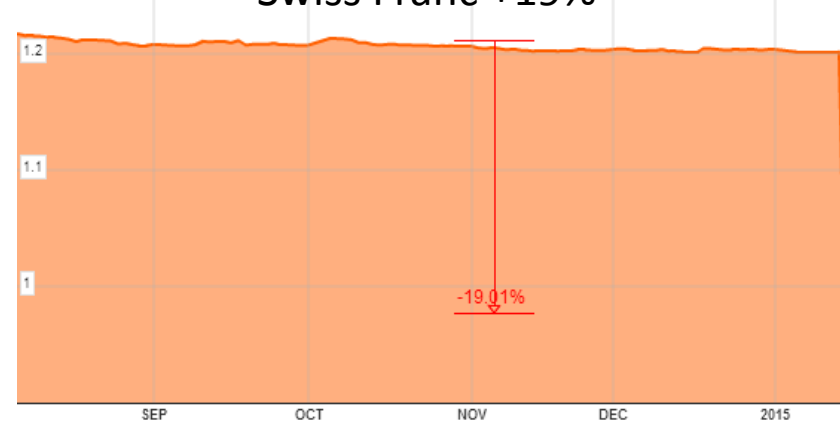


Euro Currency -19%



Source: Bloomberg

Swiss Franc +19%



If risk happened in the forest...

Well, considering these nice dividend paying stocks recently dropped 30-50% with some cutting their dividends, most of these investors have suddenly discovered that risk *does* exist.

Now, prior to the epic collapse in energy markets, the investor was 100% correct, and we were 100% wrong. Yet, the only reason for being wrong was that the risk had yet to happen.

What we mean by this is that the risk was always there – it didn't go anywhere, it just hadn't happened - *yet*. And this is the case today with what we see as the biggest risk in investment markets.

As we've stated, written and presented numerous times in the past, Europe remains a slow-motion train wreck and recent events only confirm our perspective and sends even more icy-chills down our spines.

The risk we talk about of course, is the risk of **sovereign debt defaults** emanating from Europe. And based upon recent market events the world has moved ever so closer to the European debt bubble finally bursting and putting an end to this disastrous financial experiment.

Up until recently, no one thought energy prices or energy stocks could drop by 50% - *yet they did*.

Back in 2007, practically every investment firm, every bank, every

economist, every realtor and every homeowner all claimed that housing prices could never decline significantly – *yet they did*.

Back in 1990, no one believed the sun would ever again set in Japan – *yet it did*.

The point we make is that today very few people believe the Euro-zone will break-up. And even fewer people believe the world is currently smack in the middle of the biggest financial bubble ever created.

Yet, this is exactly where we are today and if, just like the energy market, just like the housing market, and just like the Japanese market, the risk occurs then there will be astronomical gains and losses for investors all around the world.

Now, the important point – and it is a VERY important point, should the world continue down this bubbly-path, many investments that have traditionally been viewed as safe, sound and secure are in fact dangerous, vulnerable, and unstable.

And, what makes this even more ironic is that traditionally, the investors who hold these investments are usually very conservative investors.

Let that sink in for minute.

The paradox

The world's most conservative investors are holding what they believe to be the world's most conservative investments exactly at the moment in time when these investments are actually the most risky.

As investment managers, we're always willing to change our view. Should conditions change, then we'll surely change our view as well. However, our contention and research continues to conclude that the global debt crisis is escalating in its severity. As the escalation accelerates, we have no choice but to remain with our view that the world is headed straight into some very difficult times.

Of course, our world is full of ironies and paradoxes and in the investment world, IceCap has an optimistic outlook for stocks and US Dollars due to its pessimistic outlook for everything else.

Now that's a paradox.

Although we feel we have been very clear with our stated view and stated investment strategy, we find that some people only hear our realistic outlook and then do not bother to hear our resulting investment strategy.

We are finding that our view is becoming more and more accepted by investors around the world. We frequently speak with investors and managers in Asia, North America and Europe, and many are converging to fear the exact same risk – governments defaulting on their debts.

This is normally the point when investors scoff the idea of our world's leading countries squelching on money they owe. After all, as far back as these people remember, excluding Argentina – no major country has ever missed a bond payment.

Unfortunately, nothing could be further from the truth. **Chart 2** (next page) details many such events. Normally, we shy away from using such small font sizes, yet in an effort to save a few trees we tried to shrink this monumental risk down to a smaller size.

You'll notice that over time, many countries have actually defaulted on their debt. As well, defaults have not just been relegated to small emerging market countries. In fact, the list is full of G5, G7, and G20 countries.

Also notice that defaulting countries are from all over the world, and these countries were governed by all spectrums of the political landscape including socialists, capitalists, the left-of-center, the right-of-center, the extreme left, the extreme right, and even a few dictators, and emperors.

Yet, despite these vast differences in governments, locations, currencies and economic beliefs – every single name on this list had one thing in common – too much debt.

Now we are the first to concur that too much debt can certainly exist

Chart 2: List of countries & states that have defaulted on their debt

Americas

- Antigua and Barbuda (1998–2005)^[18]
- Argentina (1827, 1890, 1951, 1956, 1982, 1989, 2002–2005)^[18] (see [Argi](#))
- Bolivia (1875, 1927,^[18] 1931, 1980, 1986, 1989)
- Brazil (1898, 1902, 1914, 1931, 1937, 1961, 1964, 1983, 1986–1987,^[18]
- Canada (Alberta) (1935)^[18]
- Chile (1826, 1880, 1931, 1961, 1963, 1966, 1972, 1974, 1983)
- Colombia (1826, 1850, 1873, 1880, 1900, 1932, 1935)
- Costa Rica (1828, 1874, 1895, 1901, 1932, 1962, 1981, 1983, 1984)
- Dominica (2003–2005)^[18]
- Dominican Republic (1872, 1892, 1897, 1899, 1931, 1975–2001)^[18] (see
- Ecuador (1826, 1888, 1894, 1906, 1909, 1914, 1929, 1982, 1984, 2000,
- El Salvador (1828, 1876, 1894, 1899, 1921, 1932, 1938, 1981–1996)^[18])
- Grenada (2004–2005)^[18]
- Guatemala (1933, 1986, 1989)
- Guyana (1982)
- Honduras (1828, 1873, 1981)
- Jamaica (1978)
- Mexico (1827, 1833, 1844, 1850,^[18] 1866, 1898, 1914, 1928–1930s, 19)
- Nicaragua (1828, 1894, 1911, 1915, 1932, 1979)
- Panama (1932, 1983, 1983, 1987, 1988–1989)^[18]
- Paraguay (1874, 1892, 1920, 1932, 1986, 2003)
- Peru (1826, 1850,^[18] 1876, 1931, 1969, 1976, 1978, 1980, 1984)
- Surinam (2001–2002)^[18]
- Trinidad and Tobago (1989)
- United States (1779 (devaluation of [Continental Dollar](#)), 1790, 1798 (see [The Quasi-war](#)), 1862,^[21] 1933 (see [Exe](#)
 - 9 states (1841–1842)^[18]
 - 10 states and many local governments (1873–83 or 1884)^[18]
 - Orange County, California (1994)^[22]
 - Detroit, Michigan (2013)
- Uruguay (1876, 1891, 1915, 1933, 1937,^[18] 1983, 1987, 1990)
- Venezuela (1826, 1848, 1880, 1885, 1892, 1898, 1982, 1990, 1995–1997,^[18] 1998,^[18] 2004)

Europe

- Albania (1990)
- Austria-Hungary (1796, 1802, 1805, 1811, 1816, 1868)
- Austria (1938, 1940, 1945)^[18]
- Bulgaria (1932,^[citation needed] 1990)
- Croatia (1993–1996)^[18]
- Denmark (1813)^[18] (see [Danish state bankruptcy of 1813](#))
- France (1812)
- Germany (1932, 1939, 1948)^[18]
 - Hesse (1814)
 - Prussia (1807, 1813)
 - Schleswig-Holstein (1850)
 - Westphalia (1812)
- Greece ([external debt](#): 1826–1842, 1843–1859, 1860–1878,
- Hungary (1932, 1941)
- The Netherlands (1814)
- Poland (1938, 1940, 1981)
- Portugal (1828, 1837, 1841, 1845, 1852, 1890)
- Romania (1933)
- Russia (1839, 1885, 1918, 1947,^[18] 1957,^[18] 1991, 1998)
- Spain (1809, 1820, 1831, 1834, 1851, 1867, 1872, 1882, 1)
- Sweden (1812)
- Turkey (1876, 1915, 1931, 1940, 1978, 1982)
- Ukraine (1998–2000)^[18]
- United Kingdom (1822, 1834, 1888–89, 1932)^[18]
- Yugoslavia (1983) (Yugoslavia didn't default directly, it's debt was split between the nations once part of Yugoslavia)

Africa

- Algeria (1991)
- Angola (1976,^[18] 1985, 1992–2002)^[18]
- Cameroon (2004)^[18]
- Central African Republic (1981, 1983)
- Congo (Kinshasa) (1979)^[18]
- Côte d'Ivoire (1983, 2000, 2011)
- Gabon (1999–2005)^[18]
- Ghana (1979, 1982)^[18]
- Liberia (1989–2006)^[18]
- Madagascar (2002)^[18]
- Mozambique (1980)^[18]
- Rwanda (1995)^[18]
- Sierra Leone (1997–1998)^[18]
- Sudan (1991)^[18]
- Tunisia (1867)
- Egypt (1876, 1984)
- Kenya (1994, 2000)
- Morocco (1983, 1994, 2000)
- Nigeria (1982, 1986, 1992, 2001, 2004)
- South Africa (1985, 1989, 1993)
- Zambia (1983)
- Zimbabwe (1985, 2000, 2006)^[18] (see [Hyperinflation in Zimbabwe](#))

Asia

- China (1921, 1932,^[18] 1939)
- Japan (1942, 1946–1952)^[18]
- India (1958, 1969,^[citation needed] 1972)
- Indonesia (1986)
- Iran (1992)
- Iraq (1990)
- Jordan (1989)
- Kuwait (1990–1991)^[18]
- Myanmar (1984,^[18] 1987,^[18] 2002)
- Mongolia (1997–2000)^[18]
- The Philippines (1983)
- Solomon Islands (1995–2004)^[18]
- Sri Lanka (1980, 1982, 1996)^[18]
- Vietnam (1985)^[18]

Source: various



Stop being so negative

for a too long time. Of course the inflection point will occur (it always does), when the country in question is no longer able to borrow. As long as countries are able to borrow, the little debt game can continue along for a “very long time.”

Which brings us to the real question – what will happen to result in some countries no longer being able to borrow?

After all, today for many countries we see the highest bond prices in history. France, Italy, Spain, Germany and America are all borrowing money at the lowest rates ever recorded. This in itself should cause investors to believe that maybe there is a bubble in government bonds.

Of course, other investors say the sky-high bond prices reflect the very high demand for these very safe and very solid investments. Yet, when one considers who is buying the bonds they'll discover that the real demand isn't so real after all.

The primary buyer has been central banks of these countries. Either directly through QE (quantitative easing or money printing), or indirectly through direct bank funding; the main buyer of government bonds have been the governments themselves. But to make this a bad joke, the punch line is that governments are not using tax money to buy the bonds – instead they are printing money out of thin air.

To make matters even more interesting, we've been told that the

recovery is quite strong around the world – yet, over the last 4 weeks 18 countries have all reduced interest rates in one form or another to help stimulate the economy.

The jaw dropper of course is that the Eurozone, Denmark, Sweden and Switzerland have all announced **NEGATIVE** interest rates.

Instead of the bank paying you interest on your deposit, banks in these countries will collect interest from you. Confused? Well, you should be. After all you are not borrowing money from the bank. If this was the case, you'd expect to pay interest. When you place money on deposit at a bank, the bank is actually borrowing from you. You should be receiving interest, not the other way around.

In other words, with **NEGATIVE** interest rates - term deposits will become mortgages and mortgages will become term deposits. We love a good laugh as much as the next person – we wish we were making this up, but we are not.

Just as money printing, more taxes, less spending, lower currencies, and bank bailouts were suppose to stimulate the economy, now central banks are telling us that negative interests will as well.

And just think, many advisors, big banks, and media are telling us that the world is on the road to recovery. Good grief – when will it end?

Well, we think we are about to find out. Which brings us to Greece.

Countless this, countless that

Someone has a problem

When you owe someone \$340, it is YOUR problem.

When you owe someone \$340 BILLION, it is THEIR problem.

As of today, Greeks everywhere – all 11 million of them, owe the rest of Europe \$340 billion. Considering that over half of this debt was forced upon them by Germany and the IMF, and also considering that their economy is -25% less than it was 5 years ago, and not forgetting that Brussels controls all Greek tax rates, pensions and government spending, it's very clear that the \$340 billion is Europe's problem.

And if this isn't enough to worry Germany, one should also know that as of January 25, 2015 – there is a new sheriff in town, they are called Syriza and they were elected by the same 11 million Greeks with the mandate to change the terms of the \$340 billion debt owed to Europe.

Ever since Greece revealed in 2009 that with help from Goldman Sachs, it had been fudging its wealth, taxes and debt numbers for over 10 years, Europe stepped in and called the shots. The reason for this fond concern for Greece wasn't due to Germany's fondness for sun, sand and ouzo, but rather it was due to Germany's concern that if Greece defaulted on its debt, then German and European banks everywhere would tumble like a fig into the Aegean Sea.

Since then, the entire European charade of countless bailout funds,

countless austerity decrees, and countless threats of economic doom have all been structured to keep the European banking system together.

In its current state, Greece has debt that will never be repaid. It will literally take several generations to repay the loans forced upon them. And this is assuming the country can miraculously start running budget surpluses and then avoiding the temptation to spend the surpluses.

The situation between the Greeks and Brussels is fluid and is changing by the hour. While we fully expect Greece to leave the Eurozone, we have no idea when it will occur. In fact, we're pretty sure Brussels, and not Greece, will blink and offer up some kind of debt extension. After all, at this point it is Europe that has everything to lose and not Greece.

Europe's fear is that if Greece leaves the Eurozone, the seal will have been broken and no one knows what the reaction will be in Italy, Spain, Portugal, Ireland and France. Bank runs are a real possibility, and so too will be the 1000s of protesters in the local squares – clearly not an ideal situation for politicians who want to be re-elected. In short it can get really messy, really quickly.

And that's just the short-term fear. The long-term fear is one where Greece leaves the Eurozone, suffers greatly for a year or two, but then suddenly returns to prosperity.

The current most interesting place on earth

Either way, the gig is up. The most important point to understand about Europe is that any change that occurs is a result of the people standing up to the current status quo. The situation is extremely interesting. We've discussed it inside and out and suddenly financial markets are moving in the direction which we expected to occur.

And should the debt crisis in Europe escalate further, we expect the investment world to be turned upside down. Those investments that are considered safe will be risky, and those that are considered risky will be safe.

What goes up can also come down

Whether unknowingly or not, the media and the investment industry has created an information gap wedging the 2008 debt crisis with today's debt crisis. **Chart 4 (next page)** shows the difference in debt outstanding from 2008 compared to today. The Public Sector consists of government and tax payers, while the Private Sector is made up of individuals and companies.

Notice the enormous gap that has developed between the two groups over the last 6 years. This is the part that isn't talked about by the big banks, fund companies and advisors with their clients. The debt crisis was never really resolved. Instead, governments decided to simply transfer the debt problem from the private sector to the public sector.

This is important as it is one of the key reasons for the current crisis.

As a result, capital markets were never allowed to reset. Instead, our governments and central banks have created a financial environment where traditional savers receive little to no interest on their cash deposits, and an economic environment whereby sophisticated investors are slowly withdrawing investment.

This combination is creating deflationary trends around the world, and it is causing the Velocity of Money to plummet. Ironically, this central-bank induced economic combination, is causing central banks and governments to do even more of the same. Insanity at its best.

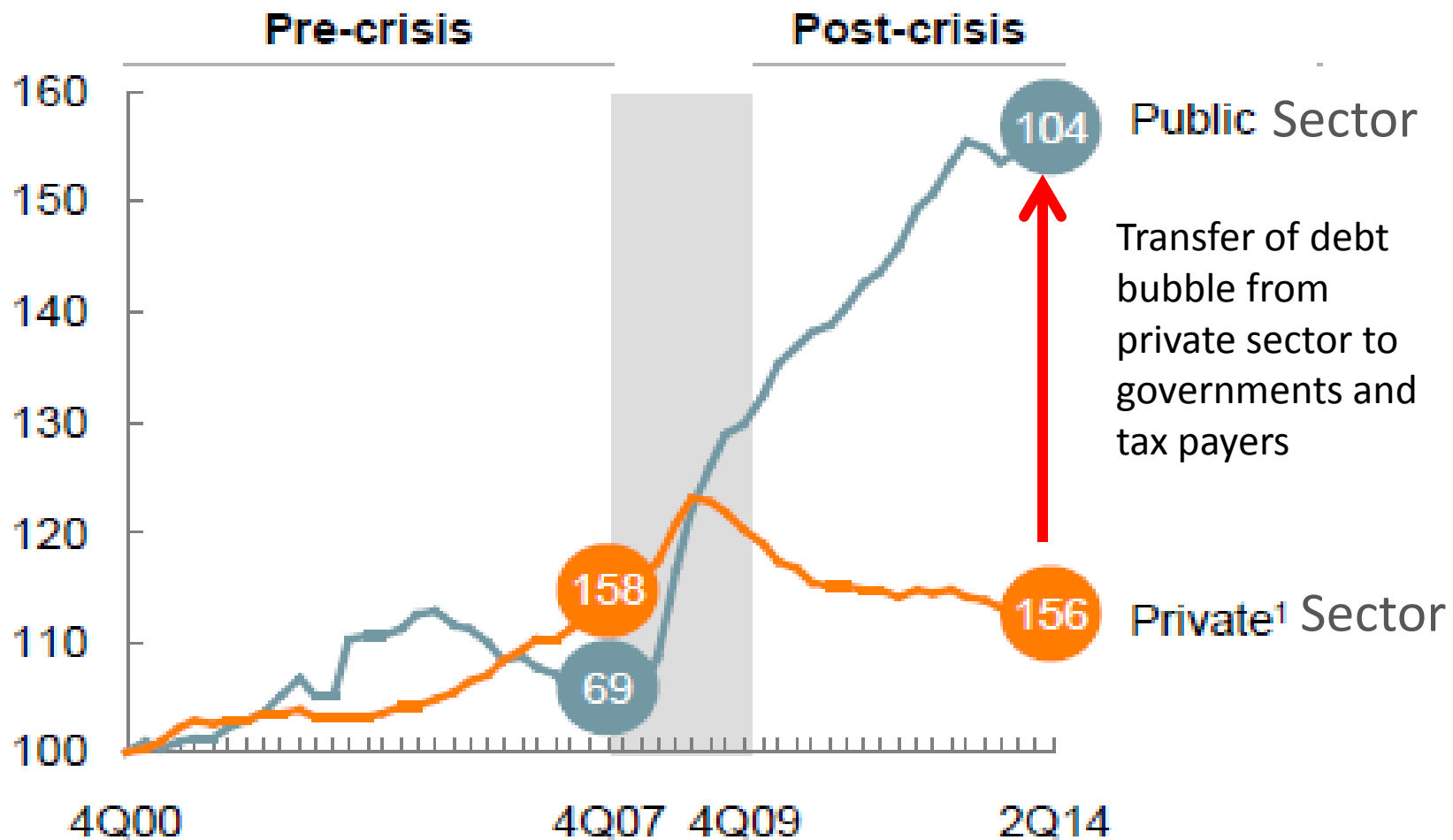
At some point very soon, this financial-spin-top will lose a few riders and the key one to watch is the government bond sector. **Chart 5** illustrates the size and difference between the bubbles in our all too recent past. And as they say in California – the next one will be a big one.

As the bubble in government bonds blows higher and higher, the following investment groups will become considerably risky:

- Government bonds
- Bank & insurance stocks
- Pension funds
- Target Date Mutual Funds

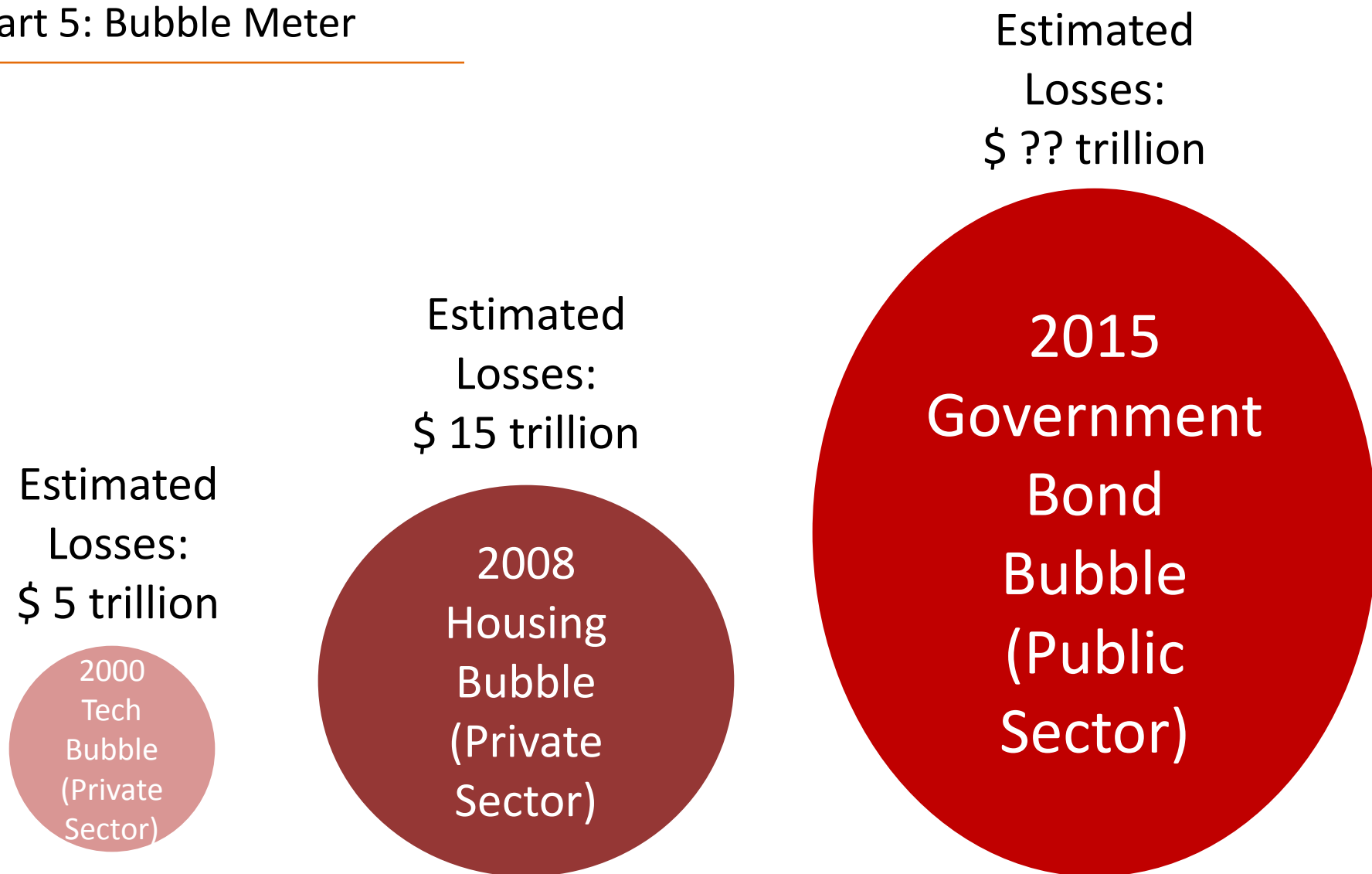
Practically every investor in the world has exposure to the bond market, as well as bank and insurance stocks. Some investors have little exposure while others have a lot of their eggs in this seemingly low-risk basket.

Chart 4: Debt crisis was never resolved



Source: McKinsey & Company

Chart 5: Bubble Meter



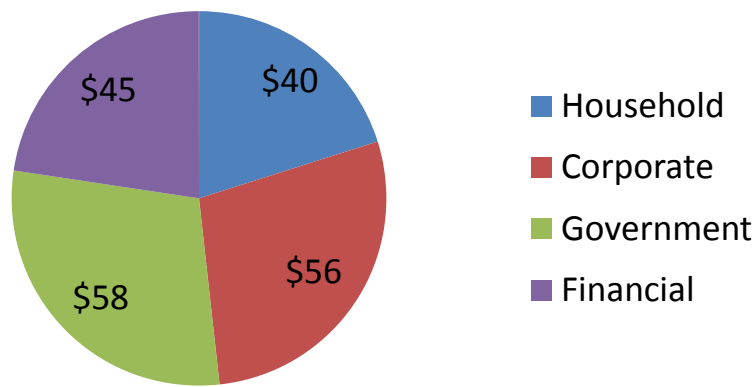
Source: IceCap Asset Management Limited

The current most interesting place on earth

We'll next explain why we are nervous about these, **4 investment groups** (page 9) and then go into greater detail about each one in future Global Market Outlooks.

First, note the following amount of global debt outstanding.

Global Debt (\$Trillions)



Source: Data from McKinsey & Company

Next, note that over \$58 TRILLION is owed by governments, and over \$45 TRILLION is owed by banks and insurance companies.

Also, understand that banks and insurance companies are required by regulators to hold safe investments as their capital.

And finally, understand that regulators say government bonds are recognised as risk-free investments and therefore should make up the majority of a bank's capital.

So, if you accept our view that government bonds are in a bubble phase and that eventually this bubble will burst, governments as well as anyone holding government bonds will be affected the most.

And because banks and insurance companies invest their required capital in government bonds, they are extremely vulnerable to a popping of the government bond market.

To summarise, the groups who hold a whole bunch of government bonds include:

- Bank & insurance companies
- Pension funds
- Target Dated Mutual Funds

Banks & Insurance Companies

IceCap is a global investment firm based in Canada. For those who are not aware, the majority of Canadians love 3 things - hockey, Tim Horton's coffee and their banks. Yes, unlike every other place on the planet, banks rank right up there in the love-column for most Canadians – we kid you not. Therefore, for IceCap to share a view that bank stocks are entering a market phase where downside risk is considerable, well let's just say we are being very un-Canadian.

The truth is, every bank and insurance company in the world is a levered company. The company has its own money (regulatory capital), and then it borrows, borrows and borrows some more to turn itself into a highly leveraged firm. Now many banks have a buffer above the minimum regulatory capital – this is good.

The most interesting place in the world

And, when everything is going smoothly, it's impossible for a bank not to make money. However, when things go poorly, and losses occur, the bank's buffer between its own money and its regulatory capital absorbs the losses.

This is what happened during the 2008 debt crisis. Banks lost money and they didn't have enough capital to cover the losses while also maintaining their required minimum capitals levels – this is why they were bailed out.

The risk today however, is bigger because instead of banks having to use their required "safe" capital to cover losses, it is actually their "safe" capital that is at risk of incurring the loss. In one way, it's the exact opposite of what happened to banks in 2008.

This is a big deal.

In summarising our concern about banks and insurance companies - the risk is always there. These companies are leveraged and small losses can be very significant. However, just as until recently with energy stocks, few people are willing to believe that banks are risky. They believe that since the risk hasn't happened, it isn't risky. We believe otherwise.

Be forewarned, due to the way banks are structured, if the government bond bubble bursts, banks will have an awful time. It's impossible for them not too.

Pension Funds and Target Date Mutual Funds are also highly exposed and unfortunately they are the preferred investment vehicle by conservative investors. We'll cover both in our next Global Market Outlook.

US Dollar

Our Strategy

We've made no strategy changes since our last Global Market Outlook. This isn't because we are not seeing opportunities – it's quite the opposite actually. In fact, we are seeing lots of opportunities but our portfolios are already significantly invested across these areas. No changes have been necessary.

Our non-USD portfolios are benefiting greatly from our decision to significantly increase our exposure to US Dollars. Our currency strategy equals 20% of client portfolios and has returned +9.8% in 2015.

We've also positioned our global equity strategy with a 70% allocation to US markets and this has returned +9.4% in 2015.

While we certainly do not have a short-term crystal ball, we fully expect volatility in stocks, bonds, currencies and commodities to remain significant in the near-term.

In the long-term, we continue to expect the European crisis to deteriorate further. Yes, the current situation Greece has produced a few fireworks, yet we believe this is merely the tip of the iceberg. As we venture further into 2015, we expect to see serious dislocations within Europe which will create serious dislocations across all investment strategies.

While this shouldn't be a surprise, our future strategy changes will see a remodeling of portfolios to significantly reduce our exposure to banks.

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.

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Thank you for sharing your time with us.