IceCap Asset Management Ltd.

Our view on global investment markets:

September 2011 – Hopelessly Devoted

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Blasphemous

While Ben Bernanke may say his mentor has always been Stanley Fischer, here at IceCap we are able to see through this charade. Mr. Bernanke's inspiration has always and will always be the 1978 cinema classic – *Grease*. Whether his inspiration is Olivia Newton-John-Travolta or in fact Mr. Fischer, we know that Helicopter Ben is belting out Grease show tunes while in his office, car or bath tub (if Warren can do it, why not Ben?).

And although the Chairman of the US Federal Reserve will always claim he is hopelessly devoted to doing what is best, he is actually doing the only thing he knows how to do – *print money*.

Exactly where he got this drive to be a money printer is undeniable – we'll blame it squarely on the shoulders of the father of modern economics, John Maynard Keynes.

Blasphemous you say? Well, step aside sonny, here's the real story behind the money printing machines from the USA, Japan, Britain and Europe, and why they will continue with this unsuccessful strategy.

In the World today, there are effectively 2 views on how governments should manage their money and their economies. The 2 views are:

1) Keynesian economics and
2) Austrian School of economics

The **Keynesian view** was created by British economists John Maynard Keynes in the 1930s. His central premise was that **business cycles could be controlled through the use of fiscal and monetary policies**.

Just think, if economic growth is a little slower than needed simply cut interest rates a little, reduce taxes a little, and have your government spend a little more money than usual. The result? Stronger economic growth, more jobs, more investments and more tax revenues. Just like that – *presto*! Everything is fixed.

This new approach to modern day economics made sense at the time and was obviously very appealing to everyone involved, after all how could you not like a win-win-win situation?

The view taken by the **Austrian school** however is rather quite dull, unexciting, uninteresting – especially to anyone with master of the universe ambitions. The rock solid foundation of the Austrian approach is based upon the belief that human behavior is so "complex" that entrusting important decisions to anyone with a brain (and agenda) is completely unwise.

Instead, the Austrian school believes that the amount of money available in the system is the primary cause of most business cycles. In other words, do not try to control interest rates or spending levels, instead simply focus on ensuring there is a steady amount of money available for the real economy to function.

The main distinction between the 2 very different approaches, is that

No re-set button available

one involves trying to control the global economy by using a giant console and joystick, whereas the other approach requires very little man-made intervention. Since the World is usually controlled by people with very big egos, is it any wonder that the Keynesian approach won?

Now if Mr. Keynes was alive today, I'm confident he'd protest emphatically, not necessarily against IceCap's interpretation of Keynesian economics but rather how his view is being mangled by today's central banks, treasury/finance ministers, and a NY Times economic columnist.

The reason to be worried and alarmed is that Mr. Bernanke and other pro-Keynesian economists have taken Keynesian economics to the *n*th degree. Yes, this approach has managed to boost growth – however the cumulative excesses from trying to boost growth has created the debt monster we are seeing today.

The problem with the Keynesian approach is that there is no re-set button available. What we mean by this is that after "juicing the goose" with interest rate cuts, lower taxes and increased spending – it becomes increasingly difficult to undo what was done.

Politicians, the economy and the stock market all become annoyingly complacent about any downside risk. If something goes wrong, Keynesian economics will always be there to bail us out.

Or will it? **The real challenge with an addiction to Keynesian economics is what happens when there are no more interest rates to cut, no more taxes to cut, and no more spending to be found**. The result is no more growth to be found anywhere – and worse still, this economic deal with the devil now has the World facing the reaper.

Chart 1 on the next page shows an unintended consequence of Keynesian economics. As the World knows by now, the bursting of the tech-bubble in 2000, resulted in the US Federal reserve cutting interest rates to a then all-time low of 1%. The result of this Keynesian move was a housing bubble that lead to millions of people taking equity out of their homes.

From 2001-07, Americans extracted billions of dollars from their homes in the form of equity (or Mortgage Equity Withdrawal). These people in effect used their homes as ATM machines. This unprecedented act created the allusion of wealth - people purchased new cars, experienced nice vacations, and even purchased more homes as investment properties. This was all fine until the housing bubble collapsed and left people with mortgages that were greater than the value of their houses. Thank you Mr. Keynes.

Chart 2 on page 5, shows that the Keynesian strategy boosted cumulative GDP by 400% during the housing bubble years. Today, the good times are gone yet the debt from this blunder continues. The sugar high was nice while it lasted.

Chart 1: Excessive use of Keynesian economics created excessive Mortgage Equity Withdrawal

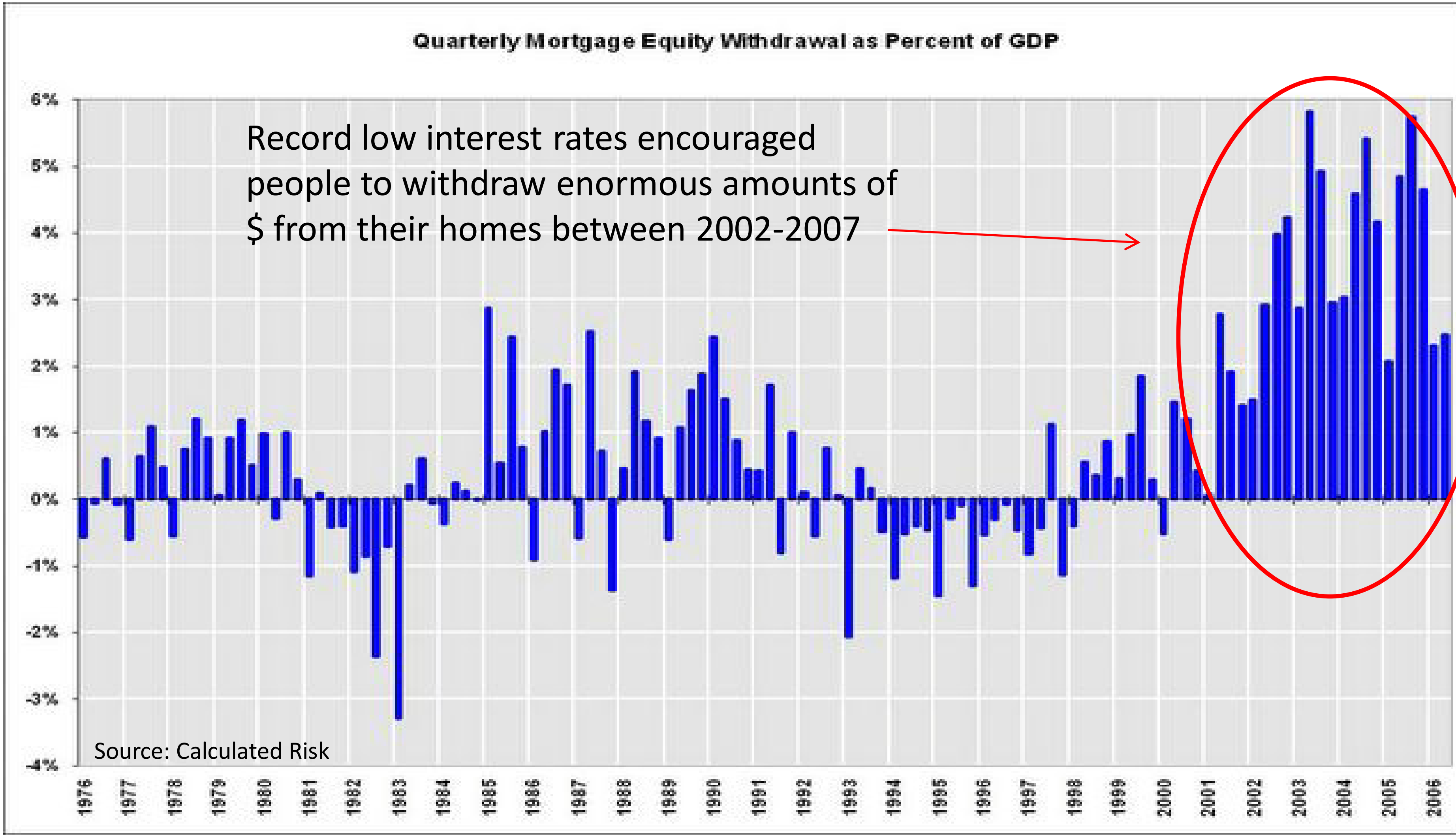
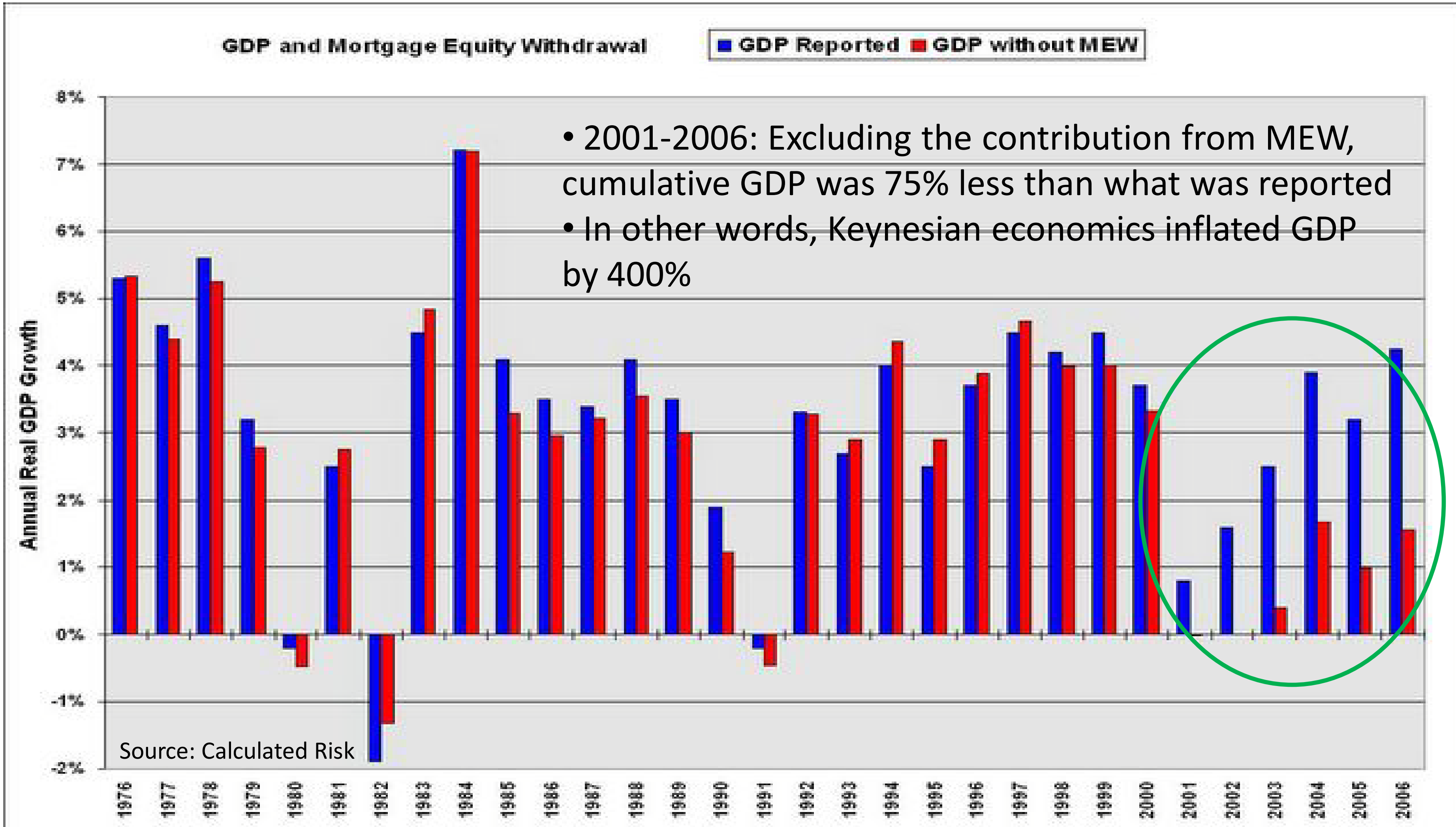


Chart 2: Excessive use of Keynesian economics created the allusion of strong GDP growth



At least it's good for Starbucks

Now that we've seen how Keynesian economics stimulated GDP during the housing bubble it is also important to understand that the Keynesian approach is providing yet again another shot of false growth in the economy.

Refer next to **chart 3** on page 7, historically the US government through its various social welfare programs contributes between 12-15% of total disposable income for the average American. Since the Great Recession of 2009, this number has skyrocketed to 20%. **Taken another way, that $5 latte from Starbucks is costing many Americans $4 and President Obama $1.**

The point we make is twofold: for starters, the Keynesian approach to economics has reached its end-game. The imbalances in the global economy has reached a point where additional stimulus measures either from interest rates cuts or government handouts is no longer having a net positive effect, much less a sustained positive effect.

The second and we think the most important point to understand is that the powers that be, have no intention of discontinuing the Keynesian approach. Governments will continue to create short-term programs to help the economy, and central banks will continue down the path of manipulating interest rates and printing money. Which of course, bring us to **Operation Twist**.

How to destroy the banks

Over the last 4 weeks, the US Federal Reserve had not so quietly leaked that their next version of Quantitative Easing will not consist of trillions of more money printing, but rather a "twisting" of their current balance sheet.

It's ok to be confused, after all the Fed is confused as well. Here's what you need to know about "QE3 - Operation Twist":
- QE1 printed $1.25 trillion and purchased bonds & mortgages
- QE2 printed $600 billion and purchased more bonds & mortgages
- All of these bonds and mortgages have maturity dates ranging from 1 year to 10 years
- QE3 Operation Twist will see the Fed selling bonds/mortgages with maturity dates between 1-3 years and then use that money to buy bonds/mortgages with maturity dates between 6-30 years.

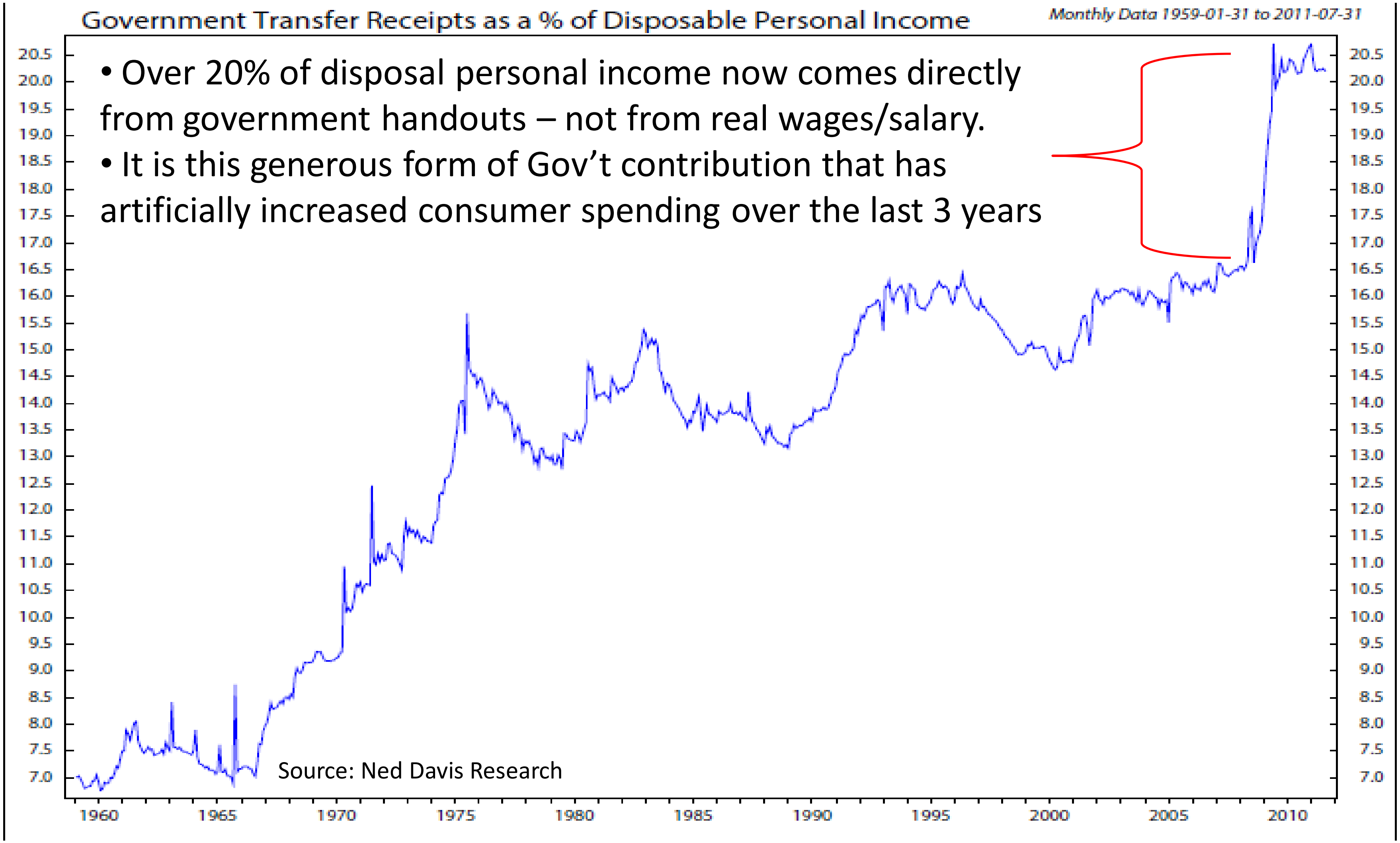
Why do the twist?

The hope is that the act of buying bonds/mortgages with 7-30 year maturities will in effect cause long-term interest rates to decline.

Lower long-term interest rates will make it cheaper for people and businesses to borrow money. And when they borrow money they will spend this money. And when they spend this money it will cause the economy to grow. And when the economy grows, businesses will hire more people. And when more people have jobs, they too will borrow more money and spend this borrowed money.

There's just one problem with this plan – it didn't work when the Fed tried it in 1961 and it won't work today in 2011. We are seeing Einstein's insanity theory all over again.

Chart 3: Excessive use of Keynesian economics is creating another allusion of stable income



$8 million for IceCap

For starters, long-term interest rates are already at their all-time lows. It now costs 1.9% to borrow money for 10 years. If this all-time low rate isn't enticing, why should a rate that is a shade lower work?

Next, the direct result of pushing down long-term interest rates will have a horrible impact on US banks revenues – let's just say there won't be much "net" in their "Net Interest Margins" once this happens.

This bizarre decision by the Fed to twist their balance sheet shows how twisted and inconsistent they are with their use of monetary policy. To better understand how horrible of a decision this is and how it is devastating for banks and insurance companies, we must remember that the # 1 strategy to fix the American bank problem is to have the banks slowly bleed the average person into poverty.

Third, lower interest rates are not going to encourage individuals and companies to borrow. Money is already cheap and companies already have lots of it – they do not need to borrow more money. For companies to loosen the purse strings they need to see an improving economy and the withdrawal of direct government interference in the market place. In other words, allow banks and governments to declare bankruptcy. Hit the economic reset button and then watch the global economy flourish. But this of course would fly in the face of Keynesian economics

One thing that is for sure, Operation Twist will result in over $400 billion in bonds to be sold and another $400 billion in bonds to be purchased. For a total trade of $800 billion.

Mr. Bernanke, if you are reading (and we know you are) IceCap humbly volunteers our services to help you execute these trades and since it is for the good of the World we will only charge 0.001% for our services. We are confident this $8 million fee will be considerably lower than what you will be paying Goldman Sachs and other Wall Street primary dealers. You can call us collect if you want.

Swissie, how could you?

September 27, 2010 Brazilian finance minister Guido Mantega stated what is widely known amongst the World's central bankers – "**the World is in an international currency war as governments manipulate their currencies to improve their export competitiveness**." While this proclamation received generous headlines within the financial World, we doubt the average investor received any further elaboration from their local client service investment managers.

The significance of this statement and the recent actions of the Swiss National Bank (SNB) are well...*significant*. The Swiss Franc has been heralded as one of a very few safe haven currencies on planet earth, and justifiably so. Switzerland and banking go together like Brad and ~~Jennifer~~ Angelina. The point being, countries with strong currencies are ones that have both solid fiscal and monetary policies. Besides Switzerland (and Germany before they adopted the Euro) there are

Arghhhh – be a pirate

are few other currencies in the World that deserve the "safe-haven status."

On September 6, 2011 the SNB shocked the financial World by announcing that they are going to "peg" the Swiss Franc to the Euro. With the move, Switzerland instantly lost its monetary independence.

Worse still, it has attached itself to the riskiest monetary union this side of Tripoli. Linking with the Euro is equivalent to mooring up to the Titanic *after* it hit the iceberg. Why would Mr. Hildebrand and the Swiss National Bank defecate on the very fabric of Switzerland's vaunted economic supremacy?

Ironically, they have decided to destroy their currency with the hope to make more money. As the World's debt crisis continues to spin our of control, investors seek safe places to put their money. As a result, billions of Dollars, Euros, Pounds and others are flowing into Switzerland and buying the Swiss France. This action has caused the Swiss Franc to soar in value. **While this is good news for Swiss tourists who want to personally witness riots in Athens, it is downright bad for Switzerland's multi-national companies** such as Nestle, Xstrata, Novartis and others. Every time the Swiss Franc rises, these exporting machines lose millions of dollars.

With the "Swissie effectively gone as a paper currency, who will replace her? You have to look long and far, after all there are not many candidates. Maybe Singapore from Asia, but after that the list stops abruptly. The end result is very clear – the safe haven currencies in the World now consist if the reclusive group of the US Dollar and the Japanese Yen. Yikes.

The real end result of course, is a real nice boost to gold as becoming increasingly recognized as the only safe haven currency in the World.

Merde Creek

France is not doing very well these days. French bank stocks have plummeted over 60%, the cost of buying insurance against them collapsing is soaring, meanwhile other banks and large multi-national companies are pulling their money out. This combination make sit a near certainty that France will lose its AAA credit rating.

France losing its AAA credit rating, further complicates the European bailout fund, EFSF. Absent the credit strength of France, more pressure falls upon Germany. The health of Europe has always been about the conviction of Germany to bail out everyone. In addition to the fact that Germany doesn't have the funds available to bailout everyone in Europe, one also has to consider the fact that in a recent state election, the Pirate Party (yes, we said that correctly) received 9% of all votes. The last time we checked, pirates are not known for any socialist tendencies.

Now, we could also talk about the absurdity of Greece, the non-governments of Belgium, the blatant lying within the European Bank Stress Tests, but when we introduce Pirates to the political theatre we think we said we've said enough.

There is light at the end of the tunnel

Our Strategy

Sadly for human beings everywhere, we are witnessing the complete failure of market economics – the ability of free will to determine the price for products, services and money is more and more being strangled by central banks.

Central banks are trying their hardest to make a mockery of portfolio management. In the end, history will not be kind to Bernanke, Trichet and Hildebrand. Central bankers have become the Darth Vaders of the financial World, and it is very clear they remain hopelessly devoted to continuing down this path until they either hit a wall or are forced down.

Consequently, unknowingly to the average person on the street, he and she both continue to bailout global banks as savers are increasingly forced to take on greater investment risk to meet their income requirements.

Rumors of an assured Greek default are coming fast and furious – exactly when it happens, we do not know. What we do know is that the powers that be are preparing to protect the global financial system and any fallout from this event.

In this environment, our portfolios maintain strong cash positions and remain conservatively positioned to preserve capital on a real and nominal basis. Despite the dour situation today, we do see light at the end of the tunnel – however unless the central banks and governments pull up their socks, the tunnel remains very long indeed.

If you'd like to chat further about our view and our unique investment solutions, please feel to contact:

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Thank you for sharing your time with us.