IceCap
Asset Management Ltd.

Our view on global investment markets:

December 2016 – "The Ostrich"

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Awesome or Odd

The ostrich is an awesome bird.

It has awesome legs, awesome eggs and an even more awesome history.

5,000 years ago, the Mesopotamians featured the giant bird on cups, shirts, and walls; and even used its eggs as currency in trade.

2,000 years later, the ostrich continued to be revered and this time in Egypt. On special occasions, pharaohs received ostrich eggs, ostrich feathers, and even ostrich hats as gifts of honor and respect.

Yet, despite all of these accolades, the ostrich is also incredibly odd.

During heated moments of battle, the giant bird chooses not to use its powerful legs as weapons, but instead uses its head to slam it repeatedly against its opponent.

As well, the ostrich loves a good bath. Sight of the slightest pool of water is enough to make the ostrich circle about in delight.

But when it comes to oddities, nothing is more odd than the ostrich and the most famous coping mechanism of all – sticking its head in the sand.

Today, the ostrich population is in decline but not its relevance. With the financial and political world in chaos, investors everywhere are suddenly imitating this legendary bird.

Some investors recognise global financial risks are accelerating, yet they remain stubborn, refusing to acknowledge where the risk runs deepest and are repeatedly slamming their heads against the wall in frustration.

Others meanwhile, refuse to believe that any risk exists at all, continue to wear their favourite market hat and shirt, while sticking their heads in the sand at the next sight of trouble.

So, for everyone with a bruised and sandy head, we suggest you alter your perspective, shed any biases and embrace the opportunity to run around in delight in our rapidly changing world.

The IceCap View

All investment managers need a clear and easy to understand view.

Next, they must articulate this view in a clear and easy to follow manner.

Finally, investment managers need to structure portfolio strategies to correctly reflect their view.

It's all easy enough, except that for many money managers it is so incredibly difficult to be clear, articulate and reflective.

Instead, investors must suffer reading, hearing and watching the standard industry jargon, gibberish and confusion that normally swamps the airwaves.

Be Fair

In fairness, being an investment manager isn't easy. No financial market ever moves in a straight line. And of course, there will always be times when there is seemingly a complete disconnect between a manager's view and market movements.

Naturally, and most important of all, investment managers absolutely must be able to change their view when the evidence has proven that their view and strategy is in fact wrong.

Here at IceCap, we've written, spoken, and presented countless times how we start every day with the objective of finding reason to change our view.

Yes, we may occasionally bang our head against something, but we absolutely refuse to stick our head in the sand.

We do this as it reminds us not to develop tunnel vision and ignorance.

Investing can be a humbling experience, and we always maintain that the sooner you recognize and accept that your market view is wrong, the sooner you can exit your strategy to avoid or limit losses.

After all – a 50% loss in anything requires a subsequent 100% recovery return just to breakeven.

Yes, avoiding significant losses is that important, and it should always be on the minds of every investor.

Which brings us to the **IceCap View**, and we objectively report that while a lot has happened since our last writings, nothing has occurred to give us reason to change our market view and overall strategy. In fact, it's been the exact opposite – the world continues to trend along the path as we expect.

As you know, our research firmly reasons that the world is in the late stages of an enormous bubble in the bond market, and as it turns over it will affect all markets and strategies – regardless of where you sit in the world.

This convergence of political, social, economic, monetary and fiscal factors is developing, that while may seem chaotic to many – appears quite plain and simple to those who are able to see straight.

Our view has remained very consistent and has been stated through various media outlets and in private presentations – which results in our view as being "made public" with a "time stamp". This means we cannot suddenly twist any of our past words to reconcile with current markets.

Considering all of the recent chaos in the world, it's important for us to revisit our success in forecasting many of these seemingly low probability events.

Of course, we share these experiences not because we want to tout our success in forecasting these events, but rather because it helps investors understand our perspective, why it has been correct, and most importantly – why we continue to maintain our view.

The Common Man

Our April 2016 IceCap Global Outlook "Revenge of the Risotto" discussed why the Brexit Vote would likely produce a victory for the Leave campaign. At the time, the mere thought of Britain voting to leave the European Union (EU) was seen as lunacy at best.

Yet, we understood that the majority of people, companies and media who benefitted from the European Union were located in London. And that this group carried a very loud voice that was echoed by the political establishment and media around the world.

Seemingly every main stream media news outlet slanted all stories to support Britain staying in the EU, and that those who supported the Leave Campaign were therefore eejits.

In effect, the voice of the common man was very easy to miss. Yet in the end, the common man flipped the bird to the main man, and the only eejits turned out to be those in London and Brussels.

Next up was the American Election, and in our September 2016 IceCap Global Outlook "Fright Night" we spelled out very clearly why we expected Trump to win.

It is irrelevant whether you supported or didn't support Trump, instead – our success in expecting this event was due to our ability and objectiveness to understand that many Americans have lost confidence in the political establishment and were not participating in any of its claimed economic successes.

Like the Brexit Leave victory, the Trump victory was once again, very much the common man, rising up against the main man.

It really is as simple as that.

Next, was Italy. For months prior to the referendum, we strongly suggested that investors should keep a very watchful eye, ear and nose to the situation in Italy.

For those who are not familiar with the event, just know that in an attempt to unclog the Italian political system and make it more efficient, Prime Minister Matteo Renzi launched a referendum to enact change.

However, although the vote was specifically about changing the political structure, it instead turned into a vote of support for or against the political establishment and the EU.

Again, from this perspective it was rather easy to see and understand why the referendum would fail with over 60% voting against the EU.

The "No" vote not only shot a Roman arrow across the EU's head, but it also resulted in Prime Minister Renzi resigning.

Moving along, our July 2016 IceCap Global Outlook "Chaos vs Harmony" plainly stated not only our affection for the British rock band "Oasis", but also why we saw enormous risk in the bond market.

Watch your wine

Our view on the bond market is crystal clear, yet up until a few weeks ago many investors dismissed it as being as far fetched as Britain leaving the EU, Trump winning the election or Italy voting out its prime minister.

Yet – from November 7 to Nov 15, the US aggregate bond market dropped -3%.

Now, a -3% decline may not seem like a big move to many investors, especially those focused on the stock market.

However, just know that in the bond world, this -3% drop was similar to stock markets crashing 10% in a single day.

Yes, let that sink in – it was a very nervous day for everyone managing bond strategies.

In fact, this -3% decline was so catastrophic that it produced the following headlines:

Sleepy bond market stirred by a November like no other

MarketWatch

Published: Nov 30, 2016 2:54 p.m. ET

Global Bonds Suffer Worst Monthly Meltdown as $1.7 Trillion Lost

by Garfield Clinton Reynolds and Anooja Debnath

November 30, 2016 — 10:16 PM EST *Updated on* December 1, 2016 — 11:18 AM EST

Bloomberg Markets | Markets

Ned Davis Research Group — Fixed Income

December 01, 2016 | NDR.com

Worst Month in 12 Years!

Fixed Income | U.S. Comment | Joe Kalish, Veneta Dimitrova

Now that you know the bond world was shaken to its core, it's even more important to know why it was shaken to its core.

Our warnings on the bond market are focused on long-term interest rates unexpectedly, shooting higher.

We know that it WILL occur and when it DOES occur, it will be devastating. Of course, there are different degrees of devastation.

Spilling your glass of pinot noir is obviously devastating.

Not having enough snow for your Jackson Hole ski holiday is even more devastating.

Gaining Perspective

And, having a delayed delivery of your new Maserati GranTurismo is perhaps one of the most devastating things that could happen to a person.

Unless of course, you are a bond investor and long term interest rates shoot up unexpectedly.

Our September 2016 Global Outlook "Fright Night" described in detail how and why long-term interest rates will catapult higher and therefore create an incredible rush of capital away from bonds and into USD and the stock market.

After publishing, we had many kind emails, meetings and conversations thanking us for providing a simplified explanation of the risk in bond markets.

We also had people shrug their shoulders and roll their eyes – after all, while bonds may not provide much of a return anymore, they are the safest investment in the world.

Or , so you've been told. The reason why the world's bond market was turned upside down, inside out and tossed out with the trash was because of the following:

Long-term interest rates increased from +1.7% to +2.4%

Yes, that is not a typo. A mere 0.7% move higher was enough to wake up sleepy bond investors, create $1.7 Trillion in losses, and devastate the entire bond world.

Our **Chart 1**, next page puts this historical event in perspective.

It's at this point where big bank economists and bond lovers everywhere carelessly proclaim this is not a big deal. In fact, they say it's easy to see that long-term rates have increased like this before and everyone adjusted swimmingly.

Of course, this kind of linear thinking fails to consider the following:
- massive accumulation of government debt
- deteriorating government deficits
- increasing taxes & increasing government spending
- NEGATIVE and 0% interest rates
- money printing

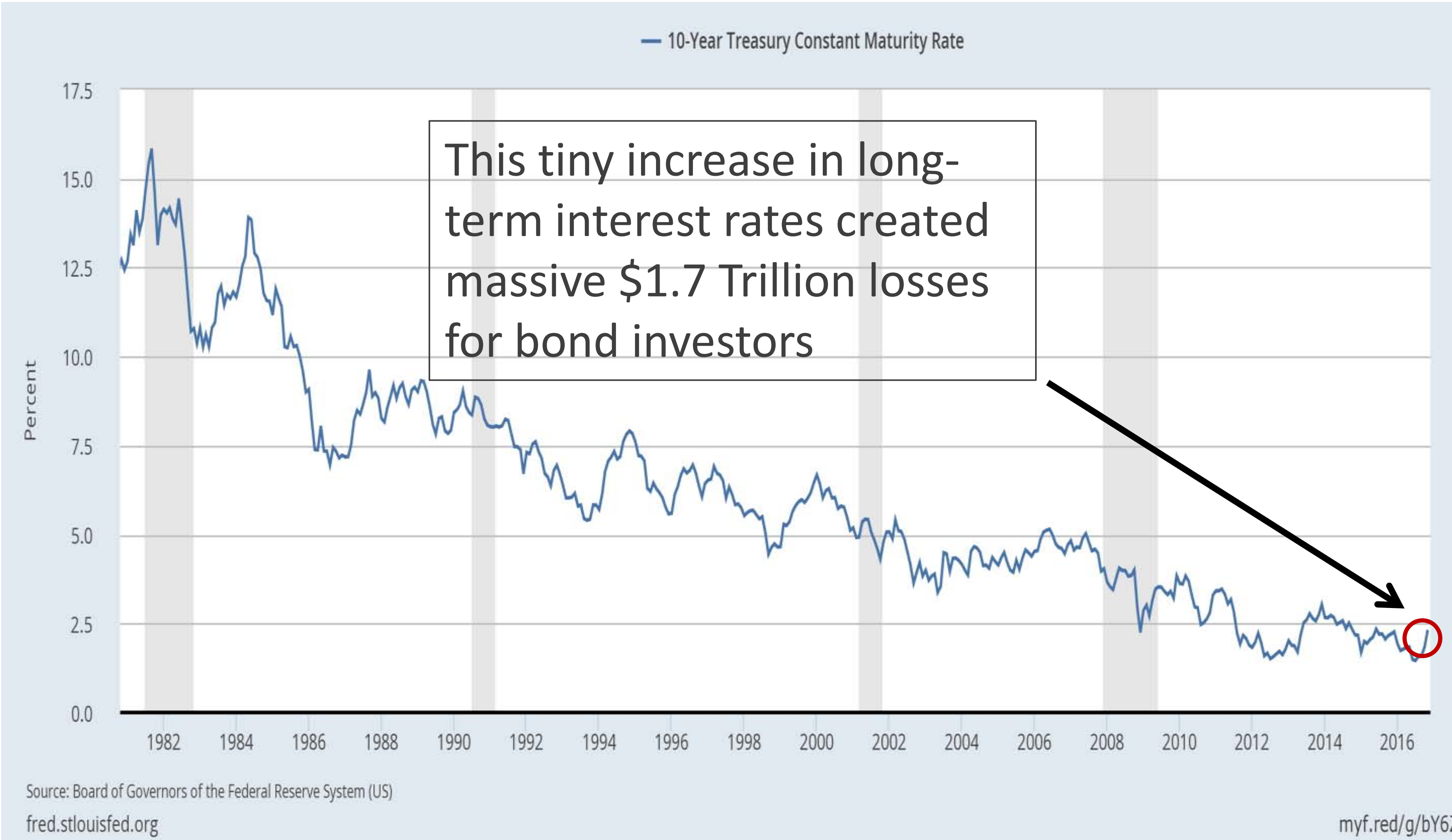
Analysing these points obviously shows that the problems in the world today are squarely centered in the public/government sector – not the private sector.

Few people alive today, and certainly no one working in the investment industry, has ever experienced a global crisis in the government sector before.

Think about this for a long time – yes, it is that important.

Every other crisis we've experienced (housing crisis, tech bubble crisis, savings and loan bank crisis, 1970s oil/inflation crisis, etc) has always originated in the private sector.

Chart 1: US 10 Year Treasury Bond Yield 1982 - 2016



It can be uncomfortable

And since these crises were in the private sector – the risks eventually manifested themselves (they always do) in the stock market.

Since today's sovereign debt crisis is in the public sector – the risks will manifest not in the stock market, but in the bond market.

This really is the most important point to understand today. Yet because the big bank mutual fund machines cannot find (or really, even bother to look) this risk or perspective, trillions of investment Dollars, Yen, Pounds and Euros are all fighting yesterday's war and refuse to see where the front has opened.

To be clear – the front is the bond market.

Of course, many investment managers clearly know there is a certain big risk in today's market place.

As well, we've commented before that many of the really big investment firms in the world do not really manage your wealth.

Instead, they simply collect your assets, plunk them into their various investment funds, make micro-changes at the fringe and then proceed to watch the trillions in fees roll through the door.

Those who are in the investment industry are quietly nodding in agreement, while those not in the investment may be rather unconvinced. After all every investment manager and mutual fund manager is sharp as a tack, and has their finger on the pulse of the global financial system. Sadly, this isn't true.

Instead, if it hasn't happened already, many investment managers are actually slowly morphing into – an ostrich.

As this can be a tricky and uncomfortable transition, our **Chart 2** (next page) provides an easy to follow analysis to help you determine whether your investment manager is in fact a giant, bird-like creature.

The **first type of manager** is the one who believes the world is just fine. Yes, growth may be a little slow but markets are forward looking and have discounted any and all future worries.

While the optimism is to be respected, the ignorance towards zero and negative interest rates, money printing strategies to suppress long-term interest rates, and the sharpening knife of the anti-establishment political movement - results in these managers sticking their heads in the sand at the first sight of trouble.

Since these managers are always seeking the best growth opportunities around the world, today they find themselves drooling over emerging market stocks as well as emerging market bonds, and high yield bonds.

Chart 2: Ostrich Transformation Table

Market Outlook	Strategy	Behavior	Conclusion
World is recovering	Global Stocks, Emerging Market Stocks, High Yield Bonds, Emerging Market Bonds	Sticking Head in Sand	
World is in trouble	Cash Bonds Gold	Slamming Head against things	
World is in trouble	USD US Stocks	Open minded, Objective	

Jive Turkey

Next up, we have the investment manager who is acutely aware of the many risks running around the world today. They clearly see the rise of political uncertainties, fear the consequences of zero and negative interest rates and feel queasy towards all of the money printing going on.

This deep respect and acknowledgment of the risks around the world is a sign of a dynamic thinking investment firm. There are many of these firms out there, and some of them correctly foresaw the housing market crash

However, while we obviously respect this group of managers we politely point out that while we agree with their deep concern about market risk, we disagree with their conclusion as to where the risk lies

This group believes the stock market & USD are the center of the evil universe and investment in these areas should be avoided at all cost.

Unfortunately, if you avoid stocks and the USD then by default you love bonds, Euros and gold.

And even more unfortunately - bonds, Euros and especially gold are growing weaker by the minute, which is resulting in these managers repeatedly slamming their heads in frustration.

Investments in these markets are eliciting not only painful negative returns, but also painful reasons why the market is wrong and it will turn around any day now.

While investment markets are always full of unexpected events, we do hope that these managers are able to see the error of their ways, otherwise there's the very real probability that eventually they turn into a different bird altogether - a turkey.

Code Red

Days after the dust settled on the bond market debacle, we had a meeting with one of the world's largest bond managers. We asked them on a scale of 1-10 with 10 being complete devastation, how would they rate the recent decline in the bond market?

The answer = 8

Again, we stress to you that a 0.7% increase in long-term interest rates created untold havoc throughout the bond world.

Imagine what would happen if long-term interest rates increased by 1% or 3%, or even 6%?

The short answer is a surging USD and a surging stock market.

The best thing (or worst, depending upon your view), is that this tiny 0.7% increase in long-term rates is merely the tip of the iceberg.

Great Opportunity

The long end of the bond market is now broken and the 30 year bull market in long duration, fixed income is over, kaput, done.

If you own any of this stuff, it's time to make a change.

If you manage any of this stuff, it's time to get a new job.

But, if you need to borrow money, now is the time to borrow and lock in the longest maturity possible. Doing any of these three, will help you prosper in a devastating world for bonds.

The Next Big Thing

Now that the bond genie has been let out of the bottle, increasingly more and more investors are suddenly (and painfully) learning that believing bonds are safe is old-school thinking.

Over the last 35 years, your mind has been molded, massaged and lulled into believing that bonds, and especially government bonds are safe.

Over the last year, IceCap has been quite specific with our research and analysis that a major bubble has developed in the bond market and once it breaks, it will have both negative and positive effects on all investment strategies.

The trick of course, is to accept it is happening and then to position your wealth for the positive effects, while avoiding the negative effects.

Over the last few weeks, the first dramatic movement in the bond market occurred – the tiny 0.7% movement in long-term interest rates was enough to ignite gigantic movements across the entire bond spectrum.

But, maybe there's hope.

Optimism is a human trait, and since bond managers are humans it is only natural to expect optimism to arise from the bond ashes in some shape or form.

And that form is clearly in the shape of inflation-protected bonds.

While most investors are enthralled with the stock market, the bond market is THE most interesting investment market on the planet.

After all, there are seemingly no limits as to what Wall Street can create. In effect, if Wall Street thinks they can convince someone to buy it, they'll create it (look no further than the 2008 housing crisis).

And one 'different' product from the bond market has actually stood the test of time, and that is the 'Real Return Bond'.

To begin, know that besides rising interest rates – the other giant monster that scares the crap out of bond managers is inflation.

The Three Faces of Inflation

Since bond interest/coupon payments are usually fixed, any rise in inflation means the income from your bond can't buy as much stuff as it could before. Therefore, inflation is bad for bonds and it causes bond prices to decline.

To counter this, Wall Street created a bond that actually benefits from rising inflation. These Treasury Inflation Protected Securities (TIPS) have been around now for over 20 years, and aside from short-term spikes in inflation, these bonds haven't exactly set the world on fire.

Until now.

The narrative goes something like this – Donald Trump will dramatically cut taxes which means there will be dramatically more money available for spending, AND he will also borrow dramatically to spend even more money.

While all of this spending is considered to be good for the economy and jobs, bond investors see it as creating a devastating surge in inflation.

And since inflation is bad for regular bonds, it must be awesome for TIPS.

This would be true if the world was experiencing a normal business and interest rate cycle.

But since the world is not experiencing a normal business and interest rate cycle, we suggest investors be cautious or at least somewhat skeptical about a focus on TIPS.

Should the geopolitical and economic world continue to trend as we expect, yes there will be inflation around the world – but not in the United States.

Let us explain.

There are 3 kinds of inflation:
1 – inflation caused by an increase in demand for certain things
2 – inflation caused by a decrease in supplies of certain things
3 – inflation caused by a currency moving sharply

Investors who are trumpeting TIPS are clearly expecting inflation to rise due to #1.

All else being equal, if there are no further disruptions across the political establishment, social tensions decline, zero and negative interest rates disappear, and European banks magically replace their bad loans and bad investments with new capital – then yes, TIPS will be a good investment.

As you may sense, our view is different and TIPS investors should take notice.

As the world continues to trend towards our outlook and forecast, our expectation for a surging USD will absolutely create inflation, but not in the United States.

Anticipation

Instead, the surging USD will actually create deflation in the US making TIPS a not so good investment.

Investors everywhere should know that the world does not work with an extremely strong USD. And unfortunately, the world continues to venture down the path that we have explained very clearly.

A strong USD is negative for global growth, which means less demand for global goods and global services. The United States will not be immune and their exports will be affected – which is deflationary.

As well, a strong USD makes foreign goods/services cheaper for people who own USD – this is also deflationary.

The net effect of slower economic growth and a stronger USD therefore means less inflation for the United States which is not good for TIPS investors.

Naturally, financial markets move in anticipation of something happening. And, since the bond world has suddenly realized their days in the sun are over – they will be tripping over themselves to climb onto to this next sure thing.

Yes, this trade may work out for a while. However, as the world continues to move along as we expect, the USD will surge which will be good for some markets and not so good for other markets.

Unfortunately for TIPS investors, financial markets will eventually anticipate this as well meaning they will be on the wrong side of this trade.

Momentum is building

Our Strategy

As the final days of 2016 draw near, it's important to anticipate what happens next.

Considering the recent political events in Britain, America and Italy – it's safe to say everyone was a bit knocked off-side when the final votes were tallied. Some would say 2016 was the most tumultuous year ever in politics – and we don't disagree. However, the political turmoil isn't over yet.

Investors everywhere must now understand that the 2017 elections in France and Germany could hammer the final nail in the Euro coffin.

Ignoring the political and social side for a moment, the worst kept secret this side of Pluto is that financially the Euro-zone doesn't work.

The 1 common currency linked to 19 different ineffective governments, 19 different mountains of debt, 19 different unworkable budgets, and 19 different unstable banking systems is the surest thing to disaster since the Titanic hitting a bit of ice.

Adding to this a strong-armed law dictated from Germany, and it should be no wonder that Euro-skeptic political parties have sprung up everywhere from Finland down to Italy, over to Spain and even back into Germany itself.

While victories by the anti-establishment in Britain and America are not linked directly to the Euro-skeptic parties – they all represent an increasingly growing minority (and now majority in some countries) of people who are just not happy.

As investors, we absolutely must remove our personal political, social and financial views. This movement has started, gained momentum with Brexit and is now gaining more momentum with Trump. And it will very likely steam roll over both France and Germany,

Considering this combination, it really is beyond our comprehension how the Eurozone and European Union remain in its current structure.

Relating this to financial markets, the restructuring of the Eurozone and European Union will manifest itself in currencies and sovereign debt.

And as every negative action has a positive reaction – all of the negative energy from currencies and bonds, will be captured by USD and US stocks.

To our knowledge, IceCap is amongst the first managers to identify this risk. Today, increasingly more and more managers are sharing the same view.

This is a positive development, as it means more investors will now have the opportunity to both protect or grow their capital.

Great Opportunities

Bonds

There's not much more we can say about bonds. All of our portfolios hold minimum allocations to bonds, with no high yield, no emerging market debt, and no long duration. We were unaffected by the recent correction in the bond market.

Stocks

Our long-term view on stocks has also not changed. Since our previous IceCap Global Outlook our sentiment and trend models indicated an opportunity in stocks, so we therefore aggressively increased our allocations. This occurred prior to the US Election and we have captured the Trump rally.

Currently, stock market sentiment has reached extreme levels, and we'll once again patiently await for an opportunity to add further to these strategies.

Currencies

Our long-term outlook remains the same – as the crisis accelerates, we fully expect USD to surge.

As we write, Euro is dropping like a stone. Just as the long end of the bond market has been broken, so to now has the Euro. We cannot stress enough our bearish view on the Euro. While maybe not in a straight line, but Euro is heading towards $0.80 level.

The Canadian Dollar however has performed quite well versus non-USD, and has traded sideways versus USD.

For Canadian Dollar portfolios, a few months ago we reduced our USD allocation in anticipation of CAD performing better. This was the correct short-term strategy, and we're now waiting for a re-entry point.

Commodities

We continue to hold no allocations to any commodities. Oil has certainly zoomed higher, and we were not able to capture this move. Although the recent move was strong, we'll assess year-end levels before committing to this asset class.

All else being equal, should our strong USD thesis continue, it will be negative for oil. Yet, we will remain objective and change our view on oil if warranted.

Gold is frequently sold as a doomsday machine, yet the recent doom around gold has been the price itself. Although we very much want to own gold bullion, we continue to have zero holdings.

The price trend is outright scary, and it will run its course. At this point, we wouldn't be surprised to see gold breaking $1000.

Those that know us will agree for better or worse, that IceCap is a very patient investment manager. We rarely invest in any market hoping for it to move in our favour. Instead, we wait for confirmation that the trend and cycle has confirmed its direction prior to allocating client capital.

Warm Holiday Wishes

While this means there will be times when we trail headline stock market returns, it also means we avoid any significant downside losses, and allows us to preserve client capital and gain better entry and exit points.

2016 was another successful year for our firm. We've warmly accepted new clients, and new team members, while also making new friends amongst other investment firms, and media.

We wish everyone a safe and happy holiday season.

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 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.

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