IceCap
Asset Management Ltd.

Our view on global investment markets:

July 2018 – "Eruption"

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Surf's up!

Similar to volcanic lava flows, financial contagions start slowly at first and then end by destroying many things in its path.

In between the beginning and the ending, is a baffling experience that can only be understood from afar.

Once the eruption begins, people everywhere want to look, see and feel this infrequent experience.

Yet by the end, few actually recognise how the crisis spreads before subtly engulfing everything in its path and ending in a full-on, blow-out contagion.

The financial lava flow has started.

Emerging market bonds and currencies are already experiencing the scorching effect of a capital outflows.

Next up will be the European experience.

The culmination of the end of ECB money printing, the end of Angela Merkel's grip on power, and the end of strict German austerity policies will see the financial lava flow first through Italy, then Spain and then before you realise it - France too.

From there, the contagion spreads far and wide. Few bond markets will be spared and few interest rate sensitive equities will be safe.

All investors, including pension funds, bank owned mutual funds and individual investors have a tremendous opportunity - anticipate and proactively embrace the financial lava, or do nothing and claim ignorance.

We know which action we are taking.

It Happened

Well, it has happened. IceCap made a significant strategy change to our portfolios – we INCREASED our allocation to equities.

Those that know us well, are fully aware of our cautious, meticulous, and OBJECTIVE approach to managing clients' hard earned wealth.

Those that are just getting to know us, will come to understand, embrace and look forward to hearing, and reading our rationale for our long-term view, and how it reconciles with short-term market fluctuations.

Whereas descriptions and announcements of strategy changes will be included in our **IceCap Global Outlook**, clients benefit from these changes immediately in their portfolios.

When we make a strategy change it is always based upon objective decisions driven by data dependent analysis – we check subjectivity at the door.

Be flexible!

One thing we are very proud of here at IceCap is that we have unequivocally demonstrated an ability to change our mind, change our view and most importantly, change our portfolio strategies.

In other words – we do not stick our heads in the sand. We never dig in our heels, and it would be absolutely shocking if we ever refused to entertain the thought that maybe our strategy, outlook and perspective is wrong.

Back in 2011, our portfolios held a 20% allocation to gold bullion. The reasons for holding gold were astonishingly clear, and when prices tipped $2000/oz, these reasons seemed even more clear.

For those that remember, gold hit the $2000 ceiling and started a sharp, excruciating and painful decline to $1280 levels.

Recognizing trend and technical support levels were broken we quickly sold all of our positions with the last sale at $1648.

Even though the fundamental reasons for holding gold <u>had not</u> changed – the technical/market reasons for holding gold <u>had</u> changed.

We share this with you to demonstrate that although all investment managers have long-term views on various markets, many do not have the ability, or the inclination to re-wire their brains and produce independent thoughts to enact significant change.

Unfortunately, "same-old-same-old" actually is a very popular investment philosophy.

But not at IceCap.

We haven't been back into gold since. Yet we have a very clear vision as to how the gold re-entry path will look, and until the time when markets guide us in that direction, we'll sit on the sidelines.

During the same time frame (2011-2012) our portfolios were positioned to protect client capital from the potential of a sharp decline in equity markets.

Again, the fundamental reasons for expecting this event to occur were quite strong – and today, many bearish managers continue to shout and scream the same fundamental reasons as to why stocks should collapse.

But they haven't.

Back around that time, our thinking and perspective changed to better understand <u>not why stock markets were avoiding collapse</u>, but instead to understanding <u>why they were going higher</u>.

Now, there is a subtle difference in what we just said. And our approach to solving the riddle was to change our perspective.

Instead of beginning with a thesis that all bad things in the world

Watch support!

eventually create a crisis, which is then always reflected in a stock market crash – we took a different perspective.

And this perspective led us to understand two crucially important things:

1) the risks in the world today are not in equity markets – instead they are in sovereign debt markets;
2) the reason few have correctly diagnosed this disease, is due to no one in our (limited) lifetime ever having the displeasure of experiencing a crisis in government bond markets.

Put another way, all the bads that we experienced over the past 50 years have always been a result of excess largess from companies and individuals.

And every single time, governments and central banks have come running to the rescue of financial markets.

Which have culminated in the rather odd and peculiar situation the world finds itself in today.

One turned upside down by zero and negative interest rates. One pushed offside's by preventing bad banks from going under. And one dominated by 180 degree turns in the political arenas.

From our perspective, it is crystal clear that the majority of investors, are completely uneducated towards the current global financial environment.

In some ways, you can't blame them. After all, for many, their informational world is completely monopolized by domineering media, big banks, and perhaps, most harmful of all – social values which force and expect you to behave, eat, sleep and breath "correctly."

And this brings us to today and our latest decision to increase equities.

We've been very transparent and very consistent with our view that we expect the US Dollar and equities to go higher due primarily to a growing crisis in bond markets.

We've also been very transparent and very consistent with our view that corrections will occur and unless serious technical support has been broken, we'll continue with our holdings and strategies.

As an investor, you are well aware that equity markets declined sharply in January 2018 and have largely remained range-bound ever since.

In our February 2018 IceCap Global Outlook we wrote that none of our models were indicating a serious downturn was unfolding and it was very likely that the bottom has been reached and if it was confirmed by our research – we would add to our equity positions.

Well, over the last few weeks our models did in fact turn positive which provided us with a green light to do exactly as we indicated – buy more stocks.

Be Safe!

As a global investment manager, we absolutely reserve the right (and expectation) to change our views and strategies.

At this point in time, our market view remains completely on track.

This means that anyone who is bearish on stocks, bearish on the US Dollar and believes the bond markets will provide safe footing are about to be hit with a major dose of reality.

Reality

A few years ago, I had a conversation that not only caused my head to turn and eyebrows to rise, but it also confirmed my suspicions towards the pension investment industry.

And the conversation was with an 8 year old kid.

Me: “How’s your Dad these days?”

Kid: “Great. Did you know he’s a pension lawyer and pension lawyers can charge higher rates than other lawyers.”

Me: “Well, it is a *faceless client*”

Kid: <now bored and leaves>

As we know, kids do say the darndest things. And we also know, kids know very little about the pension investment industry.

Hence, when I hear the pronouncement about various vendors being able to charge higher fees to pension funds, it only further affirms the inherent dangers and risks within the pension industry.

And it is all due to culture.

Culture is everywhere. It’s in countries. It’s in specific regions of countries. It’s in languages. And it’s in organizations, industries and companies too.

As well, culture is never right or wrong – it is what it is.

Yet, recognizing culture and objectively understanding the pros and cons within a culture is absolutely vital to correctly (and objectively) developing a projection of what will happen.

Although many investors do not have significant direct exposure to the pension industry – especially Defined Benefit Pension plans, everyone has indirect exposures as to how these extraordinarily large pools of money are invested.

The best way to understand how and why, you will be affected by the pension industry’s culture, look no further than the “**greater fool theory**”.

The greater fool theory is quite simple – it means the price of something is determined not by its intrinsic value, but rather by the irrational beliefs and expectations of other buyers.

Don't be so foolish!

In other words, as long as you believe someone else is willing to pay an even higher price than what you paid for something, then you will continue to buy (or hold) that investment.

Knowing this simple concept, and understanding the culture of the pension industry, we'll next show you why and how many of the world's pension schemes will be exposed as fools.

To begin, pension plans were created and are managed to provide people with income during their retirement years.

Individuals and their employer both make regular contributions to the pension fund. This pension fund is then invested to ensure there is enough money available to make payments to the individuals when they retire.

Easy-peasy.

Not so fast.

Because we do not live in a risk-free financial world, the moment the pension industry was born, sharp people with sharp pencils and sharp calculators came out of the wood work.

After all, when you're dealing with pension monies, you're talking about a pool of money that is suppose to last for a very, very long time.

And when you combine a very long time period with a very large number of other moving parts – it has been decided that a very large number of smart people need to be involved to ensure monies are always available to meet retirement payment commitments.

And whenever you have a large group of people bandied together, with the same cause and with the same training and pedigrees – you get group-think, and this is bad, very bad.

This is where culture comes into play. And those who know culture, knows it is extremely difficult to change, move or alter.

And understanding this culture will help you see exactly why the bond market is going to completely blindside the majority of pension plans and turn those happy retirement years into ones of bitter resentment towards those entrusted with keeping everything in-line.

Yes – these are harsh words but they are absolutely needed to be heard, read and then re-heard and re-read.

The best way to explain why the culture of the investment industry will prevent itself from seeing beyond its nose, is to understand how it is structured.

To start with, the pension fund is created by an employer for its employees and the employer is either a company or a government entity.

Live for the future!

Next, you must completely understand there is always a risk that the pension assets (investments) will not be enough to make all of the promised future pension payments.

And, all of this shortfall (deficit) must be made up by the company/government entity.

This is where the risk part comes into play, and this is also where and why all of the consultants, actuaries, pension lawyers, investment committees, trustees and board of directors enter the picture.

As you'll agree, the future is sometimes tricky to predict – especially when you're dealing with how long people live, how healthy they remain while living, and financial market returns.

Yet, the number 1 item that affects all of the above is actually NOT that hard to predict – long-term interest rates.

Yes, long-term interest rates directly or indirectly drives all of the above factors including health and longevity (medical research and discoveries are significantly impacted by funding available which in return is affected by long-term rates).

Therefore, simply understanding where long-term rates are going is really the key to solving the looming pension crisis.

And as we've detailed in our previous IceCap Global Outlook publications, long-term interest rates are on the verge of exploding higher which will create significant losses for everything affected by long-term interest rates – including pension funds.

The reason for this is twofold.

First, practically all pension funds hold anywhere between 15% to 100% of their investment assets in bonds and/or other investments directly affected by interest rates.

The vast majority of the professional investment management industry theorizes that the future cannot be predicted.

The investment industry also lectures that stock markets produce higher returns and than bond markets, and stock markets also contain greater risk than bond markets.

And since pension funds are suppose to be professionally and conservatively managed – they will always err on the side of caution and therefore hold a combination of stocks and bonds.

Which presents us with the *voila moment!*

The preferred mandate for pension funds (as well as the most common strategy for most individual investors) – the balanced fund, or a similar version of the same including life cycle funds, and target dated funds.

Voila!

The key part here is that the culture of the industry whole-heartedly believes that the future cannot be predicted.

Naturally, there's a little bit of truths and untruths in this statements.

Yes, the future is difficult to predict – especially during a mid-cycle period.

No, the future is not difficult to predict – especially during an end-cycle period.

Today, in the land of interest rates – we've reached the end of the mother-of-all interest rates cycles.

And because the pension industry is so tightly wound and wrapped-up in its culture, the majority of those fiduciaries are unable to see the future.

It simply isn't in their genes, and chromosomes and it certainly isn't reflected in the most important make-up of all – their assumptions for the expected long-term rate of return and the discount rate for liabilities.

Let's start first with the Rate of Return Assumption. This number is provided to pension funds by actuaries and it is simply a number used to smooth out return expectations over the life of a pension fund.

The error with these numbers is that it is using past performance to predict future performance.

As any investor will tell you – this is the first disclaimer stamped all over any performance data from every investment fund.

But not the pension fund.

The error with this expected return number lies in the assumption used for fixed income returns.

As fixed income returns are completely dependent upon the directional movement of long-term interest rates, historical data from the past 36 years has completely skewed the average performance returns for the bond market.

Chart (next page) shows the historical yield of the US 10-year Treasury Bond, which is the proxy for global bond markets.

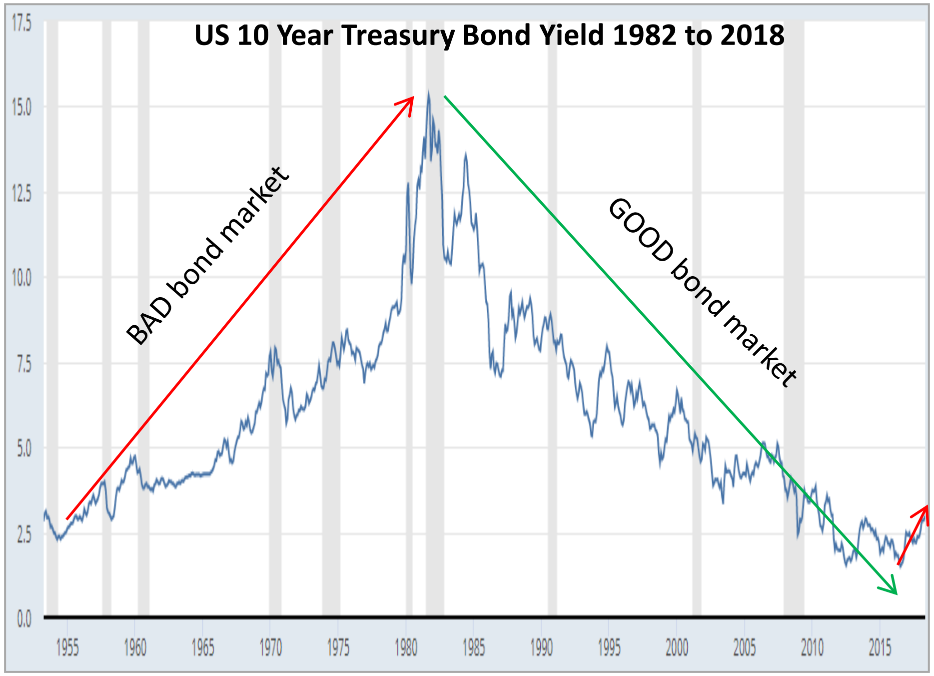
Put simply, when long-term interests are increasing (red line 1960 to 1982), bond funds are horrible investments.

The opposite is also true.

From 1982 to 2018, long-term interest rates (green line) declined, creating the most incredible period ever for bond market returns.

And this simple observation, creates another *voila moment*.

Lower rates for ever!



Virtually everyone working within the industry today either worked during this green arrow period or were trained by mentors who worked during this green arrow period.

In other words – all everyone has ever known is a period of declining long-term interest rates.

This unintentional happenstance is going to produce a lot of angst.

Today, long-term interest rates are at 3%. Which means, the only way possible for bond strategies to return greater than 3% is for long-term interest rates to remain at 3% or lower forever.

We can assure you this will not happen. And anyone who is using bond return estimates greater than 3% will be disappointed.

To demonstrate that there are pension groups that have been blinded by culture, spend a few minutes with the **table on the next page**.

This public data is from one of Canada's largest private sector pension funds and shows the expected long-term rate of returns.

There are several items that jump off the page, with the most significant being:

1) The 55.2% allocation to Nominal Bonds
2) The +3.4% expected return from Nominal Bond strategies

IceCap can assure you that there is zero probability of this pension fund's nominal bond strategies producing a return +3.4% or greater.

In fact, as long-term rates surge higher, the assets in this pension plan will decline -20% or more.

When this occurs, the **culture** of the pension industry reveals itself with board room whispers and proclamations that "no one saw this coming."

We are telling you that it is coming.

Table: 2016 Valuation Data for a Canadian Private Sector Pension Fund

The following table summarizes the DB Component asset mix at the valuation date and the ranges as per the Plan's investment policy, as well as the long-term expected return for each asset class:

	Minimum	Allocation at Valuation Date	Maximum	Long-Term Expected Return
Low Risk Assets ***(target = 70%)***	**60.0%**	**70.0%**	**80.0%**	
Real Return Bonds	5.0%	9.0%	15.0%	2.5%
Nominal Bonds	45.0%	55.2%	75.0%	3.4%
Infrastructure Equity	0.0%	2.6%	10.0%	6.2%
Real Estate	0.0%	0.3%	10.0%	5.4%
Cash & Money Market	0.0%	2.9%	10.0%	2.0%
Return Generating Assets ***(target = 30%)***	**20.0%**	**30.0%**	**40.0%**	
Canadian Equities	0.0%	4.1%	12.0%	6.6%
Non-Canadian Equities	0.0%	14.1%	30.0%	6.6%
Dividend Equities	0.0%	3.8%	7.0%	7.1%
Private Equity	0.0%	3.4%	8.0%	9.8%
Hedge Funds	0.0%	3.0%	10.0%	5.0%
Other(1)	n/a	1.6%	n/a	3.6%

(1) Includes High Yield Bonds, Loans, Risk Parity and units of diversified pooled funds

IceCap Asset Management Ltd.

Be a change agent!

If this guaranteed bond market crisis is coming, and other managers (in addition to IceCap) are telling you it is coming – then why are pension funds so reluctant to take action?

The answer – their culture prevents them from taking action.

Put another way, <u>the fear of making a decision that is not aligned with the status quo is beyond measurement</u>.

In other words, consultants, actuaries, investment managers, trustees, and board's of directors are much more comfortable experiencing losses if everyone else in the industry is also experiencing the very same losses.

Expressed differently, the excuse given by many pension funds (and investment managers) for losing money during the 2008-09 credit crisis was that no one saw this coming, and everyone experienced losses.

Therefore – if no one saw the crisis coming and everyone else had losses, then there is no reason to blame anyone for what happened.

Looking at this from a different perspective; as a trusted fiduciary if you authorise investment strategies for your pension fund that few other pension funds are using, and you are wrong – you can kiss your job good bye.

Quite simply – in the investment world, if you are wrong BUT everyone else is wrong too, you <u>do not</u> lose your job.

The opposite is also true – in the investment world, if you are wrong BUT no one else is wrong, you <u>do</u> lose your job.

There is good news.

We can tell you first hand, there are pension funds that do see these risks, and are restructuring to protect pensioners' assets in the face of a culture which prefers to keep the status quo.

Sadly, these are the minority.

We've also had experiences where despite agreement from key board members, the fund's chief investment officer and CEO refuse to even have the conversation.

This fund has no hope of protecting their pensioners' assets, and it's all due to the culture of the plan.

We know many readers of the IceCap Global Outlook are actuaries, accountants, lawyers, consultants, and investment managers – and this is the point where the actuaries and the lawyers will say rising interest rates will have a zero net effect on the health of the pension plan.

We have to admit – this claim is correct.

Be a winner-winner!

But only in a financial world that has 36 years of history and one that has never experienced a sovereign debt crisis.

And this brings us to the **second** reason why pension funds are set-up to experience significant losses.

All defined benefit pension plans really have two perspectives. One covers the plan's assets, and the other covers the plan's liabilities.

IceCap has been very clear that many plans' assets are at risk of loss of capital.

We'll next detail why pension plans' liabilities are also skewed.

In very simple terms, the ultimate objective of the pension industry is to create a pool of investments that is immune to changes in interest rates.

The experts agree that when rates rise, the value of bonds decline.

The experts also agree that when rates rise, the future liabilities of the pension fund decline.

So, if the mouse trap is built just right – just as assets are declining due to higher interest rates, liabilities are also declining due to higher interest rates.

This nirvana-like scenario produces an experience where the losses are offset by the gains.

Put another way – the ultimate, risk reduction strategy used by armies of actuaries and pension lawyers is to create a WIN-LOSE proposition for your pension assets.

There are two challenges with this strategy.

To start with, why on earth would anyone be happy and content with a win-lose outcome?

Yes, it's better than a lose-lose outcome, but when the probabilities are in complete support of structuring a WIN-WIN outcome – why not consider this as an option? Or at the very least – a discussion?

The answer – culture.

Yes, despite actuaries and pension lawyers dedicating their entire professional lives to the study of numbers – the inability to see beyond their linear thinking perspective has placed trillions of pension assets at risk.

The other challenge facing the interest rate-liability relationship, is the complete absence of dynamic thinking as to what actually happens during a sovereign debt crisis.

Avoid losses make money!

Currently, actuaries and consultants only see the world as one with economic **cycles**.

The mere thought of an end to a **secular** decline in rates is unimaginable.

Two things will happen with the sovereign debt crisis:
1) Long-term rates will skyrocket higher, <u>faster and stronger</u> than any model can predict
2) Losses in the fixed income portfolio will be PERMANENT

And this is where the win-lose goal of liability matching fails.

Permanent losses from fixed income portfolios cannot be recaptured, cannot be reclaimed, and definitely cannot be made-up over time.

When these losses occur, there are less future assets available to meet future liabilities.

Therefore, pension plans who do not restructure their fixed income exposures will turn their win-lose strategy into a lose-lose strategy.

And that's not a strategy anyone would be happy with.

Final Comments on Pension Plans

Yes, we know conversations about pension plans are usually snooze-inducing. But certainly not this one.

Every investor needs to accept that as the bond market crisis re-escalates, not only will losses occur across the entire bond market spectrum, but the reactions from your governments will all be the same – increase your taxes, and decrease government jobs.

This is the peculiar difference between pension plans for companies versus pension plans for government workers.

Whereas all the risk of the corporate sector pension plan ultimately lies with the company (exceptions duly noted), the risk for a government employee pension plan lies with every single tax payer – regardless if you are a member of the pension plan or not.

This material difference also explains (from our experience) why corporate sponsored pension plans are significantly more interested in discussing our solutions for pension plan management.

After all, IceCap solutions has the goal of helping the company AVOID future losses. Yes, we prefer win-win.

Yes, deficits and losses in the pension plan will ultimately have to be made up by additional contributions by the company itself.

And, additional contributions by the company means less money available for earnings, profits, bonuses, and raises.

This is <u>incentivization</u> and it exists all the time in capitalism.

Pay the man!

Government sponsored pension plans are a different story. Losses by the plan rarely effect salaries, bonuses and of course – the non-existent bottom-line.

As well, any deficits of the government pension plans have to be made up by all tax payers!

We've seen government plans where the people in charge have zero experience managing money yet they make more money than most investment managers.

Which is a curious phenomena if you think about. Those entrusted with overseeing pension assets take on no investment risk, yet are paid as if they are taking on investment risk.

As off-kiltered as this seems, the market will eventually take care of this imbalance. Once the bond market crisis hits and pours losses onto these pension plans; pensioners, tax payers, politicians and the media will be out in full force to blame someone.

The final and latest experience we'll share with readers continues to focus on risk.

In this instance, take note of Canada's telecom behemoth – BCE Inc. and its decision to sell the risk in their pension plan to Canada's insurance behemoth – Sun Life Financial Inc.

March 03, 2015

Sun Life and BCE reach groundbreaking $5 billion longevity insurance agreement

BCE shifts pension longevity risk to Sun Life

This break-through deal has been described as win-win.

Under the win-win deal, BCE pension plan pays monthly insurance premiums to Sun Life.

And in exchange for receiving these monthly insurance premiums, Sun Life agrees to pay monthly pension payments into the BCE pension plan .

Put another way, the BCE pension plan has sold its investment risk to Sun Life.

And alternatively, Sun Life has purchased that investment risk.

Which creates the obvious, but very often misunderstood feature of investment risk – it can never be eliminated, removed, or vanquished from the system.

In theory, this groundbreaking deal removes investment risk from the portfolio and will ensure BCE pensioners receive payments for the remainder of their retirement years.

No one else saw it!

In reality, this groundbreaking deal has simply shifted the investment risk from BCE Inc to Sun Life.

And since Sun Life will be making these payments (and other commitments) from its investment portfolio, the natural question is – what risk is in Sun Life's investment portfolio?

Answer: 73% is in various parts of the bond market (source: Sun Life 2017 Financial Statements page 112).

Of course, this is the point where BCE, and Sun Life will both proclaim bond markets are stable, and Sun Life's investment portfolio is rock solid.

As well, Sun Life will also point out how they've reinsured some of this risk with RGA Canada and SCOR Global Life – who both have their investment portfolios crammed full of, you guessed it – bonds.

This is the exact same situation that happened in 2008 with the American insurance behemoth – AIG.

Back then, AIG was required to pay out billions in insurance claims to Goldman Sachs and others, yet their investment portfolios collapsed due to holding housing market securities.

If not for the apathy of the US tax payer and its bailout of AIG, Goldman Sachs would not exist today.

Pension Funds

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

If you are a fiduciary of a pension fund, we invite you to contact us directly, and have an open conversation about your fund's assets and opportunities to improve its exposures.

IceCap offers 4 different solutions for pension funds.

Contact directly:

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Translated into today's investment world, BCE pensioners AND BCE Inc are now completely exposed to the balance sheet of Sun Life, who in return is exposed to the balance sheets of RGA Canada and SCOR Global Life.

Put another way, when the sovereign debt crisis re-escalates, the risk from bond losses will spread very quickly throughout the system.

And this will be accepted as okay – because no one else saw it coming.

King Dollar!

Why our view has not changed

At IceCap, our investment outlook has not changed, and we'll next tell you why.

The world remains on course to experience a significant, life-altering crisis in the bond market.

No matter which way you slice 'em and dice 'em, the facts continue to confirm the sovereign debt world will be rocked by a crisis never before seen or experienced by today's investment professionals.

To start, once again you need to look no further than Europe.

In February 2018 IceCap Global Outlook, we detailed why Italy was on the verge of forcing the sovereign debt crisis in the Eurozone to re-escalate.

Four months later, we've been proven correct, and we'll tell you why this was very easy to see.

At the time, Italians were headed to the polls and the two leading political parties had a very common theme to their platform: let's stick it to Brussels, Germany and the Eurozone.

Once the election concluded, the very same two parties who were leading the polls, with the very same political mandate finished ahead of everyone else.

But even more importantly - the pro-EU, incumbent party lost and lost badly.

This is important to understand, because knowing this (and not attributing the election outcome to extreme-anti-establishment crazies) will help you better see why the sovereign debt crisis re-escalates in Europe.

We've stated before that as an investment manager, it is absolutely critical to check your political beliefs at the door.

Yet incredulously, we see, hear and feel the extreme disdain by other investment managers for various political parties, individuals, and ideologies in numerous countries and markets.

We cannot stress enough – managers MUST remain geopolitically objective.

Around the world, established political parties and career politicians are being booted to the curb.

This does not represent a love for the newly elected politicians – it represents an absolute dislike for the incumbents.

Understanding this is critical.

Play nice!

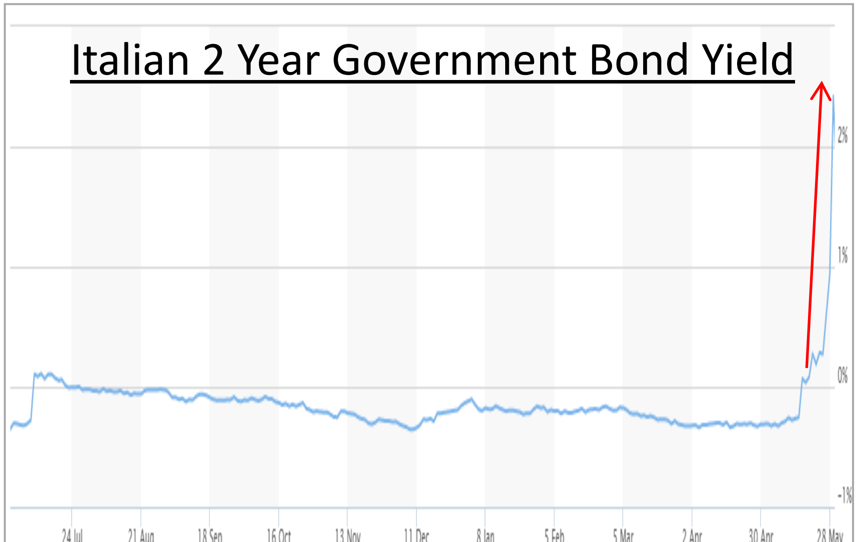
Carrying this one step further, anything associated with the established political class will (rightly or wrongly) also be booted to the curb.

Enter Italy.

The moment the pro-EU party was booted to the curb, those in Brussels and Berlin waited anxiously to see how this new Italian political coalition would react.

And react they did – by appointing a hard-line, Euro-skeptic as Finance Minister.

Brussels, and Berlin reacted by doing THIS:



Source: MarketWatch

THIS is why the Eurozone sovereign debt crisis re-escalates.

Note:

1) The chart shows the interest rate the Italian government must pay to borrow money for two years.
2) Italy spends more money than it collects in taxes, which means it must constantly borrow money by issuing bonds.
3) The ONLY buyer of these bonds is the European Central Bank (ECB), which means private investors have decided not to touch Italian debt with a 10 foot pole.
4) Since, private investors refuse to buy Italian government debt the true/real price of Italian government bonds is not known.
5) Which means the current price and interest rate of Italian government bonds is completely manipulated by the ECB.
6) The ECB is printing money to artificially suppress the interest rate Eurozone governments pay when they borrow.
7) Which means, without the ECB printing money, interest rates across the Eurozone would surge.

Which brings us back to the chart on this page.

Many investors (and investment managers) remain ignorant as to how the world works – and it isn't full of niceties.

And that is what happened between Italy and Brussels/Germany.

Within minutes of Italy announcing their choice for Finance Minister, the ECB (as instructed by Brussels/Germany) immediately stopped buying Italian bonds.

Know who you're playing with!

And as the true price of everything in the world is determined by what someone will pay it – the price of Italian bonds went into freefall causing the yield to surge higher.

The yield on the Italian 2-year government bond instantly surged from +0.4% to 2.5% before the ECB decided to stop the massacre.

While many in the investment world (especially those outside of Italy) were unaware of this event – this "shot across the bow" was a deliberate message from Brussels/Germany to the newly elected Italian government – don't mess with us, or we'll do the same to you as we did to the Greeks.

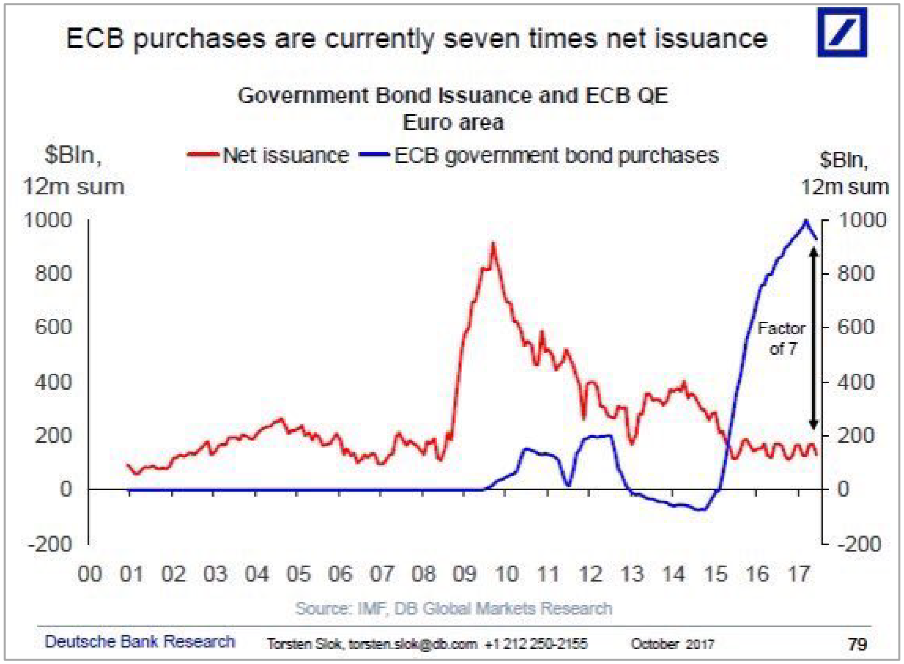
While it may not seem like a big deal – this was a BIG TIME nasty and mean deal.

We are telling you, there is an extremely high probability this escalates to the point which will be seen as the snap that cracks the bond bubble.

The only reason governments across the Eurozone can borrow at the lowest interest rates ever recorded is due to the ECB printing money to buy all the debt.

Chart on this page, shows the ECB as buying over 7 times the net issuance of sovereign debt by Eurozone countries (including Italy).

This means two things:



One, the ECB and their money printing machine is the ONLY buyer of Eurozone sovereign debt.

Two, because their purchases are greater than issuance – private investors are lined up to sell their holdings of Eurozone sovereign debt.

Obviously, the ECB isn't aware of the Greater Fool Theory.

You can also think of it this way – at the poker table, there is always a patsy. And if you do not know who the patsy is, then the chances are it is you.

Blink-182!

So, at the Eurozone sovereign debt poker table – who do you think is the patsy:

-The ECB buying sovereign debt at the lowest (and sometimes negative) rates ever recorded?

- Or the private investors who are selling sovereign debt at the lowest (and sometimes negative) rates ever recorded?

The ECB is headed by Mario Draghi and his term is up in 2019. His successor will undoubtedly be a German who is completely against monetizing southern Europe's fiscal malfeasances.

German Chancellor Merkel is on the political ropes. A full 68% of Germans did not vote for her in the last election. And the ONLY reason she remains in power is due to the fragile coalition with the CSU party which is distancing themselves from Merkel.

Chancellor Merkel represents the political establishment and she alone (without any blessings from other EU members) opened Europe's borders to African and middle eastern migrants.

Yet, instead of a cohesive, harmonious group - country after country is saying no to further immigration and have started to block boats, build walls, construct fences, and publicly announce that immigrants are no longer welcomed.

And finally, you have Italy where the majority have now stated they recognize that the Euro has been a financial anchor around their neck, and German policies of fiscal prudence has been a chained ball around their ankles.

Italy is the 3rd largest borrower in the world – it cannot be pushed around like the Irish, the Portuguese, the Greeks, and the Cypriots.

Regardless of who blinks first – the blink will occur.

Either Italy effectively leaves the Eurozone by developing their own fiscal guidelines and currency, or Italy is provided concessions to remain which only further increases tensions with other Eurozone countries who have played by the rules, and Germany who ultimately has to fund the bailouts.

The outlier of course, is for Germany to shock the world and leave the Eurozone (more on this in future publications).

This is the combination that will trigger the eruption in sovereign debt markets. And because this crisis is in the bond market, it will spread around the word and across all bond markets.

Including pension funds.

Be proactive!

Banks, Insurance & Fund Companies

Dear executives and key management at banks, insurance and mutual fund companies;

If they haven't already, it is only a matter of time before your investment clients begin asking for solutions to address the imbalances across global financial markets.

Partnering with IceCap Asset Management, we can provide solutions in various fund structures to directly address your clients' questions and concerns.

This is your chance to be proactive, improve relationships across your client base, and gain market share against your competitors.

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Our Strategy

Bonds

No changes. Yes, the yield curve is flattening. And yes we agree that growth will slow in 2019. However, long-term rates will surge due to re-escalation of sovereign debt crisis. Some of our best investment ideas are on the short side within different fixed income markets.

Stocks

Changes – we increased equities with an increased allocation to US stocks. Contrary to the headline news and market doomsayers – our data is currently not indicating any massive sell-off in stocks.

Currencies

We remain structured to benefit from a strengthening USD. A slowing global economy combined with a declining supply of US Treasuries creates a perfect environment for a very strong USD. Add in a sovereign debt crisis and the USD will surge.

Commodities

We've been completely wrong on crude oil. The current rally in crude has been exceptional and we missed it.

We've been completely right on gold. Despite strong fundamental reasons to hold gold, gold remains incredibly weak from a technical perspective. We'll remain patient and buy gold when conditions improve.

We're growing!

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

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

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

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We want Partners

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

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