IceCap
Asset Management Ltd.

Our view on global investment markets:

October 2020 – "Hysteria"

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Oh, I get hysterical

LONDON (August 3, 1987): British hard rock band Def Leppard releases their new album "Hysteria" and the hysteria begins.

Pouring sugar on people, biting love and running around riot - the album combined the band's hard rock heritage with a blend of softer pop to create a hysteria that swept the music world into a frenzy.

The album would go on to sell over 25 million copies worldwide, demand a sold-out 16 month concert tour, and make big, long hair cool for teenagers during their awkward years.

And then, as fast as the hysteria began - it ended.

The hard rock icons continued to attract attention from their loyal fan base, but as time passed, the hysteria never returned.

In the investment world today, another sudden hysteria has gripped markets, keeping investors and the media on the edge of their seats.

According to many, the US Dollar has apparently begun a cascading descent that will end the days of USD supremacy and its reserve currency status.

In this **IceCap Global Outlook**, we'll share how this US Dollar hysteria will also stop suddenly, and King Dollar will once again do what it was designed to do - rule the global financial system.

Understanding the role of the US Dollar and how it drives all markets, really is the key to navigating through these incredibly awkward, monetary times.

It is true, the US Dollar will *eventually* lose its reserve currency status, but for this to occur, a few other hysterical financial moments have to occur first.

WKRP in Cincinnati

"As God as my witness, I thought turkeys could fly". This classic quote from the classic American TV show encapsulates the investment industry's view of the emerging market world.

In the investment world, the emerging market universe includes countries who are" transitioning from a low income, less developed, often pre-industrial economy towards a modern, industrial economy with a higher standard of living" (source: Investopedia).

Put another way, these countries and economies are about to fly and are on the verge of becoming the next great investment market. And all they need to succeed is capital investments from people in the developed world.

It is for this reason, emerging market funds and strategies have always been a perennial favourite for all major and minor brokerage houses around the globe.

Yet naturally, like any investment opportunity, risks are everywhere. And the one major risk of any emerging market country is its sudden inability to receive US Dollars via trade and investment.

déjà vu all over again

We've shared before how the financial world is completely dependent upon US Dollars to function, and the moment the supply and flow of US Dollars is interrupted - very bad things happen.

Case in point - Turkey.

Recently, **IceCap Global Strategist, Keith Oland** published an in-depth report on why we believe Turkey is on the verge of experiencing a severe financial crisis. The report can be found on our website [here](#).

The primary reason Turkey is on our alert radar is due to its economy, banking system and central bank experiencing a severe shortage of US Dollars coming into the country.

When this happens for an emerging market country, the cracks first begin to appear in the local currency.

Chart (next column) shows how the Turkish LIRA has been declining lower now for over 5 years, with the most recent crisis occurring in 2018 when the Lira dropped -43% relative to the US Dollar.

What catches our attention is how the 2018 crisis wasn't specific to Turkey. During the same period, the Brazilian Real declined -18%; the Russian Ruble also dropped -18%; and the Indian Rupee fell -15% at its lowest point.

The point we make is that despite investment industry claims that each emerging market country is unique and independent from each other,

contagion is very real in this space and all it takes is the slightest nudge to loosen the first olive in the jar. Of course, once that first olive moves, the rest come tumbling out.

We believe Turkey could become that olive and be the trigger event that could give every investor in both emerging AND developed markets a reason to reduce their portfolio risk by selling anything that isn't bolted to the ground.

To demonstrate how this happens, consider the following charts and perspectives.

Wax on, wax off

In the investment world we often simplify the current market trend by saying it is **risk-on** or **risk-off**.

A **risk-on** market means stocks and other growth focussed markets are rising rapidly, and the US Dollar is usually declining.

A **risk-off** market is one where these markets are selling off rapidly, while the US Dollar is usually rising.

The **chart to the left** shows the recent movements of American stocks (S&P 500 Index) and the Euro currency.

Both are positively correlated and both have really taken off since the market lows in March 2020.

Another point to consider is that during times of strong market movements, investors are constantly looking for a reason to close their positions, take profits and live to invest another day.

March 2020 to current day, is one of those risk-on periods.

Investors (especially technology stock investors) have made a lot of money in this time period and are now feeling edgy and are starting to look around for a reason to sell.

And just as a jar of olives only needs one little olive to move to get things going, the same is true with risk-on markets.

Everybody loves Euro

The chart on the previous page demonstrated the high positive correlation between equity markets as proxied by the S&P500 and the Euro currency.

Therefore, a trigger event causing either market to decline should drag the other market down. Kinda like a guilty by association scenario.

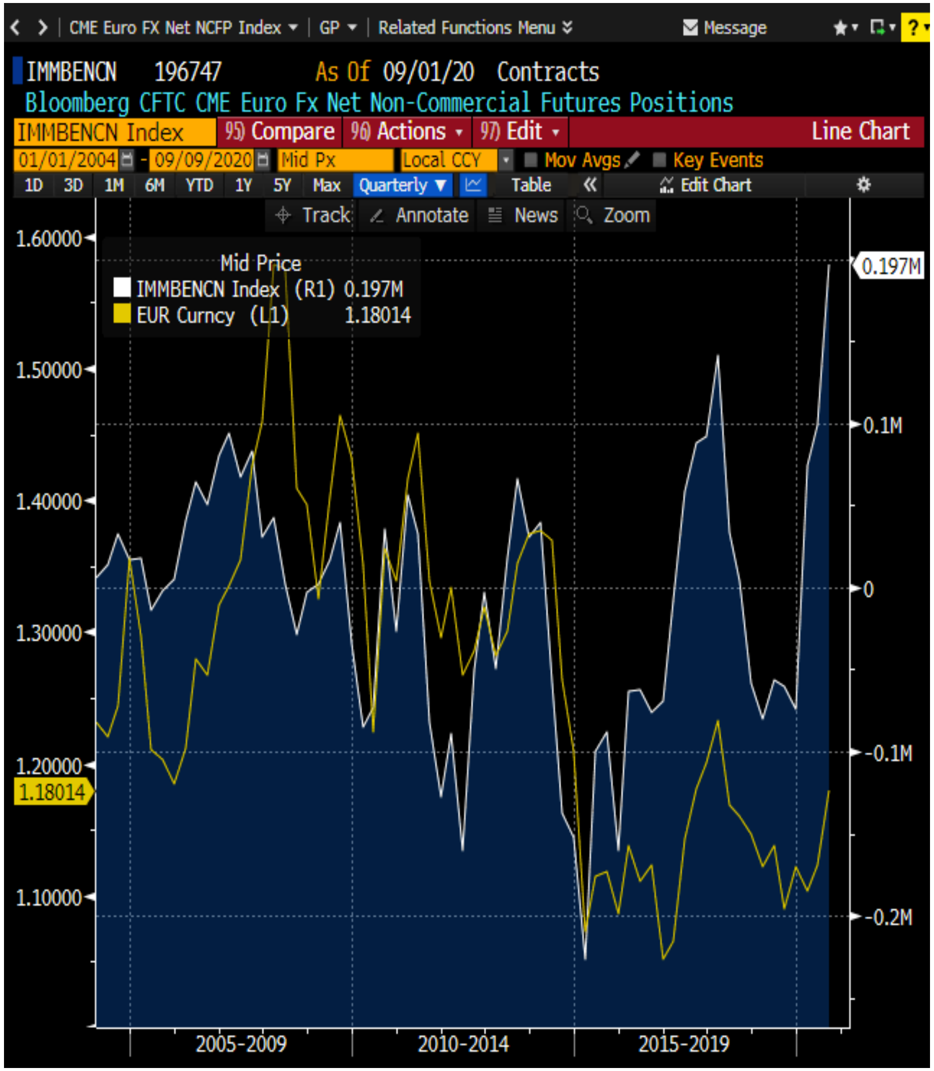
The **chart to the right** shows the excessive bullishness for the Euro currency. The white line quantifies the net positions by hedge funds, and the yellow line shows the price line for the Euro currency.

As you can see, the yellow line (Euro currency) usually follows the white line (hedge fund positioning).

This chart is of interest because it demonstrates the current bullish hysteria of investors in the Euro currency. In fact, using this metric, it is accurate to conclude that this is the most bullish investors have ever been on the Euro currency since its inception in 1998.

Now, this may create a little bit of confusion, but understand in the investment world when the majority like something, by definition there are fewer investors remaining to buy that something.

This is exactly the case for the Euro currency today. The measurement of sentiment has never been higher, which suggests that if there is any trigger event, a lot of investors could begin selling Euro in a hurry.



It’s easy to see if you look

And any event that causes Euro to decline, will likely lead to the stock market declining.

The 1997 Asian Currency Crisis began in July with stress in Thailand - a mere minnow in the global financial system.

Days later, Malaysia spun out of control.

Next month saw Indonesia screaming for mercy, followed next by effectively every other country in the region including South Korea.

Back in those days, I worked for a major Canadian bank and after each Asian country entered crisis, we were told fables including:

- Thailand’s economy is smaller than Ontario’s economy;
- Canada has limited net trade with each country;
- Canadian banks have no lending or banking exposures to these countries.

Put another way - don’t worry, be happy.

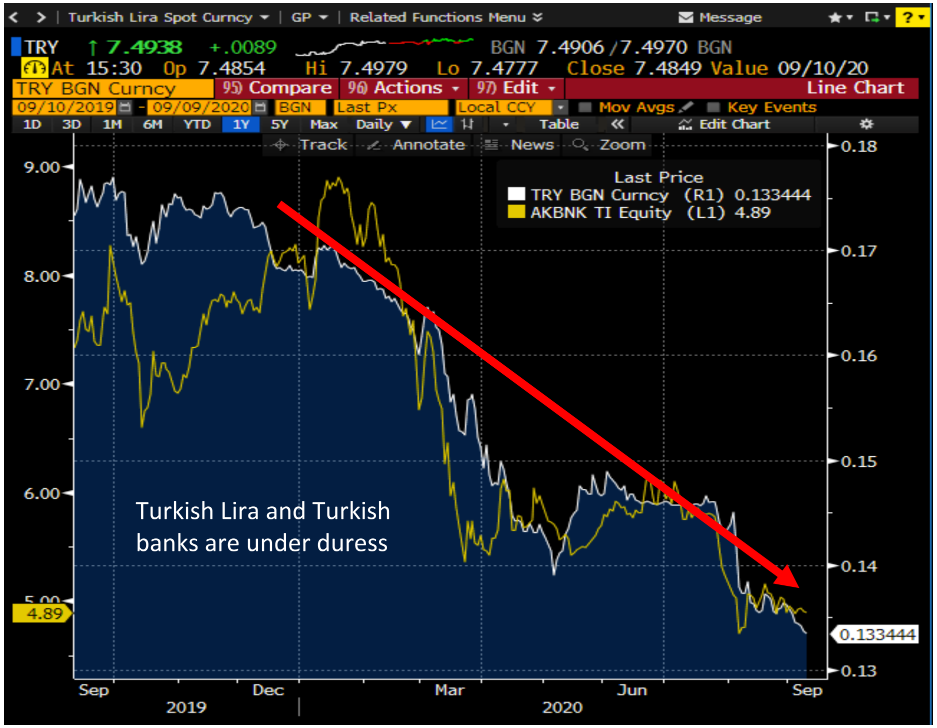
A few months later, the Canadian Dollar was down 10%, the economy slowed from +5% GDP growth to to +2% GDP Growth, and most Canadian bank stocks declined -40%.

The point we make is that trigger events can come from out of the blue, and at first may appear immaterial or insignificant to the bigger picture.

Which brings us to Turkey.

Turkey is experiencing a slow burning monetary/fiscal/geopolitical crisis. We expect this slow burn to develop into a fast burning flame which could turn into a trigger event, just like the one from 1997 Asian.

Turkish Lira $TRY is on verge of a significant devaluation, which in turn will be very negative for Turkish equities including banks.



Contagion

The risk with the developing crisis in Turkey is that it spreads to other markets.

One of these markets is European banks and specifically Spanish banks.

This is the point where MOST believe contagion is not possible. Yet, we know contagion is started by the smallest, unexpected event. The probability of Turkey being this event is a higher than expected probability.

Spanish banks have exposure to Turkish banks and the Turkish economy. IceCap and other firms have previously detailed how the European banking system has become zombified - meaning, they are mostly surviving due to monetary-fantasyland-like support from the European Central Bank (ECB).

If bad loans were appropriately charged against capital, most European banks would be impaired and face an inability to raise capital from private investors.

Spanish bank BBVA is one of these banks and it has significant exposure to Turkey.

And considering that even BEFORE the crisis in Turkey spins out of control, BBVA's stock price is already back to 1995 levels.

In other words, that's a 0% capital return on a 25 year investment.

European Banks back to 1990s lows

If BBVA enters crisis, so too will other Spanish banks which will then likely spread to other European banks whose stock prices are also testing record lows. **Chart on the left** shows French bank BNP Paribas which is back to 1998 levels. Yes, that's 22 years of 0% growth from one of the European jewels of the banking world.

Again, we are pointing out facts that support the view that European banks have become zombified and have become unattractive to private investors.

And if European banks experience increased stress, it's highly likely it will spread to broader European and other developed world equity markets.

Of course, along the way other emerging market economies including Brazil, South Africa, Chile and others are judged guilty, by association.

This will result in a sudden shift from **risk-on** to **risk-off**.

Remember, during times of a sudden re-escalation in market stress, capital surges towards a place to rest comfortably.

And in the investment world, the biggest, deepest and most liquid place to rest comfortably is the US Dollar and the US Treasury market.

Objectivity is non-existent

USD Crashing Hysteria

In the investment world, several markets have at some point in time become lightning rods for emotional, irrational and nonsensical reactions.

In fact the response to short-term movements has become so severe that objectivity has been shamed out of all conversations.

The crashing of the US Dollar is one of these markets.

In no specific order, the foundational arguments for this end-of-an-empire perspective are based upon the following:

- The twin deficits
- Spiralling debt
- Money printing
- 0% interest rates
- Bankrupt social security
- Social unrest
- Extreme Politics
- Deteriorating military

And this is just a Monday morning list. By Friday, the list has undoubtedly multiplied several times over.

For those adverse to lists, the column to the right shares headlines from various media showing nothing but doom and gloom for the US Dollar.

Forex | Market Outlook

The U.S. Dollar May Be Due For A Collapse

Aug. 4, 2020 3:32 PM ET | About: Invesco DB USD Bullish ETF (UUP), Includes: GLD

What a U.S. Dollar Crash Might Mean for Canadian Investors

Victoria Hetherington | June 19, 2020

Markets

How the Coming Crash in the Dollar Will Unfold

The argument that there is no alternative to the U.S. currency makes little sense.

By Stephen Roach
June 14, 2020, 7:00 PM ADT

Economy / China Economy

US dollar at risk of sudden collapse? Ex-IMF official warns 'blow-up event' could sink currency as debt mounts

Currencies

Dollar could be a 'crash risk' if U.S. loses 'credibility,' analyst warns

Last Updated: Aug. 3, 2020 at 5:53 p.m. ET
First Published: Aug. 3, 2020 at 5:33 p.m. ET

By William Watts

Take a break

Seeing it this way, one has to admit, the outlook looks pretty dim, justifying the hysteria.

Yet, this is exactly when and where a pause is needed. A pause that refreshes, one that discards the hysteria and clarifies the outlook.

This is where IceCap comes into the picture.

And this is where we will be very clear:

- The US Dollar is NOT collapsing; and
- The US Dollar is NOT *currently* in danger of losing its status as the world's reserve currency

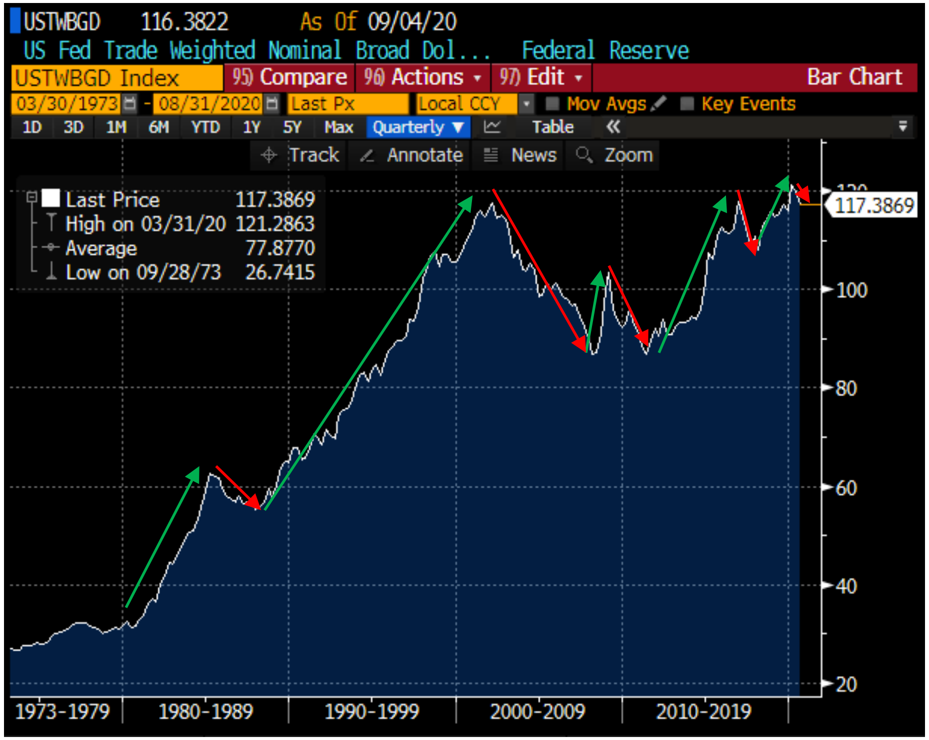
And to avoid further confusion - yes, the US Dollar will eventually lose its world reserve currency status; but a whole lot of other things have to happen first.

Over the last 6 months, using broad based currency indices, the US Dollar has declined between -8% to -10%.

In the currency world, this kind of decline can be a big deal - especially for an emerging market currency, and even more of a big deal if it happens relative to every other currency

Yet, like all big deals it's best to put things into an objective perspective.

Here's the long-term chart of the US Dollar as measured against a basket of currencies determined based upon trade weighted flows. Kindly note, this is the preferred currency basket used by the US Federal Reserve.



Over time, there's certainly been a few major, long-term moves with each illustrated by strong USD periods (green arrow) and weak USD periods (red arrow).

Emerging Markets !

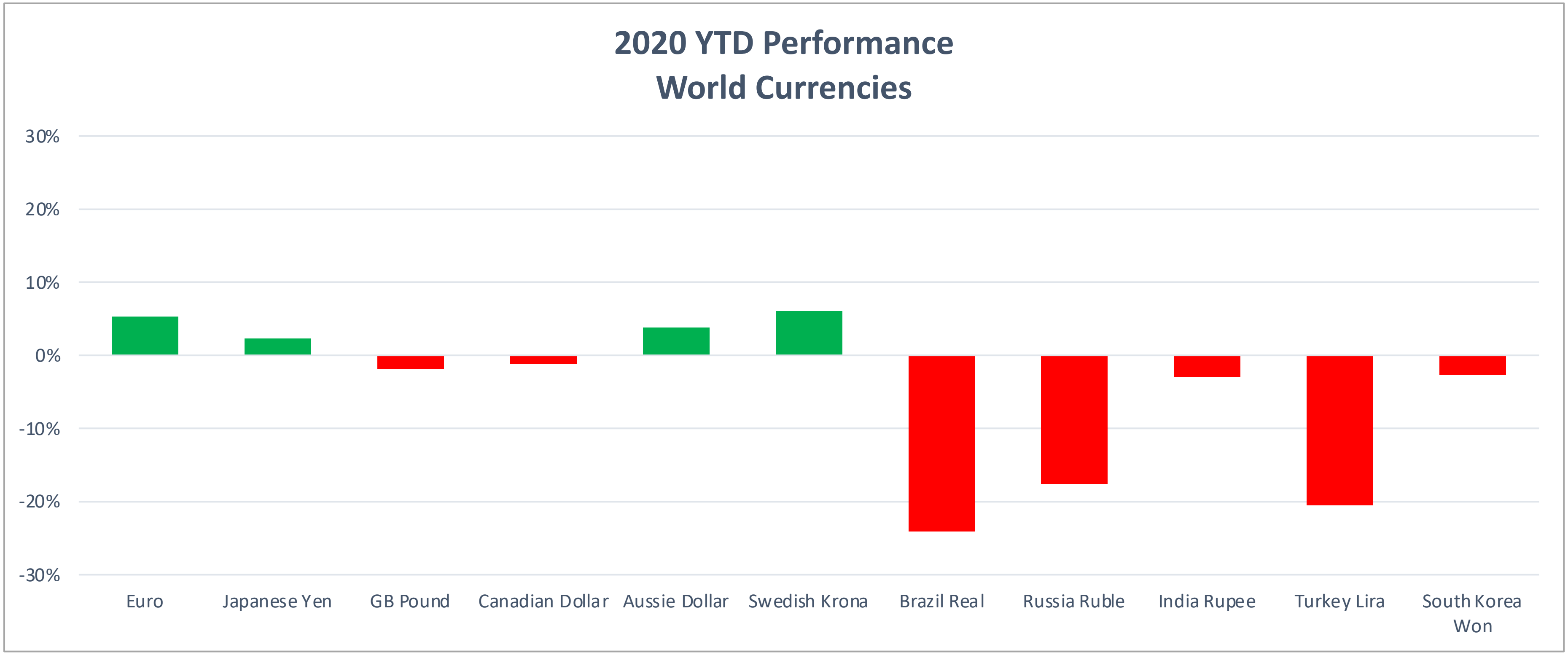
Yet, this is where objectivity needs some attention. The current US Dollar decline is in the top right corner of the chart on the previous page and it is barely noticeable. It barely registers on any crisis meter, and most importantly - it's a big fat zero on the hysteria meter.

On a shorter-term basis, here are the performance numbers for various major currencies and emerging market currencies in 2020:

Objectively, the only hysteria in the 2020 currency world remains in the emerging market universe.

The US Dollar has softened relative to some currencies, but by in large the fact remains, the "US Dollar is crashing hysteria" is not happening at this moment in time.

To fully understand why it isn't happening at this moment in time, we'll bring you back in time - all the way back to 1944.



Unshackle your mind

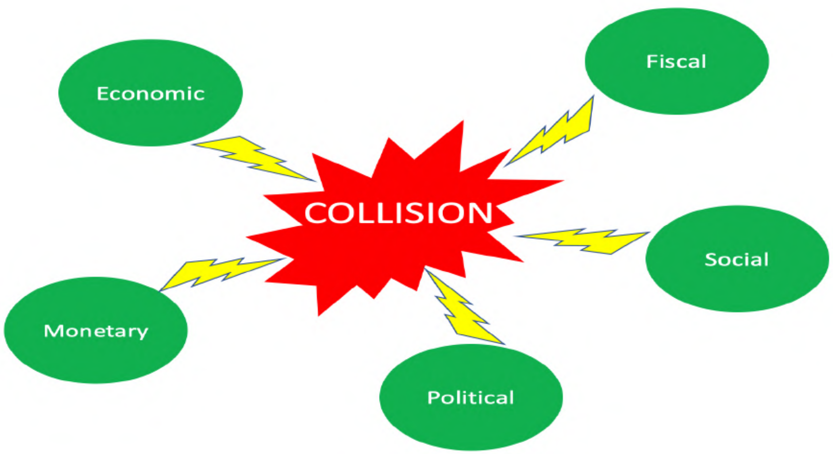
The 75-Year Cycle

Perhaps one of the single biggest faults of the investment INDUSTRY and MEDIA today is the heightened focus on short-term movements and the complete lack of focus on long-term movements.

To properly understand why and how the US Dollar is not crashing nor on the verge of losing its world reserve currency status, one has to go all the way back to 1944, New Hampshire, USA.

In fact, if the industry and media sat everyone down and shared the following little chat, there would be a whole lot less confusion in the money world.

And to make this simple - the world has now completed a 75-year cycle and the end to this cycle is unleashing a collision across the following factors:



Put another way, the end of this 75-year cycle has a created a collision between virtually every aspect of our daily lives.

Yet, because this is the end of a 75-year cycle, and few ever really experience a 75-year cycle - the media, industries, schools, and governments are unable to see this critical turning point.

Ironically, most can feel this turning point across several of these factors - yet most cannot articulate and decipher what they are feeling, and why.

And if one cannot see this turning point, then it is virtually impossible to recognize the turning point, and what is about to happen next.

However, for those who are able to unshackle their mind, they can see how the financial, monetary and economic world has grown over the last 75 years. They'll gain a sense of clarity and understanding of why the system is moving as it is.

More importantly, they'll understand why the US Dollar is not crashing, and why a few other things must occur before the US Dollar surrenders its world reserve currency status.

To start on this journey, understand that immediately after WW2, the world's Allied leaders gathered in Breton Woods, New Hampshire to create the Bretton Woods Agreement and a new financial world order.

Climb Mount Washington

The Bretton Woods Agreement included several major decisions culminating in the following:

1. Creation of the World Bank
2. Creation of the International Monetary Fund (IMF)
3. To fix or peg all currencies to the US Dollar
4. To fix or peg the US Dollar to Gold
5. Adoption of Keynesian Economic Theory to govern future fiscal and monetary policy decisions

Now here we are, 75 years and the last fragments of the Bretton Woods Agreement have practically unravelled.

The effectiveness of the World Bank and IMF has diminished with each passing crisis.

Meanwhile, excluding China, Hong Kong and Saudi Arabia, the majority of currencies around the world are no longer pegged to the US Dollar.

And finally, the US Dollar is no longer pegged to the price of gold.

Which brings us to the last and final remaining policy piece from the Bretton Woods Agreement that is still etched into the minds of our political and monetary leaders - *Keynesian Economic Theory*.

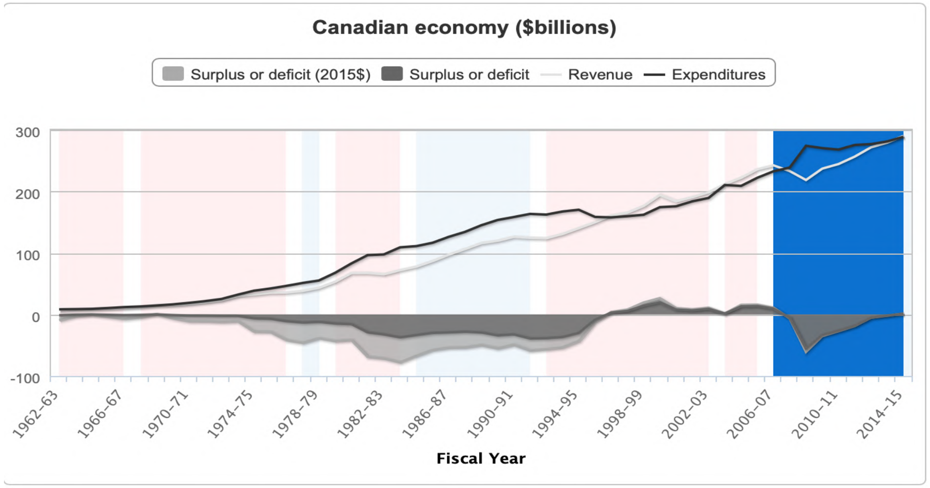
Next, as we move into a easy to understand discussion of Keynesian Economic Theory, we ask you to think about your own country, province, state or territory and its current fiscal position.

For example, here in Canada we've now seen a 5-year progression where the Federal Government has increasingly spent more money than they've collected in taxes.

This isn't a condemnation of the government - rather, from an investment management perspective, it is what it is.

In fact, assessing fiscal balances from all governments over the last 6 decades all point to the same conclusion - they sure do like their debt.

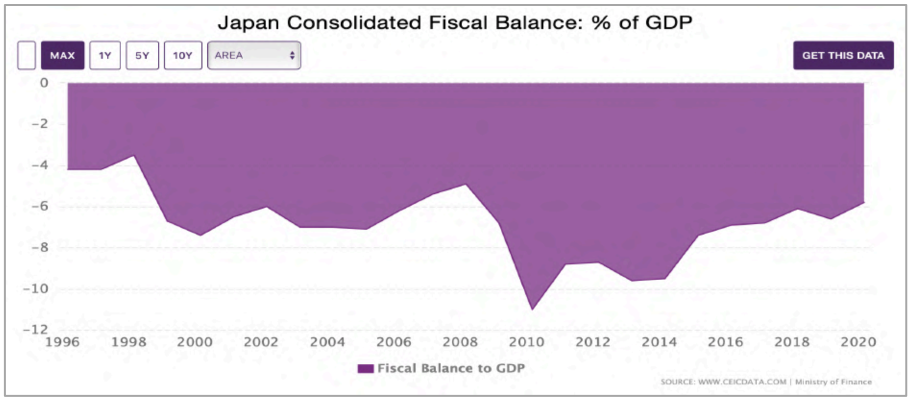
Here's the Canadian experience over nearly 50 years. Aside from a brief period of (manufactured) surpluses, the country has demonstrated time and time again an inability to spend less than what it collects in taxes.



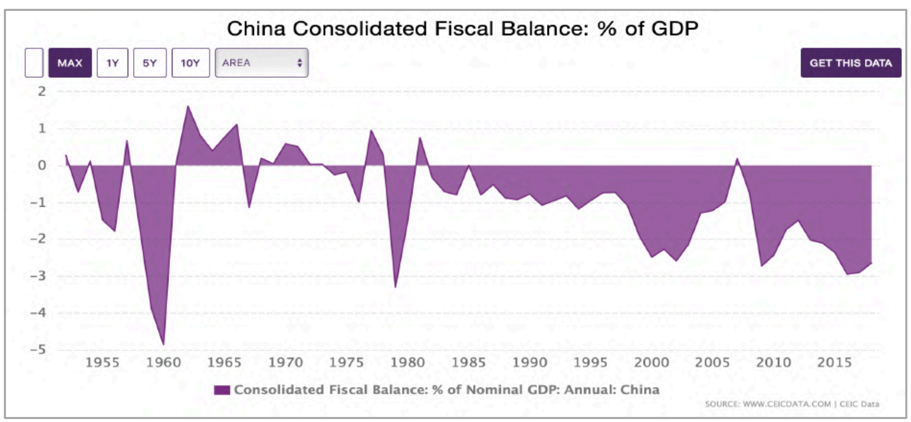
There's no stopping it now

Yet, this isn't just a Canadian story. All around the world, deficits and borrowing have become a cultural foundation for every country, government and political party.

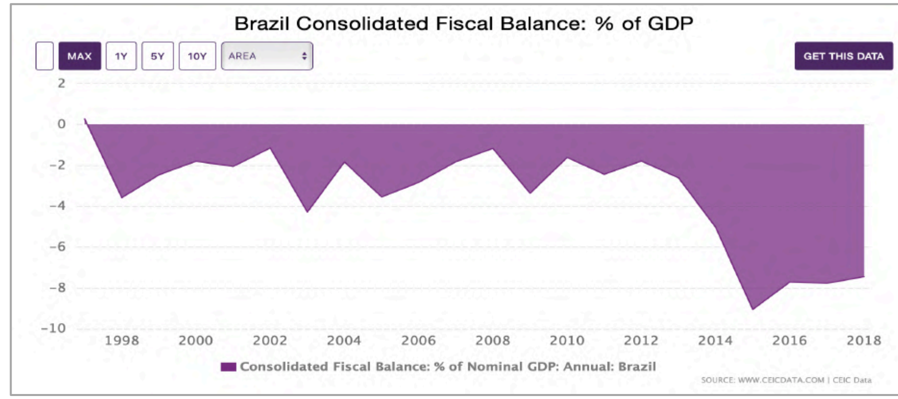
Here's Japan:



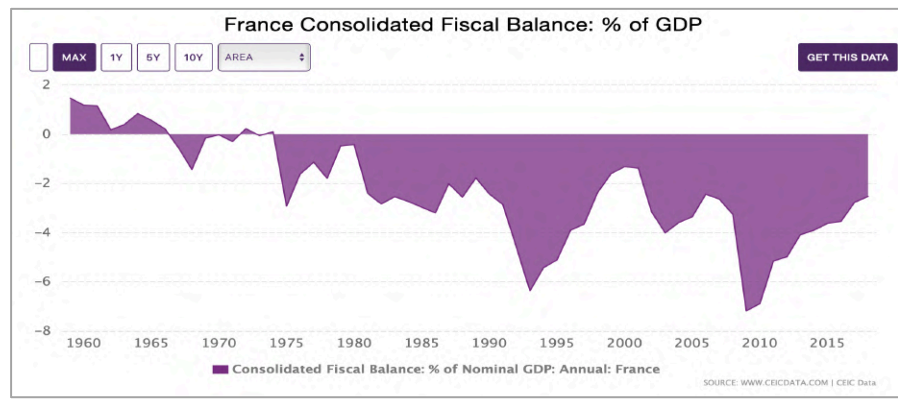
And China:



And Brazil:



And France:



Every where you look, governments and countries have become really good at spending more than they collect in taxes.

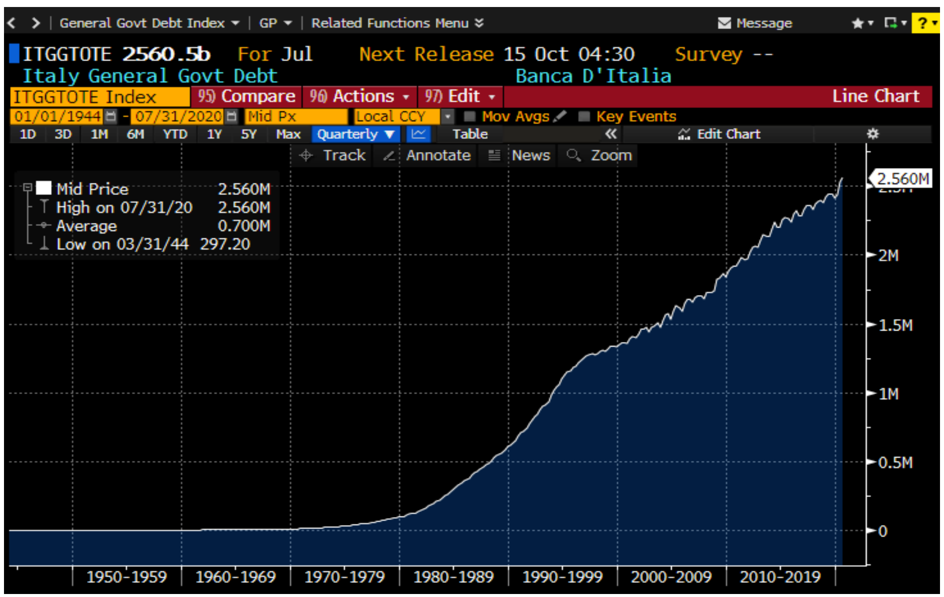
Can policy makers influence the economy?

One of the main beliefs of Keynesian Economic Theory is that a government is able to influence, shape and affect its economy by injecting stimulus through borrowing and spending.

The point we are making, is that EVERY country has been injecting stimulus into their economies now for a very long time. This is demonstrated in the **chart below**:

And it's been such a long period of time now that debt loads around the world have exploded higher.

Here's Italy's debt growth since 1944:



Meanwhile in China, despite a reputation as being a gigantic, economic growth machine – is now being understood by investors as having achieved this growth by heavily using debt.

November 12, 2018 | Andreas Kern

Shades of 2008 – Unprecedented Levels of China's Debt Threaten the Entire Global Economy

What makes this chronic spendthrift lifestyle so unbelievable is that politicians and policy makers have completely forgotten why they are spending more money than they are collecting in taxes.

And even more terrifying (or disappointing, or both) is that these groups have become completely desensitized to this financial calamity.

What follows next, is of course, a blanket statement. However we challenge any government and central bank to convince us otherwise:

Central banks have enabled excessive borrowing

The culture within and across governments around the world has completely developed to the point where deficits and debt are always considered good.

The opposite has also occurred.

Many times when a government has found itself in a fiscal SURPLUS position - pet projects come out of the woodwork seeking their share of this money pie.

Put another way, most policy makers either don't care, don't understand, or claim it isn't their responsibility to be fiscally responsible.

The next time you have an opportunity to speak with anyone in government, feel free to ask them about the effectiveness of Keynesian Economic Theory and fiscal stimulus through deficit spending.

We suspect most will respond with the usual rhetoric how they do not like running deficits and accumulating debt, but it is necessary to help people get back onto their financial feet.

Debt can also be viewed as the total of net deficits over the history of time. And since practically every country has been running deficits forever, and practically every country has the inability to stop running deficits; total global debt will continue to grow exponentially until something happens to stop this growth.

IceCap will write about debt forgiveness and jubilees in an upcoming IceCap Global Outlook.

For now, understand that the first half of Keynesian Economic Theory involves governments borrowing and spending to stimulate the economy - and this debt bonanza has been happening now for nearly 75 years.

Of course, this 75 year money party has been completely enabled by the Keynesian partner in crime - the central banks.

The other half of Keynesian Economic Theory focuses on controlling interest rates.

The belief is that lower interest rates will stimulate the economy, and higher rates will slow down the economy.

While Ministers of Finance and Treasuries have lived a lustful life of pressing the Keynesian Spending Pedal to the Metal - their central bank brethren have occasionally shown restraint.

Yes, sometimes central bankers have actually raised interest rates.

Occasionally the need to slow inflation or to support their currency has gotten in the way of providing stimulus.

The key word here of course is "occasionally".

Keynesian Economics is ineffective

Chart below details precisely how committed central banks have been to providing stimulus in the way of lower and lower interest rates.

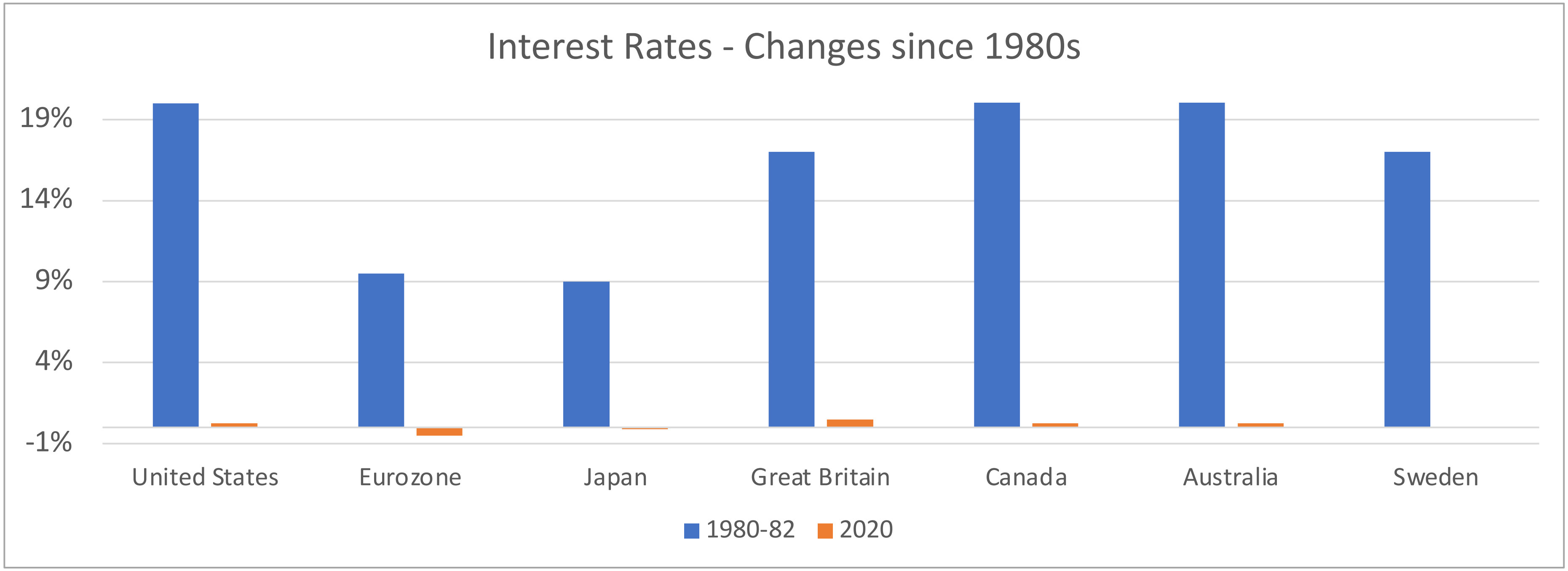
For example, in 1982 the United States Federal Reserve had set over-night interest rates at +20%. Today, they are at +0.25%.

Over 30 years ago, the Bank of Canada had over-night rates of +21%, and today it is +0.25%.

The Europeans of course have taken Keynesian Economic Theory to the nth degree. Using Germany as the proxy 30 years ago, showed the over-night rate = +9.50%. Today, the Eurozone has over-night rates of -0.50%. And, yes that is a NEGATIVE sign.

One of the key outcomes of central banks' continuously cutting interest rates, is that it has completely enabled governments to consistently borrow, increasingly higher amounts.

Yes, one is literally feeding off the other.



We've run out of interest rates

What we find funny and peculiar about Keynesian Economic Theory is the following:

1. World leaders have agreed it is the only way to manage the world's economy.
2. Yet, after 75 years of applying Keynesian Economic Theory everyone has become trapped in a fiscal and monetary nightmare.

One would think that after 75 years of using such an optimal and efficient approach to fiscal and monetary policies, the world would have no debt, no booms, no busts, no crises and a whole lot of happy people.

Yet, here we are, 75 years later and there are no more interest rates left to cut. Government borrowing is only continuing due to extreme assistance from central banks, and financial & economic crises are occurring frequently and across many countries, regions and markets.

Continuously digging down this financial hole has created an economic world where each additional unit of debt is producing increasingly, lower amounts of economic output.

And now in a world that has no more interest rates left to cut, our financial survival has become completely dependent upon interest rates NEVER rising again.

In effect - no one can tolerate higher rates.

And if rates were to rise, the negative effects would completely overwhelm positive effects from lower rates.

Yet - not one government nor central bank is stating Keynesian Economic Theory has been a failure and we need a new system.

Not one.

In some ways, from a pure financial perspective - this is okay.

This adamant refusal to even admit to the problem has created that awkward financial moment where incredible opportunities exist.

Whereas most investors are always focused on return, the end of Keynesian Economics has created an investment market where the focus is on risk.

As central banks, government entities and regulators try to socialise capital markets, they have forgotten that in a capitalist system, financial market risk is ALWAYS looking for a place to express its feelings.

And as the financial system comes to the realization of the end of Keynesian Economics, market risk will shift at first gradually and then quickly from one market to another.

The illustration on the next page, illustrates IceCap's expected path of market risk.

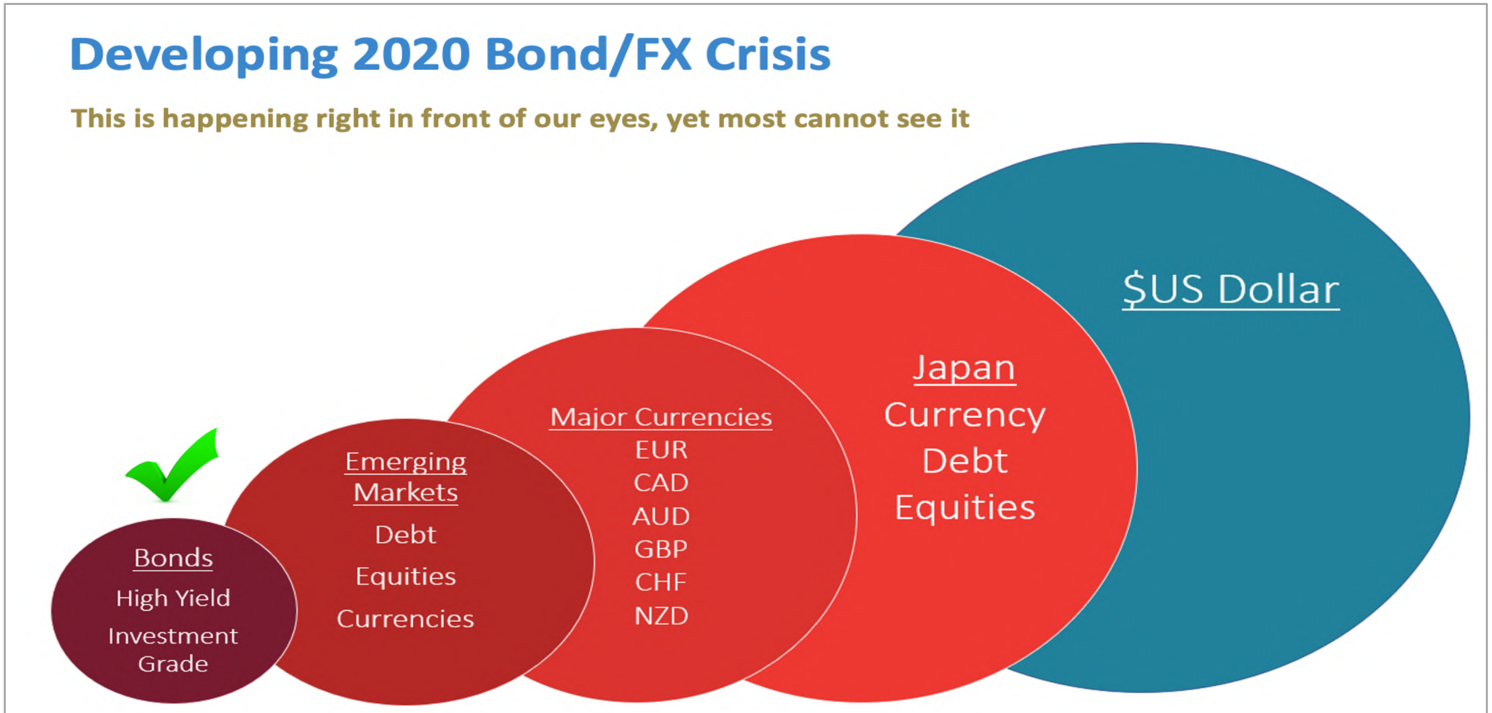
All Roads Lead to the US Dollar

March 2020 saw the initial crack in the system. Credit markets in the developed world literally froze overnight, and the central banks galloped in to restore some semblance of order.

Next up on our expected path is emerging markets. And while the situation in Turkey intensifies, we ask you to keep your eye on Brazil, South Africa and other emerging market players.

For many reasons, each country is simultaneously experiencing a collision across social, economic, monetary, and fiscal factors.

And the primary trigger point for all is the lack of US Dollars in their economies and banking systems.



Source: IceCap Asset Management Limited

It's not even close

What is the Alternative?

While the "US Dollar is crashing" hysteria grows - the cult-like worshippers, fail to offer an alternative.

If the US Dollar loses its world reserve currency status, by default there must be a replacement.

For starters, and this point is ALWAYS completely lost on the "US Dollar is crashing" cult - even before a replacement currency is named, a SYSTEM must be in place to support this new world reserve currency.

Currently, the global financial system is effectively run, managed and owned by the Americans.

Specifically, the Americans own the following:

1. US Treasury
2. US Federal Reserve
3. US Clearing Banks
4. US Office of Foreign Asset Control
5. US Committee on Foreign Investments in The United States
6. US Society for Worldwide Interbank Financial Telecommunications

Effectively, the vast majority of all US Dollar global trade and settlement transactions are controlled by the United States.

And the final factor that virtually guarantees control by the Americans:

7. The US military

We won't go into detail in this issue of the IceCap Global Outlook - yet it's incredibly important to appreciate that the American military absolutely dwarfs every other country's military.

It's not even close.

The day will come when the American's will no longer want/need to own the world's reserve currency, but until that day arrives - there is no other country/region on the planet that has a stronger military AND an alternative global financial system.

Yet, there is a chorus of uninformed opinions that the US Dollar is on the verge of being replaced by either:

1. China and the Renminbi (RMB)
2. Europe and the Euro (EUR)

However, to become the world's reserve currency - the following conditions MUST exist:

1. Must have an open capital account
2. Must run continual current account deficits
3. Must be an inventory of available debt issuance for secondary markets
4. Must have a system in place to support transactions
5. Must have the political will and military to support the system

Let's do a light dive into each of fabled replacement currencies, starting with China and the RMB.

Fixed vs Floating

China and the RMB

It's a nice story. A country that was literally catapulted from being a frontier market to the fastest growing country in the world and the next global financial super power, would be the making of nice story.

It may and most likely will happen - yet a whole slew of other things have to occur first. And in between these things happening, China will experience a significant financial crisis.

It has to happen that way. It's the way financial markets work.

For starters, China has a CLOSED CAPITAL account. This means it is incredibly difficult and next to impossible to get your money INTO the country and OUT of the country.

These capital controls are a show stopper for international investors - and a key contributing factor to billions of domestic capital trying to leave the country.

Next, this toxic combination is held in check by the RMB being a pegged currency. Recall earlier in this publication we explained how over 75 years the world has evolved from a financial world of mostly pegged currencies to one of mostly free-floating currencies.

For RMB to considered as an alternative to the US Dollar, it must first be allowed to float freely in the market place.

Of course, if the RMB were to float, its value would depreciate immediately due to the surge in domestic capital escaping the country.

Next up, to be the reserve currency, you better have a tonne of debt instruments available for both foreign and domestic investors to park their liquid capital.

And these debt instruments must be free of any kind of capital controls, must be extremely liquid, and most importantly, investors must have confidence and faith in the Chinese Communist Party to honor these debts.

Presently, foreign investors have zero faith in this requirement.

Next up - a global financial system available and trusted by everyone. Neither of these requirements currently exist in China.

And finally - China must have the political will and military to defend and support the financial system. Again - this is a hard no.

Perhaps, AFTER the US Dollar reserve status changes (and this change will not be willingly), China and the RMB may very well be a part of the new structure.

Until then, RMB as an alternative to the US Dollar is a fantasy.

Which of course, brings us to Eurozone and the Euro.

Europe is an economic fantasy-land

Eurozone and the Euro

For the Euro to become the world's reserve currency, it first must stick together. The Euro breaking up and restructuring is one of IceCap's most confident market views.

Yet, we'll indulge the Europhiles out here and pretend the Euro becomes a pillar of financial stability, strength and truth.

Running through our checklist, the Euro is lacking requirements 3, 4 and 5.

The moment any of these requirements remotely become closer to reality, we'll update this publication.

Of course, this is likely the point where the Europhiles claim the European Union and the Eurozone (there's already confusion) are already on their way to a federal bond, and therefore the Euro truly is on the verge of becoming mainstream.

We disagree.

These Euro Federal Bonds will be equal to EUR 750 Billion.

The US Treasury market is equal to USD $20 TRILLION.

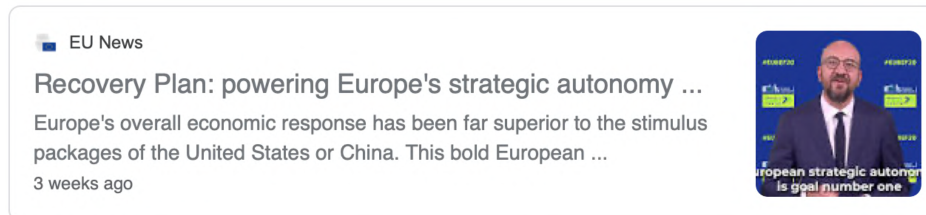
Recall requirement #3 - inventory of available debt issuance for SECONDARY markets.

Put another way, Europe is a long way off from having a viable and agreeable federal bond market.

And with the northern EU countries barely "agreeing" to a small issuance of federal debt, the likelihood of them accepting fiscal responsibility for 20x that amount is zero.

Which next brings us to the "viable" factor.

The EUR 750 Billion fiscal stimulus package was hailed as a success.


EU News

Recovery Plan: powering Europe's strategic autonomy ...

Europe's overall economic response has been far superior to the stimulus packages of the United States or China. This bold European ...

3 weeks ago

Yet, in typical European economic fashion, the details sometimes get in the way of reality.

To begin with, while American economic growth plummeted earlier this year, the European economies did even worse:

2020 Q1 GDP: USA -5%, European Union -12%

2020 Q2 GDP: USA -32% European Union -46%

Germany!

The EU's 2 largest economies (Germany and France) were already experiencing an economic decline BEFORE the COVID-19 crisis hit.

The only thing worse than having a weak economy is having a weak economy supported by a weak banking system.

The Horde of the European Zombie Banks

Many investors around the world have no idea about the extent of the weakness of European banks. Many of these banks are insolvent and continue to operate solely due to explicit support of the ECB.

Considering this fragile state of the European banking system, anyone believing the Euro could replace the US Dollar as the world's reserve currency is rather uninformed.

Returning to the EU Recovery Fund, understand the following: this EUR 750 Billion is to be distributed over 3 years. That's 262 Billion/year which equals approximately 1.4% of the total EU economy.

And this stimulus doesn't even begin until 2021.

By that time, the EU economies will have declined even further from the COVID-19 crisis, and you'll be hearing cries for even more spending and borrowing support.

We suspect, it is at this point the northern EU countries will offer a stern no.

Which will result in the European Central Bank (ECB) instituting even more Keynesian Monetary policies including deeper negative rates, bank bailouts, sovereign debt bailouts and possibly even direct payments to individuals (Universal Basic Income/UBI).

Keynesian Economic Theory really has reached its end point in Europe.

And since Europe is Europe, those believing in the Euro as a replacement to the US Dollar, should also consider that nothing of significant ever truly happens in Europe - there's just so many groups with different objectives.

US Dollar - World Reserve Currency

Final Words

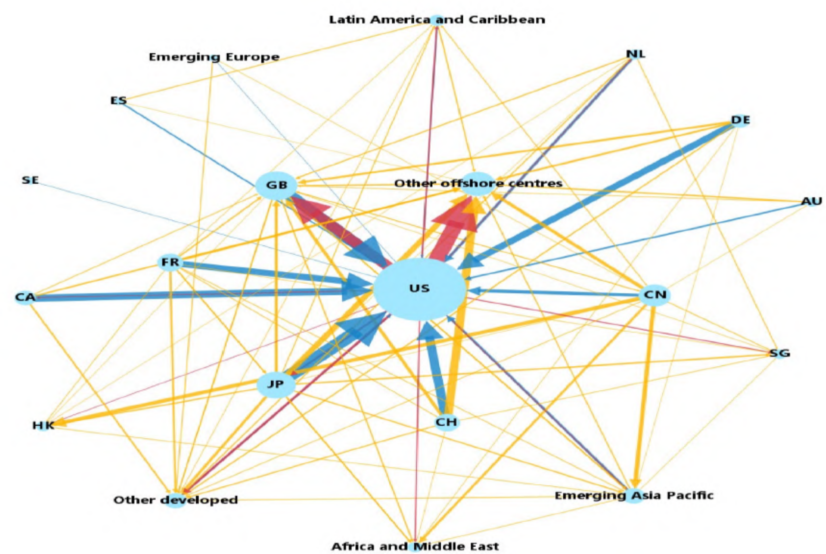
The hysteria being drummed up for a crashing US Dollar and replacement as the world's reserve currency is mostly supported by camps who view the US Dollar in isolation, who do not understand the composition of the global financial system, and who over inflate the attributes of any replacement currency.

The IceCap view towards the US Dollar is not linear. We fully expect a significant change in the global monetary and financial system, which will result in a decreased importance of the US Dollar. However, these changes occur BECAUSE of a surging US Dollar.

The irony of the "US Dollar is crashing" hysteria, is that it will be a "US Dollar is surging" crisis that eventually triggers the eventual decline.

Meanwhile, we leave you with 2 additional data points. **Chart bottom left** shows 61.82% of FX reserves are in US Dollars, which is 3 times greater than EUR and 32 times greater than RMB.

Chart bottom right shows nearly 50% of claims in the global system <u>do not</u> involve a US entity in any way. In other words - the world is completely dependent upon the USD and the USD financial system.



US dollar-denominated cross-border claims of banks on all sectors, by country[1]

Amounts outstanding (more than $20 billion); as of end-March 2019

Our Strategy (long-only)

Currencies

The current risk-on market trend has been the key driver behind a weaker US Dollar. We've used this opportunity to add further to USD positions.

Fixed Income

Bond allocations continue to be uneventful. We see little value in credit markets. Our preferred allocations across the fixed income spectrum has continued to focus on fixed income volatility.

Commodities

We continue to hold no positions. As the actual economic recovery measures less than expected, energy and base metals should see weaker markets. We are avoiding direct long-only positions in these markets. Gold has our attention, and we will become aggressive with allocations pending gold's reaction to a strengthening US Dollar.

Equities

Our portfolios continue to hold significant allocations to equities and have benefited from the current risk-on trend. However, we remain concerned of equities and the potential for downside risk as all markets transition beyond the US Election on November 3, 2020.

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 Chief Investment Officer. He has over 25 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, RealVision, MacroVoices, 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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