Our view on global investment markets:

May 2011 – Straight from the horse's mouth

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First publication June 2010

Toast

Late Friday afternoon on May 6, 2011 German Newspaper Der Spiegel released the following story and headline "Greece Considers Exit from Euro-zone"

Amongst the more interesting tidbits you'll find: "Papandreou's government is considering abandoning the euro and reintroducing its own currency."

Which was quickly followed by "Alarmed by Athens' intentions, the European Commission has called a crisis meeting in Luxembourg on Friday night."

Those who follow anything in Europe fully appreciate the seriousness of this situation. For it to evoke a response by government officials to actually have a meeting beyond 2 pm is one thing. To result in an evening meeting and one on a Friday evening at that is quite another. This MUST be serious stuff going on here.

To add further insult to the injured Union of Europe, Luxembourg Prime Minister, Jean-Claude Juncker quickly confirmed that there is no secret meeting taking place.

Which naturally invoked the following Monday morning response from his spokesperson, Guy Schuller - yes, we lied, there was a secret meeting but "we had Wall Street open at that point in time" and the Euro was falling.

Meanwhile, other credible quotes from the weekend included:

From Standard & Poors (S&P Credit Rating Agency):
"In our view, there is increased risk that Greece will take steps to restructure the terms of its commercial debt, including its previously-issued government bonds." (source: S&P)

IceCap Translation: "since we completely fell asleep at the wheel before, during and after the US credit crisis and now that our company's survival is at stake, we are finally getting around to doing our jobs again. Greece will default...it is toast."

From UK Chancellor George Osborne:
"UK should not help any second Greece bailout." The chancellor said that the UK was a "reluctant participant" in the bailout of Portugal. "I didn't sign up to that approach. It was something signed up to by my predecessor," he added. (Source: BBC)

IceCap Translation: "I want to be re-elected...and Greece is toast."

From Jean-Claude Juncker, Luxembourg Prime Minister:
"We think that Greece does need a further adjustment program…. this has to be discussed in detail and will be taken up at the next Eurogroup meeting on May 16th." (source: Reuters)

IceCap Translation: "I'm lying through my teeth...calamity within the European financial system is hanging by a thread and...Greece is toast."

So, who should we believe? Page 3 provides a quick recap of the increasingly absurd excuse for transparent markets. And, because IceCap is an equal opportunity investment manager, on page 4 we provide reasons why the EUR will escape crisis.

Straight from the horse's mouth

Which horse do you believe?

British Chancellor George Osborne: Britain will not participate in another bailout of Greece

Greek Prime Minister George Papandreou: There are absolutely no swimming pools in Athens

ECB President Jean-Claude Trichet: there was no secret meeting and we didn't discuss Greece defaulting during this secret meeting

Finnish politician Timo Soini: The little guy is being milked and lied to in order to keep the insolvent system running

German Chancellor Angela Merkel: the last year as a whole absolutely gives me certainty that Europe will solve its further challenges

Reasons why the EUR will escape crisis

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Methinks thou doth protest too much

Finally, a politician who is talking straight

Recently, the World of Finnish politics was turned upside down. The True Finns party earned 19% of the vote which not only secured them a part of the new leading coalition group, but also the sympathetic ear of the venerable Wall Street Journal (WSJ) newspaper and its highly regarded opinion page. With the WSJ as its medium, the leader of the True Finns, Timo Soini eloquently spoke the truth about the current mess in Europe with his piece "Why I Don't Support Europe's Bailouts." In our opinion, the key phrase was as follows:

"In a true market economy, bad choices get penalized. Instead of accepting losses on unsound investments—which would have led to the probable collapse of some banks—it was decided to transfer the losses to taxpayers via loans, guarantees and opaque constructs such as the European Financial Stability Fund.

The money did not go to help indebted economies. It flowed through the European Central Bank and recipient states to the coffers of big banks and investment funds."

The piece is a great read and provides further insight into the World of European politics and how it is affecting the global economy.

How does it end?

Everyone knows by now that when history doesn't repeat itself, it at least rhymes. Whether it was Mexico, or Argentina in the 1990s, or Greece, Ireland and Portugal today, every single incident was feverishly met with denials and ridicule to suggest there was any crisis to be concerned about. Concerning all of these denials of truth, we're pretty sure Will Shakespeare saw straight through it.

Meanwhile, last Friday's "rumour" that Greece is considering leaving the Euro-zone was the first time a rumour of this caliber reached mainstream media while simultaneously affecting financial markets. Here at IceCap we are not Euro bulls – we believe the European financial system is chock full of bad debt and the strategy of having everyday men, women and children bail out the big banks is doomed.

To put the situation into perspective, the yield on a Greek 2 year bond is about 25%. It may actually be cheaper for Greece to fund their deficit using their VISA and Master Cards instead. It simply isn't sustainable.

While the first round of bailouts started with the banks themselves, the next round spread to the very same countries who bailed out the banks to start with. Fast forward (a mere 2 years) to today and Greece, Ireland and Portugal are now showing the fissures within the European system. The next round of bailouts has the potential to crack the fissures wide open.

So, here we go with round 3 of European bailouts which will consist of bailing out Greece, then Ireland and then Portugal yet again. Yes, this is the classic definition of insanity at its best. The risk now

The mighty

however with round 3 is that the Greeks have now informally played the "we're leaving the Euro" card. The Irish and the Portuguese will watch closely to see if the Greeks get what they want. If the Greeks are successful (and they will be), the Irish and the Portuguese will demand even better terms for their bailouts.

We do not blame anyone for becoming dizzy with this ongoing story. All you need to know is that the ride may continue for a while longer, yet at some point, someone will leave the Euro. And when this door opens, the rush to the exits may surprise everyone.

How does this affect everyone else in the World? A destabilization of the European financial system will create the same effects as that of the US credit crisis from 2008-09. Just because you do not live in Europe, doesn't mean you are immune to this risk.

Here we go again

Two weeks ago, the US Federal Reserve announced their QE2 experiment would indeed expire as planned on June 30, 2011.

Since then we've seen money flow mostly out of commodities, then stocks and back into the bond market. Yes, the same bond market that has been pronounced dead several times over the last year. It seems the absence of money printing is scaring the crap out of some investors and is forcing them to run into the safe hands of US Treasury Bonds.

Next (as if on cue) we had the European Central Bank (ECB) also pull the rug out from under the feet of investors by declaring that maybe the mighty European Recovery might not be that mighty after all. This sudden lack of confidence, has steered the ECB away from raising interest rates in June 2011.

And then to completely add more confusion to the confusion pie, we see the German newspaper Der Spiegel story that Greece would be defaulting imminently on their debt and seceding from the Euro-zone.

Over a very quick 3 week period, we've suddenly seen the wheels begin to wobble. As investment managers, a few wobbly wheels are fine – it creates that so called "wall of worry" stock markets love to climb. However, the biggest cliché that we still need to respect is the so-called "don't fight the FED."

When the FED is lowering interest rates and printing money, it is a green light to buy stocks. The irony today is that the reason the FED has indicated they will stop printing money (the first sep towards raising rates) is due to their belief that the so-called green shoots are here to stay. Unfortunately, the FED has now created a classic stand-off. If they are correct, the economy will recover on its own towing along higher profits and rising interest rates.

If they are wrong, we'll see an economy running at stall speed at best and a significant shift towards safer investments.

The "A-ha" moment

Our Strategy

Within financial markets, the sudden "a-ha" moment is only known with hindsight. To make matters even easier to scrutinize, everyone has access to instant market information. This advancement in technology has undoubtedly shifted many investors' time horizons to minutes and days, instead of the years and more years.

Considering the events and subsequent volatility over the last few weeks everyone is left to wonder if financial markets have indeed reached this "a-ha" moment. With time, we will know the answer with certainty. Meanwhile, prudent investors must consider that yes indeed, central bank policy in the US is moving towards that all important first step of tightening (in reality, we do not expect any interest rate hikes this year – what is more important is the FED's intentions to end their QE2 money printing program on June 30, 2011). This in itself is a caution flag that should be respected.

Coincidently, the Chinese are beginning to experience signs of inflation within their liquidity induced economy. Their policy response of tightening bank reserve requirements will sooner or later slow their economy – another worry for financial markets.

Having said this, we have begun to reduce exposure to risky assets and most certainly will continue with this strategy if conditions continue to deteriorate. Additionally, we continue to hold a significant allocation to gold bullion which has been providing protection against wayward actions by the central banks and sovereign debt concerns.

Should the "Ah Ha" moment be even more surprising than anticipated, we fully expect to see yet another round of money printing by the US, Japan, the UK and Europe and thus igniting another monster rally in paper assets. The trick is to ensure you have plenty of capital available to take advantage of the opportunity should it arrive.

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

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Thank you for sharing your time with us.