IceCap
Asset Management Ltd.

Our view on global investment markets:

October 2010: Here it comes....

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I can see the future

As an investment manager, I have a skill that is extremely valuable (it's worth gazillions), highly desired (the Russians and the Chinese want it) and rather unique (very few punters in the local pubs have it) – *I can see the future*.

Using this talent, I know for certain that 20 years from now my children will ask me the following all important question: "Dad, why did Mom decide to marry you?"

The answer? Well, I'm definitely not tall nor dark. No one has ever referred to me as being handsome. Athletic? No. Witty? A wise-ass maybe, but certainly not witty. Then why? What made her say yes? The answer – *Star Trek*.

While you won't find us parading around with pointed ears, or attending conventions in Vegas, we have always enjoyed the show. It was truly ahead of its time. **Apologies to the creators of the Blackberry, but I'm pretty sure Captain Kirk and the gang were touting around the same device back in 1966 – a full 40 years before the rest of us.**

Of course, everyone knows the crew of the Enterprise always prevailed over the bad guy. But (and this is a big but), there was one bad guy that almost won and his name was Kahn. For our non-Trekkie readers, Kahn was played by Ricardo Montalban (the boss from Fantasy Island fame) and he was the baddest dude in the universe. Fortunately for the Federation of Planets, Kahn also had one bad trait - stubbornness. You see, years earlier Captain Kirk defeated Kahn and banished him to a remote planet for the rest of his life. Years pass, and out of the blue Kahn emerges, more powerful than ever with one objective – get even with Kirk.

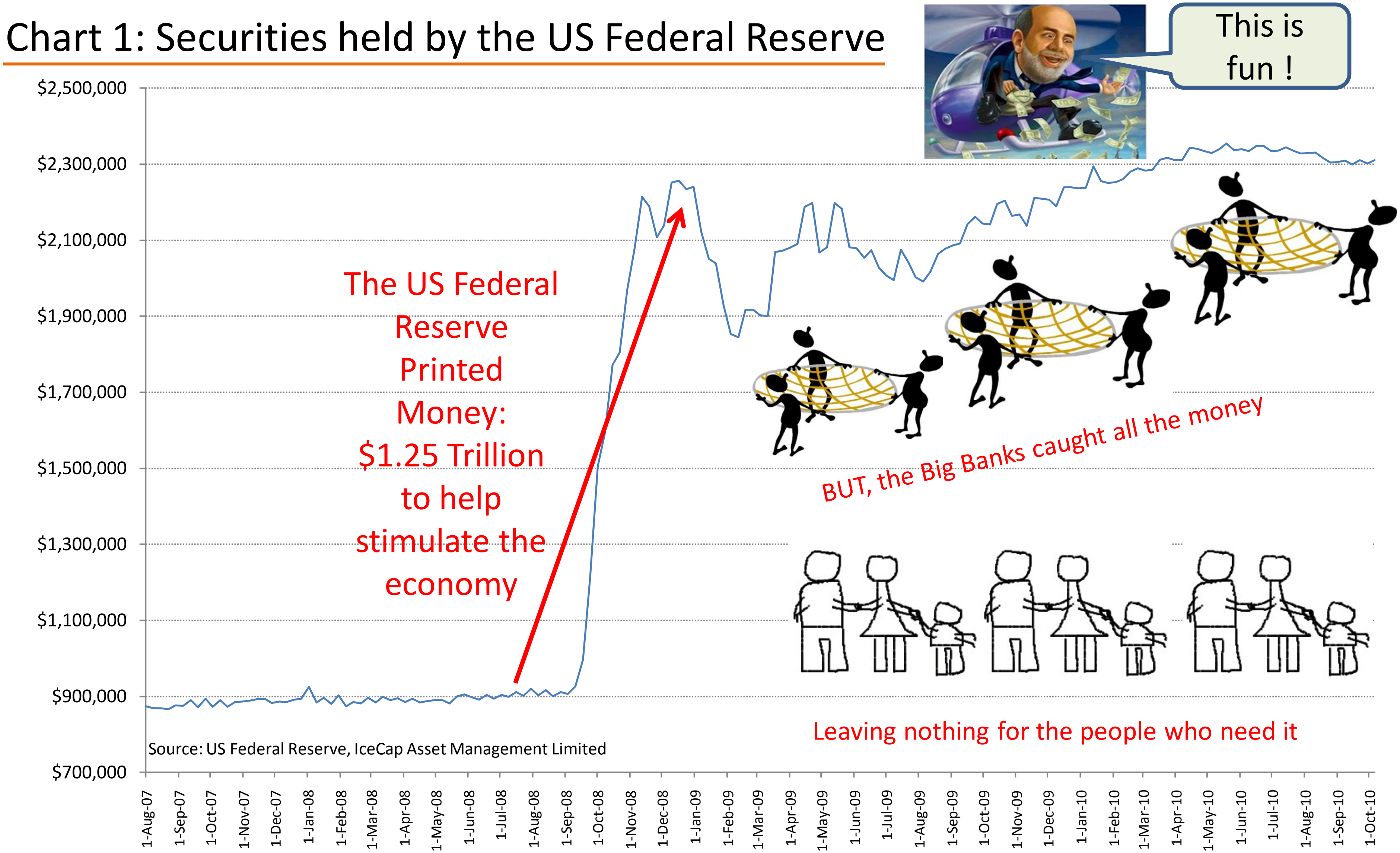
Without making a long story longer, Kahn actually has the Enterprise defeated but his preoccupation with destroying Kirk as well, blinded him to a counterattack. From his Captain's chair, watching Kahn on his 120 inch plasma TV (another early invention by Star Trek), **the good Captain pulled the trigger on the biggest giant death ray known to mankind whispering "Here it comes" – and with that, Kahn was gone**.

Fast forward to October 2010. Ben Bernanke, the Chairman of the Federal Reserve (the most powerful financial institution on the planet) is also sitting in his captain's chair, watching a 120 inch plasma TV and he too is getting ready to pull the trigger on his own version of "Here it comes." What exactly is "it"? Well, "it" refers to a big helicopter filled to the blades with money – **Helicopter Ben, you see, is about to drop the single biggest financial bomb ever; anywhere from $500 billion to $7 trillion onto America**.

Exactly 2 years ago, Helicopter Ben made his first "Here it comes" announcement and started the first ever Quantitative Easing (or money printing) program by the good ole US of A. At that time, Ben and boys printed $1.2 trillion to help save the World (see Chart 1).

October 2010: *Here it comes...*

Chart 1: Securities held by the US Federal Reserve



and, it involves wet pants

At that time, the financial world was in turmoil. We all know the story by now – housing markets collapsed, banks collapsed, soufflés collapsed and retirement plans collapsed. Someone had to take control and start to rebuild – *enter Mr. Bernanke and the gang.*

Back then they had a decision to make – who will be bailed out and who would pay for it. There is no doubt that the Big Banks (including some French & German banks, and let's not forget the Chinese) would be bailed out and there was never any doubt about who would pay for it – *the American tax payer.*

On a normal planet, these banks would have declared bankruptcy, and the stock and bond holders of these companies would have lost their shirts. That's the way capitalism works. The only area where the long dangly arm of the government should have been involved was with those who held GICs and Term Deposits at the banks. These are the people who should have been helped. **Yes, in this situation, chaos would surely have existed, but the Great Recession of 2007 would have turned into the Great Recovery of 2010.**

Think about this for a minute; close down 75% of the American banks, post an ad in the Globe & Mail, Financial Times and Wall Street Journal asking who would like to open a bank in the US. The result would have been 100s of shiny, new, clean, healthy banks ready to kick-start the economy (come to think about it, IceCap Bank sounds nice). Instead we have the following:

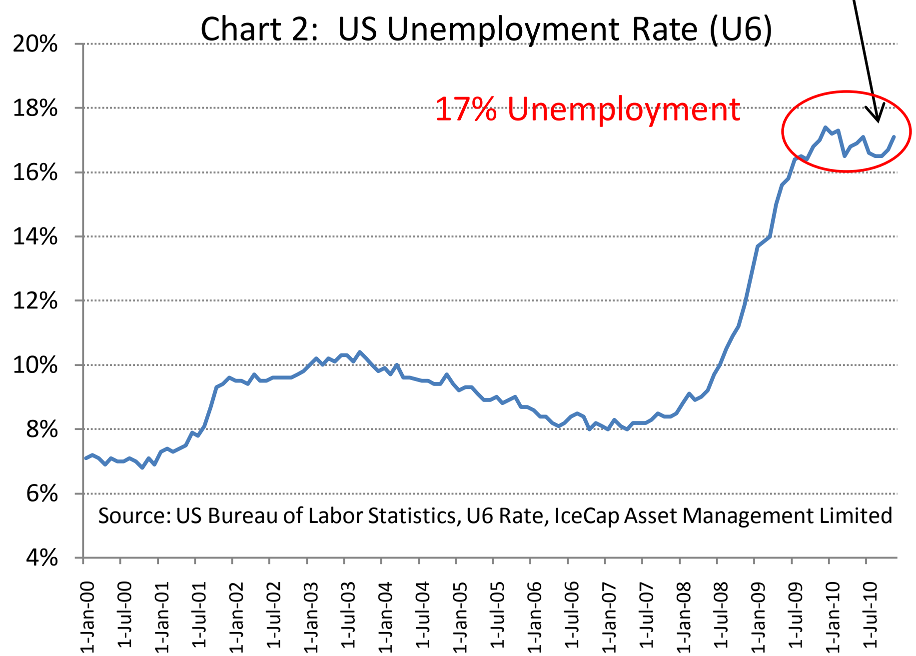
- House prices still declining
- 8 million people still looking for work
- Budget deficit approaching $ 1.3 Trillion
- States & cities issuing IOUs
- Capital spending by small businesses at a 35 year low
- Big banks sitting on $1.2 Trillion in cash and refusing to lend
- Senior citizens trying to live on 0% interest from their savings

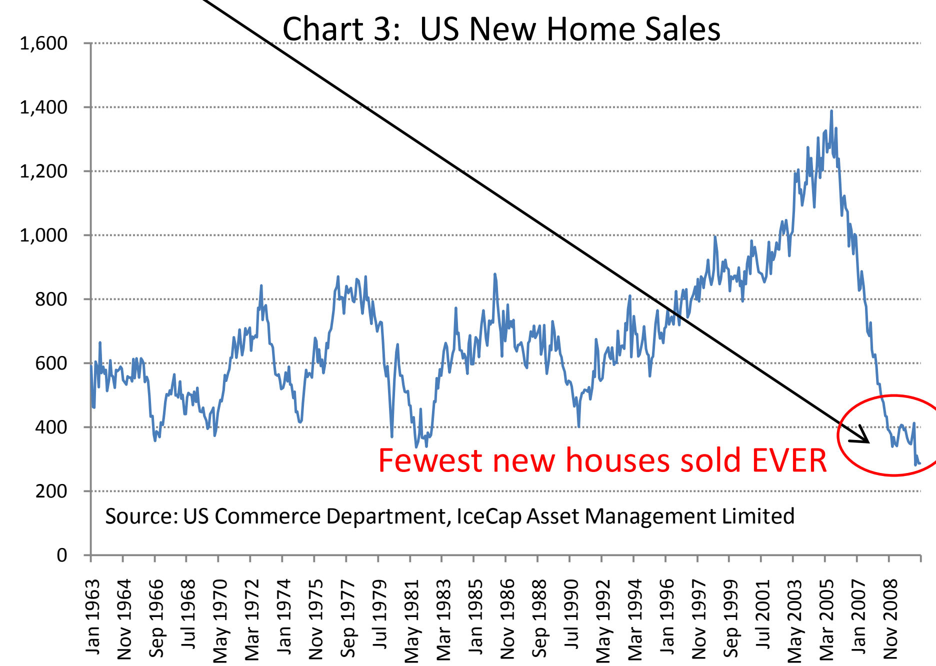
Is there anyone else who finds this to be a little weird? T**he first attempt of Quantitative Easing was suppose to be a panacea.** The economy was suppose to be growing at 8%, unemployment was suppose to be down to 7% and housing prices should have been increasing. **Instead, we are witnessing a bug hitting a windshield in slow motion.**

Recall our July 2010 Outlook "Somewhere over the rainbow" where we first described Mr. Bernanke's attempt at Quantitative Easing as being equivalent to wetting his pants to stay warm. Mr. Bernanke was then humble enough to follow this with a slight trickle down his leg which was covered in our August Outlook "Oops...I did it again."

Here we are now in October 2010 and the global media has decided that Bernanke's next version of money printing shall be called Quantitative Easing 2, or QE2 for short. While that has a nice ring to

yet, money printing didn't work here, or there





it, we'll stick with the pants wetting theme (because that is what it really is) and call it Pee2.

The probability of the economy not working out the way the rose-coloured glasses wearing economists are telling you is actually quite higher than you would think. Mr. Bernanke knows this and in some aspects, you have to admire the guy – just as Kahn was preoccupied with destroying Captain Kirk, Bernanke is just as determined to destroy the threat of deflation. The difference being of course, (apologies to my fellow Trekkies) Star Trek isn't real. Bernanke however, is very real and he is conducting the World's biggest science experiment – completely funded by the American taxpayers.

It has been written before that the definition of insanity is doing the same thing over and over again and expecting a different outcome. **With QE2 coming, why would the banks pull away their net and not catch the free money?** In other words, why should QE2 work when QE1 didn't work?

and now we have a bonanza for lawyers!

The real challenge today is not a lack of money or liquidity in the system, rather, the real problem is a lack of demand – for the recovery to occur, people and businesses must have a desire (or need) to borrow and spend. Take a look a Chart 2 and Chart 3. It's pretty clear why neither people nor businesses are spending.

Although it's nice of Mr. Bernanke to make money even cheaper, the result will once again be risk-free profits for the banks. For America to recover the government has to create attractive conditions to encourage companies to invest and hire again. Cheap financing has already been established, the challenge baton now should be passed along to the folks in Washington. However, considering the current political landscape, it will be a surprise how any spending program or tax cut will become effective.

The bottom line: regardless of the potential size of QE2 it will not make things right. We ask: when will this madness stop?

The Latest Goof-up

Previously, we've written about the US housing market crapping out and how the big US banks are essentially insolvent because of it. As a matter of fact, if it wasn't for a change to some accounting rules, the banks would have had to close their doors. **There really isn't much left to say, unless of course we discover that the entire mortgage approval process had been built out of duct tape. Correction, let's make that scotch tape.**

Over the last few days, virtually the entire foreclosure system has been frozen due to dodgy paper work by the banks. Few people understand all of the details, but we can tell you this: of the 12 legal steps required to buy and sell a house, it turns out that about 12 of those steps were performed illegally.

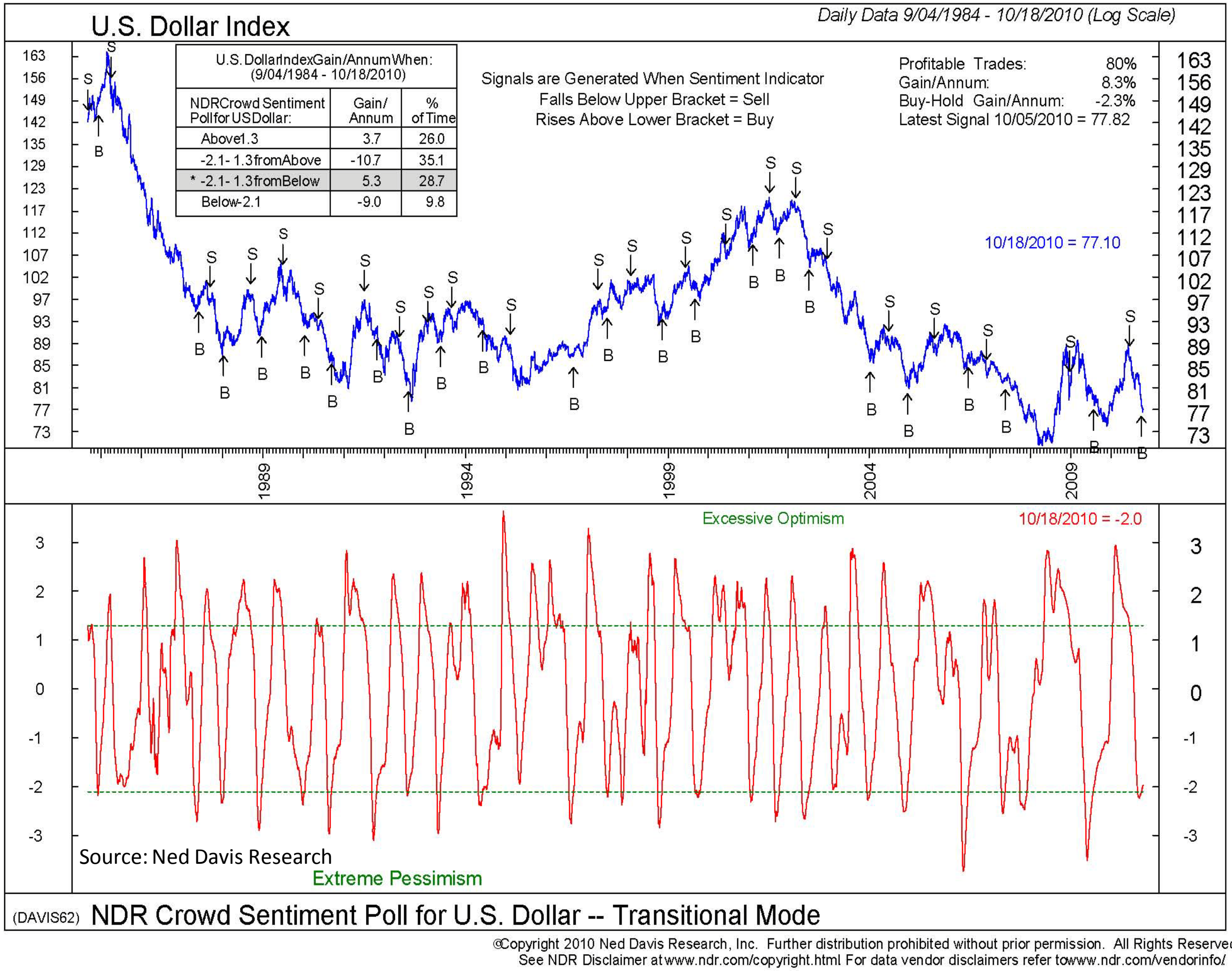
While Obama has refused to declare a moratorium on foreclosures, in effect he doesn't have to. No one in their right mind is going to buy a house until this has been cleared up. If you do proceed with a purchase, there is a chance the house you just purchased didn't legally belong to the seller to start with. The immediate result is about $1 trillion worth of houses that will exist in limbo until the issue is resolved. If you are a banker – good luck with that. If you are a real estate lawyer, this is your chance of a life-time. Pack your bags head to Florida, California or Nevada – Obama needs you.

Our strategy

A few weeks ago Mr. Bernanke confirmed that he would once again start the printing press. Since then stocks, bonds, commodities, gold and every currency except the USD all increased; the key driver of the returns isn't an improving economy and profits for companies, rather it is the systematic depreciation of the USD – that's what printing money does for you.

Presently, sentiment for the USD is extremely pessimistic (see Chart 4) and we believe this will reverse itself soon enough causing a correction in most other asset classes. Our strategy is to overweight

Chart 4: US Dollar Sentiment



Source: Ned Davis Research

bonds, underweight commodities and stocks. We continue to like gold and will look to add to positions during periods of weakness.

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.