IceCap Asset Management Ltd.

Our view on global investment markets:

November 2010: The Money Printers

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Clap those hands!

President Obama:
"Ladies & gentlemen since I no longer control Washington, I am now devoting my newfound and considerable free time to managing the latest rock sensation – "The Money Printers!"

Allow me to introduce the band:
- *Masaaki Shirakawa, Bank of Japan (drums)*
- *Jean-Claude Trichet, European Central Bank (keyboard)*
- *Mervyn King, Bank of England (bass guitar)*
- *Ben Bernanke, US Federal Reserve (lead vocals)*

And now, without further ado put your hands together and sing along to our first release:"

♫ There she was just a-walkin' down the street, singin'
"Do wah diddy diddy dum diddy do"

Snappin' our fingers and creating money out of air, singin'
"Do wah diddy diddy dum diddy do"

She isn't good (isn't good), she isn't fine (isn't fine).
She isn't good, she isn't fine and we did lose our minds

Before we knew it she was walkin' next to me, singin'
please print some more money for me" ♫

You know the global economy is becoming even more ridiculous when well-respected investment managers have stooped to writing parodies of the World's most powerful central bankers forming a rock band and walking down the street dropping money. Yes, it has come to this.

Our loyal readers know that we've been discussing these big issues now for several months and while it certainly isn't our intention to bore you to death (the big banks around the world do a very good job of that already), we are witnessing a once in 100 lifetimes event.

Last month in "Here it Comes", we had some fun preparing you for Ben Bernanke's Quantitative Easing 2 (QE2). Like a rock concert, the warm up act – QE1 2008 – was pretty good; it made everyone dance & sing a little. Then, as with all concerts the main act was delayed, and to keep the crowd in good spirits Mr. Bernanke came on stage in August 2010 and entertained us with his "trickle down the leg" trick.

Finally, the moment he had been waiting for his entire life came. From September to October, Mr. Bernanke managed to whip the crowd (and markets) into a frenzy with the build-up to QE2. Estimates for the newest amount of money printing ranged from $500 billion to $7 trillion. Stocks went nuts, commodities went nuts, gold went nuts, heck even the nuts went nuts. The amount didn't matter anymore, Mr. Bernanke achieved his goal – he turned the entire mess into a zoo.

The result? This time on Nov 3, 2010 Mr. Bernanke cranked up his printer to the tune of $600 billion. Today the concert is over and we ask what's next?

This rock band has gone global...

With the QE2 announcement now out of the way, Mr. Bernanke's game plan is as follows:

1. Lower interest rates for "everybody " and "everything"
2. Stocks & Bonds will then increase in value making "everybody" and "everything" feel wealthier
3. "Everybody" will then start to buy "everything"
4. Pray that the price of "everything" doesn't increase too much and therefore cause "everybody" not to buy "everything"
5. If steps 1 to 4 are successful, businesses will begin to create jobs for "everybody" because they will once again be buying "everything"
6. Ignore the housing market problem
7. Ignore the debt problem
8. Ignore the effect of numbers 6 & 7 on the banks
9. Pray that foreigners continue to buy newly issued American debt

Simple enough. But wait, this is where it becomes interesting.

In Japan, they are also following steps 1 thru 8. Unlike the Western World, the Japanese save more than they spend. These excess savings are used to buy the new debt issued by the Japanese government and therefore eliminating the dependence upon foreigners to buy Japanese bonds – essentially making step 9 unnecessary. [Editor's note: these net savings are about to disappear as Japan's older demographics finally catch up to economic reality, and the net savers become net spenders during their retirement years].

While the Americans are new to this game plan, the Japanese have been following this script for 20 years – so they of all people know that it hasn't worked in the past and that it won't work in the future. Why are they continuing with the madness? Besides wanting to play in the band (who wouldn't want to play in a band?), **Japan recognises that the implicit longer-term strategy of every major country is to depreciate their currency with the hope that this will help with exports**. A continuation of a strengthening Yen will not be profitable for Sony and other big Japanese companies, hence put Japan down for more money printing and a weaker currency.

Over in Britain, the Bank of England is also following Bernanke's 9 steps to prosperity. Unlike the Japanese, Britain cannot ignore step 9 for, like the Americans, the British also relies upon foreigners to give them money. Britain however is doing something I doubt the American's can (or will do) – reducing their deficit by raising taxes and cutting spending. David Cameron's government has a mandate and so far they are following it to the letter. Hopefully it will work.

Which brings us to Europe. Germany is an economic machine and this wasn't achieved by accident. In some aspects, Germany is the antithesis of China. German companies have never been coddled

and they'll be talking about this concert for a long time...

with a cheap currency. Their competitive advantage is the quality of their product (*what a novel idea*), which has them specializing in high tech machinery that few others have been able to duplicate. **When you have a chance, take both a BMW and a Chevrolet for a spin and let us know your thoughts**. In addition to their conservative fiscal and monetary policies, Germany also benefitted tremendously from the unification with East Germany as well as the creation of the Euro-zone. Both events provided unlimited cheap labour as well as years of capital investment within their own country.

The rest of Europe however, is struggling to say the least. We're all familiar by now of the plights of Portugal, Ireland, Greece and Spain.

All you need to know is the following:
- without the financial support of Germany, these countries would be defaulting on their debt.

The other thing you need to know is the following:
- Germany likely won't be this charitable for much longer.

As a result, the risk inherent in bonds from Portugal, Ireland, Greece and Spain is increasing by the day. Which creates a bit of a problem.

Whereas the FED essentially has the mandate to do whatever they want, the European Central Bank (ECB) was established under the guidelines set forth by Germany which means a focus on inflation, and not to have any fun while doing so. This is a problem for the weaker European countries because whereas as every other country in the World is trying to devalue their currency to help stimulate exports, members of the Euro must adopt to the German way or hit the highway. Unfortunately it will take years and years for the peripheral European countries to morph into exporting machines. Meanwhile, their debt levels continue to increase while their attempts to raise taxes and reduce spending is being fiercely resisted through demonstrations of all kinds. Success will be marginal at best.

Others have prophesized that the Euro is doomed. While we are not prophets, it would be incredible if there isn't another financial crisis within the Euro-zone in the near future. **The irony is that the strong currency policy of the ECB will likely lead to a much weaker currency at the end of the day.**

And finally, if you are wondering exactly how the Germans feel about Bernanke's QE2, Finance Minister Schaeuble's response says it all when he referred to the FED as being "clueless."

What the central banks really need to know

"The Aftermath of Financial Crises" by Carmen M. Reinhart and Kenneth S. Rogoff is one of the best papers ever written about debt bubbles and financial crises. The results of this study were widely covered by the mainstream media 2 years ago but unfortunately it seems to have been forgotten about ever since.

hopefully we won't see a reunion tour...

Anyone who has followed financial markets have likely heard the dreaded expression "this time it's different." The Reinhart Rogoff study concludes that the 2007-2010 financial crisis is actually no different that any other crisis that has occurred – and there have been over 150 of them during the last 200 years. The study shows that there are 3 main outcomes of each crisis:

1) Collapse in asset (real estate) markets are deep and long
2) Profound decline in GDP and employment
3) Debt levels explode due to the inevitable decline in tax revenues resulting from the decline in GDP

Sound familiar? Yes, this is exactly what is happening today. Admittedly, today's financial crisis is unusual in that it involves the World's 4 major currency countries (US, Japan, Europe, UK). This obsession with trying to solve a debt problem with more debt is just plain…*weird*, to say the least. The people running the central banks should be forced to do push-ups. **Today's central bankers and politicians want a quick cure, unfortunately one does not exist.** If the $1.7 trillion QE1 didn't work, why would a $600 billion QE2 work? In due course, it will be confirmed that this time isn't different.

There has already been a lot of talk of a QE3, QE4 and so on. We believe this is unlikely due to Bernanke losing 3 voting members on the board next year with them being replaced with 3 new members who are against money printing. **In effect, QE2 may be Helicopter Ben's last flight.**

Our strategy

The World's central banks have made it very clear. They will continue to keep interest rates very low, they will continue to print money and they will continue to try to devalue their respectful currencies. The ultimate goal is to boost the value of everything.

The combination of the FED's QE2 announcement and Bernanke's Washington Post op-ed piece contained a very powerful statement - a higher stock market "*will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion*."

The take-a-way: the FED wants the stock market to go higher.

All investors are familiar with the axiom "don't fight the FED." If the FED wants higher stock markets, it is very likely we will see higher stock markets. Considering the situation, it is even more likely that we will see higher prices for gold, silver and other commodities as well.

The frightening part of having the stock market increase in this manner is that unless the economy really does improve, higher stock prices are not justified based upon fundamentals. In other words, the FED is simply creating another bubble to help correct the previous bubble. This phenomena can continue for quite some time, but make

because their music isn't that good after all

no mistake the trouble that was brewing in the back room, is now brewing out in the wide open for everyone to see.

Our portfolio strategy will continue to benefit from the actions of central banks. Precious metals are an integral component of our portfolios, as are our positions in agricultural commodities and base metals. Considering the stated goal of the FED, we will not be decreasing our stock positions and will look to increase weightings as opportunities arise.

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.