



**IceCap**  
Asset Management Ltd.



Local heritage,  
Global experience.

Our view on global investment markets:

*January 2014 – The Shoe*

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## Size 9

As leader of the world's most powerful communist country, Nikita Khrushchev commanded respect, fear and most of all – your attention. In Stalingrad, he stared down the Nazis and willed his comrades to victory. Next, his “Secret Speech” gained him supreme power and crushed his political enemies for good. For a finale, Khrushchev rescued a floundering Soviet Space Agency and helped launch it past the Americans.

Khrushchev will forever be immortalised but not as the brave soldier or as a rocket scientist – instead, his place in history was firmly planted the moment he beat the heck out of his desk at the United Nations - *with his shoe*.

A few generations later, then President George W. Bush had his very own shoe encounter. Apparently, someone registered his disagreement with America's presence in Iraq by hurling the Muslim insult – a shoe, straight at the President's head. There was nothing slow moving about the Texan and his lightning quick reflexes helped him dodge the oncoming size 9 projectile.

The latest shoe drop, occurred just a few days ago at supposedly, the most peaceful place on earth – the United Nations. To tell you the truth, the UN has always been bit of an odd place. It was created in 1945 to achieve ever lasting world peace. Ironically it has been home to many of the most interesting attempts to destroy it.

Khrushchev's table banging tirade was certainly un-peaceful. Perhaps the most astonishing act within the curved walls at 46<sup>th</sup> Street, was on October 18, 2013 when Saudi Arabia flipped not a shoe but a bird at the entire UN Security Council and declined an appointment to this highly respected group.

Saudi Arabia wasn't the first (nor will it be the last) to commit such a bold act towards the world's most powerful leaders. But its especially noteworthy because it provides insight into the politics of middle east, oil and sand.

Dynamics in this region are changing very quickly, and the impact on financial markets will be significant meaning it could very well be the next shoe to drop.

### **Not too long ago**

Our world has always needed oil to grease the big wheel. It seems that at some point in time, everyone strikes a big gusher and then the party really starts. In the early 1900s, the discovery of oil in Texas launched the US into its very own gusher age.

At the same time, Mexico also fell into a major discovery and it too became an oil exporting machine. Some 50 years later, Norway discovered they had the black stuff and quickly became slick at selling it to anyone and everyone.

Yet, like all good things, the Americans, Mexicans and Norwegians

## The bottom of the barrel

learned that oil drums do indeed have a bottom as their production peaked and was followed by swift declines.

Now, it was at this point the global economy was starting to truly become global. Oil was needed, and no one really cared where it came from. As long as it could be refined into gasoline and heating fuel people were happy.

As a result, the happiest place in the whole world was about to be – Saudi Arabia. Not only did Saudi Arabia have enormous oil discoveries, it was also fully on board with becoming America's primary provider forever and ever. Naturally, in exchange for providing America with its energy fix, Saudi Arabia needed the Americans to set-up a few military bases, just in case someone else had their own ideas about the Saudi oil fields and the riches that went with it.

All in all, this America-Saudi marriage has been pretty good for both sides. America receives its oil, and Saudi Arabia hasn't had to worry about any of the Shenanigans taking place in the Middle East.

Until today...

### American Shale Boom

Just when you thought America had finally dug its last economic grave, once again it rose from the almost-dead to change the game. Up until the late 1960s, America's oil production increased at a

steady pace. But then, the inevitable happened and over the next 40 years, America was unable to pump out more oil than the year before, making it increasingly dependent upon foreign oil to survive.

This is about to change. Just a few years ago, US regulation changed in favour of allowing exploration and development of shale oil and natural gas from government protected lands. The result – America should be able to produce up to 10 million barrels/day in total oil.

Considering America consumes about 20 million barrels/day, there is still a shortage. But wait, American uber optimism combined with hope (there's that word again) and oil from their Canadian neighbours in the great white north has created the *potential* for America to rid itself of all the headaches associated with depending upon oil from the Middle East.

This is good for America, but not so good for Saudi Arabia, and the real reason behind them throwing the metaphorical shoe at the United Nations Security Council.

Yet, to better understand Saudi Arabia and the Middle East, investors must first start in of all places – Pakistan.

### Pakistan

Saudi Arabia has provided financial assistance to Pakistan for decades. In exchange, Pakistan's army has provided near-bullet-proof

## Guns for sale

protection for Saudi Arabia's southern, oil rich border.

During the first Gulf War in 1990, while everyone's attention was on Iraq and Kuwait, the Saudi's southern border was under constant threat by Iranian supported groups.

It was there that the metal, determination and the loyalty of the Pakistani army really showed as Saudi Arabia's vast oil fields remained protected from their long-term enemy – Iran.

This symbiotic relationship has remained in place ever since. Saudi money supports Pakistan, while Pakistan's army supports Saudi Arabia.

Fast forward to today, and the geopolitical landscape in the middle east is changing rapidly. For starters, in 2014 NATO will be withdrawing from Afghanistan leaving a gigantic military void that is all but certain to spillover into Pakistan.

Unfortunately, this shifting of the Pakistani military chairs, leaves the Saudi southern border and therefore its oil fields exposed. Of course one man's crisis is another man's opportunity - and this is where Egypt comes into the picture.

### Egypt

Westerners intrigued with the seemingly perpetual middle east crises, need look no further than Egypt. This country of 80 million people, has long been the fulcrum providing balance in the region.

In fact, Egypt was considered so important to the region, that over the years it has received billions in military funding from Washington in the form of tanks and F-16 Fighter Jets. Washington sees that as a small price to pay to protect their access to middle east oil.

However, the Egyptian political and social cycle reached its peak and changed rather dramatically with the 2011 revolution that saw the American backed Egyptian President Mubarak removed not only from office, but from the entire country.

As can be expected, violent revolutions are not exactly promising from an economic perspective. Sure, the longer-term outlook may sometimes improve, but in the short-term foreign money leaves and the domestic economy implodes. Egypt's situation was no different.

The Muslim Brotherhood was now in charge and they did have the support of the powerful and independent military; yet it was very clear that it was only a matter of months before their fountain of cash would run dry.

At this point, the only product or service available to Egypt for sale

## Unanimous disagreement

was their military, and fortunately for them, their newest best friend Saudi Arabia had lots of cash and were in dire need of military protection. So, as Pakistan begins its NATO induced return home from Saudi Arabia, Egypt will conveniently begin to fill their shoes, so to speak along Saudi Arabia's southern border.

While political borders in the middle east are certainly important, religious borders are even more so. Yes, the region is predominantly Muslim but the Muslim world is very much separated between the Shia and Sunni denominations, and sectarian violence between the two groups stretches throughout the Muslim world.

From the Saudi perspective, Iran and its Shia groups are quickly gaining control over Iraq and remain forever linked to the Muslim Brotherhood in Egypt, Syria, as well as Saudi's eastern border neighbour Bahrain.

Iran is beginning to significantly increase its strength and power and this has Saudi Arabia rather concerned. This should be crystal clear to everyone.

This brings us back to the United Nations and the Security Council. Arguably the most powerful group at the UN, the Security Council has five permanent members consisting of USA, China, France, Britain and Russia. As well, there are ten non-permanent members who are elected for two year terms.

Considering the five permanent members never unanimously agree on anything, its little wonder the Security Council rarely takes any action. And, this is what compelled Saudi Arabia to throw their shoe and reject their September 2013 election to the Council as a non-permanent member.

The World edged closer to war between the USA and Russia over the civil war in Syria. In our [September 2013 Global Market Outlook](#) we detailed the real reason behind the then sudden global crisis. Sadly, what attracted the world's elite to the civil war wasn't the atrocious use of chemical weapons but rather the proxy war between Russia/Iran versus the USA/Saudi Arabia/Israel and the fight for access to the European natural gas market.

In what can only be described as a classic Tom Clancy novel, the crisis was resolved by Russia and America agreeing not to become directly involved in Syria. The hands of war were quickly washed, scrubbed and cleaned and the world's attention abruptly returned to money printing and the accelerating economic recovery. Of course, indirect involvement remains which means you can count on headlines again at some point in the future.

Syria meanwhile, remains a war torn country with no foreseeable end to the bloodshed. The Security Council has the primary responsibility for the maintenance of international peace and security; nevertheless, it was the inaction by the Security Council that became Saudi Arabia's last straw.

## The middle east will heat up in 2014

With America's influence in the region waning, and the threat of the Iranian coalition growing, Saudi Arabia has decided it has no choice but to make a statement as well as begin to grow its very own military force.

From an investment perspective, the probability of major war within the region has increased dramatically. The Russian and Iranian supported war in Syria continues while Qatar's money supports the opposition groups. Meanwhile, the Muslim Brotherhood's grip on power in Egypt is in flux, while Saudi Arabia's commitment to a bigger and better defense system plows ahead.

The obvious near-term risk lies with the Winter Olympics in Sochi, Russia. During the recent crisis in Syria, it was widely reported that Saudi Arabia offered Russia a guarantee of a terrorist-free Olympics in exchange for a new OPEC-style oil partnership. As expected, Russia called the bluff and responded with a stern "nyet". By late December 2013 the Sochi region has already been hit with two separate suicide bomber attacks.

As 2014 rolls through, investors need to be prepared for increased geopolitical risk in the middle east. Should events occur, be prepared for a stronger US Dollar and higher crude oil prices, as well as the unexpected.

### **The World is Booming**

If one were only to look at the stock market and the buzz within New York, London, San Francisco, Sydney or Toronto; they would conclude that the world is indeed booming.

After all, people say the stock market is a leading indicator and that is telling us that the world is bursting at the seams with accelerating growth. In addition, business in restaurants, shops and real estate in these major cities are also off the charts. And of course, the leading financial news stations are tripping over themselves with gushes of great news.

Now, we don't mean to be the party pooper; however one must understand what is really happening to truly appreciate the still, slow moving and delicate economic pickle the world has been stuck with.

For starters, these major cities are always booming. When is the traffic not flowing, when are the restaurants not chalk full, and when are the brownstones not expensive? Instead, for a better picture of economic life, feel free to visit St. Louis, Winnipeg, or Marseilles and we're sure you'll have no problems at all securing that dinner reservation.

Peeling away the top layer of fabulous news resulting from the stock market, we cannot help but see that the deep structural issues associated with the 2008-09 crisis remain. The mountains of bad debt

## The masses

have simply shifted away from specific investors, to governments and their tax payers.

From a global perspective, this transfer of bad debt from specific investors to tax payers is THE most important issue to understand. In simpler terms, and unknown to many, the bad debt has been spread around the world for everyone to share. Yes, socialism has arrived and few in our capitalistic world have noticed.

Now, if we said “Okay the bad debt has been spread around, let’s everyone take losses and then we’ll be on our way,” then that would have been a good thing. On with the show.

However, major governments and central banks have decided that no one will take losses, and everything will be okay over time. To prevent (actually “delay” is a better term) these losses, the following occurred:

- 1 – 0% interest paid on savings
- 2 – bailouts to big banks
- 3 – money printing
- 4 – currency manipulations
- 5 – long-term interest rate manipulations

Of course, these extreme policy responses have resulted in:

- 1 - extreme sluggish growth
- 2 - extreme unemployment
- 3 - and perhaps the most terrifying of all extremely unhappy masses

And when we say masses, we mean the average person not working on Wall, Bay or Threadneedle Streets. This is where change will occur.

And, it is the unhappy masses that will shape the world in 2014 and beyond. Although this is very clear to some people, the world is on the verge of experiencing even more draconian responses from our world leaders.

First up is the 10% wealth tax which will occur in the Eurozone countries. In our last global market outlook, we provided the details behind this IMF issued and endorsed recommendation. The thinking is that if everyone contributed 10% of their wealth to the governments then that would be enough to restore debt levels to pre-2008 levels. The key words are “tax on your wealth” not a tax on your income - two completely different animals. Europe actually believes their citizens will be quite fine with having 10% lopped off of their bank and investment accounts – we disagree.

Next, the Eurozone is likely to see negative interest rates. Apparently paying little old ladies 0% on their savings wasn’t evil enough. Now, to further improve morale amongst the savers, the ECB is increasingly becoming comfortable with banks charging people for having their savings on deposit. Europe actually believes that if there is a penalty for keeping money on deposit, people and companies will instead spend their lifelong savings which will help with the recovery.

Instead, we see the opposite happening: People and companies will simply withdraw or hoard their money instead.



## Espresso sipping

Why is there such a positive outlook by European governments for Europe? Simply put, the Eurozone governments believe they will not experience any reputational damage from taxing the rich and stealing from the poor.

Now, at various times many emerging market countries experienced catastrophic money problems as well. In the end, just as every rational human being would do - foreign money fled along with local private money. The result was a complete collapse of the local currency, moon high interest rates as well as zero access to international capital markets.

Yet in Europe, the espresso-sipping and champagne-gurgling powers-that-be, actually believe the continent will have no reputation damage whatsoever. Foreign money will stay put, locals will stay put. All the wealth will stay put.

We completely disagree, and unless all 18 Eurozone countries agree to form one government, create one tax code and consolidate all debt the world will be facing the largest debt default in the history of mankind.

This isn't all bad news however as Japan is also clearly on the path to debt destruction and when it happens, Europe's debt mess will drop to the second largest debt default ever. Beyond not being the worst, there is no other good news.

This debt debacle will occur in one of two ways – slowly or quickly. The slow version occurs as a buildup of social unrest grows momentum across the hardest hit countries including Greece, Portugal, Spain, or Italy.

The traditional political parties in these countries are all in disarray with government approval ratings setting new lows by the week. Meanwhile new parties, some with extreme views, are gathering momentum in the opposite direction. Public protests are the result, and are once again increasing at an alarming rate.

This emerging disapproval by the masses is certainly creating an environment whereby major change can occur in Europe. And, it is during these chaotic days that foreign investors and private capital will accelerate their money transfer transactions to help protect their hard earned capital.

Of course, we may also see a quicker, swifter fleet of private capital should the IMF, the ECB and Brussels make the first move. During our last global market outlook we detailed the astonishing IMF report which recommended the Eurozone charge a one-time 10% tax on all wealth.

For whatever reason, this bombshell announcement has been widely ignored. Again, we caution any private investor with savings in a Eurozone bank to consider the IMF recommendation and then make a rational decision.



## Big shifts are taking place

Should this 10% wealth tax occur, it will likely be the spark to ignite the exodus of private capital out of Europe. And that is when life for Brussels really starts to become interesting.

As the main stream media reports Ireland, Portugal and Spain are able to borrow at the lowest rates in years – surely a sign of recovery, it fails to report the implicit guarantee from the ECB.

From our perspective, increasing social unrest is rather easy to see (**see Chart 1 next page**). In Athens, gun shots have been fired at the German Ambassador's house, in Italy, the pitchfork movement is protesting against high unemployment, recession and taxes and has even secured support from the Pope.

And a rarity that can only happen in France, the poorest of farmers and the richest of the rich are simultaneously protesting against higher taxes.

Unfortunately, this increase in social unrest is not contained to Europe. In Ukraine, hundreds of thousands are fighting the police forging THE next fulcrum war between Russia and the West.

Meanwhile, in Turkey protests are building against government corruption, and over in Asia we have the Thai government on the verge of collapse. Not to be outdone, Syria remains as relevant as ever as the 2<sup>nd</sup> attempt at peace talks begin.

Connecting the dots, it's fairly obvious to us that social, political and economic stresses are converging in different spots around the world. While some may say that this is typical, we don't believe that.

The point we make is that the recovery from the 2008 crisis remains very sluggish, and the medicine of lower interest rates, money printing and higher taxes is exacerbating the divide between the rich and poor. And it is this economic divide that is causing global social unrest.

Many people around the world are far removed from areas of social unrest and quite simply couldn't care less. The only discomfort in these people's lives is the polar vortex – easily endured with the comfort of a warm fire, an earthy risotto and matching wine. Yes, life isn't too hard for many.

However, we must not ignore the very big movements that are occurring in financial markets which will affect your wealth.

We continue to see through the daily market noise, and anticipate a return to crisis in both Europe and Japan. Although America's fiscal situation remains nefarious, US Dollars, US stocks and US high end real estate will be the temporary home of choice for those investors fleeing Europe and Japan.

# Chart 1: Little Old Ladies are bailing out Goldman Sachs

## Ukraine

### Mass protests grip Ukraine

Capital Kyiv site of demonstrations for a 3rd straight week



## State of Emergency Begins in Thailand

BANGKOK January 21, 2014 (AP)

By THANYARAT DOKSONE and TODD PITMAN Associated Press

## Tax Revolts Hit Hollande as Farmers, Soccer Clubs Protest

## France

By Mark Deen | Oct 29, 2013 8:01 AM AT | 13 Comments | Email | Print

French President **Francois Hollande's** taxes, among the world's highest, have made strange bedfellows out of the country's soccer clubs and farmers in Brittany.

Revolts against a series of levies have erupted with protests by farmers in Brittany against a trucking tax on Oct. 27 leaving several people injured, and soccer clubs refusing to play a round of league matches in November to oppose a tax on salaries of more than 1 million euros (\$1.38 million). Hollande has said he won't budge on the millionaire tax, while



Photographer: Balint Parnecz/Bloomberg

## Italy hit by wave of Pitchfork protests as austerity unites disparate groups

Demonstrations point to frustration with traditional politics, with minister warning parliament of a country in 'spiral of rebellion'

Lizzy Davies in Rome  
The Guardian, Friday 13 December 2013 19:02 GMT  
Jump to comments (136)

## Italy



Protesters with the loosely formed movement I Forconi (the Pitchforks) demonstrate in Turin, Italy. Photograph: NurPhoto/Rex Features



# Do not underestimate the upcoming strength of the USD

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## Our Strategy

Over the last year, our calls for a weaker Canadian Dollar, Australian Dollar and Japanese Yen have been accurate. While the Loonie and Aussie Dollar have been affected by weaker global growth, Yen weakness has been the result of the Bank of Japan's high octane money printing policy. We expect both trends to continue.

Meanwhile, the biggest near-term threat is within the emerging markets sphere. As protests and unrest grows in these countries, foreign investors will also shift their investments to the US.

This relative call for favoring the US is not due to an accelerating economic recovery – nothing could be further from the truth. Instead, investors must understand the US market remains the broadest and the deepest in the world; in effect it is the only market large enough to absorb the type of capital movements we envision.

We've been very clear with our investment strategy. While 2010 to 2012 had the potential to see significant corrections in stock markets, we see reduced risk in 2013 and onwards.

To be clear, 20% downside risk still does exist. It is common and actually quite healthy to remove short-term excesses. However, our view is that investors in Europe and Japan will increasingly seek other places for their wealth and will provide support for US Dollars, high end real estate and stocks.

As a result, we continue to add to these markets when opportunities are available. In the near-term, sentiment remains extremely positive for stocks which is also reflected in very low volatility measures. Both of these data points suggest stock investors should be concerned in the near-term. A correction is certainly possible, and we'll remain patient before further increasing our allocations.

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.

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Thank you for sharing your time with us.