Keith Dicker: The next major financial crisis will happen in the Bond Market

September 27th

Erik: Joining me next on the program is IceCap Chief Investment Officer Keith Dicker. Keith thanks so much for joining us on the program. You've prepared a fantastic slide deck for us. Listeners, you'll find the download link to the slide deck in your Research Roundup email. If you're not registered yet, just go to our home page at macrovoices.com, look for the information next to Keith's picture for how to get the download.

Keith, you know, the narrative that a lot of people would like us to believe is, hey, Ben Bernanke has pretty much saved the economy. Quantitative easing rescued the financial markets and, hey, everything is all better now. What could go wrong?

I tend to be in the camp that at some point the piper has to be paid. There is no free lunch. But a lot of people have challenged: What form will that come in? Where does the piper still need to be paid? And I think you've addressed a lot of those questions in your chart book.

So why don't we go ahead and get started here on Slide 1. Tell us what's going on with what's coming on this first chart.

Keith: Thank you, Erik, for having me on today. We'll have a good chat here.

With IceCap Asset Management, our global macro view has attracted a lot of attention from around the world. And what we find most interesting is that – this conversation we'll have today – it's happening in the US, it's happening across Europe, Canada, Asia, you name it.

So it's not a country-specific concern that investors have today. This is really a global situation that we're in. So that's what we'll touch upon.

You mentioned Bernanke saved the day and all that stuff. Our view is a little bit different. When we look at the world today, because we are a global macro shop, it's really important to understand that we do not live in a linear world.

And when you put on top of that, once we understand how central banks – in the Western world specifically – how they operate the economy and the global financial system, then you'll better be able to see exactly what's coming down the pike.

To give you the conclusion first, we have a very high conviction, it's a very high probability that we have another crisis, that it's coming in view right now. It's really started to ramp up this year.

We expect to see a significant crisis across the fixed income sphere. So, specifically, most likely sovereign debt. But it will spread across the entire fixed income industry. So we'll talk about that, why that's going to come, and what's happening.

Looking at our first slide that we have here, what we like to point out to people is the fact – everyone in the business today, investing, we all remember the tech bubble. It's almost 20 years ago now. That created about $5 trillion in losses. Then, next up from that, the housing bubble was about $15 trillion, three times bigger.

What we have happening today in the bond world, no one has seen that happen before. So every crisis that we've seen in the world in our lifetime, it's always originated and reflected in the stock markets. So no one is really prepared for what's happening in the bond world.

The best way to look at it, when we look at central banks – whether a Bernanke or Yellen and even Greenspan – the entire Western world, Erik, they've based their economy on Keynesian economics. Basically, what that means for everyone is that when there is a crisis the government will increase spending.

So they'll run a big deficit because that's going to stimulate the economy. And then, central banks on top of that, they'll cut interest rates to make credit easier to flow, and easier for people to borrow and so forth.

What's really happened over time, going back to our first slide here, every time that there's been a crisis in our lifetime the actions of the central banks and governments – specifically in the Western world – by saving one crisis, they really sow the seeds for the next crisis.

So all the losses that we had back in '08 and '09, they were never realized. They were simply taken away from the private sector and pushed over on the balance sheets of the government sector. So they like to call it they "socialized the bad debt losses."

But we have another bubble that has been created. And most of the world, they're just not ready for it. Because they're not used to living in a world where fixed income can be risky and equities can actually be safe.

Erik: Moving on to the second slide, it looks like you're kind of transposing the usual perspective. Normally, people think of government bonds as the safest thing that there is. The risk is in the stock market. You seem to be showing a different view here.

Keith: Yeah. What we like to tell people is that – we've all been led to believe that bonds are always safe, stocks are risky, therefore in the CFA world we live on this modern portfolio theory line where you get a combination of stocks and bonds. This way you have all your balance funds out there in the world.

It’s important for investors today, though, to realize this investment experience we’ve had in the bond market in our lifetime, it’s really been predicated upon long-term interest rates going from high to low. Whenever rates go down, bond markets go up. And it’s the easiest market to make money in.

But we’ve never lived in a period where long rates start to go higher.

And what we’ll talk about in a second is that – unlike overnight rates with either the Fed or any other central banks in the Western world, usually tell what they’re going to do with overnight rates – long-term interest rates, they surge. They go from 1 to 3 to 6 very quickly.

And that hasn’t happened in our lifetime. So, because of that, people are not ready for what happens in the bond world.

The other thing to consider is that most of the investors that we’ve experienced in our career, these are truly global investors. So these are people who lived their lives in multiple countries, they have multiple currencies in their pockets, they have no home-country bias.

It’s incredibly important for the average investor to know that with these investors, as soon as they get a sniff of trouble in the world, they run away from it. And that’s hugely important to know because the way the math works out, of course, you get a 50% loss in anything, you need a 100% return to get back to where you started. So avoiding losses in your portfolio is critical.

And once we begin to see danger in a crisis re-escalating in any market, this large pool of capital in the world, they’re going to run away from it. And once that begins to happen, then people will realize very quickly, oh, wow, that market is trouble. It’s important, though, to understand that when capital leaves one market, it goes to another market for safety.

And those who follow us, they know that we believe there’s going to be a lot of capital seeking safety in US dollars as well certain parts of equity markets. We’re expecting a very different market outcome from what happens in the upcoming crisis in the bond market than what we’ve traditionally been led to believe would happen.

Erik: Let me ask you a couple of follow-ups on that. One view that you’ll hear from a lot of people we’ve talked to on this program is, look, the real risk is in the bond market, same thing as you’re saying. And that means we’re going to get to a situation that is unusual in which both stocks and bonds are selling off together. And that really means a lot of trouble for risk parity strategies and so forth.

But there’s another view – and I’m curious what you think of that – which is wait a minute, it could actually go in the other direction to the point where there is so much danger in bond markets, particularly with the negative-yielding sovereign debt that exists around the world.

It's just so ridiculously overvalued that that selloff, because bond markets are so much bigger than stock markets, that you could actually see the safety trade out of government bonds into stocks. And you could surprise everyone with the stock market moving up in a crisis because it is the safety trade, which is hard to get your head around. But it seems plausible.

What do you think about that view?

Keith: Yeah, we're 90% in the latter camp, Erik. However, before we get to that though, the initial reaction when this crisis re-escalates it'll be a pretty big pop in the world. And we fully expect that equities will come down a little bit in the beginning, whether that number is significant or not.

As a manager, we would have different models in place that will help guide us through that moment. But once this crisis really does begin to escalate in the fixed income world, it's very likely money will flow into equities as a safe haven.

I often say to investors, who would you rather trust with money? The Board of IBM or the Italian government? You usually get a chuckle out of it sometimes, but that's really what you're coming down to.

What we expect will happen in the fixed income world, people will [do] what we call "sliding down the curve." So duration will get hit, specifically. Any type of a spread product, whether it's credit or high yield or emerging market debt, that's going to get hit as well.

So money will seek safety within the fixed-income world, which will be short duration and specifically Treasuries as well as Bonds for that matter. There's a high probability that equities can do extremely well and that's going to cause a lot of the value-investing guys out there to sort of spin around.

Because, as we tell people, valuations don't matter in the world right now. They will at some point in time. But right now if you're a value investor you're saying, wow, none of these numbers make sense. Yet, US equities continue to go up very strongly.

So we often tell people it's not that markets should do what you expect them to. You have to sit back and say, markets are doing this and why? And that really supports this thing that we're talking about.

Erik: Moving on to Slide 3, you're showing this huge secular bull market in bonds, lowering yields ever since 1982. You've got an up arrow at the end here. I'm very curious to know your view because we've had a lot of different people on this program express differing views from, oh boy, it looks like it might be over, to it's definitely over, to we're sure it's over we're betting the farm on it's over.

So do you think that the bottom is in on Treasury yields and it's all uphill from here? Or are we in kind of a bottoming process where we're not sure if there is another wave down that might take us to a new lower low in yield?

Keith: This slide is so simple it's perfect. What we're showing everyone here is just the history of US 10-years. It's really a proxy for long-term interest rates. What we see is in the early part of the '60s long rates went from 2.5% right up to almost 20% in 1982, depending on which rate market you're looking at. Then from '82 down to basically just last year, it went down to zero.

This is the key thing that most investors are really missing in the marketplace. We've all lived in a market and a career in a market environment where bond funds have always done well. When you have long-term rates go from 20% to zero, any bond manager in the world can make money. It's the biggest bull market we've ever experienced in fixed income.

What's interesting, if you think about this more from a practical perspective – we always try to make things very simple for clients, understand. I started working in the business back in the early '90s, so I was trained by a person who worked in the '80s. In the late '90s early '00s, I trained a person ten years behind me. And so forth.

Everyone in the business today, most people, have either only lived and worked and been trained by someone who only lived and worked in a period where long-term rates have only gone down. It's hugely important to know that the majority of the industry has never experienced a market with the long-term rates going higher.

On top of that, they've never experienced a crisis in the bond market before.

So we like to tell people that the bond market – as you mentioned, the bond market dwarfs the size of equity markets. It's a crowded gymnasium; there's no liquidity to get out. You can move inside the market if you want. But it's similar to having a gymnasium that's packed and there's one door open at the end. You just cannot get out of it.

To go back to your question, Erik, the long end of the curve it's clearly already turned to move up. Whether you're looking at the US with the 10-year, we've gone from 1% to 3% now in about a year and a half.

The same thing is happening in Canada. It's happening in other markets as well.

The big point to understand is when we look at the yield curve today – let's just turn to the next slide [Slide 4], it just sort of expresses the point a bit better – a normal functioning bond market has a yield curve where short-term rates are lower than long-term rates.

Since the crisis in '08 and '09, because we've had so much (I call it) interference from central banks, we've had over $14 trillion in various forms of money printing, quantitative easing. Put on top of that we had about 700 rate cuts around the world. Then we've had a negative interest rate policy and then, of course, we still have negative rates across most of Europe and Japan.

That has artificially suppressed the yield curve. In everyday language, it means that the price of bonds has been artificially locked in place and the private sector has not been able to get in and really affect what the price of bonds should be.

When we talk about a crisis in the bond market occurring, it's because long-term bonds, all of a sudden, they are now freed from suppression by central banks and they are now open to the private sector to start re-pricing again. When you get a re-pricing in the bond world, the long-term rates are going to go from 1% to 3% to 6% and then 12% and it's game over.

It's similar to what happened to Italy back in 2011–12, when they had their crisis. Silvio Berlusconi was kicked out overnight and the ECB stepped in to save the day. That's what we see happening.

We do not believe that the long end is simply going to be affected by inflation expectations or the economic cycle. The key really comes down to what's happening from central banks, specifically in Europe, and that's going to catch a lot of investors by surprise.

Erik: Let me just ask a follow-up on that because last time that this happened, when we saw interest rates bottom, was at the end of World War II.

Of course, that was a very different set of circumstances. But a lot of people expected a V-shaped recovery and it didn't really happen. It ended up being a U-shaped recovery where those very low rates stayed about the same, very low, for about 10 years. And then they finally started to take off.

You're expecting rates to V-shape here and to take off. Is that specifically because of central banks withdrawing their liquidity? And, if so, it seems to me like at some point, as soon as this starts to take off, maybe they go back to their old ways and try to suppress them some more.

What do you see on the horizon there?

Keith: Really, we tell people we're having this moment in time. Every crisis is a little bit different, but a lot of it is the same from previous crises.

Right now, we're really experiencing a collision between social, economic, political, and monetary factors around the world. Everything is hitting each other at the same time and it's created this chaos, whether it's in politics or social or economic and financial markets. There's a lot of confusion now out there. You know, what it going to happen?

Our view on why we get this crisis in the bond market is a combination of two things. One, the financial conditions are just perfect for it. We'll show you in a little bit that when you look at the percentage of many countries, the percentage of their tax revenue that has to go towards just paying interest on their debt outstanding, it's significant.

It becomes even more significant once rates rise. That will have a pretty difficult effect on a lot of governments trying to maintain their budgets.

But the other part of it, though, really comes from the social and political side of the equation. There is a lot of unhappiness around the world right now. And that is getting reflected in the political world.

We look specifically over in Europe, the Eurozone as well as the EU. The divide between the left versus the right, it's growing by the day. It's become increasingly difficult for the Eurozone, specifically the EU, to maintain what they have.

Specifically, when we look at what's happening in Italy these days. It's very likely that Italy is the one that will ultimately be the epicenter for when this crisis re-escalates again. And it's coming at the exact moment in time where the ECB, they have to unwind their QE.

Mario Draghi's term is up next year. The German government, they are against the ECB's policy with QE. They want to turn it off. So the exact moment in time where political and social stress are colliding with each other is the exact moment in time where the financial markets aren't able to absorb that type of crisis. That's what we see really happening.

Erik: I just want to follow up on that because what I can see is you've got – I couldn't possibly agree more with what you just said which is we have a mounting economic crisis.

I agree. But, boy, the mounting social crisis around the world is bigger. And it is going to have a greater impact on what governments are forced to do because they're going to be dealing with outright riot kind of situations among their constituents.

It seems to me like the thing that governments cannot afford is a secular reversal of the direction of interest rates because they're so over-indebted now that they would be unable to afford to service their debt. And it seems to me that they would need to increase that debt with more deficit spending in order to deal with some of the social issues that you're talking about.

It seems to me like a setup for governments to panic at some point and say, we've got to go back to doing everything we possibly can to suppress rates because we're screwed otherwise.

Am I wrong to think they're going to find themselves in a pickle? And when they do, is there anything they're going to be able to do about it? Or are they going to have to just suffer like the rest of us through higher rates?

Keith: Obviously, we have a very similar view on what might happen here. But, first of all, when we say "governments" we specifically mean the elected office and, of course, the ministries underneath them. You really have to separate that from the central bank with any country.

To make the assumption that any government in the world today – whether it's the American, Canadian, British, you name it – I find it's extremely unlikely any of these guys are going to be able to anticipate any crisis and then be proactive towards it. They just don't work that way.

Even in Canada, for example, during the last federal election I had the Liberal party drop by one evening – they were canvassing for their vote. And they don't realize I'm a money guy, that's the world I live in. It's pretty black and white to me. I asked them, What are the Liberals going to do with the deficit that's expected to come up?

There was a whole team of them, six or seven, canvassing the neighborhood that night. They all gathered around me and they said, well, we're expecting a $2 billion deficit. I looked at them and said that's impossible. You guys are going to be at least $20 billion for all these things that you say you're going to do. You're not going to hit $2 billion. It's going to be way north of that.

They quickly scribbled in their books: This one may not be someone supporting our party. What happened afterwards, of course, the Canadian deficit in the first year was $30 billion. So, remember, they are telling voters there is going to be $2 billion and the final number is $30 billion.

To expect governments to be on top of this, I think that's just wishful thinking.

The best way to really demonstrate what's happening, Erik, let's just shoot straight through to Slide 12. It's entitled "Sovereign Debt Has Exploded." This is a chart that's showing what the growth has been in total debt. And it's separated between the developed world and emerging markets.

What it shows here is that from 2006 (just before the last crisis) and 2016 – so a 10-year period – the debt outstanding in the developed world has grown by 25%, from $128 trillion to $160 trillion. That's pretty significant. That's big.

The most important point to understand, though, is underneath this, debt in the emerging market world has grown by 250%. Ten times stronger growth of borrowing in the emerging market world.

When we look at how the emerging market world, how they borrow, the two points to know is that they are primarily borrowing in US dollars. That instantly creates a shortage of dollars in the world. So it's a short of dollars. Which means in the future they have to buy dollars back for this.

If you look over to Slide 13, this is the data point I referred to a few minutes ago. It's showing the percentage of the government's tax revenues that has to be allocated towards interest on debt outstanding. All of these rates today are currently based upon artificially suppressed interest rates around the world with the central banks being heavily involved in suppressing yield curves.

So when we look at, hey, can governments save the day? They'll be reactive, that's all they'll be. They cannot be proactive. It's only after rates start surging higher that governments sit down and they do their budgets and they say, holy smokes, we used to allocate 6% of our budget for paying interest on the debt. Now it's going to be 12%. That's less money left over for this and that.

And that's happening at the exact point in time when borrowing for dollars, the demand, is just increasing even more. So I hold very little hope that governments around the world will be able to be proactive to correct this from happening. They won't be able to do it. And that's the same with central banks as well, Erik.

Right now, the Fed has already stated when they started raising rates just recently that we're no longer going to be the central bank of the world, we're changing our view, we're looking after the US.

And every time you have the Fed raising rates, while the rest of the world continues to have QE running as well as negative rates and zero rates, that just sucks more foreign capital into the US market, which makes it even worse for foreign currencies and foreign debt markets.

So this is setting up to be, in our view, one of the easiest macro calls to make in our lifetime. Because of that, there is a significant opportunity for people to both make and lose money. So people have to decide whether to recognize this as a risk and be able to capitalize on it – because we can't stop it from happening – or just to ignore it altogether, which is really going to hurt a lot of people's portfolios.

Erik: Keith, thanks for jumping ahead to answer my question, but I want to go back to where we left off. Let's go to Slide 6. You're showing Warning #1 here. What's the warning?

Keith: Oh boy. Again, we really separate the industry from investment markets. What we like to do with these next two slides is to demonstrate to investors that, in our mind, 90% of the investment world, they are not making big investment decisions. It's always thrown against a benchmark and managed cash flows and that's it.

What we're showing here on Slide 6, we call it Warning #1. This is the US 10-year. It's showing the history of the 10-year from 1982 to the end of 2016. We like to show this because this is what's happened with long-term rates in the US immediately after the 2016 American election.

And what happened after that – people were following equity markets of course – but within about a 48-hour span the US 10-year went from 1.7% to 2.4%. A 70 basis point rise effectively overnight.

For most investors, they'll say, no, Keith, round it. It's gone from 2% to 2%. There's no big change here. But this small 70-basis-point change in long-term rates, it just created so much chaos in the bond market world.

I actually had meetings with one of the largest bond managers at the time about a week after this happened. I said to them, how were the last few days for you guys (with "1" being everything is great and "10" things haven't been very good)?

They looked at each other and they said it was an 8. I said, wow. So a 70-basis-point unexpected increase in the 10-year cost these guys, one of the biggest bond managers in the world, to go down for an 8 count.

If you look at the slide here [Slide 6], we have the headline stories from that day. One from Bloomberg is saying, "Global Bonds Suffer Worst Monthly Meltdown as $1.7 Trillion Lost."

Another one says "Sleepy Bond Markets Stirred by November Like No Other."

Again, this is to warn people that the industry and the bond market are not ready for a crisis or a long-term surge in rates.

The same thing happens again on Slide 7, Warning #2. This took place back [about] 7 to 8 months after the US election, in Japan. I woke up one morning, and I'm going through data points to see what's happening. And the Japanese bond market, it's gone crazy. What happened to cause it to go crazy?

The 10-year in Japan, the Japanese government bond 10-year, went from 0.10% yield to 0.125%. So a two-and-a-half-tick increase. And the BOJ went nuts. They said, we will never tolerate this again.

And they bought everything they could in sight to get the bond yields down again. Again, demonstrating that the second biggest bond market in the world, they couldn't tolerate a .0012% change in the yield curve.

On Slide 8 (Warning #4), the same thing in Canada in August of 2017. You see the title here from a Bloomberg story: "How Funds Are Regrouping After Worst Canada Bond Rout Since '94." It's the same thing on the bottom corner, they talk about the Australian bond market.

On Slide 9 (Warning #3), Erik, one of the best, easiest slides that we've shown in a while. This is from March of this year. Not too far back. Another Bloomberg story. And they say "Not a Single Japanese 10-year Bond Traded on Tuesday." Again, that's just crazy stuff.

It's an equivalent to the stock market [if they were] saying zero shares of Google traded today.

People are not ready for this lack of liquidity in a crisis in the bond market.

And then the most recent one [Slide 10 Warning #5], of course, which should really plant the seed in everyone's head that the central banks are really suppressing rates, specifically in Europe. What we're showing here is what happened with the Italian 2-year bond.

Just to refresh everyone's mind, the Italians had their election back in the spring. Leading up to it, we wrote about this. We said it's very clear what's going to happen in Italy with the political scene. The two parties leading in the polls – #1 and #2 – their main political platform, they're both flipping the bird to the EU and the Eurozone and Brussels. These guys are going to win and this is going to create chaos in the European bond market.

Sure enough, these guys win and markets were somehow surprised by it. And, of course, a few days later, this new coalition party in Italy, they appoint their new finmin (financial minister). And this guy's entire career has been dedicated to trying to tear up the Eurozone.

And the first thing that happens the next morning, Brussels and Frankfurt and the ECB, they get together. And they say, wow, you know, the Italians are really rocking the boat down there. How about shooting one across the bow? And the ECB said, sure, no problem.

So instead of buying Italian bonds that day they sell some on the market. And – this is the key point again where the market is not ready for this – the 2-year yield in Italy went from 0.2% to 2.4% in one day. So .2% to 2.4%. That's equivalent of a stock going from 100 down to 2 within hours.

This should be sending shivers down your spine if you're long the bond market or cause you to jump up with excitement if you're short the bond market. Because we're getting these consistent warning shots that the market is not ready for a crisis in the bond market and the bond market itself is not ready for it.

This is enormous. This is a terrific opportunity coming up, depending on how you position your portfolios.

Erik: To summarize all of this, it sounds to me like your views are very similar to my own. Let me state my own view and tell me, first of all, if it's similar but, most importantly, what happens next and what can we do about it.

My view has been that what we've done with shortsighted thinking is central banks have solved all of the symptoms of the last crisis by creating artificially low interest rates. They propped us up into this negative-yielding sovereign debt situation where there is no room left when we get to the next crisis. You can't go to the safety of bonds because bonds are not safe.

So, at a minimum, the bond market, which is four times bigger than the stock market, selling off in a way that could be self-reinforcing. It becomes a question of what could happen there?

And it happens at a time when we're already reaching a boiling point on social crises around the world. I think that what it creates, most likely, is a situation where governments go into a financial crisis at the same time they're coping with the social crisis.

According to old-school Keynesian philosophy, they most need to spend a lot of money on deficit at a time when markets are least allowing them to do so.

I guess the first question is, is my summary – which is my own view that I've had for many years about where we are – consistent with yours?

But, more importantly, to whatever extent it is, what the heck does that mean in terms of what's coming? Because I think when we get to the next crisis, it's not a question of just turning on the printing presses and more QE. It's a global social crisis that I'm not sure what it's going to lead to.

Keith: I agree, Erik. Our views are quite similar. We tell people that we believe there is a very high probability that the world does trend towards what we expect. So that is going to happen.

As for how it turns out, we think we'll probably be 80% correct, marketwise.

The first part of your question, from a social-political side, there's going to be a lot of angry people out there. That will happen. Because, again, the conversation that we're having today – and people listening, I think that represents a very small percentage of the marketplace – most people are oblivious to these types of conversations that are happening.

So, yeah, there will be a lot of confusion out there. And it will create some unfortunate times for a lot of people.

In terms of the marketplace and how this transpires, Erik, the central banks have always been reacting towards a crisis that's been created by the private sector. You and I, we caused the housing crisis, we caused the tech bubble, and so forth.

Once this crisis re-escalates again in the bond world, there is no blueprint for it. So I'm not quite sure how it looks, what the reaction will be from central banks.

Specifically, everyone will be looking towards the Fed. Even back in '08, what a lot of investors don't realize is that, without the Fed opening their line to Europe, Europe would have gone under.

And everyone starves for dollars. The US dollar, it's the only market big enough in the world to put money into during times of crisis.

People listening to this today, they're hearing your view, and a lot of other people have a similar view as us. As bad as things may seem in the US right now, from a singular perspective, the US dollar has the real potential to go significantly higher, I hear.

We tell people, with markets you have to think of the world from a currency perspective. And we tell people really only three currencies matter in the world. Think of the US as the foundation base. Next to that you have the Japanese yen. And then on top of that is the euro. Every other currency is sort of swirling around and it's just making noise.

We anticipate crisis in the Eurozone first. Capital will flow into yen and dollars for safety. And then, all of a sudden, once the crisis more or less has sorted itself out in Euro-land, then it will hit the world of Japanese yen. And then, finally, the dollar will have their day as well.

So to get through this thinking in a linear fashion will not work. You have to understand it's going to be very fluid. Things happen extremely quickly.

The main blueprint is that no one is ready for it. You and I, we can't change it. Talking about it today will help a lot of investors prepare for it.

But this is happening and it is what it is.

Erik: With the dollar strengthening as it already has – it's retraced just barely more than half of the move down over the last year or so – and that already seems to be creating a crisis in emerging markets.

If we move to new highs about 104, or whatever the recent peak was a little over a year ago, what does that mean for emerging markets? And what's the transmission mechanism into developed markets from there?

Keith: Well, first of all, the recent strength in the dollar that's just been – there has been strength, Erik, but it's not what we expect. We expect a surge in money going into USD.

So whether we're measuring it by DXY or whatever other currency you want to look at, we're telling people this is nothing. This hasn't even started yet. If the dollar, once it does begin to strengthen –

Remember, all this happens simultaneously. You don't have a stronger dollar and then emerging markets experience a weakness. One leads from the other. It's going to be extremely difficult in the emerging market world. We're already seeing it now in several countries. It's happening.

What I find most unfortunate – just a side note – we continue to get calls from fund companies, the ETF manufacturers trying to sell us emerging market debt funds. And I say to these guys, are you joking? Do you have any idea what's happening in the world?

And they don't. They look at it as – you know, the old story with emerging markets is that the fundamentals are better than the developed world. They're growing faster, lower debt, better workforce and stuff like that. But they just don't understand that the probability of this group hitting a more severe crisis – it will dwarf what happened in ‘97 and ‘98 with the Asian crisis back then. And that’s happening.

Because we live on a global yield curve – banks are in a global funding space, that’s where they are – one crisis in one market leads to the next which leads to the next, the next.

We quite often get people they’ll ask, Keith, what will cause the housing market in Toronto and Vancouver to slow down? And I say, oh, that’s easy. It will be Italy. And they look at me like I have 10 heads. And they’ll say, no, we asked about Toronto.

And I go through the Italian bond market, how they’re relying on the ECB to finance their deficit, and you go down that route. And then they look at you like deer in the headlights.

But the main point here is – whether it’s the Canadian market, or the US, or the emerging market world – everyone lives on the same yield curve. And a crisis in one part of the market, it just spreads into the others.

I know we talked a lot about the bond market today. But, again, we tell people it’s extremely important to know that no one asset class operates in isolation. There’s no zero correlation among asset classes. They’re all connected.

And this crisis that’s facing us, that’s coming up, it’s going to be fixed income, currency-driven. It’s going to cause a lot of capital to go scattering around the world.

Erik: Let’s touch on gold briefly. Because, according to conventional wisdom at least, if you’re expecting a huge surge up in the dollar, that should be extremely bearish for gold. On the other hand, your larger-picture outlook, in terms of a major bear market in bonds, could potentially be extremely beneficial to gold.

So is it time for gold yet? Where’s the trade there?

Keith: It could be time. With IceCap, we tell people we’re asset class agnostic. In simpler terms, we don’t love or hate any asset class.

As an example, we had a pretty significant allocation to gold bullion back in ‘11 and ‘12. People in the gold world, they all remember what happened next. Gold broke from – it almost hit $2,000 and then went down to $1,600 and then $1,200. And it’s been there ever since.

People who follow gold, they all know the same fundamental story, why it should be surging and the reasons why it hasn’t and so forth.

We’re a lot simpler with that. We don’t disagree with that storyline. However, when any asset class or market, when it breaks specific support levels, you have to respect that whether it’s on the upside or the downside.

So, once gold broke back then, our last trade was out at $1,648. And we haven't been back in since. Our story that we tell people from a market perspective is that we do expect the dollar to become extremely strong.

And, initially, Erik, we expect that will be negative for gold. We think gold – it has an opportunity here to come down one more bump. But, after that, we can see a period where both gold and dollars do very well.

With us, we have our current strategies in place. Then we also have other strategies on deck. We've had gold on deck now. People who have been following they'll say, yeah, IceCap has been saying this for a while.

We've had gold on deck now for a couple of years. We really want to add gold to the portfolio, but the conditions are still not there. Gold remains weak. We think the long-term outlook is quite big. But you've got to get through this dollar market first.

Erik: Well, I couldn't agree more. I really, really believe gold is going to have its day in the sun and I think it's going to be the trade to be in. But I don't think it's time yet. I think we've got more down before we go up.

I want to go back, though, to something you just said about people following you. You guys have been extremely popular. Zero Hedge has really taken a liking to your research work.

For people who are interested in following your work, please tell us more about what you do at IceCap Asset Management and where people can learn more about it.

Keith: At IceCap Asset Management, we provide investment portfolios for individuals as well as institutions. We are what we call absolute return. So, in more technical terms, benchmark on constraints.

So we really focus on avoiding markets that we expect are going to produce losses. I mentioned earlier the importance of doing that. And constructing portfolios, really, from a currency perspective first and going out from that.

For our Global Market Outlook, Erik, people can sign up for that. It's free. It's on our website at IceCapAssetManagement.com. And we're on Twitter as well @IceCapGlobal.

Erik: Well, Keith, I can't thank you enough for a fantastic interview. Patrick Ceresna and I will be back as MacroVoices continues right here at macrovoices.com.