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Weekly Summary of Daily Updates

1) **Disclosure Statement** – please read and remember that this in NOT investment advice in any way, but instead represents the internal end of day ramblings of an individual with poor enough judgment to give up a well-paid, low risk position for the dream of entrepreneurship and self-expression. Interpret accordingly.

2) Daily Updates

Tuesday, May 27th, 2014 – Daily Update:

Wednesday, May 28st, 2014 – Daily Update:

Thursday, May 29th, 2014 – Daily Update:

Friday, May 30th, 2014 – Daily Update:

Thank you for your time and support. Comments and feedback are always appreciated.

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The Fund's actual returns and volatility will depend on a variety of factors including overall market conditions and the ability of the Investment Adviser to implement the investment objectives and policies of the Fund. The Fund's investments are subject to the risks of market volatility, which may be severe. Such market volatility may be caused by, among other events, unpredictable economic and political events that may cause sudden and severe reductions in the value of the Fund's investments.

This material is as of the date indicated, is not complete, is subject to change and does not contain material information regarding the Fund, including specific information relating to an investment in the Fund and related risks factors. Certain information, including information related to indices and benchmarks, has been provided by and/or is based on third-party sources and, although believed to be reliable, has not been independently verified. Ice Farm is not responsible for errors or omissions from these sources. No representation is made with respect to the accuracy, completeness or timeliness of information and Ice Farm assumes no obligation to update or otherwise revise such information.

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The Offering Documents contains detailed information relating to the Fund's investment objective and strategy, fees, risks and other material aspects of an investment in the Fund and should be carefully reviewed.

This material must be read in conjunction with the accompanying Disclaimer at the back of this material.

The Funds are unregistered private investment funds that may invest and trade in many different markets, strategies and instruments (including securities, non-securities and derivatives) and are not subject to the same regulatory requirements as registered investment funds (such as mutual funds), including requirements to provide certain periodic and standardized pricing and valuation information to investors. There are substantial risks in investing in the Funds. Persons interested in investing in any Fund should carefully note the following:

- The Funds represent speculative investments and involve a high degree of risk. An investor could lose all or a substantial portion of its investment. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment in a Fund.
- An investment in a Fund should be discretionary capital set aside strictly for speculative purposes.
- An investment in a Fund is not suitable or desirable for all investors. Only qualified eligible investors may invest in the Funds.
- The Funds' offering documents are not reviewed or approved by federal or state regulators.
- The Funds may be leveraged and a Fund's performance may be volatile.
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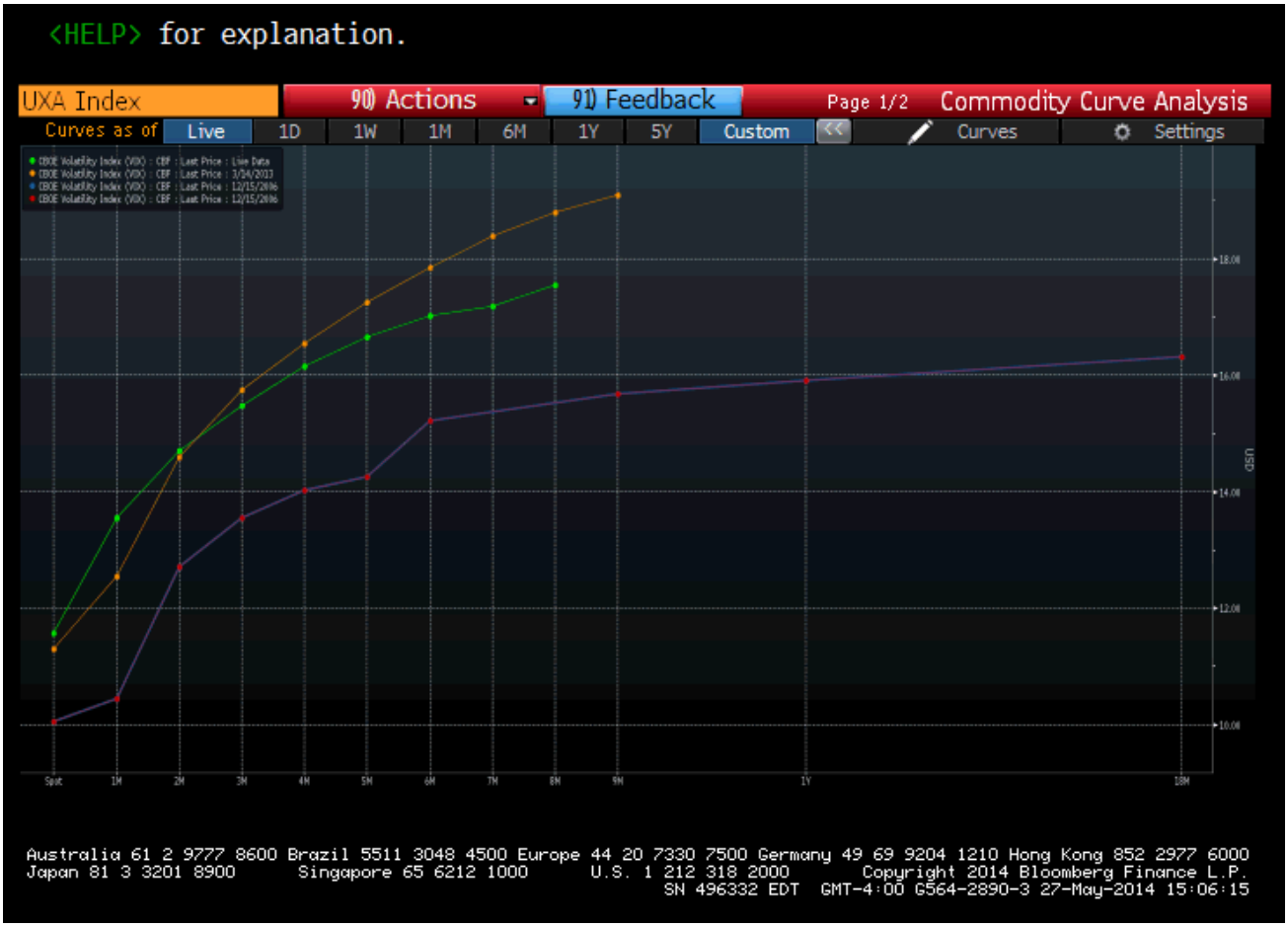
- A Fund may have little or no operating history or performance and may use hypothetical or pro forma performance which may not reflect actual trading done by Ice Farm and should be reviewed carefully. Investors should not place undue reliance on hypothetical or pro forma performance.
- Ice Farm has total trading authority over the Funds.
- The Funds may employ a single strategy, which could mean a lack of diversification and higher risk.
- The Funds may involve a complex tax structure, which should be reviewed carefully.
- The Funds may provide no transparency regarding underlying investments to investors.
- The Funds may execute a substantial portion of trades on foreign exchanges, which could mean higher risk.
- Each Fund's fees and expenses—which may be substantial regardless of any positive return— will offset the Fund's trading profits.
- The Funds are not required to provide periodic pricing or valuation information to investors.
- The Funds and Ice Farm may be subject to various conflicts of interest.

The above summary is not a complete list of the risks and other important disclosures involved in investing in the Funds and is subject to the more complete disclosures contained in each Fund's Offering Documents, which must be reviewed carefully.

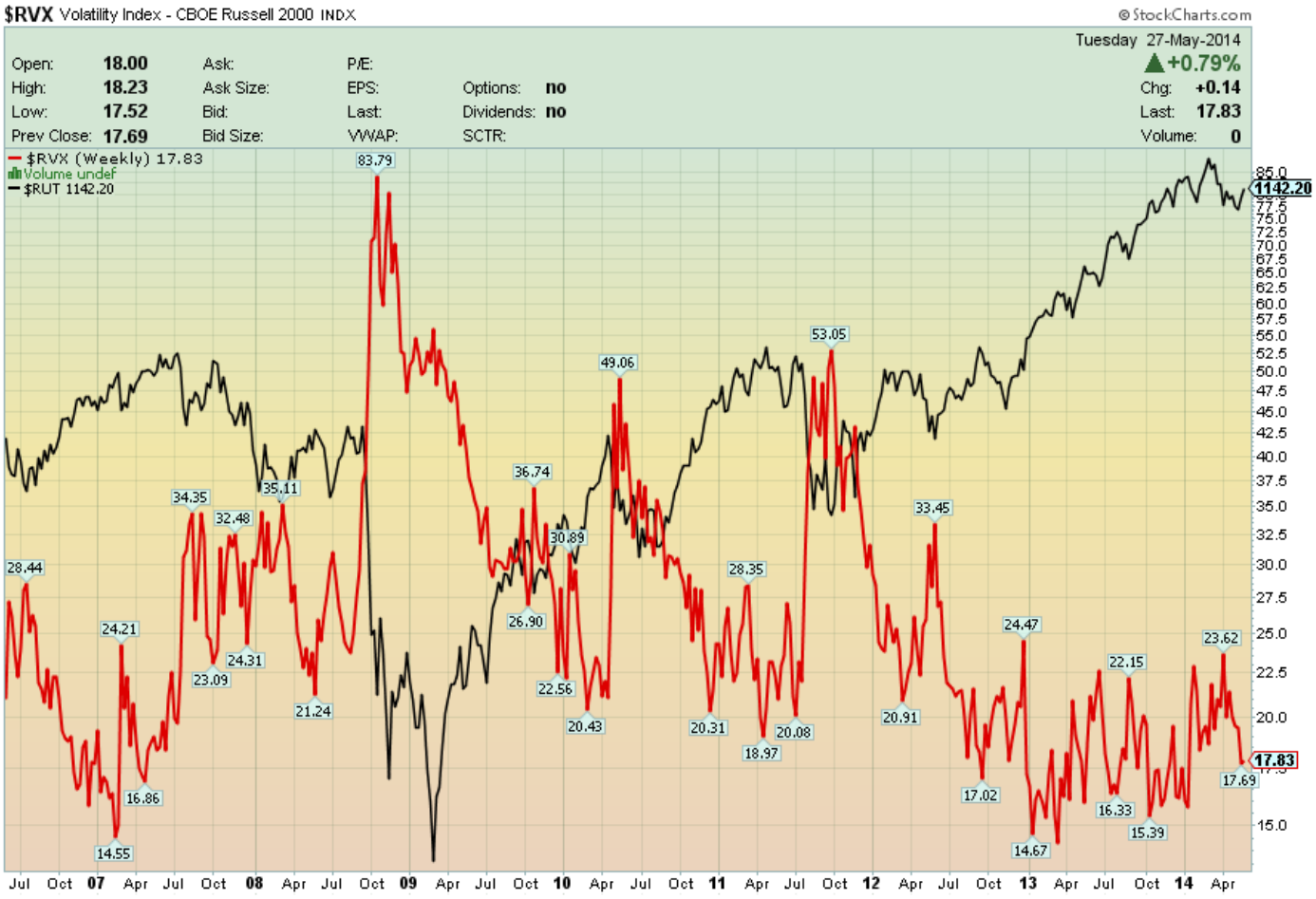
Tuesday, May 27th, 2014 - Daily Update:

The primary story in the markets continues to be the collapse of volatility. While the closing spot VIX print has yet to undercut the lows from March 2013 (orange line below), the current VIX forward curve beyond three months is unquestionably making new post-2008 lows (green line). The only remaining records to chase after in the forward curve are the December 2006 lows (blue line below) which would suggest another 1-2 pts. are possible.



We have repeatedly emphasized the different experience in the small cap indices where volatility has clearly undercut the pre-2008 lows and now appears to be trending higher. The pattern of higher highs and higher lows since the early 2013 R2000 volatility index low is consistent with a market where volatility pressures are slowly building, setting the stage for a meaningful increase in the perceived "cost" of owning small cap equities. As we have noted, R2000 earnings have turned markedly lower over the past year with absolute declines in EPS. A significant component of this earnings deterioration is coming from loss making companies rather than significantly lower earnings at the majority of companies.

This pattern has preceded the past two recessions. While it seems implausible given the current perception of acceleration, this is additional evidence that the Q1 GDP contraction may not have been a weather fluke.



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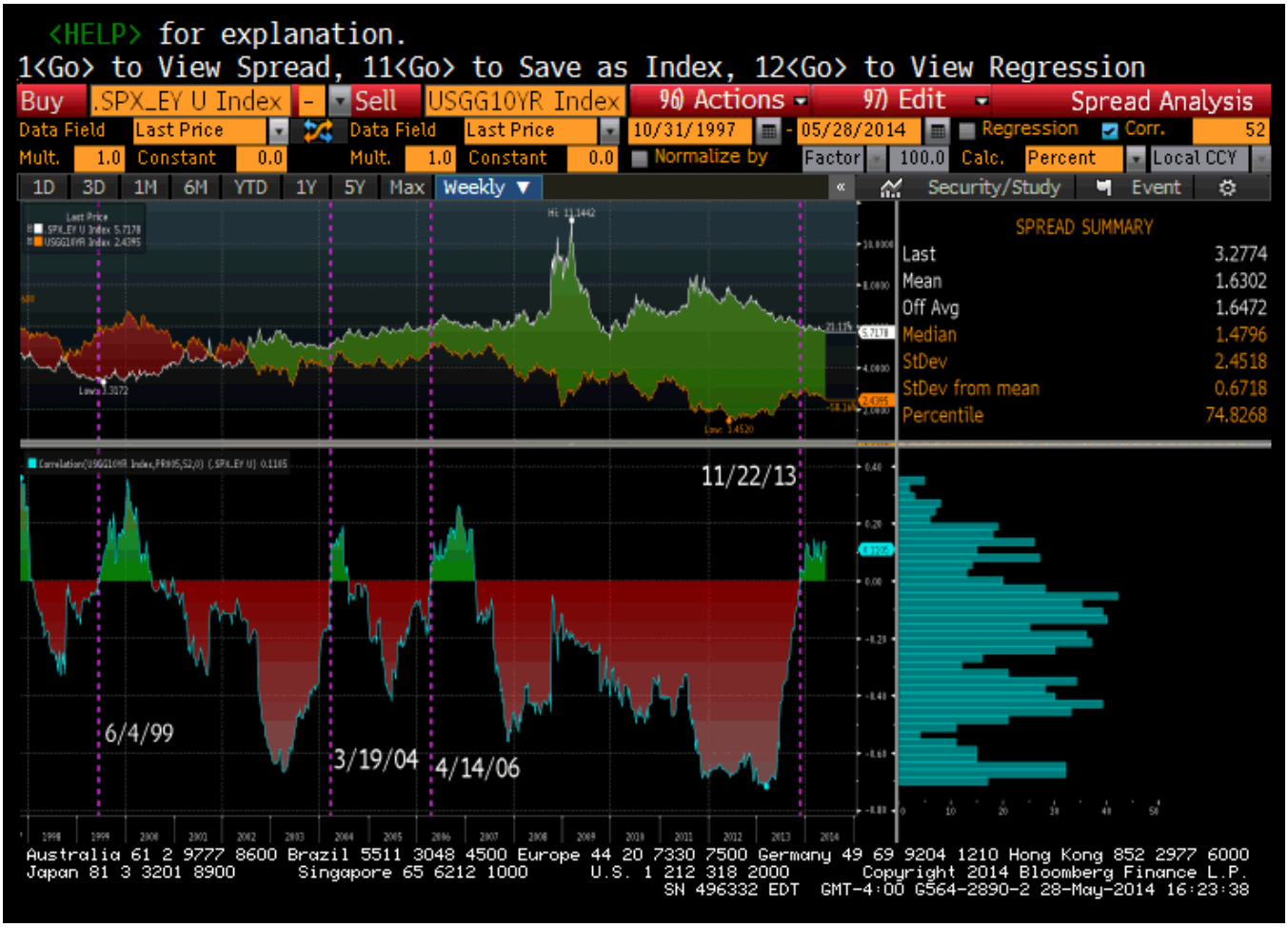
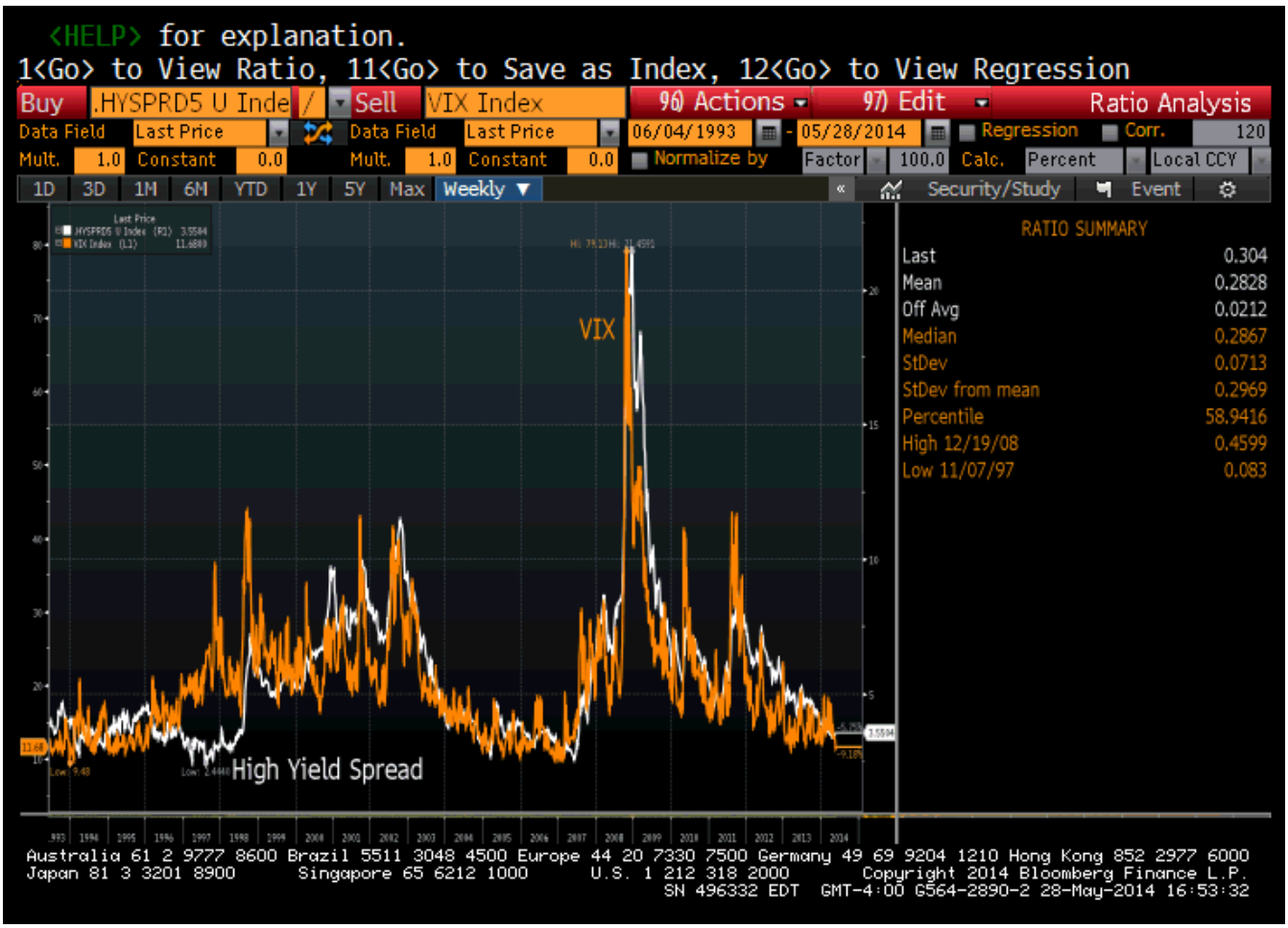
Wednesday, May 28th, 2014 - Daily Update:

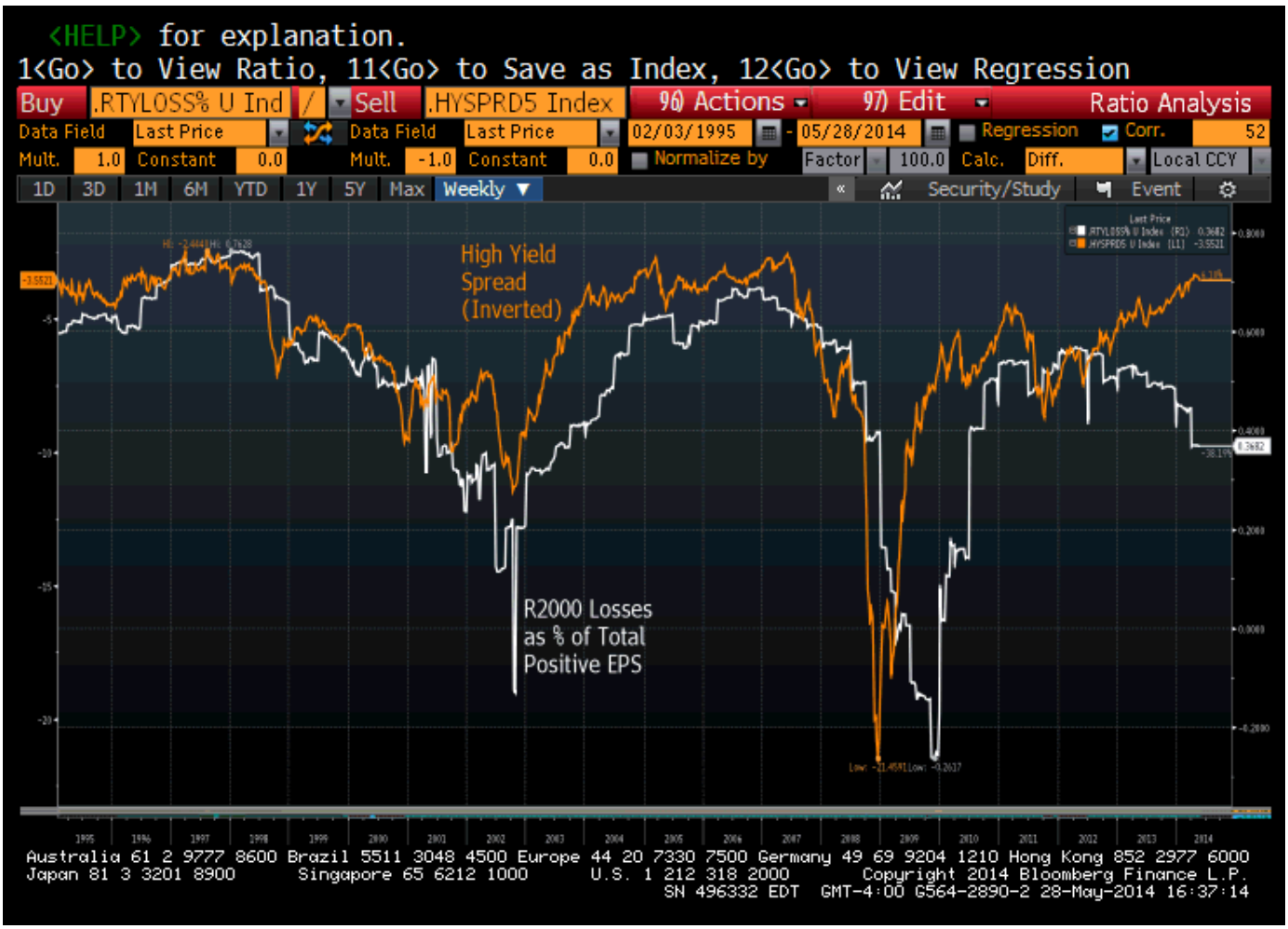
Since roughly 1997, the "Fed Model" of stock market valuation has been a disaster. Earnings yield has been negatively correlated with 10yr interest rates over a 52 week rolling period nearly 90% of the time. From our perspective, this reflects the fact that there is no embedded relationship between interest rates and stock prices – instead the relation reflects the expectations of Fed policy behavior. On rare occasions, we have seen correlation turn positive as perceptions of a hostile Fed have emerged – late 1999, early 2004, early 2006, and November 2013. In 1999 and 2004, the Fed almost immediately commenced rate hikes. In 2006, the Fed continued hiking for another few months before being forced to aggressively cut rates. In 2013, the Fed began tapering QE at the next meeting. While it is unclear whether the Fed will ultimately begin the process of outright rate hikes, what is clear is that the rate market has begun pricing in a hostile Fed.



Unfortunately, risk markets are not showing any such excitement. Equity volatility and the closely associated high yield spread are in almost perfect synch on the "always look on the bright side of life" interpretation. There is none of the 1998 disconnect in favor of equities (i.e. equity vol high relative to credit vol) or 2012-13 favor of credit (hy spread wide to equity vol). Instead, they are sitting almost exactly on top of each other.



Which of course creates a problem when fundamentals begin to diverge. Below is the relationship between "total EPS as % of total positive EPS" on the R2000 (i.e. a measure of earnings quality) and high yield spread (inverted). Historically, these have tracked quite well. The recent divergence is somewhat unprecedented in nature, suggesting a marked deterioration in the behavior of high yield spreads and the quality of the EPS that underpin the credit repayment capability. Combined with a "hostile" Fed, and we better change the "expectation" of economic acceleration into fervent prayers for that acceleration.



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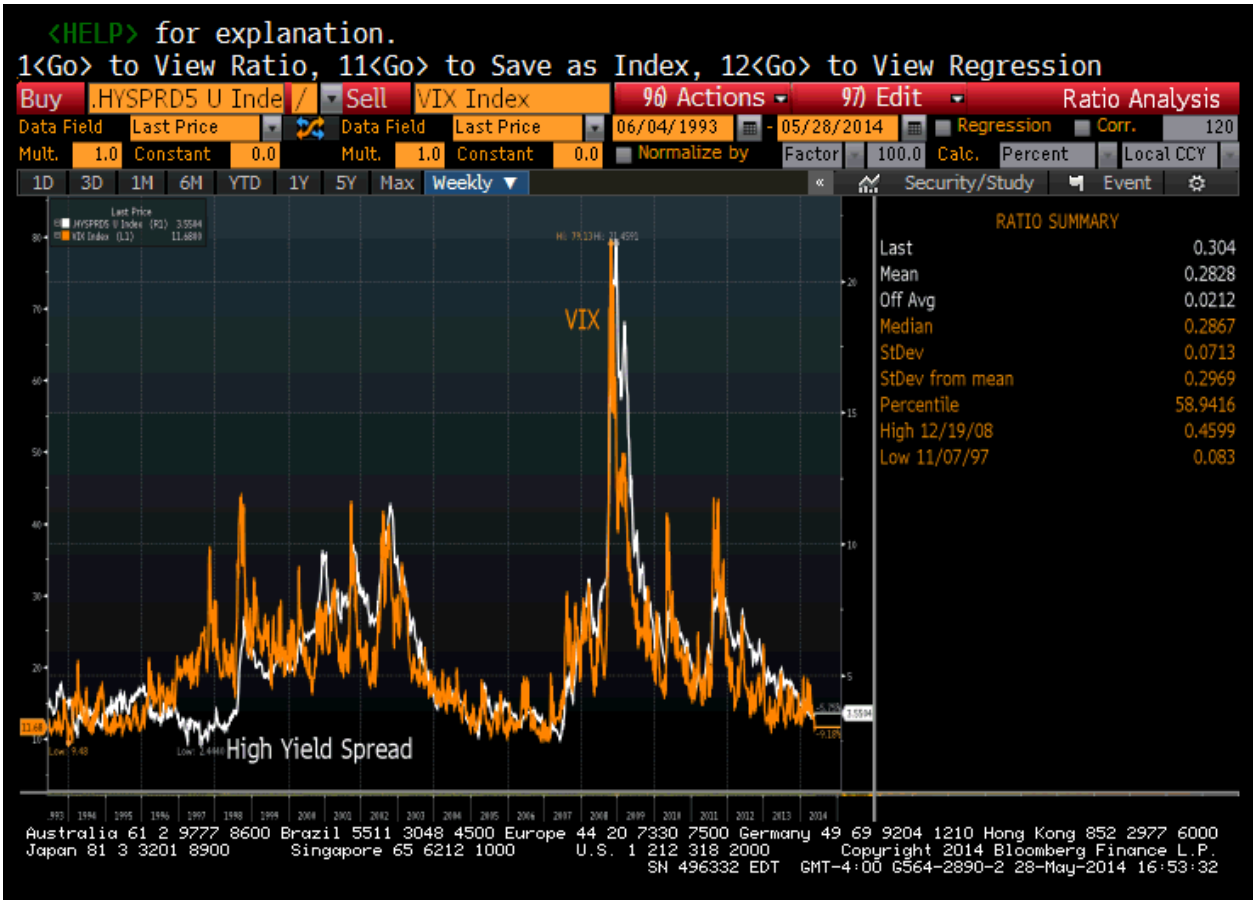
Thursday, May 29th, 2014 - Daily Update:

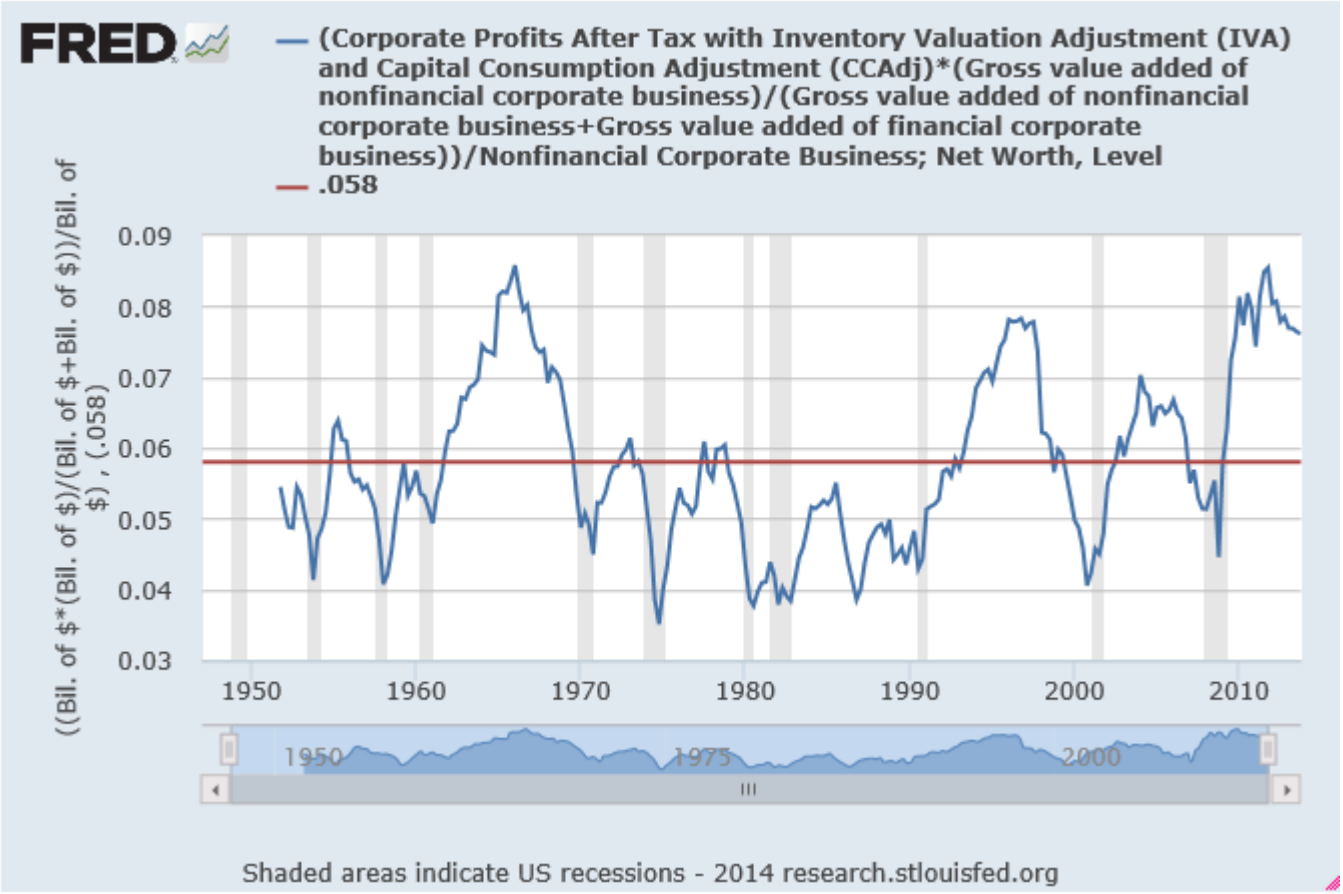
In 1929, Joseph Kennedy supposedly knew to exit the stock market when the shoe shine boy was giving him stock tips. Today's analog could well be the constant clanging of the "volatility is too low" (we are among the town criers of course). While we agree vol is too low given underlying equity fundamentals (a view that extends to high yield spreads), the reason vol is so low is rarely discussed. Put simply, it's a function of the hunt for yield.

The below chart highlights the record low price of S&P 1 year 105% calls. At 2.5%, this has hit an all-time record low. However, this should not be a surprise in our low credit spread environment – by definition, a structured product composed of long a zero coupon bond and long an equity call has to be comparable to the return of a risky bond. With low rates and low credit spreads, implied volatility in equities becomes an arbitrage relationship.

This is why the price of volatility so closely tracks the level of credit spreads:



Unfortunately, there is no clear catalyst that will cause this process to reverse. The 2007 quant meltdown, 1998 Russian crisis, 2008 Lehman, 2006 housing – all were significant events that drove an increase in fundamental volatility. What event drives it this time will only be known in hindsight, but this event will ultimately occur. The underlying volatility of corporate profitability (when defined as ROE %) has shown remarkable mean reversion characteristics over the past 50 years. This cycle does not appear different. With profitability beginning to decline, the stage is set for future credit widening:



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Friday, May 30th, 2014 - Daily Update:

We are cursed to live in the most interesting of times. This included a surprising negative GDP print in Q1 when business investment turned sharply negative. The rationalization of "weather" and "inventory" are of course available (while few acknowledge the "stimulus" to spending created by Obamacare), but the print is now in place for history to judge. It will make interesting reading in 2024 to evaluate Janet Yellen's decision to continue with monetary tightening in the face of a negative GDP print. My guess is no one will be debating the relative amount of snow cover in 2024.

However, Janet Yellen is not the only one ignoring the negative GDP print. While many will correctly point out that GDP growth and equity market performance are only loosely linked, the simple fact is that a negative GDP print more than doubles the probability that the S&P will have printed negatively in the prior quarter to an expected outcome rather than an outlier. Not only did that not occur this time, but the S&P was up 10.5%. Nor did we get our negative print this quarter… up 1.81%. While we can cry over spilled milk, it is more valuable to accept that we should have had a correction, but we didn't.

QoQ GDP	Number of Occurrences	S&P Down Prior Qtr	S&P Down Current Qtr	S&P Down in Either
Positive	189	32.3%	34.9%	54.0%
Negative	27	66.7%	44.4%	77.8%
Total	216	36.6%	36.1%	56.9%

So now looking forward, if we look at prior periods where the S&P ignored a negative GDP print it appears that there is not a lot of information supporting the bear case. In the five pre-2014 experiences, the S&P was only down once over the next six months:

Date	GDP QoQ	SPX Prior Qtr	SPX Current Qtr	SPX Next 6 Mos	Largest Drawdown previous 12 months
3/31/2014	-1	9.9%	1.3%	?	-1.8%
3/31/2011	-1.3	10.2%	5.4%	-13.8%	-12.4%
3/31/1991	-1.9	7.9%	13.6%	5.1%	-13.2%
9/30/1980	-0.6	11.9%	9.8%	8.4%	-10.1%
3/31/1975	-4.7	7.9%	21.6%	0.6%	-34.0%
12/31/1970	-4.1	15.8%	9.4%	8.2%	-25.0%

But again, there's that nagging feeling that it just doesn't feel right – unlike any previous experience, there was no major drawdown that was driving a recovery in the equity markets – it was just up and to the right. And that's apparently the new normal (or new neutral)… it just doesn't feel right.

In related news, we got personal income and spending that indicated a bounce in the savings rate on reasonably sanguine income numbers. It's important to highlight that the savings rate is simply a plug – there is no measure for how much of their income people are actually stuffing in mattresses. Nor is this number a "private sector" number. In fact, as one commentator noted:

> *As we've shown in prior notes, the "savings rate" is a plugged number and actually isn't savings at all. It is defined as Income minus Spending minus Taxes. But "Income" isn't exactly income, as it includes government transfer payments such as Medicare, Medicaid, Unemployment Benefits, and Social Security. When you factor in that individuals are receiving more in government benefits than they are paying into those programs, it becomes clear that savings isn't actually savings; rather the government is running up the debt on our behalf. This debt is essentially an off-balance sheet item. When we add it back,* ***we find that the true "savings rate" is actually -5.63%****! --Rich Farr (B&S)*

Unfortunately, this is a disturbing pattern in this recovery. If we look at the last 8 recessions, the current recovery shows the lowest real growth in wages & bonuses (by a wide margin) and relatively robust real growth in Social Security distributions. This should come as no surprise to those following the demographic story – there are simply more and more retirees and a very slowly growing pool of labor despite a rapid plunge in unemployment that defied the post-recession forecasts of most prognosticators (including the Fed). What normalized growth looks like as we exhaust the available pool of labor is not something we think the majority of investors are prepared for:

Date	Forward Wage Growth	Forward Soc Security Growth
2/28/1961	5.71%	8.69%
11/30/1970	2.06%	10.11%
3/31/1975	3.57%	4.55%
7/31/1980	2.48%	2.49%
11/30/1982	4.19%	0.95%
3/31/1991	2.46%	2.79%
11/30/2001	1.99%	2.83%
6/30/2009	1.65%	2.91%

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