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Financial Crisis Report

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Advancing in a Time of Crisis

Inside this issue:

Except for the Great Depression, economically we are experiencing the most unstable period in the history of the modern world. This period will be marked with extreme fluctuations in the stock, commodity and currency markets accompanied by severe and sometimes violent social disruptions. As is typical of such times, many fortunes will be made and lost during this period. After talking with many business owners, executives, professionals and government officials from around the world, the writer believes that for the financially astute investor, this is a time of unprecedented opportunity given the global trade unbalances and distortions in the commodity and currency markets. The *Financial Crisis Report* is a free compilation of the opinions of David Miyoshi as well as of those advisors he himself subscribes to (with appropriate credits given) on how to benefit during this time of crisis. The writer receives no compensation of any kind from any advisors whose articles or ideas may appear in this report. The reader is welcomed to check on all sources of information mentioned herein. Because the opinions and observations of this writer and other advisors are provided herein without charge, the reader is asked to make his/her own judgment on the contents.

CHINA'S DESTINY

All great civilizations have their rise to power and their eventual collapse. As Rome went, so will the U.S. and China go. The U.S. has enjoyed being the world's economic and political leader for almost a century. But we are now witnessing its dramatic decline that may end its reign as the world's sole super power. Eventually, even China will share this fate. How long this will take, no one can know for sure. But the reasons for its eventual collapse are becoming clear. These reasons are both internal and external to the affairs of China.

The Internal Reasons:

In his analysis of China, Peter Zeihan of Strafor, discusses the rebalancing that the major commercial nations are currently undergoing and indeed striving to attain. Zeihan describes China's current economic system as inherently unstable. He goes on to say it is a closed society that is highly regulated, overly export dependent, without private capital allocation and strictly dependent on a controlled currency. Historically this is similar to Japan and East Asia in the '90s. China "funnels these massive deposits of people's funds through state-run banks to state controlled firms at below-market interest rates. It's amazing the growth rate a country can achieve and the number of citizens it can employ with a vast supply of zero percent, relatively liability free loans provided from the savings of nearly a billion workers...It's also amazing how unprofitable such a country can be. The Chinese system, like the Japanese system before it, works on bulk, churn, maximum employment and market share." The consequent effects include: inefficient capital use, a large number of property bubbles, regional disparity, a tiny consumer base, and over-dependence on exports and foreign consumption of its products.

China's economy operates with the focus of the United States being its primary customer. Unfortunately, it's not good business to have your primary customer in debt more than it can probably pay its debts. If the United States' economy falters even a little bit (as is currently happening), this will mean a greater fall for the Chinese economy. If the United States plunges into a depression, then the entire world's economy will also falter which will have dire consequences for China. This is because China's society does not have sufficient backup customers to support their manufacturing economy if the entire world encounters an economic slump.

The one saving grace for China is that they can develop an even bigger customer base than any of the countries in the West. That bigger customer base is itself. With an estimated 1.2 billion to 1.5 billion citizens, the Chinese economy can become the biggest and most powerful consumer of Chinese products to help stabilize its own economy and further increase its economic hegemony. But the only way for the Chinese government to achieve this goal is to heavily invest in their country by improving their infrastructure, education, and technological developments in all business areas in addition to expanding their businesses as they have been doing for the past decade. This will take time however, and in the meantime, China will need to continue support the United States until they become more self-sufficient.

Another reason the Chinese economy can falter is because of limited worldwide resources. Essentially, our planet does not have enough renewable resources to sustain its current population, let alone allow for increases in populations of developing countries. Furthermore, we are being depleted of the non-renewable resources. Thus, the continued growth in Chinese manufacturing will eventually encounter a dwindling and then perhaps a complete absence of key resources, thereby creating chaos among its myriad manufacturers and the local economies they support.

CHINA'S DESTINY (continued)

World Currencies

- Argentina Peso (ARS)
- Australia Dollar (AUD)
- Austria Euro (EUR)
- Belgium Euro (EUR)
- Brazil Real (BRL)
- Canada Dollar (CAD)
- Chile Peso (CLP)
- China Yuan (CNY)
- Czech Rep Koruna (CZK)
- Denmark Krone (DKK)
- Euro Union Euro (EUR)
- Finland Euro (EUR)
- France Euro (EUR)
- Germany Euro (EUR)
- Greece Euro (EUR)
- Hong Kong Dollar (HKD)
- Hungary Forint (HUF)
- Iceland Krona (ISK)
- India Rupee (INR)
- Ireland Euro (EUR)
- Israel Sheqel (ILS)
- Italy Euro (EUR)
- Japan Yen (JPY)
- Korea South Won (KRW)
- Kuwait Dinar (KWD)

The only solution to this dilemma is for China to locate or create long term renewable energy resources. The need to heavily invest in green technologies including solar, wind and thermal will thus become essential for China's survival.

Perhaps, the biggest problem that China faces is the destruction to the environment that its economy is causing on an exponential scale. The growth of the Chinese economy and their manufacturing factories and facilities are being fueled by literally dirty fuel, which is polluting their country at the fastest rate in the world. One of the first signs of this environmental disaster will be several main sources of fresh water that will become contaminated, which some information sources have indicated has already begun to occur. Also, food production and its quality will gradually decline. Several key foods, including fish, rice, and corn, are already at dangerously low levels.

Eventually, numerous major environmental disasters will occur throughout the country directly impacting millions of people. Consequently, hordes of people will be displaced from their homes and jobs and numerous factories and businesses will be forced to close. As a result, the quality of life and life expectances will begin to decline while at the same time the cost of living will increase dramatically.

The External Reasons:

For the past 30 years, China has been protected by a major structural factor in the global economy which is also happens to be a core tenet of U.S. foreign policy: Bretton Woods. Bretton Woods was essentially an agreement between the U.S. and the Western allies that gave the allies near duty-free access to American consumers in exchange for the right of the U.S. to control security and foreign policy of the rebuilding allied nations. In essence, the Americans took what they saw as a minor economic hit with an expensive dollar in exchange for being able to rewrite first regional, and in time global, economic and military rules of engagement. Thus was the USSR contained and because of this China eventually benefited.

Now, the Obama administration is rethinking Bretton Woods, ostensibly to update the global financial system, but in reality the National Export Initiative (NEI) is much more mercantilist, calling for the doubling of U.S. exports in five years and targeting countries including China. While the NEI is vague as to method and optimistic in aim, it spells a major policy shift. Trade policy will no longer be subordinate to foreign and military policy but potentially "a beast unto itself!" Peter Zeihan cites the 1980s Japan as his perfect analogy, which does not portend well for China.

In the face of this pressure to become a customer rather than a supplier of the U.S., China has no good options. China, unlike Japan is not a U.S. ally, and it will have a much harder time resisting should Washington pressure Beijing to buy more U.S. goods. Dependence upon a certain foreign market means that market can easily force changes in the exporter's trade policies. Refusal to cooperate means losing access, shutting the exports down. Thus, China's only recourse would be to stop purchasing U.S. debt which is unlikely because Beijing can't safely invest in its own undeveloped capital markets. Also, China's U.S. bond purchases largely fuel U.S. consumers' ability to buy China exports. After all, the U.S. presents a market that has more disposable income than all of China's other markets combined!

Zeihan's company Stratfor sees a race, but it isn't a race between the Chinese and the Americans or even China and the world. It's a race to see what will smash China first, its own internal imbalances or the U.S. decision to take a more mercantilist approach to international trade.

Time will only tell but it appears (as in the case of the U.S.) that China's days are now marked.

References:

Stratfor

For subscription information contact "www.stratfor.com"

WAR WITH OUR CHILDREN

We of the Baby Boomer generation (of every country that participated in WWII) comprise the biggest consumer group in the history of the world. Thus, it is no surprise that we will also make the biggest economic impact upon our respective societies within that same span of history.

And now we are beginning to retire to enjoy our due. After all, this is what happened when our parents retired back in the 1970's. They sold their homes for huge gains and along with their savings and pensions, moved to the sunny climes of Florida, Arizona and California to enjoy their retirement.

But we U.S. Baby Boomers expected to even exceed our parents since we were the heirs to the largesse that would naturally flow from a country that was at the pinnacle of world power. After all, we certainly had enough economic bubbles to do it.

But in three consecutive booms and crashes, we had the rug pulled out from under us. Each time, we lost a little more faith, but somehow regained our hopes when a new bubble started. And each time we got a little wiser and began to finally understand what our grandparents had told us. We and the U.S. government had been cheating the system, creating entitlements for our old age that we could not afford. Now the time has come to pay for our sins….and we do not have the ability to do it.

We may have a little more energy left in us to make another fling of it, but it will not be enough. As events now emerge, it becomes clear there will not be another opportunity to get rich again before we retire. Our skills are not in tune with the technological requirements of the day and our demands for compensation are too expensive for the budgets of the day. In short, if we recall Economics 101, our productivity is insufficient to generate the profit level that shareholders of companies now expect.

We can now read the writing on the wall, this trend is no fluke. The economy (in the U.S. as well as the world) is massively shifting. As the years pass, our jobs will become obsolete and it will be difficult to find replacement positions. So we will transition from being the grand generation that, for the past forty years, has contributed the most in terms of production, taxes and spending to benefit our economy to the generation that will take the most and contribute the least to that same economy.

This sets up a new front (read battle front) between us and our children. We have effectively shifted the burden and liabilities for our extravagant, self-indulgent spending to our offspring. Considering that the U.S. public debt is now $14.35 Trillion Dollars, on a per capita basis that means each person (man, woman and child) in the U.S. now owes about $46,000. That works out to about $184,000 for the average family of four. As our offspring try to raise their own children, this will put a rather large crimp in their plans.

Thus, we will be forced into a generational war. Our children will be in charge of the businesses and the industries generating the money to pay these debts but we will have more voting power.

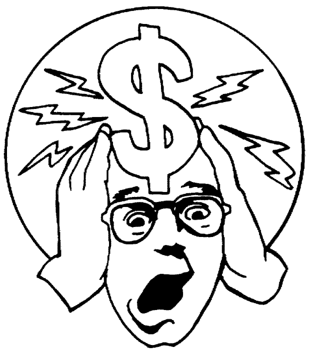
Therefore, we will create more social security and retirement benefits for ourselves by voting for higher taxes like we have never done before. Even Republicans, as they age will take on a new view of taxes and will conclude that they are essential for the survival of our country. Consequently, with our numbers, the Baby Boomers will win the vote for taxes and higher elder care costs…..to the chagrin of our children's generation. This struggle between generations will take its toll and perhaps will finally end in the dissolution of the nuclear family. In the end, however, the younger generation will ultimately prevail, not only due to our eventual demise but also because they will gain control of the media.

Perhaps, this is just another expected consequence in the historical panoply of natural economic evolution, but it still hurts.

World Currencies (cont.)

- Mexico Peso (MXN)
- Netherlands Euro (EUR)
- New Zealand Dollar (NZD)
- Norway Krone (NOK)
- Pakistan Rupee (PKR)
- Peru Sol (PEN)
- Philippines Peso (PHP)
- Poland Zloty (PLN)
- Portugal Euro (EUR)
- Romania Leu (RON)
- Russia Ruble (RUB)
- Saudi Arabia Riyal (SAR)
- Singapore Dollar (SGD)
- Slovakia Euro (EUR)
- South Africa Rand (ZAR)
- Spain Euro (EUR)
- Sweden Krona (SEK)
- Switzerland Franc (CHF)
- Taiwan Dollar (TWD)
- Thailand Baht (THB)
- U.A.E. Dirham (AED)
- Ukraine Hryvnia (UAH)
- United Kingdom Pound (GBP)
- United States Dollar (USD)

Advancing in a Time of Crisis



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1 STOCK INVESTOR INSIGHT

The following comes from Dan Ferris, author of the *Extreme Value* newsletter*.

I want to tell you what I believe is the No. 1 insight I've learned about investor psychology in more than 20 years of doing my own investment research.

It comes from Peter Lynch, the former Fidelity Magellan mutual fund manager who made 30% a year for 13 straight years. In no uncertain terms, Lynch says, "The key to getting rich in stocks is not getting scared out of them." He also says, "The stock market demands conviction as surely as it victimizes the unconvinced."

There are lots of people who claim they know when to enter and exit the stock market. I don't believe one of them knows anything of the kind.

The stock market is not difficult because it's hard to know when to get in and when to get out... It's difficult because it's emotionally uncomfortable to weather the ups and downs and stay in long enough to make money. That's the mistake people make.

There's a famous ongoing study by Dalbar, the people who study investor behavior. They compare the returns of equities (the S&P 500 index) with the actual returns earned by the average holder of mutual funds. The latest data I saw tells the tale...

As of the 20-year period ended December 31, 2009, stocks returned about 8.2% per year, on average. But investors earned just 3.17% per year.

Why did investors fail to earn even half the market's return? Because they bought at the top when everyone was confident, and they sold at the bottom when everyone was scared. They thought they knew when to get in and out... and they were wrong.

So it's not the euro or the government or Wall Street or the Fed you need to worry about the most. They're not your worst enemy. Paraphrasing the comic strip Pogo, "We have met the biggest threat to our investment capital, and he is us."

As long as the underlying fundamentals of the businesses we've covered remain intact, we will stick with them. We don't use trailing stops in *Extreme Value*. If you can't stomach the market's ups and downs – and I promise you, it will have plenty of them over the next few years – without selling in a panic or buying at the top, you shouldn't be in stocks.

**Extreme Value* by Dan Ferris

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