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Financial Crisis Report

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Advancing in a Time of Crisis

Inside this issue:

1. Semper Fidelis for Investors
2. If We Can Solve This Riddle
3. Dividends or Capital Gains
4. What Is It About Golf?

Except for the Great Depression, we are experiencing the most economically 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.

SEMPER FIDELIS FOR INVESTORS

This past month I had the privilege of attending a Memorial Dedication in Quantico Virginia given by our Marine Corps Officer Class to honor our fallen classmates in Vietnam. It truly was inspiring to see my classmates pay tribute to our brave classmates who made the ultimate sacrifice for our country. Indeed the Dedication exemplified the finest traditions of the Marine Corps as each classmate was a living expression of our motto *Semper Fidelis* "to be always faithful." Marines believe that by adhering to this motto in homage to their country and to their Corps, they will succeed in their mission.

So to, in these seemingly confused and chaotic times in our economy, to be successful in generating consistent profits, investors must continually practice this same motto of *Semper Fidelis* as it applies to certain core investing principles. Let's review some of these investing principles.

Using the Boom and Bust Cycle.

Certain assets such as biotech companies, commodities, airlines go through tremendous rallies of hundreds of percent. They draw in the "hot money" and rise to absurd valuations. When everyone has piled into the trade and there's no one left to buy, they get crushed and lose 60% to 90% of their value. Investors who know how to ride the booms and avoid or short the busts, can make a fortune. In the coming years, our inflationary monetary policies will produce huge booms and busts in these areas as they have since 2007. For investors who know the right time to buy the stocks (at the bottom when nobody can stand the thought of owning them) and the right time to sell them (at the top, when they are very popular with the masses), they will profit handsomely.

Investing in Emerging Markets.

Most investors are fearful of placing their assets in foreign countries. This is normal because it is out of their comfort zone, both physically and mentally. But you are fighting with a hand tied behind your back if you ignore the potential here because whether we like it or not, some foreign markets are growing faster than the U.S. Most economic experts agree that by the next generation the largest economies in the world will be in the order of:

China

United States

India

Brazil

Russia

Just by being bold enough to buy when people think China will never amount to anything and sell when people believe China is about to take over the world, you can make a lot of money in Chinese stocks.

Recognizing a Great Business.

To make money you must know how to identify and invest in a great business while avoiding marginal ones. By doing so, your portfolio will likely survive the large systemic shocks headed our way. If you invest in a marginal business, your portfolio will blow away like leaves in a typhoon. But how do you identify a great business? There are five financial metrics you look for.

Consistent returns on equity. This number tells you how much money you are going to make on average over the long term on the cash you put into the stock.

Consistent profit margins. Competition usually drives profit margins lower. So if you find a company that can hold its profit margins steady, you know you have found a great competitor.

Strong balance sheet. A company that either has much more cash than debt or generates much more than enough cash to cover its debt payment is much less risky than a company that depends on the debt market to keep running.

Lots of free cash flow. A stock is a piece of a

business. Businesses get their value from how much cash they produce for their owners. So the more free cash flow, the better.

A history of rewarding shareholders. Companies put cash in their shareholders' pockets by buying back shares or paying dividends.

Mastering Volatility.

Most investors have a completely warped view of volatility and the market environments it creates. Volatility is typically associated with falling stock prices and negative headlines. Most investors see volatile markets, falling stocks and bad news as cause to give up the ship. But sophisticated investors flock to volatile markets because they know this is what creates incredible buying opportunities.

When trading options (puts and calls), especially in the case of selling naked puts and covered calls, the premiums (your income) can increase dramatically escalating your overall annual rate of return. It is not unusual to safely and consistently earn a return of 5% every two to three months for an annualized return of 20%. Many traders are consistently earning average annualized returns as high as 120%. The key is to sell puts and calls on world dominating dividend generating stocks that you would want to own in any case. These are the type of stocks you need to own as the dollar gradually loses its value. Great companies will preserve your purchasing power. With these underlying stocks, the sale of naked puts and covered calls can be used in tandem as in the case when you are required to buy a stock when a naked put matures (after receiving a premium), you can immediately use the newly acquired stock and sell a covered call on it to receive another premium. Doc Eifrig of Stansberry Research has recorded 136 consecutive profitable trades selling a combination of naked puts and covered calls on selected stocks.

Knowing How to Sell Stock.

This sounds ridiculously simple. But it takes most people years of unfavorable investment results before they finally learn the basics of selling stocks.

It's easy to buy stocks. It's easy to get excited about their business prospects and profit potential. It's a lot harder to admit a mistake and move on. It's also hard to hang onto a winning investment without getting an "itchy" trigger finger and selling too soon.

This is where one must learn the disciplined and consistent use of the "trailing stop." Studies have shown that the consistent use of trailing stops dramatically enhance the ultimate returns on stock investments.

A trailing stop is different from a fixed stop in that it automatically tracks the stock's price direction and does not have to be manually reset like the fixed stop loss. Like all stop orders, the trailing stop enforces trading discipline by taking the emotion out of the "sell" decision, thus enabling traders and investors to protect profits and investment capital. There are several good software available to implement the use of trailing stops. One especially good software is "TradeStops"

Of course, to have a successful investing program, there are other fundamental principles that also need to be followed including proper asset allocation (diversification) and position sizing of a given investment.

In the final analysis, as an elite warrior is well served by being faithful to his "Corps" fighting principles, so to an elite investor is well served by always being faithful to his "core" investing principals.

Semper Fidelis,

D. Miyoshi

If We Can Solve This Riddle

As a follow up article to our previous "*This Trap is Destroying America*" we present this article by Rodney Johnson, Editor of *Survive and Prosper*, that portrays another aspect of the problem that is distorting our current education system in America.

D. Miyoshi

There was a vocational tech center at the Texas high school I attended for one year. It was a square building located across the street from the main campus, and everyone knew exactly what it was.

This building was the destination for the dumb kids, or at least the ones who were not putting in the effort to get into college. It was also the way station for kids who were flunking out, but not yet 16 so they had to remain in school.

Obviously, this was the place to avoid at all costs, because the goal of high school was to make sure we all went to college. Or at least that was how it seemed when I was there.

Looking back, it now seems upside down.

College was my destination, as it was for millions of others. But it's not on everyone's radar. In fact, college is not the destination for the majority of Americans.

In the U.S., we churn out about 35% college graduates from each group of 18-year olds. We have about 80% graduating from high school (another 5% get GEDs) and less than half of these earn college degrees.

The numbers have bumped up slightly in the last few years, but we're not anywhere close to 50% of young people graduating from college.

That raises the question: "What are we doing with the majority of our student population?"

We have closed, or dumbed down, vocational tech offerings in high school and yet roughly 65% of our kids don't get college degrees. Clearly, we have a gaping hole in our educational process.

And Corporate America has begun to complain loudly about this.

The idea of technical training for high school and even college students is not new. The claim that there won't be enough skilled workers to carry the U.S. through the next fifty years is also an old re-

frain. What has changed recently is the U.S.'s position in manufacturing. We could, just maybe, find ourselves in the enviable position of 'low-cost producer' in the years to come.

With many candidates applying for each position available, American companies have been able to keep a lid on compensation over the last five years, while retooling their businesses to be more efficient. Meanwhile, countries like China saw their compensation rising.

At the same time, U.S. energy producers have brought vast amounts of domestic natural gas reserves online, so that our local cost of natural gas is exceptionally low. Because natural gas is used to generate electricity and run large industrial plants, American companies are enjoying a competitive advantage in energy when compared to companies in Europe and Japan.

These two factors are the main drivers of what many believe to be a coming resurgence in American manufacturing. In addition to "re-shoring," where a company that had sent production overseas brings it back to the U.S., there is also "on-shoring," where a foreign company sets up shop in the U.S. to produce goods.

Both of these trends are gathering speed.

But the one caveat that seems to keep coming up is the long-term availability of skilled workers.

A report from Boston Consulting Group (BCG) notes that today there are probably less than 100,000 job openings for which there aren't the right skilled people available. This is not seen as a constraint on American business at present. However, the group estimates that the gap between jobs available and skilled-labor available could grow to 875,000 workers by 2020, particularly if the U.S. experiences growth in manufacturing. This yawning gap will be caused by retiring workers and a lack of training programs to develop replacement workers.

Germany, the juggernaut of manufacturing, starts tracking children for college, vocations or academia around age 10. Their training programs are rigorous and require apprenticeships. The result is an exceptionally qualified workforce skilled in precision manufacturing of all types.

At this point it seems unlikely that Americans would be willing to have their children "pegged" as college material, or not, at such a young age. I can't say that I'd have done that with my own kids.

However, there is a change that we can make… one that seems to be taking hold no matter what: A newfound respect for vocation.

As we look around at so many college grads working in low-end service jobs, while those who can weld or machine parts get high-income offers, technical training is getting more attention.

The question is this: "Can we institutionalize the training?"

There are some efforts to do just that, including a $20 million grant from the Obama Administration announced last fall. The funds will go to 10 programs selected through the Advanced Manufacturing Jobs and Innovation Accelerator Challenge. These programs are expected to train over 1,000 workers.

While this is great, it's woefully inadequate given the size of the population that could benefit from it. We need more.

Recognizing the resurgence in manufacturing and addressing the lack of skilled workers can put the U.S. on a great footing for growth in the years to come. High quality, well-paying jobs are the foundation of consumer spending and consumer borrowing, which are the building blocks of our standard of living and economic success.

If we can solve the riddle of training, then we can move our economy out of the doldrums that much faster.

Dividends or Capital Gains?

Here is another argument to seek dividend paying stocks written by Chris Hunter of Bill Bonner's *Diary of a Rogue Economist*.

As Bill mentioned, there's an interesting discussion going on behind the scenes at Bonner & Partners.

You see, one of our new analysts, Jim Nelson, is convinced that investing for income is the single best way to make money in the markets.

Jim has an impressive track record to back him up. Over the four years he edited the popular income investing newsletter Lifetime Income Report (2009 to 2012), his recommended portfolio had an average gain (including returns from dividends) of 34.3%.

But you know Bill. He's a skeptic.

Here's what he wrote in an email when Will suggested the idea of an income newsletter to him:

Sounds like the strategy in question would be good for producing income a family might live on...

Less ideal for maintaining or expanding capital.

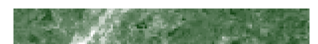
It's a fair point.

Bill's argument is simple. If a company is paying out cash in the form of dividends, it is not reinvesting that cash back into the business.

Apple is a good example. It didn't pay any dividends until recently. Warren Buffett's Berkshire Hathaway is another good example. It doesn't pay dividends at all.

Few people would say these are bad businesses. They are just more focused on reinvesting cash back into their businesses than paying it out to shareholders. That reinvestment helps grow future profits. Shareholders still benefit... they just do so through higher capital gains over time.

But Jim doesn't buy this line of thinking... Here's what he emailed



back to Bill:

The argument about whether a company should reinvest its capital back into its business or pay it out to shareholders just doesn't make sense to me. It never did. A company – unless under specific conditions – should never do one and not the other.

Reinvesting its earnings through R&D spending, strategic acquisitions and expanding its business or markets is a good thing. But I can't think of many cases for established companies where they have enough reinvestment opportunities to spend all their money. Take Apple as a good example. Despite Apple's big spending, the company is still flush with cash.

Apple is always trying to grow its market share. And it has competitors to race against. Surely, it should have no problem finding places to reinvest its earnings. But as we all know, that's not the case.

That's a case where a higher payout ratio – the amount of earnings paid out in dividends to shareholders – is definitely warranted. In other words, I think Apple should pay an even bigger dividend to attract more shareholders. It'll still have plenty of cash left over for R&D, etc…

That's what I look for. Put simply, companies that have a track record of finding the right balance between reinvesting cash and paying it out to shareholders.

Besides, returning cash to shareholders in the form of dividends supports a company's share price and keeps its cost of equity low.

Isn't that better than having a company you're invested in spend all of its earnings on investments it isn't sure will grow its business? We all know that management often does dumb things with cash… especially spending it on ill-advised or over-priced acquisitions.

You may recall what happened when Quaker Oats bought out Snapple, back in the 1990s. Snapple was a hot brand. But it couldn't compete in the same large-scale grocery store environment Quaker Oats participates in.

After paying $1.7 billion for Snapple in 1994, Quaker Oats sold Snapple for just $300 million three years later.

I'd rather a company pay me a share of its earnings in the form of dividends than take big gambles which, let's face it, a lot of acquisitions are.

After all, shareholders are company owners. They should get paid like owners.

Jim certainly got Bill's attention. But Bill's still not convinced.

I wouldn't go as far as saying income strategies "don't work." But they're best for people who actually want an income to spend (for example, retirees).

Another problem with dividend income is it's taxed at a higher rate than capital gains.

Surely, this is a big problem for dividend investors?

Another good point…

What Is It About Golf?

Early in my legal career my boss told me "you must play golf to be successful." Well, I found out my DNA and those of Tiger Woods are different. Here is an article by Rodney Johnson, Senior Editor of *Survive and Prosper* that puts a different perspective on why we should play the game.

D. Miyoshi

Jack, my golf pro, must be dead by now. He was in terrible shape 25 years ago when he gave me lessons.

I was a college graduate and had just received a pair of golf shoes, a five iron and a set of lessons as graduation presents. My father believed that playing golf went hand-in-hand with business success.

Unfortunately Jack really liked smoking cigarettes, so he wheezed, coughed and hunched. This rail-thin man would ride from the club house to the practice range, a distance of about 100 feet, and sit in the cart while I flailed about.

In my first round of golf, I got a birdie. Golfers will recognize this term as a score of one less than the expected number of strokes required to play a hole. But that's not the kind of birdie I got. Instead, one of my tee shots was a line drive about a foot off the ground (a bad shot, certainly) that actually killed a bird.

Even though my golfing career got off to a rough start, I really enjoyed it. There was the fresh air, the openness, the chance to compete against myself for improvement, and the constant need for attention to detail that makes the game so compelling.

But I don't play anymore. I've played one round in eight years. I just don't have the time. It's as if my life and golf are incompatible, and I'm not alone…

The National Golf Foundation (NGF) reports that from 2005 through 2010 the sport lost a net four million players, and currently golf participation is at its lowest level in more than 25 years.

Keep in mind that during the last 10 years this drop in golfing has occurred while the population of those who are at the prime age for the sport – empty nesters and young retirees – has been growing.

The NGF and other golf associations are desperate to turn the tide, but aren't sure how. Some information in their survey reveals the problem, but probably not in the way the associations think.

WHAT IS IT ABOUT GOLF?

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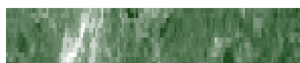

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He is CEO of Miyoshi Capital LLC, an international investment advisory company. In Vietnam, he led a Combined Action Platoon as an officer in the U.S. Marine Corps.

He is listed in 14 Who's Who publications and specializes in international business and finance.

When those who are interested in golf but don't currently play were asked why they weren't taking to the greens, the number one answer was: "My spouse/ significant other doesn't play."

Using this as a starting point, many in the game have begun championing programs that foster player development, women's groups, family outings and other ways to include entire families or couples.

On the surface this makes sense, but it brings up questions. Were there a bunch of spouses playing golf in the previous generation? Did women suddenly opt out of the sport and thereby pull their husbands with them? I doubt it.

I think the problem with golf is much more about my father's point of view – that golf goes hand in hand with business success – than that of my wife.

While it's true that my wife doesn't play the game, it's not true that I need to pursue the game for business development or contacts. From the outside looking in, it appears that golf has lost its position as a common meeting place for potential business associates.

Those left playing the game are the ones who truly enjoy the sport and make the time to play, not the ones who are marginally attached as they look for another networking opportunity or the chance to rub elbows with the boss.

If my view is correct, then it means golfing associations are struggling with the wrong questions. They're working very hard to make golf a faster game by changing the number of holes in a round… they're revamping their offerings to include more inviting lessons and player development for spouses and families.

Yet it's entirely possible that the sport should instead be considering how many golfers are left once the possibility of drumming up business is removed, or at least greatly diminished, and what lies ahead as our nation ages.

By focusing on changes in the game rather than on the reason people play, these associations could be damaging their own growth in the years ahead.

For the next 30 years, America will get older as Baby Boomers move through the empty nester and retirement phases of life. This should be a good time for the game of golf as more Boomers retire because there will be increasing numbers of potential players who now have the leisure to play if they so choose.

But what happens when these potential players get to the course and there are a bunch of small kids running around and groups of beginners clogging the practice range and the fairways? Or when those who return to golf are told that on Tuesdays and Wednesdays the course only allows for rounds of 12 holes?

This strikes me as being similar to the ill-fated advertising of Las Vegas in the early 1990s when the city tried to make itself a family-friendly place. Really?!

It failed miserably, and the town didn't shoot to the moon until it embraced its racy side with the highly successful "what happens in Vegas stays in Vegas" campaign. Basically it went back to its roots.

Golf should do the same. Be a refuge for people who enjoy the elitist edge of the game, who enjoy walking around in funny clothes and cursing a little white ball. There should be more than enough people in the years to come who want to be in the clubhouse to put golf back on a growth trajectory.

Past issues of the *Financial Crisis Report* can be found at the company website www.miyoshicapital.com

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