



Financial Crisis Report

Written and Edited by David M. Miyoshi

Advancing in a Time of Crisis

A METHOD OF INVESTING IN THE STOCK MARKET

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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.

Some people have asked me how best to invest in the stock market. It seems there are as many approaches to investing in the stock market as there are investment companies. At our company Miyoshi Capital LLC, we take a somewhat restrictive approach to investing. We do not think this is an exclusive approach nor is it the only successful way to invest. But it is our preferred way that has led to success. I thought I would take this opportunity to explain this approach so that perhaps you may consider it when you invest your own funds in the market.

Basically, we follow three principles to guide us in how to invest. These principles are:

Principle 1. We trust in the maxim "It's very difficult to make money if you're buying what's popular." The reason most people lose money in stocks is because they believe the way to get rich is by making a "big score." But the real way to get rich in stocks is by simply making a reasonable return (10%-12% a year) over the long term. Warren Buffet is the greatest investor who ever lived. He makes 19% a year on average. Is it reasonable to expect you're going to do better than that just by reading a book on how to invest?

We believe the way to successful investing is not racking up big winners...but it is avoiding catastrophic losses. By avoiding big losses, it is amazing how many big winners always come around. With that always in mind, we believe it is best to invest the majority of one's funds in sure, lower risk discounted opportunities and only once in a while invest in speculative positions that offer a risk return ratio that is heavily in our

favor. Principle 2. We make sure emotions do not drive us to buy and sell at the wrong time. Buffet said it best when he explained, "I try to be greedy when others are fearful and fearful when others are greedy." Simply stated, we buy into positions that are clearly depressed and therefore discounted. Basically, this is common sense because something that is cheap for the moment clearly has less risk and this is what we are always trying to do...minimize the risk and maximize the reward. After all, the more expensive something gets, the less likely it is to get more expensive. And conversely, if something has gotten very, very cheap, all things being equal, it probably has less risk and more upside. For some reason, this isn't intuitive to most people. In the grocery store, they might recognize a sale, but in the stock market, they tend to crowd around the most expensive cans of coffee. It's another mystery of the mind.

With regard to locating discounted plays, we follow the rule of thumb: Never commit a substantial amount of capital to any sector of the market unless that sector has previously fallen by more than 50%. Of course, just because an individual stock has fallen by 50% doesn't mean it's a buy - not at all. But getting involved in market sectors (real estate, for example) after they've fallen apart is a simple way to learn to do the opposite of what your emotions want you to do. You've still got to make smart choices, but you have a much better chance of eliminating mistakes if you simply focus on what other investors have walked away from...instead of what other investors are buying in the mania. An-



A METHOD OF INVESTING IN THE STOCK MARKET (continued)

other rule of thumb we follow is if we see lots of newsletter touting the same idea, we avoid it. Newsletters are contrarian indicators. Statistically, the investment ideas newsletters love do poorly overall.

So we allocate to value, we don't chase hot sectors, we don't buy into heavily promoted investment ideas, we study the market sectors that have been wiped out, we look for value, we learn to temper our emotions (fear and greed) by always being rigorous with our position sizes (not matter what) and we learn how to properly value the equities we buy, and never pay too much.

Lastly, we never allocate more than 50% of our assets into stocks and always keep 20% - 30% of our portfolio in cash or cash-like assets to be able to take advantage of declines in the market to buy high-quality assets at "stupid" prices.

Principle 3. We affirmatively use alternative investment strategies that greatly reduce the risk in our portfolios. It's hard for most people to grasp the concept that Wall Street and the financial industry doesn't exist to help you get rich. These businesses exist to make themselves rich. Thus, you can pretty much guarantee that the strategies the industry is eager to help you to learn (buying mutual funds, day-trading stocks, etc.) are going to cost you money, not make you money.

And the strategies the financial industry tries to hide from you are likely to be better alternatives. Here are two examples: High-yield corporate bonds and selling put options. If you call your broker and tell him you would like to learn how to sell options, he will likely tell you to take your business elsewhere...or give you a mind-numbing amount of forms to fill out in an attempt to keep you from these markets.

Why should you bother to jump through the hoops or find another broker who will work with you? Both of these strategies have proven to be the very best way for us to actually make money safely.

Our basic strategy is to buy discounted corporate bonds and sell puts and covered call options.

Regarding investing in options, a common way to profit from investors' fear is to simply buy put options. But we feel it's not the best way. When you buy a put option on a stock, for example, you're buying the right (not the obligation) to sell it

at a set price by a certain date. You're essentially betting the stock will go down. If investors get fearful and sell the stock, pushing the price lower, you win.

But options have a predetermined shelf life. They expire in a few months or, at best, a year. So when you buy an option, you not only have to be right on the direction of the stock, but also on the timing. The stock must fall by a certain amount before the option expires. For most investors, this is very difficult. And that's why most options expire worthless. In other words, those who buy options have very low odds of winning.

That's why we prefer taking the other side of that trade by selling put options. It's the best way to collect income from investors' fear. Essentially we are doing business exactly as an insurance company does (which is the best business in the world). Here's an example of how it works.....

Recently, we sold put options on Intel (INTC) for \$0.66 a contract. Since one option contract covers 100 shares, selling one contract then resulted in an income of \$66. In order to execute that trade, we just needed to deposit a margin of \$475 with our broker. So we generated an instant yield of 13.9% (\$66/\$475). To put that in perspective, Intel is currently paying an annual dividend yield of just 4%. So we tripled our income simply by selling a put instead of collecting dividends.

When the market gets scared, volatility is one of the main determinants of option prices. In other words, higher volatility leads to higher premiums. When you sell puts, you're the one collecting the premium (like an insurance company). If you're to generate income by selling puts, you want to see higher volatility. The next time we have a risk event, such as the "fiscal cliff" or the return of the European debt crisis, fear will return to the market. Frightened investors will get nervous and look for ways to protect their profits and investments. They will do that by buying put options, pushing the premium higher. Once the premiums are fat enough, we want to be the one selling to them. And if history is any teacher you can be sure the market will get scary again for investors.

In any case, these principles incorporate one approach to investing that has worked for us.

D. Miyoshi



THE ARAB SPRING MATURES

The easy part of the Arab Spring -- the part that brought instant gratification to Western elites -- is over. That part was about the overthrow of tyrannical regimes in some places and the weakening of them in others. Because the object was only humbling the dictator, it was essentially a liberal affair, an attack on the over-centralization of power. The United States and Israel were not relevant to this initial phase.

The second phase now upon us is about who gets to rule in the streets and in the palace. It is about defining society from the ground up. This part is about political values, and because Islamism is somewhat shaped by views toward the United States and Israel, the United States has been the object of mob fury. Israel is, for the moment, spared. That is only because the anti-Islamic video happened to have originated in the United States. Sooner or later, the mob will vent its anger against Israel directly. After all, frustration with the United States is, in significant measure, due to its support for Israel and Israel's refusal to stop settlement building.

This internal struggle for power will go on for years. Because it involves societies afflicted with severe economic woes, which have little experience with free governance, the new regimes will be preoccupied with merely maintaining power in the face of tumultuous domestic politics. Such weak, preoccupied regimes will have limited capacity to wage war. This is the opposite of the situation in Asia, where governments have consolidated military and governing institutions through decades of economic growth and can now project power outward -- leading to territorial disputes in the maritime sphere.

The fact that Arab regimes are inhibited from waging interstate wars is offset by the fact that they have difficulty controlling their own borders and the militant elements within their societies. Thus, the Sinai Peninsula has become more insecure after decades of relative quiescence, and armed groups unconnected to the elected government roam Libya, where geographic distance and tribal identities bedevil central control. Libya is an apt metaphor for the region: It has an elected government but little governance.

Indeed, the Middle East has evolved in stages from organized interstate warfare during the Cold War decades (1956, 1967 and 1973) to the relative anarchy of the Cold War's aftermath. Though, the possibility of interstate warfare remains because of one non-Arab state, Iran -- even as major Arab states such as Iraq, Syria and Libya have in varying degrees weakened or dissolved while Islamic militants run amok and inter-communal tensions flare.

Jihadism also will flourish in this power vacuum created by the replacement of strong central authority with weak democratic rule. But rather than a transnational jihadism focused on planning attacks against the United States, we are more likely to see homegrown jihadism preoccupied with political power struggles within each society. After all, some of the pro-western governments al Qaeda sought to topple have already fallen, thus al Qaeda as a force with a pan-Islamic *raison d'etre* has been somewhat superseded. Everywhere from the Maghreb to the Iranian Plateau, political structures are crumbling, while the possibility of a sectarian bloodbath increases in Syria the longer the fighting there grinds on. Syrian President Bashar al Assad has no possibility to reconstitute his regime; rather, he might emerge as the most powerful warlord among many in Syria, with the Lebanonization of the country being a likely scenario.

The state of anarchy flows naturally from the lack of institutions hidden for decades under the carapace of authoritarian rule. With that rule gone or weakened, feeble or nonexistent bureaucracies must try to cope with mayhem in the streets and in the tribal desert reaches. The Israelis well understand this sobering reality. So far, Israel has only made peace with strong authoritarians. Frightened and besieged democrats do not have the political space to take risks. Likewise, there is no Palestinian leader who is not paranoid and who is not constantly looking over his shoulder. The peace process is in disarray: Israel may, thus, continue to enlarge settlements and then, perhaps at some propitious moment, stage a unilateral, strategic withdrawal from the major West Bank cities and contiguous areas it chooses not to occupy.

The toppling of authoritarian regimes may have been unavoidable, but it has unleashed a whirlwind because stable democracy can take decades to develop. Moreover, in a world of overcrowded megacities beset with bad infrastructure, at a time when media travels at virtually the speed of light, the appearance of mobs because of this or that suspected outrage is the new normal. Middle East geography in such a circumstance has not been negated; it has only become more claustrophobic and more precious.

In this anarchic new Middle East, Egypt is no longer the political anchor for the West that it was until recently. Since the 1970s, beginning with dictator Anwar Sadat and continuing with Hosni Mubarak, Egypt's geographical centrality and demographic heft were a force for regional stability against radical forces. But the new Islamic regime in Cairo must assuage its radical elements, even as internal politics give it little energy for seriously projecting power beyond its borders. Meanwhile, Saudi Arabia is politically infirm with aging, Brezhnevite rulers grasping for dear life onto the status quo, while nascent youth dissatisfaction fed by the toxic combination of social media and unemployment hovers around them. As for Iran, *Marg bar Amerika* ("Death to Ameri-



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ca") is the bumper sticker of the revolution that must be maintained in the face of new economic woes coarsening the society - since revolutionary discipline is now especially required to keep the regime intact.

The key insight to be had from all of this is how little leverage the United States has. The United States cannot nation-build across the Middle East. It can have limited arrangements with local security services in this country and that for the sake of protecting American embassies and other equities. It can encourage moderate forces with aid and use its leverage to influence the Egyptian government on some issues and the Saudi government on others. But the United States cannot, for example, make Libya a strong, well-governed state without an extraordinary effort that would rob Washington of bandwidth elsewhere in the region and around the world.

The Arab Spring, in other words, is about the limiting of American power through the breakdown of authority on which Washington once depended to exert its influence. The fact that the Middle East is more democratic than it once was does not necessarily benefit the United States. This is because democracies are themselves value-neutral: They need not always represent liberal orders, especially if they are frail and unstable.

By Robert D. Kaplan
Stratfor

California's Path to a Smaller America

No doubt that voters sending Barack Obama back to the White House was the biggest news in the November elections. But another vote – this one in California – could ultimately prove equally consequential to the future of America.

There, the spendthrift, welfare-worshipping Democratic Party won a supermajority in the state legislature. Though the Democrats have controlled California politics for 40-plus years, this is the first time since the Great Depression that they've fielded a supermajority – a voting block large enough to override Republican resistance and pass any piece of legislation they and their tax-mongering leader, Gov. Jerry Brown, want.

California has always been a trend setter, and with this particular election it could establish a new trend that will see America slowly disassembled.

My prediction: The supermajority could mark the beginning of the end for California as a unified state ... and, if it happens, that will establish a trend that sees a quest for smaller, more-responsive government across America. Empires die.

That's just the way it goes. History has yet to allow one to survive – though that's not a function of history itself so much as it's a function of government arrogance. Politicians pursue empirical ambitions and the empire ultimately grows too large for the governed to support, even with usurious taxation.

America is clearly an empire – the last of the great empires. And it is arguably in the early stages of its inevitable decline. I realize some people will rail against that comment because, they fiercely believe, America is the last great bastion of freedom, prosperity and opportunity ... though that is actually a dated and incorrect view of the modern world. They don't understand history, the Law of Large Numbers, the Second Law of Thermodynamics, human nature and the impossibility of equality, which is what U.S. politicians are trying to create by destroying the values that built our country – self-reliance and personal responsibility – and replacing them with increasingly great dependence on the welfare state.

Regardless of whether it was the Romans, the Soviets or the Brits, empires almost always overreach.

The core government reaches a point where its ability to grow hits a wall, though that doesn't stop government from trying to grow by consuming an ever-larger piece of the economy. It's a catabolic collapse, if you will – destructive, metabolism in which the body (government) consumes periphery muscle tissue (the income from people and businesses that define the economy).

Like all previous empires, government in America – and, in this example, California – either doesn't recognize the empire is near death or it is actively raging against it. In one final grasp at maintaining itself, government will unleash its full bore – dramatically increasing taxation and dramatically increasing social spending to bribe the lazy who want government to pay for everything, and the small-minded too blind to recognize that, at some level, large government is malevolent simply because of its need for self-preservation.

At that point, large government typically collapses upon itself and smaller governments will emerge – meaning states or even cities will break off and form smaller countries or federations.

All the Ways the Supermajority Will Screw Up
That's where California is headed, in my view, under the leadership of a Democratic supermajority. (And, to be fair, I am not a fan of Republicans either. They'd screw up the state as well with a supermajority, just in a different way.)

California, where I once lived for several years, simply makes no sense in its current configuration. Northern California has little in common with Southern California, and the rural, ag-heavy Central Valley has nothing in common with the glitzy, pricey coast. Lawmakers – who make a mockery of leadership in California – have proven time and again through the years that they're incapable of effectively or prudently managing the diverse needs of such a diverse state.

In short, California makes far more sense as three separate states ... and the supermajority is quite likely the accidental



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path to that future.

That's because I'm quite confident that British historian Lord Acton was absolutely correct when he observed in the nineteenth century that "All power tends to corrupt, and absolute power corrupts absolutely."

With a supermajority, California's Democrats have unfettered power, and they *will* screw it up. They will raise taxes on businesses and the wealthy. They will hike fees for various state services to raise more revenue with which to spend foolishly. They will hike spending. They will dramatically increase regulation on the ignorant belief that government oversight trumps the necessarily cruel hand of free-market economics. They will increase salaries and benefits for the constituents that keep them in power – namely rapacious state-workers' unions.

Undeterred by that pesky need for sensible compromise now that Republicans are voiceless, the Democrats will ultimately create far greater fiscal woes for California, a state that is arguably the country's most financially deranged already. And, I predict, their actions will spur an overwhelming grassroots movement among aggrieved, sensible Californians who will ultimately seek a referendum to split the state into smaller, more manageable pieces.

It is, quite likely, the future of California ... and ultimately the future of America, given the deep and growing political, economic and social bifurcations that are epidemic in our country today.

Protecting Yourself When America Breaks Apart Though painful as the process will likely be, the shrinking of America will ultimately prove beneficial.

From the ashes of a today's overgrown government will rise up several smaller, more-responsive governments. Taxes will be right-sized. Welfare will be downsized. The currencies that replace the dollar will have actual value (imagine a Republic of Texas dollar backed by all the oil and gas assets of Texas, Louisiana and

Oklahoma – the trio that would make up a sensible, intriguing new energy-rich country). All the bloat that has built up in government since the 1930s will go away. And we will have learned, just as other failed empires learned, that "big" is ultimately a liability.

When the process begins, who knows? But I would not be surprised to see Californians push for a referendum within the next three to four years ... and, if so, then other cities and states will follow suit shortly thereafter.

Whatever comes of it, you're going to want some of your wealth outside the dollar – in physical gold and silver, in oil, and in foreign assets. Every empire's decline brings with it the destruction of the local currency, even if that currency is a global reserve. Debasement of its money is the only means an empire has of raising the funds necessary to keep the charade alive for a little longer ... and that's precisely what is happening now in America.

By owning non-dollar assets, you are essentially self-insuring against the end of the American empire.

But maybe I'm wrong about all of this. Maybe California's supermajority means nothing. Maybe America will be the 1,000-year empire.

Then again, what if I'm right?

Given all the worrying signs in our country today, are you willing to risk being on the wrong side of that gamble?

Until next time, stay Sovereign...

By Jeff D. Opdyke

Editor *The Sovereign Individual*

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