PUBLISHED BY MIYOSHI CAPITAL LLC

April 2013

Volume 1, Issue 18

Financial Crisis Report

Written and Edited by David M. Miyoshi

Advancing in a Time of Crisis

Inside this issue:

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.

THE BEST BUSINESS IN THE WORLD

There's a reason INSURANCE is the largest business in the world, as measured by revenue. And that reason isn't because insurance is a smart buy.

Insurance is usually a terrible thing to purchase. After all, for the insurance industry to make a profit, you have to have wasted your money. And the fact that the insurance industry not only exists but is the largest industry in the world is nearly a guarantee that when you buy insurance, you're wasting your money. Except of course, if your house does get blown away in a tornado…

For the rest of us, insurance is simply a cost of living. It's like rent and your electric bill. You have to have it. So you pay the toll.

Few investors pay much attention to insurance companies because they are hard to understand… and they seem to take on awfully big risks. But I've learned over my career that many of the best investors always focus their portfolios on insurance stocks. Consider Warren Buffett, the greatest investor who has ever lived.

The basis of his conglomerate, Berkshire Hathaway, is insurance companies. He writes about insurance in almost every one of his annual letters. This year, he once again explained why he's put insurance companies at the center of his financial empire…

Insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit…. If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit occurs, we enjoy the use of free money – and, better yet, get paid for holding it.

I want to make sure you understand this point. All of the people who make their living providing financial services – banks, brokers, hedge-fund managers, etc. – all of them pay for the capital they use to earn a living. Banks borrow from depositors and investors (who buy CDs) and also from other banks. They have to pay for capital. Likewise virtually every actor in the financial services food chain must pay for the right to use capital.

Everyone that is, except insurance companies. Using Berkshire again, as our example, let's consider the benefit of getting capital for free (or even being paid to hold it) over time.

We have now operated at an underwriting profit for nine consecutive years, our gain for the period having totaled $17 billion. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we accomplish that, our float will be better than cost-free. We will profit just as we would if some party deposited $70.6 billion with us, paid us a fee for holding its money and then let us invest its funds for our own benefit.

Again… I want to make sure you understand how extraordinary this business model can be. Buffett's insurance companies have earned more in premiums than they've paid in claims for nine years in a row. That's pretty remarkable considering that, as a whole, the industry loses money on underwriting. The result is, he's been able to invest the premiums (which total $70 billion) and keep all of the gains for Berkshire. Additionally, he's made $17 billion on the premiums alone. That greatly increases his ability to compound his returns over time.

Just since 2000, the size of Berkshire's float – the amount of insurance premiums it holds for investment, has grown from $27 billion to $70 billion. These premiums aren't like bank deposits. They can't be taken back. They aren't like an investment with a hedge fund, they can't be redeemed. They are paid in full. Thus, they are a

THE BEST BUSINESS IN THE WORLD (continued)

form of permanent capital. That is, even though they are held in trust for the payment of future benefits, all of the actual privileges and income of this capital accrues to Berkshire.

Just imagine if you were given $70 billion a year to manage, where you got to keep all of the investment gains. Now imagine if, in addition to the investment income, you were also paid $17 billion over nine years simply for the privilege of holding the capital!

The nature of this business gives Berkshire – and other insurance firms who can earn a profit with their underwriting and their investments – a truly mind-boggling advantage. And that's not the only one.

Their other huge advantage – and it's a doozy – is that they don't have to pay taxes on those underwriting gains for many, many years because, on paper, they haven't technically earned any of the float until all of the possible claims on the capital have expired. So unlike most companies that have to pay taxes on revenue and profits before investing capital, Berkshire and other insurance companies get to invest all of the float, without paying any taxes for years and years and years.

These companies then… much like Visa (see my June 2009 issue) … are very sensitive to increased economic activity (which leads to more insurance being sold), inflation, and interest rates because they are extremely leveraged to the capital markets thanks to their float.

Let's assume that I'm right and that the value of the U.S. dollar is going to collapse over the next five years. If that happens, the dollars these insurance companies are collecting in premiums today will be invested with the full purchasing power the dollar has now. But they will only pay out claims over the next 10 or 20 years… when the value of that dollar will have fallen by 50% or more. This inflation/time arbitrage almost guarantees big profits for the entire industry.

The biggest profits will go to the companies that earn a profit on their underwriting – that is, they collect more in premiums than they pay out in claims. Inflation will make future claims more expensive. (Prices will rise, damages will rise with them.) But inflation will also push up the value of the investments the insurance companies make – especially those firms that make equity investments.

And there's one other important thing you should know about insurance stocks. Normal measures of valuation don't usually apply to these companies, which gives knowledgeable investors a great advantage. The float we've been discussing – the permanent capital that these firms use to make investment gains – is actually put on the balance sheet as a liability. Technically, it's money that the firm might one day owe on a policy. So… when you're looking at insurance stocks to invest in, it's usually possible to buy the float at a tremendous discount to its actual intrinsic value.

But there's one overriding consideration… and you must be extremely careful about this… most insurance companies aren't able to consistently earn a profit on their underwriting. And in those cases, the float indeed becomes a liability.

As Buffett also says in his latest letter, "In most years the insurance industry as a whole operates at a significant underwriting loss. For example, State Farm, by far the country's largest insurer and a well managed company besides, has incurred an underwriting loss in eight of the last eleven years. There are a lot of ways to lose money in insurance, and the industry is resourceful in creating new ones."

To reiterate… we want to own insurance stocks because we believe inflation will increase the size of policies sold, increase the return on float, and enable these companies to profit from the time arbitrage of inflation. (The dollars paid today in premiums will be worth substantially more than those same dollars paid back later.) Also, the nature of the float means that these companies are hugely leveraged to the financial markets – their investment portfolios are typically large relative to the equity of the firms. If I'm right about a big bull market this year, these stocks will soar.

I asked one of our new analysts – Bryan Beach – to figure out how much Buffett has paid for well-managed insurance stocks in the past. I wanted some benchmark to help us figure out a fair price to pay for these stocks since book value often underestimates their value by a wide margin. Rather than complain that all of Buffett's deals are private and he never reveals the details, Bryan reversed engineered the deals.

I found info on three of Buffett's biggest insurance purchases. In 1995, Buffett bought 49% of GEICO for $2.3 billion, which added $3 billion to Berkshire's float and $750 million in additional book value. So Buffett paid $0.61 for every dollar of float and book value. In 1998, Buffett bought General Re for $21 billion, which added $15.2 billion to Berkshire's float and $8 billion in additional book value. So Buffett paid $0.94 for every dollar of float and book value. Way back in 1967, Buffett paid $9 million for $17 million worth of National Indemnity float. That's $0.51 for every dollar of float. This was Buffett's first insurance purchase.

Looking at these numbers, I'd expect to pay something between $0.75 and $1 for every dollar of float and book value. Yes, I realize Buffett got GEICO for less than this amount (what a deal!)… But you have to remember, he already owned 51% of the business at the time. In short, he was selling to himself. (Surely Uncle Warren would never take advantage of minority shareholders this way… Oh, no! Oh, yes.)

So my dear subscribers… are there well-managed insurance companies that earn a consistent profit on underwriting… that invest in stocks… and whose shares we can buy for a considerable discount to float and book value? Yes, there are. Thanks to a "soft" market in insurance since the mid-2000s, many of these stocks are trading near record-low valuations.

By Porter Stansberry of Stansberry and Associates

(For subscription information contact customerservice@stansberryresearch.com)

WHY IT'S THE YEAR OF THE SNAKE

Just before President Obama jetted off to Hawaii and the U.S. Congress broke up for its short Christmas recess on Thursday, Dec. 28, 2012 the U.S. Senate debated renewal of the Foreign Intelligence Surveillance Act (FISA).

It's not for nothing the Chinese calendar calls 2013 the Year of the Snake.

FISA allows government spying on almost all our telecommunications. Several senators tried to attach amendments to the law, simply to provide some modest transparency and oversight to ensure that the government's warrantless eavesdropping powers were constrained from abuse.
These senators were charged with "aiding terrorists" by the Chairman of the Senate Intelligence Committee, Dianne Feinstein (D-CA). Then in virtually identical 37-54 votes, Feinstein and her conservative Democrat comrades joined with virtually all Republicans (except for Senators Rand Paul, Mike Lee and Dean Heller) to reject each one of the proposed amendments and thus give Obama exactly what he demanded– he can continue to eavesdrop on Americans without any warrants, transparency or real oversight.

As columnist Glenn Greenwald pointed out: "Feinstein repeatedly argued that requiring even basic disclosure about the eavesdropping program – such as telling Americans how many of them are targeted by it - would, as she put it, "destroy the program". But if "the program" is being conducted properly and lawfully, why would that kind of transparency kill the program?"

Bus Buzz

And speaking of privacy, do you ever ride on public transportation – city buses or vans at the airport?

Transit authorities in several U.S. cities are installing audio/video enabled surveillance systems on public buses that will give them the ability to record and store private conversations, according to documents obtained by an online news outlet.
The systems are being installed in San Francisco, Baltimore and other cities with funding from the U.S. Department of Homeland Security. The use of the equipment raises serious questions about eavesdropping without a warrant, particularly since recordings of passengers could be obtained and used by law enforcement agencies or even viewed in real time.
So much for your public transport and e-mail privacy my fellow Americans.

Police State

But email and travel privacy as a right pale in comparison to being detained by the U.S. military, thrown into jail and held without charges.

Just a few days before the FISA renewal, Charles Savage reported in *The New York Times* that a few members of Congress had taken it upon themselves to decide that reaffirmation of the protections in the Fifth Amendment of the Bill of Rights is unneeded.
Virtually ignored by most of the news media preoccupied with their meaningless "fiscal cliff" blather, here is what Savage revealed:

"Lawmakers charged with merging the House and Senate versions of the National Defense Authorization Act decided on Tuesday to drop a provision that would have explicitly barred the military from holding American citizens and permanent residents in indefinite detention without trial as terrorism suspects…"

What that means is that instead of a flat-out prohibition against the military arresting and holding U.S. citizens without charges, the next time a president tries to lock up an American citizen without trial – as President George W. Bush tried – it will be left up to the courts to decide whether or not it's legal.

Don't Look Up

And if you are truly concerned about your privacy, earlier this year, Congress passed the FAA Reauthorization Act that authorized the deployment of fleets of aerial spy drones to cruise above the United States.

This followed a major lobbying effort by defense contractors to promote the use of drones in American skies: 30,000 of them are expected to be in use by 2020, some as small as hummingbirds, meaning you won't see them tracking your every move. Some drones will be as big as passenger planes. They will be used by businesses, and certainly by police, as in Seattle where they have already been deployed. Keep in mind these are the same aerial drones that can be equipped with much more than video cameras; they can and do carry lethal weaponry as proven in Afghanistan, Pakistan and Yemen. That should cut the crime rate in Detroit, Chicago and Los Angeles while removing the need for costly trials.
A U.S. Air Force document states that it will deploy its own military surveillance drones within the borders of the U.S. and may keep video and other data it collects with these drones for 90 days without a warrant.
And you thought police SWAT teams were a threat!

Be Prepared

My point in choosing these few examples of the destruction of freedom in America, some that occurred in just the last week, is to emphasize your need to know – and that need for useful knowledge is one of the prime reasons we founded the *Freedom Alliance* more than two years ago.

If there ever was a year in which you needed to stay way ahead of the curve, 2013, the Year of the Snake, according to the Chinese calendar, is that year, a year of super tense times. The Chinese horoscope for 2013 warns of unsettled ground, sudden shocks to shake us out of false realities and unexpected events that create major change.

Bob Bauman

Offshore and Asset Protection Editor

North Korea (Ferocious, Weak, Crazy?)

On March 15, 2013, the U.S. Pentagon announced that it plans to add 14 missile interceptors to its existing anti-missile system in Alaska aimed at North Korea, which has issued increasingly bellicose threats since it tested an underground nuclear device and launched a small satellite. These new interceptors are part of an effort by the U.S. to stay ahead of North Korea's missiles and nuclear programs, which are apparently progressing more swiftly than anticipated.

But what is behind North Korea's bellicose stance?

On January 29, the founder of Stratfor, George Friedman, wrote a piece that described North Korea's strategy as a combination of ferocious, weak and crazy. In the weeks since then, three events have exemplified each facet of that strategy. Pyongyang showed its ferocity February 12, when it detonated a nuclear device underground. The country's only significant ally, China, voted against Pyongyang in the U.N. Security Council on March 7, demonstrating North Korea's weakness. Finally, Pyongyang announced it would suspend the armistice that ended the Korean War in 1953, implying that that war would resume and that U.S. cities would be turned into "seas of fire." To Friedman, that fulfills the crazy element.

Friedman's argument was that the three tenets – FEROCITY, WEAKNESS AND INSANITY -- form a coherent strategy. North Korea's primary goal is regime preservation. Demonstrating ferocity -- appearing to be close to being nuclear capable -- makes other countries cautious. Weakness, such as being completely isolated from the world generally and from China particularly, prevents other countries from taking drastic action if they believe North Korea will soon fall. The pretense of insanity -- threatening to attack the United States, for example -- makes North Korea appear completely unpredictable, forcing everyone to be cautious. The three work together to limit the actions of other nations.

Untested Assumptions

So far, North Korea is acting well within the parameters of this strategy. It has detonated nuclear devices before. It has appeared to disgust China before, and it has threatened to suspend the cease-fire. Even more severe past actions, such as sinking a South Korean ship in 2010, were not altogether inconsistent with its strategy. As provocative as that incident was, it did not change the strategic balance in any meaningful way.

Normally North Korea has a reason for instigating such a crisis. One reason for the current provocation is that it has a new leader, Kim Jong Un. The son of former leader Kim Jong Il and the grandson of North Korea's founder Kim Il Sung, Kim Jong Un is only 30 years old, and many outside North Korea doubt his ability to lead (many inside North Korea may doubt his ability, too). One way to announce his presence with authority is to orchestrate an international crisis that draws the United States, Japan, China, Russia and South Korea into negotiations with North Korea -- especially negotiations that Pyongyang can walk away from.

The North Korean regime understands the limits of its strategy and has been very sure-footed in exercising it. Moreover, despite the fact that a 30-year-old formally rules the country, the regime is a complex collection of institutions and individuals -- the ruling party and the military -- that presumably has the ability to shape and control the leader's behavior.

It follows that little will change. U.S. analysts of North Korea will emphasize the potential ferocity and the need for extreme vigilance. The Chinese will understand that the North Koreans are weak and will signal, as their foreign minister did March 9, that in spite of their vote at the United Nations, they remain committed to North Korea's survival. And most people will disregard Pyongyang's threat to resume the Korean War.

Indeed, resuming the Korean War probably is not something that anyone really wants. But because there are some analysts who think that such a resumption is plausible, Friedman thinks it is worth considering the possibility that Pyongyang does want to restart the war because it is always worth examining an analysis based on the assumption that a given framework will not hold. For the record, Friedman thinks the framework will hold, but is simply examining the following hypothetical: That this time, North Korea is serious.

To assess Pyongyang's sincerity, Freidman suggests beginning with two untested assumptions. First, assume North Korea has determined that it is unable to develop a deliverable nuclear weapon within a meaningful time frame. Either there are problems with constructing the device or its missiles are unreliable. Alternatively, assume it has decided that any further development of weapons will likely lead to attacks by the United States against its nuclear facilities. In other words, assume it expects to lose its nuclear capability because it cannot move forward or because moving forward will invite attacks against nuclear facilities.

The second assumption, more likely accurate, is that North Korea has realized that the strategy it has followed since the 1990s is no longer working. The strategy has lost its effectiveness, and North Korean ferocity, weakness and insanity no longer impress anyone. Rather than generating financial and other concessions, the strategy has simply marginalized North Korea, so that apart from sanctions, there will be no talks, no frightened neighbors, no U.S. threats. Kim Jong Un would not announce himself with authority, but with a whimper.

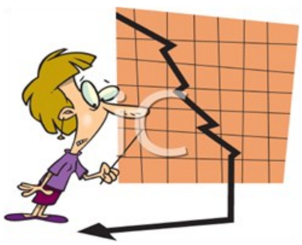
An Unlikely Scenario

Taken together, these assumptions constitute a threat to regime survival. Unless its neighbors bought into the three premises of its strategy, North Korea could be susceptible to covert or overt foreign involvement, which would put the regime on the defensive and reveal its weakness. For the regime, this would be a direct threat, one that would require pre-emptive action.

It would be a worst-case scenario for Pyongyang. Stratfor considers it highly unlikely. But assume North Korea deems it more

NORTH KOREA (FEROCIOUS, WEAK, CRAZY?) (continued)

Advancing in a Time of Crisis



Financial Crisis Report

David M. Miyoshi is a California attorney and real property broker, having earned a Bachelor of Science degree from the University of Southern California, a Juris Doctor degree from the University of California, an MBA degree from Harvard University and an international graduate degree from Waseda University in Tokyo.

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.

likely than we do, or assume that, despite the scenario's improbability, the consequences would be so devastating that the risk could not be borne.

It is a scenario that could take form if the North Korean nuclear threat were no longer effective in establishing the country's ferocity. It would also take form if North Korea's occasional and incomprehensible attacks were no longer unpredictable and thus were no longer effective in establishing the country's insanity. In this scenario, Pyongyang would have to re-establish credibility and unpredictability by taking concrete steps.

These concrete steps would represent a dramatic departure from the framework under which North Korea has long operated. They would obviously involve demands for a cease-fire from all players. There would have to be a cease-fire before major force could be brought to bear on North Korea. Last, they would have to involve the assumption that the United States would at least take the opportunity to bomb North Korean nuclear facilities -- which is why the assumptions on its nuclear capability are critical for this to work. Airstrikes against other targets in North Korea would be likely. Therefore, the key would be an action so severe that everyone would accept a rapid cease-fire and would limit counteraction against North Korea to targets that the North Koreans were prepared to sacrifice.

The obvious move by North Korea would be the one that has been historically regarded as the likeliest scenario: massive artillery fire on Seoul, the capital of South Korea. The assumption has always been that over a longer period of time, U.S. air power would devastate North Korean artillery. But Seoul would meanwhile be damaged severely, something South Korea would not tolerate. Therefore, North Korea would bet that South Korea would demand a cease-fire, thereby bringing the United States along in its demand, before U.S. airstrikes could inflict overwhelming damage on North Korea and silence its guns. This would take a few days.

Under this scenario, North Korea would be in a position to demand compensation that South Korea would be willing to pay in order to save its capital. It could rely on South Korea to restrain further retaliations by the United States, and China would be prepared to negotiate another armistice. North Korea would have re-established its credibility, redefined the terms of the North-South relationship and, perhaps having lost its dubious nuclear deterrent, gained a significant conventional deterrent that no one thought it would ever use.

Friedman thinks the risks are too great for this scenario to play out. The North would have to assume that its plans were unknown by Western intelligence agencies. It would also have to assume that South Korea would rather risk severe damage to its capital as it dealt with North Korea once and for all than continue to live under the constant North Korean threat. Moreover, North Korea's artillery could prove ineffective, and it risks entering a war it couldn't win, resulting in total isolation.

The scenario laid out is therefore a consideration of what it might mean if the North Koreans were actually wild gamblers, rather than the careful manipulators they have been since 1991. It assumes that the new leader is able to override older and more cautious heads and that he would see this as serving both a strategic and domestic purpose. It would entail North Korea risking it all, and for that to happen, Pyongyang would have to believe that everything was already at risk. Because Pyongyang doesn't believe that, Friedman thinks this scenario is unlikely.

It is, however, a necessary exercise for an analyst to find fault with his analysis by identifying alternative assumptions that lead to very different outcomes. At Stratfor, it normally keeps those in-house, but in this case it appeared useful for them to think out loud, as it were.

For the peacemakers in the U.S., South Korea and Japan, they should hope Friedman's assessment that little will change in North Korea is right.

D. Miyoshi

Miyoshi Capital LLC

1055 Wilshire Blvd.
Suite 1890
Los Angeles, California 90017
U.S.A.

Phone: 310-378-0615
Fax: 310-378-0000
E-mail: david@miyoshicapital.com
www.miyoshicapital.com
http://about.me/dmiyoshi