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Financial Crisis Report

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Advancing in a Time of Crisis

MANY HAPPY RETURNS FOR 2014

Inside this issue:

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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.

Happy New Year !

I would like to wish you a very Happy New Year for 2014.

A little over 17 million hours ago Jesus Christ was crucified. A little over a few hours ago the U.S. deficit exceeded 17 trillion dollars. Is there any numerical connection between the two? Probably not, except that we can look forward to deliverance from our sins from the former but will likely “pay” dearly for our sins from the latter.

Over the Christmas holidays someone asked me if I really believed that our country will actually undergo a financial crisis, the namesake of this newsletter. To that I can answer an emphatic YES! This belief is based on my conviction that history always repeats itself both in terms of human behavior and economic valuations.

ON HUMAN BEHAVIOR

We experience booms and busts, inflation and deflation, new innovations and the demise of old technologies because these are the consequences of human nature.

People and companies grow and excel until their success creates complacency and failure. We endure failure until we grow sick of it and learn our lessons, resolve to change our ways, then innovate to success again. These are the cycles of our existence that we undergo because it is in our DNA to do it this way.

Just as college football programs enjoy periods of dominance and later suffer episodes of letdowns (i.e. USC, Texas, Ohio State, Oklahoma, Penn State, Notre Dame, Nebraska, Alabama, Michigan, you get the idea) so also do companies, organizations and individuals. The main difference being colleges usually survive their downturns because their main enterprise is education, not football.

But as I see it, a financial crisis portends not failure and loss but to the contrary, offers maximum opportunity for growth and profit. Consequently, I believe it is incumbent upon us to embrace challenges and difficulties because our greatest growth will come out of these times.

If we look back into history we see that the most radical innovations such as the combustion engine, telephones, electricity, jet engines, radar and computers were developed during the winter economic seasons and deflationary downturns between the 1880’s and 1890’s and 1930’s and 1940’s.

Winter and deflation, summer and inflation are opposite determinants that will always duel, alternately dominating and waning to create progress.

Just recently we experienced the greatest boom in history as a result of fundamental demographics, new technology and economic cycles. But when the cycle began its inevitable turn, the government (in all its supposed omniscient benevolence), businesses and consumers launched a resistance because no one enjoys the pain and suffering from austerity. Kicking the can down the road was the inevitable upshot.

A conspicuous example of this propensity is Japan which, thanks to its government efforts, the economy has daily deteriorated in the last 20+ years of its comatose existence.

With their refusal to embrace the natural economic cycle, Japan, the U.S. and to a lesser degree some European governments are killing the “golden goose” of capitalism. They refuse to allow the old debt to deleverage, the sick

MANY HAPPY RETURNS FOR 2014

banks and businesses to fail and thereby allow new innovations to emerge out of the ashes.

What is needed is a “financial crisis” that would force the system to break down and correct itself so that not only unproductive debt and businesses would expire but would also extinguish the corruption of special interests that now run rampant in our government and politics.

But, as destiny would have it, the most dominant cycles – demographic, geopolitical, commodity and financial – all point to a crisis unfolding from 2014 to 2019.

This is the only time since 1930 to 1934 that these same cycles have pointed downwards simultaneously. If one recalls, there were more millionaires made during this period of the great depression than at any time in U.S. history. If one were a betting person, there is more than a 50/50 chance that an economic winter season awaits us. Actually, it’s more like a 90% chance that the opportunity of our lifetime to reap and enjoy huge gains and profits lies ahead.

ON ECONOMIC VALUATIONS

Based on history, U.S. stocks at today’s valuations cannot be trusted to deliver decent rates of return. We all know the adage “buy low, sell high”. It’s usually not wise to buy high and try to sell higher. In the short run, this may occasionally work but over the long run, it’s definitely not the way to do it.

Flipping the adage to “sell high, buy low” and applying it to today’s circumstances, we can see a methodology for earning large profits now.

Things that drive stock prices higher (i.e. credit, capital flows, and sentiment) are all near record highs. Credit has never been cheaper (record-low risk spreads). Cash into equity mutual funds has never been stronger (money flows). And sentiment has never been more bullish: 19 stocks with a market capitalization of $10 billion-plus are trading for more than 10 times sales. That’s the most since the top of the market in 2000.

We know when sentiment is at a bullish peak, it has nowhere to go but down. When credit can’t get any cheaper, it’s bound to become more expensive sooner or later. And when individuals have already spent their cash reserves on stocks, it’s unlikely they’ll be able to keep buying at the same pace.

In short, as investing legend Warren Buffett once said, to invest successfully, you must be fearful when others are greedy and greedy when others are fearful. You have to know when conditions have become overheated. You have to know when to stand aside. Without a doubt, now appears to be one of these moments.

Merryn Somerset Webb, editor of *MoneyWeek*, in a recent article wrote:

The NASDAQ has just passed its pre-crisis high. It trades on an average price/earnings (P/E) ratio of around 25 times – with a tiny dividend yield of under 1.5%.

The S&P 500 index has risen nearly 27% so far this year. Into this market, 192 companies have recently issued new shares, raising a total of $51.8 billion – a number not far off that raised back in the 2000 dotcom bubble. Based on last year’s profits, the P/E ratio has risen from 16.4 times to 19.1 times over the same period. This is not about companies being worth more, it is about people paying more.

The index, as Christopher Wood of CLSA points out, is also trading on a cyclically adjusted P/E ratio or Cape – a measure which is based on the average of the last ten years’ earnings – of 25 times. The long-term average is more like 16 times.

It’s been higher, much higher – think 44 times in 2000 and 33 times in 1929. But it is, says Wood, “just exceeding the highs reached in 1901 and 1966.” Nasty market falls – 20-year bear markets in fact – followed both of those peaks.

So here’s my question: would you call this market: (a) a bubble, (b) pretty expensive, but not yet a bubble, (c) different to any market that has gone before it in myriad complicated ways, or (d) a stock picker’s market?

If you are a normal person, you will have gone for (a) or (b). If you are a fund manager, an analyst working for a stock-broking firm or someone who is hoping to be one of those things at some point in the future, you will have gone for (c) or (d).

How do you justify a market that is clearly overpriced, on any conventional or historical measure? You announce that thanks to some change or another – demographics, accounting rules, technology, one-off crisis, shale gas, the fact your kids’ school just put the fees up by 9%, whatever – it should be henceforth valued in a new way.

All in all, the article simply seems to say stocks will either go higher or lower. Probably a lot, in whichever direction they take. They could go much higher, because the Fed is a buyer bringing $1 trillion of new money into the market each year. This could

make investors very excited.

But on the other hand, investors could suddenly realize there is something inherently dangerous about a market that is supported only by the authorities. The smartest investors might just skip out of the theater and then call the fire department.

Either way, it promises to be quite a ride. It's not much fun waiting around for the show to begin. But it will be even less fun if the market suddenly "melts up" as some analysts expect.

But there is no doubt, the financial crisis will be memorable. Just be sure you are on the smart side of it.

D. Miyoshi

The Greatest Financial Gift You Can Give to Your Children

I wrote this essay for your children and grandchildren.

You've probably heard about America's huge debt load. The U.S. government's financial obligations now exceed $663,000 per American family. This burden will fall on the youngest Americans.

It's unethical. It's unfortunate. But it's the reality.

With this giant financial obligation bearing down on them, it's critical that now – right now – your children and grandchildren learn about money and finance. They need to know the basic principles… like how to be independent, why debt is dangerous, and how to grow money.

They don't teach finance in schools. If you don't teach them this knowledge, no one will. They call this financial illiteracy.

If our children are financially illiterate, they have as much chance of survival as a swordsman in a gunfight. There will be no mercy for the financially illiterate in the future. It's likely these people will live as indentured servants to the government and its creditors.

But if our kids have a grasp of finance and its basics – and they obey its laws – they will grow up rich. They will be in a position to help other Americans, too.

Below, you'll find the three vital financial concepts all children need to understand. Please pass them on to your children and grandchildren as soon as you can. I have three young children… And these three concepts are my starting point for their financial education.

First of all, our kids must know that they are not entitled to money or wealth… or anything for that matter, even Christmas presents. They must earn money. I want my children to learn that they shouldn't expect anything to be handed to them. I don't want them to rely on the government for their livelihood, like many people do right now.

So many people treat money and prosperity as an entitlement. The government even calls its welfare programs "entitlements." This word – and what it represents – gets stamped into young people's brains. Kids act as if they are somehow entitled to toys, video games, and cars. But why should they be? Just because they have parents, it doesn't mean they should get everything they want… or anything at all, for that matter.

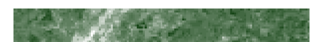
I plan to regularly remind my children of this when they are old enough to understand it. And I'm not going to pay my kids an allowance. An allowance would reinforce the sense of entitlement. They can make money by earning it: doing the dishes, making their beds, mowing the lawn… there are a million things. My wife and I will pay them for doing those things. But I'm not going to just give them money.

The second concept our children need to understand is debt. Debt is expensive. If you abuse it, it will destroy you. Like the entitlement mentality, debt is an enslaver. It robs you of your independence. I avoid debt in my personal life… and when I'm choosing investments.

The best way to illustrate the cost of debt is to calculate the total amount of interest the debt generates in dollars over the lifetime of the loan, instead of looking at the interest rate (like most people do). Once you look at it like that, you can see how expensive borrowing money really is.

For example, say you borrow $100,000 with a 30-year mortgage at 7%. Over 30 years, you'll end up paying $140,000 in interest to the bank. In the end, you're out $240,000 for a house that cost less than half that. Not a good deal.

The third thing our kids need to learn is the power of compound interest and the best way to harness it.



An Opportunity to Shine

Compound interest is the most powerful force in finance. It is the force behind almost every fortune. The brilliant Richard Russell calls compound interest "The Royal Road to Riches." And it's mathematically guaranteed.

Let's say, for example, you have $100 earning 10% annual interest. At the end of a year, you'll have $110. During the second year, you'll earn interest on $110 instead of $100. In the third year, you'll earn interest on $121… and so on. This is the power of compound interest. The numbers get enormous over time, simply because you're earning interest on your interest.

Because time is the most important element in compounding, it's an incredibly powerful idea for children to understand. They have the ultimate edge in the market: the time to compound over decades.

The stock market is the best place to earn compound interest. You buy companies that have 50 years or more of rising dividend payments ahead of them. Then you let the mathematics work.

As soon as my kids are old enough to understand some arithmetic, I am going to sit down with the classic compounding tables and show them which stocks they have to buy. I'll use Coca-Cola, Johnson & Johnson, and Philip Morris as examples.

Another very safe place to save and compound your money is our "Income for Life" strategy. It involves using a uniquely designed, dividend-paying, whole life insurance policy from a mutual life insurance company. This type of policy is one of America's best-kept and most misunderstood secrets.

After that, assuming they have the discipline to follow through, they will get rich. There's no doubt about it.

In sum, you have the responsibility to educate your kin about finance. If you don't, no one else will, and they will suffer for it.

Encourage them to work hard and avoid the entitlement mentality. Teach them the power of compound interest and explain the dangers of debt.

If you do this, you will equip your kids and grandkids to survive financially in the difficult circumstances ahead. You'll provide them with something that nobody can place a price on: the power of independence.

Good investing,

Tom Dyson, publisher, The Palm Beach Letter

An Opportunity to Shine

This article is revealing in that it expounds on and provides insight into how a financial crisis can directly benefit both our economy in particular and our society in general. I hope you find it informative.

D. Miyoshi

In the mid-1930s President Franklin D. Roosevelt signed the Wagner Act that allowed collective bargaining in industry. The forces of the Industrial Revolution and the Great Depression combined to make the working conditions of the average factory employee very difficult.

Safety was an afterthought and wages were tight. If anyone didn't like it they were free to leave… there would be hundreds more workers, desperate for any job, who would jump at the chance to take a disgruntled worker's place.

The point of collective bargaining was to give employees a singular voice that carried weight. One worker leaving is trivial, shutting down an entire factory is crippling.

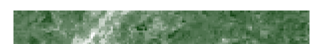
The interesting part of collective bargaining is that it can be a game of brinkmanship. Auto workers pressed for the benefits and pay – which management agreed to – that eventually ended up mortally wounding the U.S. car companies.

The bankruptcies of these companies washed away the contracts and much of the ancillary benefits (like guaranteed employment) that made no sense. The prospect of having no job at all for hundreds of thousands of employees was all too real, and led to an agreement that all parties could abide by.

Now the car companies have much more competitive labor pricing. It's not perfect, and I might dislike how it came about, but there is no doubt that the U.S. car companies are in better shape today when it comes to labor costs and flexibility than they were before the financial crisis.

And that's the key… it took a crisis.

While President Roosevelt signed the Wagner Act, he specifically declined to allow civil servants the right to collective bargaining. President Kennedy provided this right in the early 1960s.



A Hidden Source of Double-Digit Annual Returns

Over the past 40 years, private industry unions have shed millions of members as manufacturing employment in the U.S. declined, but public employment unions exploded.

Just as they did in the private sector, these unions pushed for more generous wages, benefits, and employment guarantees. Now cities around the country are facing a series of financial crises of their own, and of their own making.

Over the last several decades cities (and a few states) have agreed to employment contracts and benefits with workers' unions that threaten to bankrupt them. Detroit is the biggest example of such a disaster, but the city is in no way the only example.

Chicago is not far behind Detroit in terms of owing billions of dollars it can't possibly pay.

New York has 152 different employee bargaining units that have been operating with expired contracts for six years. The city is only 70% funded in its pensions.

Just as what occurred with the auto industry, cities around the country are headed for their own day of reckoning. This is where the opportunity exists.

One of the outcomes of the financial crisis was laser-like attention to how government, at all levels, spends money. Constituents of every town, no matter what the size, have the ability and the duty to ask their elected officials how money is spent and why it is spent in that way.

Allowing existing employment contracts to drive cities over the fiscal cliff at the expense of all other programs doesn't make sense for anyone.

While the way Detroit got to bankruptcy isn't pretty, the city is now at a point where it can define what it wants to look like in the years ahead. This process should include all the parties – taxpayers, business owners, elected officials, municipal workers, etc. – and should start from the point of what is possible tomorrow, not what was on paper yesterday.

If Detroit – or Chicago, or even New York, for that matter – takes the initiative, this could be the start of a public employment evolution in the U.S. where administrators, sanitation workers, policeman, and others return to the same side of the table as the taxpayers.

The goal should be to develop fair pay and benefits for the work performed, while providing the flexibility to deal with the changing economic landscape.

Without such leadership or change, the U.S. will continue to be a nation filled with economic landmines that could explode at any time, taking businesses, vendors, bondholders, current workers and retirees with them.

Rodney Johnson, Senior Editor, Survive & Prosper

A Hidden Source of Double-Digit Annual Returns

This article is written by Dan Ferris, editor of the 12% Letter, a publication this editor subscribes to. Its message is extremely important to investors today.

D. Miyoshi

If you're looking to earn 10% or more on your portfolio year after year, chances are, you're looking in the wrong place…

Chances are, you're buying risky, overpriced, "high growth" stocks that have a good story. Or you're buying risky, leveraged, "high income" stocks. Either way, over the long term, you're more likely to lose money than make it.

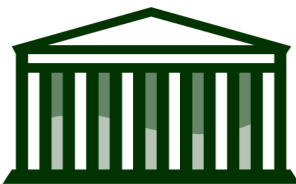
Most companies that are growing fast command much too high a premium in the market. If the growth comes in below expectations, you lose big. And most companies that pay double-digit yields are vulnerable to even small potholes in the credit or commodity markets.

Here's the thing: You're missing one of the world's greatest sources of double-digit annual returns. It's right under everyone's nose. But hardly anyone sees it.

Let me show you what I mean…

Over the long term, big dividend growth usually comes with big share-price growth…

A Hidden Source of Double-Digit Annual Returns



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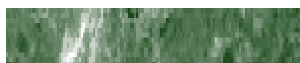

David M. Miyoshi is a California attorney and real property broker, having earned a Bachelor of Science degree from the University of Southern California, a Juris Doctor degree from the University of California, an MBA degree from Harvard University and an international graduate degree from Waseda University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

Think about it… A higher dividend makes the shares more valuable.

Think about a company that pays $0.50 in annual dividends. If the share price is $20, that's a 2.5% yield. Now let's say the company increases its dividend payout to $0.55. For the yield to stay at 2.5%, the share price would have to climb to $22.

So all things being equal, a 10% increase in the dividend payout will translate into a 10% increase in share price. (Adding in the original dividend, you've made 12.5% in a year.)

I've found that over the long term, companies that regularly make large increases to their dividends see large long-term share-price growth as well.

Take Wal-Mart, for example. Since March 1974, the retail giant's split-adjusted dividend has grown about 24.2% a year, and its split-adjusted share price has grown about 21% a year. That's incredible.

Of course, the math doesn't always work out so perfectly. I first recommended Wal-Mart to my readers in 2006. Over that time, its share price is up 53%. Its dividend is up an incredible 180%.

Even when the numbers don't line up exactly, big dividend growth and big share-price growth move together.

McDonald's split-adjusted dividend has grown about 21% per year since 1976. Its split-adjusted share price has grown about 14% a year. Yes, the McDonald's numbers are different… But they're both enormous, especially when you stop to realize you're talking about 37 years of compounding.

Medical-equipment manufacturer Becton-Dickinson is another example. Becton-Dickinson's split-adjusted dividend has grown about 13% a year since 1992. Its split-adjusted share price has grown about 14% a year.

The point isn't that share price and dividend growth are exactly the same over time. It's that when one of them grows a lot over the long term, the other grows a lot, too.

When dividends rise decade after decade at inflation-beating rates, you can expect the value of that growth to be reflected in the share price.

In other words, when a high-quality company – like Wal-Mart, McDonald's, or Becton-Dickinson – raises its dividends by double digits every year, you can expect to average double-digit returns over the long term. And you'll do it without the risks you take on with almost every other strategy.

Most investors look for companies with high current yields or high rates of revenue growth. I look for steady, high rates of dividend growth.

For the safest double-digit long-term returns, you should, too.

Good investing,

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

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