



# Financial Crisis Report

Written and Edited by David M. Miyoshi

## Advancing in a Time of Crisis

### Words of Financial Wisdom: “When your outgo exceeds your income, your upkeep becomes your downfall”

#### 99% Boredom, 1% Sheer Terror

In the jungles of Vietnam, this is how we lived our lives.

In 1969 there was a period of two months in which each day we faithfully mustered the troops, checked the perimeters, cleaned our weapons and equipment, reviewed our schedules, completed reports, took inventory, ate chow and bunked down for the night (or day if we were on night watch). Things were becoming quite routine and actually very boring. Then in the 54<sup>th</sup> night of that two month period, the night sky opened up like the finale of a grand 4<sup>th</sup> of July celebration. The concussive shock of explosions and shrapnel whizzing by us instantly turned our tranquil boredom to extreme anxiety. I was convinced I was going to die. Yes, our lives were ninety-nine percent boredom and one percent sheer terror.

There are two types of jobs. The type we lived in Vietnam, and then the type where there’s a steady flow of activity all the time, like a teacher or a dentist.

Trading isn’t like being a dentist. It’s more like being in a war, 99% boredom, 1% sheer terror.

But writing about trading is not like trading. It’s like being a dentist (I don’t have anything against dentists, at times I envy their tranquility). I write about ten articles a month on the economy, the financial markets and trading regardless of how boring or exciting the market is.

When the market is really boring, I should probably be writing less. When it’s blowing up, I

should be writing more. But my publishing schedule is linear!

Same with TV. What is there to talk about all day in those slow summer markets? Nothing. They should just go home.

One of the things that scientists have learned is that adrenaline increases the strength and intensity of memories. Chances are, you remember the really stressful times in your life—good stress and bad stress. You don’t remember the boring stuff. You don’t remember August 26, 2006, when you were watching TV on the couch. It just goes into the blob, the soup of all the things that make up your life in between the stressful moments.

I would guess you remember less than a tenth of a percent of your entire life. The rest are generalizations—the TV-watching bucket, the sleeping bucket, the driving bucket.

And people wonder why some people are adrenaline junkies.

#### Nonlinear Time

Here is a theory that explains it all: Time, as we experience it, is not linear. It speeds up during boring times and slows down during exciting times. If you’ve ever been in a car accident or have been seriously injured, you remember the moment of impact. It lasted... forever. But it didn’t last forever. It lasted a hundredth of a second. But as you experienced it, time actually slowed down, which is why your memory of it is so intense. The two hours you just spent watching TV—it went by in a flash.

In *Interstellar*, Dr. Amelia Brand (played by Anne Hathaway) says that time can stretch and squeeze and do all sorts of things, but it can never run

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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.



## The concept of “Freedom” in America and how it’s changing our politics.

backward. But boy, can it stretch and squeeze.

The amazing thing is, the nonlinearity of time as we experience it is represented in the financial markets.

### Time and Volatility

If I have an option to buy stock, the more time goes by without the stock moving in the money, the more the value of the option will decay. It will be worth less because there is less time to go until expiration.

But when the stock is volatile, there’s more time for it to go in the money, which increases the value of the option, slowing down the decay from the passage of time.

Think about it: more volatility, more exciting—time as we experience it begins to slow down.

As the stock returns to normal and things become boring again, the decay resumes and the option is worth less.

I think I understood options once I figured out that time and volatility work in opposite directions.

But I really understood options when I realized that time was nonlinear.

### Nonlinear Work

Here’s a question: If you’re not a teacher or a dentist (believe me I have nothing against teachers and dentists, and on occasion I envy them) and you’re in one of these 99% boredom/1% terror occupations, why do you come to work every day?

If your work environment is nonlinear, why is your work linear?

In all seriousness, there is a lot of unstructured time on a trading desk. This is how so many people end up betting on sports.

But that’s not even the problem. The problem is that people think they have to trade every day in order to make money.

It has been shown that in many if not most cases, more money is made trading during very selected and short periods of time. For me I only trade when markets are volatile and exciting, giving me more opportunities, because—time had slowed down.

These guys sitting in day trading firms, spending all day trying to scalp pennies out of stuff when the market isn’t even moving... should probably be waiting on tables. But if you told your boss that you were only going to work 20 days out of the year, you’d probably get fired.

Wasting time.

Finance is nonlinear. Most people approach it linearly, with predictable results. If you’ve reached the age of “n” and you don’t know what the second derivative is, you should probably take a calculus refresher before you do any more damage to your portfolio.

Here’s to our smart trading.

D. Miyoshi

## The concept of “Freedom” in America and how it’s changing our politics.

Actually, the title should read The concept of “Free,” its dominance in America and how it’s changing our politics.

The following is taken from an article written by Rabbi Steven Pruzansky, the spiritual leader of Congregation Bnai Yeshurun in Teaneck, N.J. This article is far and away the most succinct and thoughtful explanation of how our nation is changing. It will explain what I mean by my title above. The article appeared in *The Israel National News*, and is directed to Jewish readership. Seventy percent of American Jews vote as Democrats. The Rabbi has some interesting comments in that regard. I provide it here for your thoughtful consideration.

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"The most charitable way of explaining the election results of 2012 is that Americans voted for the status quo - for the incumbent President and for a divided Congress. They must enjoy gridlock, partisanship, incompetence, economic stagnation and avoidance of responsibility. And fewer people voted.

But as we awake from the nightmare, it is important to eschew the facile explanations for the Romney defeat that will prevail among the chattering classes. Romney did not lose because of the effects of Hurricane Sandy that devastated this area, nor did he lose because he ran a poor campaign, nor did he lose because the Republicans could have chosen better candidates, nor did he lose because Obama benefited from a slight uptick in the economy due to the business cycle.

Romney lost because he didn't get enough votes to win.

That might seem obvious, but not for the obvious reasons. Romney





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lost because the conservative virtues - the traditional American virtues – of liberty, hard work, free enterprise, private initiative and aspirations to moral greatness - no longer inspire or animate a majority of the electorate.

The simplest reason why Romney lost was because it is impossible to compete against free stuff.

Every businessman knows this; that is why the "loss leader" or the giveaway is such a powerful marketing tool. Obama's America is one in which free stuff is given away: the adults among the 47,000,000 on food stamps clearly recognized for whom they should vote, and so they did, by the tens of millions; those who - courtesy of Obama - receive two full years of unemployment benefits (which, of course, both disincentives looking for work and also motivates people to work off the books while collecting their wind-fall) surely know for whom to vote. The lure of free stuff is irresistible.

The defining moment of the whole campaign was the revelation of the secretly-recorded video in which Romney acknowledged the difficulty of winning an election in which "47% of the people" start off against him because they pay no taxes and just receive money - "free stuff" - from the government.

Almost half of the population has no skin in the game - they don't care about high taxes, promoting business, or creating jobs, nor do they care that the money for their free stuff is being borrowed from their children and from the Chinese.

They just want the free stuff that comes their way at someone else's expense. In the end, that 47% leaves very little margin for error for any Republican, and does not bode well for the future.

It is impossible to imagine a conservative candidate winning against such overwhelming odds. People do vote their pocketbooks. In essence, the people vote for a Congress who will not raise their taxes, and for a President who will give them free stuff, never mind who has to pay for it.

That engenders the second reason why Romney lost: the inescapable conclusion that the electorate is ignorant and uninformed. Indeed, it does not pay to be an informed voter, because most other voters - the clear majority – are unintelligent and easily swayed by emotion and raw populism. That is the indelicate way of saying that too many people vote with their hearts and not their heads. That is why Obama did not have to produce a second term agenda, or even defend his first-term record. He needed only to portray Mitt Romney as a rapacious capitalist who throws elderly women over a cliff, when he is not just snatching away their cancer medication, while starving the poor and cutting taxes for the rich.

During his 1956 presidential campaign, a woman called out to Adlai Stevenson: "Senator, you have the vote of every thinking person!" Stevenson called back: "That's not enough, madam, we need a majority!" Truer words were never spoken.

Obama could get away with saying that "Romney wants the rich to play by a different set of rules" - without ever defining what those different rules were; with saying that the "rich should pay their fair share" - without ever defining what a "fair share" is; with saying that Romney wants the poor, elderly and sick to "fend for themselves" - without even acknowledging that all these government programs are going bankrupt, their current insolvency only papered over by deficit spending.

Similarly, Obama (or his surrogates) could hint to blacks that a Romney victory would lead them back into chains and proclaim to women that their abortions and birth control would be taken away. He could appeal to Hispanics that Romney would have them all arrested and shipped to Mexico and unabashedly state that he will not enforce the current immigration laws. He could espouse the furtherance of the incestuous relationship between governments and unions - in which politicians ply the unions with public money, in exchange for which the unions provide the politicians with votes, in exchange for which the politicians provide more money and the unions provide more votes, etc., even though the money is gone.

Obama also knows that the electorate has changed - that whites will soon be a minority in America (they're already a minority in California) and that the new immigrants to the US are primarily from the Third World and do not share the traditional American values that attracted immigrants in the 19th and 20th centuries. It is a different world, and a different America. Obama is part of that different America, knows it, and knows how to tap into it. That is why he won.

Obama also proved again that negative advertising works, invective sells, and harsh personal attacks succeed. That Romney never engaged in such diatribes points to his essential goodness as a person; his "negative ads" were simple facts, never personal abuse - facts about high unemployment, lower take-home pay, a loss of American power and prestige abroad, a lack of leadership, etc. As a politician, though, Romney failed because he did not embrace the devil's bargain of making unsustainable promises.

It turned out that it was not possible for Romney and Ryan - people of substance, depth and ideas - to compete with the shallow populism and platitudes of their opponents. Obama mastered the politics of envy – of class warfare - never reaching out to Americans as such but to individual groups, and cobbling together a winning majority from these minority groups. If an Obama could not be defeated - with his record and his vision of America, in which free stuff seduces voters - it is hard to envision any change in the future.





## Are You Investing Or Gambling?

The road to Hillary Clinton in 2016 and to a European-socialist economy - those very economies that are collapsing today in Europe - is paved.

For Jews, mostly assimilated anyway and staunch Democrats, the results demonstrate again that liberalism is their Torah. Almost 70% voted for a president widely perceived by Israelis and most committed Jews as hostile to Israel . They voted to secure Obama's future at America's expense and at Israel's expense - in effect, preferring Obama to Netanyahu by a wide margin.

A dangerous time is ahead. Under present circumstances, it is inconceivable that the US will take any aggressive action against Iran and will more likely thwart any Israeli initiative. The US will preach the importance of negotiations up until the production of the first Iranian nuclear weapon - and then state that the world must learn to live with this new reality.

But this election should be a wake-up call to Jews. There is no permanent empire, nor is there an enduring haven for Jews anywhere in the exile. The American empire began to decline in 2007, and the deterioration has been exacerbated in the last five years. This election only hastens that decline.

Society is permeated with sloth, greed, envy and materialistic excess. It has lost its moorings and its moral foundations. The takers outnumber the givers, and that will only increase in years to come.

The "Occupy" riots across this country in the last two years were mere dress rehearsals for what lies ahead - years of unrest sparked by the increasing discontent of the unsuccessful who want to seize the fruits and the bounty of the successful, and do not appreciate the slow pace of redistribution.

If this election proves one thing, it is that the Old America is gone. And, sad for the world, it is not coming back."

The problems we face today are there because the people who work for a living are outnumbered by those who vote for a living.

## Are You Investing Or Gambling?

Last month I visited Las Vegas and checked out my usual haunts. At the end of my trip, I counted my winnings (this was an unusual positive visit) and did a quick cost benefit analysis. In the end it seemed that for all the time I had spent in the casinos, my return was less per hour (and day) than what I usually manage in the financial markets. But I wondered, do we as traders on occasion confuse the two?

According to Cory Mitchell, a famous Chartered Market Analyst, gambling is defined as staking something on a contingency. However, when trading is considered, gambling takes on a much more complex dynamic than the definition presents. Many traders are actually gambling without even knowing it - trading in a way or for a reason that is completely dichotomous with success in the markets.

So let's examine the hidden ways in which gambling creeps into trading practices, as well as the stimulus that may drive an individual to trade (and possibly gamble) in the first place.

### Hidden Gambling Tendencies

It is quite likely that anyone who believes they don't have gambling tendencies will not happily admit to having them if it turns out they are in fact acting on gambling impulses. Yet discovering what drives us to take certain actions can create change within us as the underlying motivators are discovered by the conscious mind.

Before delving into gambling tendencies when actually trading, one tendency is apparent in many people before trading even takes place. This same motivator continues to impact traders as they gain experience and become regular market participants.

### Social Proofing

Some people may not even have an interest in trading or investing within the financial markets, but social pressures induce them to trade or invest anyway. This is especially common when large numbers of people are talking about investing in the markets (often during the final phase of a bull market). People feel pressured to conform by their social circle. Thus they invest so as not to disrespect or disregard others' beliefs or feel left out.

Buying some stocks or placing some trades to appease social forces is not gambling in and of itself if people actually know what they are doing. But entering into a financial transaction without a solid investment understanding is gambling, regardless of what the social media portrays. Such people lack the knowledge to exert control over the profitability of their choices. There are many variables in the market, and misinformation or disinformation within investors or traders creates a gambling scenario. Until knowledge has been developed that allows people to overcome the odds of losing, gambling is taking place with each transaction that occurs.

### Contributing Gambling Factors

Once someone is involved in the financial markets, there is a learning curve, which based on the social proofing discussion above may seem like it is gambling. This may or may not be true based on the individual. How the person approaches the market will determine whether she/he becomes a successful trader or remains a perpetual gambler in the financial markets. The following two traits (among



## Six Biggest Millionaire Flops

many) are easily overlooked but contribute to gambling tendencies in traders.

### Gambling (Trading) for Excitement

Even a losing trade can stir emotions and a sense of power or satisfaction, especially when related to social proofing. If everyone in a person's social circle is losing money in the markets, losing money on a trade will allow that person to enter the conversation with her/his own story. When a person trades for excitement or social proofing reasons, it is likely that she/he is trading in a gambling style rather than in a methodical and tested way. Trading the markets is exciting; it links the person into a global network of traders and investors with different ideas, backgrounds and beliefs. Yet getting caught up in the "idea" of trading, the excitement, or emotional highs and lows is likely to detract from acting in a systematic and methodical way.

### Trading to Win, and Not Trading a System

Trading in a methodical and systematic way is important in any odds-based scenario. Trading to win seems like the most obvious reason to trade. After all, why trade if you can't win? But there is a hidden detrimental flaw when it comes to this belief and trading. While making money is the desired overall result, trading to win can actually drive us further away from making money. If winning is our prime motivator, the following scenario is likely to play out: Bill buys a stock as he feels it is oversold compared to the rest of the market. The stock continues to fall, placing him in a negative position. Instead of realizing that the stock is not simply oversold and that something else must be going on, he continues to hold the position, hoping it will come back so he can win (or even break-even) on the trade. The focus on winning has forced the trader into the position where he doesn't get out of bad positions, because to do so would be to admit he lost on that trade.

Good traders take many losses; they admit they are wrong and keep the damage small. Not having to win on every trade and taking losses when conditions indicate they should is what allows them to be profitable over many trades. Holding losing positions after original entry conditions have changed or turned negative for the trade means the trader is now gambling and no longer using sound trading methods (if she/he ever was).

### The Bottom Line

Gambling tendencies run far deeper than most people initially perceive and well beyond the standard definitions. Gambling can take the form of needing to socially prove one's self, or acting in a way to be socially accepted, which results in taking action in a field they know little about. Gambling in the markets is often evident in people who do it mostly for the emotional high they receive from the excitement and action of the markets. Finally, not trading in a methodical and tested system, but rather relying on emotion or a must-win attitude to create profits, indicates the person is gambling in the markets and unlikely to succeed over the course of many trades.

Here is to your profitable trading (and not gambling).

D. Miyoshi

## Six Biggest Millionaire Flops

This article is taken from Investopedia.com



Portfolio losses got you down? That's understandable. The dramatic 2008 market drop-off caused the S&P 500 Index to tumble 37%, wiping out more than \$4 trillion in workers' retirement plan savings alone.

If you lost money, you're not alone, but at least you can put some blame on the market. Major errors of judgment have cost some of the world's richest people more than just a pretty penny - and these are people who have a lot to lose. Console yourself with these famous financial flops. (Want to be a millionaire yourself? Read *Getting A Millionaire's Mindset*.)

## Six Biggest Millionaire Flops



### Two Rocks and a (Could Have Been) \$17 Billion Family Legacy

In 1883, Dr. William Howey went to check on crews building the Canadian Pacific Railway. While searching for a lost worker, he found some interesting copper-colored rocks and pocketed them. Upon returning home he sent them to the director of the Geological Survey of Canada. The verdict? The stones were deemed worthless, and Howey threw them away.

A contractor picked them up, and a year later decided to check out the site where they were found. It turned out those "rocks" were copper and the contractor - Thomas Murray - had discovered one of the world's largest copper deposit, producing millions of dollars of ore.



### A \$75 Million Marital Mistake

Madonna may have a knack for putting out hit records, but her most recent divorce to film director Guy Ritchie will hit the "material girl" where it really counts - the wallet. Why? No prenuptial agreement. The 25-time gold record winner will pay her ex-better half \$75 million as part of their divorce settlement. That equates to just a little less than \$10 million for each year of their eight-year marriage.

Don't feel too bad for the pop and rock icon, however - she's still worth more than \$400 million. (Don't make this mistake. Read Marriage, Divorce And The Dotted Line to learn how to set up your own prenup.)



### A \$54 Million Hand-Motion Markdown

Vegas casino owner and art collector Steve Wynn was entertaining a small group of friends in the fall of 2006 when he decided to show them his prized Picasso "Le Reve," ("The Dream"). He had recently agreed to sell the piece for \$139 million to fellow collector and hedge fund director Steve Cohen.

But Wynn's "dream" turned into a nightmare when, with one seemingly harmless hand motion while hosting a party at his home, he put his elbow through the famous painting of Picasso's mistress. It cost Wynn \$90 million (\$5 million more than it was now worth) for restoration work. (A sound insurance policy could have saved the day. Read The importance Of Property Insurance.)



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### Stop That \$4 Million Cab!

In 2008, Russian violinist Philippe Quint left a \$4 million 1723 Antonio Stradivari violin in the back of a taxi after a ride home from Newark Airport. There are fewer than 700 of the handmade, highly-prized instruments worldwide.

Six frantic hours after reporting the loss, Quint got a call from the port authority that driver Mohamad Khalil had returned to the station with his instrument. When the two met, Quint fell to his knees in thanks; to demonstrate the depth of his gratitude Quint later treated Khalil and 200 of his cabbie-driving comrades to a 30-minute private concert at the airport.



### What?! Call That \$2 Million Foul, Ref!

Wimbledon champion and TV commentator John McEnroe wouldn't let an opponent get away with anything on the tennis court, but a high-flying rare art salesman got away with \$2 million of McEnroe's

fortune. Lawrence Salander, a New York art dealer, defrauded McEnroe through an elaborate scam by selling him half-shares in painter Arshile Gorky's pieces "Pirate I" and "Pirate II." One slight detail the dealer forgot to divulge: he didn't own the paintings. (Want to try your hand at investing in collectibles? See Fine Art Can Be A Fine Investment.)



### The \$1.5 Million Ferrari Fiasco

Actor Eddie Griffin had the best of intentions when he signed up to drive a \$1.5 million Enzo Ferrari for a charity benefit and to promote his 2007 movie "Redline," in the process. Just moments after taking the wheel, Griffin took a corner a little too tight, clipped a cone and locked the wheels of the prized car, slamming it into a concrete barrier. Although he walked away unharmed, the rare car was declared a total loss.

Could it get any worse? Actually, yes. The car was owned by Griffin's boss, "Redline" executive producer Daniel Sadek.

## What's Really Happening in East Asia

Living in Los Angeles, I think of Japan and China as being the Near East due to their relative proximity to me. Those living in New York may have more veracity in calling it the Far East. Today, we take a more global perspective and simply call it East Asia. In any case, in this article I hope to give you a historical perspective of what's happening in East Asia and how it impacts the U.S. With that objective in mind, there is no one better prepared to provide such a perspective than George Friedman, senior editor of Strafor. Here is his perspicacious view of how East Asia, its past and present affects the U.S.

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## What's Really Happening in East Asia

Asia is so vast and diverse and geographically fragmented that it is impossible to speak of Asia as a whole. East Asia is that part of Asia east of the Central Asian deserts that extend deep into China, and north of the Himalayas and hilly jungles east of the Himalayas. It consists of two main parts: One is the mainland, the region between the southern barriers and Siberia, which is Han China and its subordinate states, Tibet, Xinjiang, Inner Mongolia and Manchuria. The other is the East Asian archipelago, a string of islands and peninsulas stretching from the Aleutians to the Malay Peninsula-Java interface. Of particular importance to an East Asian net assessment are Taiwan, the Philippines and Japan. One additional feature is noteworthy: the Korean Peninsula, wedged between China and the archipelago. In the simplest terms, at this moment, the critical question is the dynamic in the northeast, involving China, Japan, the Koreans and, of course, the global power, the United States.

East Asia shares one major feature with the rest of Eurasia. It was part of World War II, which both transformed the region and defined it. In East Asia, World War II involved two issues: The first was Japan's ability to access raw materials and manpower from the Asian mainland and the rest of the archipelago. The second was the military balance between the two major Pacific powers, Japan and the United States. The two issues became intertwined.

### Economic Development in Japan and Korea

Japan is an island group almost completely bereft of raw materials. When European and American imperialism goaded it into becoming an industrial power, Japan immediately developed dependence on sources of raw materials (and on manpower to support its industrial expansion without immigration). Japan's enormous success at industrializing in the early 20th century made Tokyo insecure about access to these resources and therefore aggressive in trying to secure them. The United States, historically concerned about maritime defense of its coasts, saw Japan's increasing power and insecurity as a threat to U.S. control of the Pacific, which Washington saw as essential to protection of the West Coast.

The United States sought to limit Japan's control and even access to necessary resources in order to control its behavior. The Japanese saw this as an American plan to permanently subordinate Japan to the United States. When the Germans overran France and the Netherlands, the status of Indochina and today's Indonesia became murky, and Japan's ability to secure the resources it historically obtained from these places was uncertain. Japan moved to secure these areas, but doing so required securing the Philippines lest the sea-lanes from the south remain insecure. The Philippines was an American protectorate, so securing it meant war with the United States. This dynamic led to Pearl Harbor, which ultimately led to the catastrophic defeat of Japan.

Two dimensions of this defeat were interesting: The first was that the Japanese industrial plant, and therefore the Japanese economy, was wrecked. The second was that in spite of defeat and disaster, Japanese

society maintained its cohesion. In addition, the Americans needed Japan to revive its industry and use its social cohesion and human capital to produce equipment that the United States needed for the Korean War. The destruction of Japan's industrial base, the maintenance of social cohesion, and the American need for Japanese production created a dynamic that has been crucial in shaping East Asia since 1945.

Historically, global capitalism has relied on certain regions providing inexpensive manufacturing. This produced low-wage, high-growth countries like the United States at the end of the 19th century. World War II reset the Japanese and German economies so that they could become low-wage, high-growth engines that were particularly efficient because of the social discipline in these countries.

Japan's postwar recovery depended on the country playing this role, which it did for four decades. Such economies can both build an economic infrastructure and foster rising standards of living. However, a focus on growth rather than on rates of return on capital inevitably undermines profitability. In the end, growth can be maintained only by repressing wages or, when that is no longer viable, by slashing profit margins in order to compete with other low-wage countries. In due course, the country reaches a climax that results in a financial crisis, built around the fact that profitability has been sacrificed for growth. In Japan, this climax occurred between 1989 and 1991, between the last surge of Japanese exports, a crisis with the United States over Japanese export policy, and a banking crisis.

In the wake of its financial crisis, Japan became a much lower-growth country, less dependent on exports and more on domestic consumption. Moreover, to maintain social stability, Japan focused on maintaining full employment, not only by sacrificing profits but also by increasing debt. But another way to put this is that Japan managed the transition from a low-wage, high-growth country to a more stable economic platform without social unrest. Given their imperative, the Japanese did well.

South Korea also went through this process, reaching its climax in the 1997 East Asian financial crisis. Unlike Japan, it did experience social unrest, and unlike Japan it never managed a dramatic reduction of dependence on exports. It has straddled contradictions, but it has managed to maintain a relatively coherent social-economic policy that is still heavily export-oriented but less dependent on low wages.

### China Enters the Next Economic Phase

China is the third wave of this process in East Asia. During World War II, China was both a victim and a battleground. In large part this was because of China's fragmentation before the war. This fragmentation was caused by China's forced integration into the international economic system. The vast majority of China's population lives in the interior, where transport is difficult. Western interaction with the Chinese economy tended to focus on relations with coastal Chinese. This created a fundamental schism. The coastal cities were oriented toward







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the Western powers. Their economic interests aligned more with the Europeans' and the Americans' than with those of the Chinese central government. Thus, when the communists tried to spark an uprising in Shanghai in the 1920s, Mao Zedong failed and took the "Long March" into the interior, where he raised a peasant army. The split between coast and interior was institutionalized, and splits between coastal interests emerged as well. The result was a highly fragmented society at first exploited by Japanese interests, then caught between Japan and the United States.

After the war, Mao defeated the pro-Western factions, closed off China to most international trade, and sought to create national unity by excluding foreign influences. The result was internal repression. China did not come close to fulfilling its potential. When Mao died, the Chinese had to choose between this situation and reopening to the global economy. It chose the latter and assumed its place as the low-wage, high-growth country of its generation. And like Japan before it, when China's customers stopped buying after 2008, Beijing's attempts at maintaining social stability through employment at the cost of profitability led to inflation. This inflation was not massive, but as competition in the class of products China excelled in intensified, and as new players with much lower wage rates entered the game, even limited levels of wage inflation caused China to lose market share. In fact, even Chinese companies began to seek out labor in lower-wage countries. China experienced both the loss of global competitiveness based on low wages and a complex financial problem that was more endemic than a crisis. China is now shifting to a post-low wage, post-high growth economy to a more sustainable one.

It should be remembered that the culmination phase in Japan and South Korea was characterized by massive capital flight, which the West saw as evidence of the Asian countries' economic power rather than as a vote of no confidence in their own economies. Recall the Japanese purchase of American real estate in the late 1980s or Korean purchases of business in the 1990s. These were not particularly successful, nor were they meant to be. They were designed to reduce the Japanese and Koreans' exposure at home. The same can be said with China's current propensity for foreign investment. It is driven, at least in part, by a lack of confidence among those within China who really understand the country's situation. Much of it is state capital flowing out. Some is state capital flowing outward and becoming private capital. Other funds are private capital. The types and patterns vary, but the flow has continued.

### Managing Economic Change

A major difference between China and Japan is social cohesiveness. The economic dysfunction was managed socially in Japan. Given that the majority of the Chinese public participated in this process only marginally, the inability to sustain this model has caused significant fragmentation, as before. The first priority for the Chinese is retaining the power of the Communist Party and the central government in Beijing. Thus, the Chinese are engaging in political repression and purges in order to maintain the political system while the country transitions to a new economic system.

It is important to note the sequential enthusiasm Westerners have had to Japan's and China's economic development. Both were seen not as they were — simply a phase of the Asian countries' history — but as a permanent process that would cause each country to rapidly surpass the rest of the world. Westerners did not recognize that this process had inherent limits that would assert themselves in due course. Therefore, the lingering perception in the West about East Asia — or, in its current phase, of China — is that it is likely to become a singularly powerful international player.

The Chinese have severe limits on their ability to engage in international adventure. The People's Liberation Army is physically blocked from large-scale military operations by terrain. The Chinese navy is similarly limited, blocked as it is in the South China Sea and the East China Sea by the East Asian archipelago. It can exert pressure within these confined spaces until and unless the United States intervenes. Even with its anti-ship missiles, which can be destroyed by air campaigns, China cannot yet risk facing the U.S. Navy. It therefore probes below the threshold of triggering action.

The same can be said about North Korea, a fascinating case of a country whose significance is far less than the impression of importance it has created. Its ultimate goal is regime preservation. The position of "not quite ready to use nuclear weapons" aids in this. Passing the threshold to being ready or to actually use them would defeat the North Koreans' primary goal. Nothing would assure regime destruction more certainly than excessive aggression. Its actions have to be carefully calibrated and have been for well over a decade.

What all of this shows is that East Asia is transitioning from a period in which it — or each of its major components in sequence — played a critical role in the global system. Each has now climaxed, and both Japan and China are now playing a much more normal role in the system. This is the result of success and not failure, but it is also the result of the fact that while their previous economic models could exist for decades, at a certain point a shift is necessary.

As they shift, they experience different internal patterns. The Japanese have accepted low and no growth in return for social cohesion. The South Koreans went through spasmodic unrest followed by a shift not in export dependence but in the type of product exported and its position on the value chain. The Chinese are focused on maintaining centrifugal forces.

On the whole, it can be argued that this region is inherently stable. This is true of Japan and, depending on North Korea, true of the South. But China has not yet demonstrated that it can make the transition without internal fragmentation or intense repression. History would seem to argue that either is more likely than a return to the past decades. Mao was minimally aggressive after the lessons of the Korean War, where Chinese losses were extensive, so a strategy of regime preservation would tend to turn China inward. If China fragments and the coastal region draws in foreign powers to protect mutual interests, as happened in the 19th century, that would be another story. But this is not the 19th century, and such action from the coastal region is not





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highly probable.

### The U.S. Role

In spite of the U.S. rhetoric about a pivot to Asia, East Asia is not the United States' top priority in Asia. Washington's main concerns remain the Middle East and the borderland between Russia and the European Peninsula. Unless East Asia undergoes a fundamental redefinition, the United States has few interests that involve military intervention. South Korea's concern is preventing the collapse of the North Korean regime, but the price West Germany paid to integrate East Germany is not something the South is eager to bear. And China, for all its posturing, is more than content to not have to face the United States at sea.

The country that appears most content is Japan, but it is the wild card. South Korea's power is limited on a broader scale. China can sustain itself, on some level at least, even cut off from the world. Japan is the world's third-largest economy, yet it is the most vulnerable industrial power in the world. It has few industrial resources, and if it loses access to international sources — if only because of chaos among the sources — its industrial ability would wither with extraordinary speed. That the third-largest economy in the world depends completely on imports of raw materials and is incapable of securing those materials by itself is the underlying tension within the region and the global system.

The United States guarantees Japan access to its raw materials. But Tokyo sees the American concern in Russia and the Middle East as potentially dangerous to Japan's ability to access what it needs. A war that closes the Strait of Hormuz would cut Japan off from its supply of oil. Washington, from the Japanese point of view, is prepared to take risks that are minor to the United States but potentially disastrous to Japan. Tokyo's fear is that the United States will act not against Japan, but against a country on the road to a country Japan needs, heedless of the consequences to Japan.

The Japanese are quite aware of the problem, as well as that there is no way to limit this risk apart from staying close to the United States. Tokyo is also aware that the more problems the United States has with China, the more thoughtful Washington will be with Japan. But the United States has a queue of problems, and China, rhetoric aside, is not one of them. Whether it gets there will have less to do with what Beijing intends than with Beijing losing power over parts of China. That would draw the United States in and give Japan the leverage it needs.

But that is, as I have argued, a possibility for the future. The internal evolution of China is, in fact, the key to the region. China has moved from limited liberality to increasingly intense authoritarianism. The evolution of this government is at the heart of the East Asian dynamic. North Korean nukes, Chinese aggressiveness at sea and American threats are all secondary.

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**W**orld I was called the war to end all wars. World War II was called the Great War. What will World War III be called? Of course this question presupposes that there will be a World War III. Talk of this war happening began after the recent onset of terrorist shootings, beheadings and immolations occurred in the Mideast.

Dr. Martin Weiss, PhD and well known financial analyst was asked what will WWIII look like and how will affect our investments.

His reply was that it is unlikely World War III will be a nuclear holocaust as many have predicted.

Of course anything is possible. Indeed, to the degree that mankind believes a future event "can never happen," it creates a climate of extreme complacency that ultimately negates the validity of that same belief — a self-negating prophecy.

So, with that danger in mind, we can never categorically state anything is impossible with zero risk. But, realistically, a nuclear conflict is far less likely today than at any time since August 6 and August 9, 1945 ... when the first and last of two atomic bombs ever used in warfare were dropped on Hiroshima and Nagasaki, Japan.

From that point forward, even during the darkest, most frightening days of the Cold War, no hot buttons were pushed, no missiles launched, no nuclear bombs deployed in battle — for a very obvious reason:

The universal fear of mutual self-destruction and a nuclear winter.

According to the late Carl Sagan, who coined the term, after any massive nuclear attacks between two superpowers, soot and smoke would create a dark blanket of clouds covering most of the planet. Average temperatures would drop below zero centigrade. And Earth could witness "a mass extinction event," reminiscent of the "Great Dying" of 252 million years ago, when 70% of land species disappeared.

Anyone who has — or has ever had — decision-making authority over the deployment of nuclear bombs knows these scenarios all too well.

Ultimately, this fear is what prevailed during the Cold War of the 20th Century. And thankfully, it's the same ubiquitous fear that hangs over every nuke deployment decision likely to be made in the 21st.

In that regard, nothing has changed. Thank God. What has changed is that the mutual reliance for trade and financial transactions among major nuclear powers is many times greater today than any time during the Cold War. So they have much more to lose from war, even





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conventional war.

In 1962, the year of the Cuban missile crisis, for example, the total exports and imports between the United States and the Soviet Union were a meager \$36 million.

And in 1968, at the height of the massive Vietnam conflict — viewed by historians as a full-scale proxy war between the U.S. and the USSR — the trade between the two countries was still a meager \$80 million. Today, it's nearly \$28 billion. Even after discounting inflation, it's over \$11 billion, or about 141 times more than during the Vietnam War.

Moreover, the flow of investment funds and banking transactions between them are thousands of times greater; they were virtually non-existent during the Cold War.

And precisely the same argument can be made for every nuclear power on the planet:

The leaders of India and Pakistan, for example, know that a nuclear conflict between them would create what their own scientists call "a nuclear autumn" of regional famine and global climate change.

China knows that any use of its nuclear weapons in warfare would merely destroy its vast export markets, which despite its domestic growth, still represent a huge chunk of its economy.

Even North Korea's leaders, despite their belligerence, depend heavily on the outside world for the hard currency they continually need — to maintain their lifestyles ... for perks they award to assure the loyalty of their military brass ... for the food they need to keep their people alive ... and to do all the things that support the propaganda machine that keeps them in power.

No one dares use nukes. Everyone knows it's suicidal.

### So What Could World War III Look Like?

All you have to do is look around you, and you will see its many facets — economic wars, proxy wars and cyber wars.

Economic war has already been declared, particularly among three of the world's largest superpowers — the United States, the European Union and Russia.

Due to Western sanctions, Russia's embargo on imports from the West and other factors ...

- Russian companies already have limited access to foreign markets and capital.
- Global investors have already taken large sums out of Russian markets.
- The Russian ruble has already lost half its value. And ...

- The Russian economy has already suffered surging inflation, major job cuts, and a rapid decline in living standards.

Worse, if the current pattern of tit-for-tat retaliation and escalation continues, it could lead to a scenario in which ...

- Russian banks are excluded from the global SWIFT system, isolating their economy to the point of strangulation.
- Russia cuts off oil and gas supplies to Europe, fomenting new waves of protests and Russophobia.
- The Russian ruble suffers an even deeper collapse, driving the country into a Depression reminiscent of the early post-Soviet era.

Proxy wars have also been declared — especially in Syria and Ukraine, where the U.S. and Russia are already supporting opposite sides.

The two do everything to avoid confronting each other directly on the battlefield. But they wage a seemingly endless battle by using the opposing sides in local civil wars as their proxies.

This is what happened in the Vietnam War, when the USSR emerged as the largest weapons suppliers for North Vietnam ... while, over the course of the 11-year conflict, 2.7 million U.S. troops served on the ground for South Vietnam.

It's also what happened when the Soviet Union invaded Afghanistan in 1979 — but in reverse. There, it was hundreds of thousands of Soviet troops on the ground, while the U.S. provided weapons and logistic support to the Afghan mujahidin ("one who fights for jihad"), including none other than Osama bin Laden.

And in the years ahead, it's very possible that we will see similar proxy wars in Eastern Europe, North Africa, the Levant, the Persian Gulf, on the Korean Peninsula, and elsewhere.

Perhaps most concerning of all, cyber wars are already escalating at a rapid pace, with the U.S., UK, China, Russia, Israel, and North Korea first on the cyber-battlefield.

Former spy chief Mike McConnell believes a cyber war might be compared to a nuclear war by the scale of destruction.

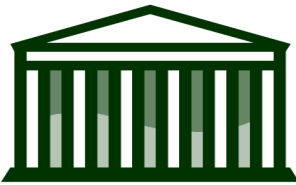
And Richard Clarke, Special Advisor to the President for Cyberspace and National Coordinator for Security and Counter-terrorism, writes that, in the wake of all-out cyber-attacks, the world's infrastructure could collapse within 15 minutes. In his doomsday scenario, computer bugs destroy national systems for e-mail, air-traffic control, underground transportation, and financial transactions. Cash dries up. Power grids go down. Orbiting satellites lose navigation. Pipelines explode.

To some this may sound like science fiction comedy. But quite a few smart people aren't laughing.

Perhaps that's why NATO held the largest-ever cyber war games in



# World War III?



Advancing in a Time of Crisis



Financial Crisis Report



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Tartu, Estonia in November 2014. The games were supposedly predicated on a scenario pitting NATO against a fictional African country. But according to Financial Times, they simulated real situations that could occur in the wake of a worsening Ukrainian crisis.

And perhaps that's why governments all over the world are pouring massive resources toward developing both the offensive and defensive cyber-technologies, with, unfortunately, most of the money spent on offense.

Lone wolf hackers-for-hire are another big wild card: One 15-year-old successfully invades NASA, causing a 22-day shutdown of systems that support the international space station.

Others, albeit slightly older, easily penetrate the world's "most secure" military installations, megabanks and multinational corporations.

And this is not science fiction. It has happened — repeatedly and massively.

Why? Because the entire structure of the Internet was created for fluid access and convenience — not for security.

Mobile phones, GPS, the Cloud, Big Data, drones and driverless cars — everything that we've been talking about that powers global techno-economic advancement — also has a soft underbelly: Vulnerability to cyber-attacks.

### Connecting the Dots to Your Money

There may be two phases to the new war:

In Phase I, the reality, and the fear, of these kinds of World War III scenarios drives the Global Money Tsunami — capital flows of scared money to the one economy still perceived to be the safest and least vulnerable, the United States.

Thanks, in great measure, to these massive inflows ...

The U.S. dollar, despite setbacks, continues to gain in strength.

The U.S. economy, despite its continuing big debt burden, continues to benefit.

The highest quality U.S. stocks, despite zigzag up-and-down periods like now, make their owners wealthy.

But ...

In Phase II, if economic wars, proxy wars and cyber wars become truly destructive, everyone loses: World trade shrinks. Highly indebted governments impose austerity or they default. Global fear and depression replace global investment and growth.

The bottom line is always invest in the best and drop the rest. Better safe than sorry.

### A Final Word

For every flood of fear, there's a fountain of hope. And just as forecasts of bliss can lead to complacency or trouble, each forecast of disaster can be self-negating as well, leading to prudence, prevention, and a better, or less severe, outcome than expected.

Whether they're among credible ones or not, we must pray that the same will also be the fate of the increasingly common prophecies of World War III.

Some are bound to come true. But we should also be able to avoid the ugliest of their consequences.

With this we pray that God will be merciful.

D. Miyoshi

Past issues of the *Financial Crisis Report* can be found at the company website [www.miyoshicapital.com](http://www.miyoshicapital.com)



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