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# Beacon Reports

Lighthouse For Japan's Thought Leaders

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**Tokyo - 14 June 2013**

**K**yle Bass told Beacon Reports that he hopes the Abe administration gets it right - that 'Abenomics' succeeds. Just in case, the Managing Partner of Hayman Capital Management LP holds two kinds of positions: One in yen betting with the BOJ. The second position is way out of the money in rights (option agreements) which is a systemic hedge for the firm's global portfolio, should the BOJ lose control. That way, if Kyle gets it wrong, it only costs the firm a few basis points.

Where does Kyle think our readers should invest their capital? Beacon Reports Editor-in-Chief, Richard Solomon, put that question to him directly:

**Beacon Reports:** "Kyle, if we accept your disaster scenario – where should our readers, both here and abroad, be invested?"

**Kyle:** The first question is, "What do you do with your capital if you live inside Japan?"

As a Japanese investor you need to think in terms of a much weaker yen going forward. My best advice to you as someone who has their income and savings in yen is - get it out of yen and put it into some other basket of global developed nation currencies because the debt problem is so much larger in Japan than it is elsewhere. Really think about the domicile of your savings account and the currency you're holding.

Here, on a relative basis you're trying to maintain purchasing power. So far the Japanese people haven't felt the full effects of currency devaluation. I think you will see

within the next six months the prices of finished goods increasing because input prices are up so much. These have a lagged impact.

If you have your money in a Japanese company that will benefit in a weak yen environment, then I think you will stay ahead of the crowd in Japan. Therefore, study companies which focus on exporting to other nations and sell in foreign currency. Stay away from those that don't export too much or that focus on selling into Japan.

Companies in Japan that are experiencing a net benefit on the early side of significant yen depreciation are those that still do a significant amount of manufacturing within Japan – like the Toyotas and Nissans of the world. Those companies, especially Nissan, understand the global macro forces impacting them and have adopted western

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corporate ideology. They have reacted and adapted well to this environment.

Other companies which import much more than they export, like Kobe Steel, will do poorly. If you're selling domestically and your import costs significantly increase, then you are in big trouble. You're losing dramatic amounts of purchasing power at yen 100 as opposed to 76 or 77 when you are buying from all over the world.

The second question is, "What do you do if you live outside Japan?"

If you're going to invest in Japanese companies as an international investor, I suggest you use the same bottoms-up thinking as that of a domestic investor when choosing which kinds of companies to invest in.

I would also suggest that you hedge your yen position. The net effect of unlimited LTRO purchases with durations up to two years accompanied by the 'shock and awe' monetary easing plan of the Bank of Japan - means a much weaker yen. You need to be thinking about hedging your purchases inside Japan with yen because it's apt to get much weaker.

**Beacon Reports:** What's your feeling about gold?

**Kyle:** The reason you've see such a big selloff in gold is that inflation expectations are in check due to China's massive slowdown while at the same time the US's industrial production is trending lower. The inflation expectations the central bank uses (the five-year/five-year swaps in the US) fell 80 basis points right when gold was falling precipitously from 1552 to almost 1300.

The world is switching gears and thinking, "We still have this debt overhang and deflationary forces are still acting on us." Long-term, with all the central banks printing full steam, you're going to see gold move higher. It's just a matter of time. So in summary, short to medium-term gold may still move lower, but in the long-term I think you will see it go a lot higher.

**Beacon Reports:** What final tips can you give our readers who live in Japan?

**Kyle:** What's important as an investor is not to be myopic by focusing only on the next incremental data point, the next announcement by the Abe administration, or the next plan of the BOJ. Don't get lost in the trees without seeing the whole forest.

I think it is important that people make their own determination if they believe Abe's reform policies are going to move the country fast enough towards fiscal sustainability. The government will never tell you they think they won't succeed. They will always tell you that everything is going to be fine and that you can trust them.

Still, many people have a significant difficulty thinking deeply about the psychology of a situation. When the quantitative analysis is done - and I believe it is in this instance - should the probability of outcomes portend doom and gloom, then most people will shy away from the business of realism even though the first inalienable right of human nature is self-preservation. They dismiss the potential negativity.

What percentage of people get it right - identify that a crisis is coming and then try

to avoid it? And the answer is: It is very few. People start to think to themselves: "Well, what does that mean for me? I live here. I work here. I have income in Japan. All my friends are in Japan. My portfolio is denominated in yen. How does this affect me? How does it affect my friends? How does it affect my neighborhood? How does it affect the nation?" When all of those concentric circles of probabilistic outcomes of the future are negative - I think people dismiss them as a gloom and doom scenario. They convince themselves that those concentric circles are so negative that

the government will do whatever it can to fix them. Well unfortunately, when you look through history, governments have limitations. They have breaking points.

It pays to think individually. Whether or not you agree with me, make your own determination of the multivariable equation. Take everything in pragmatically, carefully and without any bias. Make your own determination about what to do with your capital. Not enough people do that.

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