

Japan side fund (private placement)

This is a single-idea side fund managed by Kyle Bass of Hayman Capital that will profit if the yen weakens and/or interest rates rise in Japan. We believe that Japan is in dire financial straits and that it's inevitable that the yen will weaken significantly and, in addition, that at some point investors will demand higher interest rates on Japanese government debt (believe it or not, the 10-year rate today is 0.72%, less than half the 1.98% on U.S. 10-year Treasuries).

We invested in this fund in November 2011 and it is designed to decay over three years. If investors continue to view Japan as a rock-solid safe haven, this investment will steadily decline to zero over the remaining 13/4 years of the fund. If, on the other hand, investors open their eyes and do even the most superficial analysis of Japan's income statement and balance sheet, and act accordingly, this investment could pay off exponentially.

It may already be starting to do so. In its first year (November 2011 through October 2012), the marked-to-market value of the fund declined by 41%, but it rose 52% in the last two months of 2012 due to the yen weakening (in mid-2012 it was trading in the high 70s vs. the dollar and has now weakened to above 90). This is due primarily to new Prime Minister Shinzo Abe pushing for even greater deficit spending by the government and significant quantitative easing (money printing) by the central bank.

I think this investment is analogous to buying credit-default swaps on leveraged financial institutions exposed to subprime mortgages in 2007, when trouble was clearly on the horizon, yet one could still buy CDSs on their debt for a pittance. I think the situation in Japan is more precarious than ever (as one person put it, "Japan is a bug in search of a windshield"), so I like this investment a great deal.