CHAPTER 12: The Magic Categories

"In a crisis, be aware of the danger - but recognize the opportunity." --John F. Kennedy, 35th U.S. President

On March 11, 2003, Japan's largest banks, dragged down by years of mismanagement and non-performing loans (NPL), were technically all bankrupt. At that time, I was a young equity analyst trainee at a German securities company in Tokyo. On that fateful day, as part of my training program, I was sitting next to a veteran equities sales trader watching his his four trading monitors. I had read all the books on cool traders, the trading culture that was sometimes celebrated, and, of course, the history those in finance had made. I was able to quote from Michael Lewis' *Liar's Poker* *(58) in my sleep -- his book was genius for a young ambitious trainee, working in investment banking. I would have never thought that I myself would one day experience a similar scene as that was depicted in his book: when he describes the bizarre atmosphere on the trading floor during the crash of October 1987.

There I was, sitting next to that old timer veteran stock trader, a Japanese version of a "big swinging dick," watching with awe as the scenario was unfolding in front of us: the largest banks of the second largest economy in the world, Japan, were slipping into oblivion minute by minute-- -5%, -8%, -10%, and falling. The trader's monitor was completely covered in red. It felt like a scene from *Das Boot* (1981), when the captain can't stop his submarine from sinking into the abyss and everybody, covered in sweat, watches the depth gauge with mouths agape.

The Japanese bank stocks kept on going down, and dragged all other sectors with them. It was fascinating in a way, even though we both knew that a lot of pension funds, insurance companies, and hedge funds were losing billions of yen at that same moment. A full-blown panic swept over the Japanese equities market.

The rumors were that at least one of the three largest commercial banks would go bankrupt, similar to LTCB (Long Term Capital Bank) a couple of years before, causing a market shock that would reverberate around the world.

I remember clearly the head of equities at that time running up and down the corridors of the trading floor, frantically looking over the shoulder of his trading team, shakingly announcing his certainty, "I bet Mizuho Bank will go bankrupt -- I am sure of it -- trade accordingly. No way will the Japanese government initiate a bailout for that piece of junk." At that time, I wouldn't dare question his reasoning and conclusions. As he was head of equities and my boss, his salary was probably 10 times mine at that time. Actually, I flat out believed him -- after all, he had been in the markets for more than a decade, and his opinion seemed to be the general market consensus reflected in the continuously falling share prices.

Suddenly, I noticed the equities sales trader mumbling to himself, "Something is going on. Someone is buying my bank shares! Not much, but someone is buying!" We couldn't believe it. Who could be so suicidal to dare to buy bank shares at that moment? We were all sure that more disaster was in the making -- even bigger than the financial crisis following the 9/11 attacks.

The day ended with Japanese banks closing at almost limit low. It was brutal -- real carnage. Nervous and anxious clients called non-stop to find out the damage and to get some reassuring comfort from our sales traders. But we knew, and they knew themselves, that no comforting word could help them forget the billions of dollars they lost that day. The well-known Wall Street expression "when there is blood in the streets" became almost a reality for at least some bankers and investors. The Nikkei 225, the Japanese national stock market index, reached its new post-bubble low of 7,862, coming from a height of 38,915 at the end of December 1989.

Little did we know at the time, the mysterious buyer of our bank shares was a secretive investing group known as "Sovereign Global Holdings," which was founded by the New Zealand-based Chandler brothers, Richard and Christopher, to manage their family funds. When everybody else seemed to dump shares in a panic selling frenzy, they calmly and methodically executed their buying plan of mass purchasing Japanese bank shares.

They began secretly buying back in November 2002 with the cash reserves accumulated over years from their independently managed family fund, paying $570 million for a 5.1% stake in UFJ Holdings, which had posted a staggering loss of $9.3 billion in its latest year. The pair went on to buy more than 3% of Mizuho Financial Group, the bank my former boss declared bankrupt. All in all, they bought sizeable stakes in several other banks, such as Sumitomo Mitsui Banking Corp. and Mitsubishi Tokyo Financial Group (which merged with UFJ in January). Altogether, they spent about $1 billion on a diversified portfolio of near-dead Japanese banking shares.*(59)

"The banks were priced for a total wipeout of equity holders," mentioned Sovereign's broker at Nikko Citigroup, John Nicholis. "We were advising our clients to stay away from the sector," he said. *(59)

The Chandler brothers obviously ignored their banker's advice, as they had so many times before that. It was the right decision. After the banking share massacre that day, the Japanese government announced, in a nervously anticipated press conference, that it would provide emergency funds to the leading commercial banks and nationalize Rezona Bank, a mid-sized retail and commercial bank. The headlines the next day read: "As stocks fall, Japan moves to prop up banks."*(60) The US government isn't the only one well versed in bailing out bankers.

Japan's economy recovered by the end of 2003 thanks, in part, to the Bank of Japan and the FED, which was then headed by Chairman Alan Greenspan, who was pumping massive amounts of liquidity into the U.S. economy. Within a couple of years, all banks eagerly returned the government's emergency loans with interest, trying to end their chapter of national shame. In 2006, the Nikkei 225 surged to 17,000, in a gain which represented more than 200%. The country's banks had recovered by then, forming the so-called three "Mega Banks."

And the Chandler brothers? Well, it is estimated that they made a killing of over $2 billion on an initial investment of $1 billion, representing an annualized return of about 44.2% (200% capital gains within 3 years). This represents an unbelievable head start of more than 8 years competing with investors who have 10% annual return expectations. It simply means, that the Chandler brothers could have retired from investing for almost 8 years and still enjoy the same annual investment returns as investors who most likely struggle to make 10% each year for 11 years in a row (200% at 10% annually compounded takes about 11 years). Making a few simple decisions, derived from years of experience and expertise in the field of banking and Japanese financial markets, they let their money work for them and it showed results. This is 80/20 Investing applied to perfection.

Understanding the mechanics of 80/20 Investing, they couldn't help but take advantage of subsequent no-brainer ideas that came their way. Afterall, why should you retire from investing when you know how the game is played. One subsequent no-brainer opportunity came along only 3 years later. In May 2009, it became public that the Chandler Brothers again had built up massive concentrated positions in stocks. According to newspaper reports Richard Chandler had built a position worth $US430 million in a Russian bank, called Sberbank, shortly after the main Russian stock market index (RTS) passed its low in March 2009, due to the subprime crises in the US.

Both Chandler brothers were experts in Russian stocks and the Russian stock market, as they had invested there in years past. They revisited the market, but now with much more cash to invest, and the prices they got this time were pure no-brainer material.

The concentrated position in Sberbank Russia's leading bank represented 3% of their outstanding shares. That is an investment that became public due to regulation. Within only two months, Chandler's initial investment in Sberbank almost doubled. As Mark Twain said, "History doesn't repeat itself, but it does rhyme." *(61) For the Chandlers, it rhymed beautifully. I am certain that the Chandler Brothers are preparing themselves for the next no-brainer situation that will surely come along their way probably sooner than later.