Shorting The Currency

Warren Buffett's, Berkshire Hathaway again captured attention last week with its renowned annual general meeting drawing significant crowds as always. A major talking point this year was the company's ongoing accumulation of cash reserves, now approaching $190 billion. This fact was also noted in the annual report, where Buffett stated that, "*Your company also holds a cash and U.S. Treasury bill position far in excess of what conventional wisdom deems necessary*."

Less publicized however, is Berkshire's strategic use of debt, despite its substantial cash hoard.

Why would they make such a move?

Buffett clarified their brilliantly executed decision by explaining that Berkshire had continued to increase its stake in five large Japanese companies. However, given the unpredictable and volatile nature of currency markets and Buffett's skepticism towards hiring currency forecasters, they opted to finance these investments largely through the **proceeds of bond debt**.

Even as the yen continued to depreciate against the US dollar, they pursued borrowing. In April, Berkshire issued an additional 263 billion yen ($1.71 billion) worth of corporate bonds to fund its Japanese acquisitions.

By issuing debt denominated in yen to acquire Japanese assets, Berkshire has effectively adopted a strategy of "*shorting*" the currency while going "*long*" the Japanese assets. This move has proven to be exceptionally astute as share prices have risen in yen terms, while the currency has consistently depreciated against the US dollar.

Buffett has essentially isolated the currency risk and therefore benefitted from both legs of the transaction.

The Japanese stock market as reflected by the Nikkei 225 Index, has been steadily rising and this year surpassed its previous all-time high set at the end of 1989. Year to date, the market is up 15% and over the last year it surged by 35%. Meanwhile, the yen has depreciated by approximately 10% against the US dollar this year, highlighting Buffett's brilliance.

In conclusion, many global strategists are watching Japan, especially its currency, as a bellwether for other highly indebted countries. While we have seen numerous third-world and emerging markets experience currency devaluations, the Japanese yen stands out as it is one of the majors, being the third-most traded currency. Volatile currencies make for more challenging cross-border investing, but Berkshire has demonstrated how to effectively mitigate this risk.

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We would love to hear from you.

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