

JULY 2012

Alexander Hamilton's Point

With debates over the role of government coursing through Europe and America, it is fitting to write a newsletter about our namesake, Alexander Hamilton. Arguably, Hamilton has moved beyond the shadows of other Founding Fathers to both infamy and prominence today, as developed economies struggle to find balance between government debt and the private sector. In this Newsletter we draw a parallel between America over 200 years ago and the problems facing Europe today – and foreshadow what may, once again, influence state and municipal finances here at home.

"Duel" Personalities

It is near impossible to speak of Alexander Hamilton who famously argued, "A national debt, if it is not excessive, will be to us a national blessing," without mentioning his political adversary, Thomas Jefferson. At our Country's founding, Hamilton believed in establishing a strong Federal government that encouraged global commerce while Jefferson favored a more agrarian, egalitarian society with power tilted toward the state and local level. Although not a direct quote, there is an "old saw" that Hamilton summarized his contrasting views with Jefferson as follows:

I differ from Jefferson fundamentally because I argue that each individual – at his or her core – is evil, while Jefferson thinks each human is basically good. The evidence supporting my view includes the entire history of the world.

The point is that Hamilton thought the Federal government played a key role in overseeing the interest of the masses, specifically as it related to consolidating debts incurred to defeat the British. The Revolutionary War was fought with state and Continental Congressional borrowing from individuals and countries like Holland, Spain and France – who shared a dislike of England at the time. Without a national currency, the Continental Congress issued debt certificates, as

did many of the states. In 1776, Massachusetts was the first state to issue loan certificates, but when inflation later ran rampant, they had to issue commodity certificates backed by corn, beef, wool and sole leather. By the end of the war, most of these state and Congressional-issued pieces of paper were nearly worthless – giving rise to the phrase "not worth a Continental."

Once the war was won, and only after political debate with Jefferson, Hamilton and other Federalists convinced Congress to issue federal currency and assume the debts of various states. Interestingly, and reminiscent of today's often unholy alliance between Wall Street and our Federal government, there were accusations of "insider" trading among Hamilton's friends. Although there are no emails to prove it, it was apparently common for wealthy Federalists to buy up deeply discounted state obligations, knowing full well that they would eventually be far more valuable when Hamilton's plan became law.

Shenanigans or not, Hamilton nationalized state debts for the good of the country and became our nation's first Secretary of the Treasury. Historians credit Hamilton's plan with establishing the platform needed for America's eventual global economic dominance and, if he was a crook as well, he must have taken his money with him since he died quite poor.

CONTINUED ON REVERSE >

United States of Europe?

The idea that American state debts were once nationalized by the Federal Government strikes us as analogous to what is transpiring in Europe currently. With full credit to *The Economist* magazine (“Don’t Count on a Hamiltonian Moment.” May 28, 2012), the mess in Europe is a case where countries (states?) like Italy, Spain, Greece and Portugal have taken on too much debt – but want the European Union to rescue them. The differences from the American situation are many, including the fact that in Europe a single state (Germany) is supposed to do the rescuing (instead of a newly formed federal government), and unlike in America at the time, Europe already has a single currency (the Euro). The biggest difference, though, is in the underlying reasons for so much debt. America’s states had borrowed to fight the British and ensure national freedom. In Europe, the financially troubled states became over-indebted largely to fund corrupt levels of government while citizens cheated on their taxes.

Few in Europe want to form a United States of Europe, but fewer still want chaos. For its part, Germany ignored recent suggestions to guarantee debts of other states by issuing so-called Eurobonds and instead agreed to directly support banking systems if states exercised meaningful austerity. Unfortunately, the “tough medicine” of discipline (Germany tells Spain to balance its books) and austerity (Spain fires unneeded government workers when unemployment is already 20%) is not a formula for growth.

It may be years before economic stability, much less prosperity, in Europe is found and, meanwhile, our interconnected world is slowing down. Remembering that some 10% of Chinese exports are to Europe and a similar volume is exported from Brazil to China, one sees how some “rain in Spain” soon drowns global growth. Best estimates now are for developed economies to grow in the range of 1-2%, while emerging countries expand at a slower than recent 5-6%. With developed economies like America and Japan saddled with debt too, the projected slow growth will scarcely allow governments to continue to “stimulate and bor-

row” their way forward as they have somewhat successfully done in the last number of decades.

Buddy Can You Spare a Dime?

Here at home we predict another Hamiltonian debate on the near horizon with respect to state and local government debt financing. States like California have unmanageable cost structures and have recently witnessed three localities file for bankruptcy. In fact, like Massachusetts in 1776, California had to issue I.O.U.s in 2009 to creditors for a time (backed perhaps by iPads and Birkenstocks as opposed to wool and sole-leather?). If one or two large states get in serious financial trouble there will be “hue and cry” for a federal government bailout. Will the rest of the country want to “federalize” selected state debts this time around, if they believe the largess was caused by waste and not war?

The election this Fall is building up to feature one heck-of-an economics lesson as our country debates the essence of capitalism and government – two forces quite capable of sporadic evil. In a nod to Hamilton’s thought that debt can be a blessing if not excessive, we remind readers that our country’s very first debts comprised 35% of Gross Domestic Product (gross). This figure fell to zero by 1835 and then rose to over 120% to finance World War II. After falling again to under 35% by 1980, it is now around 100% (not including a multitude of unfunded State and Federal promises). It would appear that if Hamilton had lived longer, he may have re-emphasized the phrase “if not excessive,” but he no doubt would have had just that much more evidence of his mistrust of humanity.

Andrew C. Burns

ABurns@HamiltonPoint.com

Richard S. Woods, CFA

RWoods@HamiltonPoint.com

Hamilton Point Investment Advisors is an independent and independent-minded wealth advisory firm. Please contact us for a complimentary review of your portfolio. In addition, visitors to the firm’s website, www.HamiltonPoint.com, can read past investment newsletters.

This newsletter contains general information that is not suitable for everyone and should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Hamilton Point Investment Advisors, LLC (“Hamilton Point”) is a registered investment adviser with its principal place of business in the State of North Carolina. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. [More information about Hamilton Point can be found in its Form ADV Part 2 which is available upon request or at the Investment Adviser Public Disclosure website.](#) Please read the disclosure documents carefully before you invest. HP-12-01