Ray's Corner

Ray L. Lent *Chairman, Portsmouth Financial Services*

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Economic Market Commentary

For more than 2,000 years, the Arawak people populated a small island in the Caribbean Sea, part of the Leeward Island chain in the West Indies that came to be known as Nevis. The island enjoys several natural harbors, lush vegetation and is a mere 36 square miles in size. This is roughly three-quarters the size of San Francisco.

The island people enjoyed fresh natural springs, a tropical climate cooled by steady trade winds and were sustained by fishing and agriculture. This idyllic way of life was soon to change once Columbus first spotted the island in 1493. The Spanish quickly laid claim to the island as they did to much of the Caribbean, enslaved most of the natives and shipped them off to Venezuela to dive for pearls.

Over the next several centuries, Nevis became a popular layover destination for English and Dutch ships on their way to the New World. Parenthetically, Captain John Smith stopped over in Nevis while on his way to Virginia in 1607. This voyage resulted in the founding of Jamestown, Virginia, the first permanent settlement in the New World for the English. By 1628, a permanent settlement was established on Nevis by the English, and the island's fertile soil produced some of the highest quality sugarcane ever known. British slavers imported thousands of West Africans in the late 17th century to work the plantations. By 1700, Nevis was the richest of the British Leeward Islands and earned the sobriquet, "Queen of the Caribes." It was a hell hole for those who worked her fields.

An Affair of the Heart

By the mid-18th century, the capital of Nevis was the town of Charlestown. Here, Europeans of all stripes found themselves trying to stake out their claim in the bustling New World enclave. Among them was a handsome young French woman of Huguenot descent named Rachel Fawcett Lavine. Rachel was married to a hard-hearted man named Johann, and they had a son named Petee. Eventually, Rachel left Johann and moved to St. Kitts, where she met and fell in love with a man named James, a Scottish merchant. James and Rachel lived together and eventually had two sons, Jim and Alex.

It wasn't long after the birth of Alex that Rachel's father passed away and left her some property on her home island of Nevis. As a result, James and Rachel and their two boys moved back to Nevis with hopes of a better life.

Now back on Nevis, the two young boys were barred from membership and education at the Church of England school. Remember, Rachel left Johann but hadn't divorced him.

How Quickly Things Can Change

The boys received their schooling through individual tutoring and proved themselves both bright and capable, particularly young Alex who cherished the family's small library of 34 books.
After a few years of prosperity, things got dark, very, very dark. Rachel's husband Johann decided to sue for divorce on the grounds of adultery and desertion. James proved spineless and deserted her. Rachel soon contracted a severe fever and died. Johann, now a widower, inherited the property, and the two young boys were left orphaned and penniless. They were eventually adopted by their older cousin, Peter Lytton, a kind man suffering from depression who would eventually commit suicide. Talk about a family being snake bitten! The boys were then separated, with the older Jim being apprenticed to a carpenter and Alex adopted yet again by a local merchant named Thomas Stevens.

A Life of Ambition and Purpose

From a most early age, Alex proved himself quick witted and capable. Starting at the age of 11, he began clerking at a local import-export firm, Beekman and Kruger. His responsibilities grew to include corresponding on the firm's behalf with prominent merchants in New England. By the time Alex reached the age of 17, the firm's principals relied on him so much that they left him in charge for five months while the owners were away at sea.

Both literate and well spoken, Alex was determined to improve his circumstances and sought a life outside his small island home. His chance came at the age of 17, when the Royal Danish American Gazette published a detailed account of a deadly hurricane that passed through the Caribbean in 1772. It was a masterly tale told by young Alex. Nevis' community leaders were so impressed with Alex's talents and enthusiasm that they pooled funds on his behalf to send him to the colonies to further his education.

Pull Out Your Wallet

All right, if you haven't figured it out by now, pull out your wallet and look at the face on the $10 bill. Our young Nevisian is none other than Alexander Hamilton, Revolutionary War hero, Washington's confidant and most trusted aide, founder of the Federalist Party, essayist, first United States Secretary of the Treasury and godfather to America's federal debt. Hamilton is truly one of America's great historical figures, and no, he was not responsible for our national deficit. But he was responsible for leaving behind a far more secure United States economy and strengthened federal government by the time of his death in 1804.

Allow me to share with you a brief summary of his most remarkable life and how it influences today's political debate, a debate that could shamefully shut down government operations and lead to American debt default. No, I'm not referring to a hypothetical doom and gloom scenario but the impending vote on raising the debt ceiling in early November and its corresponding ramifications. These ramifications will be in the forefront of our presidential election season and will directly affect our already volatile equity and bond markets.

When young Hamilton arrived in New York City in the early fall of 1772, he immediately headed to Elizabethtown, New Jersey, to receive the necessary tutelage to prepare for college work. By the next fall, he was enrolled at King's College in New York, later to be renamed Columbia University.

Bigger Than Life

Hamilton soon distinguished himself as a quick learner and deemed himself quite capable of becoming a self-made man. With the colonies on the brink of revolution, he provided a strong and eloquent voice in explaining the patriots' cause and their grievances against the British. Drawn more to political involvement than he was toward his studies, Hamilton left King's College before graduating to work as an effective pamphleteer in the patriots' cause.

At the beginning of the Revolution, Hamilton was part of the New York provincial artillery company. He served as a second lieutenant and fought in the battles of Long Island, White Plains and Trenton. By 1777, after seeing action at Brandywine Creek, Germantown and Princeton, he rose to the rank of Lieutenant Colonel. It was during this time that General George Washington recruited him to be his personal assistant and trusted advisor. For the next five years, Hamilton was at Washington's side writing crucial letters, drafting reports and aiding him with critical reforms of the Continental Army. Yearning to be in the field again, he finally convinced Washington to allow him back on the battlefield, where he led a gallant and victorious charge against British forces at Yorktown before resigning his commission, by then a general, in 1782.

With the War now over, Hamilton returned to New York where he was appointed a representative to the Congress of the Confederation. Dissatisfied with the weak national government of the day, which was still operating under the Articles of Confederation, he resigned from Congress, finished his education and practiced law in New York City. Ironically, he and Aaron Burr were co-counsels representing the accused in the first murder trial of our new nation (the defendant was acquitted). His career blossomed, and he soon founded the Bank of New York.

Looking to help strengthen the federal government, Hamilton led the Annapolis convention which influenced Congress to convene the Philadelphia convention for the purpose of writing the Constitution. Once the Constitution was written, it still needed to be ratified by the states, but many were not convinced that they wanted to be part of a strong federal government and relinquish their rights.

The Federalist Papers

Even Hamilton's own state of New York was not in favor of ratifying the Constitution. It was at this point that Hamilton recruited the help of John Jay and James Madison to write a series of essays promoting the passage of the Constitution by the individual states. Hamilton wrote 51 of the 85 essays, with the first one appearing in the press on October 27, 1787. These essays advanced concepts of division of power, legislative checks and balances, an independent judiciary and the role of a standing army. They have come to be known as "The Federalist Papers."
The Constitution was ratified and Hamilton became a senior member in Washington's new government, serving as the First Secretary of the Treasury.

Here's Where Things Get Tricky

Hamilton believed in a strong federal government. At the time, the country was facing great financial debt, both foreign and domestic as a result of fighting the War (sound familiar?). Some of his fellow cabinet members were resoundingly opposed to a strong central government. It was due to Hamilton's conviction that the Constitution gave the government the authority ("implied powers") to create economic policies that strengthened the central government. During his tenure as Secretary of the Treasury, Hamilton proposed fiscal policies, initiated the payment of federal war bonds, had the federal government assume states' debts, instituted a federal system for tax collection and would help the United States establish credit with other nations. These programs were principally funded by a tariff on imports, and later, the disastrous "whiskey tax."

These ideas and policies were met with tremendous opposition from states' rights members of Congress and members of the administration like Jefferson and Madison. To bolster his chances of success, Hamilton organized a coalition of influential, like-minded bankers and business leaders which resulted in the founding of the Federalist Party. So now, the battle lines were drawn. On one side were those principally Southern states that didn't want to see themselves even partially responsible for Northern debt through the process of the federal government assuming all the outstanding debt. On the other side were the Federalists who believed a strong central government would help the United States become a leader among nations and enhance the future prospects of the largest amount of the citizenry.

The impasse was resolved in a most civilized fashion. The deal was cut over dinner between Hamilton, representing the Federalists, and Madison representing the Democratic-Republican party, a dinner historians have dubbed the "Dinner Table Bargain."

The Deal's Been Struck

Once the deal was struck, Hamilton wasted no time stewarding the organization of the first US Mint. Congress passed the Coinage Act of 1792, and for the first time, the United States started producing its own coinage. The Revenue Cutter Service is placed into action, basically a naval police force and the precursor to the Coast Guard. It was responsible for confiscating contraband and assisting in tariff control designed to bolster the economy.

In 1790, Congress asked Hamilton for his opinion on public credit, specifically the state of the debt and what to do about it. He produced a report in which he stated that the public debt we now faced was the "price of liberty," and that it should be paid off in full. He proposed a sinking fund that would retire the debt at the rate of 5% per year so that in 20 years it would be paid in full. Thus our standing as a responsible borrower would be solidified allowing us to borrow at reasonable rates in the future in order to stimulate our economy. Part of the report called for the formation of a federal bank, the first Federal Bank of the United States. Congress eventually passed the legislation that was drafted as a result of Hamilton's report and Washington would sign the bill into law.

Return to Private Life

Hamilton stepped down from his position as Secretary of the Treasury in 1795 to return to private life. Shortly before leaving office, he submitted a second report on public debt entitled, "Report on a Plan for the Further Support of Public Credit." By this time, Hamilton was convinced that there was a public debt problem because it was not being paid on schedule. Not only was there no cohesive plan in place, there were no proposals to fix the debt problem either (sound familiar?). He called for new taxes and existing temporary taxes to be made permanent until such time that tax surpluses paid off the debt in full.

Fast-Forward

It's now late October 2015, and I've just returned from a trip back East. While in New York, I was lucky enough to land two tickets to the hottest show on Broadway, *Hamilton, An American Musical.* The musical is based on the biography written by Ron Chernow, a dedicated historian as well as a masterful writer. The biography was adapted over a four-year period by Lin-Manuel Miranda, who not only wrote the music and lyrics and adapted the book but also stars in the lead role of Alexander Hamilton.

Besides exceptional stage crafting, sets, costumes and choreography, what really sets the play apart is the fact that almost all the actors and actresses are either Black or Latino, under age 30 and that they perform the most memorable numbers in either rap, hip-hop or sometimes use the recognizable melodies from musicals such as *South Pacific* or *The Pirates of Penzance*. You truly have to see it for yourself to understand what breakthrough theater this is.

Since the play holds true to history, the corresponding music that is written for key moments in Hamilton's life is both powerful and remarkably clever. For example, Hamilton's first appearance on stage presents him as a wide-eyed 17-year-old fresh from the Caribbean who explains why he's come to the colonies in a song entitled, "My Shot." When Washington taps him as his aide-de-camp, the two break out into a musical number entitled, "Right-Hand Man." Perhaps most clever of all is the musical number that tells the story of the "Dinner Table Bargain" entitled, "The Room Where It Happens."

The show opened in February 2015, off-Broadway at the Public Theater. It played there for six months and eventually moved in August to Broadway, where it is now being performed at the Richard Rodgers Theatre, one of the most beautiful theaters on Broadway which has been around for more than 90 years. During that time, the theater has hosted 1194 performances of *Guys and Dolls*, 1639 performances of *The Best Little Whorehouse in Texas* and, ironically, 1217 performances of *1776* along with myriads of other plays such as, *A Raisin in the Sun*, *Private Lives* and *Chicago*.

A Walk to the Theater

Prior to 1990, the Richard Rodgers Theatre was named the 46th St. Theater. This unremarkable name relates to the fact that the theater is located at 226 West 46th Street. For many years now, whenever I'm in New York, I stay at a lovely club I have access to at 37 W. 44th Street. Although the street is a bit noisy, being in the heart of midtown, the architecture of this 1907 Whitney Warren masterpiece is truly exceptional.

So, with the theater only four blocks away, I naturally walked to it the other night. Heading west on 44th Street, I crossed the Avenue of the Americas and walked past 1133 Avenue of the Americas, a lovely 45-story office building owned by the 100-year-old Durst organization. With a limestone façade and sleek modern lines, this 45-year-old building serves as world headquarters for Steinway Pianos and The Ace Group, among others. As striking as the Emery Roth and Sons-designed building is what it is most famous for is its clock.

You see, this is no ordinary clock telling you the local time, or even what time it might be in Rome, Tokyo or Sydney. This is the United States National Debt Clock. The clock was the brainchild of Seymour Durst and was conceived to call attention to the soaring federal debt and each family's share of it. The original clock was a 42nd Street attraction, and when it first appeared in 1989, the national debt was $3 trillion. The clock was actually shut off just before the dot com bubble bust in 2000 because the prosperity of the 1990s resulted in the elimination of the deficit. Alas, that didn't last for long, and the clock was turned back on in July 2002. In 2004, the clock moved to its current location and needed to be replaced in 2008 when it ran out of digits. That's when the national debt exceeded $10 trillion for the first time.

Never Tax Your Reader

There are all kinds of taxes that make sense, but taxing your reader with too much information all at once is not one of them. With that in mind, I want to conclude the first of this two-part series on the national debt with a few closing thoughts. The story is big and it is important. The economic health of all societies can usually be measured by four factors:

Inflation, which provides a valuable indicator for securities markets. Why? Because it determines how much of the real value of an investment is being lost and the rate of return you need to compensate for that erosion. (If your portfolio yields a total return of 6% and inflation is 4%, how much did you really gain?)

Gross Domestic Product, **(GDP)** is the measure of the value of all goods and services produced by a country during a specific period of time which indicates if the economy is growing or contracting. GDP affects the stock market through its use as a key indicator of economic activity and future economic prospects by investors. Any significant change in the GDP, either up or down, can have a big effect on investing sentiment.

The Labor Market. There is always some unemployment. As the allocation of resources change in the economy based on what people are buying, some companies will go out of business while others that produce the things that are in demand will be expanding. This means that there is always some amount of unemployment built into the economic structure which is often termed the "natural" level of unemployment. Most economists today believe that the natural unemployment rate for the U. S. is around 5%. Bottom line, if you don't have a job, it's hard to be a consumer. If you don't have a job, there's a real good chance you'll be adding to the public debt one way or another.

Monetary Policy, Fiscal Policy and Public Debt. The federal government sets monetary policy by setting capital reserve requirements for banks and lending rates. Depending on what the government is willing to pay to borrow money directly affects what we the consumer will pay for a car loan, mortgage or the interest on our credit cards.

The federal government's fiscal policy reflects what they will spend money on, including defense, education and agency programs such as Social Security and Medicare as well as how they are going to pay for them. In other words, will they collect more taxes than they've committed to spend (creating a surplus) or will they collect less than they've committed to spend, creating a deficit and forcing them to borrow the difference?

Just To Be Clear

It's easy for some people to say, "Well, that's the government for you, it doesn't really make a difference to me." Let me bring it home because it does make a difference, a very big difference to all of us. By the time you receive this report, Congress will be voting on whether to raise the debt ceiling to keep the government functioning. Once again, Congress and the Administration are facing the reality that they have spent more than they've taken in. The last time this happened, they shut down the national parks and didn't pay government contractors for work that had been approved and completed. That is pretty despicable, and the equity markets responded accordingly with a brief yet sharp sell-off. And why not? If you can't count on the United States government to pay its debts, what can you count on?

Last week, when I walked by the debt clock, it read, $18,156,122,913,363.03 (that's 18 trillion with a capital T). It's estimated that the U. S. population today is around 321,638,889. If you do the math, that means each citizen's share of the debt is around $56,448.77. So if you're a family of four, your share of the national debt is close to a quarter of a million dollars. Ouch!

Conclusion

Next quarter, I'll pick up the narrative with a detailed explanation of just what is federal debt. I'll address why the federal government borrows, who does the federal government owe money to, how does the federal government borrow, and why is there a debt ceiling?

Please consider this two-part series a primer to help you get through this political campaign season leading up to the fall 2016 presidential election. Between now and then you'll be hearing a whole lot about the "debt crisis" and what the 18 or 20 remaining candidates (who's counting?) propose to do about it. Hopefully, this series might help you trudge through the quagmire that passes for political discourse these days.

In the meantime, please rest assured that our goal here at The Putney Financial Group remains the same: to avoid taking an oversized hit in down markets; staying true to a strategy of diversified portfolios, taking maximum advantage of asset classes enjoying low correlation relationships to each other; and trying to deliver positive rates of return with the least amount of risk possible. Toward that end, we will continue to seek out the best and most attractive instruments in the open architecture we've created for our clients. As always, with ...

Best Regards,

Ray

Ray Lent

PORTSMOUTH
FINANCIAL SERVICES

250 Montgomery St Ste 200
San Francisco
CA 94104

Toll Free: 800.443.22
Phone: 415.543.850
Fax: 415.764.1064

RayLent@portsmouthfinancial.com
www.portsmouthfinancial.com