CIO CONVERSATION SERIES

CARY STREET PARTNERS

Episode 7

ALEXANDER HAMILTON – POP CULTURE AND HISTORY COLLIDE

Tom Herrick: Welcome to the CIO Conversation Series. I'm Tom Herrick, Cary Street Partners' Chief Investment Officer. On this episode, we welcome someone who is a walking, talking history book on the subject of the financial system and the capital markets in particular.

David Cowen: There's a rich lesson to be learned from history, sort of like a roadmap. How do you know where you're going if you don't know where you've been?

Tom Herrick: David Cowen is the president and CEO of the Museum of American Finance, an affiliate of the Smithsonian Institution. David is also the author of several books, including Alexander Hamilton on Finance, Credit and Debt; and also, the Financial Founding Fathers: The Men Who Made America Rich. In short, he's one of the foremost experts on the creation of the American capital markets. He's helped make some history as well – Broadway history. For all his important work, the coolest thing on David's resume might be this. He advised Lin-Manuel Miranda in the making of the musical Hamilton. Legend has it, in fact, that he introduced Lin and costar Leslie Odom Jr. to the room where it happened. We'll get the whole story about that in our conversation. So sit back and enjoy the show. We have a lot to talk about in the capital markets from a historical and current events perspective and a lot of other fun as well. Indeed, this is the room where it happens with David Cowen. David, welcome to the show.

David Cowen: Thanks, Tom. And as you mentioned, fun, let's have a little fun with financial history for the friends of Cary Street Partners.

Tom Herrick: David, we're really excited to have you here. For our regular listeners, this conversation will be a little different than our usual fare. Any conversation with David is not only a conversation about capital markets insights, but also a rich history lesson. And to start with, you know, looking at this from the top-level viewpoint, why is history important?

David Cowen: So as someone who studied history like his entire life, undergraduate and graduate, what jumps to the fore on that question are the two often used quotes with respect to that, the Santillana, the philosophers quote that those who cannot remember the past are condemned to repeat it. And the one that's attributed to, we don't totally know, to Mark Twain, which is that while history doesn't repeat itself, it certainly does rhyme. And therefore, there's a rich lesson to be learned from history, sort of like a roadmap. How do you know where you're going if you don't know where you've been?

Tom Herrick: Right now, the world is rightly obsessed with the pandemic we've had to live through over the last year, year and a half. Are there historical parallels or lessons of our financial systems enduring pandemics in the past? It's certainly not the first pandemic in history.

David Cowen: Unfortunately, not the first pandemic or epidemic. And our nation has been through a lot of these, really going back to the earlier days. There were two horrible yellow fever epidemics in the 1790s, one in 1793, that killed 10% of the population of Philadelphia, one in 1798 in New York. And throughout our history, whether it was cholera epidemics, Spanish flu, though, is the one that comes to mind. Since this is about financial aspects, we've looked at these events, let's say the half dozen or so, to see if we can garner some lessons from history and what we learn that while no two epidemics are alike, there are certain themes that you can take a look at. Those ones I mentioned in the 1790 saw a flight to quality, particularly the latter one in government securities. One hundred years ago-ish is when we had this incredible pandemic, the Spanish flu that killed more people than all of World War I. And while it's difficult to really analyze it because of the aftermath of World War I and the dislocation with the soldiers coming home, an economist named Robert Barro did to take a look at that to see what impact it had on the markets and what we found by taking that portion out of it, to take a look at what the impact of the flu itself might have been, we saw that stock market returns were down by seven percentage points and short term government bonds by about three and a half percentage points. Of course, that was the initial reaction, as you're well aware, in March of 2020. But certainly with an active Federal Reserve that quickly U-turned.

Tom Herrick: The museum has a virtual exhibit to this effect. Am I right about that?

David Cowen: Thanks for pointing that out. On our web page at MOAF.org, we took a look at six different epidemics and pandemics, and so do check that out on the website if you want to learn a little more. It was our first reaction when we went into shutdown lockdown was to try and bring some education on this particular topic.

Tom Herrick: Now, I want to go back to the musical Hamilton, a very interesting topic and talk about your involvement there and this phrase, the room where it happened. I think I've pretty much horrified my family by threatening to try and rap this out on the podcast, but that's not going to happen. So let's start out with talking about that a little bit. Your involvement and I'm interested to know how tight to history the musical stays.

David Cowen: With respect to Lin and the museum, we have arguably the nation's finest collection of 18th century documents, particularly as it pertains to the financial system and the founding of it. And in particular, we also own Alexander Hamilton's report on public credit. This is what I call the economic equivalent of the U.S. Constitution. And this is where we untangle or Hamilton does all the leftover Revolutionary War debt and we honor it. And so Lin came to the museum several times and also brought Leslie Odom Jr. one time. And before the show, no one who visited the museum really knew much about Hamilton. Well, he was the patron saint of our museum, the creator of the financial system. You know, I would lead tours all the time and have to explain well he was the first secretary of the Treasury and here's what he did. Now, when I take tours or talk about Hamilton, what you hear is eight-year-olds finishing my sentences. So you can see how the world has changed and it's all due to this show. With respect to the specific story, we were in my office and Lin and Leslie were talking and we were looking at that report on public credit because this was stymied in Congress. This is the report that's going to assume all the debt. But the Virginians are blocking it in Congress because they hadn't been profligate with their debt. They hadn't issued a lot of debt. And they're saying, why should we pay for Massachusetts? Why should we pay for the Carolinas? And so Hamilton, Jefferson and Madison – Jefferson is Secretary of State and Madison is an influential member of Congress – had this famous dinner at Jefferson's residence. Now there is a plaque on Maiden Lane, it's across the street from the Fed that I knew about. And so in dialogue with Leslie and Lin, I said, would you like to see Jefferson's residence? And Lin looked at me with the room where it happened. And I didn't put two and two together at that time. I said, sure, come on, let's take a look. I went to the public for the showing before it hit Broadway, and you opened the playbill, and you see it – the room where it happened. And it dawned on me as soon as he started rapping in the song and put it all together. And so it was really fun to be involved with that. I can just tell you, Lin was very engaging and he even practiced a couple of rap songs for our staff, which is really interesting at the time. Nobody knew that this thing was going to go viral the way that it did. Many scholars, Tom, come through the museum. We're always accommodating them and this was just one.

Tom Herrick: You're literally seeing sort of anecdotally, you reference the eight-year-olds finishing your sentences now, just how that sort of, I'll call it democratization of information through the arts, which is a mouthful. But it's expanded the knowledge level of this period of history. You literally are seeing that on the ground.

David Cowen: And that's a great point. And I turned to my colleague, who is my coauthor and one of the deans of American financial history, Richard Sylla, you know, after two songs and said this is the way to teach history, this is the way to reach people. And it was just so obvious at the beginning of that show that, wow, this is a breakthrough moment. What's great about Lin also is he used Ron Chernow's biography, Hamilton, as his primary research tool. And therefore, by and large, you asked about poetic license. Certainly there are some we can always point out, for instance, when Hamilton is confronted in the play, he's confronted by Burr and others. But that wasn't who confronted him. It was James Monroe in real history, as well as two other individuals who are members of Congress, Frederick Muhlenberg and Abraham Venable. But the point is that Lin really captured the spirit of the times. And quite often people wax philosophically about the founders and think they all got it wrong. That is absolutely not the case. And they had very competing and different visions, and therefore Lin really captures that spirit well and I thought he did a terrific job.

Tom Herrick: Yeah, the tension of that time is hard to overstate. I mean, we talk about the tensions and the polarizations today, and that was another similar period in history. Particularly the Jeffersonians versus the Hamiltonians. The vision of Thomas Jefferson, initially, he may have changed once he got into office somewhat. But in the 1790s was this agrarian utopia of little farmers all over

America and literally despised banking and credit in every way, shape and form and actively fought against it. And that compromise, is something if it doesn't happen, you know, this is a different country. I mean, it's just certainly its early history is a different country, I would argue. Would you agree with all that?

David Cowen: Absolutely. You make several very good points. And it's not just on this agrarian vision of Jefferson, but it's also that they lean more towards France and the bloody French Revolution that was going on, whereas Hamilton and others lean towards the English version of a way to build a country. You know, underlying it all, of course, is slavery. And that is such a big component of why the two factions had a different competing vision for things. And remember, things are so difficult back then. People think things are divisive today, and they certainly are. But remember, in 1804, we have the sitting Vice President, Aaron Burr, you know, killing Hamilton, the titular head of the other party.

Tom Herrick: Literally killing him.

David Cowen: And so, yes, there is a lot of, to use your word, tension, going on at that time. And it is amazing if you do not have that dinner party and you do not find that compromise to assume the debt. It's fair to say that America probably doesn't lift off at least the way we did in the 1790s, to build this incredible base and to tie it together to say what you said at the end, as most people and including those on Wall Street, have no idea how the capital markets were even created. They just assumed they were always here. They take them for granted.

Tom Herrick: So we've talked a little bit about the compromise and the personal drama and tension around the players at this time. But what was the specifics around Hamilton's creation of the financial markets?

David Cowen: So if we take a look at six metrics before Hamilton gets into office and then when he leaves office. So Hamilton gets into office on September 11, 1789, he's going to leave at the end of January in 1795. So if we take the year of 1788 and take a look at our national public finances, we are bankrupt. This is the debt issued by the Continental Congress trading a junk bond prices depending on the state. As I mentioned, Virginia, their debt was trading at higher prices. But Massachusetts, Carolina's, other states at 10, 20 cents in the dollar are not thinking they'd be repaid. So we're effectively bankrupt. There's no securities markets on a second metric. They're unorganized, sporadic. Maybe you can go to a coffee house, Tom, and get a price for security, but certainly no place to meet, no central regulating monetary authority, no central bank in the sense that we know all of 28 corporations in America. We don't even have our own money. It's foreign coins that we are by and large using and all of three banks in the entire United States.

Tom Herrick: It's literal chaos is what it is.

David Cowen: It is. It was a boom bust cycle for sure. But by the time Hamilton leaves, we have a thriving national public financial securities market. We've got government bonds at 3%, a 6% and one that is deferred, so he creates the deferred market. We've got an organized securities markets not just in New York and Philadelphia, but Boston, Charleston, other places. And we know this, by the way, through the newspapers and the securities prices, Hamilton has created a central bank with five branches. We've mushroomed to 148 corporations. We've got the U.S. dollar, the same U.S. dollar we have now. Of course, back then convertible to gold or silver and banks were at twenty. And in Hamilton's got his either direct or indirect fingerprints on every one of these aspects. Of the first one, we mentioned the report on public credit that came out of the room where it happened. It's the most famous trade in American history because that's where the Southerners get the Capitol in exchange for agreeing to this program.

Tom Herrick: For our listeners, we're talking about the Capitol of the United States, the future Washington, D.C.

David Cowen: And then the next piece of legislation is really where the southerners dig their heels in. He presents the Congress to create a central bank, which is going to get through and signed by Washington. But he is going to go against his fellow Virginians, Jefferson, Madison and Randolph, was the Attorney General, was saying, no, the Constitution must be interpreted strictly. It is not a living, breathing document that can be expanded to create a central bank. And this is incredible because a central bank, as you know, is the heartbeat of the financial system. And so Hamilton gets that piece of legislation through and then he's got to create the U.S. dollar, which he does as well. And then the other areas are definitely influenced. For instance, Hamilton was a big proponent of banks in one of his writings. He calls them the happiest engines that were ever invented. So the capital markets take off and we go from being a junk credit in 1788 to a stellar credit by 1795, and by 1803, we're such a good credit that we borrow eleven and a quarter million of the 15 million to buy the Louisiana Purchase. And we have a good enough credit to be able to do so. That, by the way, is another amazing story about the ironies of history. Yeah, think about that. The British and French are at each other's throats. The British are going to underwrite those securities to give us the money that we've given to Napoleon, who's going to do what with the money? It's going to declare war on England and everybody else, which is the old adage, business is business and war is war.

Tom Herrick: And who's the president at that time?

David Cowen: That's a great point. Thomas Jefferson. And so he is stretching that Constitution to its extremes by going ahead and making that purchase. Of course, a brilliant one, a wonderful one for the United States in terms of being able to get a great deal for 15 million dollars.

Tom Herrick: The whole history of the time is fascinating in terms of the creation of the system in just the sort of these opposing dynamics between the Jeffersonians and the Hamiltonians. And it weaves through so much. You already referenced Jefferson in that crowd was so much more, you know, in favor of the French Revolution and the entire financial system. A lot of that, you know, rhymes with English, Bank of England history. And I think a lot of their views of Hamilton are colored by that, you know, because we obviously just fought a revolution with England and were shortly to fight another war with England. You know, and you mentioned that the slavery issue, too, it goes without saying certainly the Virginians were slaveholders and literally Hamilton, as I recall, if my history is correct, was a manumission. I think his widow, in fact, probably had a long history in that regard. Is that right?

David Cowen: Hamilton certainly was one of the founders of the New York Manumission Society. But remember his Schuyler family, Elizabeth, his wife Eliza, came from a slaveholding family. But Hamilton and there's been some recent scholarship on this, now he was involved in a couple of deals as a lawyer. But by and large, what we know is that he was against slavery. And so that underlies so many things. Back on Jefferson, so when he inherits power, he inherits this financial system that Hamilton created and he turns to his secretary of the Treasury, Albert Gallatin, and says, you know, why don't we crush this bank? Why don't we? Then he turns to his secretary of the Treasury, Albert Gallatin, and says, you know, why don't we destroy this bank? And Gallatin's saying, wait a minute, think about it. If I've got to pay a judge in New Orleans, I can do just a book entry. Right? Otherwise, we're here in Philadelphia or Washington, D.C. Now, we've got to send the money all the way down to New Orleans. Isn't this a much better system? And then he adds something along the lines of, don't worry, they're just bankers and it's completely in my control to crush them. And that's the word he uses. But so, yeah, Jefferson often can't get out of his own way with his hatred for Hamilton and his financial system.

Tom Herrick: So besides, Alexander Hamilton, who are some of the other characters over that long period of time? You know that weave that whole tale of 200 years of the financial system.

David Cowen: Well, the first one that comes to mind again is one who I had just mentioned Gallatin because he's the savior of the financial system and we have to realize he's another name lost to history. But when Lewis and Clark go west, for instance, he's so influential when they get to the Missouri, they name the Three Forks, the Jefferson, the Madison and the Gallatin. He is a hero for standing up to his fellow Jeffersonian Democrats to say, no, we need this. Now, when the central bank comes up for recharter in 1811, Gallatin says we should recharter. But of course, the Democratic Republicans, by then Madison's in power, kill the bank. And then in the needs of the War of 1812 when they find that we can't finance things. And by 1816, you know, the Jeffersonians recharter the second bank of the United States. And so your point to who tried to kill it by 1836? Yes. It's actually the 1832, Andrew Jackson in one of those, you know, incredible quotes, says, you know, the bank thinks it will kill me, I will kill it. Meanwhile the plum really was the Treasury, the United States deposits. And so well that second central bank was killed by Jackson. They were put into what they were called the pet banks, those deposits. And so quite often we're fighting over money and power with respect to the financial system. But, yes, Jackson has to be up there for his undoing of the financial system. And, of course, that led directly to a horrible recession in the late 1830s and '40s.

Tom Herrick: Yeah, literally the first depression, I would argue. Go ahead.

David Cowen: Yeah. There's several other moments in American history. There's a panic, by the way, in 1792 for securities markets, prices collapsed by twenty five percent. A very interesting then because Alexander Hamilton creates central banking on the fly and adds liquidity through a variety of methods, just like a modern day central banker. And why that's important, by the way, is everyone thinks the British invented central banking response to a crisis with Lombard Street in the 1870s. He also, by the way, during that crisis, suggested the banks, which they do, which is to lend, but on a penalty rate, which is very interesting. There also is a pull back in 1819, 1820.

Tom Herrick: So as you go into the later 19th century, the 1800s, post-civil war, there's this period of repeated panics, bank runs for a variety of reasons without a functioning central bank. Who steps into the breach then?

David Cowen: 1907 is where I think you're going. Right, Tom?

Tom Herrick: Yeah, that's a primary example. But I mean, those panics in general make some of the panics of the 20th century, absent the Great Depression, you know, look pale in comparison. I mean, those are dramatic panics. So, yeah, the 1907 experience is the obvious one. Maybe you could give us a little history around that.

David Cowen: Sure. In our limited time there, there was rampant speculation on Wall Street. Sound familiar? Which led to some bank collapses, the Knickerbocker Bank. And it was definitely like the domino effect, which you have certainly seen in our time. And at that time, since the second banking states was killed in 1836, we had no central regulating monetary authority. And so a larger than life figure, JP Morgan stepped forth and actually was the lender of last resort. And well, that was a really dramatic moment in American financial history. He locked many bankers in a room at his famous house where they decided who would be saved, who wouldn't be saved. I think the upshot of all of that was that that type of system certainly was not sustainable to be reliant on one larger than life figure. And that is what led to eventually the creation of the Federal Reserve System. And in my mind, as a historian, the Fed is nothing more than the third bank of the United States. It's once more, again, the creation of a central bank. And if you talk about figures there that were influential, that is the creation of the modern central banker is the first head of the New York Fed whose name was Benjamin Strong. He is a figure that really understood the complexities of banking, unfortunately dies too young. Many believe that if he hadn't passed away right before in the late 20s, the Great Depression, he would have known what to do because the Fed's response to the Great Depression is to tighten credit initially, which is something that the modern bankers like Bernanke, who was a great student of that time period and we were so fortunate he was at the right place at the right time for the large credit crisis that we faced, knew to do the exact opposite, which was quantitative easing.

Tom Herrick: Benjamin Strong is one of those names. Again, you mentioned some names lost to history, and he's certainly one of them that had he lived, had he not had I think he died of tuberculosis, if I recall. You think about how history could have pivoted on that one person if he had lived and you don't have that depression, you have a crash, you have a rescue or liquidity injection. You have a completely different outcome, a completely different outcome. You may not end up with fascism in Europe in that situation. You may not end up with World War II. It's just stunning to think of the ripple effects that come off of historical characters like that.

David Cowen: Yeah, agreed. And for further reading on that, you've probably read Lords of Finance. It's a book about the central bankers of that time. You know, one of the things while we're on the Great Depression and the stock market crash that most people don't realize is that, well, the market had been selling off. And then we have arguably what is the crash where we lose 20 – 23% over the course of a day or two is that the market regained most of that loss before it turned south. We had a strong recovery from the lows before it is going to absolutely fall apart and be down 90% by 1932.

Tom Herrick: To the modern sort of quick history of that period is we had a market crash and that ushered into a depression as though it occurred, you know, on a Monday and by Friday we were in a depression. In the actual history is much more over a four-year period. To your point, you have market recovery. Things start to look a little better. And then the Fed just totally you know, this is the great Milton Friedman contribution to economics, was just literally treating the money supply by freezing it and shrank the money supply by something like close to a third by 1932. I mean, just insane amounts triggering deflation, you know, just falling prices, falling prices, falling prices. And nobody got that at the time. Roosevelt's administration sort of got it after that. But nobody in that '29 to '32 period was on scene with the right policy prescription.

David Cowen: One other thing to add is the bank holiday, which most people don't realize happened. Which is that Roosevelt closed the banks as soon as he came into office for 100 days. And we've had an exhibit because what happened was there was a lack of money around. And so script was being issued by individual municipalities, companies, etcetera. We've got a terrific collection of Depression era script. But can you imagine not being able to access your money for 100 days, Tom?

Tom Herrick: Yeah, I mean, that's – we worry about it when an ATM blinks for 30 seconds. I mean, I don't know how we survived that as an economy. I really don't. I mean, it's just an amazing thing.

David Cowen: One other last piece to add, which you probably know, but the recovery wasn't a straight line. We actually have a recession in the late thirties again. And it's not until World War II and the huge stimulus that we really lift ourselves out.

Tom Herrick: I want to turn our conversation a little bit to what I think is just a very important point. You know, that there's actually an enormous competitive advantage that the finance system, the capital markets provide, particularly for the United States. Certainly, you have capital markets globally, but ours are clearly the deepest, richest and provide the most funding for risk taking, which leads to innovation and innovation, I've always argued, is your real driver of dynamism in an economy. What are the dynamics that made that happen here versus other places like Europe, for instance, at the time?

David Cowen: Can I give some tangible answers and maybe some intangible? First, we have an atmosphere for business that's very conducive. You know LLCs, the business form of incorporation to make limited liability. And the flip side of that coin would be the bankruptcy laws, which you're able to then restructure companies in a very fluid fashion. And so you've got laws in place that make it conducive for business. And on the intangible side, there's something about this DNA about America, I think. We've got a notion of free enterprise and entrepreneurial spirit. We don't really care, by and large where you came from, an immigrant story of melting pot. And so if you couple those two and then you give access to capital, what you get isn't always even handed across the board. But certainly lately we have been trying to democratize that with things like Kickstarter and even a show like Shark Tank where we glorify the entrepreneur, if he, in fact, does make it and is a winner. And so I think it's a mixture, but I'd like to hear your opinion on that.

Tom Herrick: Yeah, I think that the growth of the corporate structure was founded here in the development of corporate structures and bankruptcy laws and the ability to fail and start over again to this day doesn't happen globally by any means. And that's a feature of our system that encourages that risk taking mentality. And I often use an analogy because it's so true. There's a huge immigrant population, particularly in the tech space and in Silicon Valley, where you have very smart young people come to the U.S. with an idea in little else and get funded and start companies. This is literally how Google starts and many other names, for instance. Do you see that elsewhere? How does that look, for instance, in Europe versus the United States?

David Cowen: And I think it feels a little different there, right where the capital markets can be very bank centric. That's why so many entrepreneurs come this way. And we also don't necessarily care what your father did, what your family did. We care what you did. Very much a free enterprise, meritocracy, at least in theory, and certainly at times in practice.

Tom Herrick: I'd love to talk about historically how we're connecting the past to the present a little bit, looking at some of the things going on now in one of them is cryptos. And I think that's a kind of a fun conversation, certainly getting a tremendous amount of attention all over the press and media these days. It's not the first time we've seen a new form of, quote unquote, currency come around in the United States. Maybe, David, you could give us a little bit of information on that.

David Cowen: Sure, you know, most people don't realize that what we have greenbacks, you know, money in our pockets, that didn't happen until the Civil War. And we had such an aversion in this country to paper currency because of the experiences of the American Revolution. It's not just Weimar, Germany, where there was hyperinflation. It happened right here in the United States. There's a letter from Washington, from Middletown, New Jersey, we're seeing a wagon full worth of money will not buy a wagon full worth of provisions. And the phrase in history note is not worth the continental because of the huge depreciation. So who issued currency from the 1790s effectively till the Civil War was the banks. So what did that mean? Particularly in the 1830s and '40s, we had something known as wildcat banking, which is where, Tom, you and I decided to open a bank in the morning. We don't really have what's known as fractional reserves a lot of gold or silver. We issue a lot of paper. We send that paper out of town someplace. Individuals can't get back to the bank. And so those notes depreciate depending on where you are and whether you think counterfeiting is rampant or not. And so this lesson from history, you're right, crypto reminds us of that wildcat banking era that we had in our history. We actually got a article in our magazine which is free again on our website, which you can download in this current issue, talking about this very aspect, how crypto reminds us of wildcat banking back in our nation's early formation and decades.

Tom Herrick: Well thanks, David, for all this rich history. I think it's fascinating. So, David, if people want to learn more, they can always visit the museum, is that correct? Tell us how and where people can do that.

David Cowen: Sure. Let me just tell you what our core mission is, which is to preserve, exhibit and teach about the nation's finances and financial history. Preserve is our archive, we've got some 13 thousand record locators, some with one item like a stock ticker and some with one hundred items. We had a large exhibit floor. We had a flood, so therefore, the museum itself is not open at the present time. Having said that, we've got an exhibit right now at the municipal archives in New York on water. And we've got several other exhibits in corporate headquarters, including at PayPals both in New York and San Jose. And teach is financial literacy. It's a little bit of what we're doing right now. We have over 40 programs in a year, by and large, also a free program at the New York Public Library, all online at this moment. So there's lots of ways to interact with us if you go to our website.

Tom Herrick: Thank you, David. That was David Cowen, author and full-time president and CEO of the Museum of American Finance. To learn more about the Museum of American Finance, check out the museum's website at MOAF.org. And thank you for joining us on the show. We'll be back next month with more thought leadership as we strive to maintain Cary Street Partners, higher standard on the airwaves. In the meantime, for more information, as always, please visit our website at CaryStreetPartners.com. Subscribe, share the show, send us your feedback. We'd love to know your thoughts. Thanks again for listening. I'm Tom Herrick, talk to you next time.