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Mr. Bernanke's Federal *un*Reserve ... and America's Potential Turnaround

Here at Hamilton Point, we must confess that we see nothing "reserved" about our government's current banking and real estate bailout. Guarantee a billion here and a billion there – and soon federal taxpayers have another TRILLION dollars to repay. As daunting as this sounds, it is our view that the United States will meet its growing obligations, and we remain optimistic for certain global sectors – even in the face of America stubbing all ten of her financial toes.

RECOGNIZING OPPORTUNITY

One of the more valuable lessons learned in my investment banking career was taught by a hardened research analyst at Wheat First Securities. Following up on a potential financing lead, we visited a troubled metal bending operation in rural Virginia. An advanced study of the financial statements revealed ever-higher debt and substantial operating losses. I personally lacked so-called "turnaround" experience at the time, so the analyst counseled me, "If there is to be any investment opportunity here, we want to see a totally screwed up operation."

His point was this: if we determined the company was run like a fine-tuned machine, yet still losing money, there was no opportunity there for us to uncover. However, if we observed things that could be changed to make things better, then maybe (as they said in that part of Virginia) "that dog will hunt."

It is with this same jaundiced eye that we look at the health of America and related global investment opportunities at this time.

On the income side of our ledger, America collects some \$2.4 trillion in taxes on \$14.5 trillion in GDP annually – but our Federal deficit will soon reach over \$400 billion. To America's current \$9.4 trillion in debt, we must adjust upward by \$1 to \$2 trillion to account for the current bank-

ing bailout and the gobs being spent on wars. In addition, the present value of unfunded Social Security obligations and future Medicare/Medicaid obligations add another \$20 to \$30 trillion by conservative estimates. Meanwhile, the imputed interest on the aforementioned debt adds substantially to the current deficit-ridden budget. Clearly America must change the way it does business, but are we a "turnaround" with potential?

A VICTIM OF OUR SUCCESS

Before we attempt an answer to that crucial question, be reminded that some of today's problems were created by our own success. While America (and the West, generally) did not set out in the 1700's with a goal to have capitalism and more open societies dominate 90% of the world, this superior economic and governance system has won the day!

"Yippee," we can say now, as globalization creates new opportunities around the world. However, our position as "leaders in the clubhouse" of globalization means we are now burdened with heavy obligations. These include spending the lion's share of military expenditures to keep the world safe. America's military spending is around \$625 billion a year – more than half the world total – while places like South Korea and India spend only \$20 billion. But regardless of their relative contribution, most countries in the world today would not hesitate to call on American military might if they feared a rogue enemy. The same goes

for American assistance with crisis situations in global healthcare, natural disasters and currency meltdowns.

The fact is: America probably spends at least a trillion dollars a year as the de facto policeman, nurse and banker to the world, yet we do not formally charge anyone for our services. Hey, here's a wild idea...if America imposed a global tax averaging \$100 for each of the six billion earthlings that are not American (assume a range from near nothing for poorer countries and several hundred per person for more developed nations), we would bring in revenue of around \$600 billion a year, which would go a long way to solving our financial problems.

While the notion of taxing non-Americans is nutty, it does serve to illustrate the kind of significant financial imbalances that we suspect must improve over time. Notably, while we suffer deficits at home, emerging countries are generating huge surpluses. China's surplus alone is \$1.8 trillion and the next largest ten countries together represent another \$2.5 trillion. There are good signs that this liquidity is poised for global investment as evidenced by the formation in several countries of captive sovereign wealth funds, which now have over \$3.0 trillion earmarked accordingly. Coupled with more than \$3.0 trillion in money market funds at home, liquidity is indeed available to support the world's financial infrastructure.

The point is that there is a way out of our financial mess, even if the precise way forward is not yet clear.

AN EXPANDING GLOBAL ECONOMY

In the next ten years, the global economy is expected to expand from \$60 trillion to over \$100 trillion—leaving plenty of opportunity for everyone. Importantly, the world has as much incentive to see America fiscally fit as we do to see others moving further along the ladder of freedom. In short, many countries that were once America's enemies now recognize we have shared—and crucial—economic goals to accomplish together.

At Hamilton Point, we look to the continuing success of globalization and to the just mentioned massive pockets of liquidity as reasons to see “turnaround” potential when

it comes to the United States. Make no mistake, pain will be felt by the American consumer via higher taxes, benefit cuts, inflation and slow growth at home. But the bottom line is this: global opportunities abound and domestic opportunities can be found.

OUR STRATEGY

With today's poor domestic backdrop, but bright global outlook, Hamilton Point continues to invest in ways that we believe protect against ill and take advantage of opportunities. For example, to assuage inflation's impact we own shorter-maturity, inflation-protected and foreign bonds as well as equities with exposure to commodities. We also continue to de-emphasize most financial companies and any investment leaning heavily on the US consumer for success, while favoring companies serving global infrastructure, CleanTech and the emerging consumer.

So while America is in a bit of a turnaround situation, global growth is still an incredibly dominant force and plenty of liquidity exists to address current imbalances over the long term. In short, America may be a bit of a “dog” these days, but we are still one that will hunt.

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