

ABFG August 2011 Newsletter

This Month

This month we have a short article from ABFG board member Don Steinmann about the behavioral finance observations of Alexander Hamilton. Then we have some varied links provided by ABFG board member Larry Brody: an interview, a book review and a behavioral finance thesis.

Alexander Hamilton, America's First Financial Behavioralist by Don Steinmann, ABFG Board Member

In 1780, 25 year old Alexander Hamilton was a Lieutenant Colonel on the staff of George Washington's Continental Army. 1780 was a very bad year for the Colonists, the winter was worse for the Army than the famous winter at Valley Forge in 1778. One of the main problems was the rampant inflation of the Continental paper money. It was difficult for Washington to acquire the food and equipment he needed as the paper currency was depreciating at hyper-inflation rates.

In his spare time away from his duties to the General, Hamilton thought on how to solve the problem of financing the war. His conclusions were included in a letter he wrote to Robert Morris, a member of the Continental Congress. The conclusion of the letter is about foreign loans to halt the inflation spiral. But what is really fascinating is some of the observations Hamilton makes. In the letter he states:

"The relative value of money being determined by the greater or less portion of labor and commodities which it will purchase."

And amazingly:

"A great source of error in disquisitions of this nature, is the judging of events by abstract calculations; which, though geometrically true, are false as they relate to the concerns of beings governed more by passion and prejudice than by an enlightened sense of their interests. A degree of illusion mixes itself in all the affairs of society. The opinion of objects has more influence than their real nature. The quantity of money in circulation is certainly a chief cause of its decline; but we find it is depreciated more than five times as

much as it ought to be by this rule. The excess is derived from opinion; a want of confidence."

In the passage, "The relative value of money" and in the statement 'Enlightened sense of their interests' it's clear that he understood some of the key concepts of modern economics before he ever laid eyes on Adam Smith's "Wealth of Nations". Smith's book was first published in 1776, but Hamilton would not see a copy until after the war.

But the truly interesting thing is Hamilton's statement about depreciation. He understood that the inflation was caused much more by the behavior of individuals than by the actual economics of the situation. We think of behavioral finance as a new science developed during the last 40 years. Hamilton, however, understood the basic concepts before there even was a United States of America. It's not a surprise then that he was the first U.S. Treasury Secretary and that his portrait is on our \$10 bill. Clearly his insight into these powerful economic concepts was far ahead of it's time.

ABFG Board Changes

We would like to thank John Weisickle for his service on the ABFG board for the last two years. We'd also like to welcome back Adrienne Regrutto to the ABFG board and a special welcome to our newest ABFG board member, Colleen Robertson.

Websites/Links of Interest

Review of Dan Gardner's "Future Babble"

<http://whimsley.typepad.com/whimsley/2011/05/an-uncertain-world-1-future-babble-by-dan-gardner.html>

Michael Mauboussin Interview

<http://seekingalpha.com/article/163743-interview-michael-mauboussin-chief-investment-strategist-legg-mason-capital-management>

Andrew Brasfield thesis on Cognitive Bias

<http://www.scribd.com/doc/35793494/Forecasting-Accuracy-and-Cognitive-Bias-in-the-Analysis-of-Competing-Hypotheses>

Upcoming Events

Check this space for upcoming Fall speakers.

Editor's Invitation

Please write with any ideas, articles, rants, raves about our newsletter etc. to:

editor@abfgla.com

We also invite you to view our website, www.ABFGLA.com , and share your thoughts and ideas.