

An Exceptional Journey

It was a crisp, breezy and beautiful late October morning in 2007. Colorful fall leaves scurried across the pathway ahead of me as I headed into the university's administration building. The morning was starting off right. I managed to snag a prime parking spot on campus just in front of my destination! As scheduled, another quarterly meeting of the university's endowment fund investment committee. In this meeting, for a change, I am the client, not the advisor. This is an important distinction for those having careers in a service capacity. The service provider learns to be gracious, polite, considerate, always respectful and...sometimes obsequious. Now, it was my turn to be the recipient of these behaviors.

Times were good, investment returns were strong. Of course, investment managers continue analyzing winners and losers, parsing opportunities, aspiring for more and intellectualizing the process...with confidence! Investment managers are seldom known for lack of confidence. Maybe confidence makes up for the fact that, unlike many other professions, there are few certification requirements for investment advisors. There is an ease of entry into the investment profession which may explain why someone would want to compare the difference between a registered investment advisor and a dog. They both need a simple license but the dog needs shots.

The meeting was full of great conversation with interesting people sharing information and insights and finding ways to make money within the guidelines provided. It was a game among intellects sparring with information and opinions. The chief investment officer boldly summarized market conditions with the statement, "The continued superior performance of the US market is further support for the idea of American exceptionalism." This statement, American Exceptionalism, caught my interest. Did this term explain recent US success and this was post-game victory bravado leading to chest pumping loyalty for the home team? Or, a deeper, more profound form of superiority that cannot be denied.

I had heard the term American exceptionalism but wasn't clear on the source or history of it, or how it is explained. I suspect every country takes pride in its history and culture but Americans seem more so. We have unique attributes that have resulted in unrivaled power and prosperity which gives us a certain self-assured attitude. Apparently, nothing succeeds like success and we have the secret sauce.

American investors certainly embraced the idea that we had the special recipe of success. We were among the last of global investors to recognize the importance of investing outside of one's borders. Unlike other countries, we had the luxury of having a very large, growing and diversified economy, somewhat insulated from dependence on other trading partners. One could achieve portfolio diversification very effectively without leaving the United States. Investment management clients in the 1980s had to be persuaded to invest in other countries. It was our familiarity with our domestic companies and confidence that we had a very successful economy and market for capital that made the decision to invest elsewhere more difficult.

The French political scientist, Alexis de Tocqueville, was the first to describe the US as exceptional. Tocqueville was sent on a mission in 1831 by the French monarchy to study the penitentiary system in the United States. He traveled extensively for nine months and his notes and observations were published in 1835 in a report entitled, *Democracy in America*. In December, 1831 Tocqueville arrived in Cincinnati Ohio having traveled down the Ohio River from Pittsburgh. He noted, "Cincinnati presents an odd spectacle. A town which seems to want to get built too quickly to have things done in order. Large buildings, huts, streets blocked by rubble, houses under construction; no names to the streets, no numbers on the houses, no external luxury, but a picture of industry and work that strikes one at every step." It is believed that this visible absence of civic refinement led to his inquiry about the existence of a formal literary salon. Unfortunately, such a group would not come into being until 18 years later.

The goal of his report was to enlighten French people about the transition from a declining aristocratic order to an emerging democratic order and to help his people make sense of the stormy process. He believed democracy was an ideal balance between liberty and equality. In his words, "The greatness of America lies not in being more enlightened than any other nation, but rather in her ability to repair her faults...This state of things is without parallel in the history of the world. In America everyone finds facilities unknown elsewhere for making or increasing his fortune....The position of the Americans is therefore quite exceptional."

Over the following years, the term, "exceptionalism," stayed with me. Yes indeed, America is exceptional. We are a beacon for freedom which has resulted in remarkable advances in a multitude of areas beyond just personal freedoms and an effective government structure. We increasingly account for a greater

share of world developments in technology, the arts, health sciences, among many others. It's hard to ignore progress and our inventiveness in these various other areas. Thank goodness for inventions like garage door openers, ice machines, TV remotes and handheld hairdryers. I've heard that at one time, before these hairdryers, on certain nights, girlfriends could not go out because they were washing their hair.

The rhetoric around the last presidential election brought the concept to the surface and prompted me to dig deeper into understanding American Exceptionalism. Our ideology, according to the political scientist Seymour Lipset, is based on liberty, egalitarianism, individualism, democracy, and laissez-faire economics. These are bedrock ideals and beliefs that seem unshakable.

Interestingly, the first use of the words, "American", and "exceptionalism", together was by Joseph Stalin in 1927. A prominent American communist, Jay Lovestone, had argued in 1927 that the advanced capitalism of the United States would make it difficult for communism to develop a foothold here. Mr. Lovestone believed that communism was more likely to develop where worker parties existed because opportunities for wealth, income and class mobility were very limited. Stalin called this, "The heresy of American exceptionalism."

The term was briefly referred to over the years, but fell into near obscurity until the media picked it up in the 1980s to describe America's admirable cultural and political qualities. US presidents have very rarely used the term, but it surfaced in this context during the 2008 election. John McCain championed the concept of exceptionalism and gave a stirring explanation of the term during a debate with Barack Obama in 2008 at Columbia University. Leading up to the 2012 election, the Republican Party platform presented a twelve page section titled "American Exceptionalism." They explained the term as, "The conviction that our country holds a unique place and role in human history." This became an election issue when President Obama was asked about this topic and said, "I believe in American exceptionalism, just as I suspect that the Brits believe in British exceptionalism and the Greeks believe in Greek exceptionalism." Mr. Obama seemed to be saying that we are exceptional but not necessarily more exceptional than others. Just before the election in 2015 candidate Donald Trump dismissed the term. He said, "I don't want to say, we're exceptional. Because essentially were saying we're more outstanding than you."

This line of thinking may suggest that our exceptional qualities have waned or.....we need someone to make us exceptional again! Clearly there are different interpretations of exceptionalism that encourage further examination. James Q. Wilson and Paul Schuck, authors of *Understanding America: The Anatomy of an Exceptional Nation*, retained 20 of our most important social scientists in 2005 to dig deeper into identifying and understanding America's distinguishing characteristics. They polled 91,000 people in 50 countries and found:

-Americans are more patriotic than other countries.

-We are individualistic and believe our success is determined by our own efforts and we are much less reliant on government.

-We are more religious and these religious movements, frequently fortified by immigrants, have led to our most important reform movements.

-We believe strongly in enterprise and the benefits of economic competition.

-And finally, we embrace ethno racial diversity in a way that has no match in the world.

Digging deeper reveals some core principles and contributing factors. The scholar, Charles Murray, believes exceptionalism starts with the belief in individual liberty and the governing structure that ties closely to this belief. He identifies four key qualities that existed in the opening century of our history: our geographic setting, our ideology, traits of the American people, and our political system.

In terms of geography, innate grittiness, courage and ambition was required for people who were likely to accept the risks and hardships of crossing the Atlantic knowing that multiple deprivations and hostile conditions awaited them. The United States was thus seeded with brave, incredibly hard-working risk takers.

In the early 1830s, about 400,000 settlers headed west in wagon trains. Like their predecessors heading across the ocean, it was a hazardous and arduous journey. Dangers were ever present: conflicts with Native Americans, disease, famine, snowstorms and heat waves. The fatality rate was significant. It was not uncommon to find human skulls along the outskirts of camps of what became the Oregon Trail. One example of these courageous settlers was Marcus Whitman. Whitman, a physician from New York, was

told by Hudson Bay trading agents as he entered the northwest that the wagons he led should be abandoned for pack animals. With determination and fortitude, he forged on with his group: clearing a trail through heavy timber to get through the Blue Mountains of Oregon and when faced with the lack of a road around Mount Hood he disassembled the wagons to float down the perilous Columbia River. Dr. Whitman eventually settled and founded a mission in present-day Walla Walla, Washington. His desire to serve later took him to Montana and Idaho to minister to fur trappers and various Indian tribes suffering from cholera and other maladies. He later adopted eleven orphaned children. Ten years after arriving and a multitude of humanitarian and heroic good deeds, Whitman and 12 other settlers were ambushed and killed by the Cayuse Indian tribe.

Ultimately, the protection offered by this vast space of the Atlantic Ocean allowed the United States to benefit from the modest cost of military preparedness which helped contribute to nearly unfettered growth. It helped that large tracks of the richest soil in the world and plenty of room to spread out promoted great productivity and rugged individualism.

What is critically important for all of us to understand is that American ideology is based on a transcendent idea that is simple but powerful and unique in human history: all men are created equal with rights to life, liberty, and the pursuit of happiness. The founding fathers understood the historical experience of all previous republics. Eventually power blocs develop that go too far down a path of dominance from which republics cannot recover. The founders understood the importance of a properly balanced governing structure. Our elaborate political system of checks and balances put constraints on the exploitation of power. This political framework was complemented by the considerable freedoms accorded to individuals. This free-market principal encouraged everyone to find their highest and best use.

Our industriousness is commonly referred to as perhaps our most exceptional trait. We had a work ethic and an abundance of opportunities available to nearly all of the people. This was a potent combination that propelled astonishing results and thereby developing a culture of growth.

Egalitarianism revealed itself by the high level of class mobility and a more limited regard for class as compared to class attitudes in Europe. As Tocqueville explained, "In the United States, the more opulent citizens take great care not to stand aloof from the people. On the contrary, they constantly keep on easy

terms with the lower classes: they listen to them, they speak to them every day.” You didn’t want to appear better than others otherwise it may call for you to be taken down a notch. Charles Murray noted, “Americans retained a strong sense that whatever class you were in was a matter of what you have made of yourself. No country in Europe at the time had a social system remotely like it.”

Religiosity is another important element of exceptionalism. Nearly all European countries had a state supported religion that had special legal status and financial support. This arrangement was explicitly prohibited by our first amendment. This led to the blossoming of religious groups in the US which had a strong influence on various progressive movements: universal elementary education, abolitionism, emancipation of women, reforms of the New Deal and, later, the civil rights movement, among others.

These characteristics worked in combination to lead to the proliferation of volunteer communities.

Tocqueville observed that, “Americans of all ages, all stations in life, and all types of dispositions are forever forming associations...there are not only commercial and industrial associations in which all take part but others of a 1000 different types— religious, moral, serious, futile, very general and very limited, immensely large and very minute. Any new undertaking in France you would find the government...in the United States you are sure to find an association.” This culture of social trust made it easy for Americans to do voluntary good deeds. Tocqueville believed that human beings acting in their own self-interest will also serve the public good. This belief had close ties to laissez-faire economics, first advocated for by Adam Smith. Even today, global philanthropy is mostly an American phenomenon.

There was clearly something remarkable going on in this new country. Most Americans were from British or European descent so understanding the differences between these political systems and ours is important to understand how we have evolved differently than those on the European continent. In the early 19th century, Europe was more liberal. Liberal at that time meant something very different from how we interpret it today. In the early 1800s liberal referred to a belief in laissez-faire economics and limited government. However, in the 1830s, about the time of Tocqueville’s visit to America, worker groups began to form in Western Europe. The thinking of Karl Marx emboldened these groups to seek better working conditions, the ability to unionize and the right to vote. As communism was gaining traction in Russia, a competing force of what was called socialism was forming in Europe. Over time, Western Europe combined socialist and capitalist thoughts into a social, political and economic philosophy known

as social democracy. Social democracy includes a wide array of government regulations, citizens' right to elect their leaders, and more public benefit programs. This development underscores a key element of American exceptionalism—the absence of strong worker parties. Political scientists attribute this to our less class conscious culture. Of course, the presence of abundant opportunities, personal freedoms and considerable, widely shared income growth helped. Karl Marx noted that our more indifferent attitude toward class consciousness was an aspect of American exceptionalism. This indifference about class consciousness discouraged worker parties and many scholars believe this was key to the continued formation of American exceptionalism. Recent economic trends and the concentration of wealth may explain why this important attribute may be in decline.

A complete grasp of exceptionalism requires an understanding of its shortcomings. After all, being exceptional can be looked at as superior...or just different. Joseph Heller captured this in his book *Catch 22* when he wrote, "The (American) turned out to be good natured, generous and likable. In three days no one could stand him." We continue to be haunted by issues of slavery and the treatment of Native Americans. The concept of self-reliance and laissez-faire economics ignores the ruthless nature of the marketplace on large groups of people which can lead to wide disparities of wealth and income. Meanwhile, religious fervor in America can be a force for reactionary policies that can run counter to our founding principles.

American exceptionalism has been challenged and questioned multiple times during our history. Jon Meacham in his recent book *The Soul of America*, reminds us that protests and divisive politics have been near constants in the United States. Slavery, the Civil War, the Ku Klux Klan, Jim Crow, the internment of Japanese Americans, McCarthyism, gender discrimination and scientific racism to name a few. Mr. Meacham submits, "The current political turmoil is not unprecedented and we have survived worse,".

However, this begs the question, "Is America still exceptional?" The common belief among the founders that government should be limited is now supported by only a relatively small group of people. According to the Bureau of Economic Analysis, during the last 80 years federal government spending as a percentage of GDP has risen from 4% to 25%. Social welfare programs accounted for 24% of the budget in 1963 and today represents about 60%. Entitlement income has been the fastest growing source of

personal income in America for 50 years. In 1963 one out of every \$15 of personal income was entitlement benefits. By 2013 they accounted for one out of every six dollars. During the same period of time the percentage of men age 25 to 34 who aren't either working or looking for work has gone from 3% to more than 11%. There is no doubt that structural forces are putting great pressures on America's middle class, however, the work ethic, the self-sufficiency, the rugged individualism that was so prominent in our history have clearly slipped.

Some could argue that class consciousness has become more present today due to the disparate trends of wealth and income that has occurred in recent years. The egalitarian nature of our social structure appears to be threatened. Healthy growth, bountiful opportunities, economic rewards that are widely shared, have certainly diminished and platforms are already surfacing demanding changes and reforms reminiscent of early social democracy movements: redistribution of income, increased government regulations, and expansion of benefits and entitlements.

The threats to exceptionalism are certainly on fast forward. The last decade has witnessed a remarkable shifting of powerful and opposite forces. Prolonged and stagnant income growth for large segments of our population have led to an angry and frustrated electorate and polarized political parties. These forces are clearly what motivated Mr. Meacham to write his book and they are, once again, shaking the foundation of our exceptionalism. The seeds of this tumult was the deterioration of the mortgage and real estate markets in 2008 which led the economy into a free fall. Massive government intervention in the form of fiscal and monetary policies helped stabilize conditions, and then reverse, what had become a very dire situation. This extraordinary level of government intervention led to the formation of the Tea Party. This group was alarmed at the growth of government and uncontrolled spending which, they believed, was destroying the exceptional quality of limited government upon which our country was founded. Over the next eight years, sluggish economic growth and low inflation, lead to low interest rate policies that stimulated capital markets. These market conditions have greatly benefited the owners of stocks, bonds and real estate, and resulted in a disparity of wealth which has left behind much of the middle and under classes. This vast group of disenfranchised households are angry and resentful about how free markets have led to an unfair distribution of prosperity and power. They seek changes through a political movement that may further challenge the sustainability of our exceptionalism by limiting immigration,

diversity and free markets. We have gone from a very vocal political group advocating for brakes on the massive growth of government to a strong populist wave seeking restrictions on immigration and free trade. A third wave is forming that would swing the pendulum back to expanding the role of government, entitlement benefits and corporate regulations.

Our exceptionalism may have certainly faded on an absolute basis, but relative to the rest of the world our star is shining as bright as ever. There is a long line of immigrants seeking entry to the US to enjoy our freedoms and opportunities for personal growth. We are just 5% of the world's population, but represent 50% of its wealth. We have astonishing military power as our defense budget represents nearly 50% of the total world's spending on defense. Our culture of volunteerism is exemplified by our generous level of charitable giving that is unrivaled by any other place in the world. Things may be slipping, but we are clearly the best house in a bad neighborhood.

Ed Lazear, A professor at Stanford University Business School and Chairman of the President's Council of Economic Advisers from 2006 to 2009, observes the tangible economic benefits that we enjoy: Americans are significantly wealthier on average than any other developed country—most of the G7 countries are about 70% as rich on a per capita basis; each generation does better than the previous; we are mobile in seeking opportunities; we are more industrious as measured by working hours; our unemployment rate in recent decades is lower than about every comparable country; we are subject to lower taxes and are characterized by being an open society with a high proportion of immigrants among our working population.

The last 70 years has resulted in nearly all Americans experiencing somewhat steady economic growth during their lifetime, or their adult lifetimes. The economist Thomas Sowell recently pointed out that, "Most people living in officially defined poverty in the 21st-century have things like cable television, microwave ovens and air conditioning. Most Americans did not have such things, as late as the 1980s. People who may be considered the "have-nots" today have things that the "haves" did not have, just a generation ago."

After over 200 years of success based on attributes like individualism, enterprise, diversity and laissez-faire economics, it is concerning that we are seriously questioning those same qualities after just 15 or 20 years of modest slippage, or in many cases, just flatlining of income growth. Clamping down on

immigration and free markets and debasing individualism by assuring government benefits that are clearly not sustainable, runs a high risk of threatening the very foundation of our success.

The arc of exceptionalism faces serious questions:

Are we entering a post exceptional period marked by different but still powerful attributes?

Or, have we peaked as a powerful country and are we now in decline like many mature empires before us?

We can dismiss some of these darker thoughts because as these questions about our exceptionalism mount, it is very comforting to know, as Mr. Meacham points out, that every generation considers itself under siege, however, eventually with the right leadership, Americans find a way forward and come through the darkness. Nearly 200 years ago, Tocqueville had a keen insight. Our ability to repair our faults and recover from challenging times is certainly one of our most exceptional qualities.

That same university endowment investment committee continues to meet. However, the era of exceptionalism may be ending for many money managers. They will have a difficult time restoring their superiority. Exceptional seems to have become very rare indeed among professional portfolio managers. The investment industry has been humbled by the difficulty of outperforming the market. Their confidence is now diminished. Market forces, free market forces, have created its own vast underclass of underperforming money managers. They realize now that they are not as exceptional as computers and index funds which have made markets so efficient as to outperform those active managers sitting around the table.

One wise American knew the difficulty of maintaining success. He knew that the innovative political model designed by the founding fathers would have to weather many challenges and adversities. At the conclusion of the constitutional convention a woman asked Ben Franklin as he was walking out of Independence Hall, "Well, Doctor, what have we got? A republic or a monarchy?" Paraphrasing Franklin's reply, "An exceptional republic, if you can keep it."

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