Highlands Asset Management

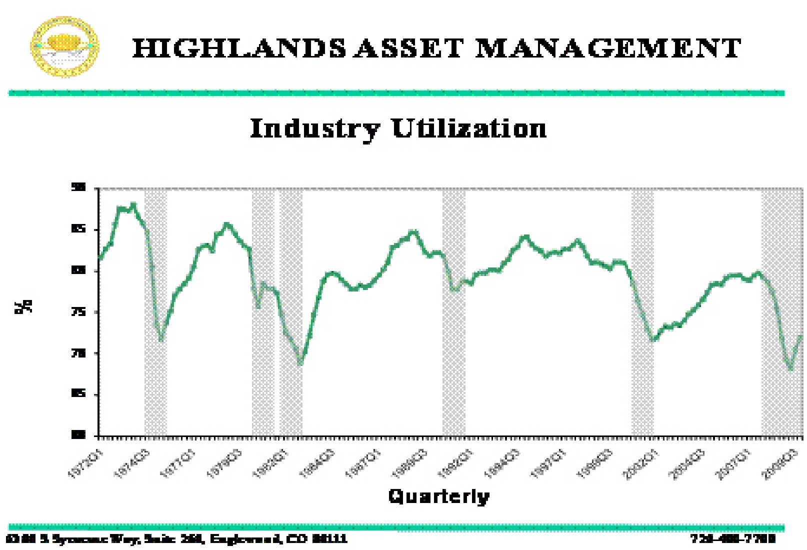
Growing and Preserving Wealth

August 2010

Are we going into “double dip”?

Today, investors are anxious about: the US economy’s recovery, unemployment, European sovereign debt crisis, housing, and stock market volatility. The US gross domestic product, which increased by about 2.7% in the first half of 2010, may only grow about 2% to 2.5% in the second half. The employment outlook remains weak. Currently, the European sovereign debt crisis is making many companies hesitant to hire. Although the housing market has reached the bottom, it is restraining the upturn. In fact, housing will remain at the current level for a long time. The economic rebound is not strong enough, especially after a major recession. Considering all these factors & conditions, many people worry about the occurrence of a “double dip” recession.

We believe the “double dip” recession still has a low probability for reasons presented and discussed in many of our seminars: Although the US economy is not as strong as we would like it be it is still growing. Unemployment rate remains high, however, unemployment always is a lag indicator. In fact, looking forward we see more signs of business improvement. For example, industry utilization (which reflects US firms ability to produce at various efficiency levels), as show below, has started to trend upward.



Higher industry utilization rate will lead to more hiring. The strength and sustainability of this business up-cycle appears relatively well defined. The just released Euro bank “stress” test may start to build confidence back for overseas economies. Results from this test, show only seven banks out of ninety-one banks have failed the test. At home, the US housing market is slowly moving to its stabilization shown by US household formation, housing starts, and new home sales. In addition, the Federal Reserve is keeping rates very low. This low rate environment will further stimulate the economy & markets.

Li Liu, CFA
CEO and Chief investment Officer