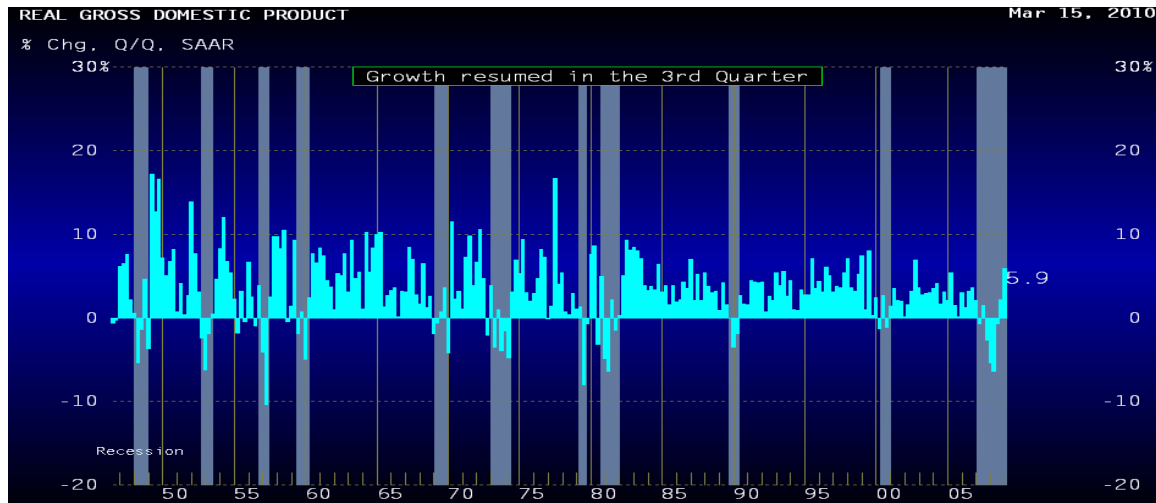




Since the recovery began late last summer, there has been talk of a double-dip recession; that is, after only a brief recovery, the economy will once again contract. In studying the following chart, we note that of the 11 recessions since World War II, the recession of 1981-82 was the only one to occur within 2 years of the prior recession. The fear is that the recession of 2007-09 will repeat this rare occurrence.



The concern with the double dip stems from the length and severity of the 2007-09 recession, including a significant housing turndown, a high unemployment rate and low capacity utilization. Despite the 5.9% growth rate registered in the fourth quarter, this recovery could be called the “Rodney Dangerfield” recovery in that it is being given very little respect. The media has been focused on job creation and housing sales, traditionally lagging indicators coming out of recessions.

In 1980 when the economy came out of its recession, inflation was a very large concern. Paul Volcker, the Fed Chairman at the time, made the decision that stabilization of prices was much more critical than near-term economic growth. Inflation at the time was running above 10% and the price of crude oil had risen from \$5 a barrel in 1973 to \$40 in 1980. The Volcker Fed immediately began to raise interest rates and the yield curve went negative, with the ten-year Treasury note yielding less than the fed funds rate. Historically, the yield curve is one of the best indicators of future economic activity with a steep yield curve (positive) being very beneficial to the economy. Presently, the difference between the 10-year Treasury and fed funds is a record 3.6% and the Fed continues to state that they will be on hold for an extended period of time. This one difference between 1980 and today is the major reason that a double-dip recession is highly unlikely.

If not a double-dip recession, then many are calling for a very slow recovery -- discounting the 5.9% growth of GDP in the fourth quarter. Once again, they are pointing

to the lack of job growth as evidence that the recovery is very weak. However, this is ignoring the fact that manufacturing, production and business sales have risen faster (from a recession low) over the past eight months than at any time since the early 1980's. The strength has been widespread across industries and has led to supply constraints as manufacturers struggle to keep up with demand. This is exactly what occurs preceding job growth as employers can no longer rely on productivity improvements to meet demand and must bring capacity back on line.

We have begun to see this happen. The unemployment rate has dropped from a peak of 10.1% to the current 9.7%. Despite the headlines showing continued job losses in the establishment survey, the household survey has shown a pickup of over 800,000 jobs over the past two months. The difference between the two surveys is the establishment survey does not pick up data for small businesses which is precisely where jobs are created coming out of recessions. We should expect the establishment survey to begin to show solid job growth in the next few months which will give this recovery more respect.

Sentiment remains quite depressed despite signs of renewed economic growth. By the summer, we expect sustained job growth, an increase in housing starts and continued low interest rates. As it becomes apparent that the economy is recovering faster than currently expected, overall sentiment will improve dramatically.

Thomas W. Wirth, CFA
Senior Vice President &
Senior Investment Officer