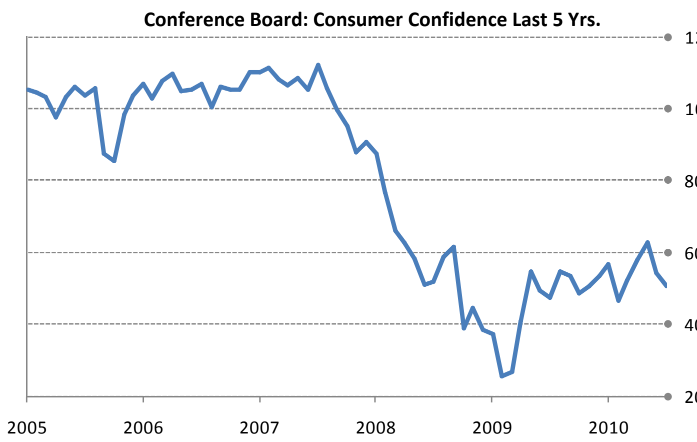
August 2010

GARCIA HAMILTON & ASSOCIATES, L.P.

"Hot Hot Hot"

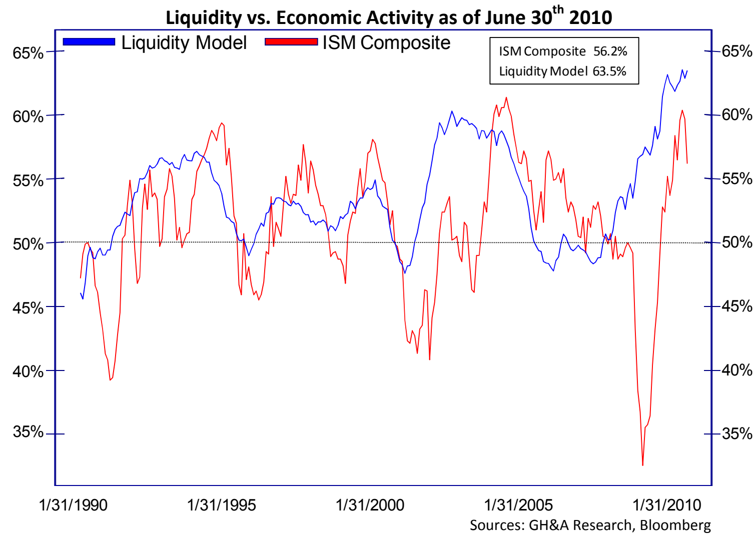
I was taking my kids to school recently when it hit me. I just can't believe that summer is over! In Houston, we are happy to see summer end as we long for relief from 100 degree days. It seems that the only two things hotter than the temperature here are the current debate surrounding a "double dip" recession and today's high U.S. treasury prices.

The "double dip" theories should not entirely be a surprise. Since March, we've seen plenty of news about Spain, Ireland, Greece and Portugal. Normally, at this time, such news involves details of exotic vacations. *Not this summer!* This summer, the news ponders their economic collapse. When you combine these stories with graphic pictures of oil spewing into the Gulf of Mexico and magnificent pelicans smothered in oil, it is understandable that people have fallen into a funk the last few months. This funk has led to plunging consumer confidence as measured by the Conference Board's index. From the chart below, it appears that confidence may soon test the lows we experienced shortly after the collapse of Lehman Brothers.



Despite weakening economic data, we think the odds of a "double dip" are quite low. In previous letters, we have highlighted the great work by our strategist, John Lohman. One tool he has developed is his liquidity model. It is an excellent objective tool that we use to help formulate our economic outlook. The model regresses various liquidity variables such as money supply growth against the ISM Manufacturing Index.

As you can see from the following graph, the blue line, representing the liquidity model output, has had a pretty strong correlation with the red line, representing the ISM Index. This has held true until the collapse of Lehman Brothers in late 2008 when the two lines diverged so dramatically. The strength in the liquidity model at that time gave us confidence that the economy would indeed start to recover. It turned out to be correct. Now, while manufacturing has rolled over, the liquidity model has not rolled over and remains at robust levels. Thus, this information, along with our other economic work, the steep yield curve and a committed Federal Reserve, gives us comfort that a "double dip" will be avoided.



As for treasury prices, we feel they are extremely overvalued. In fact, the last time the 10-year Treasury yield was near the 2.40% yield level was a few months after the Lehman collapse. At that time, the Dow was under 8,000 and our banking system was near a total collapse. That is a far cry from today's Dow at over 10,000 and from the current state of our financial system. It would not surprise us to see a 100-150 basis point increase in treasury yields as soon as key economic statistics surprise on the high side.

Thus, we remain positioned for an economic recovery in our portfolios. In our typical bond portfolios, we remain over-weighted in spread product and significantly underweighted in treasuries. In our stock portfolios, we remain overweighted in names positioned for improving economic conditions, particularly financials and industrials.

As for Houston, we are ready for cooler temperatures. Unfortunately, like the song, the forecast is "**Hot Hot Hot**!"

"*…See people rockin' -- Hear people chantin'*
Feelin' hot hot hot!
Keep up the spirit, -- Come on let's do it.
Feelin' hot hot hot!"

On a side note, we want to again say thank you to our clients and friends who have supported us as we recently concluded the final leg of our transition to the next generation in the firm. We are now 100% employee-owned and have changed our name from DHJA to Garcia Hamilton & Associates (GH&A). We want to again thank our founders, Bob Davis and Jack Hamilton, along with our former partners and good friends at AMG.

Gilbert Andrew Garcia, CFA
Managing Partner
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A copy of our Form ADV, Part II is available upon request.
FIVE HOUSTON CENTER 1401 MCKINNEY ST., SUITE 1600 HOUSTON, TEXAS 77010 PHONE: (713) 853-2322 FAX: (713) 853-2308