



October 6, 2008

Third Quarter 2008

It seems that our current legislators in Washington have forgotten their history. They would have done well recently to remember the advice of one of our founding fathers, Ben Franklin, when he said at the signing of the Declaration of Independence – “We must all hang together, or assuredly we shall all hang separately.” Clearly, based on the mockery of democratic decision making that went on over the past two weeks in Washington, the Republicans and Democrats did not heed Mr. Franklin’s warning; and come election day.... Well, you get the idea. But alas, we are not here to discuss politics but instead the financial markets. Some would say that you cannot discuss one without the other these days, but we will endeavor to be truly bipartisan in our commentary.

Let’s begin by trying to explain the problem our country currently faces. Credit availability in the U.S. and around the world is like life blood to the heart of our economy. Right now, the credit markets are effectively shutting down a main artery to the heart. There is very little blood if any getting through. The longer this blood flow is constricted through tight credit, the more damage is done to the heart (economy). Think of what Congress and monetary officials are attempting to do as putting a stent in the artery to allow the blood flow to resume. It may not be the perfect or final solution but at least it stabilizes the patient in the interim to be able to make a reasonable evaluation. This analogy is crude but I think gets the point across effectively. So that is where we are currently, and as a result the credit (think fixed income) markets have really become the driver for the overall financial markets. Any bounces in equities will be short lived if not followed by a corresponding easing of credit conditions.

At this point, you have probably heard many commentators and read literature comparing the current situation to that of the late 1920s and 30s in this country. While that comparison may be convenient and help sell newspapers given the upheaval in the economy and financial markets we have witnessed recently, it does not seem particularly helpful in this situation to create additional anxiety for investors. No doubt we have very serious problems to address in this country and we have a bumpy road to traverse over the coming quarters, but to compare today to

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a period in American History where unemployment reached 25% I believe is a disservice to investors. Policy makers in this country are taking unprecedented actions to put liquidity into the system right now. This is the exact opposite of the policy response in the Depression era period. Going back to the heart analogy, policymakers back then, rather than trying to open up the clogged artery actually clogged another one by restricting credit at that time.

So we are not in the 1930s but we are not in the late 1990s either. Damage has been done as result of this credit crunch. Main Street will feel the impact and economic growth will slow down. Let's face it, both consumers and our economy as a whole simply piled on too much debt in the last five to ten years as interest rates were historically low. The economy now has to deleverage. This is a painful process, but a necessary one that will create a stronger foundation for our economy moving forward. Many people are asking who is to blame for this or how we got into the mess we find ourselves. Fingers can be pointed in many different directions in this situation and we need to bring any lawbreakers to justice, but we would tell you it really boils down to one word at the heart of the matter and that is greed. That greed on one extreme has now given way to excessive fear as markets search for the next victim in this crisis. Warren Buffett once said, when asked of his investment strategy, "We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful." Has anyone noticed Warren has been on buying spree lately? While some would say that it's easy for a man with \$50 billion to stick his neck out in this environment, I do think it is worth noting.

We do have a few positives to talk about that have resulted from this economic slowdown. First of all, oil and other commodities are down significantly from their peaks in the spring. While this might not be as apparent at the pump, lower prices should be coming in the near future. This should result in inflation slowing from 5% to probably around 1% by the spring of next year. We talked about inflation last quarter in our letter and indicated at that time that we thought concerns expressed by policy makers were overstated. This has proven to be correct and the fall in inflation should give the Federal Reserve (and hopefully foreign central banks – hello Mr. Trichet are you listening ⁽¹⁾) the green light to continue pumping liquidity into the system to resuscitate the patient on the table – the U.S. (and world) economy.

So to recap where we are. We have a liquidity problem in our credit markets which if not addressed in the very near future will turn into a solvency problem for both businesses and consumers. The problem at hand is too big for the private sector to handle on its own so we do need some government help in this matter, despite how everyone may feel at the moment about such help. We also need foreign policy makers to get on the bandwagon, so to speak, and follow the lead of U.S. officials. Of course, the U.S. is not showing a whole lot of leadership skills at this point. To be clear, even if these steps are taken, the road to recovery in the economy will be a slow one, but it will recover. The markets will continue to be volatile as we move through this period of turmoil and uncertainty. It is critical at times like these that you assess your near and long-term goals and objectives and time horizon for your investments. We are here to help you through that process.

(1) Jean-Claude Trichet is the President of the European Central Bank (essentially Fed Chairman Bernanke's counterpart in Europe). We discussed what we believe is Mr. Trichet's misguided inflation focus in our last quarterly letter.

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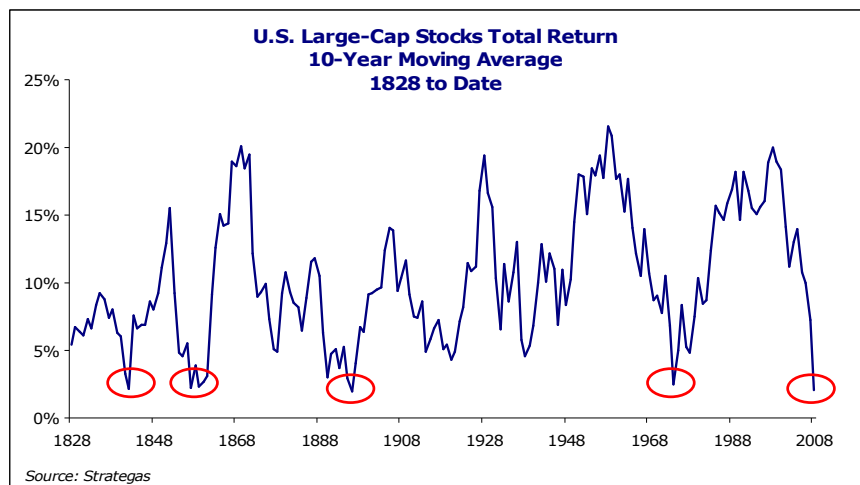
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We have tried to stay in touch with you through this period. We have made and received many calls from our clients. Staying informed is also important and while these conversations are never easy at times like this, they are necessary and we welcome having them. We sent several correspondences out via email recently and we have enclosed copies of those commentaries. If you did not receive these, please call us and give us your email address.

Finally, we will leave you with one final thought. The chart below provides a look at 10-year

moving average of returns for U.S. Large-cap stocks going back nearly 200 years courtesy of our friends at Strategas Research. You can see where we are currently on the chart near the lowest levels over this time period. Depressing to be sure, but then look forward from periods where we reached these levels in the past. Perhaps better times are ahead. Thank you for your continued confidence in Greenwood Capital.



Sincerely,

The Greenwood Capital Investment Team

Philip Bell, Will Bond, Cheves Boyce, Bill Harper, Ashley Sherman, John McAlhany, Michael Nix, Walter Todd and John Wiseman

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