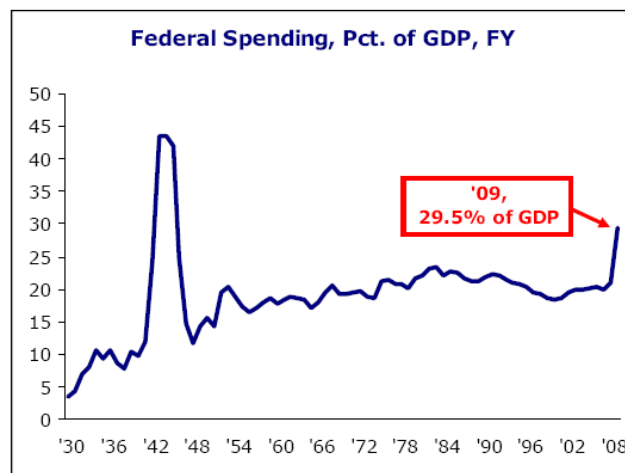


April 7, 2009

RE: First Quarter 2009

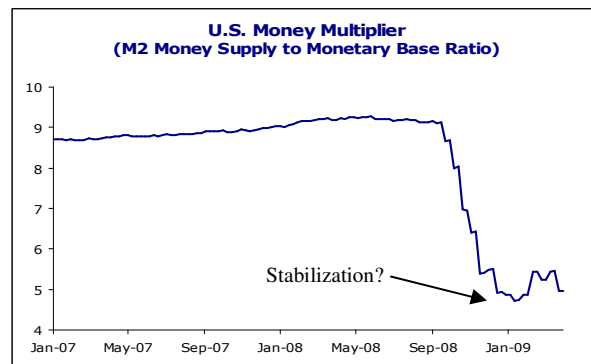
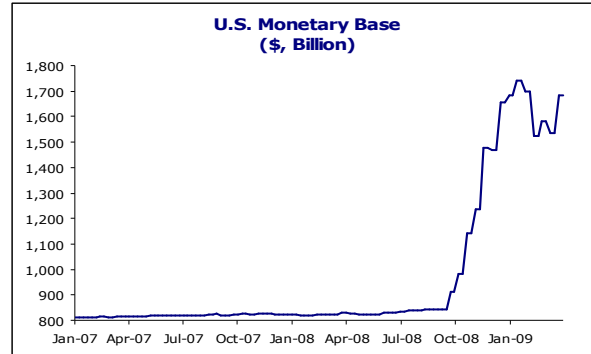
Wow! Just when we thought we had seen it all in 2008, the hits kept coming in the first quarter of 2009, punctuated by the “CEO of America”, President Obama, firing the CEO of General Motors. Who would have thought? Ronald Reagan once said “the most terrifying words in the English language are: I’m from the government and I’m here to help.” Nevertheless, here we are with the government becoming more deeply involved in our economy on a daily basis. When we talked last quarter about some old fashioned Keynesian government stimulus, I’m not sure we had this in mind. There is no question that aggressive fiscal policies are necessary during this unprecedented financial crisis, but are we going too far in an effort to ease the pain of a severe global recession that has been unfolding for over 12-18 months? The risk for the future is that we maintain what is now being billed as a “temporary” increase in government spending. After all, to quote President Reagan again, “No government ever voluntarily reduces itself in size. government programs, once launched, never disappear. Actually, a government bureau is the nearest thing to eternal life we’ll ever see on this earth.” The chart at right would seem to indicate that a new government bureau is headed toward a neighborhood near you.



Source: Strategas Research Partners

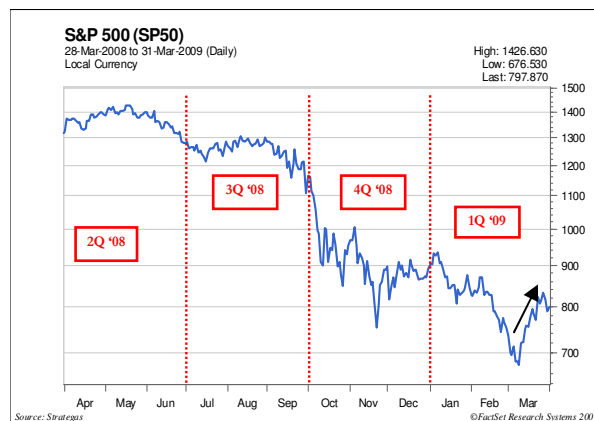
Clearly there has been a tremendous amount of public backlash regarding some of the dealings that have occurred over the past number of months as policy makers have responded to the financial crisis. This bubbled over in recent weeks with \$165 million in bonuses paid to executives of AIG. While we share the sentiment of injustice that these payments represent, we are equally appalled by the response of the U.S. House of Representatives passing a bill instituting a 90% tax on such payments. Legislating or leading from anger is not the solution to the problem. As William Penn once wrote, “passion is the mob of man, that commits a riot upon his reason.” We hope that cooler heads will prevail in Washington.

From an economic and investment perspective, it's hard to know where to start in a quarter packed with so much activity and controversy. One thing is for sure, I think we have acronym overload on the policy front. We have TSLF, PDCF, TAF, TALF, TARP, PPIP, PPIF, SLF, and on and on. As this alphabet soup would indicate, The Federal Reserve and the Treasury have taken enormous steps to increase liquidity and to improve the function of the credit markets. The problem is that all this money is not going anywhere. By that, we mean that while the monetary base has expanded dramatically (top right chart), the money multiplier, the mechanism by which this money flows into the economy has fallen dramatically (bottom right chart). In other words, banks are hoarding cash right now. This highlights the importance of the program to fix the banking system recently outlined by the Treasury. Any economic recovery is dependent on the money multiplier turning around.



Source: Strategas Research Partners

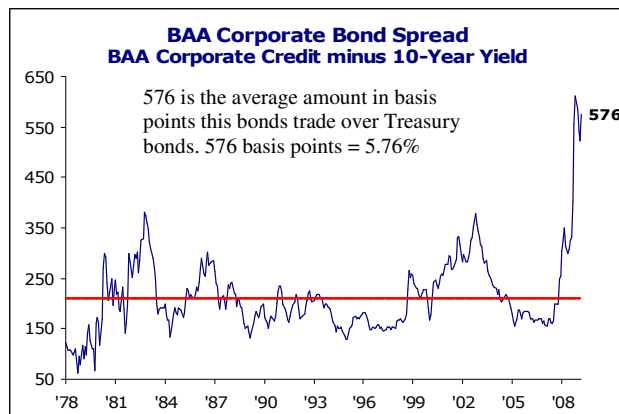
On the housing front, we have started to see a few rays of hope including the stabilization of new and existing home sales and the price declines of homes beginning to moderate. Given this is a traditionally strong time of year for housing, it is too early to tell if this is truly a bottom or simply a seasonal bump in activity. Reports from various other economic sectors over the past month have also been “less bad” than predicted. These recent “second derivative” improvements (i.e. the rate of decline is slowing) have provided at least a temporary lift to the market as indicated by the bounce in the chart at right (and you thought calculus was useless). It is important not to get too excited about this recent move as challenges remain, including the employment picture which will likely get worse in the coming months. While these conflicting signals will keep the equity markets fluctuating, it is encouraging to see the market uptick.



Source: Strategas Research Partners

As in past quarters, there was plenty of action outside of equities, with the fixed income market remaining hard to predict. We have seen improvements in certain areas, including municipal bonds and certain corporate issues but we are still far from a normal environment for credit and

debt. Perhaps we are in the process of redefining what “normal” is in this market going forward (see chart at right). While bond spreads will likely come down from still elevated levels, we do not believe we are headed toward the average (indicated by the horizontal line on the chart) anytime soon. As a result, we think that access to credit and the cost of credit will be integral factors to consider when evaluating investments. Those companies that can internally fund their growth and those that have relatively healthier balance sheets should be at a competitive advantage going forward.



Source: Strategas Research Partners

In this and prior quarterly letters, we have touched on many different topics including the economy, the markets and government policy. However, beyond the short term gyrations of the financial markets, it is important to understand the structural changes that are occurring today. The “leverage-and-spend” culture that has dominated growth in the United States for the better part of 30 years is in the process of unwinding. The implications for our economy are significant, including a slower potential growth rate in the future and the need to find other avenues of growth beyond pure consumption. Bigger government is not the long run solution, particularly if you are as cynical as our 40th President on the government’s economic acumen. President Reagan was quoted as saying “the government’s view of the economy can be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.” I have faith that entrepreneurship and the American spirit of innovation will rise to the top if our leaders in Washington will give it room to breathe.

Sincerely,

The Greenwood Capital Investment Team

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

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