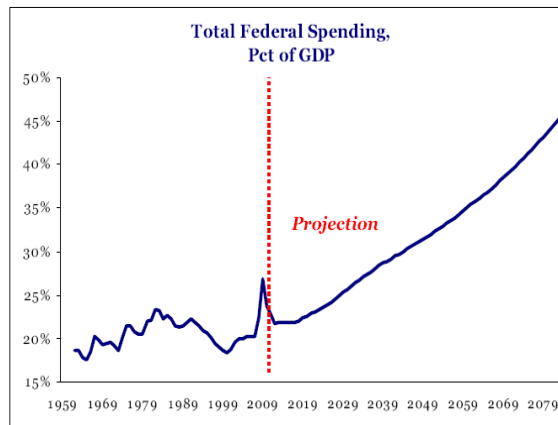


July 7, 2009

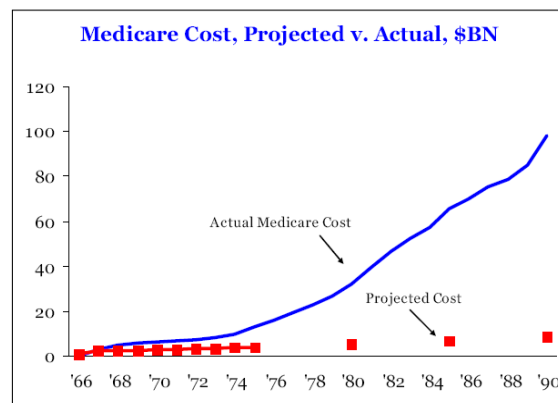
RE: Second Quarter 2009

First of all, Happy Independence Day! It is hard to believe this country turned 233 years old last weekend. While some around the world have called our most recent financial crisis and the subsequent government interventions the failure and death of capitalism and democracy, we are not quite ready to pass so swift a judgment. To be sure, there are a myriad of concerns regarding the government's increasing influence over our economic system; as highlighted in our last quarterly letter. If left unchecked, the federal government's share of the economic pie could approach a staggering 50% (see chart at right from the CBO). However, we feel confident that the American electorate will not allow this to happen as certain polls are already indicating that the citizens of this great country are more concerned than ever about the growing budget deficits. Politicians can ignore these signals but it may be at their own peril. To quote the Declaration of Independence – "Governments are instituted among men, deriving their just powers from the consent of the governed."



Source: Congressional Budget Office (CBO), Strategas Research Partners

One of the biggest reasons for this potential increase in government expenditures is healthcare. Not to step on anyone's toes here, but in case you haven't noticed, the government already has two very large healthcare programs – Medicare and Medicaid. The last we checked, neither of these were the model of effectiveness and efficiency. In fact, the chart at right paints a rather staggering picture. It shows that the projected cost of Medicare for 1990, back when the program was implemented, was \$9 billion vs. the actual cost of \$100 billion. Just a small miscalculation – by a factor of 10! In other words, our advice to the politicians in Washington if they happen to be listening would be to get their own programs in order before they start trying to fix the private sector (not that it doesn't need some fixing). We tend to agree with what Milton Friedman said of government management – "If you put the federal government in charge of the Sahara Desert, in 5 years there'd be a shortage of sand." Ok, soapbox moment over.

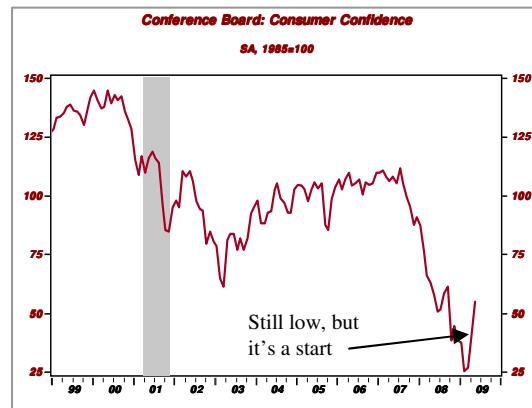


Source: Strategas Research Partners

Before we move on to the current quarter, let's circle back briefly to a story touched on in our fourth quarter letter, the Bernie Madoff scandal. As this letter is being written, Mr. Madoff has just been sentenced to 150 years in prison. This certainly doesn't ease the suffering of those institutions and individuals that lost billions of dollars through this ponzi scheme, but at least the system is working to bring criminals like this to justice. Next up on the hit list, Sir Allen Stanford. No doubt there will be more swindlers like this in the future, but perhaps this economic downturn has created a cleansing process of sorts. Painful for sure, but maybe the country will be better for it in the future.

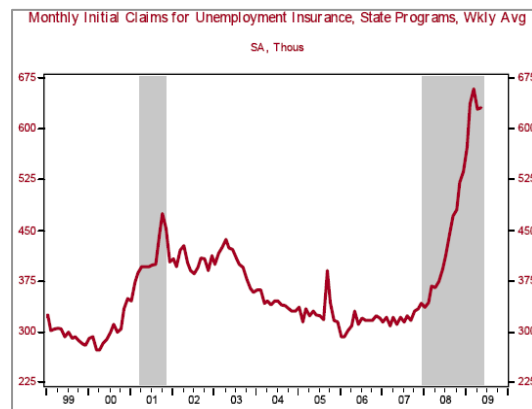
Now, back to the intended topic of this letter – the Second Quarter 2009. Similar to the first quarter, there is no shortage of topics for discussion. During the most recent three month period, the nation witnessed the death of two American icons – General Motors and Chrysler (sorry Michael Jackson and Farrah Fawcett fans). We have seen a financial system that seemed on the verge of collapse three months ago, stabilize and show improvement as our esteemed Treasury Secretary, Timothy Geithner, went from goat to hero with the successful release of the “stress test” results.

Even the much maligned American consumer is gaining some confidence in recent months (see chart at right). Not to say that all of us are rushing out to buy new 50 inch flat-screens, confidence is still at historically low levels, but similar to prior periods in our history, the American people are starting to pick ourselves up and dust ourselves off. At \$14 trillion, turning the U.S. economy around is a bit like turning an aircraft carrier; it will take some time, but it will happen. Remember, patience is a virtue.



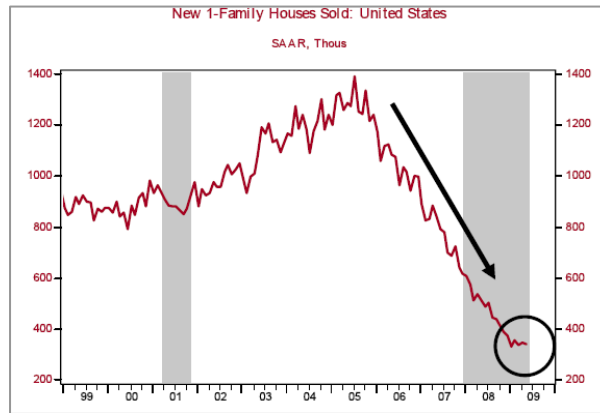
Source: Strategas Research Partners

Labor and housing markets, similar to other economic measures, have started to show modest improvements or at least stopped getting worse. You have to focus really hard at the far right of these next two charts, but you can see this with unemployment claims stabilizing (chart at right) and new home sales hitting what appears to be a bottom (chart next page). With the “pick-ups” in these and other economic readings and the “Great Depression, Part 2” off the table, the equity markets have experienced a nice rebound, as detailed in our newsletter. A pleasant change of pace after six straight negative quarters in the stock market.



Source: Strategas Research Partners

The final topic we wanted to spend some time on this quarter is inflation. With the dollar printing presses seemingly running at full speed, clients often ask about the risk of inflation in the future. After all, if as Milton Friedman suggested, “inflation is always and everywhere a monetary phenomenon...”, then how can there not be a concern. We would certainly concede that the prospect of U.S. dollars sloshing around the world is scary indeed; however, there are several factors that should keep inflation in check over the next couple of years. The first is the incredible amount of slack built up in the system. The capacity utilization rate in the U.S. stands at around 68% from a high of over 80%. Second, wages, a large component of inflation, should remain well contained with increased global competition and an unemployment rate pushing 10% in the coming quarters. The wild card in the inflation equation is food and energy, but at less than 25% of the total inflation calculation, it is hard to imagine this pushing CPI up much over 5%. After all inflation was at 5.5% with oil at \$150/barrel last summer. So to summarize our thoughts on inflation, are we concerned – yes, are we watching it – yes, are we recommending you sell everything and buy gold coins – no. See our newsletter for additional commentary on this topic.



Source: Strategas Research Partners

Sincerely,

The Greenwood Capital Investment Team

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

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