

GREENWOOD

CAPITAL

Insights



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The Stock Market

The year 2005 began inauspiciously for the stock market, with the S&P 500 trading down 2.5% in January. From the lows set during that first month, the index rebounded by 5.3% through the first week of March before selling off during the last three weeks of the quarter. For the quarter ended March 31, 2005, the S&P 500 index ended down -2.6% (-2.2% including dividends).

Market breadth continued to narrow in the first quarter of 2005, with 195 issues ending in positive territory and 239 of the 500 S&P companies outperforming the overall index. On a sector level, while six of the sectors outperformed the market return, only three were positive for the quarter. After finishing as the top performing sector in 2004, energy continued to dominate, trading up 17.1%, outperforming the second place Utilities sector (4.4%) by a wide margin. The Materials sector provided the third positive return, with Consumer Staples, Health Care and Industrials posting negative returns but beating the index. The Telecom sector fell from third place in 2004 to last place in the first quarter of 2005 falling -8.6%.

We stated in our newsletter at the end of 2004 that moderating economic growth and rising rates could provide some headwinds early in the year. Throw in rising oil prices and it is not surprising that the market treaded water during the first quarter of 2005. The next month will be a critical time for the market as S&P 500 companies will begin reporting earnings and provide their outlooks for the remainder of the year. The forecasts provided by firms during this period as well as the effects of higher oil prices on the economy will likely dictate the direction of the market over the coming months.

The Bond Market

As forecasted, the Federal Reserve's FOMC continued to raise the Fed Funds Target Rate during the first quarter, raising the rate 25 basis points (0.25%) at each of their meetings. We expect they will continue this action in the second quarter, raising rates at least once more to the 3.00% level and then becoming much more data sensitive for future action.

The market was very volatile during the period with the 10-year Treasury rate beginning the year by retreating to lower levels before, coming off February lows, making a steady march higher. We have used the move in rates to reposition into some intermediate term issues to better position for the expected continued volatility in the market. As potential inflationary pressures mount, and growth slows from 2004 levels, we do not believe that it is prudent at this point to become bullish on bonds and will continue our defensive stature in the asset class by remaining in short to intermediate maturities.

Market Indicators

(Total Return Through 3/31/05)

| | 52-Week Change | Changes Since 12/31/2004 |
|---------------------|-------------------|-----------------------------|
| S&P 500 | 6.69% | -2.15% |
| DJIA | 3.58% | -2.06% |
| NASDAQ | 0.83% | -7.95% |
| RUSSELL 1000 | 7.24% | -1.90% |

Source: Bloomberg

Economic Outlook

The U.S. economy continued to grow during the first quarter of 2005. Both consumer and business spending remained robust. Businesses added to their capital base and consumer optimism remained strong as the job market improved. Many analysts think that job growth should be stronger, but the reality is that new jobs are being created. Year to date the economy has added almost 500,000 new payroll jobs and unemployment has fallen from 5.4% to 5.2%. This growth in jobs is positive for the future as consumer spending accounts for two-thirds of our total economic output.

Economic growth as measured by Gross Domestic Product (GDP), will be positive in 2005 but probably slower than last year. Consistently higher energy prices will be the main obstacle to growth. Oil selling at almost \$60 a barrel serves as a severe tax on consumption. Consumers are having to pay over \$2.00 per gallon for gasoline which eats up a great deal of their household budget resulting in less spending on other goods and services.

Action by the Federal Reserve (Fed) will also affect future growth. Beginning last June the Fed has raised interest rates seven times resulting in the prime rate, the rate that banks charge their best customers, to rise from 4.0% to 5.75%, and it may go higher. Even though rates are still not high by historical standards, they are having an effect. The mortgage refinance market, which was a source of funds for consumers, has virtually dried up. Higher rates will also slow the housing market which has been an engine of growth over the past several years. Many people believe that the so called housing bubble is on the verge of popping, but unless rates rise dramatically higher, housing will remain a viable component of our growth. Only much higher inflation, which is not likely, would cause rates to rise to levels necessary to shut down the housing market. Most of our current inflation worries are related to oil prices and inflation is not a major problem for our economy.

Higher energy prices and interest rates will affect our economic growth but a major slowdown is not likely. Also, if we get some relief from higher energy prices, we could experience stronger growth than anticipated. Energy prices are expected to recede as the year progresses since there is not a severe shortage in the supply of oil. Current prices reflect both a fear premium and the effects of worldwide excess demand which should decline as the world economies slow due to higher energy prices. Falling oil prices would have a profound positive effect on our economy as we benefit from lower inflation expectations and a freeing up of dollars to be spent elsewhere by both the consumer and business person. Over a longer period energy prices over \$50 per barrel should also encourage the development of alternative sources and conservation to take center stage which would also contribute to energy prices falling.

Looking forward, we remain optimistic on the economy. There are many positive factors at work. Job growth; accommodative interest rates; moderate inflation and an improving situation in Iraq should all contribute to economic expansion and business profitability during 2005.

Management Team Profile

Claud W. (Will) Bond

This quarter's management team spotlight is on Will Bond.

Mr. Bond joined Greenwood Capital in December 2002. He serves as the firm's trading liaison and assistant portfolio manager. Mr. Bond received a Bachelor of Science in Business Administration from Lander University. Prior to joining Greenwood Capital, he served in Customer Relations with Countybank, and he has obtained his Series 65 and Series 66 Securities Licenses.



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