

# GREENWOOD

## CAPITAL

### *Insights*



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### **The Stock Market**

They say that “April showers bring May flowers” and in the case of the equity markets, this proved to be quite true. After falling almost 2% in the last month of the first quarter, the equity market, as measured by the S&P 500, dropped another 2% in April. After this dismal start to the second quarter, the market rebounded sharply in May. The S&P 500 was up over 5.0% from its lows through the first half of June; however, with oil breaking above \$60 in late June the market traded down 2.1% the last two weeks of the quarter. When it was all said and done, the S&P 500 Index ended up 0.9% for the quarter ended June 30, 2005 (1.4% including dividends).

Market breadth was similar to the first quarter of 2005, with over half of the names in the S&P 500 outperforming the index. On a sector level, six of the ten economic sectors outperformed the market during the second quarter, while four have outperformed YTD. Utilities (+8.3%) continued to outpace the rest of the market during the quarter while Healthcare (+3.7%) and Financials (+3.6%) also posted good numbers along with Telecom (+2.6%) and Energy (1.5%). After posting a positive return in the first quarter, Materials dropped to the bottom, posting a -10.0% drop from March to June. The Technology sector (+1.6%) showed signs of life, beating the market for the first time in a year, while Consumer Staples, Discretionary and Industrials all underperformed.

Most companies passed the test of the first quarter earnings season, with overall S&P 500 operating earnings outpacing analysts’ expectations during the period. The second quarter reporting begins in earnest in July and rising short-term interest rates and commodity prices may start to pinch profit margins. We continue to expect moderating economic growth

heading into the second half of 2005. This could actually be welcome news to the equity markets as it should cause the Fed to stop raising rates and oil and other commodity prices to moderate.

### **The Bond Market**

Not to be overshadowed by equity market volatility, fixed income markets witnessed a rollercoaster in bond yields with the 10-Year US Treasury bond moving from its highest levels of the year in March of 4.64%, to 3.89% on June 1. The volatility continued in June as mixed economic data provided no directive for future yields. As the Federal Open Market Committee (FOMC) is likely to continue raising short rates and long rates remaining range-bound, we expect yields to remain in the same trading pattern for the near term.

With a flattening yield curve, credit spreads tend to widen-out in order to entice buyers in the market. As current credit spreads are historically tight, we have been decreasing our position in corporate bonds and moving more into US Treasury issues. Our duration, while extended since last year, remains relatively short in order to provide protection when yields begin to rise.

### **Market Indicators**

(Total Return Through 6/30/05)

	52-Week Change	Changes Since 12/31/04
<b>S&amp;P 500</b>	6.32%	-.81%
<b>DJIA</b>	.65%	-3.65%
<b>NASDAQ</b>	1.10%	-5.12%
<b>RUSSELL 1000</b>	7.92%	.11%

Source: Bloomberg

## **Economic Outlook**

The U.S. economy and financial markets remain susceptible to rising energy prices. After hovering in the low \$50 per barrel range for much of the second quarter, oil prices skyrocketed and closed above \$60 per barrel for several days in late June. Even though prices were back below \$60 at the end of the quarter, this higher level for energy will affect the economy, especially the consumer, as we move forward.

Gasoline prices well above \$2.00 a gallon will serve as a tax on consumer spending which makes up over two-thirds of our economy as measured by Gross Domestic Product (GDP). Dollars that would be spent for other goods and services now have to be spent on energy resulting in less overall growth. High energy prices also impact business profitability by driving up costs. This is especially true in sectors that are highly dependent on oil such as transportation.

Up to now, the economy seems to have absorbed most of the higher costs without a major impact on growth and employment. Businesses are still adding employees and consumer sentiment is still positive. But how long will it last? Over the long run we know that higher energy prices will encourage conservation as well as the development of alternative sources of energy. As these events unfold, energy prices should fall, but during the transition the growth rates of the economies of the world will likely slow. This is currently happening more in foreign economies than in the U.S.

Even though lower energy prices would be a welcome relief, we are not on a path to recession. Growth is still positive and will probably remain so over the foreseeable future. There are still many positive factors at work. Interest rates are still low and favorable to growth even though the Federal Reserve has increased rates nine times since last June. Housing is still strong, and we have very little inflation to worry about. The business sector continues to add employees, a major reason that we are experiencing the level of growth that we currently have.

The economy grew by 3.8% as measured by GDP during the first quarter, and growth continued at a similar pace during the recent quarter. We also expect growth during the remainder of the year to be around the 3.0% rate. While not overly fast it is strong enough to encourage employment and profitability expansion. If we could get some relief from energy, growth will be even stronger.

The Federal Reserve will also play a major role in the future direction of the economy. They could reverse course and lower rates in order to jump start a slower economy if this should occur. The ability to lower rates is a luxury that the Federal Reserve did not have at this time last year. The Federal Reserve has done a very good job of raising rates to a level that is positive for growth without risking a recession. While we are concerned, we remain optimistic for the future of the economy and corporate profitability.



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