GREENWOOD CAPITAL Insights

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The Stock Market

The Chinese New Year Calendar called 2005 the Year of the Rooster, but market watchers will remember 2005 as the Year of Energy. The sector dominated trading in the market for much of the year, rising over 30% when the final tally was made. Despite this move in Energy, the overall stock market, as measured by the S&P 500, traded in a fairly narrow range for the year, spending most of the time in a 100 point range between 1150 and 1250. While stocks witnessed several strong rallies off lows set in April and October, the momentum could not be sustained. As a result, equities limped into the New Year, trading down over 1.5% during the last week of 2005. For the year, the S&P 500 was up 3.0% (4.9% including dividends).

While still impressive, market breadth continued to narrow slightly, with 310 issues ending in positive territory for the year (down from 388 in 2004) and just over half the companies outperforming the overall index. Similar to 2004, dispersion among sector performance was significant. In addition to Energy mentioned above, Utilities (+16.8%), Financials (+6.5%) and Healthcare (+6.5%), also outperformed the overall market. This left six of the ten economic sectors under the market average with Telecom (-5.7%) and Consumer Discretionary (-6.3%) performing the worst for the year. Materials (+4.4%), Consumer Staples (+3.6%), Industrials (+2.3%) and Technology (+1.0%) rounded the middle of the pack in sector performance for the year.

Despite stronger than anticipated economic growth in 2005, economically sensitive sectors, such as Materials, Industrials and Discretionary did not fair particularly well during the year. Perhaps the market is just foreshadowing a coming deceleration in economic activity. While there are few signs of it yet, economic growth should moderate as we move through 2006. Counterintuitive as it may seem, this may not be bad for the equity market as it will hopefully cause the Federal Reserve to stop raising rates. However, until we get a clearer picture of the Fed's path, including the coming change over from Chairman Greenspan to Dr. Bernanke, the market will probably remain choppy.

The Bond Market

The fourth quarter of 2005 proved to be a volatile one in the fixed income universe. The Federal Reserve steadily raising the Federal Funds rate coupled with mixed economic data provided the backdrop for this volatility with the Benchmark 10-Year Treasury moving from a yield of 4.35% to 4.65% and then back to 4.35% as the quarter closed.

The most significant phenomenon that occurred with this level of volatility was the inversion of the yield curve, which occurs when short-term interest rates exceed long-term interest rates. Historically when this is observed, it can be indicative of an economic recession. While there is much speculation whether it could be different this time, one positive is that this inversion only happened briefly and was not extreme. At the very least, it should not be overlooked.

As we peer into 2006, there are many factors that will affect the fixed income markets; the Federal Reserve is expected to stop raising rates in the first quarter with the potential of lowering rates by year-end, there will be a new Federal Reserve Chairman for the first time in over 18 years, and the reissuance of the 30 year Treasury Bond just to name a few.

Market Indicators

(Total Return Through 12/31/05)

	52-Week Change	Changes Since 12/31/04
S&P 500	4.91%	4.91%
DJIA	1.72%	1.72%
NASDAQ	2.13%	2.13%
RUSSELL 1000	6.29%	6.29%

Source: Bloomberg

Economic Outlook

The economy proved to be more resilient during 2005 than anyone anticipated. Most analysts had expected the growth rate of Gross Domestic Product (GDP) to slow as interest rates climbed and energy prices soared. But it did not happen. Through the first 3 quarters of the year GDP expanded at an annual rate of approximately 3.5%, and the economy maintained much of her strength during the fourth quarter.

The consumer remained the primary driver of growth during 2005. Hurricanes Katrina, Rita and Wilma along with higher energy prices and the negative publicity surrounding Iraq did dampen consumer confidence somewhat, but drawing on the strength of mainly housing, the consumer found the ability to keep spending. The extraction of equity from homes by refinancing reached new highs providing consumers with a source of funds even though they were paying higher prices for energy and higher interest rates.

Industrial production and government spending also contributed to growth during 2005. Businesses ramped up production to meet consumer demand and to provide resources to begin repairing the damage caused by the hurricanes. The federal government deficit also grew driven by spending on the war and hurricane relief.

Even with a stronger economy and higher energy prices, inflation remained in check during 2005. As measured by the Consumer Price Index (CPI), through November year over year prices grew by 3.5%, and excluding the volatile food and energy components underlying inflation was at a rate of only 2.1%. Another measure of inflation used by the Federal Reserve, the Personal Consumption Index grew by only 1.8%. The cost of labor helped keep inflation in check in 2005. Growth in labor costs has been at a very restrained pace, especially as related to benefit payments.

Looking forward, we expect that the economy will grow at a slower pace in 2006. Consumer spending should be weaker as the housing market cools, thereby limiting the available funds by mortgage refinancing. Higher interest rates and energy prices will also begin to eat into discretionary income.

Since beginning the process of raising interest rates in June 2004, the Federal Reserve has increased the Federal Funds Rate 13 times causing the Prime Interest Rate to rise from 4% to 7% over this 18 month period. The Prime Rate serves as a basis for many adjustable rate instruments such as mortgages, credit cards and lines of credit that will affect the amount of money that consumers and businesses have left for discretionary purposes after meeting interest payments.

While the economy is expected to slow in 2006, there will not be a recession. Economic growth will continue and business profits will increase although at a slower pace. Slower growth will allow the Federal Reserve under the new leadership of Dr. Bernanke to quit increasing rates. If this happens, as we expect, it should be a major positive for the financial markets as the markets begin to focus on the likelihood that the next move by the Federal Reserve will be to lower rates as we move into later 2006 and 2007. Historically, the transition from a rising interest to a stable environment has been very positive for the financial markets, especially the equity markets. If we can also get some relief from energy prices and the Iraqi situation improves, 2006 could prove to be a very good year.

Management Team Spotlight

Eric M. Anderson

Greenwood Capital is proud to announce the addition of Eric M. Anderson, CIMA. Eric has been hired as Senior Vice President – National Sales. In this capacity Eric will conduct national sales efforts for the firm including new business development efforts as well as national investment platform opportunities. Mr. Anderson received a Bachelor's degree in Finance from the University of Georgia. After graduation, Eric joined Merrill Lynch in their Atlanta office. Later, he was employed by Adam Investment Services, a Registered Investment Advisory firm also in Atlanta. After two and half years at Adam, Eric became the Southeastern Regional Director for Lockwood Financial, the largest separately managed account platform in the independent advisor space based in Malvern, PA. While at Lockwood, Eric was the top producing director and was promoted to head up the Western Division. Most recently, Eric was with JennisonDryden, a division of Prudential Financial. Eric and his wife, Ann, have two children. We welcome Eric to Greenwood Capital!