GREENWOOD CAPITAL Insights

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The Stock Market

In January, the equity market continued its surge from the second half of 2006. That climb continued through the first 26 days of February before hitting a wall on February 27. The move down over the last two days of the month quickly took the market into negative territory. Stocks recovered some of the lost ground in March and finished the quarter in modestly positive territory. For the first quarter of 2007, the S&P 500 finished up 0.18% (0.64% including dividends) while the Russell 1000 Growth index finished slightly better, up 0.89% (1.19% including dividends).

Private equity and leveraged buyouts were catalysts in different sectors of the market during the quarter. Specifically, the Utilities and Materials sectors benefited from interest by financial buyers. As a result, these sectors were the best performing during the quarter. Telecom also performed well after a record 2006 performance. The Consumer Discretionary sector pulled back as gas prices continued to rise in February and March. Financial stocks were the worst performing sector in the market during the first quarter as concerns about slowing earnings growth and the impacts of credit deterioration on banks and other financial institutions rose to the surface. While sub prime loan fears are certainly well founded (witness the bankruptcy filing of New Century Financial), the market reaction in some more well established names was probably excessive in the near term. After a strong start to the quarter, the Technology sector pulled back during the market sell-off in late February and early March and ended the quarter in slightly negative territory. While sector rotation was evident throughout the quarter, with no clear themes emerging, performance was driven by the smallest sector components of the market: Utilities, Materials and Telecom.

We highlighted in last quarter's summary that earnings growth was on pace to slow to the single digits for the first time since the second quarter of 2003. Once again, however, earnings surprised on the upside, growing over 10% year over year during the fourth quarter of 2006. As we prepare to enter the first quarter reporting season in 2007, the market is once again anticipating a moderation in growth to below 10%. Theses earnings numbers as well as the outlook given by companies in coming months will be a key factor in determining the direction of the market over the near-term. The volatility that started at the end of February will most likely remain until we can see some additional clarity in the economic and inflation outlook and the impact that has on the Federal Reserve and its policies.

Market Indicators

(Total Return Through 3/31/07)

	52-Week Change	Changes Since 12/31/06
S&P 500	11.36%	0.64%
DJIA	13.40%	-0.33%
NASDAQ	4.18%	0.44%
RUSSELL 1000	11.54%	1.23%
RUSSELL 1000 Growth	6.73%	1.19%

Source: Bloomberg

The Bond Market

Coming off a great year relative to our intermediate fixed income benchmark, we were able to match the benchmark for the first quarter at 1.59%. We quite possibly are near a turning point in the economy and when that occurs, economic data are often conflicting. The tug of war rages on in the bond market between slower growth – giving strength to bond prices – and inflation that is stronger than expected – reducing the value of bonds. The yield range for the 5 year Treasury note in the first quarter reached a high of 4.88% in late January and a low of 4.40% earlier this month. There is no question that there is some slowing, mainly related to the housing environment. The length and depth of the downturn are keys to any changes made by the Federal Reserve. The yield curve, while still inverted (short rates are higher than long rates), is exhibiting a more normal and steeper shape from the 2 year area to the 30 year area.

We have talked for some time about the lack of risk priced into corporate bonds, especially the high yield sector. The coverage devoted to the sub prime markets and its potential spillover into other areas is putting pressure on spreads. We continue to favor an underweight to the corporate sector as we feel there is more to come from this discussion.

Economic Outlook

Weakness in the housing market has taken center stage during the first quarter of the 2007. Writers of sub prime (lower quality) loans are beginning to suffer losses as defaults and foreclosures rise. New Century Financial, a large national writer of sub prime loans, declared bankruptcy on April 2nd, and the overall situation for other writers is going to get worse before it gets better. Unfortunately, Congress is beginning to get involved which means that bank lending standards and credit rating agencies will be in the line of fire. Higher interest rates are having an effect on the total housing market and the weakest segment, the sub prime lender, is the first to fall.

The February report on new home sales is dramatic proof of the weakness in the housing market. Completed and unsold new homes are 43% higher than they were last February. As sales have fallen, the inventory of unsold homes has increased to the point that it will take over one year to unwind the excess stock.

The breaking of the housing bubble obviously got the attention of the Federal Open Market Committee (FOMC). At their March meeting they weakened their statement referring to the need to increase interest rates. Even though inflation statistics are still higher than they would like, the FOMC is concerned with the overall economy, especially the effect that the housing collapse is having. The change in the FOMC emphasis may have been a baby step, but it was the first step to a possible easing of rates that could come before the year is over.

The economy continues to slow in 2007 as it did during 2006. As measured by Gross Domestic Product (GDP), the economy grew by 3.3% during 2006, a third year in a row of above 3% growth. However, growth was only 2% and 2.5% during the third and fourth quarters, respectively. For the first quarter of 2007 and for the year, it is estimated that growth will continue at a 2 to 2.5% rate. Housing weakness along with higher interest rates and energy prices are beginning to affect consumer spending, the backbone of our economic strength.

Slower economic growth in 2007 could prompt the FOMC to begin lowering rates, especially if inflation statistics improve. Inflation as measured by the Consumer Price Index has accelerated at a 2.4% rate over the past twelve months, not a major cause for alarm but above the threshold that the FOMC would like to see. If we can get some relief from the geo-political situation and the energy markets, inflation should recede to a level that may cause the FOMC to lower rates given the lethargic nature of the economy. A slower economy with falling interest rates would be just the recipe the financial markets need to forge to higher levels.