

GREENWOOD

CAPITAL

Insights



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The Stock Market

In case you haven't heard, September is, on average, the worst month of the year for the stock market. Similar to the man who drowned crossing a stream with an average depth of six inches, investors using this statistical average about historical market performance did not fare so well. The "September Swoon" everyone was calling for never occurred, and despite being down slightly for the last week, the market (as measured by the S&P 500) ended up over +3.5% for the month. Similarly, the third quarter overall defied the skeptics. For the three month period ending September 30, 2009, the S&P 500 and Russell 1000 Growth Indices ended up +15.6% and +14.0%, respectively, including dividends. Other areas of the market were strong as well with Small-cap stocks, as measured by the Russell 2000 Index, up +19.3% and developed international markets were up +19.6% (using the EAFE Index). Emerging markets, measured using the MSCI Emerging Market Index, continued their move higher, ending up +20.9% for the quarter.

Positive sector performance for the quarter continued to be concentrated in more cyclical areas of the market. As in the second quarter, five sectors outperformed the Russell 1000 Growth Index with all ten posting positive returns in the quarter. Financials stayed on top, rising over +17% in the quarter. Consumer Discretionary, Industrials, Materials, and Technology rounded out the top five, all up in excess of +15%. Healthcare, Telecom and Utilities brought up the rear, but still increased between +7-9%. Surprisingly, Energy (+10%) lagged the index despite oil continuing to move higher during the quarter. The Healthcare sector continued to be weighed down by the seemingly never-ending healthcare reform debate.

The nascent economic recovery that began in the second quarter continued to emerge over the summer and into September with economic statistics coming in better than expected during that period. While there is no escaping the longer-term, structural challenges this country faces, we continue to believe that growth in the near to

intermediate term will be stronger than expected. Of course the million dollar question is how much of this has been factored into the stock market given the 50%+ move we have seen from the bottom in March. If growth and earnings continue to surprise on the upside, we believe the market can move higher from here, but the gains will certainly be more muted as we move through the fourth quarter. Should either of these metrics disappoint, we could see a 5-10% correction, leaving us with a still solid double digit return for the year.

The Bond Market

With the Federal Funds Rate and money market fund rates near zero, investors loosened their collective grip on the financial steering wheel. In keeping with the driving analogy, darkness in the form of uncertain economic conditions with rain (slower sales, layoffs, etc.) made investors step on the brakes and turn down a familiar road (short-term government guaranteed securities). As the rain tapered off – or, we became accustomed to the intensity – this quarter, investors sought more driving enjoyment (higher yields) by extending their trip (longer bond maturities) and/or by taking a more scenic drive (choosing corporate bonds and other "spread" product). The corporate bond market is on track to have its best year since 1994. We have been surprised by the speed with which corporate bond markets have thawed. Investors welcomed several new issuances this quarter from companies near bankruptcy earlier in the year. We moved to an overweight position in corporate bonds last year and still believe that is the proper stance, but outperformance will become more difficult.

Treasury bonds also had a good quarter even with the headwinds of a massive supply of new issuances. The Federal Reserve has supported interest rates through purchasing Treasury securities. This program will be completed by October 31, 2009 and should put some pressure on rates to move higher. They extended programs to purchase agency and mortgage securities until March 31, 2010.

Municipal bonds continue to perform extremely well as demand remains high and supply becomes scarcer. The Municipal Master Index had its best quarterly return (+8.07%) since the index began in 1989. We still view municipal bonds as an attractive option for investors in higher tax brackets.

Economic Outlook

The worst may be behind us. History will likely record that the recession which began during the final quarter of 2007 probably ended during the second quarter or early in the third quarter of 2009. As measured by Gross Domestic Product (GDP), the economy should grow by more than +3% during the third quarter after declining by -6.4% and -0.7%, respectively, during the first and second quarters of this year.

The economy is definitely improving. Over the past two years there have been 732 stimulative policy initiatives announced around the world and a synchronized global upturn appears to be unfolding. Building on the contributions by programs such as cash for clunkers, tax credits for home buyers and other federal stimulus initiatives, the economy has gained momentum.

Actions by the Federal Reserve (Fed) have been very instrumental in the turnaround of the economy. By holding interest rates low – the Federal Funds rate is 0 to 0.25% - and by providing a backstop for the mortgage markets and the banking system, the financial system has weathered what could have been a major collapse. Generally it takes changes in interest rates around one year to effect the economy in a meaningful way; and remember it was last September when the Fed was forced to come to the rescue of our financial system. During the final quarter of 2008 the Fed lowered rates by 2% and since the recession began in late 2007 rates have been lowered by over 5%.

Our economic situation is vastly better, but we are not out of the woods yet. The keys to a sustained recovery are: an improving labor market and a lack of inflationary pressures. The labor market is improving. Forecasts call for job losses to continue to decline with the prospects of positive job growth by the end of the year. It may take a while longer for the unemployment

rate to fall as an improving labor market results in new people entering the labor force. Since the recession began, over 6.5 million workers have lost jobs. Without an improvement in the labor market, consumer spending, the basic ingredient of a recovery, cannot rebound in meaningful way.

With respect to inflation, we do not expect it to become an issue until much later – 2011 and beyond. For inflation to have an effect on monetary policy there must be an increase in labor costs. Given the large scale layoffs and wage cuts because of the recession, wage push inflation is not an immediate concern. The Fed will need to witness a vast improvement in the labor markets prior to making substantial changes to their interest rate and quantitative easing policies. Through August, inflation as measured by the Consumer Price Index (CPI) has actually fallen by -1.5% over the past year and by eliminating the volatile food and energy components, core inflation prices have risen by only +1.4%.

In summary, the worst is behind us and the future looks much better. While growth will be volatile, we anticipate an improving economy and job market into 2010. We only hope that our elected officials remain true to our capitalistic principles and do not burden us with tax and spending programs that could stifle free enterprise and economic growth.

Market Indicators

	YTD 2009	
	Total Return¹	52 Week Total Return²
S&P 500	19.26%	-6.91%
DJIA	13.49%	-7.37%
NASDAQ	35.59%	2.54%
RUSSELL 1000	21.10%	-6.01%
RUSSELL 1000 Growth	27.11%	-1.85%
RUSSELL 1000 Value	14.84%	-10.62%
RUSSELL 2000	22.43%	-9.55%
MSCI EAFE	29.23%	3.48%
MSCI Emerging Market	64.45%	19.07%

1) Through 9/30/09
 2) 12 Months Ended 9/30/09
 Source: Bloomberg



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