

# GREENWOOD

## CAPITAL

### *Insights*



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### **The Stock Market**

During the third quarter, the stock market continued to struggle against a back drop of higher oil prices and political uncertainty related to the election. After trading down over 6.5% through the middle of August, stocks rebounded into the latter half of September. For the quarter ended September 30, 2004, stocks, as measured by the S&P 500, were down -2.3% (-1.9% including dividends). Year-to-date the market is up 0.2% (1.5% including dividends).

The third quarter performance was dominated by Energy. The sector was up 10.4% during the quarter, far outpacing Utilities and Telecom in second and third place, up 5.7% and 5.5%, respectively. Of the ten economic sectors in the S&P 500, only four were positive for the quarter, with seven out of ten outperforming the index. After Energy, Utilities and Telecom, Materials and Financials rounded out the top five sectors. Consumer Staples and Information Technology were the two worst performing sectors in the third quarter, down -6.1% and -10.0%, respectively. Year-to-date, the Energy sector continues to outperform as oil prices remain high. The sector is up nearly 24% for the year. After outpacing the market in 2003, Information Technology continues to lag in 2004 with the sector down approximately 10% through September 30, 2004.

The equity markets continue to be range bound as near-term uncertainties have outweighed positive news on corporate earnings through most of the year. In addition, high profile collapses, such as Merck's plunge at the end of the quarter, have shaken market confidence. Despite these headwinds, economic growth remains positive and corporate profits, while slowing from their 20%+ pace, should continue to be healthy. These factors, combined

with an easing of oil prices and a resolution to the election in November should provide a solid foundation for the market to build on in the fourth quarter.

### **The Bond Market**

The fixed income markets proved resilient as ever during the quarter. Benchmark rates entered the period at their highest levels of the year before retracing and nearly testing the low levels witnessed in the first quarter. Available data continues to signal strength in the U.S. economy, although not as robust as had been forecast earlier in the year.

While there seems to be a disconnect between the action in the fixed income markets and the current macro environment, we believe that yields will begin their march higher in the months ahead. In this environment, the most prudent position for bond investors is in shorter maturity issues that tend to provide safety during rising interest rates, which we feel are imminent.

#### **Market Indicators**

(Total Return Through 9/30/04)

	52-Week Change	Changes Since 12/31/2003
<b>S&amp;P 500</b>	12.05%	1.51%
<b>DJIA</b>	11.00%	-2.12%
<b>NASDAQ</b>	6.71%	-4.98%
<b>RUSSELL 1000</b>	13.91%	1.47%

Source: Bloomberg

## Economic Outlook

Economic growth was solid in the third quarter, but energy continues to present a headwind. The price of oil is over \$50 a barrel and is having an impact on spending by all sectors of our economy, but especially the consumer sector. Higher energy prices serve as a tax on our economy diverting resources from domestic spending in order to pay for higher priced energy.

The consumer, who has been the primary driver of our economy since the recession ended in November 2001, is being strained. Consumer spending accounts for approximately two-thirds of our Gross Domestic Product (GDP), and we cannot have a sustained recovery without a healthy consumer.

The US economy continues to expand at a healthy 3% to 4% annual pace. While this rate of growth is not overly robust, it is adequate to provide for growth in jobs and corporate profits. Recently we have experienced what some people refer to as a “soft patch” as our rate of growth in GDP appears to have softened, but we do not appear to be headed to a recession.

Recognizing that our economy is expanding without inflation, the Federal Reserve (Fed) began a program of “measured” increases in interest rates during the past quarter. It appears that the Fed is merely taking out some insurance against a potential economic slowdown. Higher rates will give the Fed some room to take action in the event the economy does falter under the strain of higher energy prices.

Looking forward, we continue to see positive signs for our economy, but energy remains a risk that could affect our rate of expansion if prices remain at current levels for a prolonged period of time. Hopefully we will see some resolution to the Iraqi situation which will help relieve the strain on our energy supply.

## Management Team Profile

### *Dr. John W. McAlhany*

This quarter’s management team spotlight is on John W. McAlhany, Ph.D. Dr. McAlhany joined the firm in 1988. As of July 1<sup>st</sup> of this year,



John ceased being a principal of the firm, but still maintains a very vital and active consultative role with Greenwood Capital. After 16 plus years in the investment field coupled with his background in academia, John continues to bring a unique and valuable perspective to our investment process.

Prior to joining Greenwood Capital, he was the Dean of the School of Business at Lander University in Greenwood for over six years. He served as Professor and Assistant Dean of the School of Business at the University of South Carolina in Spartanburg and as Associate Professor of Business Administration at The Citadel. Dr. McAlhany earned his Ph.D in Applied Economics from Clemson University in 1971. He has a M.S. in Economics from Clemson and a B.A. in Business Administration from Furman University. Dr. McAlhany is the Past Chairman of the board of the Greenwood Genetic Center.



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