GREENWOOD REPORT

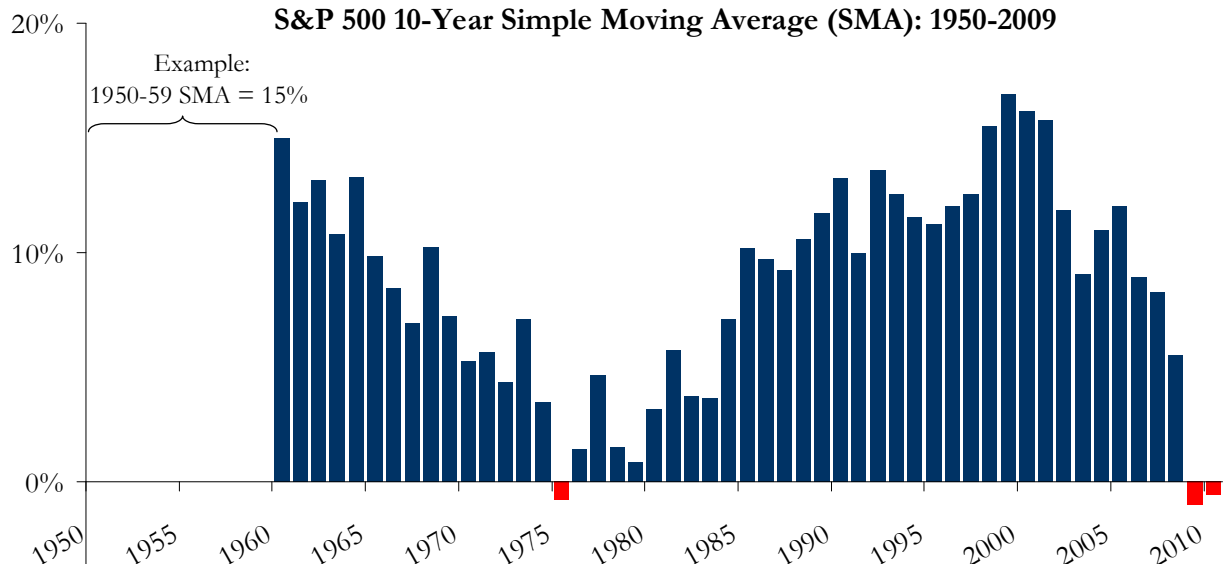
# CERTAINTY IN AN UNCERTAIN WORLD

The recovery in the global equity markets is approaching its twelfth month. It was, after all, March 9, 2009 when the Dow Jones Industrial Average hit a low of 6,547. The magnitude of the unexpected credit crisis caused heavy selling of equities globally. To date however, a chart plotting the recovery resembles a "V" rather than the "W" or even "L" that some predicted, representative of the 63% rally in the Dow through the end of 2009. Long-term investors, including clients of Greenwood & Associates, have benefited from the resurgence – a function of resiliency in the face of panic and decisiveness when the market presented opportunity. Still, short-term uncertainty remains – it is ever-present. Warren Buffett put this in context in a recent interview when he said: *"There was a lot of uncertainty on September 10, 2001, investors just didn't know it."* This is the reality of the world in which we live and invest.

As investors, we care most about long-term certainty. The long-term is much more predictable, especially when you live and work in a country with extensive economic opportunities, a history of political stability, and perhaps the world's most capable leadership. America *will* continue to lead the world to economic prosperity. The polarization of the political leadership in Washington is only a temporary function of the complexity of the short-term challenges facing us. There is no easy fix, but we believe the long-term outlook is certain and we are investing accordingly. Here's why.

## A Resilient, Flexible Economy

*"The most significant lesson to be learned from recent economic history is arguably the importance of structural flexibility and the resilience to economic shocks that it imparts."* (Alan Greenspan, January 26, 2004) History tells us that the fundamental characteristics of our economy allow for *flexibility* to weather major shocks. There will be future crises, each bringing short-term uncertainty, but the flexibility and resiliency of our economy brings long-term certainty to an uncertain world. Skeptics might refer to the chart below which shows a 10-year simple moving average of the S&P 500 since 1950, a period when America endured the Kennedy assassination, Vietnam, Black Monday, Long-term Capital Management, and 9-11. Though recent history has been painful, the trend is clear: 48 of the 51 ten-year periods exhibit positive average returns and two of the three negative periods are current. While not technicians, we do believe history provides context for investment.



## How long is long-term?

Answering the question: *"How long is long-term?"*, we can address three critical short-term uncertainties: 1) The return of job creation and, correspondingly, the rehabilitation of the consumer 2) The sound implementation of government emergency programs and their gradual, orderly unwinding and 3) The assurance to the global marketplace that *this crisis* doesn't happen again.

**The Return of Jobs** – The implementation of the American Recovery and Reinvestment Act of 2009 (ARRA) is still in its early stages. Currently, only $269 billion of the $787 billion act (or 34%) has been distributed in the form of Tax Benefits, Contracts, Grants, Loans, and Entitlements. Through January 30th, approximately 600,000 jobs have been funded through the Act. According to the Administration, the ARRA is projected to create or save 3.5 million jobs by the 4th quarter of 2010. By this measure, we have filled only 17% of the expected jobs – likely a function of the time lag between distribution of the stimulus and actual job creation. *If* the Administration's estimates prove accurate, we could expect an additional 2.9 million jobs by the end of 2010 which would have a meaningful impact on the jobless rate. Patience wears thin when Americans are out of work, but it takes time to implement a program of this size. 2010 will be the year of the stimulus. For those interested, progress can be monitored at *www.recovery.gov*.

**Government Intervention** – The continued implementation of the ARRA and the resulting budget deficit, presents challenges for the U.S. The Federal Reserve will need to unwind its various lending programs as the credit markets and general economy continue to recover. Timing is critical: Pulling back these emergency measures too soon could make the job situation worse and cause a prolonged period of stagnant growth. Additionally, the Fed has implemented all of their traditional tools to combat the crisis as well as certain new ones; reversing these measures prematurely could cause a relapse and require even more innovative, but uncertain, strategies to return the economy to growth. Conversely, concern that the expansion of the Fed's balance sheet will ultimately be inflationary prompts some policy makers to call for more immediate withdrawal of quantitative easing tactics. Though a valid concern, we believe this assertion does not consider the full picture. While an increase in the money supply always produces *monetary* inflation, whether or not it converts into *price* inflation depends on the state of the economy and how the money (or stimulus) is used. When there are unutilized resources (such as 9.7% unemployment and excess productive capacity) then the stimulus can increase output; the resulting economic growth is monetized thereby keeping prices stable. This, in our view, is representative of the current environment.

***This* Crisis Won't Happen Again** – The entire world wants assurance that the pain caused by the Credit Crisis of 2008-2009 won't happen again. In many ways we have moved to a psychological crisis whereby the consumer is afraid to consume – a phenomenon dubbed the "Human Recession" by National Economic Council Director, Larry Summers. Regulatory reform should address the underpinnings of this most recent crisis: excessive leverage, poor compensation practices, and insufficient risk management policies. Reform must be meaningful for consumers and business to feel confident once again. True reform, paired with new jobs, continued manufacturing expansion, and the return of corporate profits will ultimately break the psychological traps plaguing the economy.

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