

## Palisade Asset Management, LLC Quarterly Perspectives



**PALISADE**  
Asset Management, llc

### 2008 Benchmark Index Returns

Index	3rd Qtr 2008	YTD 2008
S&P 500*	-8.49	-19.43
DJIA*	-3.71	-16.56
NASDAQ	-9.19	-21.49
MSCI EAFE	-21.05	-31.07
Lehman Int.		
Govt/Corp	-1.19	0.22
Lehman		
3 Yr Muni	0.95	2.76

\*With Dividends

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### Market Recap - 3rd Quarter 2008

#### *Sign of the Times...*

**“Today I went to buy a toaster and was given a bank as a free gift.”**

September 30th seems like a long time ago. In the column to the left, we summarize index performance for a difficult quarter adding to a difficult year to date for equity investors. During October, virtually every index continued to fall, but the last few days of October saw a positive move upward. There are other positives, too, as Dennis Ott writes in his “Finding the Silver Lining” article. We are also starting to get excited about the very attractive equity valuations we see.

### The Need for Bells

**by Jim King**

While it is unproductive to dwell on “how we got here”, it is important to understand the major causes of our current economic crisis in order to preclude a repeat of this period. Undeniably, excessive leverage in high risk securities, poor regulatory oversight, and irresponsible congressional decision making have all combined to bring us to this point. Here are some examples:

- Five investment houses lobbied the Federal Reserve to raise their borrowing limits resulting in a capital ratio of 50:1: Merrill Lynch, Lehman Bros, Bear Stearns, Goldman, and Morgan Stanley. Have you heard these names in the news lately?
- Few companies have more powerful lobbying in Washington than Fannie Mae and Freddie Mac. Lobbyists convinced Congress to pass legislation which allowed them to excessively leverage their capital – reportedly up to 78:1 - to fund mortgages that would not have met their prior underwriting standards. It is noteworthy that Fannie and Freddie officials were direct contributors to the campaign funds of Senators Dobbs, Clinton, and Obama. To quote one columnist, “Fannie Mae has long been a cat in desperate need of having a bell tied to it”...
- While hedge funds provide a level of liquidity to the market, they also play a significant role in its volatility. In spite of their considerable influence on the markets, these highly leveraged organizations remain unregulated – thanks to yet another successful lobbying effort.

The government (taxpayers) bailout of over a trillion dollars should thwart the likelihood of a depression; however, a recession is unavoidable. A normal market cyclical decline lasts 9 to 12 months, with a drop of 30%. The Dow Jones has already declined 41% to date from its record high in October of 2007. This approximates the declines of 1974 and 1987, the two worst periods since the 1930s. During the decade of the 1970s, three major declines occurred (43%, 25%, 20%), each of which were followed by major rallies back to previous highs.

I am often asked if it is time to be selling. We all know one should buy when the market is at its bottom and sell when it is at its peak. In reality, it is virtually impossible to predict market highs and lows. “Market timing” has repeatedly proven to have little success as a money management strategy. When the media comments about all the “sellers” out there, they are generally referring to traders - who trade securities to take profits on small price changes within a short period such as days or hours – not investors who are looking at the long term horizon.

The technical bottom of this cycle is currently considered to be a DJIA of 7500; interestingly, last month it was considered to be 9000. Technical analysis, like all methodologies relating to the markets, has flaws. While the markets will continue to be volatile, the valuations are at 10 year lows and look extremely attractive. We think it is an opportune time to be a selective buyer of large companies that pay dividends which are well covered by earnings. On 10/10/08 the NYSE reported 10 new record highs and 2901 new record lows. Many market experts and economists concur we are close to a buying opportunity of a lifetime. I was managing money in 1974 when the DJIA hit 575. I may have already missed the opportunity of my lifetime...

## Finding the Silver Lining

By Dennis Ott

As we write our third quarter commentary, the S&P 500 and the Dow Jones Industrial Average reached a low of over a 40% decline in the past twelve months. It is easy to find the negatives that have caused the selling pressure and panic we have recently witnessed. However, I believe that a portfolio manager's role is to seek securities which are selling at a discount to their "worth." If markets are dominated by fear, as is the current market, many securities are probably selling at a large discount to their "worth."

Since the "talking heads" continue to harp on the negatives, I will instead point out some of the positives I see in the markets. First, with the substantial decline in equity prices, it is common to find high quality stocks yielding from 3% to over 6%. This contrasts to a U.S. Treasury security which yields between 1.6% for a 2 year note to 3.8% on a 10 year note. History has shown that when stocks yield as much or more than Government securities, they are attractive.

Second, the price of oil has declined from nearly \$150 per bu. to the current level of less than \$70 per bu. Just as the price run up was thought to be inflationary and a cause for lower consumer demand, can we not expect that this large price reduction will lower consumer costs and inflationary pressures?

Third, the Federal Reserve and the Treasury department are not "sitting on their hands." While we might debate the merits of the recent "bail out" programs, this large infusion of capital assistance should help markets and perhaps even more importantly, bring a higher level of confidence which the world economy needs.

Finally, the current economic situation is being addressed with international cooperation. Recently we have seen a coordinated move by central banks in Europe, Asia, and America to reduce interest rates. These central authorities have also acted quickly to shore up banks, insurance companies, and other financial institutions in order to maintain the fabric of the capitalistic system.

We wish we could forecast when markets will improve. Perhaps the only accurate statement we can make is that there is already a great deal of negative sentiment factored into current prices. We are finding many attractive stock valuations, and are beginning to buy selectively.

## Shared Responsibility

By Peter Rocca

There are many opinions as to who is responsible for the economic problems we now face. However, we have not heard much about the role the consumers played in all of this.

Most experts agree that the financial institutions, politicians, and rating agencies collectively share the biggest part of the blame. However, it is my belief that American consumption habits played a part as well. Being the biggest and best consumers in the world had a positive effect on stock market growth world-wide, but it was not without cost. We funded our consumption by using our home equity, credit cards and other debt as our personal ATMs; shrinking personal equity while amassing personal debt. Some, with lax underwriting standards and low down- payments, were enticed to buy more home than they could afford. Just like the financial companies, many consumers chose to ignore the risk that leverage creates. When the credit bubble burst, many found themselves with limited or no financial flexibility.

As our economic systems are examined and overhauled, perhaps it is a good time for all of us to examine our own financial management systems, to gain perspective on our experiences and also re-position ourselves to look forward. The outcome of this examination process can have many widespread, enduring benefits. Most of us can attest to the lifelong changes our parents and grandparents made while recovering from the depression. The collective effect of these changes made enormous contributions to the country, the economy and even the environment. Individuals, families, and communities became stronger and more self-sufficient as they learned to combine their creativity, strength and resources to achieve their goals. Some of us still embrace the values they passed on to us, but over time, many of us forgot them when we were able to realize the benefits of larger incomes.

As our government begins its process of analyzing, shoring up, and repairing the economy, we too can be analyzing, taking inventory and making plans. We can take an active role in the resolution of this mess by making sure our own saving, spending, and risk management systems are healthy. We can reflect on the changes we wish we would have made, and improve those areas.

As a great nation of creative and innovative people, I am confident we will apply the lessons we have learned of late to make positive changes, and wiser decisions. American's financial habits, just like the stock market's growth, will not change overnight; but the economy will improve and we will be a tad wiser from this experience, and better positioned as a result.