



PALISADE

First Quarter 2010

Asset Management, llc

Quarterly Perspectives

2009 Benchmark Index Returns

Index	Q4 2009	YTD 2009
S&P 500*	6.02	26.50
DJIA*	8.09	22.59
NASDAQ	6.91	43.89
MSCI EAFE*	2.18	31.78
Barclays Int. Govt/Corp	0.31	5.24
Barclays 3 Yr Muni	0.80	5.78

*With Dividends Included

1st Quarter 2010

Paying Attention to Investment Quality, Valuations, & Yields

By Jim King

2009 turned out to be a strong year for the stock market. While the 4th quarter equity markets finished with their third consecutive quarterly gain (S&P 500 up 6.0%), through January, the S&P 500 was down 1.5%. Although we do not see this broad-based equity market expansion continuing with uninterrupted gains, we do see certain higher quality, moderate to lower valuation companies continuing to climb.

One of the primary difficulties the markets face now is a lack of investment alternatives to common stocks. The short term and higher quality fixed income markets have been picked over and are currently netting historically low yields. Today, one year treasuries are yielding 0.30%, the 2 year is at 0.84%. To increase yield you have to extend to the 5 year at 2.30% and the 10 year at 3.65%. When you factor in the possible risk of higher taxes and inflation, the short end of the yield curve is a 'safer' bet, yet it may continue to provide low yields for an extended period of time. Additionally, many of the medium to higher yielding Corporate and Municipal bonds have associated credit problems/risks.

In this somewhat uncertain market environment, we continue to favor high quality, large capitalized, dividend paying, common stocks. An important aspect of Palisade's equity selection process is quality. S&P 'ranks' common stocks based on earnings and dividend consistency over a 10 year period. Companies are given a 'quality' letter grade based on their stability of these factors. We predominately invest in companies rated A+, A, and A-. As a result of the last several years of economic dislocations, today there are only about 300 companies that meet our quality criteria vs. over 700 companies several decades ago.

A company's valuation is another key aspect of our equity selection process. One of the lagging areas of performance in 2009 was the larger, high quality types of stocks. While stock valuations are historically about midpoint at 16.7x, versus 13x one year ago (high quality stocks have a lower multiple), the lack of investment alternatives still favors stocks. Additionally, about half of the stocks that we own pay a dividend of more than 3%.

A Few Other Observations for 2010

First, the government's role in the private sector is a concern. The government's track record with running businesses has not been distinguished (Post Office, Fannie Mae, Ginnie Mae, Social Security, FDIC, and Medicare). So what makes us believe that playing a more active role in Americans' health care will produce positive results? Secondly, while we have concerns about executive compensation levels, the government's job is to regulate industry, which they failed to regulate adequately, not issues like compensation. The current political sentiment to increase regulations in the financial industry may be a good thing as we believe it was the lack of financial regulation that caused the near collapse of our financial system. We are optimistic that progress will be made on this front in 2010.

Read On

As we always do at Palisade, we let our experience speak in our quarterly Newsletter articles (backside). I hope you enjoy hearing from Tom Welch as he speaks to the very important subject of *Safety and Soundness of Client Accounts* and Peter Rocca who shares his perspective *From Banks to Boutiques*.

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Safety and Soundness of Client Accounts

E. Thomas Welch, JD

Almost every week over the past year or so, we read or hear about some investment fraud resulting in client's funds being lost. In the forty some years I have been in this business, I have never seen so many news stories of investment fraud. So how do clients make sure that their funds are safe and sound when they choose an investment manager?

Safety Tip #1. Make sure that when selecting an investment manager, you select a custodian that is separate and not controlled or owned by the investment manager. In the Madoff case, he was the investment manager and also served as the custodian of his client funds through the brokerage firm that he owned. Thus, he had control of his client funds and had direct access to his client funds. At Palisade Asset Management, our clients can choose whoever they want to be their custodian, whether it be a bank or a brokerage firm.

Safety Tip #2. If a client chooses a brokerage firm as their custodian, they should consider carefully if opening a 'margin' account is to their benefit. Often the margin account contract has provisions that the brokerage firm can either lend the securities to others or can use the securities in the account as collateral for their own corporate loans. Thus, even if the client separates the investment manager from the custodian, they may put their securities at risk due to the margin provisions.

Safety Tip #3. If a client chooses a bank as custodian for their account, the securities in their account are held separate and apart from the bank assets. If the bank fails, as many have in the past few years, the client securities are not subject to the creditor or FDIC claims against the bank. The client securities are safe.

What about cash or cash equivalent assets in deposit accounts in the failed bank? In that case, those deposit accounts are subject to FDIC coverage and are exposed to any amounts over the FDIC limits. The FDIC rules in these cases are quite complex as to the types of accounts, other client deposit accounts in the bank, and other factors.

The scandals are real and have been far more numerous than is normal, yet it is important to note that they have received a disproportionately high level of media coverage for the overall percentage of lost assets that they represent. In these volatile economic times, clients must consider the risks not only of the investments they choose, but also the risks of those funds and securities custodied with a broker or a bank. For your asset's sake, safety and soundness of the custodian are attributes to consider and to understand.

From Banks to Boutiques

Peter D. Rocca

Despite the historic 2009 rebound in the financial markets, investors continue to move their money from larger banks and brokerage firms toward boutique sized Registered Investment Advisor (RIA) firms.

A *Prince & Associates* study published in 2008, found that 81% of investors with \$1 million or more of investable assets were planning to move from their present advisor to a new one. As you might imagine, during this volatile time period, the strain on advisor-client relationships was high especially at the larger banks and brokerage firms. 90% of those clients were planning to move assets away from their advisors, whereas only 29% of clients at boutique or local advisory firms planned to do the same.

Fast forward six quarters and the study appears to be proven accurate. Investors actually did what they said they were going to do. A recent announcement by a very large financial and banking institution reported that their wealth management unit saw net redemptions of \$10 billion per month over the past 18 months. Conversely, data published on RIA's custodians (generally these institutions house the assets for the smaller local advisory boutique) have shown a significant growth in new client assets over this same time period.

We can only speculate as to the reasons supporting this trend. We have read that in the midst of the big banks and brokerage firm mergers of the past eighteen months, the customized and higher service levels provided to wealthy clients declined. It appears that many of these clients have elected to move their assets toward local boutique wealth management firms.

Other contributing factors that may have supported this client movement is the desire for a safer and more transparent investment management platform. Additionally, the migration of Advisors to boutique sized firms has also been prevalent and clients view the highly experienced management teams in place at many RIAs to be a strong positive to supporting their transition.