

Palisade Asset Management, LLC

Quarterly Perspectives



PALISADE
Asset Management, LLC

2008 Benchmark Index Returns

Index	2nd Qtr 2008	YTD 2008
S&P 500*	-2.73	-11.95
DJIA*	-6.86	-13.37
NASDAQ	0.61	-13.55
MSCI EAFE	-3.50	-12.70
Lehman Int. Govt/Corp	-1.53	1.43
Lehman 3 Yr Muni	-0.42	1.80

*With Dividends

Market Recap - 2nd Quarter 2008

The global equity markets experienced another difficult quarter. In the U.S., the lowest performing index was the Dow at <6.82%>. The S&P 500 followed at <2.73%> and the Russell 3000 returned <1.69%>. The top performing equity indexes this quarter were the NASDAQ at +0.61% and the Russell 2000 Small Cap at +0.58%. Outside the U.S., the MSCI EAFE index also weathered another tough quarter returning <3.50%>. For 2008 to date, the equity indexes were all negative performers; the NASDAQ at <13.55%>, followed closely by the Dow at <13.37%>, the MSCI EAFE at <12.70%>, the S&P 500 at <11.95%> and the Russell 2000 at <9.37%>.

The S&P 500's two poorest performing sectors remained the same for the quarter and 2008 to date: Financials at <16.1%>/<25.1%> and Consumer Discretion <10.0%>/<14.8%>. They continue to be offset by the two top performing sectors for the quarter and 2008 to date: Energy at +23.0%/+19.1% and Utilities +8.6%/<3.4%>. For the first half of 2008, Energy was the only sector posting positive returns.

Although the bond indexes have been positive performers for 2008 to date, they posted slight negative returns last quarter: <1.53%>/+1.43% for the Lehman Intermediate Govt./Corp. Bond Index and <0.42%>/+1.80% for the Lehman 3 year Municipal Bond Index.

Is the negative performance of the equity markets over yet? Investment strategist Barry Ritholtz doubts that financial stocks have yet hit the bottom. He points out that the New York Times, Wall Street Journal and Barron's published prominent articles on Saturday (7/18) suggesting the worst was over for financial stocks. Ritholtz comments: "Can you recall the last time three major media players all picked the bottom in a market or sector on the exact same day – and were all proven correct?" We tend to agree with Mr. Ritholtz. The U.S. stock market is definitely closer to a bottom, but is not there yet. As the financial stocks led our markets downwards, they need to stabilize before we will see longer term market improvement. Our advice is to stay with high quality investments and stay disciplined to your asset allocation strategy as we move closer to the end of a volatile ride.

"When There is Nothing To Do, Do Nothing"

by Jim King

James Tisch - Loews Corp

In an economic environment such as the one we have experienced since October of 2007, to change holdings in an equity portfolio is akin to changing deck chairs on the Titanic. The end results will probably be the same. Although traders and hedge fund managers change positions daily if not hourly, experience has taught me that when managing a high quality growth equity portfolio, it is best not to change direction in a declining market.

Recessions are difficult to predict; even the various Fed chairmen over the years have been unable to accurately forecast such an occurrence. However, a recession is beginning to seem unavoidable during this market cycle. During the 1980s and 1990s, periods of declining employment lasted as little as a single month. We have already experienced four straight months of declining employment. It is reassuring to keep in mind that the stock market generally declines prior to a recession, and usually starts to recover mid-recession.

We continue to believe that we are experiencing a cyclical market decline which historically has lasted nine to twelve months and normally declines a total of 25% to 30%. We are currently at the nine month mark with about a 20% decline peak to trough. Often, there is a final capitulation where there is a broad sell off, although this does not always occur. In the past, I have expressed my opinion of the various factors that led our country to the financial turmoil it is in today. Lack of regulation, financial irresponsibility, and subsequent government bailouts have all contributed significantly to current and past market turbulence. As we enter the political season, I wanted to share a recent article written by former columnist Charlie Reese and leave you with some food for thought.

The article, entitled "545 People", contends that 100 senators, 435 congressmen, one president, and 9 Supreme Court justices are directly responsible for the domestic problems that currently plague this country. These people claim to be against deficits, inflation, and high taxes and yet we are experiencing all of the above. He asserts that "...[since these] 545 people exercise the power of the federal government, then it must follow that what exists is what they want to exist". He concludes that the self serving mind set and irresponsible behavior of this group of public servants is ultimately endangering our democratic system of government. It is something to think about as we begin the process of choosing our country's next leaders.

Jim King

Paul Kenworthy

Peter Rocca

Dennis Ott

333 South Seventh Street
Suite 440
Minneapolis, MN 55402

Phone: 612-455-2900
Fax: 612-455-2909

E-mail:

jking@palisadeam.com
pkenworthy@palisadeam.com
procca@palisadeam.com
dott@palisadeam.com

Inflation May Be The Next Big Worry

By Dennis Ott

As Harry Truman once said, "There is nothing new in this world except the history you do not know." Our policy makers seem to believe the so called "core inflation rate", which is running between 2 and 3%, is the correct focus. However, most consumers will disagree with that priority. During the 1970s when oil prices quadrupled nearly overnight, policy makers and Wall Street analysts understated the impact that higher energy prices would ultimately have on overall prices. This may be happening again.

The most recent producer price index showed an 8.6% rise versus one year ago, but excluding food and energy, the statistic was only 3.2%. We fear that rising food and energy prices will increase the cost of nearly all goods produced. This may cause laborers to demand higher wages to offset the loss of their purchasing power. The longer this divergence between the core and actual inflation rate continues, the greater the risk of accelerated core inflation. Unless productivity can compensate for these cost pressures, we may be forced to adjust to a new higher level of inflation just as we did in the late '70s. During that period, higher inflation led to earnings shortfalls as corporate America was unable to raise prices fast enough to offset costs.

As Jim King's article mentioned, we have experienced about a 20% decline in the stock market since October of 2007. The question in our minds is whether this decline has been great enough to discount the continuing difficult earnings environment that we are experiencing.

While we wait and watch, we continue to monitor and cautiously build equity portfolios.

The Sale of Budweiser - A Difficult Board Decision

By Paul Kenworthy

There has been a great deal of press lately regarding InBev, the foreign beverage company, and their pursuit of America's *King of Beers*, Budweiser. The media primarily focused their attention on the negotiations between the companies, and Budweiser's initial reaction to the InBev's offer. At the onset, Budweiser's board of directors resisted the purchase offer despite the monetary benefits to stockholders. Among their concerns was the potential loss of American jobs and American tax dollars if InBev would decide in the future to move their operations outside of the United States. While the two companies continued to negotiate, Budweiser's board of directors was scrutinized by the press for not accepting InBev's offer, which was at a significant premium over the stock's current price.

While pondering this, I began to wonder - is a board obligated to accept a buyout when the offer per share is higher than the stock's current price? There are multiple considerations to address when examining this issue. The board's primary responsibility is to the shareholders and the offer price per share is indeed a principal consideration. Of late, there has been an increasing awareness of the company's responsibility to its other 'stakeholders' - employees, customers, distributors, suppliers and the local community - and the potential effect of the transaction on this group. The stock price may increase the investment value for shareholders, but may not always be in the best long-term interest of the company, stakeholders, or the shareholders.

There are many acquisitions that do not work out for either the acquired or acquiring shareholders. We advocate that the board's role in is to search for long-term synergistic benefits. You may recall a few years back that Fingerhut was sold at a significant premium to Federated Department stores. Within three years, Federated ended up selling Fingerhut operations due to a poor strategic fit and execution that caused declining sales and profitability.

Often, there are controlling family or investor interests that direct the board's outcome. From the press's point of view, that appeared to be the case with Budweiser. The press reported that the Busch family was influencing the refusal to accept InBev's offer. However the 'controlling' Busch family owned only 4% of the outstanding stock and in reality had little actual control. We believe that Budweiser's board acted in the best interest of shareholders and stakeholders by refusing the offer; they had faith that there were further concessions to come from InBev.

The board finally approved the deal after InBev agreed to keep Budweiser based in St. Louis, saving over 5,000 jobs. Additionally, the sale price was increased by over 10% from the initial offer. This created a "win-win" for everyone including the Busch family who increased their personal valuation by over \$250 million.

The Budweiser board made a difficult but wise decision to sell to InBev. There were many aspects of the deal to evaluate considering the intense competitiveness of the global beverage market. Budweiser's thoughtful and prudent negotiations as well as the consideration they gave to their shareholders and stakeholders will insure the best possible outcome for all involved.

Suite Change: Please note we are now in our permanent space in Suite 440 of our building.