

Palisade Asset Management, LLC

Quarterly Perspectives



PALISADE
Asset Management, LLC

Market Recap - 3rd Quarter 2009

Market Overview and Valuations

Steven E. Landberg, CFA

2009 Benchmark Index Returns

Index	Q3 2009	YTD 2009
S&P 500*	15.62	19.33
DJIA*	15.83	13.81
NASDAQ	15.66	34.58
MSCI EAFE	18.80	25.49
Barclays Int. Govt/Corp	3.25	4.92
Barclays 3 Yr Muni	1.93	4.94

*With Dividends Included

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The 3rd quarter added significantly to year-to-date returns across all equity markets. The S&P 500 index ended the quarter at 1,057.08 up 15.62% for the quarter and up 19.33% year-to-date. The DJIA closed at 9,712.28 up 15.83% for the quarter and up 13.41% for the year. The NASDAQ closed the quarter at 2,122.42, up 15.66% and was the largest gaining index year-to-date, up 34.58%. For the quarter, the Russell 2000 small cap index was up the strongest at 19.28% for the quarter and up 22.43% for the year. The MSCI EAFE international index was up 18.80% and 25.49% for the year. The Barclay-Lehman Intermediate Govt./Corp. index was up 3.25% for the quarter and up 4.92% year-to-date. The 10-year Treasury ended the quarter yielding 3.31%.

For the 2nd consecutive quarter, the equity markets have had an exceptional move upwards. This has the multitude of analyst's consensus on the next directional move for the equity markets as quite mixed. At Palisade, we spend most of our research time analyzing both market and individual company valuations. With this focus on valuations, we are able to sift through the varying opinions and create our own consensus on stock market and individual stock directions.

One measurement guide of a market's valuation that we track is the number of stocks reaching new 52 week highs compared to the number priced at new 52 week lows. On Saturday mornings, you will find me with a cup of coffee and the weekend edition of the *Wall Street Journal (WSJ)*. Recently, the *WSJ* reflected 180 stocks on the NYSE hitting a new 52 week intraday high with only 5 stocks trading at 52 week lows. This compares to the new highs and lows listed earlier this year in the March 7-8 edition of the *WSJ*. At the close of the trading session for Friday, March 6th, the NYSE had only 1 (yes one) stock hitting a 52 week high and 827 stocks priced at 52 week lows. By the way, that one stock hitting a 52 week high was Sturm, Ruger, a company which designs, manufactures and sells firearms.

The 52 week high/52 week low stock listing is one indicator we use for monitoring stock market valuations, market trends and inflection points for possible reversals of markets. Although the different market valuations have increased strongly from the March lows, not every company's value has accelerated beyond their earnings growth. Overall, we think market valuations are high, but do not see every stock as being over valued. Based upon the on-going economic uncertainties and this 'fast and furious' market and valuation move upwards, we expect the U.S. and global stock markets to experience a pull back (perhaps as much as 10-15%). As this takes place, our plan is to invest cash reserves and look towards a bumpy and slower economic recovery.

The Mass Marketing of 'Target Funds'

James C. King

Recently, a large investment firm introduced another 10 new *Target* funds to their already large stable of fund offerings. For some time now, I have been amazed at the popularity of this category of mutual funds - *Target*, or *Life Cycle* funds. Started about thirteen years ago, these funds are structured to change the asset mix (stocks, bonds, cash) as a person approaches their retirement date. These funds are invested differently for someone thirty years out (more stocks, less bonds) vs. ten years out (more bonds, less stocks) from their target retirement date.

'Target Date' investment funds (or age directed asset allocation) were created as simple and easily marketed solutions for retirement investing, but in our opinion are not appropriate for most investors. At Palisade, we allocate our client's assets based on 1) each individual's growth and cash flow needs, along with their tolerance for volatility, and 2) the relative attractiveness of the various asset classes to meet financial needs. The investor's needs and investment opportunity, not their age directs their investment allocation. *Target* funds overlook these very important investment principles.

Target funds were designed for each age group to invest the same way and to make investment decisions easy & logical for retirement plan participants. In actuality, we believe they were designed more as 'easy' funds for the managers to manage. Recalling bond yields in 1976, the Treasury issued a popular 8% ten year bond, but with inflation expanding, the bonds declined as much as 50% during the period before they matured. The idea is nonsense that a person or institution should structure their portfolios (e.g. 50% stocks, 50% bonds) based on a target date in the future instead of considering the investor's financial needs. The simplicity of this idea has been great for marketing purposes and great for fee generation, but that is where the quality of these products stops.

In today's environment, managing different asset classes is challenging and should not be a 'cookie-cutter' decision. With the uncertainty in the global economies, excessive government spending complicated further by credit factors and inflation fears, managing the risk in bonds is complicated. Also, based on where stock valuations are in the economic cycle, risk in different types of stocks varies immensely. If a high quality, dividend paying common stock was purchased back in 1976, it probably would have tripled in value, but that opportunity would have been lost if your were near retirement and had invested in a *Target* fund with a high allocation in bonds. A little more thought put into the allocation of one's investments will prove far superior to a *Target* fund.

Our advice is to always customize your investment's asset allocation to match your individual retirement needs vs. the less appropriate, yet well marketed route of investing in *Target* funds.

All in the Client's Best Interest

E. Thomas Welch, JD

As I stated in my article in our previous quarterly newsletter, I cannot imagine a client setting up an investment account for their spouse and family members knowing that their family will be dealing within an impersonal 'call center' relationship. Adding to this discussion, I cannot believe a client with a portfolio of \$1 million or more would knowingly agree to have his investments managed in a portfolio if the client knew the following:

- The portfolio may contain hundreds of stocks with the average holding around 1% or less of the portfolio, and is managed by managers you will never meet, AND
- There is limited regard respective to short-term or long-term gains or losses nor any customized tax considerations of the client, AND
- The client is not informed when a portfolio manager change occurs nor do they have control over the tax consequences the 'new' portfolio manager creates when reconfiguring the securities to their investment style, AND
- The cost of the above investment service is in the range of 1.3-1.5%.

The above describes using mutual funds to manage a portfolio. We believe that this 'low touch' structure is designed more for clients with investment of assets less than \$500,000 where obtaining professional management and a diversified individual security portfolio are challenging with this amount of assets. We do not believe that the mutual fund solution is cost effective or tax efficient for clients with larger amounts of investable assets. Nor is this solution what most clients want for their spouse or their family members.

Compare that service to what a boutique money management firm like Palisade can offer:

- A portfolio of around 30-40 securities with the average holding being around 2-3% of the portfolio, with a consistent dividend and/or interest return for the client, managed by a manager you know and who understands your individual needs, AND
- A portfolio managed with consistent attention to the tax situations of each client's taxable accounts, AND
- Clients meet directly with the portfolio manager on a quarterly, semi-annual or annual basis, based on each client's desire, AND
- The cost of this service ranges between .8% to 1%, AND
- The performance ranks at the top tier level of high quality growth mutual funds over the last 1, 3, 5, and 7 year periods.

Another common misconception is that the cost to build a portfolio of individual securities is expensive. Yet, the actual cost to build a Palisade portfolio is quite nominal at around \$350 or only around 0.035% with a low annual turnover causing even lower future annual trading costs.

So which of these approaches would an informed client prefer for their spouse or family members? We believe that a client would choose the customized boutique money management solution rather than the mutual fund approach.