



PALISADE

Second Quarter
2010

Asset Management, llc

Quarterly Perspectives

2010 Benchmark Index Returns

Index	Q1 2010
S&P 500*	5.40
DJIA*	4.77
NASDAQ	5.94
MSCI EAFE*	0.22
Barclays Intmd. Govt/Corp	1.54
Barclays 3 Yr Muni	0.30

*With Dividends Included

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How Do You Define an *Investment*?

By James C. King

In today's investment vernacular, one hears the words bets, play, or trade right alongside the words 'invest' or 'investment'. Years ago, the term investment meant to buy a company's shares that produced a better product or service than its' competitors, had strong financials, all to support an investor's participation in its earnings and dividends over a long period of time.

Today, we are led to believe that this longer time period of 'investing' in a company's stock is out of date. With the advent of sophisticated trading systems, inexpensive computer power, and instantaneous communications the timeline of an "investment" today is often reduced to minutes. If we dig into the outcomes for the large investment banking firms that adhere to this mind set, we sometimes see quick profits, but with an increasing dependency on these riskier profits and with increasing misconduct and fraud by the participants.

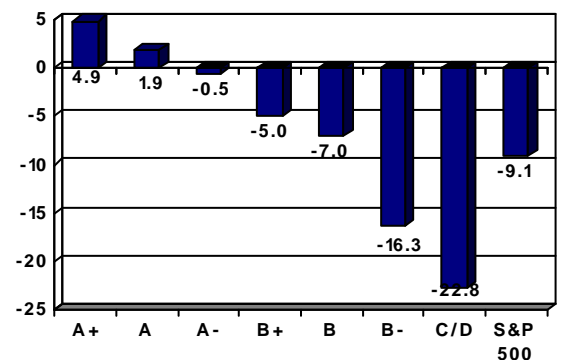
In our opinion, this casino like atmosphere is very unhealthy for the U.S. capital markets. In addition to this short term trading mentality, a greater appetite for risk has evolved because of a lack of regulation of the market participants. As a result, the financial regulatory bill before Congress is of the utmost importance for the improved controls needed for our capital markets. Let's hope it will reign in some of the over leveraging and speculation that is currently in the financial systems.

At Palisade, we still adhere to the traditional definition of the word investment and believe it has benefited our clients in the extreme volatile environment experienced over the last decade. We adhere to our high quality investment philosophy (A+, A, A- rank) of investing in companies that pay dividends over a market cycle. We continue to believe that these companies will provide superior returns on a risk adjusted basis and well out perform in difficult markets as the price performance by Standard & Poors Common Stock *Ranking* shows of companies ranked during the year 2000 Recession.

While the U.S. equity markets continue to exhibit volatility, we see the current equity valuations at about midpoint. With the lack of growth alternatives, we continue to favor stocks at these current levels.

Read On

With a similar 'Quality' theme, Paul Kronlokken and Dennis Ott discuss how the quality of owning Minnesota-Regional stocks has helped over the last 'Lost Decade'. And, Steve Landberg raises some very valid questions about the strength of the American consumer who is back spending again.



The Lost Decade? Not Here in Minnesota

Dennis M. Ott, CFA & Paul J. Kronlokken

The *Wall Street Journal* has coined the phrase, “The Lost Decade” when describing the performance of the “Market” over the past ten years. A key selling point for investing in stocks has always been that over time, the risk of owning stocks diminishes and the chance of making money increases. As so many investors experienced, this did not hold true for the ten year period, 2000-2009. Here the annual returns for the S&P 500 and other popular equity indices were actually negative, even after a significant rally in the latter half of 2009.

As most of our readers know, our investment philosophy at Palisade is to own high quality investments. Our research uncovered a very noteworthy statistic about the benefits of owning high quality Minnesota companies. If we look at the returns of a basket of stocks (a universe of 94 companies) within Minnesota over this same ten year period, returns were quite good, +53% versus -6% for the S&P 500. If we filter further to only look at the highest quality names (31 Minnesota companies), these returns were exceptional, +149% over this same period.

New to Palisade, but a style we have been managing from the mid-’90s is our strategy of owning higher quality regional stocks. This strategy owns a base of our Large-Cap stocks with added holdings from this strong performing multi-cap, high quality Minnesota regional stocks. We know that past performance does not always predict the future, but our research supports how important it is to own high quality companies combined with the growth opportunities that companies in our region provide.

As we look forward to the rest of 2010, all of us at Palisade believe that owning high quality companies will be ever important as investors and political leaders figure out the ramifications of the recent cracks in the global financial system.

Being American - Spending Again

Steve E. Landberg, CFA

The Bureau of Economic Analysis (BEA) preliminary estimate of Q1 Gross Domestic Product (GDP) growth came in at +3.2%. The main component of growth in the quarter was personal consumption expenditures (PCE) or, in other words, consumer spending. For the quarter PCE increased by 3.6%. This increased pace of consumer spending, up from fourth quarter’s +1.6%, represents the biggest increase since the first quarter of 2007. Spending by consumers during the first quarter of the year contributed 81% of GDP for the first quarter of 2010.

While consumer spending contributed positively, what did other areas add, or subtract, to first quarter’s GDP growth? Positive contributions to GDP came from private inventory investment, exports, increased federal spending and nonresidential fixed investment. Partially offsetting the positive contributors were decreases in state and local government spending, residential fixed investment, and an increase in imports.

Consumer spending is back as a positive main component of GDP growth, but how does personal consumption at approximately 81% of growth compare on a historical perspective? In his article, [Economic Hangover: Recovery Is Likely To Be Prolonged, Painful](#) Bill Emmons, an economist at the Federal Reserve Bank of St. Louis, provides an excellent summary of the composition of GDP growth. The following table is found in the article and is derived from data provided by the BEA.

Composition of U.S. GDP Growth

	Average Annual Real GDP Growth (% change from previous year)	Personal Consumption Expenditures (PCE; % of GDP growth)	Contribution of Government Spending (G; % of GDP growth)	Sum of Contributions of PCE and G (% of GDP growth)	Contribution of Business Investment (I; % of GDP growth)	Contributions of Net Exports (NX; % of GDP growth)	Sum of Contributions of I and NX (% of GDP growth)
1950 - 1987	3.72	63.4	18.8	81.2	13.0	-2.1	10.9
1988 - 1997	3.05	64.9	7.4	72.3	20.1	3.3	23.4
1998 - 2007	3.02	82.5	13.9	96.4	18.1	-15.5	2.6

SOURCE: Bureau of Economic Analysis

The table shows that consumer spending provided 63.4% of GDP growth during the post WW II period (1950 – 1987), slightly increasing to 64.9% during the post Reagan years (1988 – 1997). During the next ten years (1998 – 2007), consumer spending saw a significant increase to 82.5% of the 3.02% average annual real GDP growth. Also, note that the table reflects percentage increases in both government spending and imports during the same period.

So what does this mean? Is the consumer back to their previous spending ways after a brief period of increased savings and debt reduction? We can’t help but think about what role the government spending will play in generating GDP growth. Is it time for business investment to contribute a larger portion of GDP growth? Or, perhaps our trade deficit will finally begin to shrink from the sharp increases realized since 1997? Obviously, no one yet knows the answers to these questions. Eventually time and history will provide a closer picture as to the composition of future GDP reports.

In the meantime, at least for the first quarter of 2010, the consumer is back to being ‘American’ – and is spending again!