Palisade
CAPITAL MANAGEMENT

PALISADE CAPITAL MANAGEMENT, LLC
ONE BRIDGE PLAZA, SUITE 695
FORT LEE, NEW JERSEY 07024
T (201) 585-7733 • F (201) 585-7552
www.palisadecapital.com

October 5, 2016

Dear Investor:

The September quarter proved to be relatively benign for investors. Most market indices advanced in the period, as shown in the table below. The NASDAQ Composite performed very well (+9.2%) and the major indices advanced modestly (+2.1% for the Dow Industrials and +3.3% for the S&P 500®). After nearly two years of notable volatility, at last oil prices seem to have settled into a price channel between $45 and $50 per barrel.

	Sep. 30, 2016	June 30, 2016	% Change
S&P 500® Index	2168.3	2098.9	3.3%
Dow Jones Industrial Average	18308	17930	2.1%
NASDAQ Composite Index	5287.1	4842.7	9.2%
Russell 2000® Index	3110.7	2862.8	8.7%
VIX Volatility Index	13.3	15.6	-14.7%
Barclays Bond Index – ETF “AGG”	112.4	112.6	-0.2%
10-Year U.S. Treasury Yield	1.60%	1.47%	8.8%
Gold (ounce)	$1,313.30	$1,318.40	-0.4%
Oil (barrel – West Texas Intermediate)	$48.11	$48.27	-0.2%

Data Source: FactSet Data Systems

This is the last quarterly investment letter you will receive from Palisade before Election Day on November 8, 2016. The common view is that this is the strangest presidential election in the modern history of the United States. We have no quarrel with that. Hillary Clinton (D) and Donald Trump (R) are the two oldest candidates to vie for the presidency. Their combined ages – he is 70 and she is 68 – are greater than any two major party candidates in history. Then there is the obvious: Mrs. Clinton is the first woman to have received the presidential nomination of a major party. And Mr. Trump, should he be elected, would be the first president never to have held elected office or to have served the country in either a military or ambassadorial position.

Because of the uniqueness of this election, there are few antecedents we can rely on for investment guidance. We examined the record of market performance in the aftermath of each postwar presidential election, and the record is ambiguous. There were eight party “turnovers” of the White House in the entire postwar period, but these “change elections” failed to show a clear stock market pattern. Between the ends of the third and fourth calendar quarters of those eight election years, the S&P 500® fell twice (2008 and 2000) and rose six times; the years of declines were periods of severe (2008) or modest (2000) economic recessions, which might better explain those declines than the shifting winds of political fortune.

As to policy, Mr. Trump has promised to cut taxes (fiscal stimulation) but to erect trade and tariff barriers (fiscally contractionary) with countries that he deems to be taking American jobs, such as China and Mexico. For her part, Mrs. Clinton has promised to raise taxes on the wealthiest Americans (fiscally constrictive) but to plow a huge dollop of tax revenues into rebuilding America’s aging infrastructure (fiscal stimulation). No wonder that the polls show this to be a tight presidential race, and that the election may turn on issues of “temperament” and “style” rather than on the candidates’ policy positions.

Presidential candidates always promise more than they can ever deliver. Mrs. Clinton’s promise to raise taxes could run into the brick wall of a Republican controlled House of Representatives. Under the Constitution, all revenue measures must originate in the House of Representatives, and it seems highly unlikely that the House will shift to Democratic Party control in November. And Mr. Trump’s promise to “repeal and replace” the Affordable Care Act – President Obama’s signature health care legislation – would encounter fierce resistance in a closely balanced Senate, even *if* that chamber were slightly tipped in favor of the Republicans. The one

thing on which the two presidential candidates agree is the need to step up infrastructure spending, *i.e.*, building and repairing roads, bridges, ports, etc. The non-partisan Congressional Budget Office recently calculated that inflation-adjusted public spending on transportation and water capital infrastructure had dropped by 23% between 2003 and 2014 – the only significant 10-year decline since the CBO began keeping such records in 1956. The American Society of Civil Engineers estimated in 2013 that $3.6 trillion would have to be spent by 2020 to improve U.S. infrastructure to an acceptable level of safety and performance. Many of the equities that you own would benefit from this fiscal largesse. Politically, too, public expenditures on infrastructure *could* reduce the factionalism that has paralyzed Congress in the last eight years. For example, President Eisenhower, a Republican, was able to achieve amity with a Democratic controlled Congress by presiding over large spending programs for the Interstate Highway System and the Cold War-inspired Space Race of the late-1950s. Eisenhower and his Democratic allies in the Congress, Sam Rayburn (House Speaker) and Lyndon Johnson (Senate Majority Leader), ensured that federal "gravy" flowed to enough Congressional districts to keep the legislative peace and move the American economy forward in the aftermath of World War II and the Korean Conflict.

The lament of non-partisan American policy analysts, including the last two Federal Reserve Board chairs, is that U.S. economic growth has depended too heavily in recent years on monetary stimulus (quantitative easing and ultra-low interest rates) and not enough on fiscal policy (federal and state spending and tax policies). It may come to pass that the FRB's complaint will be answered in the next administration, whoever is elected president. If so, the Fed may then be emboldened to raise interest rates in keeping with its long-run targeted inflation rate of 2% plus some *real* component – say, one percentage point. That would be a boon for pension funds, savers, and financial institutions such as banks and insurance companies. However, such change will not occur overnight. For one thing, European and Japanese central bank interest rates are far lower than ours at the moment. Thus, if the Fed raised U.S. rates substantially and soon, it could have the unintended effect of pulling up the exchange value of the dollar to the detriment of U.S. manufacturers and exporters. Whatever the Fed does with rates in the coming year (or so) will have to be weighed carefully against the likely counter-effects.

Though the U.S. stock market has performed well since the end of the Great Recession, so have "riskless" securities such as Treasury bonds. For example, the 30-year U.S. Treasury bond enjoyed a total return of 87% from mid-2009 (the end of the last recession) to the current time. That is an extraordinary performance for bonds and superior to any other 7-year period in modern financial history. And the reason is simply explained by falling interest rates. But if the Fed now were to focus on restoring rates to their historically normal level, bonds might be a poor investment in the years ahead – at least in relation to the performance of risk assets such as equities. The bonds that we *have* recently purchased for most accounts are short-duration, higher-coupon corporates and agencies; these would be well-insulated from an interest rate boost.

Clients have asked us if they should move out of stocks in light of the election uncertainties. Our advice is to hold slightly higher levels of cash both as a hedge against an election shock, as well as to be in a position to exploit any opportunities that might occur in the wake of such a shock. In the long-run, however, reasonably priced common stocks of well-run companies in growing businesses have proved highly resistant to government follies, fumbles and foibles over the years. We do not think this will change in the future.

Thank you for allowing us to manage your investments. We aim to reward your faith in us with creativity, diligence and good results. That is our only business model.

Sincerely,

Palisade Capital Management

Important Information:
No assurance, representation or warranty is made that any of Palisade's assumptions, expectations, views, objectives and/or goals will be achieved. **Past performance is not a guarantee of future results.** Please note that each client account has different characteristics and other accounts with the same strategy may have materially different results. The actual characteristics of any particular account will vary based on a number of factors including, but not limited to (i) the size of the account; (ii) the timing of investment; (iii) investment restrictions applicable to the account, if any; and (iv) market exigencies at the time of investment.