Palisade
CAPITAL MANAGEMENT

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Dear Investor:

What an unusual year 2020 was, and on so many levels: political, social, and economic. We shall long remember last year's financial market extremes: anxiety in the first months of the COVID-19 pandemic (March/April), stabilization at mid-year, and sharp recovery in the final quarter of 2020 as investors cheered the regulatory approval of COVID vaccines. The table below shows key market indicators for the year.

	DEC. 31, 2020	DEC. 31, 2019	% CHANGE
S&P 500® Index	3,756.1	3,230.8	+16.3%
Dow Jones Industrial Average	30,606.5	28,538.4	+7.2%
NASDAQ Composite Index	12,888.3	8,972.6	+43.6%
Russell 2000® Index	4,908.0	4,146.6	+18.4%
VIX Volatility Index	22.8	13.8	+65.2%
Barclays Bond Index – ETF "AGG"	118.2	112.4	+5.2%
10-Year U.S. Treasury Yield	0.91%	1.92%	-52.6%
Baltic Dry Index – Spot	1366	1090	+25.3%
Gold (ounce) – NY Spot	$1,902	$1,520	+25.1%
Oil (barrel – West Texas intermediate)	$48.52	$61.08	-20.6%
Bitcoin	$29,220	$7,220	+304.7%

Data Source: FactSet Data Systems

To compare end-year 2020 markets only with their start-of-year values would miss the remarkable volatility *within* the year. A good case in point is the performance of small capitalization stocks: from the start of 2020, the greatest drawdown of the Russell 2000® Index (representative of small caps) was approximately 42%, but from that trough the Russell soared 105% and finished *up nearly 19%* for the year – an outcome few would have predicted in March. Commodities like crude oil and silver performed in a similarly volatile manner. Few markets, though, outdid Bitcoin in volatility. From its start-of-year price of $7,220, the digital currency's market value *fell* by 32% in the first twelve weeks of the year (March 16), but then soared by nearly *500%* from that point to year-end, with a significant portion of that ascent occurring just in December. Bitcoin supporters insist it is the new face of money in the digital age, even though Bitcoin has none of the textbook characteristics of money: a *storehouse of value,* a *medium of exchange,* or *legal tender* (*i.e.*, backed by sovereign authority).

Why was volatility and its twin – speculation – so prominently displayed in 2020? In short, we believe this was the predictable outcome of (nearly) free money. In response to the COVID-19 pandemic, the Federal Reserve Board in March cut its key interest rate – the discount rate – from 1.75% to 0.25%, lowered member banks' reserve requirements, and provided a safety net under the bond market by announcing open market purchases of hundreds of billions of dollars of Treasury and Agency debt. When interest rates dropped to near zero in March – actually *negative* net of inflation – two notable things occurred: 1) the prices of financial assets rose as discount rates fell – and the longest maturity assets with the most distant payoffs rose the most; and 2) investors felt emboldened to take on risk because the cost of carry (margin debt, for example) had fallen so low.

That was 2020. What about *this year*? We believe 2021 will see a different landscape, which may require a new playbook by investors. This shift turns on political change. Democrat Joseph R. Biden will become the 46th President of the United States on January 20 and control of the Senate will shift from the Republican Party to the Democratic Party following the election on January 5 of two new Democratic senators in the recent Georgia state election. This year will be the first time in 12 years that Democrats will have won the Washington trifecta:

the presidency, the Senate, and the House of Representatives. So, the new administration should be able to achieve at least some major parts of its legislative wish list:

- New economic stimulus, including more direct aid to low- and medium-income households;
- Eventual (though perhaps not in 2021) higher federal taxes on corporations and wealthy individuals;
- Expansion of federally supported managed health care programs;
- Incentives and penalties to encourage the move away from carbon-based fuels; and
- Infrastructure renewal and investment.

The stock market effect of these initiatives should be pro-cyclical, i.e., foster an acceleration of economic growth, which might widen the stock market's circle of winners beyond a narrowly focused handful of technology companies. Spending-fueled growth might coincide with resumption of normal social activity after the wide distribution of the COVID-19 vaccine. In this environment, pent up demand for consumer goods and services could be remarkable. **Beneficiaries might include, among others, the travel and leisure, food service, apparel, appliance, consumer banking, medical, and auto industries.** It's a long list, as consumer spending accounts for 70% of U.S. gross domestic product. If the business cycle is about to enter a new growth phase, then many **industrial companies and capital goods manufacturers**, too, might enjoy better days**. Freight hauling railroads and truckers, machine tool and semiconductor manufacturers, engineering firms, and communication equipment makers**, among others, could benefit.

Stronger growth could finally lift inflation and interest rates. Indeed, the day after the Georgia Senate races were won by the Democrats (tipping the Senate from Republican to Democrat control) the 10-year treasury bond pierced through the 1% level for the first time since March of last year. **A steeper yield curve would help commercial banks** by widening their net interest margins. And higher inflation would be welcome by **smaller companies**, who might regain some of the pricing power they lost during the pandemic.

Change creates losers as well as winners, of course. Higher interest rates would not be welcome by holders of **long-dated bonds**, nor would they be particularly helpful to holders of **high price-earnings ratio stocks**, many of which do not pay dividends (thus, nearly all of their intrinsic value lies in the future, making them susceptible to value compression in a rising rate environment). On the other hand, we note many high growth and high P/E companies have demonstrated great innovation and flexibility – qualities that deserve premium valuations in any market.

Regarding tax changes, we think the Biden administration will attempt to raise at least corporate taxes, and *possibly* taxes on high income earners as well – though we do not expect steep or even immediate tax increases, as these could jeopardize economic recovery. If we had to guess which vector – higher taxes (a negative) or greater stimulus (a positive) – will be more potent, we come down on the side of stimulus.

Stocks are a little like fashion trends whose cachet shifts with the years. Like good fabric and fine tailoring, however, there are features of financial securities that are *always* in fashion: innovative enterprises that generate free cash flows that are invested back into the business at attractive returns. These equity securities form the bedrock of our investment portfolios.

Thank you for allowing us to manage your investments. We aim to reward your faith with creativity, diligence, and good results.

Sincerely,
Palisade Capital Management

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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.

The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance. The S&P 500® Index does not have a defined investment objective, unlike the indices above, nor does it charge fees and expenses.

The Dow Jones Industrial Average is a price weighted index comprised of 30 of the largest and most widely held public companies in the United States.

The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. It consists of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Source: London Stock Exchange Group plc and its group undertakings (collectively, the “LSE Group”). © LSE Group 2021. FTSE Russell is a trading name of certain of the LSE Group companies. “Russell®” is a trade mark of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company’s express written consent. The LSE Group does not promote, sponsor, or endorse the content of this communication.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500® Index options.

The Barclays Bond Index – ETF “AGG” tracks an index of US investment-grade bonds. The market-weighted index includes Treasuries, agencies, CMBS, ABS and investment-grade corporates.

The Baltic Dry Index (BDI), is issued daily by the London-based Baltic Exchange. The BDI is a composite of the Capesize, Panamax, and Supramax Timecharter Averages. It is reported around the world as a proxy for dry bulk shipping stocks as well as a general shipping market bellwether.

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing and is the underlying commodity of the New York Mercantile Exchange's oil futures contracts.