Palisade Head, Lake Superior, MN

"Much Ado About Nothing" — By Steven E. Landberg, CFA

During January and February numerous articles appeared concerning "The Great Rotation" where retail investors actively sell out of bond funds and reinvest proceeds into stock funds. Our take on these articles is that the authors are a bit overzealous and not exactly accurate in their call for a mass exodus out of bonds and a rush into stocks. In fact, this whole discussion is, perhaps, much ado about nothing.

While the first several weeks of this year saw net inflows into equity mutual funds, significant withdrawals from bond funds have yet to occur. In fact, according to the Investment Company Institute® (ICI), bond mutual funds have actually recorded monthly net inflow of dollars for each of the first three months of 2013. Investors have now added investments to bond mutual funds for more than eighteen consecutive months. January 2013 marked the first positive flow of funds into domestic equity mutual funds after twenty consecutive months of net withdrawals, but investors did not rotate out of bond mutual funds to do so. This marks a possible shift in the individual investor's mindset, but not a noticeable rotation from bonds into stocks.

We do not currently see a bond to stock rotation as we do not believe stock investors have decreased their stock investments to the degree that the referenced articles have stated. Taking a closer look at the numbers for the twelve months ending February 2013, ICI states that domestic stock *mutual* funds saw withdrawals totaling $135 billion, which is a large decrease. However, the authors missed that *exchange traded* funds (ETFs, a different form of investment fund) had an increase of investments into stocks exceeding $121 billion. The net of these two types of stock funds was only a small withdrawal of $14 billion, far less stock departure than many of the referenced articles reported.

A second observation is that data indicates that the increased allocation of dollars to both stock and bond mutual funds has come from investors selling money market funds and other cash equivalents, not selling bonds. We believe that because of the extremely low interest rates, the current movement from cash/money market funds to both equities and bonds will continue to occur.

Also, a recent poll by CNBC indicates that the retail investor does not view stocks as their investment of choice. CNBC's poll of 800 Americans resulted in 35% selecting gold as their number one current desired investment followed by real estate with 27% and next stocks with only 21% support. Separately, a recent CNN/ORC poll substantiated the public's disinterest in stocks with 55% saying the current time would not be ideal to invest in stocks. It is clear to us that the challenging equity markets of 2000-02 and 2008-09 have not been forgotten, leaving a great many individuals, and institutional investors alike, more risk averse. We do not believe that these investors are ready to strongly support rotating from the perceived safety of bonds into stocks.

It is our opinion that investors should not be fooled into thinking this great bond to stock allocation shift is now occurring. We see the media, which is a big component supporting investor emotions, has not been fervent in its reporting of stock markets. For now, individuals are still hesitant towards stocks. We do believe however that eventually, we will see a pickup in the bond into stock reallocation and perhaps even "The Great Rotation".

As you will read in the following articles written by my partners, Jim King and Dennis Ott, certain stocks continue to be reasonably valued; especially in the domestic large cap space. Eventually a love for stocks versus bonds will prevail, just as "love" eventually found its way in Shakespeare's *Much Ado About Nothing*.

2013 Benchmark Index Returns

March 31, 2013

INDEX	QTR 1
S&P 500*	10.61%
DJIA*	12.02%
NASDAQ	8.21%
Russell 2000*	12.39%
MSCI EAFE**	4.38%
Barclays Intermediate Govt/Corp	0.26%
Barclays 3 Yr Muni	0.56%

**Dividends included*
***The MSCI EAFE Index is a free float adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada*

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Thought for the day: "Buy a good stock and when it goes up – sell it. If it doesn't go up – don't buy it."
– Will Rogers

PALISADE
Asset Management, llc

Don’t Be Fooled By Historical Risk

By James C. King, CEO

We often hear concerns about the risk of investing in the stock market. Currently, these concerns are reflective of uncertainties in federal and state budget deficits and debt, as well as talk of slowing corporate profit margins, earnings, and the volatility of international economies. As a result, although the U.S. stock market is rising, these concerns and risks have kept stocks selling at reasonable valuations.

It is important to remember that the term “stock market” is a combination of numerous types of stocks - small cap, large cap, dividend and non-dividend paying, international, and companies traded on NASDAQ. The valuation and volatility (risk) of each stock type vary significantly. If there was little or no uncertainty, market valuations would be much higher and risk more prevalent. However, because of the uncertainty of the concerns discussed above, certain great buying opportunities do exist.

Another consideration for investors is “what are the alternatives to stocks?” The entire fixed income alternative is vastly overpriced as a result of the Federal Reserve holding interest rates artificially low to stimulate the economy. Looking to bonds for yield has become quite challenging, and now looking to bonds for safety may not be as secure as in past market cycles. Other alternative investments such as commodities, hedge funds, international bonds and equities have too much volatility for most conservative long-term investors.

A positive change that seems to be developing in the U. S. economy is the rebirth of parts of the industrial economic sector. Wage compression and energy costs seem to be the driving this reindustrialization. The U.S. has the cheapest natural gas prices in the world outside of the Middle East. Significant new oil discoveries in North Dakota, Pennsylvania and possibly California, in addition to the Keystone Pipeline, all promise to make the U.S. energy self-sufficient in the not too distant future.

This is just one example of many more positive domestic economic activities. Although masked by the global economic discussions about risks, we see many other positive economic changes occurring throughout the world. To be a successful long-term investor, it’s important to avoid following the crowd and being swayed by the short-term “noise” of the media. At Palisade, we spend our time understanding the real risks and rewards of investing in growth companies. It is our opinion that today, large capitalized, globally positioned, dividend-paying companies seem to be one of the most secure and stable growth investments for the foreseeable future.

Bond Interest or Stock Dividends?

By Dennis M. Ott, CFA

It is well known that our Federal Reserve and other Central banks are continuing to purchase government issued and government backed debt causing interest rates to remain artificially low for an extended period. This phenomenon is known as debt monetization and has produced a disparity between the yields on high grade corporate debt and equity dividend yields.

A concern of ours is that extended periods of artificially held low interest rates often results in higher future inflation. Central banks can monetize debt for a finite period and changing course may disrupt markets. Investors, especially institutions, often have a set asset allocation policy. This may force them into buying corporate debt at rates which do not compensate for the inflation risk.

Currently, investors are receiving less yield on a portfolio of high grade corporate bonds than they would receive on a portfolio of high grade common stocks. To support this comparison, we looked at an equal weighting of six high quality corporations and compared their 10-year bond yields to their stock dividend yields. What we found is interesting:

<u>Corporations</u>: Procter & Gamble, Emerson Electric, McDonald’s, Johnson & Johnson, Intel, and General Mills

<u>Yields</u>:
- 10-year bond interest - 2.9%
- Equity dividend yield - 3.2%

<u>Income Growth</u>
- 10-year bond interest - none
- Equity dividends - 11.1% average annual growth over the past five years

It is also interesting to note that at the beginning of this year, the disparity was even greater, favoring dividends by over one percent (1.00%). This difference has decreased due to the strong move that high-quality stocks made during the first quarter of this year.

The implication of this disparity may be that investors do not believe the stream of dividends will remain the same or grow over a 10-year span. We believe this is very unlikely. In addition, as my partner Jim King has stated, bonds are overvalued and high-quality equities maybe somewhat undervalued. Factoring in this valuation difference, high-quality stocks with strong dividend growth may provide a better long-term outcome for investors in search of higher yields.