Balance Sheets Strengthen

By Steven E. Landberg, CFA

Over the last few months we have been performing our ongoing ritual of reviewing annual reports. The compensation practices of various corporations have stirred one or more of my colleagues; specifically, the large pay package(s) awarded for subpar performance. Other areas of interest included exposure to European markets, mergers and acquisitions, increases in dividends paid and, most noticeably, the ongoing strengthening of corporate balance sheets. It is the strengthening of corporate balance sheets that led us to dig deeper into our research.

Our research focused on two areas: 1) corporations buying back their common stock and 2) cash and cash equivalents reported on balance sheets. In previous Palisade research, we analyzed the increase in dividends paid by a diversified group of large cap companies over a five year period ending in 2010. We selected the same group of companies to analyze in this new research. The time periods researched include the last four quarterly reporting periods, as well as, the last four annual reporting periods. Here is the summary of the findings from our research:

Corporate Stock Buybacks:
The reduction in common shares outstanding has an anti-dilutive effect, giving each remaining shareholder a larger percentage ownership of the company. Of the companies reviewed, 85% reduced the number of common shares outstanding when measured against the number of shares outstanding four quarters prior. These same companies reduced the number of common shares outstanding over the last four annual fiscal year reporting periods. Deutsche Bank's David Bianco's recent report substantiated this trend of declining shares outstanding, finding that non-financial companies in the S&P 500 reflected a decline in share count of 1.3% annually since 2005. On a company by company basis, our research showed a wide range in the percentage reduction of shares outstanding (-0.44% to -9.02% over last four quarters; -1.94% to -22.83% over last four years). One should also note that two of the five companies increasing their number of shares outstanding were involved in major acquisitions.

Cash and Cash Equivalents:
We also reviewed the cash positions of these same companies. Our research found that compared to one year ago, 57% of the companies reported an increased level of cash on their balance sheets. Over the four years, 66% of the companies reported an increase of cash and cash equivalents. Similar to the above analysis on a company by company basis, the percentages varied widely (increases of 1.80% to 98.04% over the last four quarters; 2.75% to 510.20% over the last four years). Overall our study demonstrates that corporations, for the most part, continue to build their war chest of cash and cash equivalents.

In summary, our study reveals an increased activity by corporations buying back their common shares. At the same time, companies continue to report increasing levels of cash and short term investments. It is our opinion that corporate managements will continue to be pressured to deploy accumulating cash positions. Though, many views are voiced and debated as to the best way to use such cash, we anticipate that two areas of continued cash deployment will be corporate share buybacks and increasing dividend payouts – existing shareholders should find both to be attractive.

Introducing Our New Website!

It is with great excitement that we unveil our new website to you. Aside from an updated look, the new website features more detailed information about Palisade, making it easier for you to better understand our range of investment and financial services capabilities. In addition, we have added a "News" and "Articles" section to bring you broader and fresher content, and to update you on new and exciting things happening at Palisade. We have added a new "Client Log-in" link for our clients to have direct access to their Charles Schwab & Co., Inc. account(s). We think you will enjoy the new look and the improved ease of navigation. Please check out our new website at ***www.palisadeam.com***

2012 Benchmark Index Returns

May 31, 2012

INDEX	MAY	YTD
S&P 500*	-6.01	5.16
DJIA*	-5.99	2.52
NASDAQ	-7.19	8.53
Russell 2000*	-6.62	3.37
MSCI EAFE	-12.09	-5.64
Barclays Intermediate Govt/Corp	0.48	2.02
Barclays 3 Yr Muni	0.13	1.20

*Dividends Included

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Shifting Emphasis to Greater Earnings Growth

By James C. King, CEO

During the first quarter we made several stock changes in our high quality growth strategy. As most of you know we emphasize owning large capitalized dividend paying companies with stable, and consistently rising, earnings and dividends. While this strategy has worked well in the volatile market environment that we have experienced over the last several years, *we feel that earnings growth may require more emphasis in the future*. Also, taxable accounts currently receive the benefit of a maximum tax rate of 15% on dividend income and long term capital gains. This provision is set to expire at the end of 2012.

The five companies recently sold had one year earnings growth of 4.8% and five year growth of the same. The dividend growth rate of the same companies was 6.7% for one year and 7.1% for five years. In other words, the earnings were flat over the last five years and the dividend growth declined.

The five companies that were purchased had a one year earnings growth rate of 15.4% and a five growth rate of 13.3%. This is called accelerating earnings growth. On the dividend growth rate, again accelerating 17.5% average one year and 12.6% over the last five years.

The cost for the improvement is 14.3x earnings for the purchases and 18.9x earnings for the sales which equates to creating greater growth purchased at cheaper valuations. Although the dividend yield decreased from 3.2% on the sales to 2.1% on the purchases, this should be recovered due to the increase in the "dividend growth percentages" added from the new stocks purchased.

It is important to remind our readers that our analysis behind these portfolio changes is based on historical results rather than predicted results. Our analysis that earnings growth requires more emphasis in this leg of the economic recovery is the driver behind our changes. As the future is always difficult for us to predict accurately, these portfolio changes may take time to prove positive.

Alternative Investments in Trust Accounts (Part II of II)

By E. Thomas Welch, JD

This is the second part of a discussion on "Alternative Investments" (AI). As in previous article, we will continue the discussion on AI being held in personal trusts with the focus on what a trustee should contemplate if adding this type of investment. Our intent in this article is to hone in on providing trustees with a better understanding of the types of risk and liquidity issues that are prevalent with AI. We had also planned to speak to the "negative correlation" that AI investments bring to diversified portfolios, but that subject in itself warrants a separate article.

The SEC has recently established reporting standards for the different types of AI funds. They recently established the categories of three types of AI funds – Hedge Funds, Liquidity Funds and Private Equity Funds. All three categories must be "private" funds as contrasted with publicly traded mutual funds. This reporting standard then has approximately ten categories of questions on the various types of risks in each category of these funds that have to be addressed in a prospectus by each AI investment.

To determine whether the SEC risk questions were now being communicated in actual AI prospectuses, I reviewed several prospectuses to determine whether the risks discussed matched the standards set by the SEC. Generally, the risks disclosed were in alignment with the new SEC form. I also thought it would be helpful for trustees to understand the general nature of the types of risks.

If a trustee is researching different AI investments, would they now make such an investment after considering the key risk disclosures currently communicated in the prospectuses? The AI may invest in derivatives subject to counterparty risk and some may be leveraged which increases risk, and

- The AI may invest in commodity markets which have greater volatility than investments in traditional securities and may be commodity derivatives with leverage, and
- The AI may invest in investments that are non-liquid; thus interrupting withdrawals or redemptions, and
- The AI may borrow, non-secured or secured, with assets in the AI and thus create leverage risk, and
- The AI may sell short where the potential loss is unlimited and may create leverage risk, liquidity risk and collateral impairment risk.

In our opinion, greater risk disclosure is positive. If one is a knowledgeable and prudent trustee, how would they determine that such AI would fit in the overall trust portfolio? With these types of risks discussed, the trustee must believe that the AI have reasonable possibilities of increasing value of the portfolio or dampening the volatility of the entire portfolio before being added. However, with the greater complexity of AI investment structures, understanding the true risk parameters is difficult to determine as to whether the added value will be greater than the disclosed risks.

Welcome!

We extend a warm welcome to the newest member of the Palisade team, ***Lisa Malmgren***, Marketing and Executive Assistant. She brings a wealth of client service and regulatory experience from her former positions in the nonprofit sector. You may reach Lisa when you call into Palisade, as she is helping us work toward our goal of answering all incoming phone calls personally. Thanks for joining us in welcoming Lisa to the team!